Australian Government

AUSTRALIAN FILM COMMISSION

Submission to the Department of Communications, Information Technology and the Arts

Review of Australian Government Film Funding Support

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Executive Summary

What is the rationale for ongoing government support to the Australian audiovisual industry?

Government support for Australia's audiovisual industries through regulation, direct subsidy and indirect incentives exists to deliver cultural outcomes, that is, Australian stories and Australian characters on Australian screens.

Australian audiovisual content plays a central role in creating community cohesion and promoting a sense of national identity. Since the introduction of film quotas in the 1930s and television content quotas in the 1960s, through to the establishment of the AFC and the AFTRS in the 1970s, Australian Governments have committed to policies which recognise that Australia needs to express our constantly evolving identity, and to communicate this to Australians (and the world), through the most popular and accessible forms of cultural expression – film, television and new media.

In order to meet these cultural objectives, the Government has also assisted in the development and maintenance of an Australian audiovisual industry with the capacity to create relevant, popular and diverse content. An effective, healthy industry requires continued support to develop and grow a large skills base, substantial infrastructure and well-capitalised, entrepreneurial companies with access to private investment.

Delivering cultural outcomes and supporting the development of a healthy audiovisual industry also produces a number of economic benefits. The Australian audiovisual production industry employs over 16,000 Australians, and generates over $1 billion worth of economic activity. Australian audiovisual content has also been one of the great ambassadors for this country, with films such as *Crocodile Dundee, Priscilla, Queen of the Desert, Shine, Babe, Moulin Rouge* and *Ten Canoes* and television programs such as *Neighbours, Home & Away, Kath & Kim* and *McLeod's Daughters* establishing an international profile for our country and our culture with positive flow on impacts for tourism and trade. Notwithstanding these economic benefits, government intervention in the audiovisual sector remains primarily rooted in the delivery of cultural outcomes.

What are the key challenges facing the screen production industry

Key issues facing the screen production industry include:

- The volume of feature film, television drama and documentary production is at levels too low to sustain an industry to deliver on cultural objectives into the future;
- Private investment from outside of the industry, at both the enterprise and project-based level, is low, with private investment by individuals in their own businesses, in lieu of outside investors, high;
- Marketplace dynamics are rapidly evolving with project financing increasingly difficult;
- Expanding platforms for content are continually impacting and changing existing business models;

- Technological change continues unabated requiring constant skills base retraining and capital expenditure;
- Foreign production is increasingly relied upon to underpin industry infrastructure;
- Australia is falling behind the rest of the world in the creation of digital content and applications and subsequently becoming less internationally competitive; and
- Industry growth is inhibited by existing structures of support, as they are weighted too heavily in favour of direct support.

What should the government's objectives be, moving into the future?

The AFC believes the following objectives should underpin the government's policy response to the key issues articulated above:

- Government assistance must continue to focus primarily on facilitating the creation of a rich variety of Australian high quality film, television and other audiovisual productions for Australian audiences;
- To facilitate this, and to assist in achieving sustainability, the audiovisual production industry needs to grow both its capital base and volume of production to levels significantly higher than currently exist;
- Growth will be underpinned by developing successful, sustainable and profitable audiovisual production businesses and enterprises:
    - The capacity of the industry to respond quickly to marketplace and technological change must be strengthened;
    - To remain viable and healthy, the industry requires structural diversity – in terms of the range of enterprises and services, ownership structures, financing mechanisms and content produced;
    - Private investment into businesses and projects needs to increase; and
    - The industry, both at the enterprise level and industry-wide level, must be empowered to take responsibility for its own development and growth.

What balance should be struck between direct and indirect funding?

In order to reach the goals expressed above, the AFC believes that there needs to be a greater emphasis placed on indirect funding. The AFC believes that a significant, effective incentive needs to be introduced to drive increases in the volume of production and promote sustainable enterprises.

Direct government assistance should underpin and support the industry in areas not otherwise met by the market.

What options are there for stimulating growth in private investment?

Private investment in Australian film and television (that is, investment from outside the industry) has fallen in recent years and is at relatively low levels.

It is clear that Division 10BA of the *Income Tax Assessment Act* (the '*Tax Act*') no longer acts as the significant private investment incentive it once did. The other major private investment incentive for the Australian film industry – the Film Licensed Investment Company (FLIC) Scheme Pilot – neither achieved the quantum planned for nor the diversification of the investor base sought, with the Scheme attracting only a small number of investors. The new FLIC has failed to reach its investment target in 2005-06.

The AFC continues to support the changes to 10BA it detailed in its submission to the 2005 10BA Review, including extending eligible formats, introducing platform neutrality, clarification of the 'at risk' rules and other Australian Taxation Office ('ATO') procedures.

Internationally, indirect funding models dominate the financing of film and television industries. Private investment offers an avenue for the industry to grow independently of direct government funding. In order to expand the finance sources available to the Australian film and television industry and to assist it to compete internationally, new ways are needed to encourage investment in the industry and improve certainty for investors.

There is a strong desire from industry to establish an effective financing door to sit along side of and operate independently of direct subsidy.

The AFC believes that the current Refundable Film Tax Offset ('the Offset') – which has been enthusiastically received and utilised by producers of high budget offshore productions shooting in Australia – should be made more accessible to independent Australian productions.

The AFC has undertaken extensive research, consultation and economic modelling into developing alternative incentive structures utilising a variety of mechanisms to promote growth in private investment. The AFC believes the Government should make available to independent Australian producers:

- an altered Offset at 40 per cent available for Australian feature films, telemovies, mini-series, documentaries, children's drama and some digital content,[1] with a 20 per cent offset available for Australian TV series, that can be used in combination with 10BA but with no access to FFC or other direct federal government production funding;

An altered Offset would involve the following parameters:

- A qualifying expenditure threshold for Australian independent production of $1 million for feature films, with other thresholds to be further discussed.
- An expansion of current 10BA eligible formats and delivery platforms to include television series and some digital content;
- The introduction of an Australian eligibility test.

The AFC believes that 10BA needs to be retained (with changes as recommended) and then reviewed in the light of the effects of the Offset.

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[1] Further work needs to be conducted to determine parameters of digital content

The AFC supports this model for the following reasons:

- The model can be used to attract equity investors interested in tax concessions (by cashflowing the Offset through to the investors), thereby growing the pool of monies available for production and assisting producers to finance production budget ‘gaps’;
- The model provides producers with leverage to negotiate a wider range of deals with distributors, as well as retain rights and receive better recoupment positions;
- An improvement in returns from investment would drive increased confidence from the private sector and fuel more sustained growth and profitability in the long term;
- The model lowers reliance on direct subsidy;
- The model provides an effective funding door for producers with strong commercial projects;
- The model should significantly increase the overall value and volume of production and levels of private investment.
- While 10BA is no longer utilised to the extent it once was, it is still used effectively by a number of production companies and investors. To remove this and replace it with an untested offset could substantially reduce the pool of finance available to producers;
- In supporting an Australian eligibility test similar to that already in place under 10BA the model continues to emphasise the cultural objectives of the mechanism;
- Expanding the list of formats eligible for the Offset reflects the changing nature of industry practice and economic dynamics;
- Imposing a threshold limit opens up the Offset to the majority of Australian productions while at the same time supporting genuine production;
- ‘At risk’ rules require loosening to 20 per cent of the investment to promote third party private investor interest;
- Without tax benefits for investors there will be a significant decrease in the level of private investment into the industry and the private investment that remains may impact negatively upon production businesses.

In order to cap the cost to government, it has been proposed that an altered Offset should be only made available to a limited number of businesses or producers that have been licensed by the Government, similar to the licence under the FLIC Scheme.

However, the AFC does not support the licensing of franchises for the following reasons:

- Licensing necessarily limits the growth of the industry to the number of businesses/franchises who have obtained the licence and does not permit entrepreneurial growth;
- Diversity is similarly limited by the number of licences – already established businesses are likely to be in a better position to benefit than less established businesses and new entrants;

- If the licence allows the franchise to become merely a financier, this would lead to the creation of multiple private bureaucracies, with duplicate administrative overheads which would be far less transparent than for the support currently delivered via direct funding;
- UK experience with franchises was not successful.

The AFC believes that there is a natural cap to volume and growth and subsequent cost to government:

- Raising an additional 60 to 80 per cent of a project's budget from non-government sources remains a significant challenge;
- Overseas experience demonstrates a natural plateau of production volume following the introduction of significant new tax measures;
- The numbers of private investors likely to invest for tax concession purposes is limited by: (i) a decrease in the numbers of tax payers in the highest tax bracket; (ii) the reduced benefit to those in lower tax brackets; (iii) the desire for investors to diversify their tax management products; and (iv) the inherent uncertainty for investors in a mechanism based on government policy enforced through the ATO;
- TV production will be capped by the limited pool of licence fees available from the broadcasters

The parameters of applicability of the Offset to digital content need to be considered as part of the Government's separate policy process for supporting digital content.

Which areas require continued direct support?

In order to deliver on the objectives detailed above the AFC believes direct government assistance needs to focus on those areas of the audiovisual industry that will not be fully met by the market as well as those new and developing areas of the industry that involve a significant amount of risk – risk unlikely to be taken by the market. These areas include:

- Project development;
- Professional development;
- Innovative and risk-taking screen content production;
- Support for business/enterprise development;
- Indigenous content;
- Screen culture;
- Research and analysis;
- Archiving, preservation and access;
- Marketing and export development;
- Training.

What is the most appropriate model and structure for direct government support to the film industry?

The AFC has outlined above those areas it believes must continue to be delivered through direct government funding mechanisms. Whilst the AFC believes current structures demonstrate efficiency and effectiveness, it also believes the same outcome could be achieved through a merged or newly created agency as is the case in a number of international territories including the UK.

Efficiencies and synergies that could be gained by locating all the directly supported programs under one agency include:

- Increased co-ordination and strategic streamlining of development, production and marketing assessment processes to achieve government and industry objectives;
- Improved co-ordination of business and enterprise development goals;
- The creation of a unified voice/brand to the industry and the market, both locally and internationally;
- The centralisation of archival mechanisms, resources and infrastructure, benefiting the full exploitation and lifecycle of content, and improving the creation, preservation and availability of Australia's audiovisual content to Australians.

Nevertheless, the AFC recommends that a number of key issues need to be taken into account in considering a final structure:

- A change in agency structures should be consequential to the introduction of an effective and tried and tested indirect funding alternative.
- A wide consultation process must take place in the lead up to any significant change in the structure of direct funding agencies.

The AFC believes that the following principles should continue to underpin the Government's agency structure or structures:

- An independent arm's-length relationship between the agency or agencies and the Government is essential to its successful existence within the screen production industry. In dealings with investment partners, both nationally and internationally, the agency or agencies act commercially, and would be severely limited in its dealings or ability to attract partners and sponsors if it were to be identified as an arm of government, rather than a separate statutory body.
- The agency or agencies must remain under the *Commonwealth Authorities and Companies Act 1997 (*CAC Act). The CAC Act provides for clear and unambiguous accountabilities, whilst enabling the agency or agencies to operate at arm's-length to ensure effectiveness.
- Industry expertise must be central to the employment makeup of any agency or agencies in order that peer assessment and industry knowledge is maximised. In order to properly carry out its functions of investing in potentially successful scripts and productions, agency staff, management, advisors, and board members must make creative and commercial judgments. Therefore, it is vital that the agency or agencies employ people with direct knowledge and

experience of the screen production industry, nationally and internationally. The expertise, credibility and industry relationships that such employees bring to the organisation and its programs are invaluable.

Introduction

The Australian Film Commission (AFC) is an Australian Government agency, operating as part of the Commonwealth Film Program to ensure the creation, availability and preservation of Australian screen content. The AFC enriches Australia's national identity by fostering an internationally competitive audiovisual production industry, making Australia's audiovisual content and culture available to all, and developing and preserving a national collection of sound and moving image.

The AFC welcomes this important opportunity to examine support measures for the Australian production industry. The AFC believes it is timely to examine the range of government support measures provided to fund film production in Australia and ensure that the film funding measures and structures that underpin them are appropriate and effective.

Part 1 of the AFC's submission provides the historical, economic and structural basis from which to examine the current state of the Australia audiovisual industry. This part details:

- the early history of government intervention in the audiovisual industry;
- recent developments in government intervention in the audiovisual industry;
- the current state of the industry; and
- the rationale for ongoing government support for the industry.

Part 2 addresses the key questions raised by the review issues paper:

- What does the Australian film industry need to do to increase its chances of success and sustainability?
- How can government objectives best be met?
- What balance should be struck between direct and indirect funding?
- What options are there for stimulating growth in private investment?
- What is the most appropriate model for direct government support to the film industry? Is the current agency structure a model that is delivering the best possible outcome?

Part 1 Australian audiovisual content and the Commonwealth Film Program

1.1 History and context: Early history of government intervention in the audiovisual industry

From 1906 to 1911, Australia was the most prolific producer of feature films in the world. During this period, Australian producers had easy access to cinema screens as supplies of overseas films were irregular.

This success began to decline in 1913 when a series of takeovers and mergers in distribution and exhibition led to the creation of the monopolistic 'Combine', trading as Australasian Films. However, Australasian Films' market position was gradually eroded as Hollywood studios – the world leaders in film production following European decline during the war – began to establish distribution branches in Australia during and after World War I. The US studios also began to exercise de facto control of the exhibition sector through what was known as 'the contract system' which required exhibitors to take all or most of a studio's output over a given period, generally three, six or 12 months. Overseas domination of the exhibition sector was formalised in 1931 when the Fox Film Company acquired a controlling share of the largest cinema chain, Hoyts, ensuring priority for US product.

Australian feature filmmaking faced further challenges in the following years with the Depression and the debilitating increase in production costs associated with the introduction of sound.

Two inquiries held in 1927 and 1934 attempted to act on the problems facing the industry, the latter NSW inquiry introducing screen quotas. However, the quotas were ultimately unsuccessful because of foreign distributor resistance and the lack of government support for finance and low cost studio facilities.

And while some producers – most notably Cinesound – had partial success in the 1930s, World War II almost fatally disrupted production allowing the industry to sink over the following 30 years.

It was not until the advent of television and the rise of the cine-literate culture of the 1950s and 60s that a sharpened focus on Australian content developed leading to a campaign for government intervention in the film industry.[2]

In 1960 the Government introduced television content quotas with at least 40 per cent of total transmission time to be filled with Australian programs, and one hour a week between 7.30 and 9.30pm to be 'distinctively Australian'. The Australian Broadcasting Control Board (ABCB) in 1961 ruled that no more than 20 per cent of advertisements should be shot outside of Australia, while in 1962 the overall Australian content requirement was increased to 45 per cent from 1964 and 50 per cent from 1965. In 1966 the ABCB announced a drama quota, with a requirement

[2] Elizabeth Jacka, Film, *Media in Australia*, p76

that stations screen two hours of locally produced drama per 28 days in peak time. These regulations laid the foundation of the skills base for the film industry in the forthcoming decades.

The importance of content regulation to the development of the screen production industry cannot be overestimated. The continuation and strengthening of these regulations over the decades since their initial introduction has not only created the opportunities for production, the development of skills and the support of infrastructure, but it also created a growing and increasingly strong domestic television market and a strong audience appetite for Australian programs. The existence of strong broadcasters committed to the production of Australian content has served to underpin the direct industry support initiatives by government.

The 1970s saw a major expansion in the film industry following the introduction of a range of government support measures beginning with the Australian Film Development Corporation (AFDC) in 1970 (replaced by the Australian Film Commission in 1975) and the Australian Film and Television School (AFTS) in 1973 (Radio added in 1981). State agencies in South Australia (1972), Victoria (1976), NSW (1977), Tasmania (1977), Queensland (1977) and Western Australia (1978) were also established. The AFC, as opposed to the AFDC's role as a film bank, had a greater role in film development and film culture. In addition to providing loans and making investments, it funded script and project development, and began to fund low-budget, short, experimental and documentary work, a role formerly held by the Experimental Film Fund, jointly administered by the Film Committee of the Australia Council and the Australian Film Institute. The Creative Development Fund was also set up in 1978 to fund feature films. This significant government intervention promoted and enabled a skills and infrastructure base for the film industry with facilities built and talent of an international standard nurtured and developed.

The AFC was the primary film funding mechanism until the introduction of Division 10B of the Tax Act in 1978, and Division 10BA in 1981. While there had been some private investment in films in the 1970s, this was minimal. With 10BA, the private sector became the primary financier of Australian film and television production. Originally offering 150 per cent tax deduction on investments in a qualifying Australian project as well as a tax free haven on the first 50 per cent of revenue a film earned, Division 10BA underpinned the boom in production of Australian film and television. During this eight-year period, 10BA drove an almost doubling of production levels to an average of $120 million worth of film and television projects per year. The period 1981 to 1988 also witnessed an average market share of 12.4 per cent of Australian films at the local box office. The boom in both film and TV enabled formats such as mini-series to become viable and provided capacity-building infrastructure, the development of world-class practitioners and crews, and a post-production sector that is now globally competitive.

However, these significant benefits were overshadowed by higher than expected costs to government and the perception of some rorting. This led to the steady downscaling of tax concessions first to 133/33, then to 120/20, and then finally to its current level of 100 per cent in 1988. Since then, investment levels and the contribution of 10BA to production budgets, in particular, has declined.

Following recommendations for change in 1986, the Government established the Australian Film Finance Corporation in 1988 with a $70 million budget, to cap costs and be the major government driver of film production. The FFC was empowered to invest in feature film, television drama and documentary productions with commercial potential and market participation.

Since its inception the FFC has invested in $2.2 billion worth of production and recouped a total of $249.7 million to June 2005. The FFC has invested in 193 feature films and as of 2003/04 had fully recouped its investment in nine features since 1988/89. The FFC's current budget allocation is $70.5 million (2006/07).

Following the establishment of the FFC, the AFC's role was redefined in 1989 as the Government's primary development agency, supporting script and project development, emerging talent, and professional development by funding short films, documentaries and features, research and analysis, and industry development by screen culture activities and promoting Australian films internationally.

Other significant developments in the 1980s included the establishment of the National Film and Sound Archive (merged with the AFC in 2003); the establishment of the Australian Children's Television Foundation (primarily with Commonwealth Government Funding) to provide script development and production finance for Australian children's productions; and the separation of Film Australia from the AFC and its establishment as a government-owned independent production company in 1987. Film Australia had begun in 1911 as a one-man operation to record a visual chronicle of the newly federated Australia. It evolved into the Federal Government's filmmaking arm and today is funded to produce film and television programs under the National Interest Program: a contract with the Australian Government to devise, produce, distribute and market productions that deal with matters of national interest or illustrate and interpret aspects of Australian life. Film Australia also provides support to the Australian documentary sector through a range of services and facilities.

1.2 Recent developments in government intervention

It was not until 1997 following the Gonski Review of Commonwealth Assistance to the Film Industry, that a new mechanism was introduced to promote private investment in the industry: the Film Licensed Investment Company (FLIC) Scheme. Despite a recommendation that the FLIC Scheme provide a 120 per cent tax concession on investment in the licensed company, a pilot scheme was introduced with a 100 per cent concession on any investment.

The Government has recently renewed the FLIC scheme, also at a concessional rate of 100 per cent of the investment in the company, and issued a single licence to Mullis Capital Film Licensed Investment Company. The company is permitted to raise up to $10 million in each of the years 2005–06 and 2006–07. However, this FLIC scheme is reported to have failed to reach its investment target in this financial year[3].

[3] Sandy George, *The Australian*, 'Investment Collapse bad news for local industry', 5 July 2006

The other major outcome of the 1997 Gonski Review was a refocussing and clarification of the complementary yet fundamentally different roles of the AFC and FFC. In line with its recommendations on maintaining a 'many doors' policy to ensure diversity, creativity and innovation in programs, the Gonski Report argued that the AFC concentrate on its core functions of supporting script development and the development of new entrants into the industry to progress from training institutions to the commercial environment of the industry, while the FFC provide production assistance to developed projects which demonstrate financial support from the private sector.

With the growth of the foreign production sector, federal funding was provided from 2002/03 to Ausfilm – Australia's international film marketing agency - to establish a one-stop-shop that will facilitate the location of increased offshore production activity to Australia.

A further mechanism, the Refundable Film Tax Offset (the 'Offset') was introduced in September 2001, directed at attracting large budget, mostly foreign film and television productions. The Offset is applied at a fixed rate of 12.5 per cent of qualifying Australian production expenditure on a film project. Eligibility for the offset is governed by a minimum level of qualifying Australian production expenditure (QAPE) of A$15 million on the production of the film. Formats eligible for the tax offset are: Feature films including animated features; telemovies; television drama mini-series; and eligible television series.

The FFC in mid-2004 introduced an evaluation door in addition to its marketplace process. Under the evaluation door, the FFC introduced expert staff to provide creative input and assess the quality of feature film projects.

Under the Coalition's 2004 election policy A World Class Australian Film Industry, the Government committed an additional $17.5 million over four years towards script development and low budget features allowing the AFC to strengthen its professional development role and $6.9 million over three years to expand screen culture activities particularly those directed at the educational sector, regional touring and international promotion. Film Australia received additional funding for a 10-part series on Australian history.

1.3 Current state of the industry

The most recent measure of the size of the production sector is the 2002/03 ABS Television, Film and Video Production survey which shows that the total production value of the industry is $1,502 million – a fall of 16 per cent since the last survey which was $1,792 million in 1999/2000. There were 2,174 businesses operating in the film and video production services sector at the end of 2002/03, a 10 per cent increase on the 1,975 businesses recorded by the ABS as operating in 1999/2000.

The 2,174 businesses in the film and video production services sector generated an overall income of $1.597 billion in 2002/03, up by 8 per cent from $1.474 billion in 1999/00, and an operating profit of $92 million, up from $77 million. The increase in income was in the provision of services – both production and post production – to other businesses; income from the production of completed works decreased.

Production for television continued to be the largest area of activity, accounting for $1.1 billion in production costs in 2002/03. However, this was down 13 per cent on the 1999/00 results. Commercials production also decreased, down by 10 per cent to $219 million. The value of production other than for television dropped by 40 per cent, from $233 million in 1999/00 to $142 million in 2002/03. Within this, feature film activity halved, falling from $149 million to $74 million.

The ABS data indicates that there were 16,427 people employed by businesses in the film and video production industry at the end of June 2003, an 8 per cent increase on the 15,195 employed at the end of June 2000. However, employment figures fluctuate dependent on the productions underway when the surveys were taken. Thus wages and salaries data may be a more realistic indicator of general employment trends in the industry – this indicator increased by 7.7 per cent between 1999/00 and 2002/03 with an annualised average increase of 2.5 per cent.

Federal Government allocations to key film agencies

Federal allocations to the AFC, the FFC, Film Australia, SBSi, AFTRS, Ausfilm and the Australian Children's Television Foundation totalled $168 million in 2005/06 rising from $153.8 million in 2004/05 and $143.4 million in 2003/04. In 2002/03 the value of direct federal public funding for the Australian screen content industry was $134.7 million or $6.70 per capita. This compares to A$2.9 per capita in the UK and A$13.9 in Canada.

Feature film

The number of local feature film productions rose from 16 in 2003/04 to 19 in 2004/05 but remains below the average over the previous 10 years of 24 local features per year. Australian films have averaged 5.0 per cent box office takings over the past 13 years ($436 million out of a total of $8,757 million). The Australian feature film share of box office was 2.8 per cent ($23.1 million) in 2005, rising from 1.3 per cent in 2004 and 3.5 per cent in 2003.

Local distributors and exhibitors, such as Roadshow, Palace, Icon, Dendy, Hopscotch, Madman, Accent, Sharmill, Buena Vista, Hoyts and Sony, continue to play an important role in supporting the Australian film industry by contributing finance to produce Australian films through distribution guarantees and advances, as well as considerable expenditure on print and advertising costs.

Television production

The television industry, including the television commercial production sector, underpins the financial strength and skills base of the audiovisual production industry in Australia. It sustains an infrastructure of skills, experience, equipment and facilities crucial to the viability of the production sector as a whole and is vital in developing and supporting Australia's creative community and training its screen content personnel.

The sources of income for film and video production services are dominated by income from the television sector. Of the $779 million of income received for the production of film and video in 2002/03, $394 million was for the production of television programs. In addition, $228 million was received for the production of commercials (predominantly for television). Together these sectors comprise around 80 per cent of the income received by the film and video production industry in Australia.[4]

Television remains one of Australia's most important cultural mediums and provider of information on matters of public interest. Australian television drama depicts Australian stories for Australian audiences. It plays a direct role in the development of a vibrant sense of national identity, providing an outlet to reflect the diversity of cultural expression within Australia. Television documentaries, particularly Australian social and historical documentary, are the most widely accessible medium for Australian audiences to watch contemporary explorations of Australian society. The broadcasting of Australian content is essential to the cultural relevance of the television broadcasting sector. Access to minimum levels of Australian content by Australian audiences is therefore a fundamental tenet of our television system.

Television drama

Australian drama (local and co-produced) made for television has been trending downwards for several years, with total expenditure in Australia falling from a peak of $316 million in 2000/01 to $200 million in 2004/05. Local and co-produced TV drama hours have fallen from an average of 773 per year in the second half of the 1990s (including 722 hours of Australian programs) to 607 hours in 2004/05 (575 Australian).[5]

A large part of this has been due to the decline in Australian adult drama on the ABC. Australian content on the ABC has declined from around 58 per cent of total hours broadcast in the 1990s to 49.3 per cent in 2003/04 and 52 per cent in 2004/05. First run Australian adult drama content fell to 3 hours in 2004/05, down 96 per cent from 83 hours in 2001/02. Overall, including repeats, the ABC screened 163 hours of Australian adult drama content in 2004/05 up from 133 hours in 2003/04 but still significantly down from the 349 hours of Australian adult drama screened in 2000/01. At the same time, the hours of imported drama have increased 101 per cent from 342 hours in 2000/01 to 688 hours in the last financial year – following a peak of 771 hours in 2003/04.

In response, the Federal Government increased funding to the ABC by $30 million over the next three years for new Australian television content production.

Documentary

Documentary production in Australia is estimated at around 287 hours with production costs of $59 million a year. Although television broadcasters play a significant role in Australian documentary production most documentary activity occurs in the independent sector. An average of 185 hours worth $47 million has been produced annually by production companies in the eight years 1996/97 to 2003/04, compared to 102 hours worth $12 million by broadcasters.

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[4] ABS, *Television, Film and Video Production 2002-03* (cat. No. 8769.0)

[5] Get the Picture Online, http://www.afc.gov.au/gtp/mptvdramasummary.html and http://www.afc.gov.au/gtp/mptvdramaspending.html

After a peak in 1990/00 boosted by titles made for the Centenary of Federation, independent documentary activity fell in both 2000/01 and 2001/02, but rose slightly in 2002/03 and again in 2003/04. The high level in 2003/04 was due to an increase in production of documentary series, while production of single documentaries fell to an eight-year low.

Australian commercial free-to-air broadcasters spent $9.2 million on Australian documentary programming in 2004/05, a 318 per cent increase on 2003/04.

Sources of finance for Australian features and television drama

For **Australian feature films**, sources of finance averaged over the five years 2000/01–2004/05 comprised, per annum:[6]

- Federal and state government sources (including ABC and SBS) – 36% ($29.9m)
- Australian private (non-industry) investors – 23% ($17.8m)
- Australian film and television industry (including broadcasters, film and TV production companies, distributors) – 8% ($7.5m)
- foreign sources – 33% ($36.1m); varies significantly year to year, largely due to the presence or otherwise of high-budget principally foreign-funded films.h

For **Australian TV drama**, sources of finance over the same period comprised:[7]

- Federal and state government sources (including ABC and SBS) – 25% ($53.8m)
- Australian private (non-industry) investors – 6% ($12.1m)
- Australian film and television industry (including broadcasters, pay TV channels, production companies, distributors) – 53% ($111.2m)
- foreign sources – 17% ($35.9m).

Private investors

According to latest figures available from the ATO, the number of private investors in the Australian film and television industry has fallen from a high of 4,614 in the middle of the 1990s to only 1,475 in 2003/04. Total investment from private individuals (including 10BA, 10B, and FLICs) has also fallen from $39.49 million in 1995/96 to $22 million in 2003/04. There was a fall in average investment over this period from $20,539 to $14,915.

Digital content

The digital content industry refers to the range of digital products and services being developed across film, broadband, mobile content, broadcasting and the ICT (information and communications technology) sectors, and includes products and services such as: visual effects and animation in digital film production and post-production, computer and online games, interactive multimedia e.g. websites, and CD-ROM, digital new media arts production.

Digital technology increasingly affects every stage of screen content production,

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[6] Get the Picture Online http://www.afc.gov.au/gtp/mpfeaturesinvestors.html
[7] http://www.afc.gov.au/gtp/mptvdramafinance.html

distribution and exhibition. Digital technologies enhance existing processes as well as facilitating new methods of screen content production and delivery.

The digital content industry is a global one, growing faster than other economic sectors. The Australian Digital Content Industry is estimated to produce output worth $21 billion, almost 3.5 per cent of Australia's GDP (compared with the UK and US, where GDP shares are conservatively estimated at 5 per cent and 7.8 per cent respectively) and employs about 300,000 people.

Federal and state governments provide some limited direct support for digital content production. In the UK, Europe and Canada, the production and availability of local digital content is supported through a mixture of regulation, investment incentives and subsidy.

The recently released Digital Content Industry Action Agenda report [8] is aimed at assisting the digital content industry to direct its efforts to generate new opportunities to benefit the Australian economy. The report recommends that in order to grow, the digital content industry needs regulatory and investment frameworks that operate under technologically neutral principles, and encourage interoperability, innovation, investment and competition.

1.4 What is the rationale for ongoing government support to the Australian audiovisual industry?

Government support for Australia's audiovisual industries through regulation, direct subsidy and indirect incentives exists to deliver cultural outcomes to Australian audiences, that is, Australian stories and Australian characters on Australian screens.

Australian audiovisual content plays a central role in creating community cohesion and promoting a sense of national identity. Since the introduction of film quotas in the 1930s and television content quotas in the 1960s, through to the establishment of the AFC and the AFTRS in the 1970s, Australian Governments have committed to policies which recognise that Australia needs to express our constantly evolving identity, and to communicate this to Australians (and the world), through the most popular and accessible forms of cultural expression.

Australian content remains extremely popular with Australian audiences as is clear from recent examples of ratings for Australian programming,[9] box office results[10] and video and DVD rentals and sales.[11]

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[8] Available at:
http://www.dcita.gov.au/arts/film_digital/digital_content_industry_action_agenda/dciaa_report

[9] Channel 10's *Mary Bryant* was the most watched program on the night it screened in October 2005 with 1.6 million viewers. *The Alice* (Nine Network) was the most watched telemovie of 2004. The mini-series *Jessica* was the 3rd highest rating drama program the week it screened on Network Ten and won its timeslot against Sunday night US and UK films. When *Looking for Alibrandi* screened in 2003 on Network Nine it rated higher than *Gladiator*. Long-running Australian drama series also continue to rate highly with *Kath and Kim* the most watched comedy series in 2003, 2004 and 2005. *McLeod's Daughters*, *Home and Away, Blue Heelers* and *All Saints* all consistently rate in the top drama titles.

[10] *Wolf Creek* made $6 million at the Australian box office in 2005 and was the highest ranking film in its first week of theatrical release, while *Jindabyne* has taken over $3 million in its first four weeks of release.

[11] Australian DVD and video releases enjoy continued popularity with Australian audiences through rentals and purchases. DVD sales have continued to rise, from around 40 million units in 2004 to 48 million in 2005, while the 2005 share of Australian-produced titles on VHS and DVD was at 2.9 per cent (similar to 2004's 2.7 per

In order to meet its cultural objectives, the Government has assisted in the development and maintenance of an Australian audiovisual industry with the capacity to create relevant, popular and diverse content. An effective, healthy industry requires continued support to develop and grow a large skills base, substantial infrastructure and well-capitalised, entrepreneurial companies with access to private investment.

Delivering cultural outcomes and supporting the development of a healthy audiovisual industry also produces a number of economic benefits. The Australian audiovisual production industry employs over 16,000 Australians, and generates over $1 billion worth of economic activity. Australian audiovisual content has also been one of the great ambassadors for this country, with films such as *Crocodile Dundee, Priscilla, Queen of the Desert, Shine, Babe* and *Ten Canoes* and television programs such as *Neighbours, Home & Away* and *McLeod's Daughters* establishing an international profile for our country and our culture with positive flow on impacts for tourism and trade. Notwithstanding these economic benefits, government intervention in the audiovisual sector remains primarily rooted in the delivery of cultural outcomes.

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cent). (AFC analysis of Trade Service of Australia VideoSource data, March 2006. The VideoSource database includes around 95 per cent of all releases for rental and sale since 1983.) Notable successes include *Moulin Rouge* as the 4th highest selling DVD and 3rd highest selling video in 2001, *Chopper* as 3rd highest video rental in 2001, while *Lantana* and *The Bank* were in the top 20 video rentals in 2002. In 2004, a special anniversary edition of *Adventures of Priscilla, Queen of the Desert*, became the 17th highest selling DVD in Australia, ten years after its initial cinematic release. *Kath and Kim* also continued its television success with strong sales of various DVD releases, while *McLeod's Daughters* and the comedy series *We can be heroes – Finding the Australian of the Year* also enjoyed strong sales in 2005.

Part 2 What does the Australian film industry need to do to increase its chances of success and sustainability?

2.1 What are the key challenges facing the screen production industry?

The AFC believe that the key challenges facing the screen production industry are as follows:

- The volume of feature film, television drama and documentary production is at levels too low to sustain an industry to deliver on cultural objectives into the future;
- Private investment from outside of the industry, at both the enterprise and project-based level, is low, with private investment by individuals in their own businesses in lieu of outside investors, high;
- Marketplace dynamics are rapidly evolving with project financing increasingly difficult;
- Expanding platforms for content continually impacting and changing existing business models;
- Technological change continues unabated requiring constant skills base retraining and capital expenditure;
- Foreign production is increasingly relied upon to underpin industry infrastructure;
- Australia is falling behind the rest of the world in the creation of digital content and applications and subsequently becoming less internationally competitive; and
- Industry growth is inhibited by existing structures of support, as they are weighted too heavily in favour of direct support

Each of these challenges is addressed in more detail below:

- *The volume of feature film, television drama and documentary production is at levels too low to sustain an industry to deliver on cultural objectives into the future*

The Australian audiovisual industry produces films and television programs that are valued by local audiences and which have found export markets in a competitive international environment. It has also produced world-class talent, which contributes to a significant international profile for Australia. Despite this, the Australian production industry remains small with volume at levels unsustainable for the industry to deliver on the Government's cultural objectives.

In terms of the volume of feature film production, Australia is at levels significantly lower than other nations around the world.

The AFC examined 14 other countries[12] and found that Australia rated 12th in terms of volume of production per capita with Australia producing 1.04 films per million head of population in 2003, compared to 4.45 films per million in Denmark, 3.57 films in France, 2.91 in the UK and 2.61 in Ireland. Australia ranked 13th out of 15 countries surveyed in respect of the share of local productions released domestically (8.6 per cent). This compared to 70.4 per cent for the US, 57.6 per cent in Ireland, 41.3 per cent in France and 11.5 per cent in Denmark.

The volume of feature film production today also compares poorly to levels experienced in the 1980s and 1990s. The number of Australian films produced in the 1980s averaged 30, peaking in 1985/86 with 42 features produced. This fell to an average of 25 per year in the 1990s and 20 in the years 2000/01-2005/06.

The value of feature film production has also been falling. The annual average value of local film production has fallen from $108 million for the second half of the 1990s to $92 million for the period 2000/01 to 2005/06.

Following an increase in direct subsidy to the FFC and the AFC, preliminary results from the latest National Feature Film and TV Drama Survey indicate an increase in local feature production to 25 films for 2005/06. This level has not been achieved since 1999/2000, although it remains below the average for the 1980s of 30 films per year. The value of the 2005/06 Australian feature slate was $97m, compared to $61m in 2004/05.

Feature films made as co-productions have risen from an average one title a year spending $3m in Australia in the second half of the 1990s to an average of two titles a year spending $14 million in Australia in the five years since 2000/01.

In terms of television drama, the production of Australian and co-production telemovies, mini-series, series and serials grew significantly during the 1990s, with the total value of the annual slate reaching $350 million in 2000/01. However, over the past four years the value of production has been falling, reaching a low of $218 million in 2004/05.[13] This decline in production value is reflected in the decline in the number of hours of Australian and co-produced drama in the slate, from a high of 848 hours in 2000/01 to 607 hours in 2004/05.

As outlined on page 16, much of this decline can be attributed to a fall in the level of Australian drama and rise in imported drama on the ABC.[14]

As a consequence of the low levels of production, the Australian production industry is finding it more and more difficult to retain creative and innovative talent.

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[12] United States, Canada, Denmark, France, Germany, India, Ireland, Japan, South Korea (The Republic of Korea), New Zealand, South Africa, Spain, United Kingdom, Brazil

[13] *National Survey of Feature Film and TV Drama Production 2004/05*

[14] The fall in production is not reflected in Australian drama expenditure or hours broadcast by the commercial free-to-air networks, which have consistently met, and sometimes exceeded, the requirements of the Australian Content Quota.

- *Private investment from outside of the industry, at both the enterprise and project-based level, is low, with private investment by individuals in their own businesses, in lieu of outside investors, high*

Private investment in Australian film and television – from sources outside of the production and distribution industry – has fallen in recent years and is at relatively low levels.

According to the AFC's National Survey of Feature Film and Television Drama Production, private investment has contributed an average of 23 per cent to Australian feature budgets and 6 per cent to TV drama budgets over the five years 2000/01–2004/05 – an average of 9.8 per cent across the whole Australian feature film and television drama slate. This compares to 27.5 per cent from Federal and State government funding, 39 per cent from Australian-based film and television production companies, distribution companies, commercial free-to-air broadcasters and pay channels and 23.6 per cent from foreign investors (see page 17 for a full breakdown of sources of finance for features and TV drama).

It is clear that Division 10BA of the *Tax Act* no longer acts as the significant private investment incentive it once did. Since 10BA was reduced to a 100 per cent deduction in 1988 and the FFC was introduced as the Government's main vehicle to facilitate production, the total budget for 10BA projects has fallen to an average of $44 million per year from 1989 to 2005, down from the eight year average of $120 million worth of film and television projects from 1980 to 1988 .

In the past five years 10BA investors have contributed to on average only 10 features (14.6 per cent of the value of feature production), 3 television dramas (2.2 per cent of television drama production) and 7 documentaries (3.4 per cent of documentary production). Of these projects, 10BA funds provided 39 per cent of the total budgets.

There are several reasons why 10BA does not attract the levels of investment it once did. The primary reason for falling investor interest has been the reduction over time in the deduction rate from 150 per cent of investment and 50 per cent of earnings to 100 per cent on investment and none on earnings by the late eighties. Lowering the deduction to 100 per cent increased the level of risk to an investor to an economically unacceptable level.

There are also a number of administrative barriers and ambiguities that increase investor uncertainty. Under the Tax Act an investment in a film asset is not treated as a business expense as other more tangible assets – returns on investment are treated as income rather than returns on capital, a disadvantage to an investor when compared to other comparable investments. The application of the 'at risk' rule by the Australian Tax Office has deterred many investors, with the concept having been refined by the ATO over time. The ATO have also progressively ruled that certain items of expenditure are non-deductible e.g. completion guarantees, insurance, marketing and legal fees. This has decreased the certainty and attractiveness of film investment for investors.

The competition for private investment across all industries too has changed since the original introduction of the 10BA (and 10B) tax concessions. The high-risk nature and instability of film assets in an environment where there are other investment opportunities including biotech, mining, agriculture and privatisation of government assets, has further eroded the attractiveness of film investment. One example competing against film investment is the R&D Tax Concession which allows companies to deduct up to 125 per cent of qualifying expenditure incurred on R&D activities when lodging their corporate tax return and a 175 per cent Incremental (Premium) Tax Concession and R&D Tax Offset in certain circumstances.

In 2004, the Government announced a review of Divisions 10B and 10BA of the Tax Act. Submissions to the review have identified a number of important but relatively minor changes that could be made to the 10BA regime. These are not however expected to drive significant levels of new private investment into the film and television industry.

The other major private investment incentive for the Australian film industry is the Film Licensed Investment Company (FLIC) Scheme, introduced following the 1997 Gonski Review of Commonwealth Assistance to the Film Industry, which recommended a FLIC Scheme providing a 120 per cent tax concession on investment in the licensed company. A pilot scheme was introduced with a 100 per cent concession on any investment. The main difference between a FLIC investment and 10BA is that the 100 per cent concession was guaranteed on a slate of projects and a product ruling or certification process was unnecessary. Two FLIC licensees were appointed in April 1999 – Content Capital Ltd and Macquarie Film Corporation Ltd. Each could raise up to $20 million in concessional capital over two financial years ending June 2000. Only $22.4 million out of the possible $40 million was secured by that date: $16.26 million for Macquarie and $6.14 million for Content Capital. The Government has recently renewed the FLIC scheme, also at a concession rate of 100 per cent of the investment in the company, and issued a single licence to Mullis Capital Film Licensed Investment Company. The company is permitted to raise up to $10 million in each of the years 2005–06 and 2006–07. However, this FLIC has failed to reach its investment target in 2005-06, as did the non-FLIC film investment group, Future Films[15].

Neither the quantum planned for nor the diversification of the investor base sought from the FLIC scheme was achieved, with only a small number of investors being attracted. Nor did the model succeed in widening the film base as in most cases the FLICs co-invested with the FFC. However, the $21.4 million of additional finance to the industry, over a period of 18 months to two years, was a significant contribution at the time given the otherwise low levels of private sector investment.

The other major tax incentive – the Refundable Film Tax Offset – is directed at attracting large budget, mostly foreign film and television productions and not designed as a private investment incentive, with the deduction applying to producers' taxable income.

Few Australian productions are able to access the Offset due to the A$15 million threshold. Over the past five years there has been an average of only one Australian film and two co-productions per year that have had budgets over $A10 million. Most Australian film budgets range between $A1-6 million.

[15] Sandy George, *The Australian*, 'Investment collapse bad news for local industry', 5 July 2006

- *Marketplace dynamics are rapidly evolving with project financing increasingly difficult*

The Australian film and television production sector operates within the context of the domestic and international market.

While the capital cost of production is high the marginal cost of reproduction is relatively small. This results in three effects. First, the cost of distribution of the finished product is low and it is possible for that cost to be borne by someone other than the producer of the film. Second, this makes it possible for the price to vary from market to market since the price being charged is not dependent upon the actual cost of production. Third, as a result of their control over channels of distribution and exhibition it has long been the case that distributors and exhibitors recoup their costs and take a profit before any revenue is returned to the producer.

Vertical integration of businesses (combining production; distribution; exhibition and broadcasting) and the ability to reduce the risk involved in production when combined with the size of the domestic market give the US a huge comparative advantage in the international marketplace. These factors have made the US the largest audiovisual market in the world and the largest exporter of film and television.

In contrast, the Australian domestic marketplace is small and far less vertically integrated. While distribution and exhibition tend towards integration and concentration, production of drama is largely independent and fragmented. Few Australian producers are vertically integrated and fewer still have their own capital to fund development.

Exhibitors and distributors take most of the revenue generated from the theatrical box office. Even a successful domestic theatrical release returns a relatively small part of the cost of production. Domestic television licence fees do not cover the cost of mini-series, telemovies, children's drama and most series. As a consequence drama producers go to the international marketplace in order to finance the 'gap' by raising distribution advances or presales. Distribution channels are tightening, and the international market is becoming tougher with fewer and fewer international presales. Foreign sources provided $58 million to Australian TV drama production finance in 2000/01. This has fallen to $25.8 million in 2003/04 and $33.4 million in 2004/05. Australian producers must compete with the high volume of US product and also with producers from other small nations seeking to raise deficit finance for their own domestic productions.

Over the longer term the Australian industry has been very successful for its size, but it is now operating in an environment where there is increasing pressure on budgets and where financing is tighter than ever before. This constraint on resources further undermines Australia's competitiveness in the international marketplace. In the international television sector, there has been an increase in local content quotas, an increase in the number of broadcasting services and consequent to this, pressure on licence fees. In the international feature film sector, Australian films face greater competition from US studios who have set up their own art house production companies and strong national support systems such as in the UK, which are increasing the level of local productions.

- *Expanding platforms for content are continually impacting and changing existing business models*

  Multi-platform and multi-device entertainment is becoming increasingly important to Australian audiences seeking screen content anywhere and at anytime. New platforms for delivering content have come about through the convergence of entertainment, media and technology. Growth in broadband is fuelling the consumption of video-on-demand, and television-like services such as Big Pond TV delivered over the Internet. Mobile phone networks such as Telstra, Vodafone and Hutchinson's 3 are also growing their audiovisual content offerings introducing a vast range of content from news, information and entertainment services to drama ('mobisodes'), comedy and streaming television. These expanding platforms bring both opportunities and challenges for Australian screen content producers, but at this point in time, little financial returns.

  The development of new technology platforms does not dispense with the need to deliver cultural outcomes for Australian audiences in the audiovisual space. Just as technology is influencing the way Australians are consuming screen content, measures to ensure the prominence of Australian screen content need to be re-assessed.

  Regulatory measures aside, ensuring that Australian screen content producers have the ability to create cross platform production is key to supporting the creation of Australian screen content into the future and to the development of sustainable businesses in a changing environment.

- *Technological change continues unabated requiring constant skills base retraining and capital expenditure*

  The rapid pace of change means that new approaches to skills training that are timely, flexible and responsive to industry needs are essential. The recently released Digital Content Industry Action Agenda (DCIAA) report[16] found that industry based training structures are frequently resourced outside the accredited skills and training frameworks, which cannot respond rapidly enough to changes in technology and industry practice. The report found that convergence across sectors and growth in emerging markets such as interactive television, broadband and mobile content are offering new career paths across diverse industry sectors.

  To keep apace of technological change there needs to be greater linkages between industry, education and training providers. Australian producers need to be responsive to changes in the way screen content is consumed in order to compete within an increasingly globalised market.

- *Foreign production is increasingly relied upon to underpin industry infrastructure*

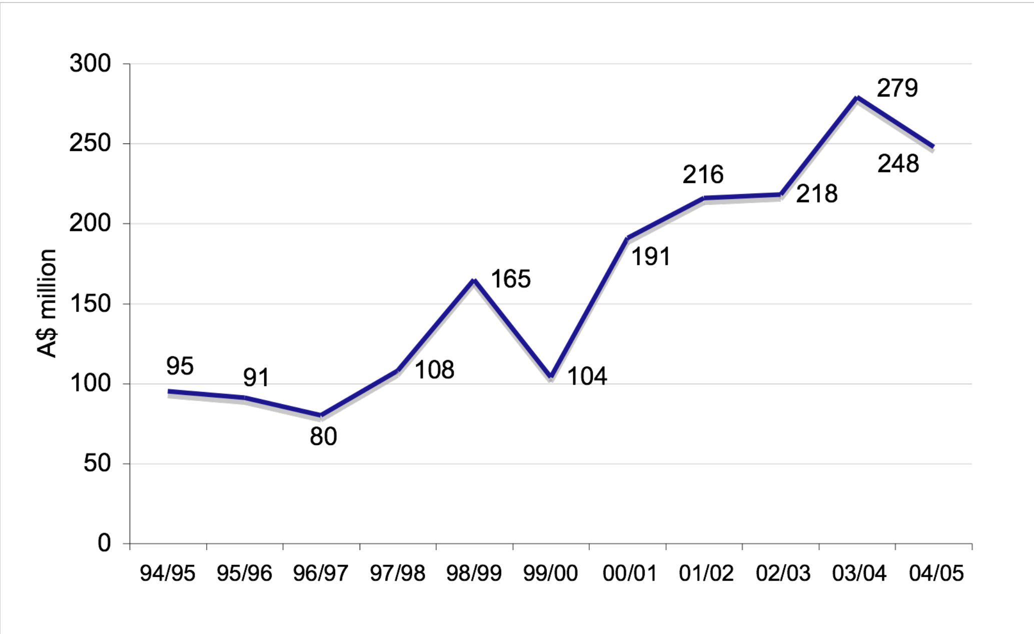
  The foreign production sector is increasingly becoming a vital part of the industry accounting for 73.4 per cent of feature production and 46.3 per cent of total (features and television drama) production expenditure in Australia in 2004/05.

[16] http://www.dcita.gov.au/arts/film_digital/digital_content_industry_action_agenda/dciaa_report

This compares to the 10 year average of 53.5 per cent for features and 31.5 per cent of total.

At the time of the Offset's introduction, the level of foreign film and television production was $216 million made up of $185 million of film and $31 million in television. In 2004/05 this figure has increased to $248 million with $243 million of that (approximately 98 per cent) in film, with foreign television production falling to $4 million. Averaged over the last 10 years, foreign productions have comprised 76 per cent film and 24 per cent television.

Spend in Australia by foreign features and TV drama, 94/95 to 04/05



Source: AFC, Get the Picture Online

Preliminary findings for the AFC's annual National Survey of Film and Television Drama Production, indicate a significant drop (well over 50 per cent) in foreign production is expected in 2005/06, with only two high budget US productions (one feature and one TV drama) plus smaller amounts of spending by Indian and Japanese productions. Despite this fall, foreign production remains a vital element of the Australian audiovisual industry.

Foreign activity in Australia takes on added economic significance for the industry as levels of local production fall. More and more, the local industry comes to rely on foreign production to provide stable ongoing employment, maintain key infrastructure and take on a greater role in providing training to the industry.

- *Australia is falling behind the rest of the world in the creation of digital content and applications and subsequently becoming less internationally competitive*

Australia lags behind most other developed nations particularly the United Kingdom, Canada and Korea, in terms of investment, presence, vision, and policies to support the creation of digital content and new audiovisual technologies. '360 degree commissioning' – where every project aims to utilise the specific characteristics of each communications medium to engage audiences in different ways – is now commonplace in places like the UK, Europe and the US where multi-platform blockbuster TV shows like *Walking with Dinosaurs, 24* and *Lost,* and multi-platform feature film blockbusters such as *Lord of the Rings* and the *Matrix* series are increasing in size and number. The Canadian Bell Content Development Fund has led to a significant number of digital properties being developed to add significant value to adults and children's TV dramas and documentaries with integrated multiplayer online worlds and games to enhance the audience experience. Examples of such developments in Australia do occur (for example, *Big Brother* and *The Dog and Cat News*) but remain the exception rather than the rule and in the case of the latter, came about as a result of direct government support.

Producing Australian digital content is expensive, characterised by many of the same economic conditions as the traditional audiovisual industries. Just as economies of scale and market size favour the US in the television and film industry, so it is with digital content.

The Federal Government currently provides some support for digital content production. While Australia is working towards a comprehensive digital content strategy through the recently released DCIAA report; UK, Europe and Canada have well developed policies and programs to ensure the production and availability of local digital content through a mixture of regulation, investment incentives and direct funding arrangements: see ***Appendix A*** for a list of funding measures. The DCIAA report also refers to a number of international Digital content policy programs and initiatives across the OECD.[17]

- *Industry growth is inhibited by existing structures of support, as they are weighted too heavily in favour of direct support*

Since the lowering of concession levels of 10BA in 1988 and the introduction of the FFC, structures of production industry support have been heavily weighted away from indirect support and towards direct support. There is no doubt that direct support over the last 18 years has significantly assisted in developing the audiovisual production industry. However, without a significant boost to indirect support, production volume and value will remain limited to within the parameters set by direct government funding. Successful projects and businesses will therefore continue to be intermittent and irregular.

The AFC feels that there is an unfortunate tendency to regard the period when the 10BA deductions were at their most generous as one in which films were simply made for the tax deal and not to find an audience. This era in modern Australian cinema was both artistically rich and commercially successful. Films such as *Crocodile Dundee, The Year of Living Dangerously, Gallipoli, The Man from Snowy River, Bliss* and top rating Australian mini-series such as *A Town Like Alice, The Dismissal*, *Bodyline* and *Return to Eden* were thrilling audiences in Australia and around the world. Moreover, during the 1980s the Australian box office share was robust, taking over 10 per cent for four years of that decade.

The availability of tax concessions proved attractive to investors and brought to the

[17] DCITA, *Unlocking the Potential: Digital Content Industry Action Agenda, Strategic Industry Leaders Group report to the Australian Government,* November 2005 p 31

industry a level of funding that allowed much more ambitious and better-resourced projects to be made. The tax concessions meant that productions could largely be funded from Australia, stimulating export revenue. Major production houses were formed in this time, talent of an international standard was produced and the production industry as a whole expanded. In the contemporary climate it would be difficult to make productions like these on the equivalent budget. Under the current support structure – that is a structure lacking an effective investment incentive – industry and business growth will remain limited.

2.2 How can government objectives best be met?

What should the Government's objectives be, moving into the future?

The AFC believes the following objectives should underpin the Government's policy response to the key issues articulated above:

- *Government assistance must continue to focus primarily on facilitating the creation of a rich variety of Australian high quality film, television and other audiovisual productions for Australian audiences*

To focus on facilitating the creation of a rich variety of high quality film, television and other audiovisual productions for Australian audiences requires a re-commitment from government to the cultural objectives of the Commonwealth Film Program as outlined above.

- *To facilitate this, and to assist in achieving sustainability, the audiovisual production industry needs to grow both its capital base and volume of production to levels significantly higher than currently exist*

As argued above the volume of feature film, television drama and documentary production is at levels too low to sustain an industry into the future that delivers on cultural objectives. The AFC believes that the audiovisual production industry needs to grow both its volume of production and capital base to levels significantly higher than currently exist.

The feature film, television drama and documentary business is characterised by high risk and uncertainty. Production in itself is a very risky undertaking and it is the chief reason why the Hollywood model is based upon the vertical integration of production, distribution and exhibition. The Hollywood studios are distribution led entities that have access to the revenues generated by theatrical, home video, DVDs, cable television and other forms of exploitation to offset in part the risk involved in production.

Far more films fail than succeed. Few television programs become hits. But large entities like the Hollywood studios have the cash flow and the accumulated value of their libraries to write off the failures and to attract finance from other sources. It is generally recognised that around one in 10 films have their investment returned through theatrical exhibition.[18] However it is the breakout hits, the films that

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[18] There are various sources to support this:
In Jack Valenti's (former Chairman and CEO of the Motion Picture Association of America) testimony to US Senate Committee on Commerce, Science and Transportation in 2003, Mr Valenti states that only around one

generate revenue constituting many multiples of their cost that spur the production of feature films. Increased volume of production increases the chance for success for both businesses and the industry as a whole.

At the core of a successful industry is the creation and retention of intellectual property, primarily though copyright. To the extent that this intellectual property remains under the control of Australians, it has the potential to create future wealth from its exploitation.

- *Growth will be underpinned by developing successful, sustainable and profitable audiovisual production businesses and enterprises*

A vital key to growing the Australian audiovisual industry lies in growing Australian audiovisual enterprises.

While the industry has moved a long way from the 1970s, the feature film and documentary sector remains largely a 'cottage' industry. While companies employing more than 100 people are increasing in number (up from seven in June 1997 to 25 in June 2000, and 36 in June 2003), close to 85 per cent of the 2,174 businesses in the film and video production industry remain small businesses employing four people or less. These are very similar to the percentages for small businesses in 1999/00.

AFC research[19] also indicates that not many of the producers, writers and directors who made a first feature film in Australia in the 30 years since 1970 have been able to follow up that experience with further production opportunities.

Government action, be it direct, indirect or via regulation, needs to be focussed towards assisting businesses and producers to build and strengthen, via improved economies of scale and volume as well as through improved bargaining power.

Enterprise development has been an increasing focus for the AFC. The AFC currently makes available General Development Investment funding that supports experienced practitioners to develop business plans, diversity strategies, raise equity finance and develop alternative income streams to build sustainable businesses. The AFC has also run Enterprise Tasman workshops which advise and assist successful screen businesses to build their companies into strong and flourishing enterprises, including reviewing the different ways in which companies can work together to ensure their stability and growth.

Further work is required to ensure the development and strengthening of independent production companies with strong business plans. Mixed development slates, diversification strategies, partnering and distribution support/output deals need to be encouraged, in order to develop strong, sustainable businesses – thereby assisting the production industry to become less dependent on individual projects and more enterprise driven.

in ten films ever gets its investment returned through theatrical exhibition: http://commerce.senate.gov/hearings/testimony.cfm?id=919&wit_id=2587

[19] http://www.afc.gov.au/gtp/oefocuscareer.html

- *The capacity of the industry to respond quickly to marketplace and technological change must be strengthened*

  In order to achieve sustainable growth across the industry, support for increasing levels of production in the screen content industry should be accompanied by increased access to market intelligence, opportunities for training and skills development, and opportunities for developing and maintaining international networks of screen content professionals and industry organisations.

  To create conditions in which film production companies flourish and continue to create commercially successful and artistically engaging audiovisual content, the industry requires relevant and up-to-date market intelligence. Access to comprehensive data and analysis concerning the film industry assists in developing an understanding of domestic and overseas audiences, the investment marketplace as well as marketing and distribution opportunities.

  Skills development and training in business development and management is key to enabling screen content businesses to attract investment, identify and exploit creative opportunities and increase returns on investment. Australian content producers in the future will be working predominantly with digital technology across a number of platforms which do not differentiate one screen from another – cinema, television, mobile, Internet, DVD, and games consoles. Continued access to training in the range of rapidly evolving digital technologies is important for screen content practitioners to bring their stories to the screen, as well as to continue to offer up-to-date technical skills necessary for attracting foreign production.

  Screen content industries are global. Participation and exposure at key international festival events and markets are critical to ensuring investment and overseas distribution. Success overseas assists Australian producers to achieve commercial viability. Australian film producers are already active internationally through international festivals, sales and distribution overseas as well as co-productions. Exchange and dialogue between Australian screen content professionals with those overseas needs to be fostered through participation in industry bodies, seminars, conferences, film festivals and educational training and exchange. Maintaining this will assist in developing strong international networks and relationships necessary for accessing international investment opportunities and new audiences through overseas distribution channels.

- *To remain viable and healthy, the industry requires structural diversity – in terms of the range of enterprises and services, ownership structures, financing mechanisms and content produced*

  Measures to encourage and enhance diversity in screen content creation are vital to developing the long term health and feasibility of the audiovisual production industry. Australia's screen content industry needs to produce a broad slate of products, across formats, genres and distribution platforms that enable different 'voices' to be heard and different 'visions' to be shared.

The diversity of output of the screen content industry is contingent upon the structural diversity of the industry itself. Structural diversity within the independent production sector promotes competition, efficiency, innovation and growth.

A lack of diversity in finance outlets will not serve to develop a screen content creation industry characterised by an array of organisations producing an assortment of screen content across a range of delivery platforms. Policies that diminish the number of ‘doors’ available to content producers to finance content creation will weaken the diversity of content produced. Commonwealth support needs to foster a range of funding sources – direct public funding, private investment, foreign investment and investment by film and television companies.

- *Private investment into businesses and projects needs to increase*

Increased private investment is another key to growing the audiovisual production industry and extending the diversity of its funding base. Low levels of private investment into the industry have been outlined above. Beyond expanding the finance available to fund increased levels of production, private investment also brings a series of other benefits and disciplines to the industry. True capital investment in a project or business – as opposed to debt finance where investors are removed from the business they are investing in and are purely seeking a predictable, calculable rate of return – brings with it business experience, knowledge and acumen to an enterprise. Capital investors seek direct involvement with firms and projects over a longer period of time, transferring knowledge of marketing, accounting and other skills gained and applying it to the business to establish greater long-term returns. Capital investors tend to adopt a more sophisticated and success-oriented approach to their investments with investment managers handling a film portfolio evaluated on the success of the investment, regardless of its industry.

Attracting a diverse range of investors (capital investors, debt financiers, private individuals, venture capitalists, trade investors (such as distributors and broadcasters who have a vested interest in taking the output) and corporate investors) and in particular attracting those investors who are not currently a part of the audiovisual production industry investment environment – is essential for the future success and sustainability of the industry.

- *The industry, both at the enterprise level and industry-wide level, must be empowered to take responsibility for its own development and growth.*

Stronger, more sustainable businesses create a successful ambitious industry. The screen content industry, both at the enterprise level and industry-wide level must be empowered to take responsibility for its own development and growth. Government assistance therefore becomes one of serving and supporting industry – servicing and assisting its needs and self-developed goals and objectives.

Recent moves to form the Australian Screen Council – the unified voice of industry made up of the Screen Producers Association of Australia, the Australian Screen Directors Association, the Australian Writers’ Guild and the Media, Entertainment and Arts Alliance – is an overwhelmingly positive step for the industry. In uniting to speak with one voice to government and seeking to increase economic returns and its cultural contribution to Australia and the world, the industry has begun to take responsibility for its own direction, articulating a united vision and setting goals and strategies for boosting audience share for Australian content. In turn, it is likely that the industry will become more attractive to investors, the business community and to government, who will continue to assist industry and develop policy in combination and consultation with the industry. The developing unity within the industry, illustrated by the formation of a single organisation to represent a range of industry interest groups, also provides new opportunities for industry and government to work together to address issues confronting the industry into the future.

2.3 Indirect vs direct funding: What balance should be struck between direct and indirect funding?

Direct funding and tax incentives share the same cultural objectives – to assist the creation of screen content. Direct funding assists the creation of particular selected projects for cultural purposes, while indirect measures such as tax incentives impact the structure of the whole market to address both cultural and economic objectives.

In order to reach the goals expressed above, the AFC believes that there needs to be a greater emphasis placed on indirect funding. The AFC believes that a significant, effective incentive needs to be introduced to drive increases in the volume of production and promote sustainable enterprises.

Indirect measures to support private investment encourage a direct link between the screen content industry and the marketplace, which in turn can assist the development of market driven screen content.

Producers and production companies should be in a position to develop innovative means to attract finance. Attracting private funding with the assistance of indirect support measures empowers producers and production companies to develop entrepreneurial skills and assists in developing a diverse and competitive industry.

Direct government assistance should underpin and support the industry in areas not otherwise met by the market. This allows a more targeted and precise delivery of funds that can be tailored to achieve particular objectives that do not necessarily always encompass immediate economic benefits.

As noted in the UK Treasury's 2005 report on promoting the sustainable production of British films[20].

> Grant funding and tax incentives……play different but complementary roles towards the same goal of addressing the cultural benefits that accrue from film production. To the extent that the development of creativity and cultural value may need to be channelled into particular projects, grants are more appropriate in targeting support at such specific objectives. On the other hand, tax incentives can play an important role in creating a favourable environment within which the market can determine what kind of cultural products are made, and how, with minimal distortions.

[20] http://hm-treasury.gov.uk/media/624/CA/filmcondocv1.pdf

In Australia, industry support is heavily weighted towards direct funding through government agencies. Federal film agencies received total appropriations of $154m in 2004/05, and distributed $84m in production funding; state agencies received $44m and distributed $16m worth of production funding. [21] Compare this with an estimated cost to the Federal Government for tax incentives of $33.2m in the same year – $16m for the 10BA scheme (raising $25.6m for 24 projects with total budgets of $60.4m), and $17.2m for the Refundable Tax Offset (estimated annual average 2001–2005).

AFC analysis of support measures in other countries reveals a mix of approaches, but generally a greater use of tax incentives than is the case in Australia. A summary of forms of assistance in place in the UK, France, Canada, Denmark and Germany is set out in **Appendix B**.

Value of direct and indirect public support (2003/04 unless noted)

	Direct support (govt agency budgets)[1]		Indirect support (tax incentives only)		Proportions (%)	
	Value (A$m)	**Main sources of agency funds**	**Value (A$m)[2]**	**Focus**	**Direct**	**Indirect**
Australia[3]	198.3	Govt	33.2	Investor (10B/BA); producer (Offset)	85.7	14.3
Canada[4]	513	Govt; broadcaster contributions	586	Producer (tax credits)	46.7	53.3
Denmark[5]	62.6	Govt	nil	No tax schemes	100.0	nil
France[6]	860.8	Industry	30	Investor (SOFICAs)	96.6	3.4
Germany[7]	323	Industry	462	Investor	41.1	58.9
United Kingdom (2002)[8]	233	Govt; Lottery	390	Producer/ investor ('sale & leaseback')	37.4	62.6

Source: AFC analysis of a range of sources; see appendix B for full country profiles
Notes: All figures A$.
1 'Government' includes both national and regional governments.
2 Value of indirect measures is cost to government.
3 Australia: Direct figure is total appropriations including around $45m for training (AFTRS) and archival activities (NFSA). Indirect – current Refundable Tax Offset is targeted at large-budget foreign productions.
4 Canada: 'Indirect' figure is total national ($236m) and regional ($350m) tax credits. National tax credits comprise $171m targetting domestic production and $67m targetting foreign production.
5 Denmark: No film-targeted tax measures, but does offer a venture capital scheme.
6 France: Direct figure is mainly CNC, funded by levies and taxes on TV broadcasters (69%), on cinema tickets (23%), on video publishers (8%).
7 Germany: Direct figure is for all agencies, with total funding coming from national (6%) and regional (38%) governments, levies on cinema tickets and home distribution (27%), broadcaster contributions (28%). Indirect investor incentive now scrapped; to be replaced by a new producer-based scheme.
8 UK: Direct is mainly UKFC ($172m), including production funding worth $32m. Indirect support now replaced by a new producer-based incentive.

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21 AFC analysis of film agency funding in Australia.

2.4 Indirect funding: What options are there for stimulating growth in private investment?

When referring to 'private investment' in this section, the AFC refers to investment from private sources outside of the audiovisual industry. However, maximising investment from industry sources such as distributors, broadcasters and sales agents is also a goal.

Are tax incentives still an effective and appropriate mechanism?

Private investment in Australian film and television has fallen in recent years and is at relatively low levels – averaging $12 million per year in television and $17 million in features over the last five years, compared to $54 million and $30 million respectively from government sources.

Current tax measures have failed to drive growth. Division 10BA of the *Tax Act* is no longer set at levels to act as a significant private investment incentive, the FLIC scheme has not achieved the quantum planned nor attracted large numbers of investors, and the Offset remains out of reach for most Australian productions.

The AFC believes that effective incentives to encourage third party private investment and build sustainable enterprises are fundamental to supporting the growth of the Australian audiovisual industry.

Private investment offers an avenue for the industry to grow independently of direct government funding. In order to expand the finance sources available to the Australian screen production industry and to assist it to compete internationally, new ways are needed to encourage investment in the industry and improve certainty for investors.

All major film and television production industries rely on significant levels of private investment and on investment incentives to propel and underpin their growth.

In examining the support regimes for audiovisual production in 14 other countries,[22] the AFC found that in all 14 countries some form of tax-based government support was available, with seven using tax credits, nine using investor-based incentives [23], five using loan support, six using venture capital incentives and four using R&D funding. Furthermore, indirect funding was the major form of funding available for six of them (the UK, Canada, Germany, Ireland, Spain, and Brazil). [24]

While quantitative comparisons are difficult, indications are that Australia is currently under-utilising indirect support, spending A$1.70 per capita on tax incentives in 2003/04, compared, for example, to the UK's A$6.50 per capita, or

[22] Canada, Denmark, France, Germany, United States, India, Ireland, Japan, South Korea (The Republic of Korea), New Zealand, South Africa, Spain, United Kingdom, Brazil

[23] These figures are understated as research indicated that while India and Korea have tax incentives in place the information regarding the form of incentive was not available.

[24] The UK and Germany have recently revised their tax incentive schemes so this balance may change.

Canada's A$18.30 per capita.

There is a strong desire from industry to establish an effective financing door to sit along side of and operate independently of direct subsidy. The AFC strongly supports this view and believes this can be obtained through the establishment of a tax Offset for Australian productions, in combination with a reformed 10BA scheme.

Although primarily a producer incentive, a tax offset, if cashflowed through to investors as a guaranteed return, could, in addition to a tax deduction, lower the potential risk for investors thereby attracting greater private investment.

Are the 10BA/10B schemes still appropriate?

Despite relatively low levels of private investment being attracted via the 10BA mechanism, the AFC supports the retention of the scheme. While 10BA is no longer utilised to the extent it once was, it is still used effectively by a number of production companies and investors. To remove this and replace it with an untested offset could substantially reduce the pool of finance available to producers. More importantly though, in order to deliver third party private investment, tax concessions remain fundamental in garnering interest from a large portion of the investor community.

While producers and investors have significant problems with 10BA in terms of procedure and anachronistically limited scope, the AFC believes many of these can be addressed. The AFC's submission to the 2005 Review of Divisions 10B and 10BA, detailed changes to 10BA that it believes need to be made in order for it to be more effective in stimulating private investment. These included:

- *Clarification by government that tax measures are a key platform of its support for the audiovisual production industry*

  A clear signal needs to be sent to the investment community that the policy of encouraging private investment by means of tax concessions is a vital element of the Government's cultural support measures.

- *The administration of the provisions by the ATO needs to be more efficient and transparent*

  There is a level of ambiguity that exists in the minds of the investment community regarding the administration of the system which needs to be reduced.

- *The inherently high-risk nature of audiovisual production needs to be acknowledged so that the 'at risk' provisions entailed in Part IVA of the Tax Act cannot be applied to disrupt an otherwise deductible benefit*

  The AFC acknowledges the legitimacy of the 'at risk' test. However, the cultural basis for 10B and 10BA should be paramount considerations. The AFC believes an 'at risk' level of 20 per cent of the investment is a reasonable level to balance the requirement of risk and ensuring investor interest. This is discussed further below.

- *The extension of Division 10BA eligible formats to drama series, short form animation, and other forms of digital content such as games, broadband content and mobile phone content*

  The current definition of the eligible formats was written some 25 years ago and reflects the understanding then current of the formats that were in need of support. The contemporary reality is that it has become increasingly more difficult to raise finance for Australian television drama in all formats. Costs have risen and the amount of finance that can be raised from domestic licence fees and international distribution advances and pre-sales tends to leave a gap that cannot be met. In this context the AFC believes that there is merit in extending 10BA to include series. The AFC would also recommend extending 10BA to include short form animation. The present requirement of 10 minutes for animation series does not match current commercial practice. The AFC also supports extending eligible formats to include digital content such as games, broadband and mobile phone content.

- *Eligible delivery platforms should not be specified in the legislation, given the expansion of legitimate distribution via newer technologies*

  Of relevance in distribution should be the stipulation of commercial quality and the delivery to a wide audience whether via cinema release, television broadcast, direct to DVD or otherwise.

- *The existing definitions for Australian programs should be retained to ensure the cultural specificity of eligible programs*

  The test as to whether a production is 'Australian' be it wholly or substantially made in Australia and has significant Australian content (an assessment based on a cumulative test set out in s124ZAD) needs to be maintained. This ensures that the policy of encouraging private investment by means of tax concessions is a cultural one.

What other models might be appropriate in encouraging private investment?

The AFC believes that a production offset similar to the current Offset – which has been enthusiastically received and utilised by producers of high budget offshore productions shooting in Australia – should be made available to independent Australian productions.

The AFC has consulted with the investment and production communities regarding the Offset. Producers report that the offset is clear, efficient and timely. It is closely monitored, financially transparent and not able to be rorted, as it is based on audited expenditure. Particular mention is made of the speed of DCITA's evaluation and the absence of 'middlemen' – no need for the layer of additional financial and legal fees that many other schemes require.

The Government is currently undertaking a separate statutory review of the Offset. That review will fall within the context of this broader review of Australian Government support for the funding of Australian films. The AFC has already made a comprehensive submission to the Review of the Offset. That submission should be read in conjunction with this submission.[25]

The AFC has conducted extensive research, consultation and economic modelling into developing alternative incentive structures utilising a variety of mechanisms to promote growth in private investment. In consulting on this analysis widely with the industry and key stakeholders, the AFC believes that the following model, utilising an Offset together with 10BA would be the optimal approach to promote both private investment and support production enterprises.

The AFC believes the Government should make available:

- An Offset at 40 per cent for Australian feature films, telemovies, mini-series, documentaries, children's drama and some digital content,[26] with a 20 per cent Offset available for Australian TV series, that can be used in combination with 10BA but with no access to FFC or other federal government production funding;[27]

An Offset would involve the following parameters:

- A qualifying expenditure threshold for Australian independent production of $1 million for feature films[28];
- This also presumes changes to 10BA as outlined above including specifically an expansion of current 10BA eligible formats and delivery platforms to include television series and some digital content, as well as loosening of the 'at risk' rule to 20 per cent of the investment;
- An Australian eligibility test[29];

The AFC believes that 10BA needs to be retained (with changes as recommended) and then reviewed in the light of the effects of the Offset.

The AFC supports this model for the following reasons:

- *The model can be used to attract equity investors interested in tax concessions (by cashflowing the Offset through to the investors), thereby growing the pool of monies available for production and assisting producers to finance production budget 'gaps'*

An Offset is primarily a producer-based business incentive. However, the model allows a producer to structure deals where the returns are prioritised to private investors. These returns would remain taxed as returns on investment.

- *The model provides producers with leverage to negotiate a wider range of deals with distributors, as well as retain rights and receive better recoupment positions*

Domestic production companies currently secure pre-sales, distribution guarantees

[25] http://www.afc.gov.au/downloads/policies/0606_rto_afcsub_final.pdf
[26] Further work needs to be conducted to determine the parameters of the Digital Content forms which should be supported.
[27] ABC, SBS and SBSI funding should still be available
[28] Further work needs to be conducted to determine levels for mini-series, telemovies, series, documentaries, children's drama and digital content, with perhaps minimum licence fees being required for some of these rather than minimum expenditure levels.
[29] 10BA style eligibility test or qualifying Australian content under the ACMA Australian content standard

and licence fees from sales agents, distributors and broadcasters in order to finance their production budgets. They have limited additional sources of finance outside the marketplace and government and this makes it difficult for them to retain an interest and therefore share in returns.

Having access to an Offset means that producers may negotiate for lower commissions, retain certain territories, secure favourable recoupment positions, or retain future distribution platforms. Retaining these ‘economics’ can also assist in attracting private ‘at risk’ investment, as well as increase a producer’s share of returns and ultimately grow enterprises.

- *An improvement in returns from investment would drive increased confidence from the private sector and fuel more sustained growth and profitability in the long term*

This model will allow producers to retain equity, create better deals and ultimately enjoy greater returns. This will increase the returns available to both producers and investors driving increased confidence in the screen content industry and promoting increased investment in both projects and businesses.

- *The model lowers reliance on direct subsidy*

The model proposed explicitly removes access to direct Federal funding through the FFC, AFC or Film Australia for productions accessing the incentive. In order to compensate for this gap the Offset has been set at a level that would assist producers to finance through the marketplace and private investment. Producers will still retain the ability to access State Agency funding and cash-flow facilities and broadcaster contributions, including national broadcasters.

- *The model provides an effective funding door for producers with strong commercial projects*

The model creates a workable and effective ‘second door’ aimed at projects that have strong commercial prospects and broad audience appeal.

- *The model should significantly increase the overall value and volume of production and levels of private investment*

While it is difficult to predict the precise impact the introduction of a new incentive in Australia would have on production levels and private investment, the AFC believes that prior experience domestically and internationally demonstrate it would drive significant levels of growth. This is outlined below in discussing cost to government.

Retaining access to 10BA also provides the ability to grow production value and volume through third party private investors interested in tax concessions. At the same time, the model promotes private investment into successful audiovisual enterprises which are able to use the Offset to grow their businesses.

- *While 10BA no longer operates as a significant driver of production investment since its reduction to 100 per cent, it is still nevertheless used effectively by a number of production companies and investors. To remove this could substantially reduce the pool of finance available to producers*

As stated above, 10BA brought $25.5 million into the industry in 2004/05, with 24 projects funded in part or wholly with 10BA finance. Producers pull together a budget from a range of sources and 10BA finance, though a small percentage of a budget, can still make the difference as to whether or not the total budget can be raised and the film produced.

- *In supporting an Australian eligibility test similar to that already in place under 10BA the model continues to emphasise the cultural objectives of the mechanism*

Eligible expenditure should be that used to produce an Australian film or program. As long as a production meets a similar Australian eligibility test to 10BA, then where the expenditure takes place is not an overriding factor.

- *Expanding the list of formats eligible for the Offset reflects the changing nature of industry practice and economic dynamics*

The expansion of eligible formats reflects the expansion of 10BA formats recommended by the AFC for the reasons outlined above.

- *Imposing a threshold limit opens up the Offset to the majority of Australian productions while at the same time supporting genuine production*

Imposing a threshold of $1 million for independent Australian feature films[30] will allow the Offset to be accessible to the majority of productions. Most Australian film budgets range between $1 to 6 million. Imposing a threshold of $1 million would allow 85 per cent of all Australian feature films to be eligible. More importantly though, imposing a threshold ensures that genuine production occurs.

- *'At risk' rules require loosening to 20 per cent of the investment to promote third party private investor interest*

The AFC believes that investors are willing to and should (in order to promote the production of genuine projects) place a proportion of their investment 'at risk'. Currently, under 10BA, the 'at risk' proportion is 53.5 per cent taking into account the highest tax rate and Medicare levy. At this level only a small number of investors have been attracted to film investment. In order to change this, the proportion of an investment 'at risk' must decrease. The investment community have generally pointed to 20 per cent, in order to be competitive with other investment options.

The AFC's 1987 publication *Film assistance: Future options*, detailed the level of risk and break-even points under the 10BA system, which has been updated.

[30] Further work needs to be conducted to determine levels for mini-series, telemovies, TV series, documentaries, children's drama and digital content, with perhaps minimum licence fees being required for some of these rather than minimum expenditure levels.

The investment equation			
10BA concessions	**Marginal tax rate (%)**	**Amount at risk (as % of amount invested)**	**Break-even point (as % of amount invested)**
150/50 (From October 1980)	60	10	10
133/33 (From August 1983)	60	20.2	20.2
120/20 (From September 1985)	60	28	40
120/20 (From July 1987)	49	41.2	61.6
100/0 (From 1988)	49	51	100
100/0 (Post July 2006)	46.5	53.5	100

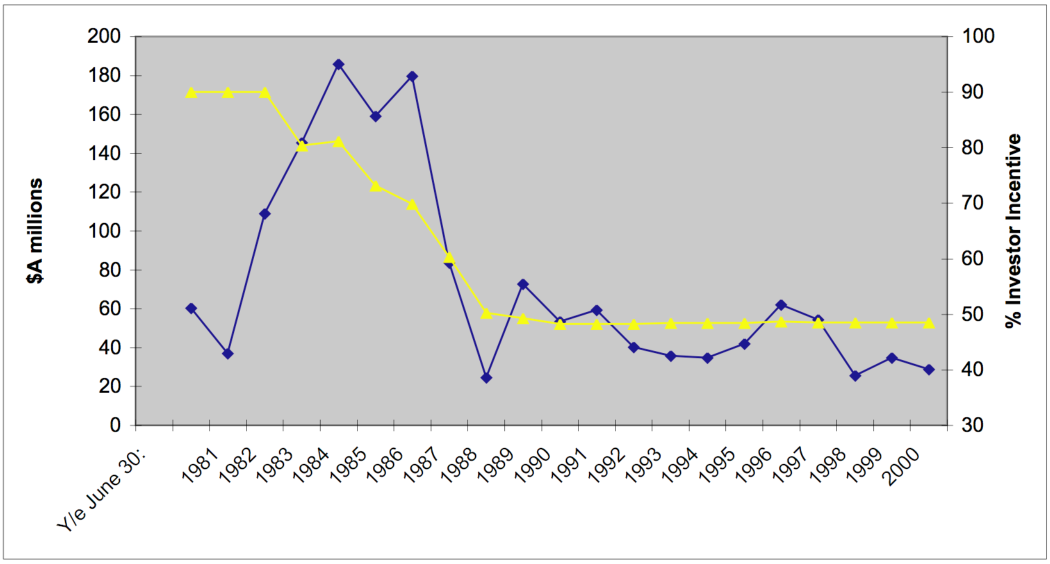
Source: *Film assistance: Future options*, Australian Film Commission, Allen & Unwin, 1987, page 4.
Notes. The *Marginal tax rate* column shows the top tax rate for individual investors (excluding the Medicare levy). The *Amount at risk* column shows the proportion of an investor's outlay which is at risk after allowing for the initial tax write-off. The *Break-even point* column shows the level of pre-tax return required for the investor to break-even after tax. No allowance is made for the cost of money or for non-deductible expenses.

The proportion of investment 'at risk' under 10BA varied according to the deduction level and tax rates, increasing dramatically with a reduction in the rate. When first introduced, the 10BA legislation offered investors an effective 90 per cent subsidy (at a break even point of 10 per cent of the amount invested). The first reduction in August 1983 reduced this to 80 per cent and the second in September 1985 to 60 per cent. In July 1987 the effective subsidy was 40 per cent reflecting a reduction in marginal tax rates. As the AFC reported in 1987:

'The original 90 per cent was a safety net on which investors could trampoline with relative impunity. At 80 and 60 per cent, the market began to take the precaution of pre-selling film rights. At 40 per cent the precaution virtually precluded the activity.'

Investment accordingly fell with the decrease in investor incentive.

Relationship between investor risk and funds raised



Key: Dark line – Total budgets for 10BA projects $m;
Light line – % Investor incentive (proportion of investment not 'at risk')

- *Without tax benefits for investors there will be a significant decrease in the level of private investment into the industry and the private investment that remains may impact negatively upon production businesses*

  The Offset when passed through to investors would be taxed. Without access to an initial tax deduction under 10BA, the investor's exposure is greater and investor interest may fall.

  With the introduction of the new tax credit in the UK, there has been a withdrawal of equity funds from the industry to be replaced by banks and other lenders to cashflow the tax credits. The terms of these deals are usually at a higher rate than the tax credit (up to 25 per cent of the value of the credit plus fees plus a percentage of the budget).[31] That is, producers will receive 100 per cent of the credit but are only able to cashflow 75 per cent into the budget.

  The introduction of a tax offset only in Australia may bring similar results and attract private equity, but this equity may have the characteristics of debt financing, that is short-term finance used to bridge gaps or advance cashflow based on collateral and a rate of return. This is in comparison to capital financing, which backs assets and comes with an understanding (or at least a commitment to understand) the fundamentals of the production business in which the investment takes place and is generally about the creation and growth in value over time.

  Ultimately, as production businesses grow, the ability to attract greater capital financing will allow businesses to be more viable.

Cost to government

An essential element to calculating cost to government is estimating the potential growth. It is difficult to predict the impact the introduction of a new tax incentive in Australia would have on production levels. In order to find some answers regarding potential growth, the AFC examined a number of historical and contemporary factors that provide some guidance as to a possible level of increase: these include figures on 10BA cost; international experience; the difference in taxation over time; and, the current potential for growth. However the figures indicate significant levels of production that could potentially be produced if more private investment monies were made available. In summary, the factors described above point to a number of conclusions:

- The industry has the capacity to meet increased growth;
- Overseas experience would suggest production will increase significantly if additional private sector incentives are introduced;
- Any increase in production growth now would be unlikely to reach the heights of the 10BA period due to a number of structural factors.

The AFC cannot provide a definitive prediction as to the production growth rate following the introduction of a new private investment incentive. However, it can provide the cost to government against a range of increases in production of between 20 and 100 per cent. This will be available in a separate submission.

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[31] Tim Adler, Screen Finance, Vol 19, Number 9, 17 May 2006, pg 1. For example, Brighthaven offers to cash flow 75% of tax credit (50% up front, 25% at post-production). Brighthaven's fee is the remaining 25% of the tax credit plus 0.5% of the budget plus 5% of producers' net profits.

Capping cost to government

In order for the cost to government to be predicted, it has been proposed that an Offset should be only made available to a limited number of businesses or producers that have been licensed by the Government, similar to the licence under the FLIC Scheme or the franchising scheme which operated in the UK.

The AFC does not support the licensing of franchises for the following reasons:

- Rather than supporting entrepreneurial growth, the growth of the industry will be limited to the number of businesses/franchises who have obtained the licence and the cap on the amount of Offset which can be accessed; and
- Diversity is similarly limited by the number of licences – already established businesses are likely to be in a better position to benefit than less established businesses and new entrants;

The AFC therefore believes that introducing a licence scheme to limit availability of any new investment incentive inherently contradicts the stated objective of growing businesses and a viable production industry.

Growth in the industry would largely be centred upon the number of licences permitted. A licensing system could promote consolidation within the industry. This places existing larger, more established businesses at an advantage over smaller organisations. Smaller production houses excluded from consolidated businesses, and newer entrants, would be limited in their ability to develop to a point where they could compete to take up a lapsed licence (assuming a sunset clause on licences were put in place).

Without access to an effective private investment or producer incentive to enable growth within unlicensed businesses, the industry will become polarised and unable to grow beyond a specified limit. While direct funding would be able to assist in the development of projects and help some small businesses to grow, licensing will lead to an industry with a number of small businesses and a number of large businesses (limited to the number of licences) and few sustainable middle ranking businesses.

While the AFC supports the objective of business growth and believes consolidation may assist in this process, mandating a limited number of licences and allowing only a limited amount of fund raising will impede industry-wide business and production volume growth, rather than increase it.

- *If the licence allows the franchise to become merely a financier, this would lead to the creation of multiple private bureaucracies, with duplicate administrative overheads which would be far less transparent than that for support currently delivered via direct funding*

Despite increasing the numbers of doors available – with franchises becoming in essence financiers to the industry, the AFC is concerned that the duplication of administrative overheads and the creation of multiple managing layers and fee structures would draw funding away from production and from assisting enterprises to grow.

The AFC is also concerned that the administrative overheads would not be transparent, as they are under the current system.

- *UK experience with franchises was not successful*

Between April 1995 and May 1999, the Arts Council of England was responsible for the allocation of Lottery funds for the production of British films. A 1996 report by the Advisory Committee on Film Finance recommended a film franchise system in order to address concerns that the British industry was comprised of small, undercapitalised, independent producers, who produced films on a project by project basis and commanded relatively weak negotiating positions with distributors. In 1997, the Arts Council implemented a system whereby lottery funds would be awarded to three franchises that could demonstrate they had the ability to produce a considerable number of films as well as having links with distribution facilities (either US companies or through PolyGram Filmed Entertainment – a new British based entity financed by Philips); thereby creating 'mini-studios' that would develop into sustainable businesses. The franchises were an attempt to address the lack of industrial infrastructure and create commercially viable British features.

Three franchises were awarded lottery funds totalling £92 million over six years. One went to a consortium of film-makers (The Film Consortium, including names like Ken Loach and Simon Relph). Another franchise was awarded to the DNA Franchise, headed up by the producers of the *Shallow Grave* and *Trainspotting* films; and one to the French-owned entity Pathe.

In 2001, the London Times reported that of the 11 films financed with the lottery money at that stage, only one was profitable and that one franchisee, DNA films, had not produced a single film up to that point.[32]

Ultimately the franchise system did not produce the volume of films initially expected. Pathe was expected to make 35 films but only made 19, the Film Consortium aimed to make 39 but made 22 and DNA was to make 16 films over the six year period but only produced six.[33]

There were a number of criticisms levelled at the lack of success of the franchise system to induce the structural change it set out to achieve. While the franchises were meant to attract third party producers from outside the consortia, funding for in-house originated productions was prioritised. The coming together of different businesses involved significant inefficiencies around organisational and structural issues, which the franchises had to sort out before executing plans and making investments. Despite each franchise having funding for multiple years and for multiple films, each film had to be separately approved by the UK Film Council – diminishing the ability of the franchisees to generate a slate of films.

The film franchise system has not been continued by the UKFC in its original form, although National Lottery collections continue to be administered by the UKFC for funding and investing in feature film development, production and distribution.

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[32] http://www.imdb.com/name/nm0000391/news
[33] http://www.ukfilmcouncil.org.uk/information/news/?p=n001214105803
http://www.ukfilmcouncil.org.uk/information/news/?p=n001214110816
http://www.ukfilmcouncil.org.uk/information/news/?p=n001031132137 and
http://www.publications.parliament.uk/pa/cm200203/cmselect/cmcumeds/667/66702.htm

A natural cap on cost to government

The AFC believes that there is a natural cap to volume and growth and subsequent cost to government:

- *Raising an additional 60 to 80 per cent of a project's budget from non-government sources remains a significant challenge*

Introducing an Offset will assist producers to fill a large proportion of the gap in finance. However, this does not alter the fact that raising finance in today's domestic and international market remains a significant challenge as outlined above.

- *Overseas experience demonstrates a natural plateau of production volume following the introduction of significant new tax measures*

Overseas experience is useful in providing a guide to possible increases to production.

Ireland has an investor-based incentive known as Section 481 which enables Irish resident investors (companies and individuals) to claim an allowance in calculating their income for amounts subscribed by way of share capital to Irish resident film production companies. The production company can expect to receive a contribution to budget of between 10 per cent and 12 per cent for films with a budget below the legislative cap of €15 million. In a 2003 review of the Section 481 tax incentive, Price WaterHouse Coopers established that the rapid growth of the audiovisual sector in Ireland was fuelled by the Section 481 scheme with the annual value of audiovisual production (including both foreign and local production) growing from €14 million to €109 million during the decade 1993-2003. This represents a compound annual growth rate of 18.6 per cent.

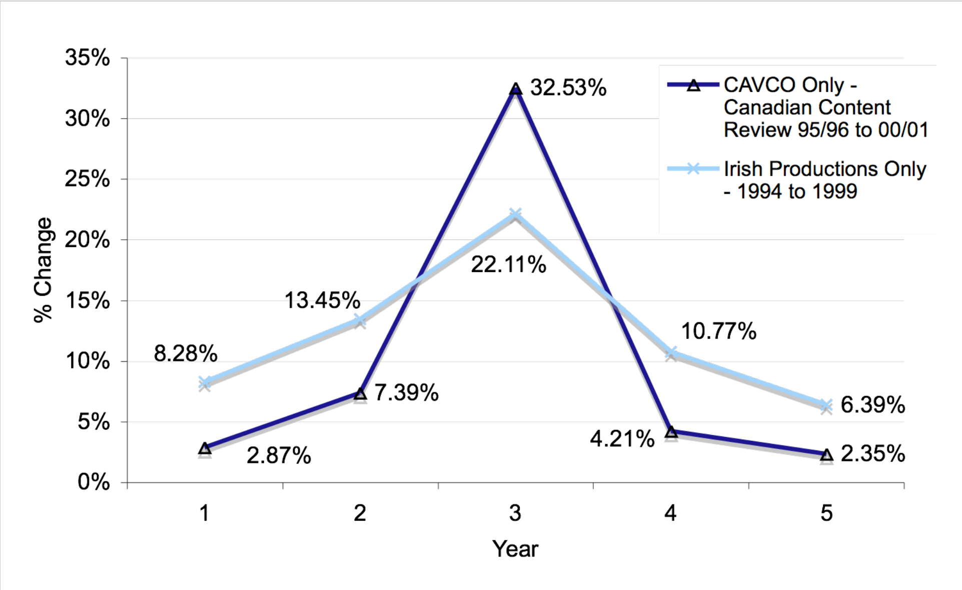
A similar analysis was undertaken for Canada. Two federal tax credits aimed at producers were introduced: the Film and Video Tax credit (FTC) in 1996 aimed at domestic production with a tax offset of 25 per cent of qualified labour expenditures and up to 15 per cent of the cost of the production; and the Film and Video Production Services Tax credit (PSTC) in 1998, with an Offset of 16 per cent of qualified Canadian labour expenditures aimed at attracting foreign location production.

Foreign production in Canada experienced a rapid growth with the annual value of production growing from C$320 million to C$1.26 billion between 1996-97 and 2003-04. This represents a compound annual growth rate of 18.7 per cent.

On the other hand, the volume of local Canadian production does not seem to have experienced the same growth.

The graph below demonstrates the patterns of growth in domestic production experienced in Canada and Ireland following the introduction of new incentives. Both experiences demonstrate a small growth in the first year (8.3 per cent in Ireland, 2.9 per cent in Canada) a slight increase in the next and then a sharp increase in the third year (22.1 per cent in Ireland, 32.5 per cent in Canada) – presumably as projects are geared up and come online. The growth rates then fall back down to levels similar to the first and second years in the following years, demonstrating a natural plateau to growth.

Growth rates in domestic production in Canada and Ireland



Source: Film Production in Ireland Audiovisual Federation Review , IBEC A/V Federation 2004, and Study on Completion Guarantees and Financing Tools in the Audiovisual Industry April 2005 Department of Canadian Heritage, Trade Routes Program.
'CAVCO only' – productions classified as Canadian by the Canadian Audiovisual Certification Office

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- *The numbers of private investors likely to invest for tax concession purposes is limited by: (i) a decrease in the numbers of tax payers in the highest tax bracket; (ii) the reduced benefit to those in lower tax brackets; (iii) the desire for investors to diversify their tax management products; and (iv) the inherent uncertainty for investors in a mechanism based on government policy enforced through the ATO*

The introduction of 10BA in 1980 had a significant impact on levels of production. On average 14 feature films were made per year in the 1970s with an average total production value of $18.51 million per year (in 2005 dollars). This increased to 30 feature films a year in the 10BA decade of the 1980s with a production value of $120.33 million (in 2005$). This involved a compound annual growth rate of 21.6 per cent for the nine year period 1979-80 to 1987-88 (before the rate for 10BA concession was lowered to 100 per cent).

The 10BA period however, needs be looked at in the context of the taxpayer of the time – taxpayers were on relatively low top marginal rate thresholds of $35,000 - $36,000pa ($78,000 to $79,000 pa in 2007 dollars) compared to $125,000 pa for the 2006/07 year. This dramatically lessens the number of taxpayers now in the top bracket.

High net income tax payers are more likely to invest in film (or other tax effective products) than investors in lower tax brackets due to higher disposable income, and a tax scale which gives greater benefits to those on higher marginal rates. The

Government's estimates are that less than 3 per cent of taxpayers will be in the top marginal rate during the 2006/07 tax year.[34] This provides a limit to the number of investors, and in turn, to the volume of investment dollars available.

Additionally investors will diversify their portfolios of tax management products as much as investment products. Investors will not overcommit to any single form of investment if there are other, perfectly fungible products. Investors will particularly not overcommit to a single product that has higher returns/risk ratios for reasons of uncertainty brought about through involvement of the ATO.

- *TV production will be capped by the limited pool of licence fees available from the broadcasters*

Broadcasters tend to provide a large proportion of TV drama and documentary budgets through licence fees. The level of production will therefore ultimately be limited by the available pool of broadcaster funding – a pool unlikely to grow much larger due to the finite number of free-to-air broadcasters and limited number of subscription TV drama and documentary channels.

Moreover, the economics of television broadcasting work against the creation of significantly more drama than that underpinned by regulation. This is because Australian adult and children's drama and documentaries are the most expensive form of television production and uneconomic for broadcasters to fully fund. The cost of creating an Australian series is significantly higher than that paid for licensing overseas drama,[35] and hence vulnerable to replacement by cheaper imports. The pressure to reduce or cap expenditure on all broadcasting services is constant, as is their commercial imperative. Therefore, while it is clear there would be an increase in television production, there remains a natural limit for such growth due to the nature of drama production and broadcasting in the Australian market.

- *The AFC believes that the parameters of applicability of the Offset to digital content need to be considered as part of the Government's separate policy process for supporting digital content.*

[34] Source: Budget Measures, 2005-06, Budget Paper No 2, p. 27

[35] An Australian series costs between $390,000 per hour (if shot on tape), over $550,000 (if shot on film or HD) to produce, or over $480,000 per hour for children's drama. This compares to a multitude of US series made for at least $1.45 million per hour available to Australian broadcasters at a mere $30,000 to $95,000 per hour.

2.5 Direct funding: What is the most appropriate model for direct government support to the film industry? Is the current agency structure a model that is delivering the best possible outcome?

Are current agency functions appropriate?

In order to deliver on the objectives detailed above, the AFC believes direct government assistance needs to focus on those areas of the audiovisual industry that will not be fully met by the market as well as those new and developing areas of the industry that involve a significant amount of risk – risks unlikely to be taken by the market.

These areas include:

- Project development;
- Professional development;
- Innovative and risk-taking screen content production;
- Support for business/enterprise development;
- Indigenous content;
- Screen culture;
- Research and analysis;
- Archiving, preservation and access;
- Marketing and export development; and
- Training.

To supplement the information below, the AFC will provide details of the activities, programs and outcomes currently being undertaken by the AFC in its response to the Review of Appropriateness, Effectiveness and Efficiency of Government Film Funding Support. A summary of the work currently being undertaken internationally in each area is at **Appendix C**. A more comprehensive examination of current support measures in the UK, Canada, France, Denmark and Germany is at **Appendix B**.

Project development

The development phase – where projects are originated, scripts are written and edited and marketplace attachments are secured – remains crucial to the success of individual projects and, more broadly, to the success of the industry.

Effective project development is key to the creation of critically and commercially successful productions that engage audiences. Well-executed development provides the time and support necessary to achieve a project's full creative and commercial potential, enabling the creation of effective scripts and helps secure relationships with creative personnel (producers, directors, writers, etc) leading to the formation of successful teams and sustainable businesses in the long-term.

Commercial investment remains largely unavailable for project development in feature films, children's drama, animation, documentary, Indigenous content and new media in Australia because securing financial support for projects that cannot be tested in advance is extremely difficult. The AFC traditionally takes risks on projects (and teams) at an early stage of development that may not attract investors, broadcasters, distributors, webcasters or games publishers. Broadcasters, both local and international, are becoming more dependent on seeing footage before investing in documentaries, as are games publishers who seek an 'electronic proof of concept.' The AFC's development funds have been crucial in securing these with many of the projects the AFC has funded in this way securing sales and pre-sales on completion or during post-production.

Without the benefit derived from scale and vertical integration, the capacity of the Australian audiovisual production industry to invest in development – like many audiovisual production industries from smaller countries – is limited. Although it is likely that some development capacity will be an outcome of an effective indirect measure, this is a function that will nevertheless still require significant continuing direct support and may need increasing as the screen content industry further develops and grows.

Professional development

Concomitant to project development is practitioner – or professional – development. This process encompasses the growth of a practitioner's career from their first modest, inexpensive production or script – usually training on shorts at a tertiary institution – followed by work on short films and short features, on to low budget features and then the full commercial, higher budget features, documentaries, television or interactive media credits. The training provided by AFTRS is quite different to the professional development role traditionally played by the AFC. Support for the professional development of screen practitioners is generally at a point when training has been completed. Professional development programs assist the careers of graduates and emerging screen content practitioners by offering them the opportunity to accumulate industry experience and experiment with short and low budget screen productions in order to develop a track record for the market.

Programs that support the production of shorts (both film and interactive), short features, documentaries and animation, low budget film, television and interactive projects, as well as attachments, fellowships and other programs, remain the key to building a talent base of directors, writers, producers, actors and technical crew. Such short material and low budget works will remain dependent on direct funding for support as they are unlikely to attract market attachments from the outset. Nevertheless, these productions provide practitioners with greater opportunities to make more than one project[36] as well as to stay in the Australian industry as their careers progress and their reputations grow.

While applicable to the vast range of screen production including film production,

[36] For example, of the producers, directors and writers of feature films, 67 per cent of Australian feature producers, 65 per cent of feature directors and 75 per cent of feature writers have made only one feature film in the last 30 years

adult and children's drama, animation, documentary, Indigenous content and new media, professional development must also pay attention to those sectors of the audiovisual industry that are developing, remain vulnerable and require nurturing, for example, the digital content industry. In order for Australian content producers and the industry to remain skilled up and competitive into the future, the development of innovative digital multi-platform and interactive practitioners must be assisted by direct government investment to supplement and support that segment that won't be supported through new indirect support measures.

The Australian film industry requires continued and additional funding targeting the development and production of low-budget features. Support for low-budget features provides filmmakers with an opportunity to develop their creative, technical and production skills, and allows cast and crew to work on feature length projects at relatively low budgets. The AFC's IndiVision initiative is aimed at energising low-budget filmmaking in Australia. The IndiVision program has been developed for filmmakers with high or mid-range level experience and supports the development, production and promotion of distinctive low-budget Australian features of any genre made for less than $2 million. The Initiative includes intensive professional workshops with leading local and international practitioners advising on script development, performance, cinematic storytelling, and production. Further workshops assist participants to develop financing and marketing skills.

Innovative and risk-taking screen content production

Apart from the important professional development opportunities provided by direct funding for new talent, support needs to focus on funding productions by experienced practitioners and emerging talent that are innovative in content, style or form or have a unique vision. Producing fresh and original projects involves taking significant risks, necessarily compounding the risk already inherent in audiovisual production. Such productions will continue to have trouble raising finance from the marketplace at the development and production stages. However such productions have shown they have a good track record of eventually appealing to audiences in Australia as well as the international marketplace.

Because of their unique vision, unknown cast, or first time directors, feature films such as *Look Both Ways* and *Ten Canoes,* children's dramas such as *Round the Twist* and *Yolngu Boy,* animations such as *The Mysterious Geographic Explorations of Jasper Morello* and *Harvie Krumpet,* and interactive websites such as *Us Mob* and *The Dog and Cat News* all required significant levels of direct government support – ranging from 60 per cent to 100 per cent – to get made.

Such content production will continue to be under-served in a commercially driven environment even with an effective private investment incentive. This will be exacerbated in areas that are particularly vulnerable due economically to:

- *the significant expense involved:* for example, animation and digital content production by its very nature is time and labour intensive requiring continuous capital investment in technology;
- *the nature of its target audience and market:* for example, the ongoing lack of commercial support for Indigenous content is demonstrated by the low

representation of Indigenous film, television and new media content available on Australian screens.

- *the nature of technological change:* for example, the growth in multi-channelling will make the provision of new adult and children's television drama, as well as digital multi-platform content integration, increasingly difficult; and
- *the nature of its content:* for example, documentaries will continue to struggle to raise production financing due to the cultural specificity of their subject matter. Projects dealing with matters of national interest, interpreting aspects of Australian life and history or providing locally relevant social commentary have been, and always will be, a task for Australian documentary practitioners, drawing mainly on those financial resources available within Australia.

Direct funding must continue to be used to support groundbreaking and cutting-edge talent across all areas of screen production: feature films, adult and children's drama, animation, documentary, indigenous content and digital content. Such funding should assist practitioners to engage with international trends taking place in international cinema and capitalise on the benefits offered by digital technology in the making and distribution/exhibition of productions.

Indigenous content

While vibrant and growing, the Indigenous screen production industry and community remains in its infancy.

The AFC's Indigenous Branch was established to develop strategies to proactively engage Indigenous Australians in the film and television industry. This was in recognition of the need for self-representation by Indigenous Australians in the film and television industry. It also demonstrated the AFC's commitment to increasing the participation of Indigenous Australians in the film and television industries. It has in the past 11 years provided Indigenous filmmakers with the opportunity to record and tell their own stories, and to participate in the wider industry, while in turn giving them control over their cultural heritage and the way it is portrayed. This role needs to be maintained and strengthened in order to further develop and support the Indigenous production industry and ensure that films from an Indigenous *perspective* continue to be seen on Australian screens.

The AFC Indigenous Branch has, from its inception in 1993, provided stepping stone programs that involve practical professional development coupled with production funding. It has established a culture of funding where the expectations on filmmakers are high, but the support provided equals the requirements of those expectations. The filmmakers are funded in a nurturing environment where their individual needs and that of their projects are considered and valued and are handled in a culturally sensitive way. The AFC believes this is the reason for the successes of the Branch to date.

Aboriginal and Torres Strait Islander cultures are integral to Australia's national identity. However, levels of Indigenous film and television programming currently appearing on Australian screens are low, as is Indigenous representation within the audiovisual industry.

On the ABC a total of 65 hours of Indigenous programming was screened in 2004-2005 (42 hours in 2003-04, 40 hours in 2002-03, 26 hours in 2001/02 and 10 hours in 2000/01), 18 hours of which was first release, 47 hours repeat. This represents 0.7 per cent of hours of total Australian programming screened on the ABC. The ABC also produces new media content through its ABC online website. Indigenous content made up 0.5 per cent of pages in 2004-05 (0.3 per cent of pages in 2003-04 and 2002-03). In 2004-05 over 20 hours of Indigenous content was produced by SBS's Indigenous Media Unit, with SBS broadcasting 10.5 hours of first run SBSi-commissioned Indigenous programs, with a further 10 hours of Indigenous programs commissioned by SBSi. A number of studies also point to the low numbers of Indigenous Australians portrayed in Australian television drama[37] and Indigenous representation within the audiovisual industry too remains low compared to other industries.[38]

The AFC believes discrete funding – separate and distinct from funding for professional development, project development, and innovative and risk taking screen production – needs to be provided to continue the work conducted by the AFC in supporting the development of a growing Indigenous audiovisual production community.

Support for business/enterprise development

In order to support the aims of economic growth and business/enterprise growth, government must shape direct programs to maximise the benefit to producers and businesses. The AFC believes a number of administrative arrangements and new programs need to be considered. These include:

- *Subordinating the Government agencies recoupment positions in order to reward success by giving producers a greater share of revenue from their projects*;

  Under current recoupment agreements, the AFC and FFC are prioritised ahead of producers. The AFC requires that a producer direct 75 per cent of gross receipts to the AFC until the AFC's investment is recouped. For feature films, the FFC allows a producer to receive proceeds from the first dollar, except in respect of those feature films where the FFC is an equity investor, in which case the FFC offers the producer a 15 per cent share of its revenue once the FFC has recouped 30 per cent of its investment. This entitlement is treated as an advance against the producer's share of profits which the producer is due to receive once the FFC and other equity investors have recouped 100 per cent of their investment. These returns were worth $9.3 million in 2004-05 for the FFC and approximately $0.5 million for the AFC. The AFC believes that if government investment took a subordinated position, this would reward success and provide significant support to producers and businesses to develop further projects and grow their enterprises.

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37 The most recent study, Cultural Diversity in Australian Television Drama, which surveyed actors appearing in main and guest roles in 13 television drama productions between May and August 2001, found that Indigenous actors are under represented with only 1.1% of actors in the survey. Only one out of 136 actors in guest or supporting roles were Indigenous. This is a downturn on the 1999 AFC survey Broadcast in Colour, which found 3 per cent of actors in sustaining role to be Indigenous.

38 Employment figures from ABS data demonstrate that Indigenous Australians represented 0.7 per cent of employees in the audiovisual industries in 2001 (0.6 per cent in the television services industries) compared to an average across all industries of 1.2 per cent.

- *Expanding General Development Investment (GDI) and Enterprise support programs for developing businesses*;

  Currently the AFC supports enterprises through its GDI funding program and Enterprise Tasman Workshops. GDI funding supports experienced practitioners to develop business plans, diversify strategies, raise equity finance and develop alternative income streams to develop a slate of projects and build sustainable businesses. Enterprise Tasman workshops advise and assist successful screen business entrepreneurs with building their companies into strong and flourishing enterprises, including reviewing the different possible ways in which companies can work together to ensure their stability and growth. The AFC believes this form of support will still be needed and possibly require expansion to support a bigger industry. Examples of various enterprise support programs in place internationally are set out in **Appendix D.**

- *Expanding matched-funding programs that will attract and lever non-government finance in to the development of projects and businesses*.

  The AFC employs matched development investment funding for drama projects, documentary features and interactive digital media projects to encourage the financial participation of genuine marketplace third parties, such as distributors, sales agents or broadcasters, in the early stages of the development of promising projects.

  Expanding the number of programs requiring matched-funding will improve development budgets, encourage projects with audience and market appeal and assist in the development of businesses.

- *Providing automatic support schemes*.

  The AFC does not currently provide any automatic support schemes, although the past commercial success of producers may be a factor in determining eligibility for funding. The majority of support schemes in the film industry internationally are selective in their approach; however a range of automatic support schemes are in operation providing financial support to producers to develop and produce new projects. Eligibility for such support is automatic, based on the past commercial or critical success of a film. Automatic funding schemes recognise and support production companies that are responsible for successful films. Automatic funding schemes also create a strong relationship between successful production companies and the marketplace. Examples of international automatic funding schemes are set out in **Appendix E**.

Screen culture

Screen culture is the environment in which film and other screen programs are made, seen and discussed. A vigorous, diverse and innovative screen culture provides the intellectual heart of a distinctive screen industry, fostering its development and encouraging audiences to consume and engage with screen programs.

Screen culture describes a variety of activities and events through which audiences and practitioners engage with screen content, including film festivals and screenings, publications and books, conferences and seminars, professional development activities, film competitions, and touring events. These activities provide opportunities to engage with production, allowing audiences and practitioners to consume, discuss, critique, enjoy and learn. They provide increased access to Australian films, television and interactive media programs whether consumed in the cinema, at home, via the internet, on mobile phones, on computers or in outdoor venues. They aim to further develop audiences and to create increased demand for Australian screen programs. By providing access to programs where the marketplace fails to do so and by stimulating further demand for diverse content, screen culture is an integral part of the screen content industry, fostering its growth and expanding the means for audiences to consume and engage with Australian screen programs.

The Government has supported screen culture activities though direct funding since 1975. Today, as is the case internationally, federal government funding supports a myriad significant screen culture activities offered to Australians. This support is crucial for the ongoing viability of Australia's screen content industry.

Over 60 organisations and well over 80 projects are supported by direct funding annually for events and activities that are held around the country in over 90 regional and metropolitan centres. These activities are mainly delivered by not for profit organisations. Government funding support is crucial for both their ongoing stability and viability, as well as in assisting them to raise further sponsorships and other funding.

Direct support is needed to deliver screen culture in areas most poorly serviced by the market. In regional areas, audiences and practitioners are denied access to programs commonly enjoyed in larger metropolitan centres. In metropolitan areas continued funding is required for activities that support diverse or innovative screen culture that are too risky for the commercial marketplace. Seed funding supports new initiatives that need time to mature into commercial activities that can be wholly supported by the market.

The AFC believes screen culture funding must continue to be directed towards addressing the following priorities:

- providing the wider Australian community, including regional Australia, with opportunities to access screen activities not otherwise supported by the marketplace;
- supporting the creative development of a community of Australian filmmakers, television producers and interactive media producers;
- ensuring the availability of and promoting Australian screen culture to young people within the education sector; and
- promoting Australia and its culture internationally through its films and television programs where the purpose is cultural rather than commercial and the market is being developed.

The AFC believes that the current level of government funding for screen culture activities, including the additional funding received as part of the Federal Government's 2004 commitment, *A World Class Film Industry,* needs to be maintained.

Research and analysis

Research and analysis of the audiovisual industry is integral to assisting with the development and growth of enterprises, the industry as a whole and contributing to the development of government and industry policy relating to the creation, availability and preservation of Australian audiovisual content.

The current effectiveness of the AFC to conduct research and assist the Government to develop policy relevant to the audiovisual industry fundamentally depends on the industry expertise and specialisation of its staff and continuing close engagement with industry. The ability of such research and strategic analysis to be accepted by industry and contribute to the policy development processes of the Government rests upon the actual and perceived independence of such advice at arms length from government.

As a major collector and analyser of data about the industry, the AFC helps the industry and government anticipate and respond to the changing needs of our dynamic culture. Much like the UKFC, the AFC's policy and research area comprises public policy and research professionals with considerable public and private sector experience in issues relevant to Australia's screen content industries. Whilst formal responsibility for film policy remains firmly with DCITA – the AFC provides substantial input to government on the creation of policy on matters affecting the audiovisual industry. The AFC's industry expertise allows it to contribute to government policy making processes in a way that demonstrates a deep understanding of issues affecting the screen content industries. This position has allowed the AFC to develop a holistic and integrated set of strategies and programs across all sectors of Australia's screen content industries.

Archiving, preservation and access

The archiving, preservation and continued availability of Australian audiovisual material is an essential element in contributing to the collective memory of Australian culture and society. Audiovisual and sound collections illustrate who we are, our history and the diversity that makes up Australia's identity. It has long been recognised that national archival custodial objectives would not be met by the commercial sector and require on-going government support. Commonwealth funding ensures that the collection and preservation of our audiovisual heritage is an independent and objective record of the moving images and recorded sound produced and not determined by commercial markets alone.

The work done by the NFSA dates back to the National Historical Film and Speaking Record Library (part of the then Commonwealth National Library), which was established by a Cabinet decision in 1935. In 1999, the Archive was renamed 'ScreenSound Australia' and functioned as an operational section of DCITA, reporting to the Minister for the Arts through the Departmental Secretary. Following a Federal Government Review of Cultural Agencies in 2002 and 2003, ScreenSound Australia, the National Screen and Sound Archive, was integrated with the AFC and reverted to the title of the National Film and Sound Archive in December 2004. The AFC's dual role of fostering an independent internationally competitive audiovisual production industry and developing, preserving and providing access to Australia's national collection of sound and moving image means that it now supports the entire life-cycle of films.

To facilitate the integration and to enshrine the functions of the Archive in legislation, the *Australian Film Commission Act 1975* was amended to encompass the following functions.

- Develop and maintain a national audiovisual collection;
- Preserve the national collection according to the highest curatorial standards;
- Exhibit and make available the national collection to the widest possible audience.

The AFC believes that these three interrelated functions must continue to be supported through direct funding. This model is consistent with national audiovisual institutions worldwide.

Marketing and export development

Marketing and export development remains fundamental to support a growing industrial base and further the economic development goals of the industry. The work of direct funding to support national events, international representation, travel for practitioners and dissemination of market intelligence is essential to ensure practitioners are equipped to present their work in the global marketplace.

In order for screen content producers to successfully attract higher levels of private investment, they must be equipped with extensive intelligence of the national and global audiovisual marketplace, and must be able to successfully relate this information to potential investors. Direct funding for marketing activities can assist producers in acquiring this information from commercial sources, as well as to enable producers to form the international business networks that are a prerequisite for sharing marketplace knowledge and information and making deals.

The promotion of Australia as a production destination also remains an important element to grow the industrial and employment base. With foreign production becoming an increasingly important sector of the industry, assistance to foreign producers looking to locate productions in Australia, by providing information on Australian locations, federal and state tax incentives, crews and services, production facilities and studios is vital.

Most governments around the world complement audiovisual production programmes with schemes to support marketing in the national market through cultural activities and in international markets through supporting a presence at major international festivals, the publication of yearbooks and catalogues; funding to support international marketing; and support for subtitles and re-versioning.

Direct government support provided through marketing grants and loans can also support the distribution of unique and risk-taking Australian screen content to audiences across Australia. The AFC and the FFC currently fund this activity but only to a very limited extent. The AFC believes that in the future more resources will need to be targeted to this area in order to ensure Australian audiences are made aware of, and have access to, Australian-made content.

Training

The economic structure of the film and television industry and the nature of the labour market in the production sector is such that the audiovisual industry is unable to sustain a level of training that would ensure a sufficient supply and quality of new entrants without government assistance. Directly funded training institutions such as the AFTRS foster the development of a strong pool of talent for the local industry and develop the industry's business skills.

AFTRS short courses complement the initial training its students may have in the production industry and provides industry professionals with opportunities to gain additional skills and assist them in their creative and professional development. A fundamental element of this process involves training and re-skilling practitioners in new technologies and platforms, as well as assisting practitioners in the development of business skills. To this end AFTRS recently received additional funding of $9 million over three years from 2005/06 to implement dedicated interactive and multi-platform production courses (LAMP) and establish the Centre for Screen Business to assist graduate and industry practitioners to develop business skills. These developments are positive steps and need to be maintained.

2.6 What is the most appropriate structure for direct government support to the film industry?

The AFC has outlined above those areas it believes must continue to be delivered through direct government funding mechanisms. Whilst the AFC believes current structures demonstrate efficiency and effectiveness, it also believes the same outcome could be achieved through a merged or newly created agency as is the case in a number of international territories including the UK: see **Appendix F**.

The AFC believes that there are some obvious efficiencies and synergies that could be gained by locating all the directly supported programs under one agency. These include:

- *Increased co-ordination and strategic streamlining of development, production and marketing assessment processes to achieve government and industry objectives*

The AFC supports the 'many doors' policy, that is, the policy that there be a number of funding and financing outlets for producers to support a diversity of production output. The AFC believes that the introduction of an effective Offset will go some way to developing a true alternative door, distinct from direct government funding processes.

For those productions that will continue to fall within the scope of innovative and risk-taking production, as outlined above, the AFC believes the centralisation of script development, production and marketing may assist the full development and exploitation of projects. Greater co-ordination will enable the nurturing of projects through the entire creative cycle; foster consistent decision-making with inevitable efficiencies for the industry; establish the development of closer relationships between practitioners and the funding organisation; and enable the streamlined provision of expert knowledge across all production phases.

- *Improved co-ordination of business and enterprise development goals*

  The production industry exists within an increasingly globalised and convergent media environment with businesses having to engage across multiple platforms of distribution, as well as diversify their production output and cross-sectoral linkages. Across the federal agencies there has been a growing emphasis on developing programs and improving processes that assist in supporting the growth of sustainable and profitable businesses within this convergent environment. There are clear efficiencies for businesses to access support through a single centralised outlet. There are also clear synergies in a holistic and co-ordinated approach to the development of enterprise development policies and programs – programs that are targeted, complement one another and fulfil the cultural objectives of the Commonwealth.

- *The creation of a unified voice/brand to the industry and the market, both locally and internationally*

  While the AFC, FFC and Film Australia all market Australian productions overseas, each has been focussed on different areas. The FFC is primarily concerned with deal making for its productions, assisting the industry in raising finance by bringing together producers and sales agents. Film Australia concentrates on selling its productions. Other federal agencies as well as Ausfilm, who promote Australia as a production destination, and the ACTF, who attend children's markets, also provide marketing assistance for the industry internationally. The AFC promotes the full spectrum of productions, practitioners and marketplace representatives. The AFC's coordination of the marketing of Australian productions internationally has provided a focal point at international markets such as MIPCOM, MipTV and the Cannes and Berlin Film Festivals, providing a profile and kudos for the entire industry. However, the AFC sees potential benefits in greater coordination of international (and domestic) marketing activities in order to present a unified Australian brand to the marketplace.

- *The centralisation of archival mechanisms, resources and infrastructure, benefiting the full exploitation and lifecycle of content, and improving the creation, preservation and availability of Australia's audiovisual content to Australians*

  The combining of the functions of audiovisual archiving with those of production and screen culture provides a dynamic and strategic framework for both enhancing a proactive role in collecting and preserving the national audiovisual heritage, building stronger more effective links with the content creation sector, and expanding access to Australia's screen culture regionally, nationally and internationally.

  Developing, producing, preserving and providing access to content are all part of one cycle and natural compelling synergies exist between each step. Combining the functions of collection and preservation within a broader production environment allows for much stronger links between archivists and content creators facilitating information, trust and credibility between the two sectors. The archive is charged with collecting the content of the audiovisual production industries. In the absence of legal deposit for the audiovisual industry, the strength and depth of the archive's collection largely depends on the positive relationships between the archive and the production industry. These relationships are better fostered and understood by uniting the functions, rather than situating the archive apart from the production industry.

In terms of providing access to the national audiovisual collection, combining the archive with the screen culture sector fosters improved and more proactive public access to audiovisual material for all Australians. The synergy between the production industry, screen culture and archiving makes for a legitimate coexistence of all functions, and this combination of functions is modelled internationally. A resilient production industry grows within the context of a strong cultural environment. Screen culture nurtures and fosters film development by supporting emerging talent, industry and professional development and the development of audiences for Australian and international programs. Facilitating that access to the nation's audiovisual collection enhances the delivery of screen culture and public access.

Delivering increased access to screen culture requires experience in rights management, exhibition, distribution and marketing. These are functions not necessarily best located within a stand-alone archive, which is not a content creator nor a rights holder. Providing the experience and mechanisms for negotiating and managing intellectual property rights, marketing and promotion, both domestically and internationally that reside within the production and screen culture sector greatly enhances access that an audiovisual archive can provide.

The model of combining a production and screen culture agency with an archive is not unique but exists in several other developed countries with strong and internationally competitive local film cultures, including Britain[39] and France.[40] Other countries including Sweden, Belgium Denmark and Holland also provide screen culture and archival programs together with production funding programs.

Nevertheless, the AFC recommends that a number of key issues need to be taken into account in considering a final structure:

- *A change in agency structures should be consequential to the introduction of an effective and tried and tested indirect funding alternative*

It is essential that an effective alternative indirect funding door be in place before any proposed adjustment in the structure of direct government funding agencies be undertaken. The 18-month hiatus between the demise of 10BA as an effective incentive and the establishment of the FFC was a major factor in the contraction of the industry at that time. The industry needs a transition period to adjust to new financing mechanisms and adjustments to the delivery of direct funding should be

[39] The UK Film Council manages its screen culture function through the programs of the British Film Institute, which it funds to carry out a range of activities supporting and developing film education and culture in the UK. At the heart of the BFI's remit is an educational role through which it aims to nourish critically aware, visually literate and more demanding filmgoers and filmmakers. The National Film and Television Archive is also managed by the UK Film Council.

[40] In France, The Centre Nationale de la Cinematographie (CNC) finances production, national archive, screen culture (cinematheque) programs and an education program through schools.

complementary to and occur as a result of the outcomes of the implementation of a new indirect support scheme.

The AFC believes that the introduction of any changes that arise as a result of this review must be planned carefully and not rushed. Any change to the structure of indirect funding support will need to be accompanied by an ongoing discourse between the production sector and the finance sectors, with an information campaign to assist the production and private finance sectors to understand and engage with the new model.

- *A wide consultation process must take place in the lead up to any significant change in the structure of direct funding agencies*

Consultation with the screen production industry and other key stakeholders must take place when considering adjustments to the direct funding agency structure to ensure that any change is comprehensive in scope, and maintains industry confidence. The AFC believes that a considerable lead time would be required to enable a smooth transition to a model that delivers Commonwealth objectives and industry needs.

As a minimum, the AFC believes that the following principles should continue to underpin the Government's agency structure or structures:

- *Industry expertise is essential:* Industry expertise must be central to the makeup of any agency or agencies in order that peer assessment and industry knowledge is maximised. In order to properly carry out its functions, agency staff and management must make creative and commercial judgments. Therefore, it is vital that the agency or agencies are managed by people with direct knowledge and experience of the screen production industry, nationally and internationally. The expertise, credibility and industry relationships that such employees, managers and board members bring to an organisation and its programs are invaluable;
- *Agency or agencies must be at arms length from government:* An independent arm's-length relationship between the agency or agencies and the Government is essential to its successful existence within the screen production industry. In dealings with investment partners, both nationally and internationally, the agency or agencies act commercially, and would be severely limited in their dealings or ability to attract partners and sponsors if it were to be seen as an arm of government, rather than a separate statutory body.
- *Must remain under the CAC Act:* The agency or agencies must remain under the *Commonwealth Authorities and Companies Act 1997 (*CAC Act). The CAC Act provides for clear and unambiguous accountabilities, whilst enabling the agency or agencies to operate at arm's-length to ensure effectiveness.