Screen Producers Association of Australia

SCREEN PRODUCERS ASSOCIATION OF AUSTRALIA

SUBMISSION TO THE HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON COMMUNICATIONS INFORMATION TECHNOLOGY AND THE ARTS

INQUIRY INTO THE FUTURE OPPORTUNITIES FOR AUSTRALIA'S FILM, ANIMATION, SPECIAL EFFECTS AND ELECTRONIC GAMES INDUSTRIES

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1. INTRODUCTION

The Screen Producers Association of Australia (SPAA) is the leading industry association representing Australian independent film and television producers, television commercial producers, and services and facilities providers to the industry. SPAA represents the interests of independent producers on issues which affect the business of film and television making.

SPAA's aim is to provide the environment and conditions under which a vigorous and creative, independent production sector can thrive in Australia, and to provide SPAA members with the means to have an effective say in government and policy debates and decisions, and in industrial relations and other legal matters.

2. EXECUTIVE SUMMARY

In this submission we argue that the film and television production industry is a significant contributor to the economic and cultural life of the nation.

It is an industry that has been growing steadily through the nineties but that growth has been uneven. Growth has been propelled by the introduction of pay television, increases in the cost of news, current affairs and sport coverage by the broadcasters and by foreign production attracted to Australia.

Australian originated drama production has been growing only slightly or stagnating since the late nineties. The causes of this have been:

- ✓ The failure of television broadcasters to provide a sufficient level of investment in new production;
- ✓ Contracting levels of Government investment in production; and
- ✓ Increasing dependence on foreign finance in a competitive international market.

Production exists in a fragile ecology dependent upon investment from broadcasters, distributors and government and on the changes in the global screen production economy.

The post-production and animation sectors of the industry are centers of innovation in the application of digital technology and place Australia in a highly competitive position to make use of these skills in the development of content in new media.

However, the bedrock of innovation and creativity must rest upon a solid level of constant production activity. There are immediate issues, which the Commonwealth need to address to ensure that this occurs. These are:

- ✓ Extend the refundable tax offset to high budget television production so that Australia can remain competitive in attracting foreign production;

- ✓ Expand and enhance the Film Licensed Investment Company scheme to provide a long-term solution to stimulating private investment.
- ✓ Stimulate independent production activity for television by the introduction of an independent production quota that ensures broadcasters do not stifle competition and diversity through vertical integration;
- ✓ Ensure that the commitments on the introduction of High Definition television are met so that the investments in new technology made by the post production sectors are not rendered worthless; and
- ✓ Ensure a level of funding the ABC that makes it possible to undertake an adequate level of Australian production.
- ✓ Actively promote the use of co-production treaties so as to increase creative and economic partnerships between Australian and overseas producers to act as a spur to growth.

3. THE SIZE AND SCOPE OF THE FILM AND TELEVISION PRODUCTION INDUSTRY

Australia has one of the world's most efficient film and television production industries. It is a cultural industry with both a national and an international focus. What it creates plays an important part in the life of the nation, but also projects a powerful image of Australia to the world.

The broader economic benefits of the screen production industry include:

- increased employment in the film, television and other related industries;
- increased demand for Australian goods through international exposure for Australia;
- increased awareness of Australian creative talent and abilities;
- increased foreign investment in Australia;
- increased exports of Australian products;
- increased tourism expenditure; and
- increase in Australia's skills base.

3.1 What do we mean by Film and Television Production?

In this submission we will argue the film and television production industry is part of a larger audiovisual industry but it is distinct from the broadcasting, distribution and exhibition industries. The production industry creates the product that is used by those sectors to generate revenue.

Film and television production is based on the creation of copyright in the completed film or television program and that copyright is traded to finance production and to earn future revenues from its exploitation along the value chain from production through distribution, exhibition and broadcasting. Producers earn revenue from the fees collected for production and from their share of subsequent commercial exploitation of what they produce.

The industry we are talking about encompasses the production of feature films, television drama and non-fiction television programming, documentaries, television commercials as well as corporate/educational training and short film production. It includes companies that are undertaking their own production, those providing production services to other companies and companies that are providing post-production and related technical services.

Post-production refers to the stage of production from the completion of image acquisition through to the striking of a release print or the creation of master videotape. It involves processes such as image and sound editing, special visual effects, music synchronization, colour grading and printing.

While the public as consumer of film and television might be regarded as the ultimate end user of what is produced, for those in the production industry it is the distributors and the broadcasters (or in the case of television commercials the advertising agencies) that provide the immediate customers for production. Distributors and broadcasters in Australia and internationally provide the finance for production through mechanisms such as distribution advances, equity investment or broadcast licence fees. Also significant is direct government and private concessional tax investment as another important source of finance for feature film and larger budget television drama production.

It is important for the Committee to understand that the cost of producing films and television programs is independent of the number of people who consume them. This means that the number of people who consume these productions; even if higher levels of consumption might increase the revenue generated along the value chain, does not reduce the cost of production. Unlike manufactured goods where the unit cost of production can be reduced by volume manufacture, this is not the case for film and only marginally the case for television.

The cost of producing a feature film like "Lantana", for example, remains the same whether one person sees it or a million people see it. Obviously the producer endeavours to make a film at the lowest cost without compromising those factors that make it attractive to the audience. This helps to maximise potential profit to the producer and investors.

However, the cost to the consumer remains the same irrespective of the cost. For example, viewers of "Lord of the Rings" did not pay a premium to view this film because of its additional cost. Nor do broadcasters necessarily increase the amount they are willing to pay for television programs in response to ratings success.

Distribution revenue and broadcast licence fees paid to producers are only indirectly related to the audience who see their productions. Producers do not get a share of the first dollar from theatrical exhibition and video rental. Nor do they share in the revenue to broadcasters from advertising or subscriptions.

The revenue earned by broadcasting, distribution and exhibition is substantial. In 1999/2000 it amounted to $6.8 billion dollars from the sale of advertising by commercial broadcasters, government allocation to the national broadcasters, subscription revenue to pay television, cinema box office and the revenue from home video. However, a substantial part of that revenue is either retained by broadcasters, distributors and exhibitors or paid to foreign producers of film and television programs. For example, US feature films account for approximately 90% of gross cinema box office.

3.2 The Value of Production

Statistical data on the production industry is gathered and published by the Australian Film Commission (AFC) and the Australian Bureau of Statistics (ABS). Since 1993 the ABS has conducted a triennial survey of film and video production in Australia, reporting on the value of production within the industry.

3.2.1 Overall Production Value

The latest survey covers the year 1999/2000 and shows the total value of production was $1.8 billion in that year. Production for television, including the production of television commercials, accounted for 87% of the total value of production. Production for television provides the volume of activity and value in the industry. Australian feature films represent high profile production and attract keen public and media interest, but in 1999/2000 they accounted for 8% of the value of production and represented two thirds of the value of television commercial production. Feature film production could not exist without the skills and infrastructure supported by production for television.

The independent production sector, which SPAA represents, was responsible for generating 53% of the value of production with the remainder being in-house production by broadcasters. The main areas of in-house production are news, current affairs and sport, which accounted for 36% of the total value of production in that year.

The total value of production activity in Australia increased by 38% from $1.3 billion in 1993/94, the year of the first ABS survey. The AFC has attributed the increase in value to the introduction of pay television to Australia in the mid nineties and an increase in the value of news and current affairs and sport production by both free to air and pay television. [1] Foreign production in Australia has also been growing since the early nineties.

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[1] Australian Film Commission, 2002, Get the Picture, pp 32-33

3.2.2 Drama production in Australia

The AFC conducts an annual survey of drama production in Australia, including both Australian and foreign production[2]. The last survey was for the year 2001/2002. It showed that total expenditure in Australia was at $662 million and that this represented and increase of 8% over the previous year. Australian drama accounted for 51% of the value of production and foreign production, co-productions[3] accounted for 17% and foreign production 32%.

The survey showed that while the value of Australian drama production grew by 7% that of foreign production grew by 13%. Australian television drama production value declined by 12% as did the number of Australian television drama hours produced. Looked at over a slightly longer period between 1999/2000 and 2001/2002 the value of Australian drama production expenditure in Australia actually decreased by 7%, while the value of foreign production expenditure in Australia increased by 108%.[4]

Foreign drama production and co-production has been growing at a faster rate than Australian drama production. Between 1994/95 and 2001/02 the value of domestic drama production increased by 71%, the value of foreign drama production increased by over 127% and the value of co-productions by 692%. However, most of the growth in domestic drama production occurred in the mid to late nineties, so that the value of domestic production was higher in 1997/98 than it was in 2001/02.

Animation production is drama and covers feature films, television series and short films, however the bulk of hours and value of production is in television. The AFC reports that between 1988/89 and 1999/2000 343 hours of animated television drama was produced with a total production value of $216 million.

3.2.3 Documentary Production

Documentary production has developed and diversified as a cultural form that has been used not just to record reality, but also to interpret it for its audiences. Documentary production reflects Australian life and helps the community deal with current and historical issues affecting the nation. Documentaries also travel internationally, earning export revenue and providing a window into Australian life.

During the nineties the value of documentary production was on average $44 million per year, representing an average of 172 productions a year. About 80% of this was production undertaken by the independent sector, with the remainder being in-house production by broadcasters.[5]

The nature of documentary production is such that the Government plays a significant role in supporting it. This is done first through Film Australia, which undertakes the National Interest Program of documentary production for the Government, and commissions from the independent sector for this production. Second the

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[2] Foreign productions are those where a substantial amount is produced in Australia utilising Australian personnel and infrastructure but are not under the creative control of Australians.
[3] These are productions where creative control is shared between Australian and foreign partners.
[4] Australian Film Commission, National Production Survey 2001/2002
[5] Get the Picture, 6th Edition ,pp66-67

documentary accord between the FFC and the national broadcasters underwrites a minimum annual slate of documentary production broadcast on the ABC and the SBS.

3.2.4 Post-production

Unlike production companies the firms involved in post-production, including the creation of special effects, employ highly skilled practitioners on a long-term basis and require continuous investment in technology to take advantage of innovations and to remain competitive.

Less statistical data is available about the post-production sector. The ABS reports that in 1999/2000 those businesses involved in the provision of post-production services reported revenues of $263 million, or about 15% of the total value of production. This represented a 158% increase from revenue of $102 million in 1993/94. [6]

4. FUTURE OPPORTUNITIES FOR GROWTH

4.1 The role of Government

The Government's role is a crucial one to the continuing development and growth of the production industry. This is for two reasons. The first is that it is key provider of investment funding to the industry. The second is that its policies and programs are a key determinant of the environment in which investment decisions are made.

The Commonwealth and State governments provide assistance to the industry through a mixture of direct investment in development and production, regulation, and indirect assistance through tax concessions and rebates.

Direct Investment: In 2000/2001 the Commonwealth appropriations to film support agencies[7] were a total of $113 million or approximately 4% higher than they were in 1990/91. Appropriations to the FFC accounted for over 50% of the total, but they have declined by 27% over this period. In real terms the Commonwealth reduced its appropriation to Commonwealth film agencies over the decade. The reduction is even greater if the introduction and phasing out of the Commercial Television Production Fund between 1995 and 1998 is taken into account.

On average about 65% of Commonwealth funding is provided for production and development. This funding is supplemented by revenue earned on production investments made. During the period between 1990/91 and 2000/2001 the total investment in production by all Commonwealth agencies declined by 13%. Over the same period funding for development has fallen by 48%.

SPAA consistently argued to the Commonwealth that the declining government funding base, combined with a contracting market for production finance

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[6] Ibid, pp 28-29

[7] The AFC, FFC, AFTRS, Film Australia, National Film and Sound Archive SBS Independent, the Australian Children's Television Foundation and the Commercial Television Production Fund (1995-98).

domestically and internationally was affecting the ability of the production industry to grow.

The Government responded in September 2001 by announcing additional funding of $93 million dollars over five years to film agencies. This increase in agency funding is welcome but essentially means restoring funding to the levels of the early nineties. It will mean that by 2005/2006 the FFC will have 90% of the appropriation it was receiving in 1990/91 and that the AFC will be restored to the level of appropriation it had in 1995/96 in the current financial year.

Tax incentives: The Commonwealth government has introduced a number of tax incentives over the years to stimulate private investment in production. The first of these was under Division 10BA of the Income Tax Assessment Act in 1980 and the most recent the film tax offset scheme. The latter is discussed under foreign production.

Since 1988 when the 10BA deduction was reduced to 100% and the FFC became the principal means of Commonwealth production investment funds raised under this scheme have been on average about $20 million per year. Investment can only be in eligible Australian films – features, mini-series, telemovies, documentaries and animation.

In 1999 the Commonwealth introduced a trial tax investment scheme known as the Film Licensed Investment Company Scheme (FLICS). Under the scheme two companies were licensed to raise concessional capital up to a limit of $40 million. Investors received the same rebate as in 10BA for purchase of shares in these companies. The Capital so raised could only be invested in eligible Australian films.

The two licensed companies, Content Capital and Macquarie Film Corporation raised only $22.4 million by June 2000. This capital has now all been invested in production, mainly in 2001/2002 and the trial scheme will end on 30 June 2003.

No decision has been made as to the continuance of the scheme or its replacement by another initiative to stimulate production. SPAA maintains that a narrow examination of FLICS in isolation from all the other factors, including the operation of the FFC and Division 10BA of the Tax Act, will not inform Government on the best options available.

SPAA has proposed to the Government that the FLIC scheme should be extended and enhanced. More detail is supplied at Appendix 2

If Government were not inclined to alter any of the current arrangements, SPAA submits that the current holders of the FLIC licenses i.e. Macquarie Film Corporation and Content Capitol Limited, should have their licenses renewed for a further period of at least two years and that access to 10BA on individual film projects should continue.

Recommendation: Expand and enhance the Film Licensed Investment Company scheme to provide a long-term solution to stimulating private investment.

ABC Funding: The level of funding to the main national broadcaster the ABC has been in serious decline since the mid nineties. In television the ABC does not have sufficient finds to match the level of drama production undertaken by each of the three commercial networks.

The ABC's budgets have suffered from government neglect. At the same time the ABC has been expected to convert to digital and take on new-media initiatives. Australian drama and comedy are the big losers; especially after ABC news and current affairs was effectively quarantined from internal budget cuts.

SPAA fully supported the ABC's Triennial Funding submission for 2003-2006, which included a new initiative to address the ABC's poor recent record in commissioning first release Australian drama and comedy. The proposal was called the Industry Partnership but more easily identified as ABC Independent (ABC I). ABC I was modeled on the successful SBS I, which has forged a reputation for its creative relationship with the independent production sector.

The ABC was asking for an additional $62.5 million over three years to fund 180 hours of independently commissioned, co-produced drama and comedy. The extra 180 hours of production would have put the ABC on par with the current output of the commercial networks.

Ultimately the Government did not support this proposal for additional funding, leaving the ABC in the position where it is cutting its commitment to digital television in order to find the funding to maintain existing levels of production.

Recommendation: Ensure a level of funding the ABC that makes it possible to undertake an adequate level of Australian production.

Digital television: The introduction of digital television mandated High Definition as the pathway to the future for Australian viewers, Australia's broadcasters and the production industry. From a production and post-production perspective, the new standard gave Australia a competitive advantage in terms of both the technology and picture/storytelling quality. Enhancing the new 16 x 9 aspect ratio with a 4 times improvement in picture resolution (HD with 1080 active lines and 1440 horizontal pixels compared to 625 active lines and 768 pixels for the current PAL system), offered Australian viewers the best television pictures in the world.

The independent production industry has accepted the challenge of upgrading from a film and video based technical environment to the highest digital standard. The post-production sector has spent in excess of $110million investing in the infrastructure for HDTV. For example, the cost of a HD compliant telecine to transfer film to tape is between $3m to $4m and many companies made this commitment in order to meet the Government's mandated HD standard.

HD acquisition, post production and broadcast is the future of television programming in Australia and internationally. Television will become the first completely digital production and delivery environment and Australia is at the forefront of this development, with the potential for innovations in digital television production to affect the growing digital environment for film.

The introduction of the HD standard coincided with Australian post-production and special effects companies being able to attract business from foreign productions filmed here. This work would have previously been done in LA and other overseas film centres.

The potential to attract further international production in Australia will be raised significantly with the introduction of HD. The USA and Japan consider themselves experts in the area, and rightly so. To have a sophisticated HD infrastructure in Australia sends a very clear message to overseas producers that Australia is capable of fulfilling any technical requirement they need and goes hand in hand with the already excellent reputation Australia enjoys with special effects, sound, crew, talent, locations and other production specialities

The take-up rate of digital television in the community has not met initial expectations and there is pressure coming from the broadcasters for the Government to relax the mandated minimum levels of HD broadcasting or convert the use of the spectrum to multi-channelling.

SPAA has argued strongly that the Government should resist these calls and proceed with the original plan. High quality HD content will help drive the take-up of digital television; particularly as the cost of wide-screen television sets and decoders fall.

Any decline in HD investment will adversely affect the post-production sector and make Australia less competitive in the provision of this important value added, high-tech work.

Recommendation: Ensure that the commitments on the introduction of High Definition television are met so that the investments in new technology made by the post-production sectors are not rendered worthless

4.2 Commercial Television

The main customers for Australian television program production are the commercial television broadcasters. For decades these broadcasters have had exclusive control of a very highly valued public asset, the broadcast spectrum. In exchange for protection against competition, the networks are required to meet social and cultural standards for programming output, including minimum levels of Australian content.

The business of commercial television is to sell audiences to advertisers. To be successful commercial television needs programs that attract the audience advertisers want to reach, but they also need programming that is cost effective relative to the revenue they can generate.

In 1999/2000 the commercial networks earned $2.8 billion in advertising revenue and spent a total of $864 million on programming of which 69% was spent on Australian programming. Total revenue for that year was $3.2 billion on total costs of $2.4 billion. In that year programming costs was 36% of revenue. By comparison in the UK in 1999 programming costs as a percentage of revenue ranged between 92% for the BBC and 46% for the ITV network.[8] This indicates either that Australian broadcasters are more efficient than their UK colleagues in managing costs or that Australian broadcasters are undervaluing the rights they acquire.

Between 1991/92 and 1999/2000 the commercial networks program expenditure increased by 36% from $635 million to $864 million. Spending on Australian programming increased by 30%, most of this being accounted for by a 73% increase in spending on sport and a 69% increase in light entertainment.

While news, current affairs and sport is a high proportion of Australian program expenditure and attracts large audiences it is not easily subject to replacement by foreign programming. Equally it is generally difficult to export. On the other hand, drama and documentary programming has a much higher potential to earn export revenue but is more subject to import replacement.

Spending on foreign programming during this period increased by 51%, largely accounted for by a 59% increase in spending on foreign drama from $158 million in 1991/92 to $251 million in 1999/2000. Over the same period spending on Australian drama increased by only 3% from $100 million to $103 million, but this increase was all accounted for by a regulatory requirement[9] to spend more on children's drama. In the period the spending on adult drama actually decreased by 5%, at the same time as the value of domestic drama production increased by 69%.[10]

In Australia, as in other markets, foreign drama programs can be purchased cheaply due to the operation of primary and secondary markets. This is especially true for programs originating in the United States, where the operation of the networks and the process of syndication often mean that a production can cover costs and may be in profit before it is sold into international markets. Hence, drama series that would cost over two million dollars per episode to produce can be sold in Australia for around $30-50,000 per episode.

Australian television drama series costs between $270,000 and $400,000 an hour to produce so that it would therefore be more profitable for Australian commercial channels to show primarily foreign, and particularly American, produced programs.

However, the commercial channels do not meet the full cost of production. Analysis published by the AFC shows that between 1999 and 2001 the contribution of the commercial broadcasters to the cost of producing Australian drama ranged between 64% of the production costs of series and serials and 13% of mini-series.

The proportion of the total cost of production provided by commercial networks steadily declined during the nineties. In 1991/92 the network drama expenditure represented 60% of the value of domestic drama, but in 1999/2000 it represented 44%

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[8] David Graham and Associates, 2000, *Cut of the Box*: The Program Supply Market in the Digital Age,
[9] During the nineties the Australian Broadcasting Authority doubled the minimum hours of new Australian children's drama to be broadcast.
[10] Australian Film Commission, op. cit., p.217

of the value of domestic drama. There has been an increasing trend for broadcasters to maintain licence fees and expect producers to fund the deficit between their licence fee and the cost of production.

This change in the level of financing available has meant that independent production companies must find other investment in order to support production. This comes from a range of sources, including international distributors, the government where applicable, from their own investment and increasingly from Australian subscription television. Foreign sourced finance in the way of distribution guarantees and presales accounted for between 18% and 60% of financing for foreign drama between 1999 and 2001.

Foreign financing is essentially pre-sales or distribution advances that are cash flowed into financing production. This finance is recouped from foreign sales so that producers are mortgaging their potential profits in order to make productions happen. The broadcasters being aware of the potential, if at times uncertain, revenue from foreign sales will often demand that a substantial part of their financial contribution is equity as well as a licence fee for the Australian television rights.

Over the last decade and more the commercial network spend on Australian drama has declined while the value of exports from television has substantially increased. This has meant that any increase in the value of television drama production has tended to be paid for out of export revenue and government investment. In 1999/2001 the export returns on television drama were roughly equal to the finance generated in the domestic market.

This is not a welcome outcome because the export revenue does not represent profit to the producer. It stands in place of finance that cannot be raised in the domestic market. In the longer term a successful industry will not be possible if it depends entirely upon production for export. A stronger domestic market is essential to the production of programs that can be attractive internationally.

The conclusion therefore is that the opportunities for growth in the domestic television market are limited by the approach of the broadcasters to the support of drama.

4.3 Independent production quota

Despite a history of sourcing programs from the independent sector, we are witnessing an increase in the amount of in-house production and co-production with multinational companies with significant international distribution infrastructure. Broadcasters are doing this in a bid to reduce their costs and gain greater control over content. This puts additional pressures on Australian independent producers.

The networks are involved in a number of businesses but their core business is the sale and broadcast of advertising. They occupy an oligopoly position and control the access to audience and advertisers. The business of producing television programs is secondary to that and there is no reason why they should increase their monopoly control of this business. While they compete only with each other in the sale and broadcast of advertising, they compete with the independent sector in the area of production. As large vertically integrated entities with access to significant amounts of finance capital, it is inevitable that this competitive playing field is not a level one.

SPAA has consistently proposed the introduction of an Independent Production Quota. An independent production quota would ensure diversity by making it impossible for Australian content requirements to be merely produced in-house or by large offshore companies in Australia with exclusive deals with networks.

The quota would require that independent Australian producers produced a significant proportion of programming on commercial networks by setting minimum levels of independent production. It could run the gamut of programming and include areas as diverse as sport and adult drama.

International experience points to the efficacy and workability of an independent production quota. The development of the United States' production industry was achieved through the regulation of networks, which were prohibited from owning both the broadcast licence and the content they broadcast. In response to the Department of Culture and Media's White Paper on Broadcasting and Media, the United Kingdom introduced regulatory requirements on networks to provide a minimum percentage of all content to be produced outside the broadcast network concerned. In the United Kingdom, this percentage figure is 35 per cent. The rationale for the introduction of this quota, and the standard set, reflects the very low level of production commissioned independently of the network (previously, the majority of content was produced in-house), and represents a significant increase in independent production.

The European Union requires member states "to ensure where practicable and by appropriate means that broadcasters reserve at least 10 per cent of their transmission time, excluding the time appointed for news, sport events, games, advertising, teletext services and tele-shopping...or at least 10 per cent of their programming budget, for European works created by producers who are independent of the broadcasters"[11]

The introduction of an independent quota ensures:

- the delivery of diverse content;
- a more productive use of the broadcast spectrum; and
- support for a commercially viable, independent production industry.

An independent production quota would specifically:

- generate a revival of corporate and international investment in our creative sector;
- substantially increase income for the creative community from international sales and licensing of rights overseas;
- support the development of a competitive and secondary television market, and

[11] Article 5 of the European Union Television Without Frontiers Directive 1989 (Directive 89/552/EEC), reprinted at Table F.1, Productivity Commission, Broadcasting, 2000.

• increase the capital base of the independent production industry, improving viability and providing increased program research and development activities.

Recommendation: Stimulate independent production activity for television by the introduction of an independent production quota that ensures broadcasters do not stifle competition and diversity through vertical integration

4.4 Foreign Production

Foreign productions have always occurred in Australia, but they have become an increasingly important part of production activity since the late eighties. It cannot be overstated that the level of foreign production now occurring in Australia is dependent on the existence of a vibrant and successful domestic industry.

Major US feature films like STAR WARS, MISSION IMPOSSIBLE II and the MATRIX series are high profile, with big budgets to utilise Australian crew and facilities. These productions attract national and international media attention and create the impression of an industry that is expanding rapidly.

The reality is that in recent years growth in the value of production is being fuelled largely by foreign production as domestic production value has stagnated or decreased.

Foreign production occurs mainly in feature film, telemovie and mini-series production and to a lesser extent in television commercial production. These productions, predominantly from the USA, are attracted to Australia by a range of economic and creative factors, including the efficiency and flexibility of Australian production crews, the exchange rate, studio facilities and government incentives.

It has been estimated that US production offshore is worth in the order of $US3 billion annually. Australia competes for a share of this production with other countries such as Canada, the UK, New Zealand, South Africa and Eastern Europe.

Canada has the advantage of proximity to the USA but it has also been particularly aggressive in the level of government support it provides to foreign production coming locating within its borders. In the early nineties Canada introduced tax credits for the employment of Canadians on foreign productions within Canada. Initially worth 11% of the expenditure on employment the Canadian Federal government in February increased these to 16%. The provincial governments also offer tax credits so that this form of assistance could be worth up to 20% of the production expenditure in Canada. In 2000/2001 foreign production in Canada was valued at $C 1.8 billion ($A2 billion).

In the southern hemisphere New Zealand and South Africa are Australia's principal competitors. Both have the advantage of weaker currencies against the US dollar than Australia. In the case of South Africa labour costs are substantially cheaper. In the case of New Zealand the success of Lord of the Rings has demonstrated the capacity of the country to mount large scale studio and location based productions.

Some Australian state governments have had payroll tax rebates available for foreign production for some time. However, in 2001 the Commonwealth introduced a new tax offset scheme. Under the scheme a feature film that spends 70% of its production budget above a threshold of $15 million is eligible for a cash rebate equivalent to 12.5% of the production expenditure in Australia. The scheme is designed to encourage foreign production in Australia and to make Australia competitive with Canada and other nations.

There is no clear reason why the tax offset was not extended to television productions and in particular to large budget telemovies and series like FARSCAPE and BEASTMASTER, which had been shot in Australia. This television production is potentially more long term and stable than feature film production as it can run over a number of years and provide continuous expenditure in Australia. For example, FARSCAPE resulted in 88 episodes of the series produced in Sydney with a total expenditure of about $A200 million.

In 2001/2002 despite the 13% growth in foreign production value this was all due to feature film production and there was in fact a decline in this kind of television production. In the current financial year the indications are that this trend in television production has continued and that the rate of growth in the value of foreign production may be slowing.

The industry has proposed to the Government that the tax offset be extended to television on the basis that productions with a minimum budget of $1 million per hour and an aggregate annual minimum expenditure of $15 million should be eligible. This would represent a measured response to the more competitive position of Canada and other countries and recognize that as in domestic production it is television that drives the critical mass of production activity.

Recommendation: Extend the refundable tax offset to high budget television production so that Australia can remain competitive in attracting foreign production;

4.5 Co-production

Co-production involves Australian producers forging financial and creative relationships with producers in other countries so as to pool resources and leverage those resources into a larger and more competitive production.

Many of these co-productions are made under arrangements between Australia and another country in the form of a treaty or memorandum of understanding between government agencies. Australia has treaties with Canada, the UK, Italy, Germany, Ireland and Israel and MOU's with France and New Zealand. The AFC manages the program for the Commonwealth

The advantage of these arrangements is that the co-production is treated as a national film in each country giving it access to benefits such as funding and market access provisions that are available to national films. For example, an Australian-UK production is treated as a British production, giving it access to UK tax arrangements, and as a European production, giving it access to European film and television quotas. The same benefits in Australia flow to the British producer.

In 2000 the Commonwealth reviewed the co-production program and found that it was providing benefits for Australia and was supported by the industry.

As indicated above co-productions have grown substantially since the mid nineties, with the most substantial growth being in production for television. This reflects the realities that Australian producers are confronting in financing television production and the need to use any available mechanism to procure that finance.

SPAA continues to strongly support the co-production program and believes that more could be done to promote its use. Specifically attention should be given to facilitating more exchange between producers in partner countries as SPAA and the AFC did in 2001 with the support of the Canadian Producer mission to Australia.

We also understand that there may be problems with the operation of the Australian French MOU so that it is not working as effectively as it should to continue what has been a fruitful level of co-operation between Australian and French producers.

Recommendation: Actively promote the use of co-production treaties so as to increase creative and economic partnerships between Australian and overseas producers to act as a spur to growth.

4.6 Animation

Animation production in Australia has to some extent been overshadowed by live action drama production. In part this is because live action drama has a higher profile and more obviously famous stars to attract the attention of the public and the media. A large amount of animation is also produced specifically for children and this also can limit its visibility in the wider community.

Nevertheless animation production is a significant and growing sector of the industry with the potential to grow further and to take full advantage of advances in digital technology.

The production of animation requires a highly skilled and creative work force and a relatively high degree of investment in a permanent production infrastructure. It is more time consuming than live drama production and generally takes place over a longer period of time. Not all of the production process will take place in Australia as colouring and 'in-betweening' are often sub-contracted to cheaper studios in Asia. However, the animation sector is increasingly applying digital technology through the entire production process and developing skills can be applied to the post-production and games sectors.

The main producers of animation are Yoram Gross, Animation Works(Media World), Burbank Animation, the Australian Children's Television Foundation and Southern

Star. These companies are driving the value of animation production in Australia and largely this production is for television.

Walt Disney also has an animation studio in Australia, but its sole function is to service work that has originated from the US.

Two characteristics of animation increase its potential value and ability to raise finance independently of the FFC. The first is that it has a longer distribution life cycle than most live action drama. Most of it is produced for children and this is a market that renews on a more constant basis than other markets, however animation is also less subject to dating than other drama forms.

Second, animation is also more congenial to co-production arrangements because of the potential to cross cultural barriers such as language and location of the story. For this reason Australian companies have made use of treaty co-production arrangements to facilitate production, particularly with Canada and Europe. There is ongoing interest in such arrangements and the more they can work to facilitate production the better.

4.7 Post-production

Post-production has been a site of technical innovation in Australia built around the digitisation of the production process at this point. While image acquisition still remains largely analogue the whole post-production process is now digital and non-linear, with consequent advances in efficiency, productivity and innovation.

Australia has demonstrated that it is in the forefront of innovation in post-production and the skills that have been demonstrated there are transferable into the production of electronic games and broadband content. However, at this point the heart of the post-production business is in servicing production.

Growth in post-production is inextricably tied to growth in production. Without the continuity of production activity in Australia the post-production sector will not continue to grow or be able to fund the constant demands of digital capacity and investment.

Therefore those initiatives that encourage domestic production or foreign production also benefit the area of post-production.

Access to broadband connectivity is a continuing issue for the post-production sector and its ability to service both domestic and international clients. The digitisation of the post-production process has meant that it then became possible to use the telecommunications system to transfer data files of images and sound. While there are still problems for some post-production businesses getting a broadband connection the main problem is that there is a lack of fit between the needs of the post-production sector and the pricing structures of telecommunications providers.

Put simply this revolves around the fact that the pricing structures are based around a demand profile where continuous use and access is the norm, such as in the financial services sector. While the demand for broadband connectivity can be quite substantial in post-production it is not continuous – large amounts of data may need to be transferred but not all the time. This means that the cost can often be prohibitive.

The industry sought to resolve this problem by the formation of the Film Industry Broadband Enterprise (FIBRE) in 2001. FIBRE has since received funding from the Commonwealth to undertake an assessment of demand aggregation and to negotiate with telecommunications providers. This work is still ongoing.

5. EDUCATION AND TRAINING

The skills being utilised and developed in the industry have come from a mixture of formal and on the job training. The AFTRS, tertiary media courses and the network of media resource centres provide a range of training from the elite level at the AFTRS through to short courses that provide for entry level training.

The AFC and many of the state agencies through programs to fund short film or short feature production also provide opportunities for practitioner development.

However, the best way to maintain a continuous level of skills development is through production itself. This is not necessarily a substitute for basic levels of formal training, but once these skills have been acquired or an aptitude identified then the experience of production or post-production in solving issues and problems on a daily basis is crucial.

This is where television commercial production in particular continues to be crucial in providing opportunities for skills to be developed and maintained. Two examples, illustrate this. The director of "Lantana", Ray Lawrence has spent most of his career working in television commercials production between the success of that film and his first feature "Bliss" in 1985. Glendwyn Ivin, whose short film "Cracker Bag" won the Palm D'Or at the 2003 Cannes Film Festival, produced the film with no government funding while working as a television commercial director.

It is equally the case with animation and post-production where technological developments and innovations in software mean that without constant practice there is a danger that the competitive edge that Australia has acquired will not remain in place.

This is a glamorous industry to many and there is a large pool of aspirants, some of whom have undertaken to train themselves on equipment they have acquired themselves. Events like the TropFest Film Festival encourage these aspirants and give expression to new talent and ideas. SPAA itself conducts annual conference event, SPAA Fringe, which is designed to serve the demands of this group. Many of these aspirants will not achieve their ambition, but equally it is not easy to predict form what quarter new talent will arise

Appendix 1

Government Assistance Measures

Direct subsidy for production and development through the AFC, the Australian Film Finance Corporation, Film Australia Limited, the Australian Children's Television Foundation and the State Film agencies;

Regulation of Australian Content through the standards imposed on commercial television by the Australian Broadcasting Authority and the drama expenditure requirement for subscription television;

Indirect support through taxation concessions for investment in feature films, television miniseries and documentaries which includes –

> Concessions under Division 10B and 10BA of the Income Tax Assessment Act for investment in qualifying Australian films;
>
> the Film Licensed Investment Company Scheme (FLICS); and
>
> the Taxation Amendment (Film Incentives) Act 2002, which provides incentives for higher budget productions to be made in Australia.
>
> State government payroll tax rebates for production activity in their states.

Other measures include:

> Regulation of temporary entry to Australia of foreign actors, crew and performers under Migration Regulations;
>
> Revolving loan schemes provided by State agencies to cash flow production in their states;
>
> International co-production treaties and MOU arrangements;
>
> Direct support for promotion of Australian production resources to AusFilm and the Film Industry Broadband Resource Enterprise (FIBRE);
>
> State government investment in studio developments in Sydney, Melbourne and the Gold Coast;
>
> Direct support for training through the Australian Film, Television and Radio School; and
>
> Support for preservation of Australia's audio-visual culture through the National Film and Sound Archive.

Appendix 2

Analysis of FLICS performance

The Tax Act was amended in 1998 to introduce the pilot Film Licensed Investment Company (FLIC) scheme, based on recommendations arising from the Gonski Review into Commonwealth funding for film and television in 1997. This review, whilst directly acknowledging that government support was necessary to sustain the industry, stated that the industry needed to be able to attract increased private investment if it were to grow and reach its potential. However, the Review also recognised that private investment in film production also required government subsidy, and concluded that the FLIC scheme would be a more efficient way of using tax concessions to attract private investment than the existing 10BA arrangements.

The Government implemented the FLIC scheme for a pilot period of two years, which allowed investors to obtain a 100 per cent tax deduction by way of a concessional investment in slate funding through a licensed company.

Two companies, Macquarie Film Corporation and Content Capital Limited, were granted FLIC licenses under the scheme. They were each entitled to raise a maximum of $20m concessional capital for qualifying Australian films. The capital raising period ended on 30 June 2000, with capital to be invested by 30 June 2002. All projects funded under both these schemes must be completed - that is they must receive final 10BA certification - by 30 April 2003.

Macquarie raised $16.5m under the pilot scheme and invested in the following feature projects: *Crackerjack, Bad Eggs, Dirty Deeds, The Nugget, Horseplay, Take Away, Wannabes, Danny*. Macquarie Films have gone on to issue a prospectus with Nine Films and Hoyts Distribution prior to 30 June this year, raising $22.5m out of a maximum of $65m. Projects invested in under this scheme are the features *Getting' Square, Under The Radar, McLeod's Daughters (series 2), Young Lions (series 1) and Postcard Bandit* (telemovie).

Content Capital raised $5.5m and their investments include the feature films *The Monkey's Mask* and *The Bank*, underwriting of *Old Tom*, an animation series with Yoram Gross, as well as the documentary series on well-known cartoonist Michael Leunig.

The imagined benefits of the FLIC pilot scheme were:

> to provide another avenue of funding for independent producers, to be amalgamated into a slate of projects administered by the two licenced companies, thus sharing risk all round;
>
> Producers would be able to fund a broader range of genre and budget level;
>
> Potential attraction of non-government support which might stay in the sector dependent on success;
>
> Greater certainty of reaching an audience;

Concessional capital capped;

Broader information available about projects funded through the FLICs.

One of the attractive prospects about the FLIC scheme was the 'other door' approach, i.e. it offered producers another avenue to raise finance outside the FFC and 10BA. However, many of the projects invested in have aggregated both FFC, state government agency and FLIC financing, and it could be argued that allowing FFC investment in these projects would effectively narrow the gate and not afford an alternative avenue at all.

The Government review at this time cannot take into account measurable success of all the projects invested in. To date, only two of the Macquarie projects have been commercially released, *Dirty Deeds* and *Crackerjack*, although many of the others are due between now and February 2003. Of the Content Capital slate, *The Bank, The Monkey's Mask* and the Leunig animated series have been released or aired.

10BA Funding

SPAA would strenuously resist any attempt by Government to abandon 10BA. The retention of 10BA side by side with FLICs was widely supported at the time of initial consultation on the pilot scheme, on the basis that 10BA would be open to all – there would be no 'picking winners'.

Investing the decision making for Government supported private investment raising into the hands of two companies would effectively remove an avenue of funding to many independent producers, and remove the ability of many independents to operate outside of government supported funding.

If all Government subsidy is channelled through capped funding, then it follows that a limited amount of production would ensue.

The legacy of the well publicised abuse of the film tax system in the '80's is dissipating, with many legitimate and successful films being made with part or whole 10BA raisings. However, the excessive scrutiny of the ATO on all film deals continues to frighten off potential investors.

Whilst the FLIC trial is operational, there is still the security of knowing that 10BA can be accessed.

Types of projects funded under any new FLIC scheme should at least mirror those available for funding under 10BA, i.e. the qualifying Australian film provisions should not be changed. It could be argued that in a changing landscape where more delivery mechanisms are coming on stream ever faster, the qualifying provisions should be widened.

SPAA Proposal

1. Expand FLICS

The limited features of FLICS, which cost the Government nothing or very little, actually have made it easier to raise funds. One option would be to expand the FLIC scheme making it accessible to a wider number and type of entities.

This could be achieved by allowing entities to tender for simplified FLIC licences of indeterminate amounts on 1 July each year. That is, the Government would set a sum of say, $100 million and various entities would request licences of different amounts. For example a Macquarie type entity may seek a licence to raise $25 million while a collective of filmmakers may seek a licence to raise $5 million to make five low budget features and so on. Government would allocate the $100 million in licences in a manner that will achieve a diverse slate of quality Australian films with strong commercial appeal. The Government could be confident, unfortunately, that the licence holders would be unlikely to raise the maximum amounts allowed under the licences as the experience of Macquarie and Content Capital have shown, and so $100 million in licences may only lead to $40 million being raised.

Such a scheme would still be capped and would still be at little cost to Government. Licences would be current for 12 months for capital raising and a further three years for completion of the production slate.

Note that 10BA does allow 100% depreciation in the year of investment but it largely seeks to redress the "quirk" of circumstances that make it impossible to depreciate film investments over their true economic life because the copyright in the film lasts 50 years.

In the longer term an expanded FLIC scheme aimed at a diversity of entities could make any discontinuation of the current 10BA legislation possible.

2. Enhance FLICS

The original 10BA, and the FLIC structure proposed by Gonski, had a tax break on returns to investors. Put simply, if investors get a 100% deduction on investment and were not taxed on the return of their original investment, their break-even point would be 50% of their investment returned. That is, under current 10BA and the FLIC scheme investors need to get all their money back to break even, other than they will have "put off" their tax bill for the couple of years between investment and getting their money back.

It would clearly be easier to raise funds if some kind of tax offset was allowed for, but such a concept is usually not considered because it would allow income to leak from the tax system permanently, as opposed to 10BA that catches the tax unless people genuinely lose their money.

One option would be to provide tax relief on net returns to investors derived from overseas revenue only. SPAA recommends that no tax be paid on up to 50% of returns on an individual investors equity if those revenues are from such sales. The benefits of overseas returns, or injection of funds from overseas generally, is well accepted and evidenced by the 12.5% rebate for offshore production for feature films with budgets greater than $15 million and Export Market Development Grants. However any tax concessions on overseas returns has many other benefits, including:

> It presupposes the export of Australia's culture and society/landscape/environment, providing benefits to the tourism industry not accruing to a *Matrix* or *Star Wars*;
>
> It is "income" to Australia that would not otherwise have eventuated, an argument possibly able to be put by any other exporter but films do not really displace other parts of the economy, as say a new coal mine would to an existing coal mine:
>
> It would help attract private investment for films in the first place, thereby partly relieving the pressure on government to increase direct assistance to the industry and possibly providing a solution to the Government's exposure under 10BA.

Summary

While further economic analysis may be required, and SPAA is prepared to undertake this with Government, the basic thrust of our submission for an expanded and enhanced FLIC scheme may provide Government with a long-term solution to the vexed issue of 10BA. SPAA is aware that at any time DCITA and the ATO cannot measure the extent of its concessional tax dollar exposure under 10BA i.e. the difference between provisional certificates and final certificates.

The suggested option also provides the "many doors" outcome that producers and investors are seeking. The increased competition for licences, be they five or ten a year, will, with appropriate creative and commercial criteria, make available a range of options for filmmakers outside of the FFC but within overall fiscal parameters. It would provide for greater competition between licence holders and make the Directors of FLICs more accountable to their investors.