

**Evaluation of Alabama's
Entertainment Industry Incentive Program
and
New Markets Development Program**

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Executive Summary

In this report, we take an in-depth look at two components of Alabama's broader economic development strategy: the Entertainment Industry Incentive Program, which provides attractive tax breaks to support a variety of movie, television, and sound productions in the state, and the New Markets Development Program, which provides investment capital for low-income areas. For each program, we begin with a brief history and comparison to programs in other states. We then discuss, evaluate and extend the available estimates of the economic and revenue impacts of each program as possible. Next, we turn to a point-by-point evaluation of the strengths and weaknesses of each program, using the features of good tax incentive programs that we laid out in our initial report for the Alabama Department of Revenue. Finally, we briefly consider several available policy options and provide suggestions for improving the state's economic development efforts in these important areas.

Entertainment Industry Incentive Program

Alabama's Entertainment Industry Incentive Program allows up to \$20 million per year in incentives to encourage certain media productions within the state. Qualifying productions can receive incentives in the form of an income tax rebate and an exemption from the state portion of sales, use, and lodgings taxes. Specifically, the Qualified Production Company (QPC) receives an income tax credit equal to 25 percent of certain approved non-payroll production expenses plus 35 percent of payroll paid to Alabama residents. It is noteworthy that the credit is refundable; the QPC receives the full amount of the credit even if it exceeds their income tax liability. Only expenditures incurred after the project's approval may count towards the tax credit.

A wide array of projects can qualify, ranging from motion pictures (and/or their soundtracks), documentaries, television programs (except for certain news, weather, sports, or financial programming), sound recordings, videos (including music videos), commercials, and even video games. The primary requirement is that at least some portion of the project is produced in Alabama. Projects must be of a certain minimum size in terms of production expenditures, and the minimum varies by project type. Additionally, income tax credits are capped, again subject to limits that vary by project type. Projects of any type must involve \$150,000 or more in production expenditures in the state in one year in order to receive the sales, use, and lodging tax exemptions.

Projects are subject to a variety of reporting requirements, including the mandatory filing of all necessary state tax forms and compliance with all applicable business and employment laws. The Film Office is also required to review each project's progress at least twice per year. The QPC must submit a final audit to the Film Office following the completion of production in order to verify all production expenditures. Certain claw-back provisions govern the receipt of incentives in the event of unsatisfactory performance, such as when expenditures fall short of the required minimum.

Alabama is one of many states with a formal incentive program to attract the media production industry. The proliferation of state programs, along with revenue pressures and questions about their true economic impact, have reduced the appeal of these entertainment incentive programs in recent years. With the exception of industry-funded studies that unsurprisingly find positive effects, the literature is full of analyses that find mixed-to-negative results and offer generally pessimistic evaluations of program effectiveness. It is noteworthy that the National Conference of State Legislatures (NCSL, 2016) reports that ten states ended their incentive programs since 2009 and another three have cut them back, while only three have expanded them. These policy actions signal widespread disapproval with the programs and their effectiveness.

Administrative records provided by the Alabama Film Office show 53 projects receiving nearly \$40 million in incentives under this program between 2009 and 2015. Our in-depth analysis of the data for these 53 projects revealed a negative impact on tax revenues and only marginal impacts on employment and economic activity that together do not justify the revenue cost of the program to the state. The impacts are further reduced when one considers that some of the production activity might have taken place even without the program, and that the revenue loss creates other costs for the state.

Our evaluation concludes that the Alabama Entertainment Industry Incentive Program is associated with a number of production activities, but it is not clear how many of them would not have proceeded (at all or in Alabama) without the incentive program. It is also clear that the economic benefits are very small for an incentive program of this size, resulting in per-job costs that are very high. The program is certainly well-structured when compared to similar programs in other states. But this is not enough to result in an efficient and worthwhile program. Program benefits almost certainly accrue to nonresident production companies and their employees, and economic benefits at the local level are relatively small and short-lived. The state could almost certainly generate larger and more enduring economic benefits to the state with an alternative use of these taxpayer dollars that is more closely linked to stated economic development goals.

New Markets Development Program

Alabama's New Markets Development Program (NMDP) provides tax credits to investors in "qualified community development entities" (QCDEs) that provide funding for development projects in low-income areas. Alabama's program is designed to mirror the federal New Markets Tax Credit (NMTC) program, and it operates in a similar fashion to the Certified Capital Companies (CAPCO) program: third-party entities must be approved by the state to (a) receive investments from taxpayers who will receive the tax credits and (b) make the required investments in low-income communities. As with the CAPCOs, the QCDE (and not the state directly) retains ownership of equity investments.

Total New Markets tax credits granted by the Alabama Department of Commerce cannot exceed \$20 million per year. The per-project maximum investment size is \$10 million, although repayments of debt investments may be reinvested in the same entity without being double-counted. The credits amount to 50 percent of the total qualified investments, but are spread over six years (8.33 percent per year). The tax credits are non-refundable. In other words, they may not exceed the recipient's tax liability in a particular year. However, excess credits may be carried forward indefinitely. Importantly, the credits may be recaptured if any part of the federal NMTC on the qualified investment is recaptured within seven years of the original issue of the credit or if the QCDE fails to make sufficient investments in low-income communities. Finally, the credits are not saleable or transferrable.

The program's intended purpose is to direct new funding for business activity in low-income communities, as defined by the federal government. Specifically, qualifying areas must have a poverty rate in excess of 20 percent, or family median income below 80 percent of the statewide median family income (or, for metropolitan areas, the metropolitan area median family income if that is larger).

Alabama is one of 13 states with state-level New Markets tax credit programs, and two states have discontinued their programs in the last few years. A review of the existing state programs reveals that Alabama's NMDP resembles the programs in other states. Evaluations of the federal NMTC find that it has led to greater investment in low-income communities. However, the literature reveals the challenges that evaluators face in getting a clear sense of the program's efficiency and effectiveness.

First, it is not clear how much of that investment is truly new investment. Second, the lack of useful data and oversight mechanisms contribute to the overall inability to evaluate the program’s success.

Our analysis of confidential data provided by the Alabama Department of Commerce shows a total of 31 projects receiving NMDP incentives through 14 QCDEs. The credits granted totaled \$234.4 million for an average award of \$7.6 million. Total project costs for all projects were \$532.1 million. Reported jobs as of investment totaled 696 and projected jobs totaled 992. Based on projected direct employment, credit costs per job come in at \$236,297. If some of this economic activity would have taken place absent the NMDP, the costs simply skyrocket. Even under the most extraordinary assumptions regarding indirect effects, the NMDP program is a prohibitively costly program. Accounting for credit costs in the state budget compromises the returns to the NMTC further.

In principle, Alabama’s NMDP provides an important boost to low-income communities and provides several important advantages—especially much more effective geographic targeting—over some alternative economic development incentives. Unfortunately, it falls short in terms of economic impact, efficiency, and accountability. The program entails relatively high costs and, based on the available evidence, provides little market or fiscal return to the state other than the reallocation of investment into low-income communities. It is up to state officials to determine whether the limited benefits of the program are worth the costs.

Conclusion and Overall Evaluation

Alabama’s Entertainment Industry Incentive and New Markets Development programs are both designed to foster local economic development, though in somewhat different ways. Both programs involve the use of tax credits—representing foregone state revenues—to encourage a particular type of activity that will hopefully generate tangible economic activity in the form of jobs and earnings, and expand state and local tax bases. Both involve state investments without the retention of ownership stakes in recipient projects, whether those are new or existing businesses or high-profile film or television projects. Perhaps because of these similarities, our evaluation comes to similar conclusions regarding the overall value of these programs to the state of Alabama.

In our final evaluation, we recommend that both programs be considered for termination. The following table provides a concise summary of our evaluation of both programs.

Component	Entertainment Incentive Grade	New Markets Grade
Efficiency: a well-defined <i>return on investment</i> to the state of Alabama.	D	F
Transparency: clear benefits to taxpayers and costs to the state.	C	D
Certainty: defined impact on state budget and program beneficiaries.	B	C
Prospective: encourage future activity rather than reward previous decisions.	B	C
Simplicity: <i>easy to administer and easy to comply with.</i>	B	B
Targeted: focused and provided on a <i>discretionary</i> basis to promote new activity.	C	D
Protection of Public Funds: through caps or time limits on the use of credits.	B	C

Leverage: to encourage additional public or private resources.	F	B
Accountability: <i>performance-based incentives</i> should be built into the program.	D	D
Evaluation: to identify the extent to which incentives induced new activity.	D	F
Ownership: to ensure proper administration and to support a thorough evaluation.	B	D
OVERALL	D	D

Introduction

This is the third in a series of reports examining economic development incentives in Alabama. The first report provided an overall framework for evaluating incentives, in particular tax credit programs.¹ That framework was used in the second report to guide an evaluation of the state's CAPCO program and the Historic Preservation Tax Credit. In this third and final report, we bring that same framework to bear on two other tax incentive programs: the Entertainment Industry Incentive and the new Markets Development Program.

For each program, we begin with a brief history and comparison to programs in other states. We then discuss, evaluate and as possible extend the available estimates of the economic and revenue impacts of each program. Next, we turn to a point-by-point evaluation of the strengths and weaknesses of each program, using the features of good tax incentive programs that we laid out in our initial report for the Alabama Department of Revenue. Finally, we consider several available policy options and provide suggestions for improving the state's economic development efforts in these important areas.

Our evaluation considers the following general characteristics of good incentive programs:

- **EFFICIENT.** A good incentive will provide a well-defined *return on investment* to the state of Alabama.
- **TRANSPARENT.** Incentives should be *transparent* so that benefits to taxpayers and costs to the state are clear.
- **CERTAIN.** Policy *certainty* is important in terms of the magnitude and timing of tax relief for business taxpayers and the realization of tax losses that impact the state budget.
- **PROSPECTIVE.** The state should avoid *retroactive policy changes* that may penalize firms for previous investment decisions.
- **SIMPLE.** Incentives should be *easy to administer and easy to comply with*.
- **TARGETED.** Incentives should be *targeted* and provided on a *discretionary* basis in order to promote economic activity that might not otherwise take place.
- **PROTECT PUBLIC FUNDS.** *Fiscal exposure* to the state should be minimized through such constraints as annual financial caps or time limits on the use of credits.

¹ "Best Practices for the Design and Evaluation of State Tax Incentive Programs for Economic Development," January 2017.

- **LEVERAGE.** Some incentives produce a *leveraging* effect, drawing in additional resources from local government resources, private sector resources, or federal resources.
- **ACCOUNTABILITY.** *Performance-based incentives* should be built into the program.
- **EVALUATION.** Incentives should include a built-in framework for *evaluation*, which should seek to identify the extent to which incentives induced new economic activity rather than rewarding existing economic activity.
- **OWNERSHIP.** A state agency or agency partnership must *own* the incentive program to ensure proper administration and to conduct or support a thorough program evaluation.

These factors capture the essential elements of incentive programs and can be applied to incentive programs broadly, not just tax credit incentives.

Alabama's Entertainment Industry Incentive Program

Background

Dating to the passage of the Entertainment Industry Incentive Act of 2009, Alabama allows up to \$20 million per year in incentives to encourage certain media productions within the state. Qualifying productions can receive incentives in the form of an income tax rebate and an exemption from the state portion of sales, use, and lodgings taxes. A wide array of projects can qualify, ranging from motion pictures (and/or their soundtracks), documentaries, television programs (except for certain news, weather, sports, or financial programming), sound recordings, videos (including music videos), commercials, and even video games. The primary requirement is that at least some portion of the project is produced in Alabama.

While the sales, use, and lodging tax exemptions follow the usual procedure (i.e., the presentation of a tax exempt form upon purchase), the income tax incentive is a bit more involved. Specifically, the Qualified Production Company (QPC) receives an income tax credit equal to 25 percent of certain approved non-payroll production expenses plus 35 percent of payroll paid to Alabama residents. It is noteworthy that the credit is refundable; the QPC receives the full amount of the credit even if it exceeds their income tax liability. Only expenditures incurred after the project's approval may count towards the tax credit.

Projects must be of a certain minimum size in terms of production expenditures, and the minimum varies by project type. This reduces administrative costs associated with the program and helps focus resources on more visible projects that may cast a favorable light on the state. Additionally, income tax credits are capped, again subject to limits that vary by project type. Projects of any type must involve \$150,000 or more in production expenditures in the state in one year in order to receive the sales, use, and lodging tax exemptions. This is a very low threshold for in-state expenditures.

The program is managed by the Alabama Film Office, which is part of the Department of Commerce. Projects are subject to a variety of reporting requirements, including the mandatory filing of all necessary state tax forms and compliance with all applicable business and employment laws. The Film Office is also required to review each project’s progress at least twice per year. The QPC must submit a final audit to the Film Office following the completion of production in order to verify all production expenditures. Certain claw-back provisions govern the receipt of incentives in the event of unsatisfactory performance, such as when expenditures fall short of the required minimum.

Administrative records provided by the Film Office show 53 projects receiving nearly \$40 million in incentives between 2009 and 2015. The table below shows the number of projects by year, the annual limits on total incentives that have steadily increased over time, and the actual amount of incentives granted. The total amount of incentives granted in each year has typically been well below the annual limit in that year.

Fiscal Year	Projects	Incentive Limit	Incentives Granted
2009	1	\$5 million	\$144,175.02
2010	2	\$7.5 million	\$341,647.85
2011	7	\$10 million	\$3,246,883.63
2012	13	\$10 million	\$7,222,636.01
2013	9	\$15 million	\$9,299,172.33
2014	11	\$15 million	\$12,262,947.76
2015	10	\$20 million	\$8,593,999.24

Comparisons with Other States

Alabama is one of many states with a formal incentive program to attract the media production industry. Thom (forthcoming), Thom and An (2017), and Button (2016) document the sharp increase in the number of states with motion picture incentive programs over the past 20 years. Depending on the definition of program type, these sorts of incentives were virtually nonexistent before the late 1990s. According to the National Conference of State Legislatures (2016), Louisiana enacted the first state-level film and television incentive program in 1992; Button (2016) points to Arkansas as having the first program, adopted in 1983. Christopherson and Lightor (2010) attribute the initial expansion in the U.S. to a 1997 effort by the Canadian government to allow the use of tax credits as incentives for film and television production companies. Just as the Canadian provinces implemented their own programs, a few states added them between 1997 and 2003, and then the number of states increased from 5 in 2003 to more than 40 in 2009. The prevalence of incentives across the states means that it is hard for a single state to stand out as having a clear advantage in attracting productions.

The proliferation of state programs, along with revenue pressures and questions about their true economic impact, have reduced the appeal of these entertainment incentive programs in recent years. Thom (2017) shows that several states have repealed their incentive programs, stemming in part from the emergence of rather critical commentary from Luther (2010) and Tannenwald (2010), among others. The National Conference of State Legislatures (NCSL, 2016) notes that ten states ended their incentive programs since 2009 and another three have cut them back, while only three have expanded them. These policy actions signal widespread disapproval with the programs and their effectiveness.

Thom and An (2017) provide a useful examination of the forces behind the adoption and, in some cases, repeal of motion picture incentive programs. They conclude that states enacted these programs in response to rising unemployment and the spread of similar programs in other (but not necessarily bordering) states. Similarly, falling unemployment and the decline of programs in other states contributed to state actions to remove their own programs. While spending cuts in one year increased the odds of program termination in the following year, higher corporate taxes and total tax incentive spending reduced the odds of termination.

The NCSL (2016) and Button (2016) provide very useful details on each of the existing state programs. Common features, which are also present in Alabama's program, include minimum activity thresholds in order to qualify for incentives, the use of refundable (and often transferrable) tax "rebates" as the

incentive mechanism to ensure taxpayer relief, and regulations governing the definition of approved production expenses and limits. Some, but certainly not all, of the states also have per-project and/or overall caps on the dollar value of incentives.

Summarizing program rules across all states from 1980 through 2012, Button (2016) notes that most states have used some form of refundable rebate or tax credit, while another significant minority have allowed tax credits to be transferred to a third party for immediate financial benefit to the production company (less a 20-30 percent fee to the third party). All of the programs provided incentives for the employment of in-state workers, most also provided incentives for non-payroll expenditures, and about two-thirds allowed incentives for non-resident workers. Button (2016) also documents the steady increase in subsidy rates over time. The rising subsidies are likely a reflection of interstate competition for a limited number of productions.

Given the sheer number of states operating similar programs and the mobility of the industries that make use of them, it is perhaps not surprising that there appears to be a high degree of uniformity in program rules across states. Alabama's program certainly appears to be a typical state-level entertainment industry incentive program. It is also not surprising that the programs have received increased scrutiny in recent years. The NCSL (2016) summarizes the recent developments as follows:

Overall, states are increasing evaluation and oversight of film incentive programs. A number of states have performed a cost benefit analysis of their film incentive program, or require an audit before a production can receive a rebate or credit. At least 55 percent of all states offering incentives now require an audit or other verification from production companies. This percentage has increased from 38 percent in 2014. (NCSL, 2016, p. 2.)

Analysis of Economic and Revenue Impacts

As noted above, state entertainment industry incentives began to receive significant scrutiny in the mid-2000s. A series of 2010 publications seemingly put the industry on the defensive and even led some states to defund or repeal their programs. In addition to providing a very useful history of governmental efforts to attract the entertainment industry, Christopherson and Lightor (2010, p. 341) summarize the many economic impact studies and conclude that "the overwhelming majority of fiscal impact analyses of film and TV subsidy programs conclude that the subsidies have a negative impact on state revenues, particularly if they take the form of saleable tax credits." (Refundable credit programs would presumably have a similar impact.) The authors also raise several other questions that must accompany

the analysis of economic impacts from these programs. First is the question of whether some of the benefits might accrue to non-resident production companies and their employees. Second is the question of spatial equity, in the sense that most of the benefits appear to be focused on major cities and may not spill over to outlying areas. Finally, the usual “but for” question remains: how much of the activity that benefits from the incentives would have taken place without the incentive?

When it comes to assessing the broader economic impacts of entertainment industry incentive programs—the extent to which they create new jobs and/or economic activity—Christopherson and Rightor (2010) highlight the general lack of reliable data to facilitate the necessary analysis.

Employment data, for example, are often provided directly by the production companies, and it is not always clear whether workers are truly full-time vs. part-time, and in-state vs. non-resident. Only recently have states begun to require more intense auditing of production activities, expenditures, and employment.

In the end, Christopherson and Rightor (2010, p. 344) summarize the economic impact studies as follows: “Studies done by state officials, including legislative analysts and departments of revenue, all indicate a poor return on investment. In response to these fiscal analyses, industry supporters have paid for and promoted counter-studies that justify tax subsidies on the basis that broader impacts benefitting the state economy are stimulated by the subsidies.”

State entertainment industry incentives have received sharp criticism from all points on the political spectrum. Luther (2010, p. 16), writing for the fiscally-conservative Tax Foundation, offers a particularly scathing indictment of these programs, concluding that “Movie production incentives are costly and fail to live up to their promises... Among these failures, the two most important are their failure to encourage economic growth overall and their failure to raise tax revenue.” Luther (2010) calls for the states to do away with them on their own or by working together; federal action to end the state competition might be worth considering.

Tannenwald (2010, p. 1), writing for the Center on Budget and Policy Priorities, echoes Luther’s (2010) sentiments in an equally-critical overview, concluding that “claims that tax subsidies for film and TV productions...are cost-effective tools of job and income creation are more fiction than fact.” He summarizes the available research on these programs as follows:

State film subsidies are a wasteful, ineffective, and unfair instrument of economic development. While they appear to be a “quick fix” that provides jobs and business to state residents with only

a short lag, in reality they benefit mostly non-residents, especially well-paid non-resident film and TV professionals. Some residents benefit from these subsidies, but most end up paying for them in the form of fewer services — such as education, healthcare, and police and fire protection — or higher taxes elsewhere. The benefits to the few are highly visible; the costs to the majority are hidden because they are spread so widely and detached from the subsidies. (Tannenwald, 2010, p. 12.)

More recent independent academic research has taken a hard look at the potential for an enduring economic impact of these programs. Recognizing the limitations in prior studies, Thom (forthcoming) examines the effects of motion picture incentives on economic activity over the period from 1998 to 2013 using data from a variety of states and sophisticated econometric methods. His focus is on the extent to which the incentives contributed to a more vibrant motion picture industry, in the form of greater employment, wages, gross state product (GSP), or industry concentration. His study is important because it asks the question of whether the incentives contributed to the development of something that is longer-lasting than the temporary activities pursued by the production companies that receive the benefits from state programs. The approach taken is one of the best methodologies that can be used to evaluate incentives. Thom's results were mixed at best:

The preceding results offer little evidence that MPI programs paid significant dividends to states' motion picture industries. The results further suggest that program design choices are partially to blame. Eighteen MPI programs offered transferable tax credits, but this credit type had no significant impact on wages, GSP, or industry concentration and only modest effects on employment growth. Twenty-six programs offered refundable tax credits, which did not increase employment but did motivate short-term wage gains. Many programs offered sales or lodging tax waivers that had no effect on labor and economic indicators. (Thom, forthcoming, p. 11.)

Thom highlights four primary reasons for the lackluster performance of state entertainment industry incentives. First, they ignore the reality that economies of scale are difficult to manufacture outside the usual entertainment hubs of Los Angeles and New York. Second, the resulting competition between the states creates a race to the bottom and encourages rent-seeking among entertainment industry executives who are able to siphon many of the benefits out-of-state. Third, the defense of these programs is often based on imperfect or incomplete studies written or funded by the entertainment industry. Those studies often assume that no activity would have taken place without the incentives, thereby potentially over-stating the programs' impacts. Fourth, the incentives themselves might encourage inefficiency among recipients.

Button (2016) provides another recent and careful econometric analysis of the impact of these types of state-level incentives on economic activity. Specifically, he compares filming location decisions, business

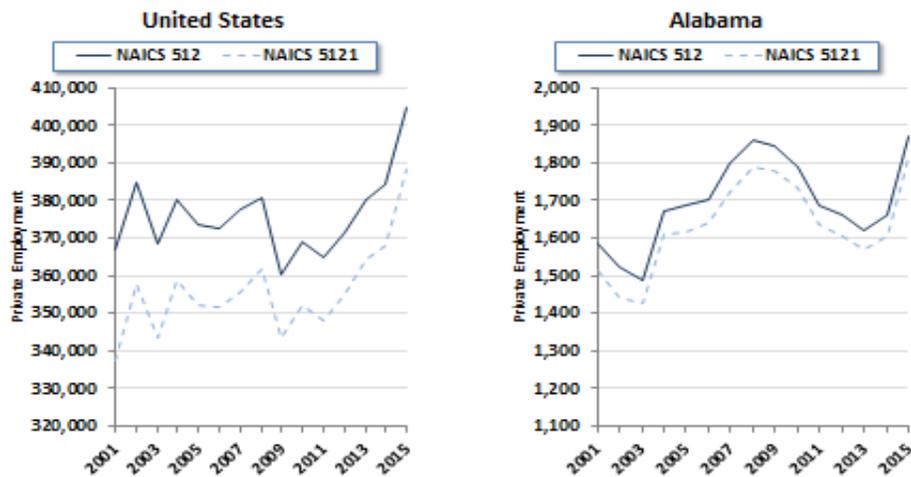
establishment location decisions, and employment in states with motion picture production incentives to similar outcomes in states that did not have incentives in place during the same period of time (1980-2012). The number of these programs, along with the variation in program rules across states, offers a useful setting for empirical analysis, especially given the mobility of the industries involved. Like Thom, Button's (2016) study is important in that it examines the extent to which these programs have generated longer-term impacts rather than transitory impacts.

Button's (2016) results are mixed, with some positive effects on certain filming locations, no effects on business establishment locations, and modest to nil impacts on employment.

I find that MPPIs increase filming of productions listed on IMDb.com and major TV series listed in the Studio System database...These effects were larger (smaller) for states with larger (smaller) existing motion picture production industries, suggesting that perhaps agglomeration effects still matter for location decisions even when they are at a smaller scale than for the industries in Greater Los Angeles and Greater New York City. However, I find no effect on major feature films listed in the Studio System database or on the total budgets of these feature films in the state. In sum, there is mixed evidence of the effect of MPPIs on filming. So even in this footloose industry, there are not necessarily effects. I find evidence of effects on employment in the motion picture production industry, but these estimates are sometimes marginally significant or insignificant and the employment increase is of a small magnitude (the average state adds about 140 employees, a 13% increase). For business establishments in the industry, the evidence consistently shows no effect. This suggests that while MPPIs can increase some filming, the translation of these filming projects into establishment increases is difficult. Broadly, this study suggests that tax incentives definitely can affect business location, but even in this extreme case of "footloose" filming, incentives can, surprisingly, have no effect. (Button, 2016, p. 29.)

The question remains as to whether Alabama's experience mirrors those in other states, as summarized by the literature to date. The following figure shows U.S. and Alabama employment levels for NAICS 512, the motion picture and sound recording sector and NAICS 5121, the motion picture and video industries sector, for 2001-2015 (2015 is the most recent year for which data are available). Both series show an upward movement in employment near the end of the time frame shown. Alabama introduced the Entertainment Industry Incentive program in 2009. Between 2009 and 2015, employment in Alabama was up just 1.3 percent in NAICS 512 and up only 1.9 percent in NAICS 5121. The comparable figures for the U.S were 12.4 percent and 13.2 percent. These descriptive data, while certainly not conclusive, offer no support for the case that the credit significantly increased film production activity in Alabama.

Motion Picture-Related Private Employment



Source: Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

Addy (2015) conducts a traditional economic impact study of the Entertainment Industry Incentive program and concludes that the program is not effective. RIMSII multipliers for the state of Alabama were used to evaluate the economic impacts and help drive estimates of state and local revenue impacts associated with the incentive program.² As is typically the case, there is no way to determine how much film activity took place because of the incentive as opposed to activity that would have taken place absent the incentive. If not all of the activity is induced by the incentive, the gross economic impacts will overstate the net benefits accruing to the state.

Addy's (2015) analysis accounts for 37 productions that span a window from August 2009 through December 2014. These films directly entailed Alabama-qualified production costs totaling \$103.9 million, 480 full-time equivalent Alabama jobs and \$8.5 million in payroll for Alabama residents. The economic impact assessment estimates that the film productions made a \$106.9 million contribution to state GDP, were associated with 742 full-time equivalent jobs, and gave rise to \$15.3 million in earnings for state residents. However, average earnings per job were only \$20,585, which is well below the statewide averages of \$42,359 and \$43,380 that prevailed in 2014 and 2015.³ Moreover, it is striking

² RIMSII multipliers are available from the U.S. Bureau of Economic Analysis. Background on the multipliers and their use is available at https://www.bea.gov/regional/pdf/rims/rimsii_user_guide.pdf

³ Bureau of Labor Statistics, Quarterly Census of Employment and Wages, https://data.bls.gov/cew/apps/table_maker/v4/table_maker.htm#type=11&year=2015&qtr=A&own=5&area=01000&supp=0 and

that the *total* earnings impact of \$15.2 million is only 57 percent of the *total* credit costs to the state. Total tax revenue associated with the 37 productions is estimated to be \$1.9 million, which includes \$1.3 million in state taxes and \$646.1 thousand in local taxes.⁴

Incentives that were granted ranged from a low of \$139,136 to a high of just over \$2.5 million, for a total of \$26.8 million for all 37 productions. The \$26.8 million total translates into \$55,874 per direct full-time-equivalent job and \$36,145 per total full-time-equivalent job associated with the productions. As noted above, it is impossible to determine how many of the productions were induced by the Entertainment Industry Incentive. In general, one would expect gross economic impacts to exceed net economic impacts because of imperfect screening of potential credit beneficiaries. If we assume that only 50 percent of the films were in fact induced, this raises the costs per direct job to \$111,748 and the costs for all jobs to \$72,290. These cost figures are in the ballpark of other state studies. For example, a recent study of film production incentives in Massachusetts showed that a net full-time equivalent job cost the state \$106,099 (Massachusetts Department of Revenue, 2016). Regardless of the assumption that is made on the magnitude of induced film activity, this is a very high price to pay for a job that provides an average salary of only \$20,585.

Two alternative dimensions of net impact should be considered when evaluating the costs and benefits of an incentive program, as discussed in our initial report. The first takes into account the new revenue associated with assisted activity allowing a comparison against credit costs. The second considers credit costs, revenue benefits, public service delivery costs, and the budget position of the state. We address each of these in turn.

The first calculus considers the rate of return to the state and local governments as measured solely by generated tax receipts versus the cost of the tax credit. During the period covered by Addy (2015), the state invested \$26.8 million into the incentive program in exchange for just \$1.3 million in state revenue and \$646.2 thousand in local government revenue, yielding a net loss of nearly \$25 million. Gross state and local revenue per direct job is only \$3,993 in comparison to credit costs of \$55,874 per job. For total employment, gross state and local revenue is just \$2,583 per job versus \$36,145 in incentive costs per

https://data.bls.gov/cew/apps/table_maker/v4/table_maker.htm#type=11&year=2015&qtr=A&own=5&area=01000&supp=0.

⁴ The report also provides upper-bound estimates of associated revenues that account for taxes that accrue to the state from non-resident production workers and in-state businesses that support film productions. We ignore these figures here because of the likely small scale of the effects. For non-resident workers, the only taxes that would be broadly affected would be sales and various excise taxes.

job for a net loss of \$33,562 for each job associated with the productions. A broader financial cost-benefit calculus includes private sector returns (earnings of \$15.2 million) as well as public sector returns (tax revenues amounting to \$1.9 million) from film productions. Together these financial returns total \$17.2 million. In contrast, the state spent \$26.8 million on incentives, reflecting a net loss of \$9.6 million. If not all of the productions were induced by the Entertainment Industry Incentive, the losses to the state would be more pronounced. Under all possible scenarios, the state sees a net loss in revenue. This revenue loss requires some combination of service delivery cuts and/or tax increases in order to maintain budget balance for the state.

The final consideration is the net fiscal cost to the state and local governments, accounting for credit costs, new revenue impacts, and public service expenditures. Film and other entertainment production activity is unique since it represents the short-term presence of production crews and related payroll and non-payroll spending, ideally building on in-state production resources and supply chains. The short-term presence of nonresident workers and production activity typically does not impose significant costs on the state and its local governments. For nonresidents, public service delivery costs would generally be very small. On the other hand, there may be Alabama residents who are employed in the state's ongoing motion picture and sound production industry that have their jobs supported by the credit. For these individuals and their families, the incentives mean the loss of ongoing revenue to fund essential public services, including relatively costly elementary and secondary education.⁵ The consequence is that taxes must rise to make up for any foregone revenue, which would have negative effects on state economic activity, or the state would have to reduce spending, which would also be contractionary.

The Massachusetts Department of Revenue (2016) demonstrates the importance of taking into account the tax expenditures associated with a film credit tax incentive. Their analysis simply assumes that the foregone revenue associated with the incentive leads to reduced state spending. While there are positive gains associated with the industry's use of the credit to spur productions, part of this stimulus gain is offset through reduced state expenditures which also ripple across the state. In Massachusetts, gross employment impacts associated with the film credit program totaled 2,007, but 743 jobs were estimated to be lost through reduced state spending, yielding net job creation of only 1,264.

⁵ In 2014, elementary and secondary costs per pupil were \$9,028. See <http://www.governing.com/gov-data/education-data/state-education-spending-per-pupil-data.html>.

We follow a similar approach here. The starting point is the \$26.8 million in film credits granted to the industry as of Addy's (2015) analysis. This represents foregone revenue that would otherwise have been used to provide services to residents of the state. If it is assumed that public sector spending declines by \$26.8 million, this would translate into 518 fewer jobs in Alabama.⁶ Some of these lost jobs would be in state government, others would be in vendor establishments, while others would be lost through the ripple effects of the multiplier process. Addy estimated 742 total jobs associated with Alabama's credit program for the productions he examined. Even if all of these jobs were induced by the credit program, the implied net job gain to the state would be only 224. This places the net cost per job at \$119,731.

The Addy report was released in June, 2015 and did not account for 16 productions that have since been completed. These productions and their economic profile are presented in Table 1. As shown, total qualified expenditures for these projects in Alabama were \$48.7 million, qualified payroll expenditures were \$31.1 million, and Alabama full-time equivalent employment was 322.⁷ A total of \$12.8 million in tax credits was tied to the productions.

We have undertaken a basic economic impact assessment of these 16 productions, using the most recently-available RIMSII multipliers for Alabama, following the general procedures of Addy (2015). The analysis is summarized in the table below. Application of the multipliers produces a gross output impact totaling \$29.0 million, 520 full-time-equivalent Alabama jobs, and \$12.4 million in earnings that accrue to Alabama residents.

To estimate revenue impacts for the state and local governments, we use data from Addy (2015). Specifically, we start by calculating the ratio of estimated state taxes to estimated earnings and estimated local taxes as a share of estimated earnings. We then apply these ratios to our estimates of earnings to arrive at the revenue impacts for the state and local governments. This procedure yields

⁶ To arrive at this estimate, we use the RIMSII final demand employment multiplier for Alabama's "other services" sector which accounts for government activity. We ignore the \$1.3 million in state revenue associated with film productions in these calculations. While this represents a benefit arising from economic activity associated with the productions, the reductions in state spending to support the tax credit program would lead to reduced state tax collections.

⁷ In order to estimate full-time equivalent employment, we use an updated measure of earnings for the state's motion picture and sound recording sector (NAICS 512) of \$19,978 for 2015; Addy's earlier figure was \$17,655. The 2015 figure was taken from the Bureau of Labor Statistics, Quarterly Census of Employment and Wages, available at https://data.bls.gov/cew/apps/table_maker/v4/table_maker.htm#type=2&st=01&year=2015&qtr=A&own=5&ind=512&supp=0.

total taxes amounting to \$1.6 million, with just over \$1 million accruing to the state and \$525.2 thousand accruing to local governments.

These estimates allow a complementary assessment of the Entertainment Industry Incentive program following the steps employed above. Total credits for the 16 more recent productions amounted to \$12.8 million. This means that each full-time-equivalent direct job cost the state \$39,799 and each total job cost \$24,645. These figures are smaller than those presented in Addy (2015), reflecting 56 percent more jobs per production and 76 percent higher earnings per production. If it is assumed, as above, that only 50 percent of the productions were induced by the incentive, then the net costs per direct job double to \$79,598 and the net costs per total job double to \$49,290. While one might quibble with this assumption, it highlights how non-induced, credit-supported productions inflate the per-job costs of the tax credit.

Factoring in the revenue associated with the productions means a net loss to the state of \$11.8 million and a net loss to state and local governments amounting to \$11.3 million. While these more recent productions appear to be less costly to the state, the price per job—especially in light of the low salaries—is still very high. The attractiveness of the program does not improve when we account for private sector gains in the form of earnings. Earnings tied to the 16 productions, plus state tax revenues, totals \$14.0 million, just \$1.2 million more than the cost of the credits to the state.

Finally, we consider the impact of reduced state government spending because of the tax expenditure associated with the \$12.8 million in credits extended to the industry. The reduction in state spending leads to the loss of 248 jobs to the state both directly and indirectly (including multiplier effects).⁸ Using the estimate of 520 jobs presented above, this measure of impact implies a net gain of only 272 jobs.

⁸ The job losses would be spread across the years for which the credits are applied.

Table 1: Gross Economic Impacts from the Latest Sixteen Productions

Output Impact

Direct Production Spending	\$24,022,657
Indirect Spending	<u>\$12,261,164</u>
Total Output Effect	\$36,283,821

Employment Impact (FTEs)

Direct Jobs	322
Indirect Jobs	<u>198</u>
Total FTE Jobs	520

Earnings Impact

Direct Earnings	\$6,442,991
Indirect Earnings	<u>\$5,972,008</u>
Total Earnings	\$12,414,999

Revenue Impact

Total State Taxes	\$1,032,928
Total Local Taxes	<u>\$525,154</u>
Total State and Local Taxes	\$1,558,082

Evaluation of Alabama's Entertainment Industry Incentive Program

In this section, we evaluate the program in accordance with the features outlined above and discussed in greater detail in our initial report. For each component, we provide a brief discussion of advantages and disadvantages, and we also provide a letter grade. We combine the component-specific letter grades at the end into a composite overall evaluation grade, which reflects our own views of the relative importance of each component.

Efficiency

At the heart of the issue of efficiency is whether the estimated economic benefits (jobs and investment impacts, etc.) are worth the costs in terms of foregone tax revenues. On one hand, the refundability and non-transferability of the tax rebates increases the overall value of the program to recipient production companies and therefore increases the potential for a noticeable impact. On the other hand, it is not at all clear how much of the activity that benefits from this program would have taken place without the incentives. One cannot observe the counterfactual (i.e., the world without the incentive program), and one cannot simply ask the production company if they would have proceeded without the benefits. With these caveats in mind, it seems likely that at least some portion of the activity would have occurred even without the program in place.

While the limits on annual incentives puts the state in the difficult position of possibly having to pick winners and losers, the fact that the annual totals of incentives actually granted falls well below the annual limits reveals that this is almost certainly not the case. The possibility remains, of course, that worthy projects might either choose not to apply for the incentives, might not be aware of them, or might simply be too small to qualify. This is unlikely given the prevalence and generosity of these incentive programs.

Perhaps the worst efficiency-related outcome of state entertainment industry incentive programs is that they pit the states against each other in a high-stakes competition for highly-mobile activity. This almost certainly results in a significant portion of the benefits going to out-of-state entities and does not leave a lasting economic impact in any particular filming location. While the Historic Rehabilitation Tax Credit program results in renewed structures of historical significance, the only realistic hope with the Entertainment Industry Incentive Program is for a short-term blip in employment and economic activity in the vicinity of the production activities. To be sure, certain productions can bring indirect advertising, visibility and prestige effects that might increase tourism or general interest in an area, but those effects are exceedingly difficult to quantify.

GRADE: D

Transparency

It is important for tax incentive programs to be transparent, such that benefits to taxpayers and costs to the state are clear. While the program rules and requirements are certainly clear, the selection of approved projects and the scale of their production activities and allowable incentives are not publicized. The well-documented lack of transparency with these types of programs makes it difficult for policy makers and the public to see their full impact. In the worst-case scenario, program administrators can take advantage of the lack of transparency for personal gain (see, for example, Luther's (2010) account of the scandal that emerged with Iowa's program). While it is fortunate that Alabama's program appears to have very tight rules, including the need for a post-production audit of final expenditures, these and other related documents are not available for public review.

GRADE: C

Certainty

The annual allocation and the refundable nature of the tax credit rebates increase the certainty for both the state and for qualifying production companies. The state knows how much revenue is at stake at the beginning of each project (subject to approved changes and the final audit report), and the annual cap on total incentives protects the state from larger negative revenue impacts. Qualified production companies also gain significant certainty since program rules are well-publicized and incentives are approved in advance. As with any incentive program, the possibility remains for actual production expenditures to stray from the initially-approved amounts and categories in meaningful ways. Fortunately for Alabama, there are numerous provisions governing the awarding of incentives in the event of these sorts of changes.

GRADE: B

Prospective

A good tax incentive rewards firms for future changes that benefit the broader economy, rather than rewarding (or even penalizing) them for past behavior. This maximizes the program's chances of spurring new activity directly in response to the incentive, rather than pouring valuable state resources

into activity that would have taken place anyway. The Entertainment Industry Incentive Program is prospective in that only expenditures incurred after the granting of incentives may qualify for the tax credits. As with the Historic Rehabilitation Tax Credit program, it is important to note that the induced economic activity and resulting benefits to the state typically accrue well in advance of the actual claiming of the tax credits themselves.

GRADE: B

Simplicity

While this program may appear to be rather complex on first reading, the fact that most states have similar programs makes the complexity less of a problem for firms. It is likely that seasoned production companies have little to no difficulty in navigating the program requirements, and it is also likely that the magnitude of the incentives provides more than sufficient compensation. The complexity in this program is absolutely necessary, in that it improves the state's ability to target incentives to worthwhile projects that are large enough to have meaningful impacts. The various requirements also serve to protect the state from some of the weaknesses that have troubled programs in other states. One notable example is the requirement of a post-production audit of expenditures.

On the other hand, the program's complexity might keep some worthwhile projects from pursuing benefits for which they might be eligible. It also might result in smaller production companies needing to expend precious resources on legal and accounting assistance that might not otherwise be needed.

GRADE: B

Targeted

Good incentives for economic development should be targeted and provided on a discretionary basis in order to maximize return on investment and generate new activity that would not have otherwise taken place. On the surface, this program is very well targeted and limited. Production companies must meet a variety of requirements in order to be eligible for assistance, and per-project and overall limits increase the state's ability to direct resources to the most worthwhile projects. The program is blind to geography, however; there does not appear to be a mechanism in place to ensure the fair distribution of

benefits across the entire state, and most of the activity appears to be concentrated in a few larger cities. While the program is targeted, it also translates into an entitlement program for production companies that meet program parameters.

GRADE: C

Protection of Public Funds

A good incentive program should minimize fiscal exposure by limiting the size of the program, limiting the time period for use of the incentives, and/or limiting each project's allowable incentive amount. Alabama's Entertainment Industry Incentive Program includes these features, and while we are generally not supportive of these programs in general, Alabama's program appears to have learned some valuable lessons from the programs in other states. Even though the state seems to have one of the better programs, the question remains as to whether this use of up to \$20 million per year is having the desired effects on economic development in the state.

GRADE: B

Leverage

Leveraging is the extent to which a tax credit program draws in complementary resources from elsewhere to support the targeted activity. In the case of entertainment industry incentives, no similar national program exists. Additionally, the states appear to be in constant competition for the most mobile production activities. No apparent opportunities for leverage exist with this program. While some in-state resources may be used to support production activity, there is no evidence of net gains surfacing in the targeted industry.

GRADE: F

Accountability

Recipients of economic development incentives should generally demonstrate accountability in the use of public resources. In practice this can be achieved, at least in part, through performance-based incentives and claw-back provisions that maximize the chances for positive economic impacts and returns on state tax credit investments. While Alabama's program includes important claw-back provisions, the general lack of reporting and data (which has been the case in most states) inhibits careful monitoring. On the plus side, the post-production audits enhance accountability to the Film Office. On the negative side, the public does not have access to any of these audit reports nor other program data.

GRADE: D

Evaluation

In some respects, a sound evaluation system is the most important feature of a good incentive program. Sound evaluations help determine program effectiveness and thus efficiency, and lessons can be learned that ripple across other elements of a good incentive program. It is noteworthy that the Film Office contributed to the evaluation of this program by Addy (2015). But the Film Office has the appearance of an advocacy organization. External evaluations such as the present document should be a regular and ongoing component of any incentive program. The enabling legislation for the Alabama Entertainment Industry Incentive Program does not require any sort of regular evaluation or reporting.

GRADE: D

Ownership

It is reasonable to house this incentive program within the Department of Commerce, and specifically with the Alabama Film Office. Their interests are well-aligned with the intent of this program. That said, as noted above, it is important to separate the program administration function from the evaluation and monitoring functions.

GRADE: B

Overall

The Alabama Entertainment Industry Incentive Program is associated with a number of production activities, but it is not clear how many of them would not have proceeded (at all or in Alabama) without the incentive program. It is also clear that the economic benefits are very small for an incentive program of this size, resulting in per-job costs that are very high. The program is certainly well-structured when compared to similar programs in other states. But this is not enough to result in an efficient and worthwhile program. Program benefits almost certainly accrue to nonresident production companies and their employees, and economic benefits at the local level are relatively small and short-lived. The state could almost certainly generate larger and more enduring economic benefits to the state with an alternative use of these taxpayer dollars that is more closely linked to stated economic development goals.

Grade: D

Suggestions for Improvement or Replacement

Under the assumption that complete elimination of state-level incentives is not likely, Thom (forthcoming) offers several suggestions for potential improvements. One is to explicitly link incentive programs to the state's economic development goals. Another is to carefully design incentive programs to better align the interests of recipient organizations with the state's interests. This can be accomplished via structured performance-based payment schedules rather than up-front transferrable or refundable credits, and claw-back provisions (as in Alabama's program).

Options for piecemeal reform are dependent on the policy goal:

- To reduce the financial costs of the Entertainment Industry Incentive, simply reduce the amount of in-state expenditures that are qualified for relief.
- To increase the financial returns to the state, require revenue sharing with film companies.
- To reduce credit costs while maximizing marketing potential, screen and confine access to the credit to larger film productions.

- To grow grassroots activity in the motion picture and sound recording sector, focus incentives on the creation of private capital investments, human capital investments and jobs in the state's ongoing industry.

The Entertainment Industry Incentive program entails very high costs relative to tax returns to the state and local governments as well as in terms of broader financial returns that account for tax revenues and earnings that accrue to the private sector economy. If the goal is to create jobs, earnings and tax revenues, the program is a failure. A complementary goal of the incentive program is presumably to serve as a public relations branding tool that will raise awareness of Alabama and its many strengths. It is not at all clear how effective the program is in realizing this goal. Given this goal, it may be better to utilize a dedicated national marketing campaign, perhaps in conjunction with the state's ongoing programs administered by the Alabama Tourism Department. Such a policy path would build on the ongoing activities and expertise in marketing the state to non-residents.

The broad and diffused tax and spending functions of the state budget are not well suited to promoting film productions and related activity in the state. However, alternative uses of film credit resources could have a larger impact on the state's path of economic development. In particular, these resources could be reallocated toward education and infrastructure investments that lay a stronger foundation for private sector activity.

Alabama’s New Markets Development Program

Background

Alabama’s New Markets Development Program (NMDP) began with the enactment of the New Markets Development Act in 2012. This program provides tax credits to investors in “qualified community development entities” (QCDEs) that provide funding for development projects in low-income areas. Alabama’s program is administered by the Department of Commerce and is designed to mirror the federal New Markets Tax Credit (NMTC) program, which has operated since 2000 to “increase the flow of private sector capital to communities long overlooked by conventional lenders” (New Markets Tax Credit Coalition, 2016, p. 5).⁹

The NMDP operates in a similar fashion to the Certified Capital Companies (CAPCO) program: third-party entities must be approved by the state to (a) receive investments from taxpayers who will receive the tax credits and (b) make the required investments in low-income communities. Specifically, a QCDE finds the taxpayers who make the investments and receive tax credits, and then the QCDE invests the funds in approved projects at the local level. As with the CAPCOs, the QCDE (and not the state directly) retains ownership of equity investments, and certain long-term debt instruments may be used in addition to the usual equity investments.¹⁰

Total New Markets tax credits granted by the Alabama Department of Commerce cannot exceed \$20 million per year. The per-project maximum investment size is \$10 million, although repayments of debt investments may be reinvested in the same entity without being double-counted. The credits amount to 50 percent of the total qualified investments, but are spread over six years (8.33 percent per year). The tax credits are non-refundable. In other words, they may not exceed the recipient’s tax liability in a particular year. However, excess credits may be carried forward indefinitely. Importantly, the credits may be recaptured if any part of the federal NMTC on the qualified investment is recaptured within seven years of the original issue of the credit or if the QCDE fails to make sufficient investments in low-income communities. Finally, the credits are not saleable or transferrable.

⁹ Marples and Lowry (2016) provide a useful overview of the federal New Markets Tax Credit program.

¹⁰ Ely and Long (2012) and Swann, et al. (2013) provide a useful overview of the program.

The program's intended purpose is to direct new funding for business activity in low-income communities, as defined by the federal government. Specifically, qualifying areas must have a poverty rate in excess of 20 percent, or family median income below 80 percent of the statewide median family income (or, for metropolitan areas, the metropolitan area median family income if that is larger). Federal regulations govern the types of businesses that can receive NMDP investments, and recipients may be non-profit entities.

Comparisons with Other States

Alabama is one of 13 states with state-level New Markets tax credit programs.¹¹ Another three states are considering legislation to create similar programs. The U.S. Government Accountability Office (2014), citing the same source on an earlier date, reports that 15 states had state-level NMTC programs at the time of their report. This suggests that two states have discontinued their programs in the last few years. Only three of the 13 state NMTC programs have defined sunset dates as indicated in the tally of state program elements posted by Novogradac & Company, although other state regulations may govern the program end-dates in other states.

A review of the existing state programs reveals several common features. All but one state have an annual limit on the amount of tax credits or qualifying investments that may receive support, and all but three states have per-project limits. Alabama's limits are near the middle of the distributions for each. All but one state have specified time periods during which credits may be used, with most following a similar 7-year schedule as the federal NMTC. The amount of the credit varies across the states, with eight states using the same 39-percent credit as the federal NMTC, and the others at 45 percent (1 state), 50 percent (Alabama), or 58 percent (three states). Rules defining qualifying projects generally follow federal rules, but many states have added their own requirements and restrictions. Importantly, all of the states with NMTC programs allow for the recapture of tax credits in certain situations. In sum, Alabama's NMDP resembles the programs in other states. Aside from the relatively large 50 percent credit, Alabama is not an outlier in any meaningful way.

¹¹ Novogradac & Company, LLP, provides an up-to-date listing of state New Markets Tax Credit programs at <https://www.novoco.com/resource-centers/new-markets-tax-credits/application-allocation/state-nmtc-programs>.

Analysis of Economic and Revenue Impacts

Our analysis of confidential data provided by the Alabama Department of Commerce shows a total of 31 projects receiving NMDP incentives through 14 QCDEs.¹² The businesses are located in 17 different counties, with most counties having only one recipient entity. A few counties contain multiple recipients, led by Jefferson County (Birmingham) with 10 of the 32. An additional five are in Mobile (Mobile), while Dallas (Selma) and Tuscaloosa (Tuscaloosa) Counties have two each. The remaining 13 businesses are located in 13 other counties.

The federal NMTC has been extensively studied and evaluated, both by government organizations and by advocacy organizations. Among the various government reports are a series of mandatory reports from the U.S. Government Accountability Office (2004, 2007, 2010, 2014) and an Urban Institute report prepared for the department that is responsible for administering the program (Abravanel, et al., 2013). On the advocacy side, the New Markets Tax Credit Coalition issues annual progress reports (most recently in 2016). While these national reports are not necessarily indicative of the strengths and weaknesses of Alabama’s program, similarities between the federal and state programs make the findings useful as we consider the basic structure of the state’s NMDP.

All of these evaluations of the federal NMTC find that it has led to greater investment in low-income communities. However, the titles of the four reports from the U.S. Government Accountability Office—reports that were required in the enabling legislation for the federal NMTC or as a follow-up to the initial program—are indicative of the challenges that evaluators face in getting a clear sense of the program’s efficiency and effectiveness:

- 2004: *New Markets Tax Credit Program – Progress Made in Implementation, but Further Actions Needed to Monitor Compliance*
- 2007: *Tax Policy – New Markets Tax Credit Appears to Increase Investment by Investors in Low-Income Communities, but Opportunities Exist to Better Monitor Compliance*
- 2010: *New Markets Tax Credit – The Credit Helps Fund a Variety of Projects in Low-Income Communities, but Could Be Simplified*

¹² One additional project was approved but did not receive funding.

- 2014: *New Markets Tax Credit – Better Controls and Data Are Needed to Ensure Effectiveness*

Themes from the four GAO reports are that the program has resulted in investment in low-income areas, but it is not clear how much of that investment is truly new investment. The reports continually point to the lack of useful data and oversight mechanisms as contributors to the overall inability to evaluate the program's success.

One early report prepared to assist the State of Alabama with its new program highlighted the general lack of data to enable necessary oversight and evaluation in other states:

One of the problems with state new markets tax credit programs is that most of the states do not have any mechanism in place to track the effectiveness of the state-level programs. Two of the states included in this report were contacted by the authors and the directors said they did not keep that kind of data because it was not required by the state law that authorized the state NMTC. This makes it difficult, if not impossible to determine how many jobs were created or how much money was attracted for investment due to the state-level credits...State legislatures should establish procedures that require state economic development offices to measure the effectiveness of the state-level NMTC in terms of jobs created, investment dollars attracted, square footage improved, property tax base increase, or other appropriate measure (Hardin and Noland, 2011, pp. 9-10).

As with any economic development incentive, the major question involves the extent to which the investment activity is truly new, or would have occurred even without the incentive program in question. Marples and Lowry (2016, p. 6) conclude that "to date, only one study has empirically assessed the question of whether NMTC investment is funded through shifted investment or whether it represents new investment." That study, by Gurley-Calvez, Gilbert, Harper, Marples, and Daly (2009), provided an econometric analysis of investor-level data and concluded that only a small portion of the NMTC investments represented truly new investment. Specifically, they find that individual investments (which make up only about five percent or less of total NMTC investments) represent largely new investments, while corporate investments replace other investments that would have been made otherwise. The authors characterize their main conclusion as follows:

The large positive effect for individuals and the no effect for corporate filers are consistent with a scenario where individuals and corporations have different motivations for investing. For individuals, involvement in the NMTC might represent a departure from their normal investing activities as funds are used to benefit specific low-income communities. Individuals might place a high value on the opportunity to make a difference in local communities. Most corporate investors, in contrast, are large financial institutions that already invest in lower income areas because of CRA requirements, and might simply be shifting investments from one community to

another or even participating in some of the same investments that they would have funded absent the NMTC. (Gurley-Calvez, et al., 2009, p. 393.)

Unfortunately, we have no idea of the extent to which investors in Alabama's NMDP are individuals or corporations. Regardless, NMTC programs are designed to increase the amount of investment in low-income areas. Even if little to no *new* investment is actually created by the program, the redirection of investment activity from relatively higher-income areas to relatively lower-income areas could be viewed as a success of the program.

Freedman (2012) provides an econometric analysis of the impacts of NMTC programs on low-income neighborhoods and finds slightly more positive results. Specifically, he compares Census tracts that are just barely eligible for NMTC investments with similar tracts that are just barely ineligible in order to isolate the program impacts, under the assumption that the two types of areas would have had similar outcomes in the absence of the program. He finds that "poverty and unemployment rates fall by statistically significant amounts in tracts that receive NMTC-subsidized investment relative to similar tracts that do not" (Freedman, 2012, p. 1000). He also finds slightly greater household turnover in recipient tracts, suggesting that at least part of the effect is driven by changes in neighborhood composition rather than entirely by improvements to existing residents. Freedman (2012, p. 1013) concludes that "while there appear to be some positive effects of subsidized investment in disadvantaged neighborhoods, the benefits associated with subsidized investment are modest."

Harger and Ross (2016) use similar methods to Freedman (2012) to investigate the extent to which the NMTC has resulted in the sorting of industries across Census tracts. Given that NMTC benefits tend to be concentrated in certain industries (especially retail), it is reasonable to expect those industries to grow relatively faster in (or at least be attracted into) eligible tracts while other industries might do better elsewhere. The authors indeed find evidence of statistically significant industrial sorting, especially benefiting retail and manufacturing in NMTC-eligible tracts. They attribute these general results to firms in industries that have received more NMTC benefits being able to outbid firms in other industries for scarce land in NMTC-eligible tracts.

Rubin and Stankiewicz (2005, p. 2) were among the first to raise the concern "that the program was vulnerable to excessive compensation of private investors at the expense of a greater community economic development impact." More recently, the Nevada Policy Research Institute responded to lobbying efforts to support a NMTC program in Nevada by stating that "an obvious concern about the

program, then, is that it attracts investors seeking to capitalize on the tax credit itself—rather than on an actual return on investment” (Austin, 2013, p. 165).

The over-arching question is whether the tax credits, which are easier to implement politically and also insulate the investment process from overt political influence by placing the investment decisions in the hands of third-party QCDEs, represent the most efficient use of public funds. A direct place-based grant program, for example, could generate more local investment for the same allocation of funds, if it avoided the necessity of providing a return on investment for private investors and overhead expenses for QCDE managers.

Again, the question remains as to whether Alabama’s NMDP experience has mirrored those in other states, as summarized above. Unfortunately, available data are insufficient to enable a careful econometric analysis or a detailed spending-based economic impact assessment of the NMDP.¹³ We have used the data that are available to provide a high-level overview and cursory evaluation of the program and its returns to the state of Alabama. Key characteristics of the NMDP are shown in Table 2 below. A total of 31 credit awards were granted under the program. The credits granted totaled \$234.4 million for an average award of \$7.6 million. Total project costs for all projects were \$532.1 million. Reported jobs as of investment totaled 696 and projected jobs totaled 992. There were 1,331 total jobs in 2015 for the 29 firms that reported employment levels for the year, though not all of these are tied to the NMDP. These jobs might reflect employment of people who live within the region of assistance, but could also reflect out-of-region residents who commute to their jobs.¹⁴

As shown in the table, the jobs associated with the NMDP are very expensive to the state, regardless of which measure of employment is used. The total credit value per direct job as of investment is \$336,792. Based on projected direct employment, credit costs per job come in at \$236,297. The most favorable portrayal of the program considers all firm employment that was reported in 2015, producing a somewhat lower cost per job figure of \$176,113. This generous perspective attributes *all* firm

¹³ Econometric analysis would require more than 32 observations on the number of NMDP credits, as well as a longer window of post-receipt time, to fully evaluate how the credits may have changed the economic conditions of recipient areas. The minimum data needed to conduct a detailed economic impact assessment include employment, associated payroll spending, and non-payroll spending that is incurred in the state. For examples, see Addy (2015) or the impact assessment undertaken in this report on the Entertainment Industry Incentives Program.

¹⁴ Freidman (2015) notes that this can be a problem with place-based programs of assistance.

employment to the credit program and the costs remain very high. If some of this economic activity would have taken place absent the NMDP, the costs simply skyrocket.

Table 2: New Market Tax Credit Award Characteristics

Tax Credit Recipients	31
Total Value of Credits Granted	\$234,407,019
Total Reported Project Value	\$532,067,770
Average Value of Credits Granted	\$7,561,517
Jobs as of Investment	696
Projected Jobs	992
Jobs Reported, 2015	1,331
Total Credits/Jobs as of Investment	\$336,792
Total Credits/Projected Jobs	\$236,297
Total Credits/Jobs Reported, 2015	\$176,113

Even under the most extraordinary assumptions regarding indirect effects, the NMDP program is a prohibitively costly program. For example, if all firm employment is attributed to the credit (1,331 jobs) and the employment multiplier is assumed to take on a very high value of 4.0, total employment would be 5,324.¹⁵ The credit costs per job would still be \$44,028.

Accounting for credit costs in the state budget compromises the returns to the NMTC further. If state spending is reduced by the \$234.4 million in credit costs, the state would lose as many as 4,531 jobs.¹⁶ As noted above in the context of the film credit, these jobs would be lost in state government, in firms that provide goods and services to the state, and in the array of business sectors that capture spending from the multiplier. This would yield net job creation of only 793 (or 5,324 minus 4,531).

¹⁵ A RIMSII direct effect employment multiplier of 4.0 is very high compared to most sectors of the Alabama economy. Based on 63 broad industry groups, only two sectors—paper manufacturing and chemical manufacturing—have employment multipliers greater than 4.0.

¹⁶ As above, we use the most-recently available Alabama RIMSII employment multiplier for other services which includes the government sector. These job losses would be spread across the years for which credit costs are incurred.

Evaluation of Alabama's New Markets Development Program

We now present a point-by-point evaluation of the New Markets Development Program using our established criteria. As with the Entertainment Industry Incentive Program evaluation above, we provide component-specific letter grades which are combined into a composite letter grade based on our evaluation of the relative importance of each component.

Efficiency

At the heart of the issue of efficiency is whether the estimated economic benefits (jobs and investment impacts, etc.) are worth the costs in terms of foregone tax revenues. The discussion above raises serious questions regarding market and revenue returns to the state of Alabama. Despite several efficiency advantages over other possible approaches to capital promotion at the state level, our view echoes the theme from our evaluation of the CAPCO program, in that this arrangement is woefully inefficient from the state's perspective.

GRADE: F

Transparency

It is important for tax incentive programs to be transparent, such that benefits to taxpayers and costs to the state are clear. On one hand, the costs to the state are fairly obvious, in that the total amount of NMDP credits is limited to \$20 million per year. On the other hand, in terms of generated impacts, it is not obvious to the casual observer whether the program generates meaningful economic benefits. This relates to the non-public nature of project-level data, and the complex nature of economic impact analysis as described in detail above.

A key advantage of most state NMTC programs, including Alabama's, is that it is relatively heavily insulated from political influence. Once the state approves a QCDE, the specific decisions over where to invest capital lie entirely with the QCDE (subject to state rules and regulations, of course) and not directly with state officials. While this importantly removes some—but perhaps not all—political pressure from the selection of recipient companies, the tradeoff is that it also limits transparency in a very significant way, as with the CAPCO program (DiSabatino, 2012 and Krumm, 2010).

The lack of detailed project-level data on recipient companies and their resulting investments and jobs, along with the absence of any public reporting of any kind, compromises opportunities for public oversight and precludes meaningful evaluation. It also raises the possibility that some of the investment may actually be taking place across state lines (Doran and Bannock, 2000).

GRADE: D

Certainty

One advantage of the use of tax credits for Alabama's NMDP program is that the revenue impact is potentially more stable than other tax incentives, such as income tax credits (Krumm, 2010). While this does not entirely remove the uncertainty with regards to the timing of credit claims by taxpayers, it greatly reduces it, allowing the state to more clearly anticipate the revenue impact at least across years. The limited nature of the credits also smooths out the revenue impact over time, especially relative to a direct investment program in which all of the necessary capital would be needed up front. Like CAPCO, the NMDP structure is such that taxpayers provide the up-front capital and then generate a relatively steady and predictable stream of credits that reduce state revenues over a period of several years (Barkley, Markley, and Rubin, 2001, and Krumm, 2010).

The evaluation of the Alabama NMDP program on this dimension is certainly mixed. It provides necessary certainty in some areas (e.g., anticipated total revenue impact and diminished up-front impact) while suffering from a lack of certainty in other areas (e.g., the timing of that impact on annual state budgets).

GRADE: C

Prospective

A good tax incentive rewards firms for future changes that benefit the broader economy, rather than rewarding (or even penalizing) them for past behavior. This maximizes the program's chances of spurring new activity directly in response to the incentive, rather than pouring valuable state resources into activity that would have taken place anyway. It is not clear whether Alabama's NMDP policy adequately limits investments to new activity that would not have otherwise taken place.

GRADE: C

Simplicity

It would be difficult to argue that the Alabama NMDP is too complex for participating organizations such as entities making the investments and receiving the tax credits and the QCDEs themselves. The program is also quite simple for the state to administer, as it only requires annual reporting from a relatively small number of QCDEs to the state. The various linkages to the federal NMTC enhance the overall simplicity of the program by taking state officials out of the decision and definition process for many of the key players involved. On the other hand, the program is not straightforward for policy makers and the public to understand. In some sense, the program's rather costly complexity could be beneficial if it allows the QCDEs to operate free of political influence.

GRADE: B

Targeted

Good incentives for economic development should be targeted and provided on a discretionary basis in order to maximize return on investment and generate new activity that would not have otherwise taken place. Targeting allows the screening of possible recipient organizations, and therefore in principle allows QCDEs to focus their capital on higher-return entities. While this may increase the costs of running the program, it also reduces the revenue cost to the state (relative to a broader-based entitlement-style program). Alabama's QCDE program is certainly targeted in terms of the written statutes behind the program, and the available data suggest that the qualifying investments are taking place in low-income communities, as intended. However, serious questions remain as to whether the investment dollars are new and are being distributed widely and fairly enough across the state, and whether the complex structure of the program might in some way prevent the most worthy projects from receiving funding.

GRADE: D

Protection of Public Funds

A good incentive program should minimize fiscal exposure by limiting the size of the program, limiting the time period for use of the incentives, or limiting each project's allowable incentive amount.

Alabama's NMDP appears to stack up rather well on this dimension, given the overall caps on available tax credits, requirements surrounding the investment of capital, and other constraints and limitations within the program. The limitation on the total amount of tax credits provides an upper bound on the program's cumulative direct revenue impact.

That being said, the tax credits used to finance these programs reduce state tax revenue which, assuming no corresponding spending reductions or revenue increases elsewhere in the budget, creates a financial burden for other taxpayers. Additionally, the necessary targeting of program benefits creates winners and losers that can be viewed as unfair by some. These same arguments apply generally to tax credit programs. Fortunately, the NMDP follows other states and the federal program by including necessary recapture provisions, such that exposure to the state can be limited in certain cases.

GRADE: C

Leverage

On the surface, the alignment of Alabama's NMDP with the federal NMTC seems well-designed to leverage additional dollars from federal sources. Indeed, a search of the publicly-available database of NMTC projects shows 34 investments in Alabama QCDEs between 2003 and 2014, totaling nearly \$325 million.¹⁷ While there appears to be considerable overlap in terms of the lists of QCDEs participating in the state and federal programs, available data do not allow us to determine the extent to which investors in state-approved NMDP projects are also receiving benefits from federal NMTCs.

GRADE: B

¹⁷ The searchable database can be found at <https://www.cdfifund.gov/awards/state-awards/Pages/default.aspx>.

Accountability

Recipients of economic development incentives should generally demonstrate accountability in the use of public resources. In practice this can be achieved, at least in part, through performance-based incentives and claw-back provisions that maximize the chances for positive economic impacts and returns on state tax credit investments. As noted above, the program's recapture provisions can improve accountability and overall program performance while minimizing risk to the state. Accountability could be further enhanced through better documentation of recipient firms and their performance prior to and after receipt of NMDP funds.

GRADE: D

Evaluation

In some respects, a sound evaluation system is the most important feature of a good incentive program. Sound evaluations help determine program effectiveness and thus efficiency, and lessons can be learned that ripple across other elements of a good incentive program. The Alabama NMDP falls woefully short in terms of building in meaningful oversight and rigorous evaluation. The absence of publicly-available data at the project level makes substantive evaluation virtually impossible without direct state support. This is not unique to Alabama, unfortunately. On a similar note, despite the recapture provisions, the program is not directly tied to measurable goals, such as the total number of jobs created for Alabama residents or dollars invested in Alabama companies.

If sustained, Alabama's NMDP program should be subject to ongoing rigorous analysis by independent experts; information on the existing program could potentially support such an analysis. This should occur prior to any new allocation of credits in support of the incentive program. More detailed information reports should be provided on an annual basis to inform policy makers and the public on the use of public resources. These steps would enhance transparency and promote accountability.

GRADE: F

Ownership

While the Alabama NMDP is understandably and reasonably administered by the Department of Commerce (formerly the Development Office), that agency did not create it or push for its implementation. This can create ownership issues if the agency might have preferred an alternative use of a similar pool of state dollars for economic development purposes, or if they might have preferred more direct involvement in the fund allocation processes that are virtually entirely handled by the QCDEs without much state oversight.

GRADE: D

Overall

In principle, Alabama's NMDP provides an important boost to low-income communities and provides several important advantages—especially much more effective geographic targeting—over many alternative economic development incentives. Unfortunately, it falls short in terms of economic impact, efficiency, and accountability. The program entails relatively high costs and, based on the available evidence, provides little market or fiscal return to the state other than the reallocation of investment into low-income communities. It is up to state officials to determine whether the limited benefits of the program are worth the costs. Our final overall grade reflects heavy weight placed on the efficiency criteria.

GRADE: D

Suggestions for Improvement

If a decision is made to maintain the NMDP, certain changes could potentially increase its efficiency. Most important would be improved screening of applicants with the goal of better identifying firms that will provide investment and employment gains. Consideration should be given to lowering the 50 percent credit value in light of the poor returns to the state.

The costs of the NMDP are extraordinarily high relative to the benefits that the program produces for recipient regions of the state. Given this dismal performance, the state should consider other programs

intended to promote the growth of struggling regions, including expansions of the existing enterprise zone and tax-increment financing programs. Unfortunately, each of these programs has been shown to have limitations.¹⁸

Alabama could also provide differential incentive benefits to new economic activity in distressed regions under the umbrella of its standing incentive programs. States commonly provide such differentials in reflection of the greater market hurdles associated with private capital investment and job creation in distressed regions. Alabama does provide an additional one-percent job credit for firms in targeted counties under the Jobs Act Incentive program; this incentive could be increased in value.¹⁹ The capital investment component of the Jobs Act Incentive could also include a differential benefit for investments in distressed or targeted areas. Similar differentials could be embedded in other state programs.

The NMDP is a *place-based* incentive program that seeks to promote economic development in depressed regions by promoting private sector capital investments. The effectiveness of this program will depend on the extent to which capital investment is created/diverted and new hiring opportunities arise from these investments. A complementary or alternative approach would be to focus on *people* who reside in distressed regions and make human capital investments that can enhance private sector employment and earnings opportunities. Investments in health and education can both improve individual wellbeing and increase labor market engagement. As discussed above, the costs per job under the NMDP easily fall into the six figure range, well above the average annual salary of a worker. To put this figure in perspective, annual tuition costs at the University of Alabama for in-state residents were \$11,270 for the 2016/17 academic year.²⁰ Investments in health and education can provide lasting returns to state residents and the state economy and provide a stronger foundation for growth.

¹⁸ The literature on these programs has produced mixed but generally unfavorable results. Ham et al. (2011) do show that enterprise zones, federal empowerment zones and federal enterprise community programs have all produced gains for assisted communities. Busso et al. (2013) also provide evidence of the effectiveness of enterprise zone programs. Recent research on tax-increment financing programs paints a largely negative picture. See, for example, Greenbaum and Landers of the Indiana Legislative Services Bureau (2014, available at https://iga.in.gov/static-documents/6/d/e/c/6dec6072/indiana_tax_incentive_review_2015_annual_report.pdf), who review the literature on tax-increment financing and offer some recommendations on program improvement. While the evidence on these programs is mixed, there may be lessons that can serve to improve place-based programs of assistance offered by the state of Alabama.

¹⁹ Any existing evaluations of the Jobs Incentive Act might help inform whether the current program is effective and whether larger incentives are warranted for distressed areas.

²⁰ Available at <http://financialaid.ua.edu/cost/>.

Using the broad tax and expenditure functions of state government would be an alternative to targeted policies. A variety of alternative uses of NMDP tax credits could provide stronger statewide gains in economic development. However, these benefits may not accrue to the regions that are the current target of the program. Place-based and people-based programs will be needed to lift the economic development prospects of poorer regions of the state.

Conclusion

Alabama’s Entertainment Industry Incentive and New Markets Development programs are both designed to foster local economic development, though in somewhat different ways. Both programs involve the use of tax credits—representing foregone state revenues—to encourage a particular type of activity that will hopefully generate tangible economic activity in the form of jobs and earnings, and expand state and local tax bases. Both involve state investments without the retention of ownership stakes in recipient projects, whether those are new or existing businesses or high-profile film or television projects. This is typical of tax credit programs. This elevates the importance of garnering other returns from the investment of scarce state tax dollars.

Perhaps because of these similarities, our evaluation comes to similar conclusions regarding the overall value of these programs to the state of Alabama. The following table provides a concise summary of our evaluation of both programs. In our final evaluation, we recommend that both programs be considered for termination.

Component	Entertainment Incentive Grade	New Markets Grade
Efficiency: a well-defined <i>return on investment</i> to the state of Alabama.	D	F
Transparency: clear benefits to taxpayers and costs to the state.	C	D
Certainty: defined impact on state budget and program beneficiaries.	B	C
Prospective: encourage future activity rather than reward previous decisions.	B	C
Simplicity: <i>easy to administer and easy to comply with.</i>	B	B

Targeted: focused and provided on a <i>discretionary</i> basis to promote new activity.	C	D
Protection of Public Funds: through caps or time limits on the use of credits.	B	C
Leverage: to encourage additional public or private resources.	F	B
Accountability: <i>performance-based incentives</i> should be built into the program.	D	D
Evaluation: to identify the extent to which incentives induced new activity.	D	F
Ownership: to ensure proper administration and to support a thorough evaluation.	B	D
OVERALL	D	D

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