DOWN THE RABBIT HOLE: THE MADNESS OF STATE FILM INCENTIVES AS A "SOLUTION" TO RUNAWAY PRODUCTION

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INTRODUCTION

This article examines the use of tax incentives by state and local governments to attract film and television production to their respective jurisdictions. Traditionally, the term "runaway production" is used to describe this phenomenon, which is typically framed as a negative force by national and local media. This begs the question: What is "runaway production?"

While definitions of runaway production vary, the following offers a sufficient description: "Runaway production refers to films that were conceptually developed in the United States, but filmed somewhere else. If the conversation is at the federal level, runaway production goes to other countries. If at the state level, production that goes to other states is runaway."[1] In general, there are three different categories of runaway productions—(1) artificial economic runaways, (2) natural economic runaways, and (3) artistic runaways:

> Artificial economic runaways are films shot abroad because of artificial, or legislatively created, incentives designed to lure productions. Natural economic runaways are films that shoot abroad to take advantage of natural economic occurring phenomenon—cheap labor—that lower production costs. Artistic runaways are films that shoot abroad to artistically service the story—a film about Paris that shoots in Paris.[2]

1. MARTHA JONES, CAL. RESEARCH BUREAU, MOTION PICTURE PRODUCTION IN CALIFORNIA 2 (2002). Runaway films can be "creative runaways" or "economic runaways." *Id.* at 35. Most industry insiders, however, will readily admit that the vast majority of runaways are for economic reasons.

2. Adrian McDonald, *Through the Looking Glass: Runaway Productions and "Hollywood Economics,"* 9 U. PA. J. LAB. & EMP. L. 879, 900 (2007).

Scope of Article

This Article is divided into eight parts. Part I provides an overview of the runaway production problem, which has been an increasing threat ever since Canada enacted generous film incentives in the late 1990s, which were quickly copied around the world and, regrettably, in over forty U.S. states. Film incentives were conceived as weapons to cause runaway production and, for the present, the only means of defense the U.S. has available to fight back. However, the weapon is not currently employed to protect the nation, but it is being used by states to fight each other. Rather than fighting back with the global competition, the U.S. is effectively shooting itself in the face. Despite the catastrophic misapplication of the weapon, the cumulative effect of film incentives gave the nation a *de facto* national incentive allowing evidence of their effectiveness as a workable solution to runaway production to emerge based on their effect on production spending and employment in Canada.

Part II explores the economic impact of the motion picture industry in the U.S. and the fundamental importance of the industry to the U.S. economy. Much of the focus concerns film and television employment statistics, which should be paramount in the minds of national policy makers in the current economic environment.

Part III is an overview of how runaway production is being studied by the academic community and offers an overview of the academic discourse on the topic, which has been virtually ignored in the legal and public policy literature. Part III also provides a brief discussion of the historical role runaway production has played in Hollywood, and how the issue has been framed in the past and present by those in the entertainment industry. Part III then concludes with an examination of the recent efforts to combat runaway production and the methods for dealing with it. In 2006, there were two main policy options to fight runaway production: (1) trade action(s) to challenge the legality of film subsidies under international trade agreements, and (2) the use of "incentive to fight incentive" or "subsidy to fight subsidy" approach. Now there is only the latter, as trade remedies by the U.S. have been ruled out. The history of the ill-fated trade action filing in the U.S. is also discussed.

Part IV contains a thorough overview of film incentives and how they are employed across the United States. A brief history of the rapid proliferation of film incentives across the U.S. and a discussion regarding the efficacy of film incentives in luring productions to new jurisdictions is provided. Part IV also contains an examination of the claims and arguments made by film incentive skeptics/opponents regarding the role film incentives play in location decisions for productions.

Part V examines the debate over film incentives, primarily from a cost versus benefit perspective. A discussion of the increasingly hostile, if not disgraceful, rhetoric and tactics film incentive proponents (film backers) employ to discredit critics and skeptics of film incentive programs is also included. The concerns of film incentive critics, as time has gone on, have proven to be justified. Sadly, despite the claims of their "return on investment," film incentives are often a monumental waste of scarce public resources that cost states billions of dollars at a time when all states offering film incentives face budget shortfalls.

Part VI takes a detailed look at the impact film incentives in other states and nations have had on California. The importance of the industry to the state and its economic impact is discussed in detail. California's response to runaway production, which consists of the California Film & Television Tax Credit, public education campaigns, and grassroots efforts, is examined and its effectiveness is evaluated in detail.

Part VII examines the collective impact of the state film incentives on Canada, which, in recent decades, has pioneered the use of significant film incentives to attract runaway productions from the U.S. in an ongoing attempt to lure the relocation of a major U.S. industry with remarkable—if not frightening—success. However, while film incentives have been used as a weapon to cause runaway production, there is now evidence showing they can be used as a defense as well.

Finally, Part VIII summarizes the issues raised and problems presented in this paper regarding the efficacy of film incentives. Given the state of the motion picture industry, the conclusion of this paper is that the incentive schemes enacted in many states beginning in 2002 have helped stem, stop and reverse runaway productions from leaving the nation. While this is an overall gain for the U.S. economy in terms of retained jobs, it has come at an astronomical and unsustainable cost. Federal legislation could end the race to the bottom by replacing the competing state incentives with a single national incentive. Such a national incentive would refocus the issue of runaway production as a national problem and allow the U.S. to compete more effectively in the global marketplace. As such, Part VIII offers a look at some basic models such federal legislation could take. Using *state* incentives to combat a *national* problem, runaway production, is madness; using one national incentive to combat the same national problem is a rational, effective and, most of all, imperative action for the nation to take if it wants to stop further economic decline and a loss of influence on the global stage.

I. THE MADNESS OF STATE FILM INCENTIVES: THE CAUSE OF RUNAWAY PRODUCTION IS ALSO A SOLUTION REQUIRING PROPER APPLICATION

Just a few years ago, much of the runaway production discussion in news, academic and government sources concerned the negative effects of runaway production on locations whose economies relied heavily on film and television production (e.g., Los Angeles) and how runaway productions might be stemmed, if not prevented. One of the primary policy options discussed in such sources to stop runaway production was the enactment of competing production incentives on par with those offered in Canada and elsewhere; to fight fire with fire, so to speak. As this article will show, production incentives do increase film and television production in locales where there had been little, if any, production before. This so-called solution to runaway production, however, is now being misused in the U.S. on a state level to weaken the strength of the movie industry at the national level.

If production incentives are the primary factor causing film and television production to run away to Canada or elsewhere, then enacting a more attractive incentive would be sufficient in redirecting it from a competing location. As more and more locations attempt to do the same, the classic race to the bottom ensues. This is precisely what is happening now. In 2006, there were relatively few U.S. states (Louisiana and New Mexico, for example, were the first) and international locations (Canada, Australia, New Zealand, South Africa, etc.) that offered competitive production incentives. But as places like Louisiana and New Mexico got into the incentive game, other states watched with envy as Hollywood productions set up shop, which was incorrectly perceived as an economic boon that might be a source of new revenue for cash-strapped states. Having Hollywood "in town" is politically popular regardless of party affiliation—red and blue states alike are all on the bandwagon now.

At the close of 2010, almost every U.S. state offered some level of significant production incentives in the hopes of becoming the next Hollywood North, Hollywood South . . . the "Hollywood anywhere."[3] Sadly, many of these cash-starved states are beginning to realize that the perceived economic benefits of film incentives are, essentially, Hollywood special effects; they may look real, but they are an illusion.

What should have been a national solution to runaway production, using a single film incentive to protect the potent concentration of the Hollywood industry cluster in Los Angeles (and, to a lesser extent, New

3. For a current list of domestic and international production incentives, visit the Entertainment Partners Incentive Group website at: http://www.entertainmentpartners.com/Content/ProductionIncentives/Jurisdictions/US.aspx (last visited Dec. 11, 2011).

York), was bastardized into a state level tool that serves self-interested short-term "benefits" to individual states. In the short term, jobs remained in the U.S. as opposed to going to Canada, but this was achieved by selfish, outrageously expensive and unsustainable policies that served to hurt not only the cash-strapped states enacting them, but also the entire nation. The race to the bottom of U.S. states enacting film incentives has been a costly distraction from the threat runaway production poses from other nations. Film incentives are a weapon that the nation can use to defend itself. But like any weapon, the nation needs to understand how to operate it. With film incentives, the fundamentals are like that of a gun. Instead of pointing the gun at the other nations causing runaway production, the U.S. has been shooting itself in the face.

In addition to the problem of states fighting each other rather than responding to threats on an international level, convincing critics that a national film incentive is needed will prove difficult. While production incentives can be employed to combat the effects of runaway production, they also have the effect of causing runaway production in other locations. One of the common arguments against the use of film incentives in the U.S., at least at the state level, is that taxpayers are subsidizing an economic activity that would have taken place anyways, even in the absence of film incentives. Hollywood, after all, will continue to make movies.

While this argument has a logical appeal, it is fatally flawed for a number of reasons. First, in places where there is no film industry or very little production activity the argument that activity would have taken place there anyways is simply not true. For example, in 2002, the year before Louisiana enacted its first incentive, production spending was just \$3.5 million. In 2010, after nearly a decade with an increasingly generous film incentive, production spending in Louisiana soared to just over \$674 million, representing an almost incomprehensibly enormous increase. Thus, at the state level in Louisiana, the argument that the film incentive is rewarding economic activity that would have taken place anyways is patently false.

Indeed, the argument that film incentives reward economic activity that would have occurred anyways is only valid in hypothetical scenarios. If the U.S. economy existed in a vacuum detached from the global economy and no states offered film incentives, the economic activity from film and television would still take place; it would occur almost exclusively in California and New York. In such a vacuum, it would be a waste of money for the nation to reward economic activity already benefiting the nation—and even more wasteful for California or New York to do so alone. Taking this logic to the global economy, but for significant film incentives designed specifically to decimate and relocate Hollywood abroad, most film and television production would occur in the U.S.

But this hypothetical argument rests on an assumption that has no basis in reality. Film incentives exist. They are a weapon being used to wage economic warfare against the U.S. Film incentives, like any weapon of war, were designed to cause maximum damage to the intended target. For example, Canadian-designed film incentives cause runaway production by attempting to erode the comparative advantages the U.S. has from its concentrated industry clusters in California and New York. These clusters are the key to the U.S. film industry's global dominance, and policymakers in the U.S. seem completely oblivious to this monumentally important fact.

If the United States has a national interest in preventing runaway production to foreign nations, then having all fifty states competing with each other is not only counterproductive, but it is financially devastating to numerous state governments unable to sustain the huge amount of funds needed to pay for production incentives. Any hope that film and television production will remain in states with no history in the industry once the production incentives cease is wishful thinking. If the industry cluster in Los Angeles remains viable in the short-term, ending incentives in U.S. states outside of California and New York should result in a return of some to those two traditional locations.

A more likely result is that productions will, in the absence of domestic film incentives, flock in alarming numbers to locations abroad. Just dealing with Canada and its film incentives was damaging to the United States. Now, however, the nation faces a new host of opponents who have imitated the Canadian model of attack at the same breakneck speed at which it was adopted in almost every U.S. state. The race to the bottom, certainly in the United States, must end. It should be a concern for other nations, not this one. With a national incentive combined with the advantage we already have from the industry cluster in Los Angeles, the U.S. would not have to compete in a race to the bottom. In waging economic warfare—and military warfare alike—it is much easier to defend than it is to attack. For each dollar the U.S. spent on protecting the film industry, the competition would need to match it with thousands more. The international race to the bottom may prove too costly and the gains, if any, insignificant enough to sustain an industry without the steady stream of productions that require government spending to attract.

All of this begs the question: What is everyone fighting so fiercely for, and is it worth fighting for?

II. WORTH FIGHTING FOR: THE ECONOMIC IMPACT OF THE MOTION PICTURE INDUSTRY IN THE UNITED STATES

Since 2007, the Motion Picture Association of America (MPAA) has released two reports on the economic impact of the motion picture and television production industry on the United States.[4] Table 1 provides the "report highlights" for each.

TABLE 1:
HIGHLIGHTS FROM THE MPAA'S 2006 AND 2009 ECONOMIC IMPACT REPORTS[5]

2005	**2007**
1.3 million jobs	2.5 million jobs
$73,000	$74,700
$30.24 billion paid out as wages	$41.1 billion paid out as wages
$30.2 billion in revenue to U.S. vendors and suppliers	$38.2 billion in payments to U.S. vendors and suppliers, small businesses and entrepreneurs
$10 billion in income and sales taxes	$13 billion in income and sales taxes
$9.5 billion in trade surplus	$13.6 billion in trade surplus

The statistics from the reports are impressive, if assumed accurate. From 2000 to 2005, motion pictures as audiovisual exports increased by 20%.[6] Indeed, the motion picture industry "is one of the few industries that consistently generates a positive balance of trade."[7] The $9.5 billion trade surplus in 2005 was "larger than the combined positive trade balance for telecommunications and computer and information services, and was 12% of the entire U.S. private-sector service trade surplus."[8] In 2007, the industry trade surplus, at $15 billion in audiovisual exports, was the highest on record since tracking began in 1992—and 23% higher than in 2006.[9]

The confusion, reliability and complexity of employment statistics in the motion picture industry were discussed and analyzed at length in 2007.[10] Since 2007, employment numbers are somewhat more consistent.

4. THE ECONOMIC IMPACT OF THE MOTION PICTURE & TELEVISION PRODUCTION INDUSTRY ON THE UNITED STATES (2009) [hereinafter 2009 MPAA ECONOMIC IMPACT REPORT]; MOTION PICTURE ASS'N OF AMERICA, THE ECONOMIC IMPACT OF THE MOTION PICTURE & TELEVISION PRODUCTION INDUSTRY ON THE UNITED STATES (2006) [hereinafter 2006 MPAA ECONOMIC IMPACT REPORT]; MOTION PICTURE ASS'N OF AMERICA. The 2006 Report is based on data for 2005; the 2009 report is based on data from 2007.

5. 2006 MPAA ECONOMIC IMPACT REPORT, *supra* note 4, at 5; 2009 MPAA ECONOMIC IMPACT REPORT, *supra* note 4, at 5.

6. 2006 MPAA ECONOMIC IMPACT REPORT, *supra* note 4, at 10.

7. *Id.*

8. *Id.*

9. 2009 MPAA ECONOMIC IMPACT REPORT, *supra* note 4, at 7.

10. McDonald, *supra* note 2, at 913–15.

Table 2 shows the employment data from the MPAA's 2006 and 2009 Economic Impact Reports, which studied job numbers for 2005 and 2007 respectively.[11]

TABLE 2:
FILM AND TELEVISION PRODUCTION EMPLOYMENT, 2005 AND 2007

2005		**2007**	
Core[12]	180,000	Core[13]	285,000
Freelance[14]	231,000	Distribution[15]	478,000
Indirect	1,000,000	Indirect	1,700,000
Total	1,411,000	**Total**	2,463,000

When the "indirect" job numbers are removed for each year, the remaining number of "direct" jobs is 411,000 in 2005 and 763,000 in 2007. The exact number of the multiplier was not supplied in the MPAA reports, but the U.S. Commerce Department reported that the highest multiplier used in such reports was 3.71 and the lowest was 1.79.[16]

The numbers in the MPAA's two economic impact reports also

11. 2009 MPAA ECONOMIC IMPACT REPORT, *supra* note 4, at 6; 2006 MPAA ECONOMIC IMPACT REPORT, *supra* note 4, at 6.

12. 2006 MPAA ECONOMIC IMPACT REPORT, *supra* note 4, at 6. "Over 180,000 people were directly employed as studio, independent production company, or core industry supplier staff. Core industry suppliers include film labs, special effects and digital studios, location services, prop and wardrobe houses, research services and film stock houses, video duplicating services and stage rental facilities among others." *Id.*

13. 2009 MPAA ECONOMIC IMPACT REPORT, *supra* note 4, at 6.

> Over 285,000 people are employed in the core business of producing, marketing, manufacturing and distributing motion pictures and television shows, including full, part time and freelance workers at major studios, independent production companies, and core industry suppliers like film labs, special effects and digital studios, location services, and prop and wardrobe houses dedicated to the production industry, among others. The industry employs workers in every major occupational group, including actors, accountants, agents, animators, camera operators, casting directors, computer specialists, directors, editors, engineers, graphic designers, marketers, producers, special effects, technicians, writers, and many, many more.

Id.

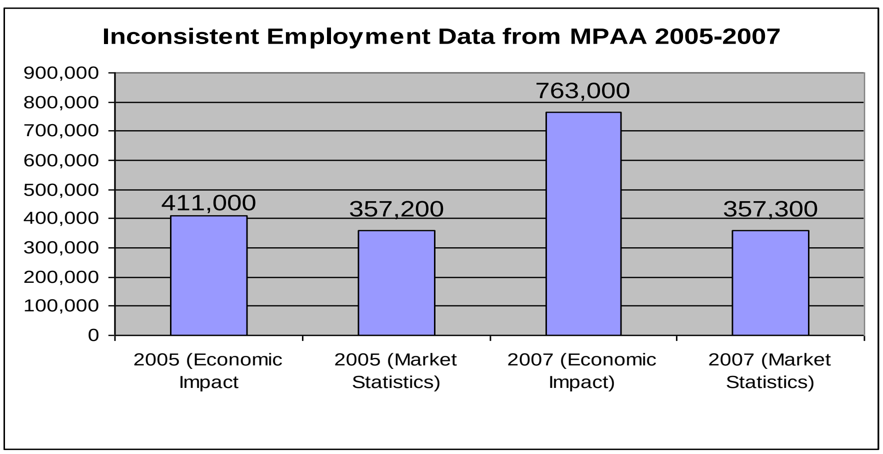
14. 2006 MPAA ECONOMIC IMPACT REPORT, *supra* note 4, at 25. Freelance workers "include actors, directors, writers," and technical or craft specialists. *Id.* at 6. "While freelance employees account for more than half of the industry's workforce, it's important to note that freelance is not synonymous with 'part-time' as many work full time." *Id.* at 25.

15. 2009 MPAA ECONOMIC IMPACT REPORT, *supra* note 4, at 6. "This includes workers at movie theaters, video rental operations, television broadcasters, cable companies, and new dedicated online ventures like Hulu and TV.com." *Id.*

16. U.S. DEP'T OF COMMERCE, THE MIGRATION OF U.S. FILMS AND TELEVISION PRODUCTION 23 (2001).

conflict with the employment numbers reported in the Association's annual Market Statistics Reports. However, the annual market reports only supply raw employment numbers from the U.S. Bureau of Labor Statistics (BLS) and do not account for multipliers or indirect impacts, etc. According to the most recent market statistic report, the total number of jobs in the motion picture industry for 2006 was 354,400; in 2007, the total was 357,300.[17] Chart 1 shows the difference between data reported in the MPAA annual market statistic reports, which list only BLS data (NAICS 5121), and the economic reports. When the MPAA applied an economic multiplier to the data in its 2009 Economic Impact Report, and indirect employment is factored into overall employment, the number of industry supported jobs spiked.

CHART 1:



In the absence of any other source of consistent annual employment data, the BLS numbers are the de facto authority for the number of people "directly" employed by the motion picture industry.

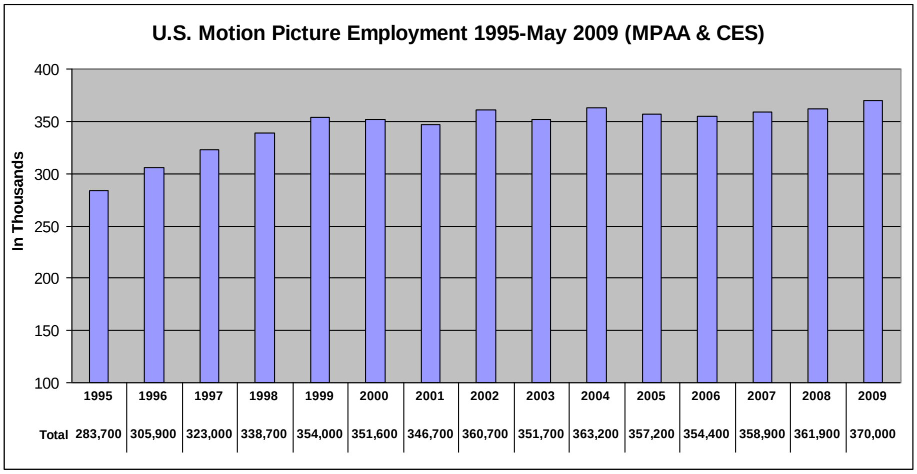
Chart 2[18] shows the number of direct jobs in the motion picture

17. MOTION PICTURE INDUS. ASS'N OF AM., ENTERTAINMENT INDUSTRY MARKET STATISTICS 2007 23 (2008) [hereinafter ENTERTAINMENT MARKET STATISTICS 2007].

18. U.S. BUREAU OF LABOR, QUARTERLY CENSUS OF EMPLOYMENT AND WAGES 2001–2010 (2010) [hereinafter BLS DATA], http://www.bls.gov/data/ (follow "Employment" hyperlink; then click "one screen data search" button next to "State and County Employment and Wages (Quarterly)"; then search "U.S. Total" for 1, "U.S. Total" for 2, "NAICS 5121 Motion picture and video industries" for 3, "Private" for 4, "All establishment sizes" for 5, "All Employees" for 6; then click on the "Get Data" button); MOTION PICTURE ASS'N OF AMERICA, WORLDWIDE MARKET RESEARCH, U.S. ENTERTAINMENT INDUSTRY: 2004 MPA MARKET STATISTICS 27 (2004); ENTERTAINMENT MARKET STATISTICS 2007, *supra* note 17, at 23.

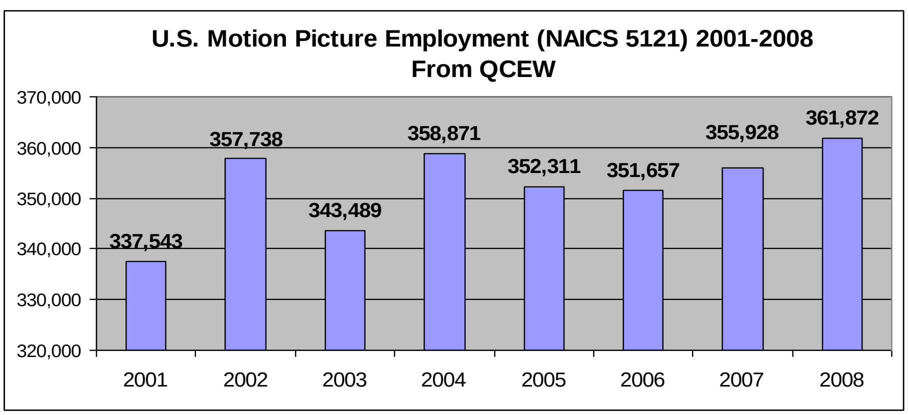
industry from 1995 through May 2009 according to the BLS Current Employment Statistics (CES), which is the same data that the MPAA uses in its annual reports.

CHART 2:



The employment data from the CES, however, is not perfectly consistent with the data from the BLS Quarterly Census of Employment and Wages (QCEW), which is generally several thousand jobs less than the CES, as seen in Chart 3.[19]

CHART 3:



19. BLS DATA, *supra* note 18.

As CES data (Chart 2) shows, motion picture industry employment grew dramatically from 1995 (283,700) to its peak in 2004 (363,300). In 2005, total employment fell to 357,200 and fell again in 2006 to 354,400. Since 2006, total employment increased each year and, as of July 2009, was at 372,300.[20]

The dramatic increase in industry employment was also tracked closely by Allen J. Scott's survey of employment from January 1983 until December 2002.[21] Using SIC 78 (Standard Industrial Classification) to measure employment in Los Angeles County, Scott noted a large and steady increase in motion picture employment that peaked in 1998 and declined each year until 2002, which was the extent of available data.[22] Scott was unable offer a comprehensive explanation for the decline, but acknowledged runaway production probably played a part.[23]

The BLS's change from the old SIC classification to the current NAICS system is problematic. For example, under the old SIC 78, motion picture employment was 408,000 in 1990 and jumped to 672,000 in 2010[24], which is much higher than the NAICS data currently used. Indeed, employment numbers are inherently confusing. Yet, it is critical that industry observers, policy makers, and anyone involved in the motion picture industry have a rudimentary understanding of the employment statistics, imperfect as they may be.

Without a doubt, the film industry's economic importance to the entire nation is very clear. But, as discussed in Part I, the benefit the industry confers to the nation stems from its overwhelming concentration in California. In 2009, California's share of the total number of people employed in the motion picture and video industries in the U.S. was 38.7% and 36% for the total number of independent artists, writers, and performers.[25] In 2009, labor income for the motion picture and video industries and for independent artists, writers, and performers was $15.5 billion and $7.7 billion, respectively (California's share of national labor income for these categories was over 60%).[26] The total economic output of the motion picture and video industry in California was a massive $48.5 billion in 2009, representing 59.2% of the U.S. total. That same year,

20. *Id.*
21. ALLEN J. SCOTT, ON HOLLYWOOD 123 (2005).
22. *Id.* at 122–23.
23. *Id.* at 122.
24. JONES, *supra* note 1, at 21.
25. L.A. CNTY. ECON. DEV. CORP., CALIFORNIA FILM AND TELEVISION TAX CREDIT PROGRAM: AN ECONOMIC IMPACT STUDY 3 (2011) [hereinafter LAEDC ECONOMIC IMPACT STUDY].
26. *Id.*

independent artists, writers, and performers generated $14.3 billion in California, representing 59% of the U.S. total.[27]

In 2011, the Los Angeles County Economic Development Corporation (LAEDC) highlighted California's unique position within the industry, noting how 92% of all purchases the industry makes are sourced within California:

> California's rich history in film making has allowed the development of a deep pool of talented workers in the variety of occupations needed to produce a motion picture or television series. This makes it possible for the industry to find suppliers for almost all its needs within the state, keeping this economic activity here. Almost 92 percent of all the goods and services purchased by the industry are sourced within the state. . . .
>
> The industry purchased $6.4 billion in goods and services from other firms within its own industry; it purchased $1.7 billion in advertising services and paid $1.5 billion in rent or real estate services. In aggregate, the industry spent $15.4 billion on goods and services in California in 2009 from a wide variety of industries.[28]

The $15.4 billion in spending, while impressive, is smaller than in the past. In 1996, for example, the year before Canada developed its first significant film incentives, production spending in California was $15.5 billion, $20.98 in 2009 dollars.[29] The concentrated industry in California was critical in preventing any other nation from cracking Hollywood's global dominance. Seemingly unaware that California's film industry cluster gives the U.S. film industry its strength, lawmakers in the U.S. have failed to appreciate that foreign nations would target filmmaking; their ignorance meant California's production dominance was completely undefended and ripe for attack.

Unlike in the U.S., policymakers in other nations, particularly Canada, are keenly aware of the importance of such concentrations:

> In business, as elsewhere in life, Darwin's rules apply. The first group to establish itself in a market generally attains an insurmountable height from which to hold down competitors.
>
> The governments of Canada, Ontario and Toronto recognized many years ago that to build a Canadian screen-based industry, public funds had to flow. Only the public could afford the risks of entry into the well established screen business.
>
> Hollywood got into the screen business in the 1920s and

27. *Id.*
28. *Id.*
29. JONES, *supra* note 1, at 11.

> established its hegemony with massive investments in infrastructure and talent in Los Angeles, at a time and in a place where more days per year of reliable sunshine was a business advantage for a technology that needed available light.
>
> Studios like RKO and MGM built film versions of old theatre repertory companies which they staffed with directors, actors, writers and crews. They put out their products through worldwide distribution networks.[30]

Recognizing that Hollywood's established hegemony developed and preserves because it concentrated in one place (Los Angeles), policymakers in Toronto understood the importance of creating their own concentrated industry cluster and warned that policies which encouraged production in other parts of the nation not only hurt Toronto, Canada's leading production center, but threatened the viability of the industry in the entire nation:

> But some industries, particularly screen arts, don't lend themselves to being spread thin. In fact, they grow best in big Creative Cities where talent is concentrated, and there is a sustaining supply of work.
>
> Screen arts, like other art forms, are only mastered by doing. They require a sophisticated infrastructure, including state-of-the-art studios, post production facilities, and schools that train sufficient newcomers to supply the business as it grows. But screen arts infrastructure is expensive, and can best be afforded where capital costs can be amortized through constant use. . . .
>
> Instead of supporting Toronto as a world-class centre of excellence, policies have begun to tear it down. If Toronto fails, the viability of the industry across the country will suffer.[31]

The same warning expressed above applies in this nation. The concentration of the film and television industries in Los Angeles is the main reason Hollywood enjoys unrivaled global dominance. No one anywhere else has been able to compete. The world-class concentration of talent and infrastructure in Los Angeles cannot sustain itself without a constant level of movie and television production. Runaway production to other nations is a national concern because it weakens this concentration, which is the one thing that makes Hollywood such a global juggernaut.

A national solution is needed to protect the national advantage the U.S. enjoys from the concentrated industry cluster in Los Angeles (and, to a lesser extent, New York). The industry cluster in Los Angeles needs a

30. TORONTO FILM BD., STRATEGIC PLAN FOR TORONTO'S SCREEN-BASED INDUSTRY 14 (2007).

31. *Id.* at 24–25.

constant level of movie and television production to survive. A film incentive in the U.S. at the national level could solve this problem, and it may be the only possible solution. State film incentives are ineffective solutions to runaway production because they exacerbate the erosion of the industry cluster in Los Angeles, further weakening the one part of the industry that makes the U.S. so dominant around the world.

III. RUNAWAY PRODUCTION AS "SCENE" FROM ACADEMIC SOURCES AND FROM THOSE IN HOLLYWOOD

For some time, a growing number of academic sources have taken a more sophisticated approach to examining runaway production, which was traditionally seen as a local concern in the United States, limited to Los Angeles. According to Ben Goldsmith, head of the Center for Screen Studies and Research at the Australian Film Television and Radio School in Sydney, and Tom O'Regan, of the University of Queensland in Australia, runaway production opponents tend to:

> [I]gnore or downplay both the benefits that international production brings to American cinema and the variety of perspectives on, motivations for, and experiences of international collaboration outside the United States. International production enriches American cinema through artistic achievement, creative renewal, and access to sources of production funding, as well as through financial returns and intellectual property rights.[32]

The relatively new, more sophisticated approach to studying film and television production in a globalized age caused some academics to deem the concept of runaway production "cross border cultural production."[33] Greg Elmer and Mike Gasher provide an explanation in a shift towards greater scholarly reflection:

> While location shooting is as old as cinema itself, the sheer size, the growing intensity, and the persistence of the trend toward moving American film and television production out of Hollywood calls for much more scholarly reflection than we have seen to date and for analysis that includes perspectives of host sites. For one thing, location production is not as simple a phenomenon as most news reportage and some academic work suggests; understanding it requires consideration, at the macro scale, of economic globalization, screen aesthetics, narrative

32. Ben Goldsmith & Tom O'Regan, *International Film Production: Interests and Motivations*, *in* CROSS BORDER CULTURAL PRODUCTION: ECONOMIC RUNAWAY OR GLOBALIZATION? 13, 15 (Janet Wasko & Mary Erikson eds., 2009) (citation omitted).

33. *See generally* CROSS BORDER CULTURAL PRODUCTION: ECONOMIC RUNAWAY OR GLOBALIZATION? (Janet Wasko & Mary Erikson eds., 2009) (examining the cross-cultural benefits that come from international production and collaboration).

> forms, and reception practices, as well as, at the micro scale, specific production communities, individual films and television programs, and particular audiences. . . . [T]he transformation of Hollywood from an exclusive and centralized base to a global network of production sites . . . alters in some fundamental ways the political economy of the commercial film industry. . . . [L]ocation film and television production does not mean the same thing to all industry actors, and therefore must be analyzed from a variety of viewpoints.[34]

Cross border cultural production, the reality of what international production entails, is a highly complex international economic and cultural field of study. According to Goldsmith and O'Regan:

> International production connects film industries in different countries, and in the process it can introduce or create new work practices. Individuals, organizations, and places employed or transformed by the experience of international production, as well as the ever increasing number of employees working to facilitate international production in particular places, often do not wholly share the interests or production norms of American production companies or transnational media corporations. They are, however, not only becoming increasingly interconnected and simultaneously integrated, informally and formally, into Hollywood's globalizing production system, but also becoming more integrated into each other's national production systems through coproductions and other cooperative arrangements.[35]

Clearly, reframing and expanding the study of film policy and runaway production to acknowledge the complexity of runaway production is long overdue. While academics have done an excellent job in elevating the discussion about runaway production, there remain some flaws in the academic arguments.

Few works of academic literature discuss the risks governments face in attempting to foster a local film and television production industry through film and television production incentives.[36] Virtually no literature criticizes the current incentive schemes as problematic or potentially devastating economic policy.[37] One possible explanation is that not

34. Greg Elmer & Mike Gasher, *Introduction: Catching Up to Runaway Productions*, *in* CONTRACTING OUT HOLLYWOOD 1, 2 (Greg Elmer & Mike Gasher, eds., 2005).

35. Goldsmith & O'Regan, *International Film Production: Interests and Motivations*, *supra* note 32, at 15.

36. *See generally* BEN GOLDSMITH & TOM O'REGAN, THE FILM STUDIO: FILM PRODUCTION IN THE GLOBAL ECONOMY (2005) (discussing the contemporary international film environment) [hereinafter GOLDSMITH & O'REGAN, THE FILM STUDIO].

37. Janet Wasko, to her credit, recognized such a problem in film and media study from a "media economics" approach: "These approaches avoid any kind of moral grounding, as most studies emphasize description (or 'what is') rather than critique (or 'what ought to

everyone in the academic community believes there is, in Janet Wasko's words, a "runaway production problem."[38]

Goldsmith and O'Regan argue that international production "both privilege[s] and expand[s] the Hollywood design interest," and view the growth of international and domestic production locations like Toronto, Canada and Wilmington, North Carolina as a positive development for Los Angeles's design and production industries.[39] Conversely, Cornell University's Susan Christopherson is less optimistic in appraising the dispersion of production to international locations, specifically Vancouver, Canada:

> Several conclusions emerge out of the Canadian story. First, although subsidies and exchange rates increased the propensity of U.S. producers to use Canadian regions to reduce costs in particular types of productions, they did not build a sustainable industry in the key region in which the subsidy strategy was deployed, Vancouver. Second, the changing organization of production in the media entertainment industries allowed TNCs to utilize the investments that Canadian citizens made in developing regional production bases over a period of 50 years. Finally, the evidence from the Canadian "success story" suggests that interregional competition has increased the profits of transnational firms rather than building competitive regional industries.[40]

Christopherson appropriately recognizes the danger of interregional competition. However, she underestimates the role production incentives play in selecting where to make a movie:

> This trajectory of Canadian success is contestable on a number of fronts. First, it ignores the impact of the exchange rate differential. The value of the Canadian dollar lagged the U.S. dollar throughout the 1990s and made the cost of producing in Canada relatively less expensive in the United States. The cost savings did not occur across all categories of production expenditures, however. Only the cost of the "below-the-line" production crew is identified as susceptible to cost savings because of the exchange rate. Outsourcing does not emerge in conjunction with subsidies. In addition to and substantiating the weak link between outsourcing and subsidies, a recent

be')." JANET WASKO, HOW HOLLYWOOD WORKS 6 (2003).

38. *Id.* at 219.

39. GOLDSMITH & O'REGAN, THE FILM STUDIO, *supra* note 36, at 178.

40. Susan Christopherson, *Behind the Scenes: How Transnational Firms Are Constructing a New International Division of Labor in Media Work*, in CROSS BORDER CULTURAL PRODUCTION: ECONOMIC RUNAWAY OR GLOBALIZATION? 47, 74 (Janet Wasko & Mary Erikson eds., 2009).

> econometric analysis of the impact of subsidies in British Columbia shows only a weak relationship between tax credits and production spending levels.[41]

The notion that the exchange rate is as big a factor in influencing production as tax incentives is tenuous at best.[42] Moreover, the correlation between production incentives and increased production spending is not as weak as Christopherson suggests, given the production data now available from jurisdictions with recently enacted incentives, which is discussed in Part II herein.[43]

A. *Framing Runaway Production: Part of Hollywood History or National Problem?*

Runaway production has a long history in Hollywood. In 1956, for example, 18 of 39 films then in production shot on location in Europe, Japan, Cuba and four states other than California, according to the *Hollywood Reporter*, while "dozens of Hollywood soundstages were dark."[44] Films shot abroad in the 1950s faced difficulties including "language barriers, cultural divides, varying regulations and fees, inadequate facilities and services, and inexperienced (or uncooperative) crews."[45] These "difficulties," according to the *Hollywood Reporter*, were "much the same as they are today, as was the controversy."[46]

In 1952, the Hollywood Film Council of the American Federation of Labor launched a public relations campaign to end the practice of

41. *Id.* at 70.

42. *See* McDonald, *supra* note 2, at 905–06 (discussing the role exchange rates play in influencing production decisions).

43. To Christopherson's credit, her recent work (written with Ned Rightor) addresses the value of production incentives in places that traditionally lacked film and television production:

> As subsidies to film and television producers have spread (43 states across the U.S. now offer them in some form) and state budgets have come under increasing pressure, questions are being raised about the use of public tax money to lure media producers. Skeptics ask whether the cost of attracting media producers is worth it. Does the state's economy benefit enough to warrant taking money from other important activities, such as education or infrastructure or the arts? Can new, sustainable industries really be built in cities and states that have no history of media industry investment nor a sizable skilled production workforce.

Susan Christopherson & Ned Rightor, The Creative Economy as "Big Business" 1 (Apr. 12, 2009) (unpublished summary of larger study published in 2009) (on file with author).

44. Todd Longwell, *Runaway Production Part of Industry History*, HOLLYWOOD REPORTER (Oct. 29, 2008, 9:19 PM), http://www.hollywoodreporter.com/news/runaway-production-part-industry-history-121999.

45. *Id.*

46. *Id.*

runaway production.[47] The union did not oppose runaway production necessitated by artistic concerns, but sought to "stop the growing tendency here among Hollywood producers, especially in television, to do their shooting in foreign countries principally to cut costs. Hollywood employment already has been considerably decreased by these activities."[48] This too is much the same today.

In 1959, Hollywood labor unions claimed between 35 and 50% of American feature films were shot abroad.[49] Some producers grew tired of the complaints. Producer Ted Richmond said, "The choice is simple. Either you make these spectacle pictures abroad or you don't make them at all."[50] At the time, Richmond just completed shooting a film in Spain because of "the prohibitive cost of shooting in Hollywood."[51] Despite the campaign against runaway production, "[t]he protests did nothing to halt the exodus."[52] And despite "the exodus" of more runaway productions each year, "doomsday . . . never came" because "the local production economy continued to thrive."[53] And thrive it did. From 1980 to 1997, motion picture and "service activities in Los Angeles County grew at a rate of 194% for employment and 248% for businesses."[54]

In recent years, a "loud chorus of complaints" has warned that Southern California's unmatched film infrastructure is slowly eroding as production shifts to foreign nations.[55] One sign of erosion is the number of shooting days in Los Angeles, which "decreased nearly 40% from 1997-2007."[56] Given the long history of runaway production in Hollywood over the years, it is prudent to ask rhetorically: "Is the sky really going to fall on Hollywood this time?"[57]

According to director Richard Donner, who helmed such films as 1978's *Superman* and the *Lethal Weapon* franchise, the answer is no, "it won't . . . [i]t'll go and come and go and come and build and fall. It's been that way forever."[58] Donner's words are not reassuring. Donner shot much of the original *Superman* film in Canada and England.[59] Donner was also a

47. *Id.*
48. *Id.*
49. *Id.*
50. *Id.*
51. *Id.*
52. *Id.*
53. *Id.*
54. *Id.*
55. *Id.*
56. *Id.*
57. *Id.*
58. *Id.*
59. *Filming Locations for Superman (1978)*, THE INTERNET MOVIE DATABASE, http://www.imdb.com/title/tt0078346/locations (last visited May 18, 2009).

producer on the first *X-Men* film,[60] which shot entirely in Canada,[61] and an executive producer on 2009's follow-up *X-Men Origins: Wolverine*, which shot primarily in Australia.[62]

Shooting *Wolverine* in Australia was objectionable for some long-time fans of the comic book character since Wolverine is, ironically, Canadian. Bryan Singer, who directed the first two *X-Men* films, was conscious of the moral dilemma of shooting in Canada over the U.S.[63] While shooting *X-Men*, filming was briefly halted because "some crazy guy" driving to his home on the evening commute became angered over a long traffic delay caused by the production.[64] The event prompted Singer's associate, Brian Peck, to joke, "[i]t was probably a gripe from America upset at runaway production. 'Why are you taking all the work to Canada?'"[65] Singer's response showed he was uneasy about the shoot: "Normally I wouldn't be so quick to shoot in another country, but much of the X-Men history and Wolverine's history is steeped in Canada. And so if we had to go out of the country to try to save money, Canada was the most responsible destination."[66]

Donner's wife, Laura Shuler-Donner, was a producer on all of the Canadian-filmed *X-Men* films[67] as well as the *Wolverine* film.[68] Moreover, Shuler-Donner was also a producer on 2003's *Timeline*, directed by her husband and filmed in Canada and the Czech Republic.[69] Thus, Donner's claim that the sky isn't falling on the U.S. motion picture industry is suspect. He is not a neutral observer of the runaway production phenomenon; rather, he is an active participant perpetuating it.

Runaway production is good for the Donner family business, however, and the powerful Hollywood couple cannot be blamed for taking advantage of it. Donner's remark that "[runaway production has] been that

60. *Richard Donner*, THE INTERNET MOVIE DATABASE, http://www.imdb.com/name/nm0001149/#producer (last visited May 18, 2009).

61. *Filming Locations for X-Men (2000)*, THE INTERNET MOVIE DATABASE, http://www.imdb.com/title/tt0120903/locations (last visited May 18, 2009).

62. *Richard Donner*, *supra* note 60.

63. *Bryan Singer*, THE INTERNET MOVIE DATABASE, http://www.imdb.com/name/nm0001741/ (last visited May 18, 2009).

64. Bryan Singer, Director's Commentary at 15:50, X-MEN (20th Century Fox Film Corp. 2000).

65. *Id.*

66. *Id.*

67. *Lauren Shuler Donner*, THE INTERNET MOVIE DATABASE, http://www.imdb.com/name/nm0795682/ (last visited Oct. 1, 2011). The *X-Men* films include *X-Men*, *X2: United*, and *X-Men: The Last Stand*.

68. *Id.*

69. *Id.*; *Filming Locations for Timeline (2003)*, THE INTERNET MOVIE DATABASE, http://www.imdb.com/title/tt0300556/locations (last visited Oct. 1, 2011).

way forever" would have us believe that runaway production is an institutionalized part of the motion picture industry.[70] Perhaps it is.

Many of Donner's films are artificial economic runaways.[71] Therefore, if economic runaways have always been part of the industry, it is because filmmakers like Donner go after them. This is not to suggest that Donner should be criticized. If anything, he is a shrewd filmmaker skillfully navigating the realities of film production. Donner did not enact incentives; he just takes advantage of them.

Not everyone in Hollywood shares Donner's take on runaway production. Director and Producer Michael Bay, well known for his flashy, big-budget summer blockbusters, including *Transformers* and *Transformers 2: Revenge of the Fallen*, has expressed solidarity with his film and television colleagues in California. Bay claimed that he could not make *Transformers* in Canada because he only had faith in his experienced sixteen-year crew to make such a technical and special effects driven project, which was nothing short of spectacular in terms of visual effects. In order to stay "loyal" to his crew, Bay agreed to waive 30% of his fee to compensate for the alleged cost savings the studio sought from shooting in Canada or Australia:

> I do like to have a good environment on the set and especially work with people that look at it [their work on films] as a career, not as a job. A director is only as good as his or her crew. And the studio wanted to ship me off to Australia and then to Canada. I went to check out Canada and thought that Australia was too far away, and went up to Canada and I was like oh my god, I was trying to make it work, trying to make it work, looking around, scouting . . . I realized this would be a waste of money . . . there is no way the crew could do the serious kind of stunt work that we really do on our sets, because they just don't have a lot of great stunt work up there and you have to ship in too many people and it just would be a lost cause. So, the studio gave me some grief for not going up there, so I ended up giving 30% of my fee so I could shoot with my crew in America and that's because I am loyal to my crew and they're just, I think, the best.[72]

Indeed, the importance of having a skilled crew base is a critical factor often overlooked in explaining runaway production.[73] In Bay's case,

70. Longwell, *supra* note 44, at 2.

71. Donner's most recent production, *X-Men Origins: Wolverine*, is so plainly an economic runaway that any argument that creative or artistic reasons were behind shooting in Australia would be a total farce. The artistic place to shoot would have been in Canada, as Wolverine is a Canadian and the vast majority of his story of origin took place entirely in Canada.

72. Michael Bay, Directory's Commentary at 54:50, TRANSFORMERS (Paramount Pictures 2007).

73. Andrew Stanton, director of 2008's *Wall-E*, echoed Bay's words regarding the

the value of an experienced group of career industry workers trumped all financial considerations. Had Bay filmed abroad, much of his long-time crew would have been left to find other projects, if available. Over time, if experienced film crews sit idle, unable to find local work, the talent base will diminish along with the advantage of institutional "know-how" California film workers possess.

The availability of an experienced talent base, which is highly compensated for its skills in places like Canada and the United States, does not always trump bottom-line concerns. Director Paul W. S. Anderson discussed the economics of producing his 2003 film, *Aliens vs. Predator*:

> To talk about the economics of film . . . we budgeted this movie. Just to build the sets, the construction budget, just for the sets alone, if we had done the sets in L.A., it would have cost 20 million dollars; to do it in Vancouver, it was 15, to do it in Berlin it was 5 million and we built exactly the same sets in Prague for 2 million dollars . . . . It's one of the reasons the movie has a huge look, but we were able to do it on a contained budget.
>
> That was an important thing to the studio, because they were there kind of looking at the bottom line of what the last couple of Alien movies and the last Predator movie had done. They had not been financial successes.[74]

The low cost of labor in Prague for Anderson's production was a factor that played a role in causing a natural economic runaway; the government did not take action to artificially lower labor costs.

Donner's statement about runaway production not being a serious issue signals a mentality that should be cause for concern if it is widely held. Indeed, Donner's feelings regarding the perpetuity of runaway production is indicative of a larger problem facing the motion picture industry: complacency.

The motion picture industry is a modern industry that did not exist just over one hundred years ago. To attach the notion of "forever" to an

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critical advantage an experienced talent base brings to the table:

> I lucked out that they were at the top of their game. A lot of these guys I have worked with have been fellow employees for over 10–15 years, some of them. And I just feel like they've just become Olympic level champions at whatever it is they do and to watch them do their job, see them excel at stuff they were struggling with or starting to do early in their career and just to be professionals, masters of their crafts, now, is really exciting. And to benefit from that is the best.

Andrew Stanton, Director's Commentary, WALL-E (Walt Disney Pictures 2008).

74. Paul W.S. Anderson, Director's Commentary at 45:00, ALIENS VS. PREDATOR (20th Century Fox Film Corporation 2004).

industry younger than some Americans creates a false impression that Hollywood has always been—and always will be—here. This belief may stem from ignorance or arrogance or both. Either way, millions of Americans, at one time, viewed the automobile industry, the steel industry, and others in the same false light. There is nothing "forever" about the motion picture industry. It can evaporate. What Donner seems unaware of is that runaway production is a vehicle for such evaporation. The only certainty in Hollywood is uncertainty.

B. Hollywood Labor Efforts to Combat Runaway Production in Recent Years: The Failure of the Film and Television Action Committee's Section 301 Filing with The U.S. Trade Representative

Industry workers have long been opposed to runaway production, considering it a form of outsourcing directly attacking their trades, crafts, jobs, and careers—or, more profoundly, their way of life. Coalitions of industry workers trying to end the negative consequences of runaway productions have had two viable options to consider in combating runaway production: (1) petitioning the United States Trade Representative (USTR) to determine the legality of foreign film incentives; or (2) lobbying for film incentives at the state, local, and federal levels. On September 4, 2007, a group called the Film and Television Action Committee (FTAC), a coalition composed of unions, municipalities and individuals whose livelihood and economic security depend on the film and television production industry, filed a petition with the USTR under Section 301 of the Trade Act of 1974.[75] In its petition, FTAC argued that subsidies offered by Canada to lure production and filming of U.S.-produced television shows and motion pictures were "inconsistent with Canada's obligations under the [World Trade Organization] Agreement on Subsidies and Countervailing Measures."[76]

Less than two months later, on October 16, 2007, the two options for fighting runaway production were reduced to one when the USTR rejected FTAC's petition and offered the following:

> As provided under USTR regulations, the petition was reviewed by an interagency committee of trade and economic experts. Based on a thorough review of the economic data, other facts, and legal arguments set out in the petition, the interagency committee unanimously recommended that the USTR not accept

75. *See* Press Release, Statement from Gretchen Hamel, Deputy Assistant USTR for Public and Media Affairs, regarding a Section 301 Petition on Canadian Film Subsidies, Office of the United States Trade Representative (Oct. 19, 2007), http://www.ustr.gov/about-us/press-office/press-releases/archives/2007/october/statement-gretchen-hamel-deputy-assistant (discussing receipt of petition and the USTR's response).

76. *Id.*

> the petition because a dispute based on the information and arguments set out in the petition would not be effective in addressing the Canadian subsidies.[77]

In response to this author's Freedom Of Information Act (FOIA) request for any and all documentation relating to FTAC's petition, the USTR provided just four pages. One page was the USTR press release. Another page informed that four pages were withheld as privileged, and the final two pages were redacted heavily.

On October 17, 2007, William Busis, Chair, Section 301 Committee, sent a memorandum to then-USTR Ambassador Susan C. Schwab. The memorandum section for "Interagency Views" was redacted.[78] Without providing any more information, the memorandum advised Schwab to reject FTAC's petition.[79] A general background of Section 301 was provided, but the discussion section was redacted. Whatever merits the petition had, they were not enough to influence the USTR, which based its decision on the redacted deliberations of an intergovernmental committee. Imperfect as that may be, the new reality was that the only viable option left to stop runaway production was to "fight subsidy with subsidy," a position taken by former actor Charlton Heston and leaders of the Screen Actors Guild (SAG) at a 1961 Congressional Hearing regarding runaway production.[80]

IV. THE RISE OF STATE FILM INCENTIVES

In 2002, Louisiana and New Mexico became the first states to enact film and television production incentives on par with the generous incentives offered in Canada since 1997.[81] The success of the incentives in Louisiana and New Mexico in attracting production was astonishing. When the Motion Picture Association of America released a 2007 report on the economic impact of the motion picture and television industry in the United States, it came to as no surprise that Louisiana and New Mexico were both in the top ten "production states" for 2005.[82]

Louisiana and New Mexico reaped tremendous benefits as first movers among U.S. states to offer film incentives, and they were able to establish robust film and television production activities in those states. As

77. *Id.*

78. Memorandum from William Busis, Chair, Section 301 Committee, to Susan C. Schwab, USTR Ambassador (Oct. 16, 2007) (on file with author).

79. *Id.*

80. Pamela Conley Ulich & Lance Simmens, *Motion Picture Production: To Run or Stay Made in the U.S.A.*, 21 LOY. L.A. ENT. L. REV. 357, 360 (2001).

81. STEPHEN KATZ, THE GLOBAL SUCCESS OF PRODUCTION TAX INCENTIVES AND THE MIGRATION OF FEATURE FILM PRODUCTION FROM THE U.S. TO THE WORLD 34, 63–65 (2006).

82. 2006 MPAA ECONOMIC IMPACT REPORT, *supra* note 4, at 12.

other states noticed the success New Mexico and Louisiana enjoyed, they began enacting their own film incentive programs, hoping to experience similar gains. By August 2005, according to the *Los Angeles Times*, fifteen states had enacted film incentives.[83] By the end of 2010, there were a total of forty-three states with film incentives.[84]

A. Film Incentives: 101

As discussed earlier, runaway production has a long history in Hollywood, which is why the complacency of those like Richard Donner is more dangerous than ever before. Although Hollywood has battled with runaway production before, the reasons why it happened in the past (cheap labor, exchange rates, etc.) are not the same as they are now. Runaway production in the last ten to fifteen years is a much greater problem because of the large and widespread use of film incentives, which Robert Tannenwald calls "a new phenomenon":[85]

> 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.[86]

The modern era film incentive can take many forms. In February 2009, Economic Research Associates (ERA) prepared a ninety-page report on entertainment industries in Louisiana for the Louisiana Economic Development Department. The following table (Table 3) provides an overview of the types of film incentives commonly used in the United States according to ERA.[87]

83. Hollyworld, *Runaway production map*, L.A. TIMES, http://www.latimes.com/news/printedition/la-hollywoodmap-fl,0,6549427.flash.

84. ROBERT TANNENWALD, CTR. ON BUDGET & POLICY PRIORITIES, STATE FILM SUBSIDIES: NOT MUCH BANG FOR TOO MANY BUCKS 1 (2010).

85. *Id.*

86. *Id.* at 3.

87. ECONOMICS RESEARCH ASSOCIATES, LOUISIANA MOTION PICTURE, SOUND RECORDING AND DIGITAL MEDIA INDUSTRIES 73 (2009) [hereinafter ERA LOUISIANA REPORT].

TABLE 3:
COMMON TYPES OF FILM INCENTIVES

Incentive Type	Description
Production Grants	A production grant is directed toward a percentage of the total production cost of a project spent. This type of incentive differs from a (refundable) production tax credit since it can be disbursed to the production company prior to the start of filming a project, thereby reducing financing costs.
Production Tax Credits	Production tax credits are tax credits that are generally based on a percentage of labor costs, and/or a combination of materials, services and other costs related to production. These credits may or may not be transferable. These credits usually have a minimum state/provincial spend, may be capped per production or per employee, might require a minimum percentage of the total production be shot in the state/province and generally apply to certain types of productions (*e.g.*, feature films, television, commercials, etc.).
Labor Rebates	Labor rebates differ from labor-based production tax credits since they allow for funds to be dispersed during production. In this respect they are similar to grants and do not require a waiting period.
Regional Incentives	Regional incentives are generally offered for film and television projects that are undertaken outside of a metropolitan area and provide a "bonus" production or labor tax credit.
Training Incentives	Similar to regional tax credits, a training incentive acts as a bonus.
Digital Incentives	The newest type of incentives being offered, digital incentives provide a tax credit for the production of digital images.
Investments in or Loans to Productions	Select jurisdictions may provide investments or loans to selected types of production projects.

ERA claimed that common incentive packages offered by states "apply either tax credits or rebates to local qualifying expenditures."[88] ERA noted the important difference between a tax credit and a tax rebate:

> A rebate is money back from the state, whereas a tax credit is a reduction in the filmmaker's overall tax liability.
>
> The difference between a refundable tax credit and a transferable tax credit is a crucial one, but it is often overlooked. Refundable tax credits are far more lucrative to filmmakers. When productions have tax liability, a refundable tax credit entitles them to a check from the state for their out-of-pocket liability. In the instance of a transferable credit, however, the production company must sell its remaining tax credits to other taxpayers (often wealthy individuals or companies).[89]

Moreover, ERA argued that transferable credits (which Louisiana has) are less desirable to filmmakers for several reasons:[90]

88. *Id.* at 72.
89. *Id.*
90. The ERA's willingness to inform Louisiana that its scheme was "less desirable" helped establish the report's credibility and mollified this author's concern(s) of bias. *Id.*

> First, buyers of these transferable tax credits do not pay the full value of the tax credits—they buy them at a discount. Second, the process involves accountants, lawyers and other middlemen, who also must be paid for their time. Third, the process can be an administrative burden and often takes many months for the production to claim the proceeds of their remaining tax credits. Every step in this process chips away some value from the incentive. This contrasts with a refundable tax credit, whereby productions often get a check for their full liability within 30 days of ending their production.[91]

While transferable credits may be less desirable to filmmakers, they are as costly to the state. Tannenwald notes:

> 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, 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.[92]

There is another little known wrinkle regarding transferable film credits that would likely draw public ire and greatly diminish their popularity in public opinion polls if it were ever widely reported: The players in the transferable film credit market. This group consists of large insurance companies and financial institutions that benefited from federal bailouts in recent years and are now profiting off of the backs of state taxpayers:

> 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. 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.[93]

B. The Incentives Arms Race

In ERA's 2009 report, New Mexico, Connecticut, Georgia, Michigan and New York—in addition to Louisiana—were designated the

91. *Id.*
92. TANNENWALD, *supra* note 84, at 3–4.
93. *Id.* at 4.

most aggressive states (in terms of competitive film incentives in the U.S.); Michigan, whose incentives include a refundable tax credit of up to 42% on in-state expenditures, was deemed the most aggressive.[94] In ERA's 2006 report, Louisiana, South Carolina, New Mexico, Florida, Rhode Island, Connecticut and Georgia were the designated "aggressive incentive states" and South Carolina, which offered a 30% refundable tax credit, was designated the most aggressive.[95]

That Michigan supplanted South Carolina as the most aggressive film incentive state illustrates a fundamental problem with the current incentive scheme in the U.S.: The race to the bottom. In just three years, South Carolina's standing as the most aggressive film incentive state in 2006 was not only supplanted by Michigan's enormous 42% rebate, but the state was not even mentioned in ERA's 2009 report as being "aggressive."

The "aggressive states" in ERA's 2006 and 2009 reports (seen in Table 4 below) were not aggressive enough, however, to make it on to the MPAA's top ten film and television production states, according to the association's 2006 and 2009 economic impact reports. The MPAA's 2006 economic impact report ranked California and New York one and two, respectively, of the top "production states in 2005."[96] The other states on the list, in descending order, were Nevada, Arizona, North Carolina, Montana, New Jersey, Louisiana, New Mexico and Illinois.[97]

In the MPAA's 2009 economic impact report, the top ten production states (after California and New York) were: Illinois, Texas, Florida, Georgia, Pennsylvania, New Jersey, North Carolina, Louisiana, Tennessee and Massachusetts.[98] While the 2009 report bumped Arizona and New Mexico from the top ten list, both states, in addition to Michigan, Utah and Connecticut were deemed "states to watch" based on "amount of productions industry-wide; production employees and wages; and the total

94. ERA LOUISIANA REPORT, *supra* note 87, at 78. Michigan's complete incentive package includes:

> (1) 40% refundable tax credit, across the board on Michigan expenditures, with an extra 2% if filming in one of the 103 Core Communities in Michigan. (Labor and Crew: 40%–42% Resident Below the Line. 40%–42% Above the Line regardless of domicile. 30% Non-resident Below the Line). (2) A 25% tax credit on infrastructure investments of > $250,000, up to $10 million. (3) A 50% refundable job training tax credit to provide on-the-job training for Michigan residents in advanced below-the-line crew positions on qualified productions. (4) A 0% investment loan program is available for up to $15 million per project, with back end participation in lieu of interest."

Id.

95. ECONOMICS RESEARCH ASSOCIATES, TRENDS IN FILM, MUSIC & DIGITAL MEDIA 49 (2006).

96. 2006 MPAA ECONOMIC IMPACT REPORT, *supra* note 4, at 11–12.

97. *Id.*

98. 2009 MPAA ECONOMIC IMPACT REPORT, *supra* note 4, at 9.

number of vendors and vendor payments made by MPAA studios during 2007 . . . as well as 2008 production levels, tax incentives, and economic impact of the industry."[99]

TABLE 4:
ERA'S "AGGRESSIVE INCENTIVE" STATES (2006 & 2009) AND THE MPAA'S "TOP PRODUCTION STATES" (2006 & 2009)[100]

2006 ERA Report	**2009 ERA Report**	**2006 MPAA Report[101]**	**2009 MPAA Report**
Louisiana	Louisiana	California	Illinois
South Carolina*	Connecticut	New York	Texas
New Mexico	Georgia	Nevada	Florida
Florida	Michigan*	Arizona	Georgia
Rhode Island	New York	North Carolina	Pennsylvania
Connecticut	New Mexico	Montana	New Jersey
Georgia		New Jersey	North Carolina
		Louisiana	Louisiana
		New Mexico	Tennessee
**ERA's most aggressive*		Illinois	Massachusetts

In January 2010, a special report by The Tax Foundation, a nonpartisan research institute in Washington D.C., discussed the pernicious nature of the race to the bottom, which it compared to an arms race:

> It is not only the quantity of MPIs offered that increased; they have also grown in magnitude. States entering the game late were behind and they knew it. Early adopters had developed infrastructure and economies of scale that made production cheaper. To catch up, late adopters have sought to overcome this disadvantage by offering even larger incentives.
>
> Michigan, for example, now offers credits worth 30 to 50 percent of personnel expenditures and up to 42 percent of production expenditures, besting even Puerto Rico's 40 percent credit. As a relative latecomer to the film tax credit game, Michigan needed a very generous incentive to draw in productions, so generous in fact that it will cost an estimated $150 million in the current fiscal year. As part of it, the state grants credits for 25 percent of infrastructure investments in an explicit effort to catch up with states like Louisiana and New Mexico. But what are they really "catching up" to? . . .
>
> Each year, legislators have gone back to the drawing board to outdo the incentives of neighboring states and give their home

99. *Id.*
100. In the MPAA's 2009 report, California and New York were not included in the top ten, but they would have been numbers one and two, respectively, had they been.
101. The 2006 report is based on 2005 data. The 2009 report is based on 2007 data.

state an edge in attracting movie production. But this just encourages other states to increase their incentives in response. As a result, the cost of encouraging film production goes up each year. Incentives that would have lured filmmakers less than a decade ago now fall short and taxpayers are left facing bigger and bigger bills to support the production incentives "arms race."[102]

C. *Film Incentives Do Attract Production*

Because of their excessive cost in numerous states, film incentives are incapable of being cost-effective or sustainable anywhere near current levels in many U.S. states. That said, leaving the cost issue aside, film incentives are incredibly effective at attracting and/or retaining production. The production gains in Louisiana and New Mexico after they enacted their film incentives in 2002 were breathtaking.

In Louisiana, the number of films shot (partially and/or entirely) went from 1 in 2002 to an estimated 118 in 2010 and the amount of production spending increased from $3.5 million (2002) to $674.1 million (2010).[103]

TABLE 5:
LOUISIANA FILM PRODUCTION BUDGET COMPARISON 2002-2010

Louisiana	Films	Actual Budgets of Productions (Millions)	Amount of budget spent in-state (Millions)
2002	1	$10.5	$3.5
2003	15	$241.1	$79.6
2004	32	$413.4	$136.4
2005	36	$609.3	$201.1
2006	49	$698.1	$281.2
2007	86	$450.6	$374.5
2008	46	$652.7	$474.2
2009	112	$519.3	$361.5
2010 (Est.)	118	$1,100.0	$674.1

102. William Luther, *Movie Production Incentives: Blockbuster Support for Lackluster Policy*, 173 TAX FOUNDATION: SPECIAL REPORT 15 (2010).
103. CHERYL LOUISE BAXTER, BAXSTARR CONSULTING GROUP LLC, FISCAL & ECONOMIC IMPACT ANALYSIS OF LOUISIANA'S ENTERTAINMENT INCENTIVES 20 (2011).

In New Mexico, the number of “major [projects]” increased from 5 in 2003 to a high of 30 in 2008 before decreasing to 16 in 2010, while production spending increased from $26.4 million (2003) to a peak of $274.9 million (2008) before decreasing to $206.4 million (2010).[104]

TABLE 6:
NEW MEXICO MAJOR PROJECT SPENDING 2003-2010

New Mexico	**“Major Projects”**	**Actual in-state spend (million)**
2003	5	$26.40
2004	7	$12.00
2005	16	$62.00
2006	21	$153.40
2007	22	$151.10
2008	30	$274.90
2009	24	$260.20
2010	16	$206.40

There are two likely explanations why states with recently enacted film incentives have not seen the same level of feature film productions gains enjoyed by New Mexico, Louisiana and Michigan. First, with 40 states now offering competitive incentives, the market is oversaturated. With so many substantial incentives to choose from, it is not possible for any one state to duplicate the success of New Mexico and Louisiana. However, Michigan is the exception to this, likely due to the enormous size of the incentive.

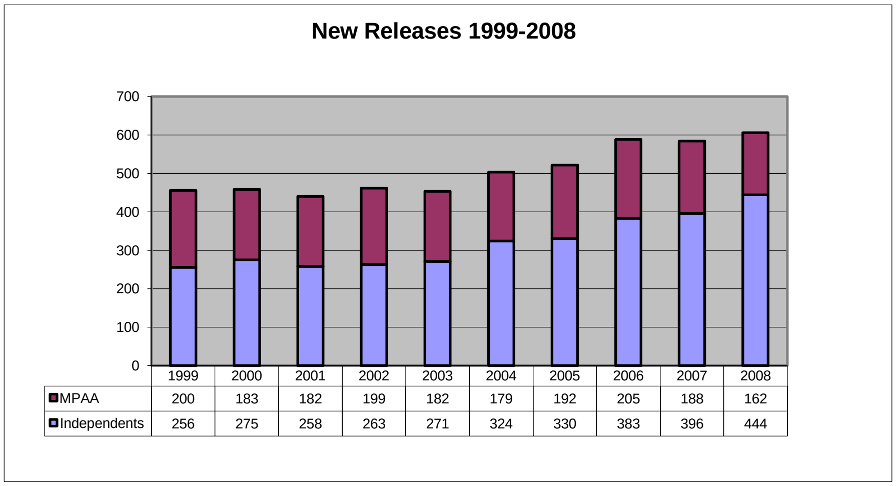
Second, the number of films that get released each year is finite. With so many state incentives that effectively slash the cost of producing a movie by 25-40%, one might expect the raw number of films that get produced to increase. This has not been the case.

The number of films released by MPAA member studios has generally declined since 1999, going from 200 (1999) to 162 (2008), as seen in the chart below.[105] The number of independent films, however, has steadily increased over the same period.[106] In 1999, 456 new films (as opposed to re-issues) were released, compared to 606 in 2008, an increase of 33% overall.[107] Most of the growth came from non-MPAA affiliated

104. N.M. FILM OFFICE, FILM/MEDIA PRODUCTION STATISTICS FY2003 – FY2011 (2011).
105. MOTION PICTURE ASSOCIATION OF AMERICA, THEATRICAL MARKET STATISTICS 2008 5 (2009).
106. *Id.*
107. *Id.*

independents, which saw a seventy-three percent increase from 1999-2008.[108] For the same time the number of new MPAA films decreased 19%.[109]

CHART 4:
THE DECLINE OF MPAA RELEASES VS. THE INCREASE OF INDEPENDENT FILMS



	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
MPAA	200	183	182	199	182	179	192	205	188	162
Independents	256	275	258	263	271	324	330	383	396	444

D. *Film Incentive Critics' Misunderstanding of How Productions Decide Where to Film*

One of the biggest flaws in the reasoning of film incentive critics is their lack of knowledge about the film industry, its economics, and how location decisions are made in Hollywood. In short, many critics have been under the false impression that filmmakers do not significantly consider film incentives when deciding where to shoot.

One of the earliest critics of film incentives was David Brunori, a contributor to *State Tax Notes*. In March 2008, Brunori received a letter from a New Mexico resident, who informed him that four movies filmed in that state were up for Oscars: *No Country for Old Men*, *3:10 to Yuma*, *Valley of Elah* and *Transformers*.[110] Brunori admitted that he did not know a great deal about filmmaking, which he demonstrated by taking issue with the letter writer's point that the movies would not have shot in New Mexico without tax incentives:

> I don't know much about moviemaking. But I do know that all

108. *Id.*
109. *Id.*
110. David Brunori, *Maybe Politicians Will Swear Off Swearing Not to Raise Taxes*, STATE TAX NOTES, Mar. 2008, at 716.

> four of those movies were shot in vast, desertlike [sic] terrain. One thing that New Mexico has is vast, desertlike [sic] terrain. Do you think it's possible that the movie guys picked New Mexico because they needed vast, desertlike [sic] terrain?[111]

Even if all films depended on a vast desert-like terrain, why would they shoot in New Mexico when California has its own deserts and neighboring Nevada and Arizona also have the needed terrain?[112] New Mexico had tax credits and the other states, at that time, did not. Moreover, if the tax incentives were not the motivating factor for the shoot, why not film in the locations where the films are set? Texas, for example, is the setting for *No Country for Old Men* and Yuma, Arizona, is the setting for *3:10 to Yuma*. *No Country for Old Men* spent $12 to $17 million of its $25 million budget in New Mexico, where it qualified for a 25% rebate on production expenses.[113] It is not clear if Brunori was trying to be sarcastic and humorous, or if he is truly ignorant of filmmaking practices. What seems clear is that Brunori lacks any sense of how the motion picture industry works and this undermines his comments and arguments against film incentives.

Brunori is not the only contributor to *State Tax Notes* opposed to film incentives. In June 2008, Billy Hamilton reported on the "angst" in Texas about losing film production to Louisiana and New Mexico, exacerbated by films like "2007's *No Country for Old Men*, a film set almost entirely in Texas but mostly filmed in New Mexico."[114]

Hamilton seems naïve about what factors motivate filmmakers to shoot in a particular locale, apparently unaware that cost is the primary concern for most productions. Moviemakers, Hamilton said, "have to shoot movies somewhere, and Texas has a modestly impressive portfolio of film work to recommend it to moviemakers."[115] Other than the occasional movie about the Alamo, Hamilton said that the following about the state's "impressive portfolio":[116]

> Sandra Bullock filmed *Hope Floats* near Austin. *Dazed and Confused* was filmed around Austin. *Giant* with Rock Hudson, Elizabeth Taylor, and James Dean was filmed near Marfa in

111. *Id.* at 715–16.

112. Not all of the movies Brunori mentioned needed to be shot in a vast "desertlike [sic] terrain." *Id. Transformers*, for example, filmed in New Mexico because part of the plot takes place in a U.S. military base in the Middle East. The studio wanted the film to shoot in Canada to take advantage of the tax incentives there, but Michael Bay refused.

113. David Miles, *Coen Brothers Coming to N.M.*, THE SANTA FE NEW MEXICAN, April 14, 2006, at A1.

114. Billy Hamilton, *Is Texas Losing the 'Arms Race' to Become the New Hollywood?*, STATE TAX NOTES, June 2008, at 907.

115. *Id.*

116. *Id.*

> 1956. In 1961 the great John Ford shot the not-so-great *Two Rode Together* with Richard Widmark and Jimmy Stewart near the Alamo set Wayne built for *The Alamo*. *Hud*, *The Last Picture Show*, *Bonnie and Clyde*, *Friday Night Lights*, *Urban Cowboy*, *The Texas Chainsaw Massacre*, *The Killer Shrews*—the list is long.[117]

Hamilton took issue with press coverage in Austin, Texas, about increased filming in New Mexico and Louisiana, which were "besting Texas."[118] Hamilton offers his own "hard-hitting" evidence:

> Just to give you some idea of what a travesty that is, the Internet Movie Database (IMDB) lists 342 movies and television shows with "Texas" in their titles. It lists a mere 29 featuring the word "Louisiana." New Mexico has an even more paltry 14 mentions. So, what's the problem?"[119]

In response to Hamilton's last question above, the problem is the unscientific nature of a rudimentary search of productions titles on IMDB. Had Hamilton bothered to conduct an IMDB search of the actual filming locations of these films, the results may have been more illuminating but still of no meaningful value. When critics make arguments based on such ridiculous "research" methods, their credibility is significantly diminished. This is regrettable because it may serve to hurt the case of other film incentive critics who do make sound arguments based on credible research.

Putting aside issues of credibility, Hamilton also displays a lack of sensitivity to the human element of the runaway production problem. For example, Hamilton said Canada's 1997 film incentives is where the trouble really began: "Films that could have been made in the United States were for financial reasons no longer being made here. Suddenly runaway film production was a major concern—well, at least a major concern for some people."[120] Some people? Hamilton's insensitivity to anyone in the film industry who lost a significant portion of his or her income—if not his or her career—because of runaway productions is odious on many levels.

Nevertheless, Hamilton did acknowledge that film production does result in private economic activity, but, despite this, he correctly pointed out that "there is little hard economic evidence that incentives at the stratospheric levels they have now achieved can be justified economically."[121] Without such economic evidence, Hamilton said supporters of film incentives are "beginning to steer clear of the economic

117. *Id.*
118. *Id.*
119. *Id.*
120. *Id.* at 908.
121. *Id.* at 911.

development argument as a primary justification" and instead, "they are making a cultural argument."[122]

Brunori and Hamilton base the value of film incentives on a narrow litmus test: Does the state get back enough revenue from the economic activity related to film production to cover or exceed the cost of the tax incentive? If yes, the film incentive is good; if no, the film incentive is bad. Let the debate begin.

V. DEBATING THE VALUE OF FILM INCENTIVES

In June 2011, the economic toll of the race to the bottom was staggering. According to a study released by the Tax Foundation, forty states offered a record $1.4 billion in film incentives in 2010, predicted to be the "peak year" for state spending on film incentives.[123] As seen in the following table (Table 7), over the last decade, states spent over $5.8 billion on film incentives, most of which (over $4.7 billion) was spent since 2008.[124]

TABLE 7:
FILM INCENTIVE SPENDING

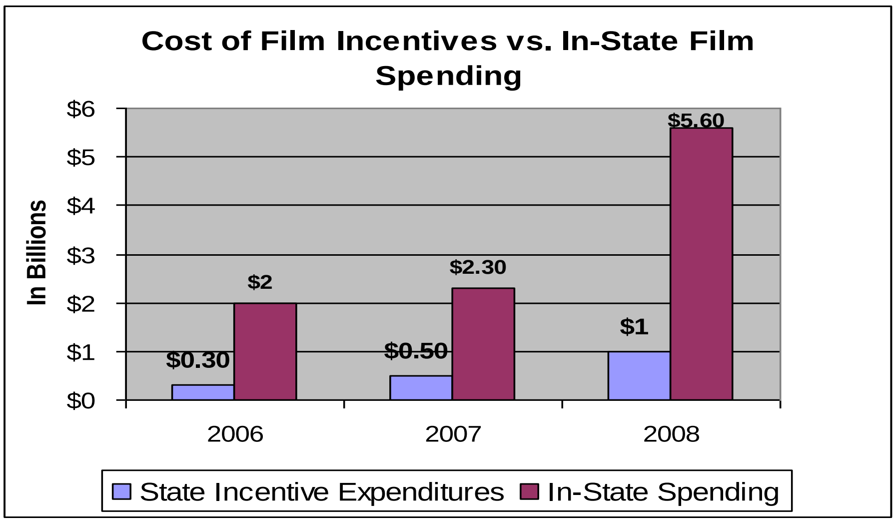
Year	Number of States with Film Incentive Programs	Incentive Amounts Offered
1999 & earlier	4	$2 million
2000	4	$3 million
2001	4	$1 million
2002	5	$1 million
2003	5	$2 million
2004	9	$68 million
2005	15	$129 million
2006	24	$369 million
2007	33	$489 million
2008	35	$807 million
2009	40	$1.247 billion
2010	40	$1.396 billion
2011	37	$1.299 billion

The Tax Foundation's numbers match closely with a three-year study conducted by the *Associated Press*, the major findings of which are set forth in the chart below.[125] From 2006 to 2008, the study tracked forty-

122. *Id.*
123. Joseph Henchman, *More States Abandon Film Tax Incentives as Programs' Ineffectiveness Becomes More Apparent,* TAX FOUNDATION: FISCAL FACT NO. 272.
124. *Id.*
125. Ben Nuckols and Martha Waggoner, *States Give Hollywood a Fortune in Tax Breaks*, ASSOCIATED PRESS, June 2, 2009.

one states with film incentives. In that period, film incentive states spent a combined total of $1.8 billion on film tax credits, rebates and other incentives.[126] More than half of the total, or $1 billion (compared to the $807 million reported by the Tax Foundation), was paid out in 2008 alone.[127] However, unlike the Tax Foundation, the *Associated Press* also reported total in-state film spending, which reached nearly $10 billion for the same period.[128]

CHART 5:



Since the amount of in-state spending was close to six times more than the total cost of the film incentives in 2008, these tax incentives may seem like a very sound investment to the casual observer. Indeed, the disparity between these two categories (cost of incentive and in-state spending) presents, perhaps, the greatest impediment to ending the "madness" of the current incentive war. Credible analyses of wave after wave of state-level data regarding various film-incentive programs lead to the harsh reality that, for almost every state offering film incentives, benefits do not outweigh costs. This data, which can include specific spending breakdowns of individual productions in specific jurisdictions, is now allowing for accurate and reliable economic impact forecasting and impact analysis to take place.

The report findings from jurisdictions where this type of analysis takes place are virtually unanimous: Film incentives do not provide a

126. *Id.*
127. *Id.*
128. *Id.*

positive economic return for the state treasuries from which they are funded. The only possible exceptions to this rule—discussed in detail later—are New York, California, and other states with very modest film incentives (under 10%, for example).

A. Evaluating the Economic Reports

According to Susan Christopherson and Ned Rightor's extensive review of available economic impact studies on various film incentive programs, the majority of programs negatively impacted state tax revenues: "The overwhelming majority of fiscal impact analyses of film and TV subsidy programs conclude that the subsidies have a negative impact on state revenues. . . ."[129]

Additionally, in November 2010, Robert Tannenwald of the Center for Budget and Policy Priorities studied ten independently prepared economic impact reports, eight of which showed that incentives were a net drain on revenue.[130] However, as Tannenwald notes, the two reports that found film incentives did pay for themselves were biased because those studies "were financed by the Motion Picture Association of America and/or a state office of film and tourism."[131]

While Tannenwald concedes that film incentives are effective if judged by their ability to attract productions, he prefers an economic analysis that evaluates the merit of such incentive programs in the long run:

> 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.[132]

Thus, despite the numerous economic impact reports that Tannenwald reviewed, a 2009 report prepared by the Massachusetts Department of Revenue was the "only independent, in-depth empirical study to date that properly evaluates a film subsidy according to this criterion."[133]

129. Susan Christopherson & Ned Rightor, *The Creative Economy As "Big Business": Evaluating State Strategies to Lure Filmmakers*, 29 J. PLANNING EDUC. & RESEARCH 336, 341 (2010).

130. TANNENWALD, *supra* note 84, at 16.

131. *See id*. at 8 ("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."). *See also id.* at 10 (criticizing at length the Ernst & Young report prepared at the request of the New Mexico State Film Office for its major flaws).

132. *Id.* at 5.

133. *Id.*

As of January 2011, forty-four states, including all of the major players in the film incentive arms race, faced massive budget shortfalls that totaled a staggering $125 billion.[134] The outrageous expense of funding film incentives would be condemnable public policy even if these states were experiencing surpluses, but the current economic picture makes them even more disastrous. According to Tannenwald, balanced budget requirements in all but one state mean that lawmakers electing to keep their respective film incentive programs will be forced to "cut public services or increase taxes elsewhere to make ends meet."[135] As Tannenwald notes, state spending on film incentives in 2010 alone could have "paid for the salaries of 23,500 middle school teachers, 26,600 firefighters, and 22,800 police patrol officers."[136]

Justifying cuts to schools and police forces in order to preserve film incentives might be acceptable to some people, assuming that the film incentive programs actually benefit the residents of the state offering them. According to Tannenwald, however, this is often not the case:

> The [2009 Massachusetts Department of Revenue Report] . . . 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.
>
> . . . .
>
> 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." 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. 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. 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

134. ELIZABETH MCNICHOL ET AL., STATES CONTINUE TO FEEL RECESSION'S IMPACT 3 (2011).
135. *Id.* at 8.
136. *Id.* at 2.

businesses.[137]

A 2009 report from the Massachusetts Department of Revenue, like Tannenwald's study, compared its findings to those in ten other major studies. Despite the different methodologies employed in the various studies and the vast differences between the states and their respective film incentives, the report found that the studies were generally consistent:

> Other than those carried out by the consulting firm Ernst & Young, the studies estimated that state revenues generated by new film production activity ranged from \$0.07 to \$0.28 per dollar of tax credit granted, although some of the studies did not assume that film tax credits needed to be funded by spending cuts or revenue increases, despite balanced budget requirements in virtually all those states. Because those studies do not account for the negative multiplier impacts of required state spending cuts or revenue increases, they tend to overestimate net economic activity and state revenue generated by the tax incentives. In calculating multiplier impacts, some of the studies also appear not to have made adjustments for wages paid to non-resident employees.
>
> While the return-on-investment estimates in these studies are not always comparable between states due to different tax credit programs (e.g., the higher the tax credit rate, the lower the rate of return tends to be, and not all states allow a sales tax exemption for production-related purchases, and such an exemption tends to reduce the rate of return), different tax systems, and divergent local economic interrelationships, the studies generally are consistent with each other.[138]

It is also worth noting that many of the in-depth studies prepared by various state agencies offer thorough and objective analyses that explicitly refrain from making any determinations about their desirability or efficacy. Rather, the studies leave such determinations to state policymakers. The 2009 Massachusetts Department of Revenue report, for example, makes quite clear that the Department of Revenue is not judging the desirability of the film incentive:

> Whether a tax incentive program is desirable is not solely a function of how much revenue it generates, but also whether the economic activity that it causes is judged to be favorable for the Commonwealth. The Department does not take any position on

137. *Id.* at 6–7 (citations omitted).

138. NAVJEET K. BAL, MASS. DEP'T OF REVENUE, A REPORT ON THE MASSACHUSETTS FILM INDUSTRY TAX INCENTIVES 23 (2009) [hereinafter MASS. DEP'T OF REVENUE REPORT 2009].

the desirability of particular tax incentive programs.[139]

Similarly, a 2010 report prepared for the Michigan Senate Fiscal Agency makes clear that it is only reporting the effect the film incentive has on the state's budget, which is significant, and not touching on the efficacy of the program, which is left to policy-makers:

> Over time, these costs of the Media Production Credit and the other film-related incentives are expected to grow rapidly and will likely have a significant impact on the budget. As with other types of incentives and credits, whether the relationship of costs to benefits is acceptable is a decision for individual policy-makers.[140]

The following table (Table 8) provides an overview of the findings in several economic impact reports on film incentives that highlight the cost of the program, the in-state vs. out-of-state benefit, the cost of each job created, and the actual "return on investment" that the respective states realized:

TABLE 8:
ECONOMIC IMPACT REPORT OVERVIEW

Study/ Report	Cost of Program (in millions)	Benefit In-State vs. Out of State	Cost Per Job	Return on Investment
Massachusetts DOR 2010	2006: $19.1 2007: $38.7 2008: $119.6 2009: $82.4 **Total: $259.8**[141]	2009: 78% of all wages paid to non-residents 51% of all non-wage expenses benefit out-of-state businesses 67% of all production spending benefit in-state[142]	2009: $123,130 for each new job created (residents and non-residents) $324,838 per Massachusetts resident[143]	For every $100 "invested," $86 lost[144]
Michigan Senate Fiscal Agency 2010	2008: $37.5 2009: $100 2010: $125 **Total: $262.5**[145]	2009: 52.6% of all production spending benefit in-state[146]	2008: $186,519 for each direct job created; $42,991 for direct/indirect jobs created	2010: Minus the 47% of the economic activity, the state will lose (spend)

139. *Id.* at 25.
140. DAVID ZIN, FILM INCENTIVES IN MICHIGAN 2 (2010) [hereinafter MICH. FILM INCENTIVES REPORT].
141. MASS. DEP'T OF REVENUE REPORT 2009, *supra* note 138, at 2.
142. *Id.* at 9.
143. *Id.* at 17.
144. *Id.*
145. MICH. FILM INCENTIVES REPORT, *supra* note 140, at 1.
146. *Id.*

			2009: $193,333 for each direct job created; $44,561 for direct /indirect jobs created[147]	$111.5 million to generate $78.5 in private activity[148]
Arizona Department of Commerce 2009	2008: $8.6 [149]	38% of all production spending was in-state[150]	$16,587 per job created[151]	For every $100 "invested," $72 lost[152]
Texas Comptroller Report 2010	2009: $48.4 <u>Breakdown</u> $12.8: film $24.5: TV $2.0: commercials $9: video games [153]	[No data available]	Each film, TV and commercial job cost between $18,500 & $19,000 Each new video game cost $5,332.[154]	The report acknowledges that after each film, TV and commercial project is completed, the "created" jobs "leave the state"[155]

When looking at the waste on a per-project basis, the excessiveness of various film incentive programs is further crystallized. In 2010, for example, Louisiana spent almost $100 million on just four films:

> For *Battle: Los Angeles*, which is completed and released, the total budget was $68.8 million, the Louisiana spend was $45.2 million, and the tax credits certified were $13.6 million.
>
> For *Green Lantern*, the estimated total budget is $118 million, and the Louisiana spend is forecast to be $114 million, and the tax credits expected to be issued are $34.2 million.
>
> *Battleship* reported an estimated total budget of $215 million; Louisiana spend is forecast to be $68 million, and the tax credits expected to be issued are $20.4 million.
>
> For *Twilight*, the estimated total budget is $247 million, the Louisiana spend is $98 million, and the tax credits expected to be issued are $29.4 million.[156]

147. *Id.* at 11.
148. *Id.* at 25.
149. KENT ENNIS ET AL., ARIZ. DEP'T OF COMMERCE, MOTION PICTURE PRODUCTION TAX INCENTIVES PROGRAM 7 (2008).
150. *Id.* at 13.
151. *Id.* at 17.
152. *Id.*
153. SUSAN COMBS, TEX. COMPTROLLER OF PUB. ACCOUNTS, AN ANALYSIS OF TEXAS ECONOMIC DEVELOPMENT INCENTIVES 60 (2010).
154. *Id.* at 61.
155. *Id.* at 64.
156. Baxter, *supra* note 103, at 24.

The $34.2 million Louisiana awarded to *Green Lantern* surpassed the previous record holder in the state, *The Curious Case of Benjamin Button*, to which Louisiana gave $27 million.[157]

Michigan, however, has Louisiana beat. In 2010, the state awarded a whopping $39.96 million to just one film, *Oz: The Great and Powerful*.[158] The film was expected to employ 251 people, roughly half of who were out-of-state residents, making Michigan taxpayers pay approximately $300,000 for each job created.[159] The cost for each direct production job on *Red Dawn,* to which Michigan awarded $16.7 million (based on $44 million the film spent in-state), was a ridiculous $423,727.[160] And, even more wasteful, the cost for each direct production job on *Master Class* was a staggering, if not unbelievable, $706,460![161]

One might expect a significant public outcry over the findings reported above, causing film backers to lay off their overzealous claims of how fantastic the film incentives have been for their respective state. To the astonishment of this author, however, the outcry came, but it came from film backers and directed at the people reporting the staggering cost and inefficiency of the film incentive programs.

On the same day Tannenwald's report was released, the MPAA issued a press release expressing its outrage. Vans Stevenson, Senior Vice President of State Government Affairs for the MPAA, said Tannenwald's report was careless at best:

> "This politically motivated, slipshod report by a think tank in Washington, DC, demonstrates no understanding of the film and television industry, nor the importance of the jobs and economic development produced by these tax credits in states all across our nation," Stevenson said. "Bottom line, this is a report produced by an organization that has already proclaimed itself antagonistic to tax cuts and incentives and it found a way to examine the data to back up its own prejudiced point of view."[162]

Stevenson's comments are distasteful and flawed for a variety of reasons. Stevenson's claim that Tannenwald's report was "politically motivated" is baseless, which may be why he makes no attempt to back it up. Similarly,

157. *Michigan Spending $40 Million to Subsidize "Oz: The Great & Powerful"!! Sets New Record for State Spend on Single Production!*, RUNAWAY PROD. RESEARCH (Mar. 4, 2011), http://www.stop-runaway-production.com/2011/03/04/michigan-spending-40-million-on-one-single-movie-sets-new-record-for-state-spend-on-single-production/.

158. *Id.*

159. *Id.*

160. MICH. FILM INCENTIVES REPORT, *supra* note 140, at 13.

161. *Id.*

162. Press Release, Statement by the Motion Picture Ass'n of America on Biased Study About Film and Television Credits (Nov. 17, 2010) (on file with author) [hereinafter Film Credits Press Release].

Stevenson offers no explanation of how or why, at least in his opinion, the report is somehow "slipshod." If anything, the only thing slipshod is Stevenson's reaction and unsupported allegations. Finally, it is ironic for someone representing the trade and lobbying association of all major Hollywood studios to say it is a public education research group that is the prejudiced party.

The MPAA's response lauds the numerous states that have kept—or expanded—the scope of their incentives even as they face "dire budget situations."[163] However, states that had "recently terminated" their film incentives, specifically Kansas and Wisconsin, are dismissed by the MPAA as "not competitive".[164] In what may be the most breathtaking and irresponsible part of its response, the MPAA claimed film incentive programs could "do wonders" for troubled states and are "revenue positive":[165]

> The film and television incentive programs can do wonders and are a robust economic stimulus. New investment in film and digital media production is, on balance, revenue positive. In the short term, it generates substantial tax revenues with credit claims paid eighteen to twenty four months after production has wrapped.[166]

This begs the question: How can the MPAA support its claim that film incentives are revenue positive?

Of the ten studies of film incentives surveyed in Tannenwald's report, only two contain revenue positive findings.[167] Ernst & Young prepared both of these "studies"; the New Mexico Film Office paid for one, and the other, for New York, was paid for in part by the MPAA.[168] In the words of the MPAA, the New York report appears to be "politically motivated" and "produced by an organization that has already proclaimed itself antagonistic to tax cuts and incentives" that had "found a way to examine the data to back up its own prejudiced point of view."[169] The irony is that the report prepared for the MPAA is also the one that best meets the MPAA's definition of slipshod.

Slipshod indeed. The Massachusetts Department of Revenue and Federal Reserve Bank of Boston discredit the Ernst & Young reports for a variety of reasons:

> The two Ernst & Young studies estimated much higher rates of

163. *Id.*
164. *Id.*
165. *Id.*
166. *Id.*
167. TANNENWALD, *supra* note 84, at 16.
168. *Id.*
169. Film Credits Press Release, *supra* note 162, at 1.

> tax revenues generated, but as pointed out in a recent Federal Reserve Bank of Boston report, those studies assumed that all above-the-line and below-the-line non-resident wages would be spent locally, did not make adjustments for production activity that would have occurred even in the absence of the tax incentives, did not assume a balanced budget requirement, and in the case of the New Mexico study, based its estimates of increased tourism expenditures on a seemingly questionable tourism survey.[170]

Despite overwhelming evidence showing how costly, inefficient and unaffordable film incentives are (at their current Canadian-style levels), film backers continue to insist they are solid investments for state governments. Whether they are willfully ignorant of reality or genuinely convinced they are right (despite having no substantial or credible evidence to support their claims) is unknown. But the unfortunate result of this persistence is that the public policy disaster is being unnecessarily prolonged since some state lawmakers are influenced by these film backers—or are in the film backer ranks themselves.

B. *The Debate in New Mexico*

Lawmakers and film backers in New Mexico seem completely unaware of how flawed the Ernst & Young report prepared for their state actually is. They believe the film incentive program in their state actually generates revenue and supports 10,000 jobs in their state.[171] The 10,000 jobs claim likely stems from the Ernst & Young report, which actually reported the number of supported jobs at 9,209.[172] According to a Federal Reserve Bank report on the flawed Ernst & Young reports, however, once the jobs attributed to the incentive in tourism (3,827) and one-time construction of a single movie studio (1,553) are removed from the equation, the actual number of jobs supported is actually closer to 3,827.[173]

When it was first implemented, the New Mexico film incentive offered a 15% rebate.[174] In 2006, it was increased to 25% in an effort to

170. MASS. DEP'T OF REVENUE REPORT 2009, *supra* note 138, at 23.

171. Press Release, Motion Picture Ass'n of N.M., Industry Association Will Not Support House Film Substitute (Feb. 27, 2011) (on file with author).

172. ERNST & YOUNG, ECONOMIC AND FISCAL IMPACTS OF THE NEW MEXICO FILM PRODUCTION TAX CREDIT 11 (2009) [hereinafter ERNST & YOUNG REPORT].

173. Memorandum from Jennifer Weiner, Policy Analyst at New England Public Policy Center at the Federal Reserve Bank of Boston, to Shelley Geballe, Distinguished Senior Fellow at Connecticut Voices for Children (Apr. 2, 2009), www.bos.frb.org/economic/neppc/memos/2009/weiner04209.pdf.

174. ERNST & YOUNG REPORT, *supra* note 172, at 1.

remain competitive.[175] New Mexico's film incentive program cost the state $65.9 million in 2010, $76.4 million in 2009 and $45.6 million in 2008.[176] Those were the three years during which the credit was operating at the 25% level. In 2007, at 15%, the program cost the state $16.6 million.[177] From 2003-2006, the state spent a combined total of $15.3 million.[178] Thus, in 2010 alone, the state spent nearly twice as much ($65.9 million) with the 25% level than it did for all five years when the incentive was 15%.

In 2011, faced with a massive budget shortfall, newly elected New Mexico Governor Susana Martinez is adamant about scaling the incentive back to its pre-2007 level. With the reduction, Martinez estimates the program would free up $25 million, which could be used to soften budget cuts to public schools, Medicaid and the Department of Corrections. Concerning the Corrections Department, Martinez would likely use $5 million of the $25 million saved from the film incentive to prevent closing some prisons and/or releasing some prisoners early.

Governor Martinez did not support eliminating the program, however, as other lawmakers in the state tried unsuccessfully to do in February 2011. The reduction to 15%, therefore, sounded like a reasonable compromise. To the film community in New Mexico, however, it was anything but. New Mexico lawmakers supportive of the film incentive remaining at the 25% level were able to reach a compromise and placed a limit on the amount the state would have to pay in the form of a cap.

Echoing the dubious findings of the Ernst & Young report at a debate over the film incentive program in early 2011, Eric Witt, of the Motion Picture Association of New Mexico, said that the incentives make money and that if the state eliminates or reduces the incentive it will have "less money to spend" on things like childcare and schools.[179] State Representative Brian Egolf, at the same debate, repeated the claim that the incentive made more money for the state than it cost.[180] Egolf also said that the film industry in New Mexico was clean and could not be outsourced, which is laughable given that the incentive program caused it to be "outsourced" from other locations, namely California and New York.[181]

When a $45 million annual cap was being considered in the New Mexico Legislature, Witt claimed that the new bill threatened to "destroy

175. *Id.*

176. N.M. FILM OFFICE, *supra* note 104.

177. *Id.*

178. *Id.*

179. Video: Film Policy in New Mexico Debate (Motion Picture Assoc. of N.M.) 4:00, http://www.stop-runaway-production.com/2011/01/14/new-mexico-film-debate-video-now-available-watch-now/ (statement of Eric Witt at 4:00) [hereinafter New Mexico Film Debate Video].

180. *Id.* at 9:05 (statement of Brian Egolf).

181. *Id.* at 10:10.

New Mexico's vibrant film industry."[182] Witt's claim is not supported by the data he and the Motion Picture Association of New Mexico maintain on their website. According to those statistics, the best year for the New Mexico film incentive in terms of the number of major productions shooting in the state (thirty), the number of worker days (207,066) and financial impact ($824.7 million) was 2008, when the amount of approved credits was $45.6 million.[183] The following table (Table 9) compares these data for the following two years, when the state spent more, yet received considerably less in return.[184]

TABLE 9:
NEW MEXICO FILM INCENTIVE SPENDING

	Cost of Credits (millions)	Major Productions	Worker Days	Financial Impact (millions)
2008	$45.60	30	207,066	$824.70
2009	$76.40	24	191,881	$780.60
2010	$65.90	16	197,474	$619.12

Based on the data above, and given the success of 2008, when the state spent just $1.2 million more than the proposed cap, it seems like the New Mexico Film Industry would actually benefit from the proposed $45 million cap.

C. The Debate in Massachusetts

In March 2009, two Massachusetts State Representatives, John Keenan and Brian Wallace, praised the state's film incentive program and said, "the cost of the film tax credit is only 14 cents for each new dollar generated in the state's economy by the film industry."[185] According to Keenan and Wallace, "the benefits to the local economy far outweigh the costs. . . . It means creating private sector jobs with private sector pension and health care benefits at a cost of pennies on the dollar."[186] Keenan and Wallace attempted to counter any argument the state could not afford the film incentives: "The question, therefore—especially now—is not whether we can afford the film tax credit. The question is, can we afford to lose the jobs and revenue the film tax credit has brought to Massachusetts."[187]

182. Press Release, Motion Picture Ass'n of N.M., *supra* note 171.
183. N.M. FILM OFFICE, *supra* note 104.
184. *Id.*
185. John Keenan & Brian Wallace, Editorial, *The show must go on*, THE BOSTON HERALD, Mar. 21, 2009, at 14.
186. *Id.*
187. *Id.*

Sadly, the two lawmakers seem oblivious to the fact that the film incentive in Massachusetts is losing the state more revenue than it generates.

The argument that, over time, the Massachusetts film incentive would become more cost-effective as the state built up its infrastructure and the number of skilled workers increased, is not proving to be accurate. The following table (Table 10) shows how the average cost to create each "Massachusetts Resident Job" has increased dramatically.[188]

TABLE 10:
MASSACHUSETTS JOB CREATION COST

2006	**2007**	**2008**	**2009**
$52,515	$93,749	$128,695	$324,838

The Department of Revenue offered the following explanation for this breathtaking increase: "The impact of state spending cuts is considerably greater in 2009 than in previous years due to the delayed use of film tax credits, which results in a smaller net increase in employment in 2009 than in previous years."[189]

Considering the massive collective cost of film incentives and the massive policy ramifications they have for cash-strapped states, it is unacceptable for incentive backers like the MPAA, Eric Witt, and others to propagate to the public the false notion that film incentives are sound investments that are revenue positive. They are not.

D. The Debate in Wisconsin

In March 2009, the Wisconsin Department of Commerce issued a report to "raise the warning flag" about problems with the state's film incentives:[190]

> Commerce feels a duty to raise the warning flag and draw attention to several fundamental flaws in the program: The program's flaws create an incentive to hire out-of-state contractors instead of Wisconsin labor. The program is really expensive because it is a refundable tax credit program, not just a tax credit program. The program's cost-benefit analysis compares poorly to other programs aimed at manufacturing, technology, and agriculture.[191]

188. MASS. DEP'T OF REVENUE REPORT 2009, *supra* note 138, at 17.
189. *Id.* at 18.
190. RICHARD J. LEINENKUGEL, WIS. DEP'T OF COMMERCE, COST BENEFIT ANALYSIS OF WISCONSIN FILM TAX CREDIT PROGRAM 2 (2009).
191. *Id.*

Thus, the Wisconsin Department of Commerce was fulfilling a responsibility to the people of that state by pointing out to the public and state lawmakers that the benefit of the program was going to nonresidents. The concern raised by the Wisconsin Department of Commerce was sufficient to motivate then-Governor Jim Doyle to scale back the amount available for funding the incentive to a miniscule $500,000, which his "critics" called "incomprehensible."[192]

In 2010, newly elected Governor Scott Walker made film backers in the state cheer by signaling his intent to revive the program and criticizing his predecessor for not giving the program a fair chance: "Gov. Doyle did not give the program a fair chance to take hold. Reasonable and sustainable incentives that give an emphasis in putting Wisconsin people to work and growing this industry for the state should receive serious consideration."[193]

The only thing which *is* "incomprehensible" is that film advocates consider a film which spent $5 million in their state and "received about $4.6 million in taxpayer money, including payments that offset part of the $5,625.16 paid to Depp's hairstylist, $16,490 for his makeup artist and $38,771.40 for two chauffeurs" a benefit to their state.[194]

E. The Debate in New Jersey

In February 2011, New Jersey's Economic Development Authority (EDA) released a report it had commissioned to study the economic impact of the state's film incentive program. The study, conducted by the New Jersey Institute of Technology (NJIT), found that the program was "breaking even" because taxes collected from jobs in the industry were $10.1 million while the incentive cost was $10 million.[195] The EDA, however, disputed these findings and recommended that the program be terminated.[196] The EDA noted that the "breaking even" claim was based on tax revenue from jobs in the "entire film industry, not just the jobs generated by the program subsidy," and that, at best, the revenue collected offset just $5.5 million of the program cost.[197] Since the intent of the program was, in addition to cost effective job creation, to "create

192. Jay Rath, *Cut! Wisconsin's Moviemaking Tax Incentive Didn't Get a Fair Chance*, THE DAILY PAGE, Jan. 6, 2011, www.thedailypage.com/isthmus/article.php?article=31792.
193. *Id.*
194. P.J. Huffstutter & Richard Verrier, *Filmmaking Incentives Losing Glamour in Cash-Strapped States*, L.A. TIMES, Sept. 22, 2009, http://articles.latimes.com/2009/sep/22/business/fi-ct-moviestates22.
195. Memorandum from Caren S. Franzini, CEO of the N.J. Econ. Dev. Auth., to Treasurer Andrew P. Sidamon-Eristoff (February 17, 2011) (on file with author).
196. *Id.* at 2.
197. *Id.* at 1.

predictable new revenue streams" for the state, EDA's careful analysis of the NJIT report was able to show no new revenue streams were being created; rather, revenue was being lost.[198]

F. Are Film Backers at War with Reality?

The harsh reality is that time and time again, film incentives have been shown to benefit out-of-state business and residents at outrageously disproportionate levels. More outrageous is that, in the face of this reality, film backers continue to make misleading claims about the value of film incentives and have the temerity to discredit study after study that proves everything backers have said about these programs to be false. Film incentive backers, by willfully ignoring reality and continuing to make erroneous claims about positive economic impact (whether they believe in them or not), are creating confusion in how the pubic perceives these incentives. Ironically, many of the same studies point to the problem of confusion:

> Significant confusion appears to exist regarding the public and private costs and benefits of the credits. Statements in the press regarding the benefits of the Media Production Credit typically highlight the increases in private sector activity and measure them against the public sector cost (often without accounting for the impact of lowering other public expenditures to offset the lost revenue from the credit). This comparison creates confusion about the impact of the credit on the budget. The nature of the credit and the resulting activity is such that under current (and any realistic) tax rate the State will never be able to make the credit "pay for itself" from a State revenue standpoint, even when the credit generates additional private activity that would not have otherwise occurred.[199]

While it is true that film incentives induce new productions, resulting in private spending, the revenue generated from this new economic activity is never enough to: (1) make more money than the cost of the incentive (revenue positive); (2) generate enough revenue to reach a break-even point for the incentive (revenue neutral); or (3) generate enough revenue to offset a significant portion (50% or more) of the cost. The state is paying considerable amounts of money to lure film production, which will then spend even more money, ideally in that state. The reality is, however, that the spending is not happening. Even if it were, given the present largesse of film incentives in the U.S., the result will almost always be revenue negative.

198. *Id.* at 2.
199. MICH. FILM INCENTIVES REPORT, *supra* note 140, at 1–2.

Any state that believes film incentives are an effective means of "creating" a new industry and rationalizes its incentives as investments that will pay-off one day is delusional. What states like New Mexico, Louisiana, and Michigan fail to acknowledge is that the industry they are attempting to "create" already exists, but it is based in California and New York, not the other states. Perhaps it is time people think of the film industry as the "U.S. film industry," rather than the "California film industry" or the "New York film industry." The U.S. film industry happens to be based in California and New York. The U.S. auto industry happens to be based in Michigan. The U.S. tobacco industry happens to be based in the Carolinas. The U.S. energy industry happens to be concentrated in Texas. And so on. The location where each mentioned industry is based is often what makes it such an important U.S. industry, either because the natural resources are there (oil in Texas, tobacco fields in the Carolinas) or the industry cluster has been established over decades (Detroit, Los Angeles, and New York). Given the ridiculous claims made by the MPAA or film backers mentioned above, it seems permissible to make what some might consider an equally ridiculous claim: state film incentives are unpatriotic. Is it really that ridiculous? The Tax Foundation called on state officials to observe the issue of film incentives from a national perspective:

> To some extent, evaluating the wealth generated by MPIs depends on which level of government one is observing. From a national perspective, even boosters would probably admit that little if any wealth is created by these programs. Jobs created in New Mexico are offset by those destroyed in California. Rather than creating wealth, MPIs just shift production from one state to another.
>
> Short-sighted state officials may not be expected to worry too much about neighboring states' job counts, but what goes around comes around. By committing tax dollars and state effort into securing film jobs, state officials miss the chance to use those resources instead for lowering tax burdens for all industries. Because MPIs are a field crowded with state competitors, committing huge resources may have little payoff.
>
> Officials should acknowledge that moving 100 jobs from one state to another does nothing for the nation's economy except enrich the film industry at the expense of other state taxpayers.[200]

The only reason—and the only way—a state like Louisiana can capture a significant share of production activity is that it is willing to fund roughly one-third of any given film or TV production. The film and

200. LUTHER, *supra* note 102, at 9.

television industry will not "take root" in places like Louisiana because it already has incredibly deep roots in California and New York.

Green Lantern shot in Louisiana only because of the $34 million the state offered. No incentives means no Hollywood. Film incentives will bring new productions to such states, but not a new industry that will grow on its own; it is already full-grown. Productions are the apples of an industry whose tree is properly rooted in California and New York. Thus, it is time for lawmakers in the other states to recognize and accept they are only buying apples (productions) and not the tree (Hollywood). And in the process, by robbing California and New York of the fruits that naturally fall there, the other states are hurting the nation and devastating California.

VI. TAX INCENTIVES USED AS WEAPONS AGAINST CALIFORNIA

California, home to Hollywood, is arguably the most significant cultural production center in the world. No other location on earth, past or present, can match the global cultural influence that Hollywood and, by extension, California can lay claim to, if only in terms of the sheer number of people it reaches. In addition to being the Mecca of the motion picture industry, California captures large swaths of the recording industry and is home to Silicon Valley, whose digital and high-tech advancements are employed by the film and television industries to create groundbreaking special effects and filming techniques that were simply impossible to do fifteen, perhaps just ten years ago. California offers unmatched depths of talent. Despite these advantages, continued hegemony is anything but certain.

The importance of the motion picture industry to California's economy, particularly that of Southern California, is critical. In June 2009, the importance of the industry was driven home when the Los Angeles County Economic Development Corporation (LAEDC) reported the tourism and hospitality industry surpassed international trade as the number one generator of jobs in Los Angeles County.[201] According to the LAEDC report, tourism and hospitality were responsible for 456,000 jobs in 2007, compared to 281,000 for international trade, which is significant since the port complex of Los Angeles and Long Beach is "the busiest port complex in the country."[202] Tourism in greater Los Angeles, according to *The Los Angles Times*, is centered around tourist destinations such as Grauman's Chinese Theatre, Disneyland, Universal Studios and the Hollywood Walk of Fame.[203]

201. Hugo Martin, *Tourism industry is L.A. County's No. 1 job generator, report shows*, L.A. TIMES, June 25, 2009, at B1.
202. *Id.*
203. *Id.*

If the motion picture industry—and the entertainment industry in general—erodes in California, the draw of tourist attractions based on them could also wane. Are attractions such as Hollywood's *Walk of Fame* popular tourist attractions because they lie in the epicenter of Cultural Production (Hollywood, if not the World)? If so, state lawmakers should consider whether such attractions would continue to draw tourists if (and perhaps, when) they become historical attractions of a bygone era rather than celebrations of Hollywood's current preeminence.

The symbiotic relationship between the entertainment industry and the tourism industry in California cannot be ignored; this is a fact that applies to California more than any other state in the U.S. If production in other locations such as Vancouver, Toronto (Canada as a whole), Louisiana, or New Mexico declines, the impact on their respective tourism and hospitality industries would be negligible. People visit New Orleans for the French Quarter, not because 2002's *Runaway Jury* shot there. Thus, California faces a unique threat to its other major industries on a scale unmatched by other filming locales.

A. The "Entertainment Capital of the World" is Under Siege

The motion picture industry in California is under siege. In 1997, employment in the "broader [film] industry" peaked at 174,000 jobs.[204] According to the Milken Institute, employment fell-off sharply after 1997 and dipped below 135,000 in 2001; it has been recovering since then to a total of 167,000 in 2008.[205] Using the same methodology the Milken Institute used to determine employment in California (NAICS codes 5121 & 7115), the number of people employed in the motion picture industry in California fell to 152,905 in 2009 and increased slightly to 155,455 in 2010.[206] These employment numbers differ slightly from a 2011 report from the LAEDC, which claimed 159,291 people worked in the "[m]otion picture and video industries" in California.[207] Unlike the Milken Institute,

204. KEVIN KLOWDEN ET AL., MILKEN INST., FILM FLIGHT: LOST PRODUCTION AND ITS ECONOMIC IMPACT ON CALIFORNIA 8 (2010). The report also notes that:

> The BLS NAICS code for the motion picture and video industry is 5121; for independent artists, writers, and performers, it is 7115. The motion picture and video industry category includes subcategories for movie and video production (NAICS 512110), motion picture and video distribution, motion picture theatres, teleproduction and post-production (NAICS 512191), and other motion picture and video industries.

Id. at 35 n.16.

205. *Id.* at 7–8.

206. BLS DATA, *supra* note 18.

207. CHRISTINE COOPER ET AL., L.A. CNTY. ECON. DEV. CORP., CALIFORNIA FILM AND TELEVISION TAX CREDIT PROGRAM: AN ECONOMIC IMPACT STUDY 3 (2011). The report does not indicate which NAICS code it used.

however, the LAEDC does include "nonemployer" data to track the thousands of people who work as independent contractors as independent artists, writers and performers in the industry; in 2009 the number of people in this category was 69,129.[208] In short, the total number of people employed in the motion picture industry in California is roughly 220,000-230,000, depending on which NAICS codes are selected.[209]

Important to bear in mind is Susan Christopherson's finding that "core" industry workers, whose income derives entirely from the entertainment industry, "declined as a *share* of the total workforce, from 38% in 1991 to 33% in 2002."[210] As the number of core workers as a percentage of the overall workforce decreased, so too did the influence of Hollywood's labor unions:

> One common complaint is that producers attempting to cut costs will reduce shooting days by requiring overtime work from the production crew. While long working hours are legendary in the media entertainment industry, the boundaries that circumscribed abuse appear to have broken down as unions have lost power over industry practices and with an increase in the proportion of productions made on 'shoestring' budgets.[211]

B. Is the Runaway Production Threat Overstated?

In March 2011, the California Research Bureau (CRB), which had been tasked with assessing the damage, if any, to California from runaway production reported that, while feature film activity declined, it was offset by an increase in television production:

> At the beginning of the decade, feature films accounted for one-fifth of total PPDs, but only 15 percent in 2007, a 25 percent relative decline in share. Television, which accounted for 23 percent of the PPDs at the start of the decade, now takes more than 40 percent of the total.
>
> The decline in feature film PPDs may in part reflect competitive pressures for feature film production arising from other states and foreign countries in recent years. However, those competing states' subsidy programs do not explain the concomitant rises in television and other production shoots in the Los Angeles area. In the aggregate, L.A. regional PPDs

208. *Id.*
209. BLS DATA, *supra* note 18.
210. Susan Christopherson, *Labor: The Effects of Media Concentration on the Film and Television Workforce*, *in* THE CONTEMPORARY HOLLYWOOD FILM INDUSTRY, 155, 157 (Paul McDonald & Janet Wasko eds., 2008) (emphasis in original).
211. *Id.* at 162.

> averaged more than 52,400 per year during 2003-07, when other states were adopting motion picture incentive policies. This compares to only 45,000 per year during 2000-02.[212]

The language above (particularly the last two sentences), in addition to the CRB's claim there had been "robust" employment growth since 2000, suggests runaway production has not caused significant damage, though it was still "unclear."[213] Before addressing the CRB's discussion on the growth in television production, it is important to look at a major point it observed about declining wages in Los Angeles. In 2000, industry workers in L.A. earned 27% more each month than non-L.A. industry workers, but by 2009, they earned 13% less:

> While industry employment in Los Angeles County grew over the decade, both in absolute terms and relative to movie industry employment in the rest of the state, the same has not been true for average monthly earnings. Los Angeles County movie industry employees earned, on average, 27 percent more per month in 2000 than their non-L.A. counterparts. In 2009, the average L.A. county industry employee earned 13 percent *less* per month than his non-L.A. counterpart. This was driven both by declining average wages in Los Angeles and rising average (nominal) wages in the rest of the state. The causes of these shifts in relative wages within the state's movie industry are beyond the scope of this brief.[214]

While the CRB was correct about the growth in television production, it did not realize the explanation for declining wages laid in the television production statistics. Most of the growth in television has been from the reality television category; in 2010, over 7,300 of the 17,833 production days were for reality shows, the largest sub-type in the category.[215] Reality programming is typically excluded from most incentive programs. This could explain why they have been immune from runaway production. Further, most reality shows are not unionized or staffed with union crews (who enjoy significant benefits like healthcare, pension, etc.), which means they pay substantially less and shoot for much shorter durations than other television categories, like the one-hour drama for example. In effect, the productions that leave California (feature films, television series, movies of the week etc.) are the ones that spend the most

212. BRIAN R. SALA ET. AL., C.A. RESEARCH BUREAU, THE MOTION PICTURE INDUSTRY IN CALIFORNIA: A BRIEF UPDATE 4–5 (2011).

213. *Id.* at 2–5.

214. *Id.* at 3.

215. FILML.A. INC., ON-LOCATION FILM PRODUCTION REPORT 2009–2010 2 (2011), http://www.filmla.com/data_reports.php (follow "On-Location Production, 2009–2010" hyperlink) [hereinafter FILML.A. 2009–2010 REPORT].

money, employ the most people (often for longer durations), offer the best benefits, and pay the highest wages.

Unfortunately, critics have misconstrued the on-location production numbers to paint a rosy production picture. For example, a 2004 report prepared by Neil Craig in Canada to counter allegations their film incentives were harming the U.S. economy noted that, while there was a significant drop in feature film activity, it was more than offset by "robust" growth in television; the report reasoned that because Canada historically captured more television work, harm from their film incentives would affect both categories rather than just features:

> There is no proof that "Canadian tax credits are responsible" for the decline in feature productions as claimed by some U.S. commentators. It is important to observe that in the international production field, Canada has historically done more television work than feature films.
>
> In the six-year period reported, television production accounted for 53.7 percent of the total volume of U.S.-based international production in the country and that figure has risen to 56.8 percent in the past two years. Yet, television production activity in Hollywood appears to be robust.[216]

The problem with this reasoning is that, like the CRB report, it fails to recognize that the growth in television production has been fueled, as mentioned above, by an explosion of reality television production. In fact, the Craig report explicitly mentioned that Canada had not captured a significant share of reality television.[217] Thus, the report's clever argument is turned on its head since the one area of robust growth was in the category of reality television, which Canada was unable to attract. In a 2005 report from the California Budget Project, the authors made the same mistake as the Craig report and said the data "suggest[s] that the industry is not in crisis."[218]

Runaway production is a very real and significant threat to California, and critics who have used data to suggest there has not been a problem have hampered countering this threat. However, when properly analyzed, that same data does show the frightening reality that film incentives have caused a dramatic decline in runaway production.

216. NEIL CRAIG ASSOCS., INTERNATIONAL FILM & TELEVISION PRODUCTION IN CANADA 26–27 (2004).

217. *Id.* at 11.

218. JEAN ROSS, C.A. BUDGET PROJECT, ARE REFUNDABLE TAX CREDITS NEEDED TO SAVE CALIFORNIA'S FILM INDUSTRY? 2 (2005).

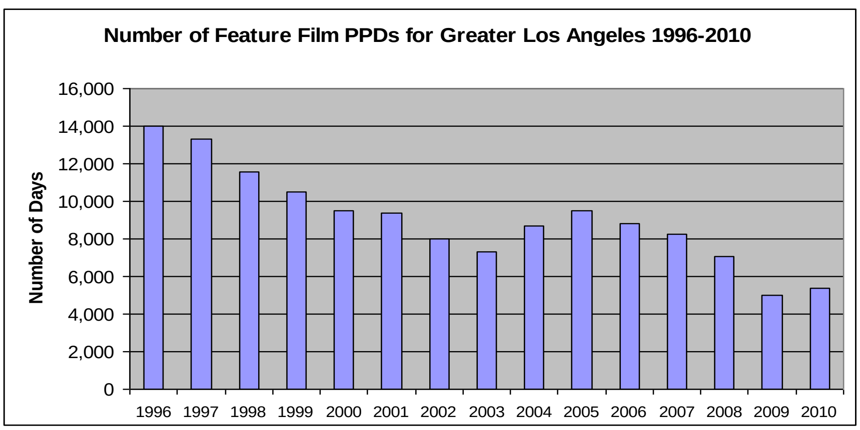
C. Devastating Declines Caused by Incentive Fueled Runaway Production:

In July 2009, the *Los Angeles Times* reported location feature film production in the Los Angeles area dropped to the "lowest levels on record" and that California's share of all U.S. feature film production dropped from 66% in 2003 to 31% in 2008:

> Student films generated as much activity on the streets of Los Angeles in the first quarter of 2009, when only a few movies, including "Fame" and "Alvin and the Chipmunks: The Squeakquel," were shot there.
>
> California's share of U.S. feature film production dropped to 31% in 2008 from 66% in 2003 . . . .[219]

As seen in Chart 6,[220] from 1997 to 2010, the number of permitted production days for feature films in the greater Los Angeles area decreased in all but three years, and the number of production days declined an astonishing 64% from 1996 to 2009, which was the worst year on record since tracking began.[221]

CHART 6:



219. Richard Verrier, *As the Hollywood machine abandons L.A., its supporting workers struggle*, L.A. TIMES, July 12, 2009, http://articles.latimes.com/2009/jul/12/business/fi-ct-runaway12.

220. FILML.A. 2009–2010 REPORT, *supra* note 215, at 1; FILML.A. INC., ON-LOCATION FILM PRODUCTION REPORT 2008–2009 1 (2010), http://www.filmla.com/data_reports.php (follow "On-Location Production, 2008–2009" hyperlink) [hereinafter FILML.A. 2008–2009 REPORT]; FILM L.A. INC., 1993–2007 ON-LOCATION FILM PRODUCTION DATA 3, http://www.filmla.com/data_reports.php (follow "On-Location Production, 1993-2007" hyperlink) [hereinafter FILML.A. 1993-2007 REPORT].

221. FILML.A. 2009–2010 REPORT, *supra* note 215, at 1; FILML.A. 2008–2009 REPORT, *supra* note 220, at 1; FILM L.A. INC., FILML.A. 1993–2007 REPORT, *supra* note 220, at 3.

The numbers for primetime television pilots filming in greater Los Angeles have also declined. In the 2004-05 development cycle for pilots, 101 of the 124 produced that cycle filmed in Los Angeles, which contributed $309 million to the local economy.[222] In the 2008-09 development cycle, California captured 59 of the 101 pilots produced, a 42% decline from 2004-05, and production spending decreased to an estimated $207 million.[223] The average cost to produce a pilot in 2008-09 was between $3-5 million; the average pilot directly employs roughly 150 people for the duration of the project.[224]

In 2005, the California Employment Development Department (EDD) reported that motion picture industry employment grew in the "mid-to-late 1990's [and] began falling in 2000."[225] At the same time, motion picture employment in other states increased.[226] In fact, the EDD reported that "the drop in employment in California from 1999 to 2003 (almost 35,000 jobs) is virtually matched . . . by an almost 39,000 increase of jobs in all other states" for the same period.[227] The EDD report was unable to place the blame for the decline squarely on runaway production, which "may have" been the cause:

> The downward trend in employment during this period may have been due to the effects of runaway production to other countries *and* other states, but it may also have been due to the national recession, or possibly to structural changes in the film industry. Pinpointing which of these factors, or combination of factors, that have produced this downward trend still eludes a definitive diagnosis.[228]

In July 2009, the LAEDC released a report that, unlike the 2005 EDD report, was unequivocal in placing the blame for free falling production numbers on runaway production on other jurisdictions:

> [R]un-away production of feature films is a growing threat to the local economy. Run-away production is not an ephemeral thing. It represents lost jobs and tax revenues to the Los Angeles economy. . . . Production costs have become a major concern for broadcast TV networks, due to the weak advertising market. Thus, the incentives offered by other states are now starting to

222. FILML.A. INC., 2005–2009 TELEVISION PILOT PRODUCTION REPORT 4 (2010), http://www.filmla.com/data_reports.php (follow "TV Pilot Production, 2009" hyperlink).

223. *Id.* at 3–4.

224. *Id.* at 4.

225. C.A. EMP'T DEV. DEP'T, REPORT TO THE LEGISLATURE ON THE MOTION PICTURE INDUSTRY IN CALIFORNIA 18 (2005).

226. *Id.*

227. *Id.*

228. *Id.* (emphasis in original).

lure more production of pilots out of the Los Angeles area.[229]

In 2009, FilmL.A., a nonprofit group that tracks filming in the greater Los Angeles area, attributed the drop in production to runaway production and said California needed a competitive incentive program.[230]

The June 2010 Milken report noted that the drops in employment and production that began in the late 1990's can be attributed to tax incentives abroad, primarily Canada's 1998 production tax subsidy:

> The falloff in the late 1990s coincides with a push by Canada, the United Kingdom, and Eastern Europe to build production facilities and cultivate local talent. These locations began offering incentives for film production, and the enticements worked. One study estimated that the total U.S. expenditure lost to runaway production was $2.8 billion in 1998. This study also confirmed that most out-of-country production went to Canada, which lured film and television producers with NAFTA-exempt production incentives, including substantial tax rebates. The Canadian production tax subsidy was passed in 1998, and within just a few years, the effect in California was notable.[231]

Moreover, despite some recovery in California since 2001, the gains were meager compared to those of Louisiana and New Mexico. The Milken report noted that incentives were once again to blame:

> Many productions returned to the United States after the turn of the millennium, as the euro and the Canadian dollar gained strength. But not all the repatriating productions returned to Hollywood. Other U.S. states had begun providing incentives and became viable competitors for movie production. Looking at BLS numbers from 2003 to 2008, compound growth in employment for California's industry was 2.3 percent, compared with a massive 45.8 percent jump in New Mexico and 24.8 percent growth in Louisiana.[232]

The Milken report said California could not afford to remain complacent and urged policymakers to take action to retain a vital industry:

> California no longer can afford to rest on its laurels or its storied entertainment industry pedigree. Especially in the current economy, it's imperative that policymakers understand what's at

229. JACK KYSER ET AL., L.A. CTY. ECON. DEV. CORP., 2009–2010 MID YEAR UPDATE ECONOMIC FORECAST AND INDUSTRY OUTLOOK 70 (2009).

230. Press Release, FilmL.A. Inc., L.A Region's On-Location Feature Filming in Freefall (Apr. 14, 2009), http://www.filmla.com/news_releases.php?year=2009 (follow "Download PDF" hyperlink after "FilmL.A. Release 2005–2009 Television Pilot Production Report").

231. KLOWDEN ET AL., *supra* note 204, at 9 (citation omitted).

232. *Id.*

> stake and take decisive steps to retain an industry that serves as a vital source of jobs and revenue. Leaders in the film industry will have to take an active role in effectively communicating this message.[233]

According to the Milken report, had California managed to retain its share of employment enjoyed in 1997 (prior to the first significant incentives in Canada), the state could have preserved 10,600 direct industry jobs and 25,500 indirect jobs through 2008.[234] The wages and economic output of these combined 36,000 jobs would have totaled $2.4 billion and $4.2 billion, respectively, in 2008 alone.[235]

D. Grass Root Efforts to Fight Runaway Production

After the FTAC trade complaint was rejected in 2007, the grass roots activism from film industry workers seemed to fall apart. Even before the complaint was rejected, many people working in the industry were already disillusioned and disengaged after promising incentive legislation in 2005 "ran into a buzz saw" in Sacramento.[236]

In 2010, Cinematographer Ed Gutentag founded "Shoot Movies in California," a grassroots organization of industry workers and concerned citizens committed to keeping production in California.[237] The group's *Facebook* page had to be expanded to several pages to accommodate the 14,000 supporters.[238] The group now maintains its own news blog and website, through which it sells t-shirts and posts videos about the importance of the movie industry to California.[239] The emergence of the group proved that there was still some fight left in the industry, which was still largely disengaged, cynical and apathetic after years of failing to get the state to take action on runaway production.

The significant division among industry activists about the best strategy hampers their ability to get the industry's rank and file to unite in an effective grassroots effort to combat runaway production. FTAC and its supporters claim that incentives offered in Canada are an illegal violation of trade laws and an odious form of "corporate welfare."[240] For FTAC, the

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233. *Id.* at 1.
234. *Id.*
235. *Id.*
236. LOS ANGELES ECONOMIC DEVELOPMENT CORPORATION, FILM INDUSTRY PROFILE OF LOS ANGELES/CALIFORNIA COUNTY 6 (2005) [hereinafter LAEDC PROFILE].
237. Peter Caranicas, *Groups Battle to Lure Filming to California*, VARIETY (April 5, 2010), http://www.variety.com/article/VR1118017207?refcatid=1236.
238. *Id.*
239. *Id.*
240. Bobbi Murray, *Canadian Bacon: Hollywood Fights Back on Runaway Production*, LA WEEKLY, (Aug. 15, 2002), http://www.laweekly.com/content/printVersion/35350/.

opposition to using film incentives to fight runaway production is an unnecessary ideological roadblock. FTAC's own attorneys suggested the trade action against Canada would not endanger the existence of film incentives in the U.S.[241] As a result, FTAC's corporate welfare rhetoric caught on in California and contributed to the defeat of film incentive legislation in 2005:

> The Governor and the Speaker of the state assembly proposed an incentive package for low-budget films in late 2005, but it quickly ran into a buzz saw in Sacramento and was not passed. Opponents called it "corporate welfare" or fretted about state tax revenue going to an industry that has had accounting issues. Overlooked in the uproar were both the jobs and state tax revenues lost to a film being shot in another state.[242]

The FTAC mentality has not abated, despite the defeat of their trade action. FTAC is no longer active on any meaningful level, but many current and former members continue to oppose film incentives for legitimate and valid reasons, such as the expensive race to the bottom.[243] However, if FTAC wants to compete on a level playing field (and they do), the only way to level it is with a competing film incentive. It does not make sense for FTAC to oppose an incentive in California to temporarily level the playing field while pursuing their push to eliminate foreign subsidies. Finally, as will be discussed in the next section, the patchwork of state film incentives in the U.S. has been effective at reversing runaway production to Canada.

E. The California Film & Television Tax Credit

In February 2009, state lawmakers surprised many when they included film incentives in a budget bill that provided $12 billion in tax increases and broke a budget impasse that had been stalled for three months.[244] California's action, however late, helped level the playing field with other states. The incentive took effect on July 1, 2009, and provides for a five-year $500 million tax credit program; the program is capped at $100 million annually.[245]

241. Videotape: Will Filing a 301(a) Endanger Domestic Film Subsidies? (FTAC 2007), http://www.ftac.org/vid/05-301a-Filing-endanger-szFM.swf.

242. LAEDC PROFILE, *supra* note 236, at 6.

243. *See* Murray, *supra* note 240 (explaining that once production costs exceed a certain amount, producers ship jobs overseas to obtain better rebates and production incentives).

244. Sam Thielman & Dave McNary, *Golden Carrot?*, DAILY VARIETY, Feb. 20, 2009, at 1 (describing how California's film production tax incentive program is intended to draw producers back to California from New York).

245. *Id.*

TABLE 11:
OVERVIEW OF CALIFORNIA FILM INCENTIVES[246]

<table>
<tr><th>Incentive</th><th>Eligible Productions[247]</th><th>Additional Requirements</th></tr>
<tr><td>20% Tax Credit for “qualified motion pictures.”</td><td>Feature films must spend at least $1,000,000 but not more than $75 million.
Movies of the Week or Miniseries must have a $500,000 minimum production budget.
New television series licensed for original distribution on basic cable ($1 million minimum budget); one half hour shows and other
exclusions apply.</td><td rowspan="2">A “qualified motion picture” must meet the following conditions:
1) 75% test= Production days or total production budget in California
2) Principal photography must commence no later than 180 days after application approval
3) Post-production must be completed within 30 months of receiving tax credit application approval
4) Copyright for the motion picture must be registered with US Copyright Office.
“Qualified expenditures” are amounts expenditures paid or incurred for the purchase or lease of tangible personal property and qualified wages for services performed in California.
Above the Line wages are not qualified expenditures: writers, directors, music directors, music composers, music supervisors, producers and actors, other than background actors.</td></tr>
<tr><td>25% Tax Credit for “qualified motion pictures.”</td><td>A television series, without regard to episode length, that filmed all of its prior season or seasons outside of California.
An “independent film” $1 million —$10 million budget that is produced by a company that is not publicly traded and that publicly traded companies do not own more than 25% of the producing company.</td></tr>
</table>

The incentive did not impress everyone. A May 2009 commentary in the *Hollywood Reporter* by entertainment and tax attorney Schuyler M. Moore pointed out some of the problems with the California’s film incentive:

> There is still so much production in California that the state can’t compete on equal footing in this tax-credit flea market, as even a modest credit applied to the massive remaining production in California would tip it into bankruptcy. The best the state can do

246. ENTERTAINMENT PARTNERS, BASIC OVERVIEW OF U.S. AND INTERNATIONAL PRODUCTION INCENTIVES 2–3 (2011), http://www.entertainmentpartners.com/Content/Support/support_files/EP_IncentivesOverview.pdf; SCREEN ACTORS GUILD, CALIFORNIA FILM INCENTIVE POWER POINT PRESENTATION (2009), http://www.sag.org/california-film-incentive-power-point-presentation.

247. The following types of production are not eligible for California’s incentives: commercials, awards, reality shows, music videos, news programs, current events or shows, productions that solicit funds, student films, industrial films, public affairs programs, talk shows, game shows, clip based programming (more than 50% of content is comprised of licensed footage), documentaries, sporting events, variety half hour episodic TV shows (sitcoms) programs, daytime dramas, adult films. SCREEN ACTORS GUILD, *supra* note 246, at 3.

> is pretend to compete, which is why it recently passed an anemic, deferred-production tax credit that looks good in news stories but in practice is a paper tiger. And in most cases, the credit is unusable because it is not refundable and generally can only be used against the production company's California tax liability, which often is zero. Even when the credit can be used, it is deferred until 2011, and given California's history of "gotcha!" tax changes and its current fiscal problems, it would not be surprising if California deferred further use of the tax credit "for a little longer."[248]

Moore's analysis was prescient, if not understated. Shortly after the incentive passed, producers of *Deal or No Deal*, the popular syndicated game show hosted by Howie Mandel, announced they were shifting production from Culver City, California, to Stamford, Connecticut, a state which offers a 30% production tax credit.[249] Under California's tax incentive program, only television series that are new or that had previously shot in other states are eligible. Thus, *Deal or No Deal*, which filmed in Culver City since it aired in 2005, was ineligible for the incentive and most of the 250 people who work on the show will lose their jobs.[250] This begs the question: would the show have stayed in California had it qualified for the incentive?

Despite such problems and Moore's cynicism, the film incentive has proven to be much more than a "paper tiger" and helped prevent what would have been the worst year on record for feature film activity. In January 2011 FilmL.A. reported that feature film production in California increased 8.1% from 2009-2010, which can be attributed to film incentive productions:

> On-location Feature production posted a 28.1 percent fourth quarter gain and a year over-year gain of 8.1 percent (5,378 PPD in 2010 vs. 4,976 in 2009). The annual increase can be wholly attributed to California's Film and Television Tax Credit. . . .
>
> In 2010 alone, the State program attracted dozens of new feature film projects to Los Angeles, which were responsible for 26 percent of local Feature production for the year (totaling 1,400 PPD). Were it not for these projects, 2010 would have been the worst year on record for on-location Feature filming in Los Angeles. As it stands, that record is held by the year 2009, when the Features category finished 64 percent below its historical

248. Schuyler M. Moore, *Could a Single Federal Tax Credit End the Economic War among the States?*, HOLLYWOOD REPORTER, May 29, 2009, at 9.

249. Richard Verrier, *'Deal or No Deal' Production is Shifting to Connecticut*, L.A. TIMES, May 2, 2009, http://articles.latimes.com/2009/may/02/business/fi-ct-gameshow2.

250. *Id.*

peak (4,976 PPD in 2009 vs. 13,980 in 1996).[251]

California's film and television tax incentive program is not as generous or comprehensive as those of other states, but it is not insignificant. Moore's cynical claims and predictions about the modest California incentive have now been shown to be incorrect.

What Moore and others fail to recognize is that California's incentives do not have to be as competitive because the state has a tremendous home-field advantage: Hollywood.[252] The major studios have much, if not all, of their corporate operations in the greater Los Angeles area and maintain studios and production facilities in Los Angeles and Southern California. Indeed, Hollywood's infrastructure advantage is overwhelming. In 2002, 69% of all digital and visual effects firms in the entire U.S. were located in Southern California.[253] In terms of production space, soundstages and studio facilities in Los Angeles had a combined square footage of 5,049,000 in 2005.[254] That is more production space than in New York, Chicago, Orlando, Vancouver and Toronto combined.[255]

Because California has such a massive infrastructure system in place, it attracts the most talented workers in the professions servicing the motion picture industry: Talented and veteran production crews with decades of experience. Veteran actor Kirk Douglas said, "[m]y recollection is that no crew was as good as a Hollywood crew, no matter where they were. There's no argument that it is much easier to shoot a movie here."[256]

F. The FilmWorks Campaign

In December 2010, a coalition of industry stakeholders launched a public education campaign spearheaded by FilmL.A. called Film Works.[257] The goals of the campaign are to promote filming in Los Angeles and California, educate state residents about the economic importance and the benefits that the state receives from filming, and to aid the effort to fight runaway production.[258] The Film Works campaign is significant because it

251. Press Release, FilmL.A. Inc., Q4 Gains Help On-Location Filming in L.A. Recover 15% in 2010 (Jan. 11, 2011), http://www.filmla.com/news_releases.php.

252. Hollywood is frequently used as the moniker for Los Angeles County or Southern California, as most of the major studios are not literally in the City of Hollywood anymore. Only Paramount is based in Hollywood. Walt Disney and Warner Brothers are in Burbank, Sony is in Culver City and Universal is in Universal City.

253. SCOTT, *supra* note 21 at 98, 105.

254. *Id.* at 84.

255. *Id.*

256. Longwell, *supra* note 44, at 2–3.

257. FILM WORKS L.A., http://www.filmworksla.com/ (last visited Oct. 15, 2011).

258. *About,* FILM WORKS L.A., http://www.filmworksla.com/about.aspx (last visited Oct.

is the first organized (as opposed to unfunded grassroots efforts of the past) campaign supported by the City and County of Los Angeles, the major industry unions (SAG, IATSE, etc.), local businesses and the major studios (Warner Bros. is one of the financial sponsors).[259] Film Works's aggressive advertising campaign in the Los Angeles region consisted of outdoor advertising, a web site and supporting blog, a social media presence (Facebook, Twitter, YouTube), and a public service announcement that will run in area movie theaters before films.[260]

By August 2011, the Film Works blog had posted dozens of articles about runaway production, the damage other state film incentives are doing to the U.S. film industry, the effectiveness of using film incentives to prevent (rather than cause) runaway production, and profiles of California businesses impacted by the entertainment industry and runaway production.[261] The Film Works blog caught the attention of the Washington, D.C.-based Tax Foundation, when it responded to testimony the Tax Foundation gave to the California State Assembly about the state's film incentives and pointed out how the Tax Foundation's opposition to film incentives was applicable to other states, not California.[262] The *Economist* covered the Film Works response to the Tax Foundation's testimony, indicating that the campaign was getting the message out to policymakers around the world who read the publication.[263]

The Film Works campaign has responded to several editorials written in California. In June 2011, an editorial in the *Press Enterprise* dismissed the need for a film incentive in the state and suggested that runaway production was not a concern: "The Hollywood hullabaloo has been that other states have tax breaks that lure production away from California. But California has a long-established entertainment industry that is unlikely to pick up and disappear."[264]

15, 2011).

259. *Our Partners,* FILM WORKS L.A., http://www.filmworksla.com/partners.aspx (last visited Oct. 15, 2011).

260. *News Room,* FILM WORKS L.A., http://www.filmworksla.com/newsRoom.aspx (last visited Aug. 15, 2011); Press Release, Film Works L.A., Film Works L.A. Marketing Campaign Shifts Gears as Organizers Turn Their Attention to Educating Local Communities (Sep. 9, 2011), http://www.filmworksla.com/newsRoom.aspx.

261. *Word Press,* FILM WORKS L.A., http://filmworksla.wordpress.com/ (last visited Aug. 15, 2011).

262. Film Works Staff, *Film Works Campaign Turning Heads Around the World*, FILM WORKS UPDATE: NEW CAMPAIGN VIDEO DEBUTS & OTHER CAMPAIGN NEWS (July 25, 2011), http://filmworksla.wordpress.com/2011/07/25/film-works-update-new-campaign-video-debuts-other-capaign-news/ (last visited Oct. 15, 2011).

263. *Id.*

264. Editorial, *Tax-break Fantasy*, PRESS ENTERPRISE (June 12, 2011), *available at* http://www.pe.com/localnews/opinion/editorials/stories/PE_OpEd_Opinion_D_op_13_ed_filmtaxbreaks.1fb47b4.html.

Fearing that many in California were unaware that runaway production was a major problem already relocating the industry, Film Works offered a harsh response, warning that "California's complacency" had "caused immense damage":[265]

> What about the aerospace industry in California? The auto industry in Detroit? The steel industry in Pittsburgh and Pennsylvania? Shortly after World War II, half of all manufactured goods sold on the planet were made in the U.S., but try telling that to the industry workers in China who produce over 70% of all products sold in Wal-Mart stores. It's time The Press-Enterprise had a reality check. California's complacency, believing it will always be the entertainment capital of the world, caused immense damage while the state took no action to address incentive-fueled runaway production from its start in the late 1990′s until 2009. Allowing further complacency to stand could prove fatal for an industry that paid California residents over $15 billion in wages in just 2008. The film and television industry has, is, and will continue to "pick up and disappear" if California fails—as it has in the past—to act.[266]

The campaign's response also assembled some of the sobering facts and figures highlighting the damage caused by runaway production:

- In 2003, over 66 percent of studio feature films were shot in California. By 2010, that number had dropped to less than 40 percent.
- In the last 15 years, the number of on-location shooting days for feature films in the Los Angeles area dropped nearly 65 percent, according to FilmL.A.
- In 2005, California captured 82% of all television pilot production activity. In 2011, however, it captured just 51%.
- In 2000, Los Angeles County film industry workers earned 27% more per month than their non-L.A. counterparts. By 2009, after a decade of unabated runaway production of high-budget films and shows (which offer the high-paying jobs), L.A.-based industry workers earned 13 percent LESS per month than their counterparts elsewhere, according to the California Research Bureau.

265. *The Press-Enterprise—Where Fiction Masquerades as Fact*, FILM WORKS L.A. (July 21, 2011), *available at* http://filmworksla.wordpress.com/2011/06/21/the-press-enterprise-where-fiction-masquerades-as-fact/.

266. *Id.*

- From 1996 to 2009, the number of Californians employed in the high-skill and high-wage visual effects industry declined over 30% as jurisdictions elsewhere used targeted visual effects incentives to capture the industry from the state.
- According to the Milken Institute, since Canada enacted the first tax credit program in 1997, now copied in roughly 40 states and dozens of nations, California has lost 36,000 jobs as a result.[267]

G. *Fighting Fire With Fire: Using Film Incentives to Stop Runway Production*

The impact of the tax incentive has been dramatic. Due to the way the law was crafted, the California Film Commission was allowed to allocate $200 million, if needed, in the first year of the program. In that period (2009-10) $176 million in tax credits were allotted to seventy productions, which had an "estimated aggregate direct spending" total of $1.2 billion ($453 million for wages, $776 million in non-wage spending).[268] The number of direct jobs from these seventy productions was estimated at 18,200 for crew members and 4,000 cast members with an additional 113,000 individuals hired as day-players or background extras.[269] For the 2010-11 program year, the $100 million allocated for the year "sold out" the day productions were allowed to apply (July 1, 2010); a total of forty-three productions received the allocated funding available.[270] These forty-three productions are estimated to have "aggregate direct spending" of $969 million, $275 million of which to pay for an estimated 7,200 crew members and 2,500 cast members in addition to 59,000 day-players or background extras.[271]

The combined economic impact of all projects described above for 2009-11, which qualified for $300 million in credits available as of July 1, 2010, is estimated at $2.2 billion in direct spending by the productions ($728 million of which was for wages to residents).[272] Applying a conservative multiplier of 2.95 for the motion picture industry in California, the California Film Commission estimated the $2.2 billion in direct spending would have an economic impact of an additional $6.5

267. *Id.*
268. CAL. FILM COMM'N, CALIFORNIA FILM & TELEVISION TAX CREDIT PROGRAM: PROGRESS REPORT, 1–2 (2011), http://www.stop-runaway-production.com/wp-content/uploads/2009/07/Tax-Credit-FINAL-Hearing-Packet.pdf.
269. *Id.*
270. *Id.*
271. *Id.*
272. *Id.* at 3.

billion in "business revenues," project earnings for qualified productions of an estimated $1.8 billion and a total of 40,996 full time equivalent (FTE) jobs just on the qualified productions alone.[273] Unlike other states with incentives, however, California can expect to be the beneficiary of virtually all of the spending from these projects since the overwhelming infrastructure of the entire U.S. motion picture industry is housed within its borders.

In June 2011, the LAEDC released an economic impact study of the California film incentive, which was funded by the MPAA.[274] Given the inherent bias issues that have caused questionable findings in other MPAA-commissioned reports discussed earlier, the LAEDC report was suspect, unjustly or not, because of the MPAA's questionable history. That said, bias alone did not discredit the other reports, they were discredited for their substance (like the flawed tourism survey in the New Mexico report).

Given this virtually universal finding for state film incentive programs from New Mexico to Louisiana to Massachusetts, how can the results for California be so different? As discussed earlier, the history of the industry being based so densely in California for decades meant that virtually everything Hollywood needed to make a production can be found wholly within its own borders allowing for 92% of all production expenses in 2009 to be sourced within the state.[275]

Thus, unlike other states where much of the production spending goes to out-of-state workers or businesses, California does not have a leakage problem thanks to the Hollywood home-field advantage. In addition, the report lists four specific reasons California's film incentive is much more cost effective, relative to other states' programs:

> First, the economy of California is large and diversified, allowing households and businesses to obtain most of the goods and services they need within the state, meaning there is less leakage of purchases out of the state and the dollars circulate within the state.
>
> Second, the motion picture and video industry itself is complex and comprehensive in California Because the supply linkages are well-established, the industry can find all production facilities and requirements within the state, although lower costs elsewhere can impel the purchase of goods and services from outside of California.

273. *Id.*

274. *See* Email from Christine Cooper, Ph.D., Director, Econ. & Policy Analysis Grp., to author (June 29, 2011, 15:41 PDT) (on file with author) (explaining the methodology used by Dr. Cooper, the report's author, to estimate the economic impacts of tax incentives).

275. LAEDC ECONOMIC IMPACT STUDY, *supra* note 25, at 3.

> Third, the California tax incentives are less generous than those offered in other states—in some cases, substantially less. With a deep talent base and skilled workers at all levels and stages of production, and a full range of supporting infrastructure and companies, California does not need to offer incentives above those (or even equal to those) offered by other states. Instead, smaller incentives that keep California "in the game" can be sufficient, as suggested by the response to the current program.
>
> Fourth, California's steeply progressive income tax gives the state the ability to recoup its tax credit quickly. Similarly, California's high sales tax rate will generate more revenue from taxes on household purchases than states with lower sales taxes.[276]

Also making California's film incentive more efficient and cost effective is the fact that above-the-line expenditures generate economic activity but do not qualify for the credit:

> A close inspection of the production budgets and impact results shows that *the overriding factor influencing this rate of return is the proportion of the budget that is spent above-the-line*. Above-the-line spending generates economic activity but does not qualify for consideration under the tax credit program, so in essence this spending comes at no cost to the state.[277]

As for the methodology, the study estimated the economic impact of the first seventy-seven productions approved for the initial tax credit allocation of $198.8 million for 2009-10 and 2010-11.[278] The study's authors examined the budgets of nine productions of differing size and type and extrapolated the findings to the broader group of incentivized projects:

> For every $1 million in qualifying expenditures, the nine productions will generate $3.9 million in economic output and support 21 jobs with labor income of $1.4 million. Each $1 million of qualifying expenditures will result in $207,100 in state and local taxes . . . .
>
> The total qualifying expenditures for all 77 productions is $970.3 million. Extrapolating from the results of our sample of productions, we estimate that the full slate of qualifying productions will generate more than $3.8 billion in economic output in California and support 20,040 jobs with labor income

276. *Id.* at 7.
277. *Id.* at 8 (emphasis in original).
278. *Id.* at 7.

> of almost $1.4 billion. Total state and local tax revenues are estimated to reach $201 million.[279]

Bottom line, the LAEDC report claimed the incentive program was generative revenue:

> For every tax credit dollar approved under California's Film and Tax Credit program, at least $1.13 in tax revenue will be returned to state and local governments. This impact is based on 2 components: (i) $1.06 per tax credit dollar in initial economic impact; and (ii) 7¢ per tax credit dollar from ancillary production.[280]

Even with the thorough, detailed and—most importantly—truthful and accurate explanation of why California's incentive is vastly more effective than competing incentives in places like Louisiana, Georgia, etc., claiming the incentive makes more money than it costs was misleading.

Since California's film incentive, like any other state incentive, is funded with state tax revenue rather than local tax revenue, the program is not "paying for itself" in terms of returning to the State's tax coffers an equal amount as allocated. The report itself does not break down the source of the revenue. When asked what portions of the revenue were from state taxes versus local, the report's lead author said a detailed breakdown was not available, but the "ballpark" estimate was 2/3 state, 1/3 local.[281] Of the numerous reports about the cost-benefit of various state film incentive programs I have seen, California's incentive is the only one that comes close to breaking even. The report does not include a balanced budget analysis to account for the opportunity cost of the program, but given the size and importance of the industry to the state, it seems unlikely using the funds for another purpose would yield a better return.

Because of the importance of the report and its ability to influence California lawmakers considering an extension of the incentive, I sent an advance copy of the study to Robert Tannenwald and asked for his feedback.[282] With the exception of a short paragraph about Tannenwald's preference for an economic modeling program (REMI) not used in the report (which was IMPLAN), Tannenwald's response was as follows:

> Apparently LAEDC has assumed that every film claiming the credit would have been produced outside of California in the credit's absence. While that might be a reasonable assumption for another state, I question its validity for California (or New

279. *Id.* at 9–10.
280. *Id.* at i.
281. Email from Christine Cooper to author, *supra* note 274.
282. Email from Robert Tannenwald, Senior Fellow, Ctr. on Budget & Policy Priorities to author (July 6, 2011, 07:33 PDT) (on file with author).

> York). I assume (reasonably, I think) that a good number of California producers who planned to shoot their film in California anyway grabbed available credits. I could be wrong, since I am not familiar with the details of California's credit. But, if a condition for receiving the credit is that the production would have taken place in another state, I don't know how the state could enforce it (except for TV productions—they had to have been produced previously in another state).
>
> There's a phrase on page 10, "After adjusting for the temporal mismatch between the spending and tax credit realization." LAEDC explains that it is adjusting for the time between production occurs and tax credits are awarded. This is a strength of the study.
>
> I think that the multiplier for film spending in California would be higher than it would be in other states, as Los Angeles has such a strong media cluster. However, above-the-line workers skilled in some aspect of film production, who travel to another state for a film, still spend most of their compensation back in California. LAEDC acknowledges that the economic benefit of retained productions are concentrated in "above the line" workers. These workers pay income tax to California rather than to some other state if the production is retained in California, true. But, even if filming in another state, much of the income earned by above the line workers gets spent in California (above their per diem allowance). It is not clear that LAEDC's analysis takes this into account.
>
> I have to acknowledge, overall, that film retention in California has a larger payoff than film acquisition by another state. Just not sure the tax credit pays for itself.
>
> Overall, except for the absence of a balanced budget analysis, not a bad study.[283]

Since Tannenwald authored the leading report criticizing film incentives, his comments above seem like high praise and should help insulate the report from unfair criticism because of who paid for it. If Tannenwald were unable to discredit the report, its credibility should not be in doubt. It is unfortunate the MPAA paid for this particular report, because the structure of California's incentive, combined with the concentration of the entertainment industry in the state, meant that California was perhaps the only place where a competitive film incentive might come close to breaking even.

283. *Id.*

Indeed, in 2005, the LAEDC predicted the California film incentive "would probably have paid for itself" after a film incentive bill almost identical to the current program was defeated earlier that year.[284] And that prediction was not from a report paid for by the MPAA or anyone else. Had the LAEDC generated the 2011 report on its own initiative or at the request of the state, it would have been a vindication of their prediction, which would only bolster what is already an impeccable reputation. The MPAA's involvement could only be a negative that could diminish the value of the report and its findings at a critical time for extending a film incentive program that has been a very effective defense, if not the only available defense, against incentive fueled runaway production.

VII. CANADA

With over forty states offering substantial film incentives in 2010, the obvious question is: has the cumulative effect the state incentives stopped or slowed runaway production to other nations, primarily Canada? Based solely on the number of U.S. productions shot in Canada (either entirely or partially), the evidence is inconclusive. The table below (Table 12) shows that the number of total projects did increase after the first major tax incentives took effect in the late 1990's and hit a high of 241 in 2000-01, but the sharp two-year increase was followed by a an even sharper drop that bottomed out with ninety-three productions in 2004 before recovering to 165 in 2007-08 and falling to 139 in 2009-10.

TABLE 12:
U.S. FILMS PRODUCED IN CANADA

YEAR	U.S. PROJECTS[285, 286]
1998/99	175
1999/00	229
2000/01	241
2001/02	169
2002/03	159
2003/04	93
2004/05-2006/07	N/A

284. LAEDC PROFILE, *supra* note 236, at 6.

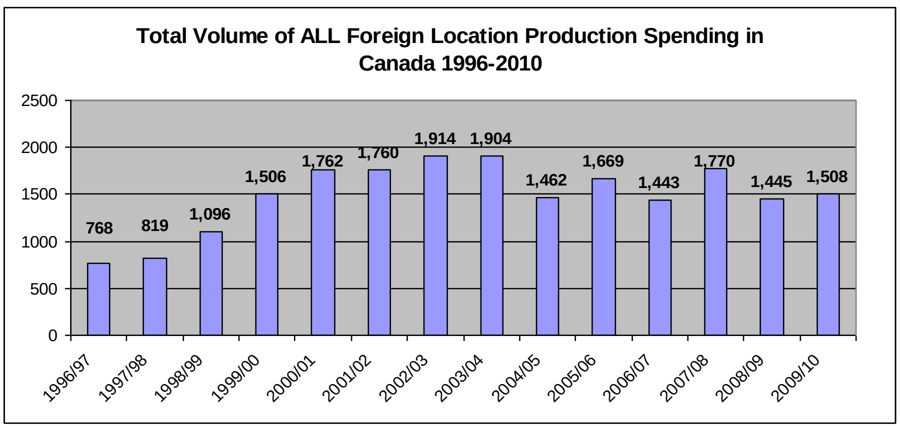
285. *See* DEP'T. OF CAN. HERITAGE, STUDY OF THE DECLINE OF FOREIGN LOCATION PRODUCTION IN CANADA 1, 3 (2005) (listing the number of U.S. productions filmed in Canada between 1998 and 2004).

286. *See* CAN. MEDIA PROD. ASS'N, PROFILE 2010: AN ECONOMIC REPORT ON THE CANADIAN FILM AND TELEVISION PRODUCTION INDUSTRY 1, 84 (2010) (listing the number of U.S. productions filmed in Canada between 2007 and 2010) [hereinafter CANADIAN FILM PROFILE 2010].

2007/08	165
2008/09	158
2009/10	139

It is much more important to look at spending totals by foreign productions, rather than the number of them. The chart below (Chart 7) shows the total amount of all foreign location spending in Canada at the national level, which increased substantially after the first significant film incentive took effect in 1998.[287] Spending for all foreign production activity peaked in 2002-03 at $1.9 billion and has struggled to approach that high again.[288]

CHART 7:



In 2009, the Canadian Department of Cultural Heritage speculated that the rise in value of the Canadian dollar compared to the U.S. dollar could have contributed to the first decline in foreign production spending, but not the second, which was "cushioned" by incentive modification:

> The total volume of FLS (Foreign Location Spending) production dropped sharply in 2004/05, one year after the Canadian dollar started to rise in value from below 70 U.S. cents. However, Canada's volume of FLS production did not fall any further after 2004/05, even as the Canadian dollar rose by another 20 U.S. cents to close to parity with the U.S. dollar. The fact that most provincial and territorial governments moved quickly to modify

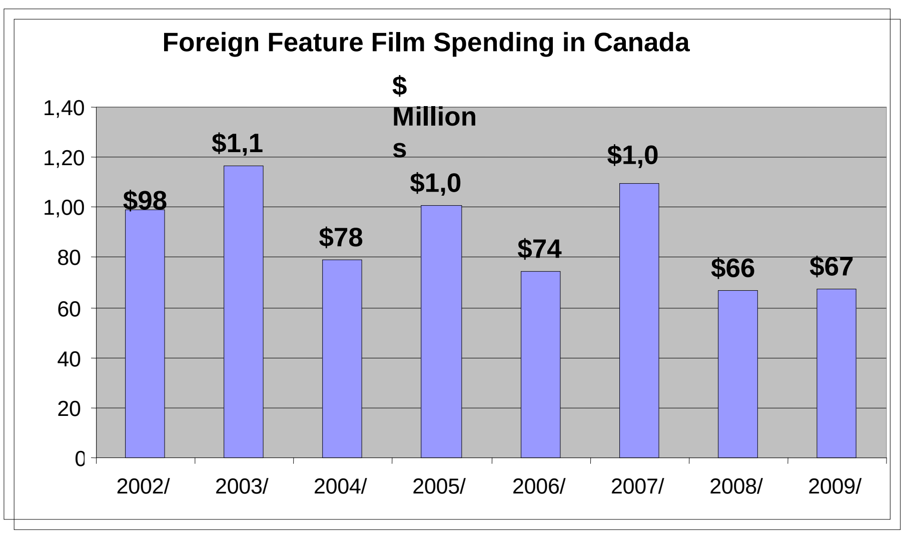
287. *Id.* at 83; CAN. MEDIA PROD. ASS'N, PROFILE 2009: AN ECONOMIC REPORT ON THE CANADIAN FILM AND TELEVISION PRODUCTION INDUSTRY, 1, 79 (2009), [hereinafter CANADIAN FILM PROFILE 2009].

288. CANADIAN FILM PROFILE 2009, *supra* note 287, at 77; CANADIAN FILM PROFILE 2010, *supra* note 286, at 83.

> their respective funding support programs appears to have helped cushion the rise of the Canadian dollar to some extent. As well, it would appear that Canada's numerous purpose-built studios, quality crews and proven track record of delivering films on-time and on-budget have allowed it to develop into more than just a low-cost location for Hollywood production.[289]

Data contained in the 2010 Department of Canadian Heritage economic report on the Canadian film industry revealed the amount of foreign location spending on feature films specifically (as opposed to all productions) in Canada increased after two years of steep declines. The first decline, shown in the chart below (Chart 8), occurred between 2004 and 2005, when foreign spending on feature film production in Canada dropped from over $1.1 billion to $789 million.[290] From 2005 to 2006, foreign location spending for feature film rebounded to $1 billion, but then dropped again, to $742 million, the next year.[291] Foreign location spending by foreign feature films increased to just over $1 billion from 2007 to 2008, but fell again over the next two years to well under $700 million each year.[292]

CHART 8:

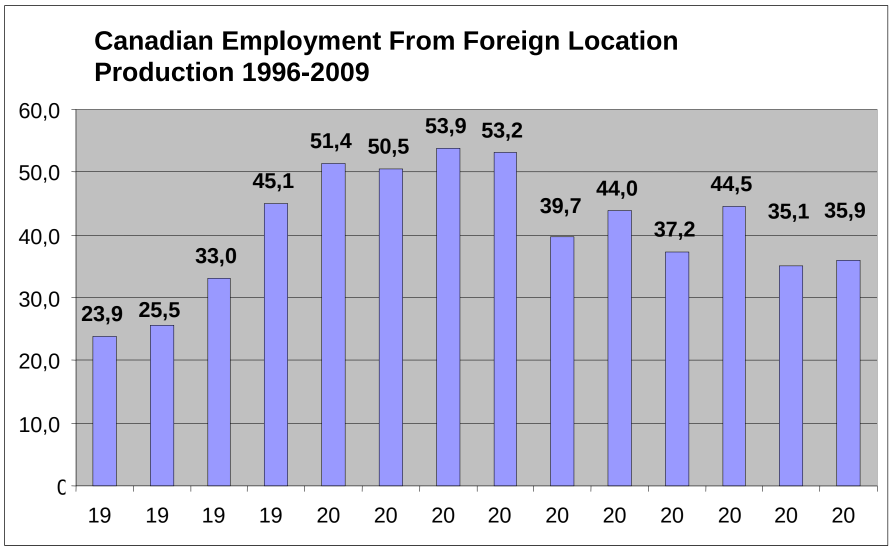


However, data for feature film spending before 2002 is not available. Employment for foreign location production in Canada, as shown in the

289. CANADIAN FILM PROFILE 2009, *supra* note 287, at 78.
290. CANADIAN FILM PROFILE 2010, *supra* note 286, at 83.
291. *Id.*
292. *Id.*

chart[293] below (Chart 9), saw dramatic gains after it enacted it film incentives in the late 1990s and peaked at 53,900 in 2002 before an overall decline to 35,900 in 2009-10. The peak year, 2002, was the same year New Mexico and Louisiana enacted the first significant incentives in the U.S., which rapidly expanded each year to over 44 states in 2010.

CHART 9:



Based on available information, an evaluation on the impact of U.S. film incentives on Canada is starting to become more and more conclusive. Film incentives in the U.S. are impacting production activity, employment and the amount of foreign location spending in Canada to almost the same levels they were at when it enacted its first significant incentives in the late 1990s. When Canada distorted the playing field in the late 1990s with significant film incentives, it saw spectacular gains. Even if the gains of the past could be partly attributed to currency fluctuations, this is no longer the case. Canada has been willing to adjust its incentives not because it is trying to compensate for currency, but because it wants to compete with various tax incentives of American states:

> Although the Canadian dollar remained high by historical standards in 2008/09 and 2009/10, and other jurisdictions—particularly American states with their own tax incentives—continued to provide competition to Canadian provinces and territories, the volume of FLS production in Canada recovered

293. CANADIAN FILM PROFILE 2010, *supra* note 286, at 81; CANADIAN FILM PROFILE 2009, *supra* note 287, at 79.

> slightly from the previous year. FLS production fell by 18.4% to $1.4 billion in 2008/09, but recovered by 4.4% in 2009/10 to reach a total of $1.5 billion.[294]

State film incentives in the U.S. have shown that when the playing field is leveled with Canada, the U.S. wins. The problem, however, is that the current incentive scheme is completely unsustainable. Once states realize—or are forced to accept—that they cannot afford to relocate Hollywood from Hollywood, they will end their incentives, and Canada and other nations will still be capable of competing with a weakened Hollywood, hollowed out from corrosive competition within the United States.

VIII. One Nation, One Film Incentive: A Workable Solution to Runaway Production

When I started writing about runaway production in 2005, I framed it as a national concern. Runaway production was leaving the United States for international locations. Canada was the primary destination because of its proximity, cultural similarities and (for a time) a favorable exchange rate. Other popular destinations included South Africa, Australia, New Zealand, Romania, Hungary, and the United Kingdom. At that time, the U.S. retained two potential weapons to fight runaway production to Canada and elsewhere: a trade action in the hopes foreign film incentives would be declared illegal and the enactment of competing film incentives in the U.S. to "fight fire with fire." In 2007, a trade complaint was filed with the United States Trade Representative.[295] The United States Trade Representative considered and rejected the complaint.[296]

In 2011, there was a development in Europe that could breathe new life into the argument favoring filing trade actions against Canada. In June 2011, the European Commission launched "a public consultation as the first step of a review of the criteria used to apply EU state aid rules to Member States' financial support for making and distributing films."[297] In the accompanying issue paper, the European Commission noted that, while European Union member film incentives may lure films to Europe, they also result in a subsidy race that contradicts treaty objectives:

294. Canadian Film Profile 2010, *supra* note 286, at 79.

295. Press Release, Statement from Gretchen Hamel, Deputy Assistant USTR for Public and Media Affairs, regarding a Section 301 Petition on Canadian Film Subsidies, Office of the United States Trade Representative, *supra* note 75.

296. *Id.*

297. Press Release, European Comm'n, State Aid: Commission consults on support to film sector (June 20, 2011), http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/757&type=HTML.

> Major US-financed films have an average production budget of $65 million (€46million), with the most expensive films exceeding $200 million (€141 million). This is many times higher than those of typical European productions. While attracting them with subsidies may ensure that these high profile films are made in Europe rather than elsewhere, such subsidies distort competition among European production locations. In these cases, the question is not *whether* the film will be produced but only *where* this will be done.
>
> To the extent that this use of public subsidies in effect leads to competition with other Member States, this is detrimental both to the sector and to European taxpayers. It was not envisaged when the original State aid rules for promoting the European cinematographic culture were designed. Avoiding subsidy races is precisely one of the objectives of the State aid provisions of the Treaty.[298]

The European Commission plans to complete its review by the end of 2012. Regrettably, the only remaining option for preventing runaway production in the U.S. is the "fight fire with fire" approach. This is not to say another trade action complaint couldn't be filed. It may be more advantageous to wait and see what action the European Commission takes first, however, before filing with the United States Trade Representative again. A finding that film incentives violate trade law in the EU may offer a stronger case to present to the USTR.

When the "fight fire with fire" approach was discussed, it was intended to be employed at the national level to avoid the foreseeable dangers of a race to the bottom:

> While record Federal deficits may make it politically difficult to support the idea of a Federal Incentive for production, there are many compelling reasons it should be considered as it would it would allow the U.S. to regain a competitive position in the global market for production. Based on a number of considerations, including those below, there is a reasonable basis to believe that a U.S. Federally-based program would quite effective. . . .
>
> In the world today, globalization is an economic fact of life. Companies across the world are seeking lower costs of manufacturing, distribution and operations. The growth of foreign production of U.S. originated entertainment product,

298. *Issues Paper on Assessing State Aid for Films and Other Audiovisual Works*, at 6 (2011), *available at* http://ec.europa.eu/competition/consultations/2011_state_aid_films/issues_paper_en.pdf (citation omitted) (emphasis in original).

> however, seems, to a significant measure, to be driven by economic subsidies to producers as a conscious decision by countries seeking well-paying jobs in a clean industry.
>
> The question is [sic] with any job leaving the U.S. is, where and when does it stop. When Canada was proposing their federal incentive their rallying call was, "these are the jobs your children want." The U.S. must decide it [sic] they want feature film production careers for their children, and their children's children.[299]

In order for the "fight fire with fire" approach to work in stemming or stopping runaway productions from leaving the country, the purpose of a competing incentive in the U.S. needs to be preventing runaway production from the nation's borders—not causing it within them. Other countries are waging economic warfare on the U.S., and rather than fight back, we have been fighting with ourselves.

With the exception of California and New York, the other states enacted film incentives to *cause* runaway production, not *prevent* it. As each new state got in the incentive game to cause runaway production for selfish gain, the inevitable race to the bottom ensued.

The "United States" is anything but when it comes to preserving one of the last great American industries we have left. A national problem demands a national solution. Rather than acting in the national interest, states with film incentives designed to cause runaway production are acting only in self-interest.

Some good has come out of the race to the bottom. Collectively, the state incentive programs served as a de facto national incentive for the United States. As discussed above, this offers convincing evidence that a national incentive is, in fact, a solution to runaway production.

In May 2009, Schuyler M. Moore proposed a basic national incentive scheme:

> So what's the solution? Easy. It is time for all the states to band together, stop the self-defeating madness and request the federal government to convert Section 181 into a useful 10% tax credit—instead of a deduction—for U.S. production costs. And it must be assignable in order to provide actual financing for production, which is what really is needed.
>
> As part of implementing this tax credit, the federal government should use its power under the Commerce Clause to pre-empt all state laws (and don't let Puerto Rico sneak away) that give tax credits for production. That way, the states would be saved from their self-inflicted immolation, and they could go

299. Katz, *supra* note 81, at 73–75.

> back to competing for production based on services, infrastructure and locations—just like in the good ol' days. We could go back to seeing ads to shoot in Wyoming because of its sweeping vistas rather than ads for shooting in Connecticut because of its sweeping tax credits.[300]

A national incentive could model itself on the California model, which confirms the incentive does not need to meet or beat the competition. If the jurisdiction has a mature and robust industry infrastructure, the argument that film incentives will always need to be increased for the jurisdiction to stay competitive is simply not true. The U.S. has Hollywood and New York, and U.S. studios account for nearly 60% of the international box office.[301] On a level playing field, the U.S. not only competes, it dominates the planet.

The genius of a national incentive is its simplicity. For a fraction of the price the nation is now paying via the multiple state incentives, the U.S. could achieve the same goal. The political reality, however, of having such a plan realized at the national level is, like the movies, an unlikely fiction. Many of the states with aggressive film incentive programs would not want to lose their advantage. Certainly, with a national production incentive plan in place, it is likely that most film and television production in the U.S. would return to the traditional bases of California and New York. States like Louisiana, New Mexico, Michigan and others are certain to oppose losing whatever gains they think, perhaps naively, they have made.

Nevertheless, an appeal that frames runaway production as a national problem requiring a national solution by arguing that the state film incentive "solution" to runaway production is actually exacerbating the problem by eroding the massive industry clusters in the nation: California and New York. Sadly, this point is overshadowed by the claims made by film backers about job creation in their respective states and the national employment statistics that show the nation is not losing jobs to Canada as a result.

Preventing runaway production is about much more than protecting jobs in the U.S., it is about protecting a vital national industry. Hollywood needs to be thought of as a high-value natural resource. The U.S. is blessed in ways most Americans do not appreciate: Hollywood is a natural resource valued throughout the entire world, and the U.S. has almost exclusive possession of the means to producing it. Hollywood's

300. Moore, *supra* note 248.

301. *See* Phil Hoad, *The Rise of the International Box Office*, GUARDIAN FILM BLOG (Aug. 11, 2011, 4:17 AM), http://www.guardian.co.uk/film/filmblog/2011/aug/11/hollywood-international-box-office (discussing the increasing role the international movie market plays in film production).

domination of the global entertainment industry is so lopsided and beneficial to the U.S. because of this concentration. It can be likened to the benefit OPEC member nations reap from the concentration of another natural resource: oil. Oil, however, is a natural resource that cannot be relocated to benefit another location through the use of economic policy like tax incentives. Even by force, if another nation wanted to be the sole beneficiary of Saudi Arabia's oil reserves, they would still have to occupy Saudi Arabia to pump the oil. Hollywood is a moveable natural resource.

Many Americans fear the U.S. is a nation in decline and worry that the world's last remaining superpower is becoming a second-rate nation. One way for Americans to help stop this decline is to protect Hollywood, one of America's few remaining strengths. For now, the U.S. enjoys complete supremacy in a very valuable global industry, the motion picture and television industry referred to across the planet as "Hollywood."

In 2010, U.S. films accounted for 60% of the global box office.[302] In important economic regions, like the European Union, that number is even higher. In fact, U.S. films account for an average of 70% of the entire E.U. box office and, in certain member nations, that percentage is even higher.[303] Additionally, the U.S. share of the E.U. home video market is equally high, exceeding 70%.[304] Conversely, the market share of foreign language films at the U.S. box office is, at one half of one percent, practically non-existent.[305]

Framing the issue as a matter of economic warfare that is damaging the national economy may also resonate with politicians reluctant to take up a "Hollywood" concern. If the nation is under economic attack, it needs a national response. We don't rely on the individual state guards to protect the entire nation from external threats, and this should not be any different. Policymakers in Canada knew exactly how and where to hit. In 2005, for example, the Director General of the Canadian Department of Heritage told Canada's National Parliament that the tax credit system was a "simple and efficient system" of attracting foreign productions, and if Canada wanted to attract more, they "would just have to give a 50 per cent tax credit on labor, and nothing would be filmed in Hollywood, everything would happen here."[306] If statements like this are not considered a direct threat to a national industry worth taking defensive action to prevent, then what is?

There are signs Canada knows it cannot sustain the ongoing race to the bottom. For example, in 2007, a Toronto Film Office report claimed

302. *Id.*

303. *Issues Paper*, *supra* note 298, at 3.

304. *Id.*

305. *See* ROBERT W. MCCHESNEY, RICH MEDIA, POOR DEMOCRACY 33 (1999) (explaining how the growth of multiplexes caused the decline of foreign films in the U.S.).

306. 24 Feb. 2005, PARL. DEB., H.C. (2008)(Can.).

the race to the bottom is one they did not "want to win" because it is also one they "can't win":[307]

> There is a race to the bottom going on worldwide to establish Booniewoods around the globe. This is a race Toronto doesn't want to win.
>
> Within North America our success has been successfully copied. Even though the provincial government raised the Ontario tax credit in 2005 to try and fend off the competition, the competition simply raised its credits higher. The race to the higher tax credit is another one we can't win.[308]

Similarly, in 2008, the provincial government in British Columbia warned the province that "at some point" it may be "either unable or unwilling to match" incentives:[309]

> The big budgets and the ancillary benefits of having a blockbuster Hollywood production film in a particular location have spawned many imitators of Canada's tax credit strategy. As a result, the incentives available to film and television producers have become more lucrative as each region tries to one-up the other.
>
> At some point, British Columbia may be either unable or unwilling to match another region's incentives, which could leave BC's film production industry with a shortage of foreign productions wanting to film in the province.[310]

As mentioned earlier, because of the response to the California Film & Television Tax Credit, the LAEDC found California did not even need to top—or even match—those offered in other locations because of its deep talent base and infrastructure.[311] Similarly, New York's program, which is also meant to prevent runaway production and shares California's modest limitations, has proven the same thing:

> New York's most serious competitors offer programs with unlimited funding, no sunset, more generous incentives, and broader eligibility of qualifying costs, such as actors', producers' and directors' fees. The difference can mean producers can get anywhere from 7 percent to 24 percent more in credit in states

307. TORONTO FILM BD., BOUNCE BACK TO FAST FORWARD: STRATEGIC PLAN FOR TORONTO'S SCREEN-BASED INDUSTRY 26 (2007).

308. *Id.*

309. *Call of the Loonie: American Film & Television Productions Shun BC in 2007*, BC STATS: EXPORTS, Feb. 2008, at 4.

310. *Id.*

311. LAEDC ECONOMIC IMPACT STUDY, *supra* note 25, at 7.

> such as Connecticut, Massachusetts, and Michigan. Despite this intense competition, however, the past year has demonstrated that when funded at an adequate level New York can remain extremely competitive in attracting production.[312]

In sum, the U.S. does not have to compete in a race to the bottom. On the contrary, if the U.S. enacted a national film incentive based on the New York and California models, it could bring a swift end to the costly race among not only the other states, but also across the planet. It is time to end the madness.

The end of state tax credits, which are based on artificial economic arguments, will not only end the maddening economic race to the bottom, but it will also help restore the creative side of the equation when deciding where to film. Many writers, directors, actors, and others in the film and television production industry recognize that runaway productions motivated primarily, if not exclusively, for economic reasons are not the most effective way to enhance the creative and artistic aspects upon which the industry is driven. Fostering this notion is critical within the film and television community and, according to Massimo Martinotti, founder and president of Mia Films, should be seen as a "quest for excellence":[313]

> In the last few years when we mentioned the possibility of shooting abroad, we all immediately characterized this option as "runaway production." Last year (2003), more than 20 percent of American production companies shoot days took place outside the U.S., and it is true that the most frequent reason to go and shoot somewhere else has been costs. Political and economic circumstances have given strong advantages to countries around the globe that can offer very low production costs and, at the same time, decent—and often excellent—structures, crew and equipment.
>
> However, I believe that we should consider the international approach of a production from the creative angle, and not only from the 'saving money' perspective. In the last several years, I shot in more than 30 countries on all the continents, and I am sure that in most of cases, the creative impact of the international choice was stronger than the budgetary one.
>
> A location is like a good wine: it has a specific color, a unique taste, a peculiar smell. If these elements can make the idea grow, this is not "runaway," it is the search for the best, the

312. GOVERNOR'S OFFICE FOR MOTION PICTURE & TELEVISION DEV., REPORT ON THE EMPIRE STATE FILM PRODUCTION TAX CREDIT 24 (2010).

313. Massimo Martinotti, *Runaway Production or Quest for Excellence?*, SHOOT, Jul. 5, 2004, at 4.

> fight for excellence. Our business is based on these concepts. Some time ago, we were working on a project. The agency was looking for a European atmosphere, a classical and elegant look, and a nostalgic mood. The example proposed was Paris. Nevertheless, we suggested a different place: Lisbon, Portugal. I don't think that any other European city can offer the same feeling: the terraces of Alfama, the climbing streets of Barrio Alto, the stones, the tiles, the flowers, the walls. Everything evokes old times, elegance and romanticism. It is not the glamorous, sexy look of Paris, the imperial elegance of Vienna, the flamboyant and charming sensuality of Rome, the mysterious solidity of Prague or the contagious happiness of Seville. It is the dreamy grace of Eisbon [sic], defined by the Fadomusic, the smell of the carnations, the blue color of its tiles, the flavor of an old wine from Porto. . . .
>
> The need for the perfect location goes much further than the quest for a specific type of geographic environment or an appropriate climate. It is a much more delicate, subliminal and creative approach. We shouldn't look, for instance, for an "ancient European city" because thousands of places fit that description: Pompeii, Bath, Tour, Koblenz, Sigüenza, Budapest, Istanbul, Olympia, etc. We should, on the contrary, concentrate our quest on finding that unique atmosphere, texture, tone of color, type of light or shape that can make the commercial different, memorable, relevant.
>
> Instead of exploring new territories, very often we are moved to go back repeatedly to the same places: if we go to Italy, we shoot in Tuscany, and in France, the spot is La Côte d'Azur. Why not Piedmont, Liguria or Trentino? Why not the Loire region, Provence or Alsace? Why not Spain, Belgium or Luxembourg instead? Why not Costa Rica, which I believe is the best-kept secret in Latin America as a production destination?
>
> Putting the location exclusively on the creative side of the equation will indeed give a more consistent meaning to the international approach of a production. The quest for excellence is in this sense the antithesis of the runaway production concept.[314]

Here's to the "quest for excellence!"

314. *Id.*