

REGULATORY IMPACT ASSESSMENT
REVIEW OF FILM CO-PRODUCTION AGREEMENTS

1. Title of Measure

Review of Film Co-production Agreements

2. Purpose and intended effect of measure

(i) The objective

The Government wants to encourage and support the growth of the British Film Industry, and believes that re-negotiating the content of existing film co-production agreements, terminating existing agreements duplicated by the European Convention and establishing agreements with new countries will maximise the potential for the co-production of films which bring economic and/or cultural benefits to the UK, whilst also helping to ensure that the film tax relief in the UK is used appropriately.

This process will result in the production of a series of clear, flexible, modernised, and effective agreements. The effectiveness of these negotiations will be measured by assessing the balance of economic and/or cultural benefit to the UK of establishing each new agreement.

(ii) The background – The Film Industry

The UK Film Council (UKFC)

The UKFC is the Government-backed strategic agency for film in the UK. Its main aim is to stimulate a competitive, successful and vibrant UK film industry and culture, and to promote the widest possible enjoyment and understanding of cinema throughout the nations and regions of the UK.

The British Screen Advisory Council (BSAC)

BSAC is an independent association representing a broad church of interests including the leading UK executives from film, television, satellite, cable and digital media. The Council is committed to serving this country's audiovisual industry by enhancing its prosperity, effectiveness and reputation.

Producers' Alliance for Cinema and Television (PACT)

Pact is the UK trade association that represents and promotes the commercial interests of independent feature film, television, animation and interactive media companies. Pact is a highly effective lobbying organisation. It has regular and constructive dialogues with government, regulators and opinion formers on all issues affecting its members and contributes to key public policy debates on the media industry.

Viewed as an economic sector, the UK film industry employs on average 51,937 people¹, produces in whole or part on average over 140² feature films per year with a combined UK production value of £839million³, earns on average £645 million p.a. in export income⁴ and achieves a trade surplus with the rest of the world an average of around £141million⁵. The distribution sector is responsible for the reproduction and delivery to cinemas of thousands of film prints and in 2003 spent £148 million on advertising⁶. The cinema exhibition sector has a presence in city centres, suburbs, rural and even remote areas throughout the UK, employs around 20,000 people and generates large box office and food and drink revenues that flow back into local economies, the film production and distribution industries and the exchequer (VAT).

In addition to their theatrical release, films are distributed through video/DVD and television, providing essential content and revenue streams for these sectors. In 2004, revenues for films on TV (£1 billion)⁷ were greater than theatrical revenues (£778 million)⁸ and video/DVD revenues (average £2.20 billion)⁹ were almost three times the size of theatrical revenues.

Film production is centred on London with clusters of production companies, visual effects, post-production houses and film financiers in Soho and other parts of the West End. Outside London there are centres of film production in Central Scotland, Cardiff, Manchester, Liverpool, Bristol and Nottingham, and all regions host location shoots to a greater or lesser extent.

The UK film industry is a substantial exporter. High end production services are directly exported when overseas (particularly American) film productions use UK studios, locations and services such as visual effects and post-production. The UK is a popular and attractive destination for the US studios. On the other hand, when UK film producers make UK films an important part of their value chain lies in the overseas markets, particularly in the USA and Europe, extending from theatrical release to video/DVD and television distribution. To facilitate the export of UK films there is an active body of sales agents and UK film makers who attend international festivals to gain critical support for their films and sell overseas distribution rights directly.

Film finance comes mainly from commercial and overseas funding, but film tax relief and lottery funding also play an important role.

The UK is currently signed up to 7 bilateral Agreements (with Australia, Canada, France, Germany, Italy, New Zealand and Norway), and the European Convention on Co-production. These Agreements enable and encourage the co-production of films between the UK and its partner countries by offering the opportunity to film producers meeting the requirements of the Agreement to qualify for a British film

¹ Including some people employed in video production and distribution who are not separated from film production and distribution in the official statistics. Source: ONS Labour Force Survey, years 2002 – 2004.

² Source: UKFC International and DCMS. Taken from years 2002 – 2004

³ Source: UKFC International and DCMS. Taken from years 2002 – 2004

⁴ In film rights and film production services. Source: ONS Film and TV Survey, years 2002 – 2003.

⁵ Source: ONS Film and TV Survey, years 2002 – 2003.

⁶ Source: Nielsen Media Research

⁷ Source: Estimate from UKFC Research and Statistics Unit, based on data and analysis from David Graham and Associates.

⁸ Source: Nielsen EDI

⁹ Source: MRIB, BVA, UK Official Charts Company, years 2002 - 2003

certificate. Qualification means they are eligible to apply for tax relief on 100% of the certified spend on the film.

The Co-production Agreements

The existing agreements have been drawn up over the last 30 years, and their outdated and ad hoc nature means they are no longer delivering optimum economic and/or cultural benefits to the British Film Industry. Re-negotiation is necessary if they are to continue to ensure that inward investment is secured and cultural cross-fertilisation encouraged. Furthermore as these agreements are, in part, gateways to tax relief, they must be modernised, and made more flexible and easier to apply and monitor, if they are to deliver maximum benefits to the film industry and the UK public.

To achieve this the DCMS has worked together with the Film Industry to introduce new, overarching principles which will underpin all future agreements. New Agreements with countries shall only be made with partners who offer some of the following:

- Objectives for film which deliver economic and/or cultural benefits to the UK.
- Film industries with potential synergies with our own film industry including complementary industry strengths, the availability of film locations and a shared film culture.
- Appropriate benefits, such as tax relief or other incentives, available to national films,
- A desire to maintain balanced relationships i.e. what each side puts in, it gets out.
- A desire for films to reflect, enhance and convey the diversity of culture and heritage in both countries, coupled with a desire to enhance the public availability of distinctive and successful films.

These key principles will be reflected in the body of the agreements themselves, and existing agreements will be re-negotiated along these terms. Bi-lateral treaties duplicated by the European Convention will be terminated and this streamlining will make it easier for the film industry to understand the provisions for co-production.

Next Steps

Negotiations on this new package of agreements will be taken forward by the DCMS, in close partnership with the UKFC and key industry representatives (PACT and BSAC). It is expected that the effects of these negotiations will begin to impact the film industry from late 2005 onwards.

(iii) Risk assessment

Establishing new film co-production agreements is a Ministerial priority. It will maximise the opportunities for UK producers to co-produce films with partners in appropriate countries across the world, and thereby increase the potential to develop films with a strong economic or cultural value to the UK. Without the economic and cultural tests included in the agreements it would be difficult to ensure that those films eligible for tax relief are bringing benefits to the UK. Furthermore, if the Government is not given the flexibility proposed, for example to authorise changes to the provisions in response to the rapid developments of the

film industry, the UK's ability to adapt to the advancement of new technologies and development of skills will be hampered. Similarly, if new co-production agreements aren't established with new countries the UK risks missing out on forming international relationships with countries which can offer considerable benefits to the UK.

Finally, reform of the agreements, which are in essence a gateway to tax relief, will also reduce the risk of misuse of the tax relief system. For example, new provisions for managing balance will allow the Government to take prompt, and effective, action to help ensure that film tax relief is distributed appropriately. Without this protection there is a risk that tax relief might be misused, resulting in an unnecessary loss to the Exchequer.

The UK Film Council (UKFC) - the UK's strategic agency for developing the film industry and film culture in the UK – has an aim to "stimulate a competitive, successful and vibrant British film industry and culture, and to promote the widest possible enjoyment and understanding of cinema throughout the nations and regions of the UK". This includes encouraging inward investment to the UK from international production companies and developing the skills base of the film industry. It will be more difficult for the UKFC to achieve these objectives if the new package of agreements are not successfully negotiated.

3. Options

Option 1

Do nothing.

Option 2

Review the current co-production arrangements and establish new overarching principles to be applied to potential co-production partner countries, and develop modern, standard and more flexible criteria for the gateway for tax relief.

4. Costs and Benefits

Option 1

The review of the UK's current co-production is important both to key stakeholder Government departments and the Film Industry. The review is necessary to ensure film co-production agreements are established which maximise the potential for the co-production of films which bring economic and/or cultural benefits to the UK, whilst also helping to ensure that the availability of film tax relief in the UK is not misused.

The do nothing option does not address the problems with the existing agreements such as duplicated agreements and unclear provisions, neither does it allow the UK to take the opportunity to forge new film co-production relationships with those countries that are important in the world of film production.

Option 2

The changes proposed to the existing series of agreements may result in benefits to the Exchequer, the film industry and the film watching public. There are unlikely to be significant costs to any party.

The principal economic impact of signing these agreements will be the production of films that would only be made between UK and these partner countries if an official co-production relationship is established, allowing co-productions to be counted as national films (providing certain conditions are met).

It is difficult to accurately predict the exact effect of the introduction of the new agreements. However, a sensible estimate can be made from looking at the effect of past changes. In 2003, expenditure in the UK in relation to co-productions was £127 million (Source: DCMS co-pro data analysed by UKFC RSU). UK expenditure as a proportion of total expenditure was 29.9%. After the measures taken by DCMS and the co-production review committee in 2004, UK expenditure increased to £442 million in 2004, and the UK expenditure proportion increased to 37.2%. It is expected that this higher UK expenditure share will be maintained or improved further as expenditure imbalances are addressed in the course of implementing the new set of agreements.

The addition of stronger cultural and economic tests, the tightening of the rules and greater management of balance are also likely to result in a more targeted allocation of exchequer funds in the form of tax relief.

For the film industry the new, clearer rules in the agreement will make it easier for producers to understand and apply the rules in their applications. The new rules will also benefit the film sector by providing a regulatory system flexible enough to respond to the innovative nature of their industry. There may also be better targeted investment in UK co-produced films which bring economic and/or cultural benefits to the UK. Such investment may result in a boost for all sectors of the British Film industry.

There may also be a social benefit for the film watching public encouraging of the production of films which offer a cultural benefit, for example those which tell a UK story.

One potential cost to the film industry could come from the termination of the existing UK – German treaty, and subsequent reliance on the European Convention. If this Treaty is ended before the new UK-South Africa Agreement is signed, producers wanting to make a UK-Germany-South African co-production would not be eligible for certification. Prioritising the establishment of the new agreements over the termination of existing ones will eliminate this cost.

6. Equity and Fairness

There are no significant issues of equity and fairness.

7. Consultation with small business: the Small Firms' Impact Test

The UK film industry is organised along 'flexible specialisation' lines in that it consists of numerous small companies carrying out the many specialised tasks once

performed within major studios. In 2001, for example, 95% of all film and video production workplaces in the UK had ten or fewer employees and 57% of all employees worked in workplaces in that size band. Most of the rest worked in workplaces with 50 or fewer employees.¹ The flexible specialisation model also manifests itself in the high proportion of freelance labour. In 2002, 47% of all workers engaged in the film and video production sector were self-employed.²

Initial soundings with film sector representatives, including those that represent small firms - the Producers Alliance for Cinema and Television (PACT) and the British Screen Advisory Council (BSAC), have not identified any disproportionate or negative impacts on small firms.

8. Competition Assessment

Only the film production sector will be directly impacted by these proposals, and we believe the impact on competition will be inconsiderable. The character of the film production sector generally dictates that it is unlikely that any one company will have more than 10% of the market share at any one time. For example in 2003, out of the 112 co-productions made, the maximum produced by one company stood at 10.

Given this wide playing field our proposals are unlikely to disproportionately affect one company. Costs would be similar for all market entrants, and the number and size of firms is likely to remain the same. However, there is a possibility that the proposals to re-dress imbalance between co-producing partner countries, may mean that at times some productions may need to be re-located in whole or part to the UK in order to qualify as official co-productions; and by the same token qualifying films are required to have a minimum UK spend. Neither of these restrictions is likely to stop companies making their films.

Finally, the film production market is characterised by rapid technological change. This change has been fully accounted for in policy making, for example the flexibility given to allow the annex to these international agreements to be changed at Contracting Party level will help enable the UK film industry to keep up with important technological advances.

9. Enforcement and Sanctions

The new agreements will be enforced by the Department for Culture, Media and Sport.

10. Monitoring and Review

The negotiation process will be continually monitored by an existing DCMS/UKFC co-production review steering group. Once re-negotiated and enacted, the application of the agreements will be scrutinised on a daily basis as the Certification unit process applications for certification. A more formal evaluation will take place in line with the completion of the accompanying Certification review.

¹ UK Film Council, *2002 Statistical Yearbook*, p78.

² UK Film Council, *2002 Statistical Yearbook*, p74.

11. Consultation

As well as with Government Departments, we have actively consulted extensively with the UK Film Council and PACT and BSAC who are both important representative bodies for the UK film industry.

13. Declaration

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs

Signed *Tessa Jowell*

Date *21/2/05*

Minister's name, title, department

Contact point

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