NEIL CRAIG ASSOCIATES

INTERNATIONAL FILM AND TELEVISION PRODUCTION IN CANADA

Setting the record straight about U.S. "runaway" production

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Executive Summary

Since the late 1990's, elements of the U.S. film production industry and some U.S. politicians have been making exaggerated claims about the volume and effect of U.S. production which comes to Canada. The underlying inference is that all film and television production involving U.S. companies belongs exclusively to the United States; or perhaps even more narrowly to Hollywood itself. This ignores the increasingly global nature of movie production and the growing importance of foreign markets to the U.S. industry. Production that takes place outside the U.S. is deemed to be "stolen" and is called "runaway" production. In June 1999, the Screen Actors Guild and the Directors Guild of America released the *U.S. Runaway Film and Television Production Study Report* written by the Santa Monica office of The Monitor Company. This often quoted study alleged that the total direct and indirect economic loss to the U.S. from "runaway" production (primarily to Canada, according to the study) was $10.3 billion in 1998 and was set to rise sharply. Thousands of jobs were said to be lost to Canada.

People in the Canadian film industry feel that Canada continues to be attacked unfairly, based on the inflated claims made in the Monitor Report and recent scaremongering. In response, it retained Neil Craig Associates to collect authoritative data on the volume of U.S. production that takes place in Canada. Neil Craig was also asked to research how much money is returned to the U.S. industry as a result of products sold or licensed for viewing in Canadian markets. The results of this study dispel many of the myths perpetrated by the Monitor Report and show that far more money is returned to the U.S. production industry than is spent by that industry on production activity in Canada.

The main findings of the Neil Craig Report are:

- **The value of U.S.-based international film and television production activity in Canada is only a fraction of what is claimed in the Monitor Report.**
  The total direct and indirect economic impact of this activity on the U.S. in 1998 was $1.7 billion, only a fraction of the $10.3 billion claimed in the Monitor Report. That Report contains contradictory claims and basic arithmetic errors, double counts figures and uses methodologies that are highly unusual in standard economic analysis. Its key

data cannot be verified or independently reviewed and is derived from financial information that is not audited.

- **Despite claims of U.S. job losses, employment in the U.S. film and television production industry has actually increased by 6.6% since 1998.**
  The strong employment numbers contradict the claims of those who argue that the U.S. industry is collapsing in the exodus of producers seeking cheaper locations in which to shoot their next movie or television program. In a recent letter to Rep. Diane Watson of California, former President of the Motion Picture Association Jack Valenti vehemently denied there has been any "outsourcing" of U.S. industry jobs. He pointed out that overall employment in the industry rose almost four times between 1972 and 2002.

- **Many U.S. states have become more aggressive than Canadian provinces in enticing film and television production away from Hollywood.**
  The term "runaway" production was first used to refer to productions leaving Hollywood for South Carolina. Today, 42 U.S. states or territories offer some form of incentive to attract film and television production. These incentives include everything from exemption from sales and use taxes for purchases and spending in the state, through tax rebates, to refundable corporate and income tax credits.

- **Unlike many newly-created production centres, Canadian centres like Toronto, Montreal and Vancouver have a long history in film and television production, the foundation of which is a vibrant indigenous industry.**
  The first feature film produced in Canada was *Evangeline*, shot in 1913. Beginning in 1938, innovative film production was nurtured and supported by the globally-recognized National Film Board. The first international production shot in Canada may well have been Alfred Hitchcock's *Confess*, produced in 1952. In that same year, the Canadian Broadcasting Corporation began producing television drama, comedy, music and variety, news, sports and documentaries for a national audience. These two agencies created an environment that has generated a steady stream of Canadian artists and film stars, some of whom have taken their talents to Hollywood and are well recognized in U.S. film and television.

- **Canadian filmmakers share many of the same concerns as U.S. producers.** Film production is an attractive industry and many governments worldwide are seeking to bring more activity to their jurisdictions. Some throw unsustainable tax dollars at producers, hoping to develop the underlying talent and infrastructure needed for a viable industry. Canada's highly developed film centres are now being passed over in favour of countries and U.S. states that have little to offer in terms of skilled crews, lighting and camera equipment or viable soundstages. Moreover, most Canadian producers and distributors share the concern of major Hollywood studios that piracy is the chief threat to the industry today. If estimates of the Motion Picture Association of America are correct, the value of stolen U.S. intellectual property far exceeds the value of U.S.-based productions in Canada.

- **The overall balance of trade in the film and television sector favours the U.S.** In 2003, more than $1.3 billion flowed out of Canada to the U.S. as net revenues from cinema admissions, sales and rental of video cassettes and DVDs, broadcast license fees and other revenues. This is what Canadians spent for the right to view U.S. movies and television programs, net of distribution expenses. Between 1998 and 2003, the amount repatriated to the United States from the distribution of U.S. movies and television programs in Canada was more than $6.5 billion. Within this period, the U.S. had a positive balance of trade of more than $1.0 billion when you compare this outflow to the volume of U.S.-based international productions in Canada.

This report shows that the quantity of U.S.-based production in Canada has not had a detrimental effect on the U.S. film production economy. In fact, more money is repatriated to the U.S. through movie and video sales and licensing fees than flows into Canada through production expenses. Moreover, employment in the U.S. film and television production sector has actually increased in the same period that film unions are claiming that jobs have been lost to Canada. Many of the claims predicting a devastating impact on the U.S. industry are based on the Monitor Report, a document that is full of unverifiable data, exaggerated economic multipliers and unsustainable conclusions.

For ease of comparison, all figures in this Report are in U.S. dollars, including figures for production activity in Canada. Where figures are converted from Canadian to U.S. dollars, the conversion is made at *either a blended exchange rate for the appropriate year, or at a specific date as noted in the text.*

Introduction

Canada has always been a lucrative market for movies, television programs and other cultural products from the United States. Most Canadians share the language and idiom of our neighbour and feel a kinship with the cultural values reflected in the films, music, literature and other cultural products we import. Because of our physical proximity, Canadians have been privileged to have virtually unlimited access to these works, even in the days when distribution required the transportation of the movie reels, television cassettes or books by train or truck. Our cultural markets are integrated to such a degree that Canada is considered part of the U.S. domestic market by the major film and television producers and distributors.

In 2000, the last full year for which data is available, Canada imported $5.1 billion[i] of cultural goods and services and exported $3.8 billion[ii].

Almost 83 percent of the television programs, books, movies, magazines and sound recordings were imported from the United States and that country received 95 percent of Canada's cultural exports. By 2003, Canada's cultural trade deficit with the United States alone is estimated to have reached $1.7 billion[iii].

While we share some cultural reference points and historical experiences, there are many ways in which we differ. Despite having been part of the invasion force that razed the White House in 1814, Canadians are among the leading United Nations' peacekeepers; community and the individual are valued equally; and our Constitution is based on "peace, order and good government." Canadians have struggled against the powerful geographic and economic pull from the south to build an independent nation on the northern half of our shared continent. We have many of our own stories to tell and our own perspectives on world events and we have, therefore, needed to find ways to communicate east and west and to pass along our values and beliefs to the next generation and to new Canadians. Thus, Canadians have been in the forefront of technological and creative developments from the early days of films, radio and television.

In the film and television business, it has been necessary for governments to intervene in the market to support Canadian producers and distributors, who must compete with imported works such as television programs sold in Canada for only a fraction of the cost of production. The federal and provincial governments provide financial subsidies, tax incentives, limit foreign ownership in the sector and use other policy tools to support the domestic industry. The Canadian Radio-television and Telecommunications Commission (CRTC) complements those with content quotas and regulatory measures.

These cultural policy measures help to level the playing field for Canadian producers and distributors in the face of the tremendous competitive advantage enjoyed by film and television producers and distributors in the United States and elsewhere, who have a substantially larger domestic market or other advantages that create economies of scale. These measures have combined with the entrepreneurial skills of our producers and filmmakers and built on the infrastructure created in the 1950s and 1960s by broadcasters and the National Film Board (NFB) to nurture a dynamic film and television production industry in Canada.

Canada also plays a role in an increasingly global audiovisual industry. We continue to be major consumers of the television programs and movies from other countries and products from the United States dominate Canada's market. For creative or economic reasons, producers sometimes look to mount their productions in other countries, and technology makes this increasingly feasible. Beginning in the 1980s and spurred on by a Canadian dollar rapidly declining in value, U.S. producers looked to Canada, since we had a highly sophisticated infrastructure, spoke the same language, had varied locations that could easily substitute for U.S. ones, were within easy reach of their head offices and had lower costs. By 1989, international productions already dominated production in British Columbia.

The global audiovisual industry is highly competitive. Globalization brings increased competition and new technologies have allowed the film production process to become unbundled. It is no longer necessary to have all the people involved in the film to be in the same place. Other countries have introduced and enhanced incentives to attract foreign productions. In the United States, 42 states and territories presently offer some form of tax incentives to attract film and television productions. These U.S. incentives include everything from exemption from sales taxes for purchases in the state, to tax rebates and state income tax credits. State and local film commissions complement these incentives with other measures, such as location scouting and other support.

To maintain Canada as a competitive location for producers from other countries, governments have established measures that encourage location shooting, including tax credits for hiring Canadians to work on the shoots and assistance with location scouting, permits and other administrative details. These measures help to attract work in an economic sector that is generally high wage, high profile, involves leading edge technologies and is environmentally benign. The resulting activity provides important opportunities for Canadian artists and technicians to practise their craft and work beside leading industry players. It assists Canada to maintain a world class infrastructure.

Yet, there are some in the United States who view all government interventions in the audiovisual business as unfair and unwarranted. They argue that by maintaining measures that attract U.S.-based producers, Canada is "stealing" work from their industry. Some even argue that government measures favouring distinctly Canadian productions, which have little relevance to anyone else, are illegitimate and "barriers" to their industry. They have filed complaints against these measures with the U.S. government, urging retaliatory action. In supporting these complaints, the U.S. interests have submitted studies and economic analyses which conclude that "runaway" production is a significant problem.

Canadians feel that they have earned their role in the global industry, producing their own television and films, providing services in Canada to foreign producers and as key players in Hollywood and elsewhere. They reject the claim they are opportunistically stealing business that "belongs" in the United States.

This Report will explore these issues and analyze relevant industry statistics to assist players in Canada and the United States to understand developments on both sides of the border.

SECTION 1

International Production in Canada

International Production Activity in Canada: United States Share

The following table summarizes the value of foreign film and television production in Canada.

YEAR	International Production	$ US (MILLIONS) Media	US/Other
1997/1998	• United States		561.8
	• Other Countries		29.6
	• Television:	378.1	
	• Film:	213.3	
	Total	591.4	591.4
1998/1999	• United States		688.9
	• Other Countries		36.3
	o Television	350.7	
	o Film	374.5	
	Total	725.2	725.2
1999/2000	• United States		977.2
	• Other Countries		51.4
	o Television	459.0	
	o Film	569.6	
	Total	1,028.6	1,028.6
2000/2001	• United States		1,111.4
	• Other Countries		58.5
	o Television	628.1	
	o Film	541.8	
	Total	1,169.9	1,169.9
2001/2002	• United States		1,068.9
	• Other Countries		56.3
	o Television	653.4	
	o Film	471.8	
	Total	1,125.2	1,125.2
2002/2003	• United States		1,176.5
	• Other Countries		61.9
	o Television	689.1	
	o Film	549.3	
	Total	1,238.4	1,238.4

Data Sources

This data is adapted from the annual survey of the Canadian production industry produced by the Canadian Film and Television Production Association and l'Association des producteurs de films et de télévision du Québec, in conjunction with the Department of Canadian Heritage, the federal government's culture department (CFTPA Study).[iv] It represents the total amount spent in Canada on labour, goods and services for international productions of all types and includes film and television productions from all countries.

The primary source of the data is the Canada Audio-visual Certification Office (CAVCO), the division of the Department of Canadian Heritage responsible for administering the tax credit. Additional analysis has been provided by the Nordicity Group which prepares the data for the CFTPA reports.

Analysis

Several factors are critical to understanding the importance of this data:

- Virtually all international productions are eligible for and take advantage of the production services tax credit. Therefore, all U.S.-based international productions are included in the calculation, whether they shoot in Canada for creative or economic reasons.

- The data is not broken down by country of origin. While there are some each year, the overall number of productions from France, United Kingdom, Germany and elsewhere is not large and roughly 95 percent of the productions originate in the United States. This figure is confirmed by CAVCO[v] and has remained constant throughout the reported period.

- Since CAVCO is responsible for administering provisions of Canada's *Income Tax Act*, the reporting on production budgets, expenses incurred in Canada and eligible labour costs is based on audited financial statements filed by producers. Thus, since they must conform to stringent accounting and auditing standards, the data is more authoritative than figures that rely on self-reporting surveys, media releases or the industry press.

- Data from Canadian government sources is generally reported on the basis of the government fiscal year, which ends on March 31. There is also a delay between the end of production and the final report submitted to CAVCO. Thus, the figures represent a blend of activity from two calendar years and this has been taken into account in the analysis wherever possible.

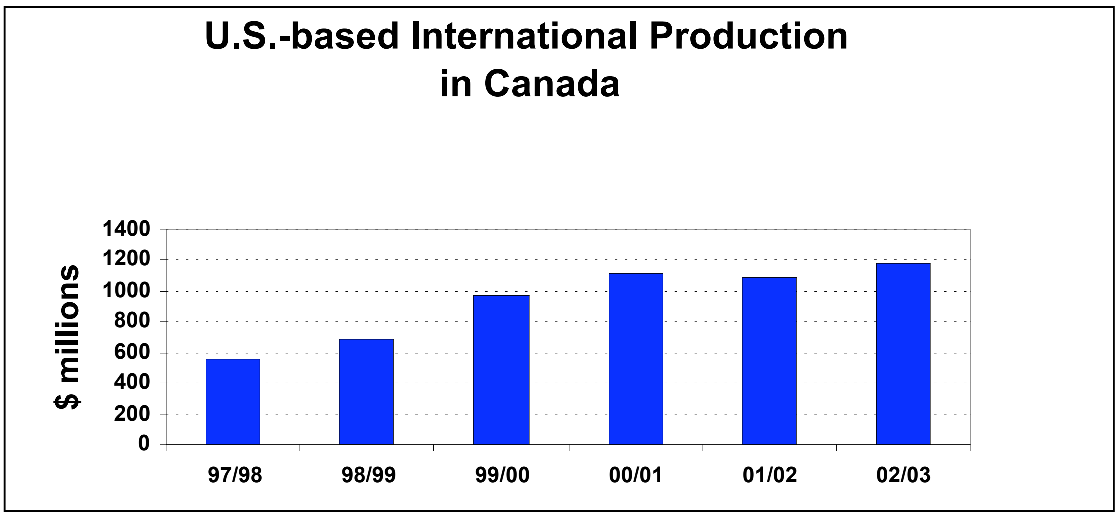
- Reporting activity on the basis of total production spending has some advantages and some drawbacks. It is important to note that growth in spending can arise either from increased production activity and/or from rising costs.

When U.S. companies first began to shoot in Canada in the 1980s, they discovered that they could use certain tax rules for limited partnerships and receive a financial advantage worth six to eight percent of the production budget or more. In 1996, the government announced it would close this tax shelter and this created considerable uncertainty in the industry. In late 1997, after lobbying by the industry, the government announced the launch of the Film or Video Production Services Tax Credit (PSTC). This program provides a tax credit against federal taxes otherwise payable, based on the amount of eligible Canadian labour expenses. The launch of the PSTC created a climate in which producers could be secure in their relationship to the Canadian tax system. The increases after 1997 can be attributed to the increasing comfort of working in Canada, the stable climate for production activity that existed and rising costs.

According to most observers, by 2000/2001 Canada had come to dominate production in the movie-of-the-week (MOW) category, since these specialized productions are particularly cost-sensitive and are produced on a relatively short time-schedule compared to theatrical feature films. By this time, producers had discovered another tax loophole related to “matchable expenditure” rules that provided a further financial incentive to shooting in Canada.

The slowing of the rate of growth after 2000 relates to issues of production capacity in Canada and the decline of the MOWs as a program genre. Since that time, North American television has witnessed the appearance of the so-called “reality-based” programs, which are unscripted and generally lower cost than other programming genres. Canada has not attracted a significant volume of foreign "reality-based" television productions.

The declines in international film production activity in 2001 and 2002 no doubt relate in part to the extraordinary period after the tragic events of 9/11 when there was little business travel and an overall hiatus in activity. Also, on 1 April 2002, the federal government closed the remaining tax shelter related to "matchable expenditures" that had been used for the previous few years. Increasing competition from U.S. states and other countries which have been actively courting Hollywood producers has also contributed to the slowdown.



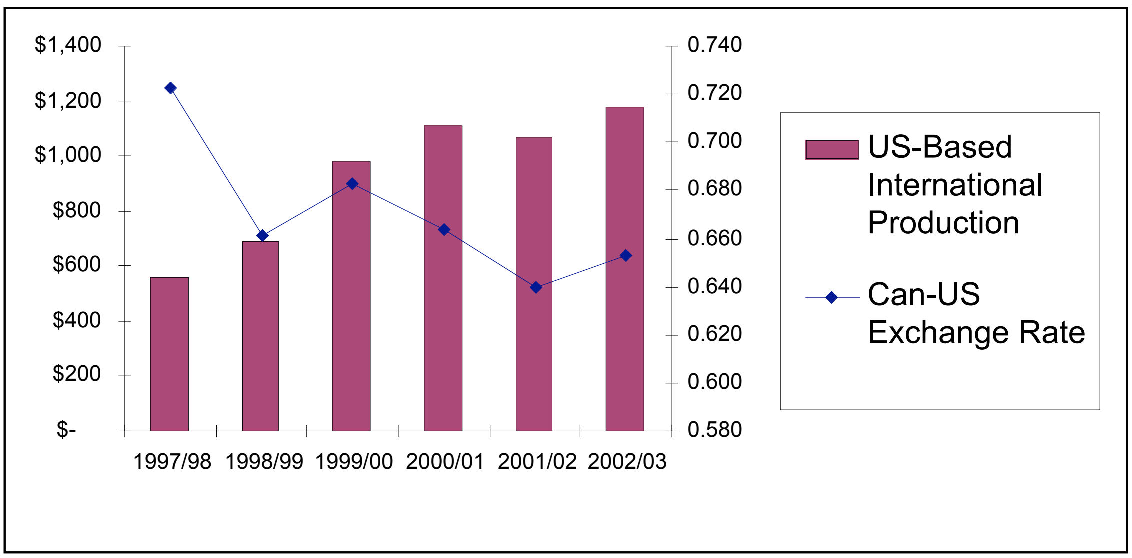
Contemporary Developments

The data does not yet show what has happened since early 2003. Anecdotal reports suggest that international production activity has declined substantially in recent months. This arises from several factors, including the outbreak of the Severe Acute Respiratory Syndrome virus in Toronto in early 2003, which cast a pall across the whole country, and the gradual increase in the value of the Canadian dollar. By 1 October 2004, the Canadian dollar had reached U.S. $0.79, a level not seen for two decades. An increase in the rate of the production services tax credit to 16 percent of eligible labour expenses was introduced in early 2004, but it is too early to judge the effect of this change.

Many people in the Canadian film and television industry believe that the single most critical factor in accounting for the presence of U.S. production in Canada is the value of the dollar, and the following tables provide some evidence to suggest there is an inverse relationship between the exchange rate and the level of production, although it is far from conclusive. When you factor in the effects of 9/11, you see that generally, as the Canadian dollar decreases in value, the production level increases and when the Canadian dollar has a higher value, the production level is lower, although the relationship is not strong.

U.S.-Based International Production to Canadian Exchange Rate

Year	$ (millions)	% Growth	Exchange Rate July 1 – June 30
1997/98	$ 561.8		.723
1998/99	688.9	22.6	.661
1999/2000	977.2	41.8	.683
2000/01	1,111.4	13.7	.664
2001/02	1,068.9	(3.8)	.640
2002/03	1,176.5	10.1	.653



Canada’s Competitive Position

The competitiveness of Canada as a location for international production is affected by many factors, including:

- The value of the Canadian dollar relative to the currencies of other countries with an established production infrastructure.
- The cost competitiveness of Canada relative to other locations.
- The long-standing relationship between Canadians and key players in the U.S. industry. This is an industry where decisions are sometimes made on the basis of "who you know" as much as "what you know."
- The size, geographical distribution and skill of the talent pool and the availability of quality crews and equipment.
- The openness with which international production is welcomed in Canadian communities.
- Access to a variety of exciting and fresh production locations and to locations that can easily substitute for U.S. ones.
- Maintenance of a competitive incentive program.

There are recent positive and negative signs for Canada's competitive position. According to a report from insurance broker Aon/Albert G. Ruben, Canada is one of a very few "low-risk" countries in its analysis of the physical risks incurred by filmmakers and location scouts working around the globe. On the other hand, the United States is considered to be a "medium-risk" location, alongside Romania, the Czech Republic, Saudi Arabia and Greece. Germany and France are considered "moderate-risk" locations.[vi]

But Canada's cost advantage is slipping. A 2003 report prepared for the Australian government analyzes Australia's competitiveness after changes to its incentive programs and concludes: "After the relevant tax incentives were applied, Sydney, Australia enjoyed approximately a 7.5 percent net cost of production advantage over Vancouver, Canada."[vii] Other locations, including the Czech Republic, South Africa and elsewhere would have a significant cost of production advantage over Canada.

U.S. Tax Incentive Programs

Many states in the United States are also heavily involved in competing for the film and television work opportunities. According to a recent report from the Motion Picture Association of America (MPAA), 41 states as well as Puerto Rico offer some form of incentive to producers. There is a broad range of tax incentives offered. Several states forego the hotel tax on lengthy stays, others forego the sales and use taxes on purchases made in the state, many offer concessions related to the purchase and lease of equipment involved in film and television productions and several offer individual income tax and/or corporate tax breaks.

New York, Hawaii, Illinois, Louisiana, Mississippi, Missouri, New Mexico, Oklahoma, Pennsylvania, South Carolina and Puerto Rico all offer a tax rebate program based upon spending in the state, usually on labour. Examples include:

- New York State provides a 10% tax credit on eligible expenses to which New York City adds another 5% tax credit plus other incentives if 75% of the production takes place in the city.
- Illinois provides a 25 percent income tax credit for Illinois labour expenses to a maximum wage of $25,000;
- Hawaii offers a refundable income tax credit of four percent of all costs incurred in filming in the state;
- Louisiana provides a 10 percent employment tax credit for in-state payrolls between $300,000 and $1 million and a 20 percent credit if the in-state payroll exceeds $1 million;
- Mississippi offers a 10 percent tax credit for labour expenses on residents;
- Missouri provides a transferable/carry forward income tax credit of up to 50 percent of expenditures in the state to a maximum of $500,000 tax credits per project;
- Pennsylvania recently enacted assignable corporate, partnership or income tax credits of 20 percent of production costs, including labour if the in-state spending is 60 percent of the aggregate production expenses for feature films and television programs. There is a three-year carry forward provision.

California has no sales or use tax on production or post-production services on a motion picture or film and there are no sales or use tax on industry specific services such as writing, acting, directing, casting and storyboarding. There is a partial sales tax exemption on the purchase or lease of post-production equipment by qualified persons and a partial exemption from both sales and use tax on the costs of designing and building sets. In New York there is a comprehensive state, New York City and local sales and use tax exemption for machinery, equipment, and services used in production and post-production activities of feature films and television programs.[viii]

SECTION 2

Canadian Content Production

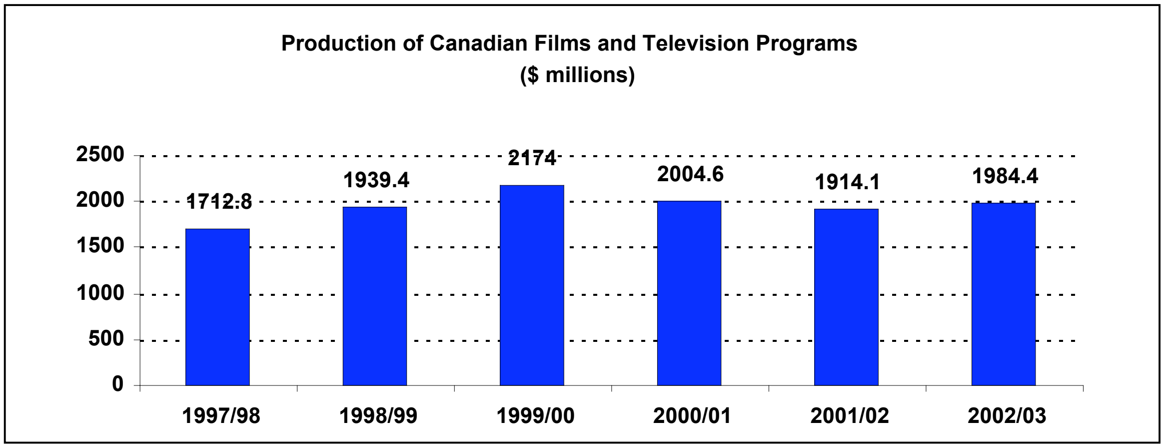
The principal government support measures and content quotas are designed to encourage Canadian Content (Cancon) productions. These are movies and television shows that are conceived, developed, written, performed, directed and produced primarily by Canadians. On these productions, the copyright is owned by Canadians and the bulk of production expenses, as well as pre- and post-production expenses, are paid to Canadians.

While Cancon shows and movies can bring a Canadian perspective to stories from elsewhere, they are more often about Canada and its people, places, history, myths and legends. Roughly 25 percent of Cancon is produced in French and some is produced with international co-production partners from France, the United Kingdom, Germany and other countries.

Some Canadian productions may sell abroad, but others will never be seen outside Canada. In recent years, perhaps as many as 70 percent are fully Canadian, achieving the maximum number of Cancon "points", awarded on the basis of the nationality of persons employed in the key creative positions, including scriptwriter, director, actors, director of photography, music composer and editor. Some of these productions, such as contemporary political satire, are uniquely Canadian to the degree they have little or no export value because they would not be understood anywhere else.

Production of Canadian Films and Television Programs

	$ (millions)	% Growth
1997/98	1,712.8	
1998/99	1,939.4	13.2
1999/00	2,174.0	12.1
2000/01	2,004.6	(7.8)
2001/02	1,914.1	(4.5)
2002/03	1,984.4	3.7



Data Sources

As above, this data is taken from the annual survey of the Canadian production industry produced by the CFTPA. They are estimates created by the Nordicity Group Limited and based on information provided by the CAVCO, CRTC, Canadian Broadcasting Corporation (CBC) and the Department of Canadian Heritage.

This is far more complex data than that reporting on international productions, since it includes broadcaster in-house productions of all kinds, production that is certified as Canadian content by the CTRC, but is ineligible for the tax credit system (the tax credit is available only for certain genre of production) and distinctly Canadian works that receive the maximum public support.

Analysis

This data shows that Canadian content production, which grew steadily through the 1980s and early 1990s, levelled off after 1999 and has struggled to remain stable since. The factors that have caused this to happen include:

- The rise in “reality-based” television programs.
- The CRTC’s 1999 Television Policy which allowed broadcasters to replace high cost drama programs with relatively lower cost regional programs and documentaries, and eliminated stringent spending requirements that had applied previously to conventional Canadian broadcasters.
- The collapse in international markets for television programming that has made it substantially more difficult for Canadian independent producers to acquire the financing they need for their projects. Sales of Canadian programs have dropped by 30 percent since 2000.[ix]

SECTION 3

Canada's Contribution to the U.S. Audiovisual Industry

In order to understand Canada's place in the global audiovisual industry and put international production activity in Canada into the appropriate context, it is necessary to look at the contribution that Canadian consumers make to the global industry. The U.S. industry receives from Canada significant revenues from cinema admission tickets, pay television, the purchase and rental of video cassettes and DVDs and licence fees from conventional, specialty and cable television broadcasters.

Despite a 1998 government policy which restricted the entry of new foreign firms into the market, the Canadian distribution business is dominated by foreign-owned companies, primarily the distribution arms of the Hollywood majors. These firms had established in Canada before the new ownership policy took effect. More significantly, whether the distributor is Canadian-owned or foreign-owned, the movie distribution and exhibition businesses in Canada have been fully integrated into the Hollywood system since the earliest days. When studios design and implement promotion and advertising campaigns, they do it for a continental market. Canada is considered to be part of the "domestic" market for purposes of the payment of residual fees to talent.

It is critical to look at the distribution data by the country of origin of the productions involved. Foreign programming and movies, overwhelmingly from the United States, whether distributed by Canadian or foreign companies in Canada, continue to dominate the marketplace.

There is no central and authoritative repository of these figures, so it is necessary to analyze information from several sources to produce a complete picture.

Revenues from Canadian Theatrical Box Office/U.S. Industry Share

	Box Office $ (millions)	U.S. Movies' Share $ (millions)	Distribution Expenses $ (millions)	Repatriated to United States $ (millions)
1998[x]	$ 438.9	406.9	(142.4)	264.5
1999	446.0	412.3	(144.3)	268.0
2000	476.1	443.7	(155.3)	288.4
2001	540.5	502.7	(175.9)	326.8
2002	616.3	570.8	(199.8)	371.0
2003	636.9	589.9	(206.5)	383.4

Data Sources

The figures are taken from the CFTPA Report and adjusted according to information received from the Motion Picture Theatre Associations of Canada. Statistics Canada data was used for purposes of determining the foreign share of the revenues. It is assumed that U.S. movies account for 95 percent of foreign movie revenue. Distribution expenses are calculated at 35 percent.

Revenues from Broadcast Licence Fees Paid for Foreign Programs and Pay TV Distribution of Foreign Movies/U.S. Industry Share

Year	Revenues/Fees For Foreign Programs $ (millions)	Repatriated to United States $ (millions)
1997/98	349.5	296.6
1998/99	300.0	254.2
1999/2000	337.9	286.0
2000/01	349.1	294.7
2001/02	357.4	302.5
2002/03	393.8	332.9

Data Sources

The data for Pay Television revenues is taken from Statistic Canada's report, *Film, Video and Audio-Visual Distribution*.[xi] The actual foreign share of domestic distribution revenues has been used as the base figure each year and it is assumed that U.S. movies represent 95 percent of this foreign share. Data from the CRTC has been used for the licence fees paid for foreign material by private Canadian broadcasters. An estimate has been made for the fees paid by Canadian Broadcasting Corporation (CBC).

In the case of television, it is assumed that U.S. programs account for 85 percent of the total foreign licence fees paid by Canadian broadcasters.[xii] While the screen time for U.S. programs on Canadian television is not this great, the average licence fee for the more popular U.S. shows is substantially greater than for programs from other countries, thereby raising the aggregate percentage factor.

Net Revenues from Sale and Rental of Videocassettes and DVDs/U.S. Industry Share

	Producers/ Distributor Share $ (millions)	U.S. Industry Share $ (millions)	Distribution Expenses $ (millions)	Repatriated to U.S. Industry $ (millions)
1998	501.6	469.4	(164.3)	305.1
1999	517.6	479.4	(167.8)	311.6
2000	596.9	550.6	(192.7)	357.9
2001	625.4	576.9	(201.9)	375.0
2002	641.9	597.0	(209.0)	388.0
2003	701.7	652.6	(228.4)	424.2

Data Sources

Statistics Canada recently released its report on *Spending Patterns in Canada, 2002.* Using this data, it is possible to estimate that the retail value of the sales and rental of audiovisual videocassettes and DVDs was $2.0 billion in that year. These figures have been adjusted for each year in accordance with the Statistics Canada report on distribution activity and that report has been used to determine the amount that relates to sale and rental of foreign films.[xiii] It is assumed that U.S. movies comprise 95 percent of activity related to foreign films and distribution expenses are calculated at 35 percent.

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Calculating the U.S./Canada Balance of Trade in International Movies and Television Programs

	Repatriated Canadian Revenues $ (millions)	U.S.-Based International Production in Canada $ (millions)	U.S. Balance of Trade $ (millions)
1997/1998			
Theatrical	264.5		
Television	296.6		
Retail Sales and Rental	305.1		
Other[xiv]	107.1		
Total U.S. Share	973.3	561.8	411.5
1998/1999			
Theatrical	268.0		
Television	254.2		
Retail Sales and Rental	311.6		
Other	101.3		
Total U.S. Share	935.1	688.9	246.2
1999/2000			
Theatrical	288.4		
Television	286.0		
Retail Sales and Rental	357.9		
Other	117.6		
Total U.S. Share	1,049.9	977.2	72.7
2000/2001			
Theatrical	326.8		
Television	294.7		
Retail Sales and Rental	375.0		
Other	128.5		
Total U.S. Share	1,125.0	1,114.4	10.6
2001/2002			
Theatrical	371.0		
Television	302.5		
Retail Sales and Rental	388.0		
Other	150.3		
Total U.S.	1,211.8	1,068.9	142.9
2002/2003			
Theatrical	383.4		
Television	332.9		
Retail Sales and Rental	424.2		
Other[xv]	160.4		
Total U.S.	1,300.9	1,176.5	124.4

The previous table compares the revenues which are returned to the U.S. as a consequence of the exploitation of U.S. movies and television programs in the Canadian market with the value of the production those same companies undertake in Canada.

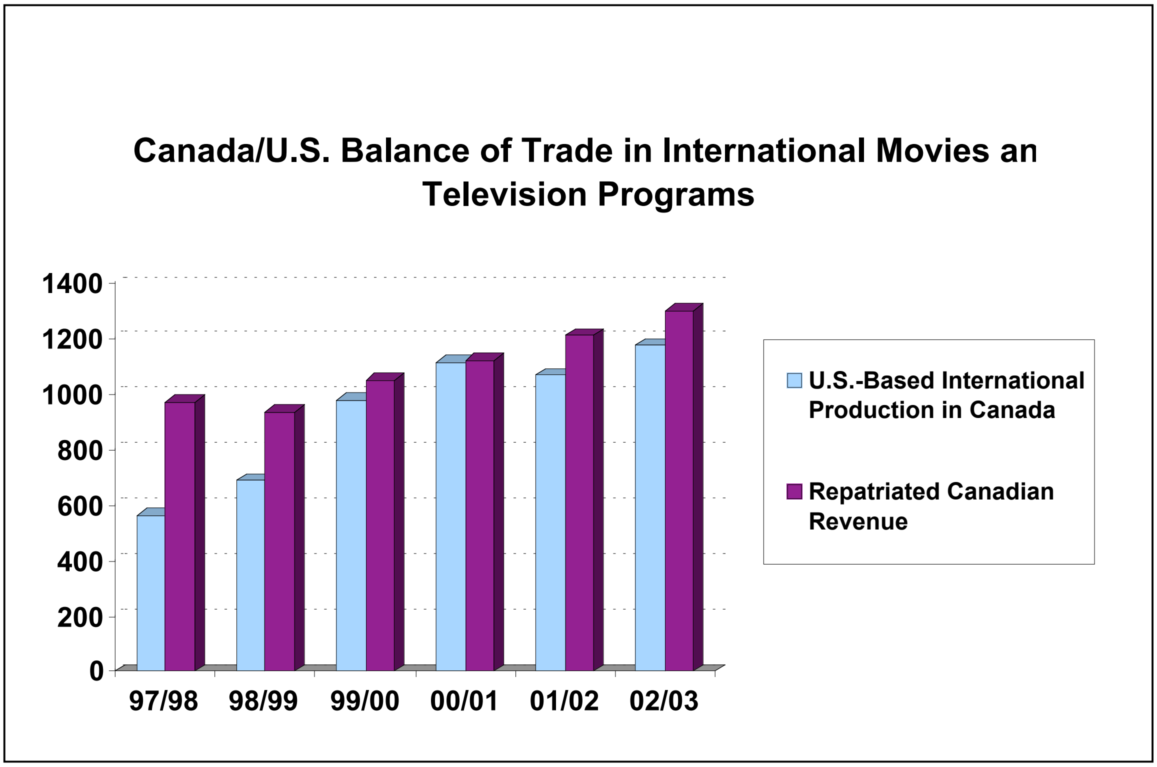
In each year reviewed, there has been a net outflow of revenues from Canada to the United States film and television industry. In the six years reported, there was an outflow of $6.5 billion, net of distribution expenses, to the United States; and Canadian consumers sent to the U.S. over $1.0 billion more than the total amount of U.S.-based international production in Canada.

According to the Motion Picture Association of America, in 2003 Canada was the sixth largest all-media market in the world, returning revenues of $1.35 billion[xvi] to the U.S. industry. When you consider that the Canadian data is reporting on a blended year, only a portion of which is 2003, the MPAA and the Canadian data are remarkably close. Thus it would appear that the U.S. data confirms the veracity of the Canadian data on the revenues returned to the U.S. from the Canadian market.

It is important to note that the data in the table on the revenues returned to the U.S. industry are *net* of distribution expenses. It could be argued that it is equally valid to use the *gross* revenues for purposes of making the comparison, since these are received primarily by the Canadian subsidiary operations of the U.S.-based studios and are thus under the control of the U.S. industry. If the gross revenues were to be used, the positive balance of trade enjoyed by the United States increases significantly in each year. For example, in 2003, distribution expenses of roughly $450 million have been deducted from the gross revenues. Comparing the volume of U.S.-based international production in that year to the gross revenues received by the U.S. industry creates a positive balance of trade for the United to States in that year alone of almost $575 million.

In his final *State of the Industry* address to ShoWest 2004, outgoing MPAA president Jack Valenti reported that total international box office for U.S. movies was $10.85 billion in 2003. Fifty-three percent of these revenues came from the international box office; only 47 percent was generated by the domestic ticket sales.

It is clear that the film and television industry is now global and substantial revenues are flowing to the United States to contribute to the financing of future productions, most of which will be produced there, or to enhance the profit position of media conglomerates headquartered in the U.S.



SECTION 4

United States Production Industry

It is also important to look at what has been the effect on the U.S. industry of the international production that has taken place in Canada. Some argue there has been a precipitous decline in U.S. film and television production activity. They blame “runaway” production for the decline and target Canada as the foremost problem area. Unfortunately, there is no authoritative public U.S. data on overall volumes of production that would facilitate a direct comparison with the Canadian information. Data collected by the U.S. government is directed at other purposes, data collected by private sector firms is generally proprietary and data collected by the industry itself, which is based on self reporting surveys, is released only for specific purposes, such as Mr. Valenti’s *State of the Industry* address.

The best available data to show the overall trends in the U.S. industry since 1998 is the employment figures collected by the Department of Labor. This is useful data since it directly addresses the charge that U.S. jobs are being lost to Canada and other countries as a direct result of U.S. “runaway” production. Available employment data appear to contradict this claim.

Employment in U.S. Motion Picture Production and Services

	Total Employment	% Growth
1998	172,000,000	
1999	182,500,000	6.1
2000	182,100,000	(0.2)
2001	180,900,000	(0.7)
2002	191,700,000	6.0
2003 (estimate)	183,500,000	(4.2)

Data Source

This information is taken from the annual MPAA Market Survey, referencing data collected by the U.S. Department of Labor.[xvii] Note that it excludes data on employment in the theatres and video stores.

Analysis

While there has been fluctuation in this period, there was overall growth in the labour force of 6.6 percent between 1998 and 2003. Interestingly, this data roughly parallels the trends in the Canadian production industry, which also witnessed a tremendous slow-down in the growth rates that prevailed through the 1990s, and absolute declines in the volume of production spending in 2001 and 2002. It is likely that similar factors have contributed to these trends, including the "reality-based" programming phenomenon and the tragic events of 9/11.

The strong employment numbers certainly contradict the claims of those who argue that the U.S. industry is collapsing in the exodus of producers seeking cheaper locations in which to shoot their next movie or television program. In a recent letter to Rep. Diane Watson of California, Mr. Valenti vehemently denied there has been any "outsourcing" of U.S. industry jobs. He pointed out that overall employment in the industry rose almost four times between 1972 and 2002.[xviii]

Los Angeles Production Activity

It is a challenge to find reliable numbers for Los Angeles that would permit a direct comparison to the overall employment figures for the United States or to the Canadian volume of production data. However, the data on the number of location filming days in the heart of the U.S. industry may reveal the reason that the shrillest voices in the United States about "runaway" production are in Los Angeles.

Total Location Production Days – Los Angeles[xix]

	Total Film and Television Location Filming Days	% Change
1998	22,727	
1999	20,805	(8.5)
2000	20,643	(0.8)
2001	20,246	(1.9)
2002	20,894	3.2
2003	21,724	4.3

Data Source

These numbers are compiled by the Entertainment Industry Development Corporation and represent the days of location filming in the City of Los Angeles, the City of West Hollywood, the City of Diamond Bar, the City of South Gate, and unincorporated portions of Los Angeles County.

Analysis

According to this data, the television and film production industry in Los Angeles appears to have fared more poorly in the period under review than has the industry overall in the United States. The total number of location filming days fell by 4.4 percent over the period, in contrast to the 6.6 growth in employment overall in the United States.

However, these figures merely report on the number of location filming days. They exclude the days spent in studio and this could be significant given the continuing trend in the film industry toward more "high-tech" and "special effect" features. Also, it is impossible to extrapolate this data into the number of people working on the productions involved, nor to the amount of money spent on those productions. But, with the average movie budget having risen dramatically over these years, it may well be that more people were employed on the productions shooting on the 2003 production days and that total budgets of the movies and television programs produced may well have increased substantially from the earlier years.

The breakdown between television and film is also revealing, because the total number of location production days on films declined throughout the period, with the decline being substantially offset by a rise in the number of television location production days.

The data provides no information about why there is such a distinction. There is no proof that "Canadian tax credits are responsible" for the decline in feature productions as claimed by some U.S. commentators. It is important to observe that in the international production field, Canada has historically done more television work than feature films.

In the six-year period reported, television production accounted for 53.7 percent of the total volume of U.S.-based international production in the country and that figure has risen to 56.8 percent in the past two years. Yet, television production activity in Hollywood appears to be robust.

When you juxtapose the decline in feature production days in Hollywood with the fact there has been an overall growth of employment numbers for the industry nationwide, it is useful to recall what the L.A.-based Film and Television Action Committee said recently:
"Ironically, the term 'runaway production' was originally used in the late eighties in Hollywood to refer to shows shot in North Carolina."[xx]

There is nothing ironic about the statement at all: it reflects the reality that, for some in the U.S. industry, production should take place exclusively in and around Hollywood. Every production that leaves Southern California for other locations in the United States is a violation of the natural order.

In the letter to Rep. Diane Watson of California cited earlier, Mr. Valenti notes that the industry in Southern California continues to be healthy:

- The motion picture industry contributed almost $30 billion to the economy of Southern California in 2002.
- The number of persons working on California-based crews to become eligible for coverage under the industry health plan increased by 36 percent between 1996 and 2003.
- Actors' earnings reached an all-time high in 2003, almost $1.5 billion. This is an increase of 57 percent in a decade.

Mr. Valenti observed that during the past 70 years, U.S. producers have gone to foreign locations for myriad reasons, including the geographic setting of the script, the time period in which the movie is set, access to military or unique locations and the ethnic make-up of the cast.[xxi]

SECTION 5

U.S. Reports on "Runaway" Productions

The Monitor Report

"He uses statistics as a drunken man uses a lamppost – for support, rather than illumination."
Andrew Lang, Scottish poet and scholar

In June 1999, the Screen Actors Guild and the Directors Guild of America released the *U.S. Runaway Film and Television Production Study Report* which purported to calculate the value of U.S. "runaway" productions. The Santa Monica office of the Monitor Company, a global management consulting firm, was asked by the guilds to study the economic consequences of "U.S.-developed feature films, movies for television, TV shows or series which were filmed in other countries for economic reasons."

The report looked at 1998 production activity and concluded that the total direct expenditures of productions that left the U.S. for economic reasons was $2.8 billion.[xxii] Budgets for these films and television programs were said to total $4 billion and Monitor estimated that $1.2 billion[xxiii] of this amount was spent in the United States on pre- and post-production work, or on personnel brought from the U.S. to the foreign location by the producer.

The report then analyzed the economic effects of the "lost" expenditures. If the activity had remained in the U.S., it would have stimulated further activity in the industry or in related sectors. Applying a multiplier of 3.6 to the goods and services purchased abroad and 3.1 to the wages and salaries paid abroad, the authors concluded that the indirect effect of the "lost" activity was $5.6 billion.

The report then argued that the "payroll, income and sales taxes on the direct spending and the multiplier spending are also lost to the U.S." It calculated the effect of this lost taxation to be $1.9 billion.[xxiv]

In a grand conclusion, the Monitor Company argued that the overall economic consequences of the film and television production that “ran-away” from the U.S. in 1998 was thus:
$2.8 billion (direct) + $5.6 billion (multiplier) + $1.9 billion (taxes) = $10.3 billion

The Monitor Company reported that Canada was the home to 81 percent of the “runaway” production in 1998, or an amount of $2.27 billion. Note that this is roughly four times the amount of such production reported by Canadian sources and roughly equivalent to the total volume of television and film production activity in Canada in that year. Recall that 25 percent of Canadian content production is in French and, in addition, there are treaty co-productions involving producers from countries other than the U.S., as well as uniquely Canadian shows that have no distribution outside Canada and in-house productions by Canadian broadcasters.

Analysis of the Monitor Report Data

There is insufficient information in the Monitor Report to permit anyone to recreate the numbers for independent verification. Its data is proprietary, with raw data accumulated from a variety of sources, including the guilds themselves and the industry press. However, there are significant internal problems in the Report that undermine the integrity of the data.

- *The report contains contradictory claims about the direct economic loss.*

The basic numbers and methodology simply do not add up. At page 14, the report analyzes the “Direct Spending” lost as a consequence of “runaways.” It claims a total of $2.0 billion has been lost as salaries and wages and $0.88 billion has been lost in the acquisition abroad of goods and services. This totals $2.88 billion, which rounds to $2.9 billion when reporting to one decimal space. But, when the report analyzes the multiplier effect at page 12, it calculates the loss of salaries and wages at only $0.85 billion in addition to the $0.88 billion on goods and services. Thus, in this section, the Report claims a direct loss of $1.73 billion.

Since they have refused all requests over the years to discuss their report, one can only ask the authors rhetorically: is the direct loss $2.9 billion, $2.8 billion, or $1.7 billion, each of which could be claimed as accurate in different parts of the Report?

- *There are basic arithmetic errors in the Report*.

The Report states: "In 1998, the multiplied effect of lost production expenditures totalled $5.6 billion ($0.8 billion multiplied by 3.6 plus $0.8 billion multiplied by 3.1)"[xxv]

If you make this calculation, you will find that the total is $5.36 billion. There is simply no combination of Monitor's multiplication factors and economic loss figures contained in the Report that can be combined together to come up with a total of $5.6 billion.

- *The addition of tax revenues to the grand total means that these amounts have been double-counted.*

There is no justification for adding lost tax revenues in the final calculation of the economic impact of "runaway" productions.

If the production company pays for a hotel room or the rental of equipment, there will be certain taxes included in the cost or added to it on the final invoice paid by the production company. The company will record the gross amount paid for the service as the production expense. Similarly, when the company hires a technician or 2nd Assistant Director to work on the production, they will pay a gross fee for the service, a portion of which will find its way into the government treasury in the form of income or other taxes. Again, the gross amount paid for the service will appear properly as the production expense. Permit fees or additional taxes paid by the production company are recorded elsewhere as part of overall production expenses.

In a similar manner, all taxes related to the "multiplied" effect of the production form part of the basic calculation. Doing otherwise merely inflates the multiplier to an unjustifiable amount. Finally, business and other taxes paid by the company itself are based not on the amount they spend on the production, but on the income they receive from its distribution, which will be an entirely different calculation and legitimately outside the scope of the study.

Put another way, if the $2.8 billion (or $2.9 billion, or $1.7 billion) reported by the Monitor Company to have “runaway” were repatriated to the U.S. economy to be spent on production activity there, it would include the income taxes that would be paid by the workers, the sales taxes that would be paid for the rental of equipment and catering, permit fees and all miscellaneous taxes paid in the course of production. Similarly, the indirect and induced spending that this activity would generate is inclusive of all of the tax revenues that would flow to governments.

Comparing Monitor to the Canadian Data

It is impossible to reconcile the Canadian data and the Monitor Report. The overriding reason is because the basic figures on the volume of production that has “runaway” and the spending abroad that relates to these productions were developed by the Monitor Company and have not been released. It is impossible to recreate this information. A part of the solution may well be the following:

- *Information on production budgets in industry press and industry databases, used by the Monitor Company in compiling its database, is not subject to verification or audit and may well be inflated.*

The film and television industry is built in part on image and hype. Movie promotion is an art designed to get the maximum number of consumers into the cinemas on the opening weekend. Accordingly, hyped production costs as reported in the trade press, especially those related to blockbuster features, are not considered to be sufficiently accurate data for quantitative economic analysis.

The British Columbia Film Commission conducts a voluntary survey to collect and publish data on the overall production budgets of the foreign movies and television programs that have been shot in the province. B.C. Film reported that, for the 25 foreign feature films shot in B.C. in 2003, the cumulative total production budgets were $0.942

billion, or an average of $37.7 million for each movie. U.S. industry press and database reports could be found on 14 of these titles. Based on the highest publicly reported production budget from these sources, the average production budget of the movies produced in B.C. in 2003 was $52.3 million,[xxvi] almost 40 percent higher than the Canadian figure. In a similar analysis for 2002, it was possible to find industry information on 13 of the 15 feature films reported by B.C. Film. B.C. Film reports average budgets of $31.0 million, whereas the industry press reports average production budgets for these same features of $41.1 million, almost one-third higher.

Some of the discrepancy may be the value of pre- and post-production costs (although this should be part of the B.C. Film data) but, if so, it would be irrelevant to the discussion since it is widely acknowledged these costs are incurred in the United States in any case, even when principal photography takes place in Canada. Thus, the Monitor Company may well have used raw data that is inflated by one-third or more when preparing its initial database.

- *Information on the amount of "repatriated spending" on runaways in the Monitor report appears to be based on an incorrect assumption.*

A related issue concerns Monitor's statement that: "In 1998, of the $4.0 billion in economic runaway direct production expenditures, $1.2 billion remained in the U.S.," meaning that 70.0 percent of the production budgets were spent on foreign goods, services and labour. Once again, there is insufficient information provided to verify this data; it is stated simply as fact.

CAVCO reports that, since the PSTC was introduced in 1998, a total of 49.2 percent of the cumulative production budgets has been spent on Canadian production activity. While the figure for 2003 was 51.2 percent[xxvii], this is still substantially lower than the Monitor estimate of 70.0 percent. Recall that CAVCO is basing its analysis on audited financial statements submitted by production companies to public tax authorities.

Multiplier Issues

In addition to the basic arithmetic mistakes and the double counting of the lost tax revenues, there are significant questions about the methodology and the multipliers used in the Monitor Report. In May 2000, the Directors Guild of Canada released a study undertaken by the Tax Services Division of Ernst and Young's Chicago Office. They stated that:

- *"Conventionally, the multiplied effects are defined to include the initial impact."*[xxviii]

There is obvious value in understanding both the direct and the indirect consequences of economic actions. There are three leading models of multipliers that are used to estimate the indirect effect, but each is designed in such a way that the final calculation includes the initial action, the indirect effect of that action and the induced expenditures. The Monitor Report *adds* the initial impact to the multiplied effects, which is, at best, highly unusual.

"Ernst and Young calculated the film industry multiplier for the State of California and the United States using the IMPLAN model. E&Y believes that the IMPLAN model is a more appropriate model to use because it compensates for factors such as internal trade and commuting that are not considered by the RIMS II multipliers (the system that appears to have been used by Monitor). …The results of the E&Y study show:

- the economic multiplier for the State of California is 1.99; and
- the economic multiplier for the United States is 3.02."[xxix]

The number for California represents the economic value of the activity within the borders of the state. However, a production in California also has an impact outside the state and thus overall on the U.S. economy. For example, some of the direct and induced purchases would be on goods and services acquired from outside the state, some of those employed on the production will spend money outside the state and the use of federal tax revenues extends beyond the state.

Applying these multipliers to the value of U.S.-based international production in Canada in 1998, one can calculate the following effect, based on the exchange rate of 1 July 1998:

For California: \$0.56 billion x 1.99 = \$1.11 billion
For the U.S.: \$0.56 billion x 3.02 = \$1.69 billion

Thus, the total economic impact of the U.S.-based international production in Canada in 1998 was \$1.11 billion for the State of California if that production had relocated in California. The overall effect on the U.S. economy would have been \$1.69 billion, if that production had relocated anywhere in the U.S., roughly 17 percent of the Monitor Company's wildly exaggerated estimate of \$10.3 billion.

We are left then only to confirm the validity of the Canadian data on the value of U.S.-based international productions in Canada in 1998. Confirmation of this data is found in the report from the United States Commerce Department.

Reconciling the Discrepancies – U.S. Commerce Department Report

Spurred on by the inflated and contradictory claims of the Monitor Report, elements of the U.S. film and television industry launched a complaint to the government against Canadian measures that encourage film and television production. As part of its investigation of the complaint, the United States Commerce Department released its 90-page study, *The Migration of U.S. Film and Television Production,* in March 2001.

This Report is a comprehensive and thorough review of the background of the issue and includes all of the relevant analyses that were provided to it, including the Monitor Report and data from the CFTPA Report.

The Commerce Department outlines the reasons that production is increasing in Canada, Australia, Ireland, the United Kingdom and elsewhere. The main reasons include: i) globalization of the industry and cost competitiveness; ii) technological change and the transformation of the industry over the past fifteen years and; iii) foreign incentives including tax credits and other support that are targeted at off-shore producers. Globalization has brought increased competition and technologies have allowed the film production process to become unbundled, according to the Department of Commerce. It is no longer necessary to have all of the people in the chain of film production in the same place.

The Report also discusses multipliers used for the film and television production industry, noting that Arthur Anderson Economic Consulting concluded that 2.12 was an appropriate multiplier in a study they produced for the American Film Marketing Association.

The Commerce Department points out that, despite the increases in production abroad, the U.S. film and television industry continues to dwarf other countries in production activity and continued to grow in the U.S. in the past decade. The Report states there is no evidence to support the conclusion that foreign incentives alone have been the reason that U.S.-based productions have been growing in other countries. Instead, the Department of Commerce concludes that globalization, rising costs, foreign incentives and technological change in the industry have combined to transform the U.S. industry into an increasingly dispersed global industry.

While it does not draw this conclusion explicitly, the Commerce Department Report contains official U.S. government data that confirms the volume of U.S-based international production in Canada in 1999.

At page 19, the Report notes that the U.S. Commerce Department's Bureau of Economic Analysis collects data on the import of services to the U.S. This data includes "Disbursements to fund production costs of motion pictures" and "Disbursements to fund production costs of broadcast program materials other than news." Companies must report data with respect to payments they make to "unaffiliated" companies. The U.S. Commerce Department analyzes these figures based on information it collected from U.S. industry sources and estimates that the reported payments for 1999 are roughly 80 percent of the total payments made outside the U.S. for such productions. The Bureau then states that, if Canada is home to 80 percent of the work as claimed by the Monitor

Company, total payments made in Canada in 1999 for motion picture and non-news television production were roughly U.S. $630 million.

According to the Canadian data, in 1999 there was a total of $690 million of U.S.-based international production activity, a figure that is within 10 percent of the Commerce Department analysis.

Thus, it would appear that the U.S. government data confirms the veracity of the Canadian data.

Unfortunately, the Commerce Department does not routinely report the film and television data separately from other imported services. The detailed analysis was done only for 1999. If it were to disaggregate the data for each year since, there is every reason to believe that similar analyses would result in conclusions that mirror the calculations of the U.S.-based international production activity in Canada provided in this Report for those years.

SECTION 6

The Canadian Production Industry

In all of the U.S. studies and reports on "runaway" production, there is a lack of understanding about the history of Canada's production industry and about the nature of Canadian content movies and television shows. For example, all of the reports seem to accept the proposition that U.S. production in Canada has been responsible for the development of the Canadian infrastructure. Some argue that U.S. production started to shift to Canada as a direct consequence of the introduction of the government tax incentive. Others argue that even the Canadian content work has been "stolen" from the U.S. industry.

This section briefly outlines when and how the Canadian production industry has developed and international production emerged.

The Early Days

Canadians have a long and distinguished history in moviemaking, both domestically and internationally. As early as 1897, there were three short films made in Canada about Niagara Falls and the following year, the Massey-Harris Company commissioned films to promote its farm implements, the first use of film for advertising. The first dramatic short film in Canada was produced in 1903 and the first feature film, *Evangeline,* was made in 1913. Mary Pickford, who began as a stage performer in her home town of Toronto before moving to Broadway, was "America's Sweetheart" in the silent film era. She went on to become one of the founding partners of United Artists.

The two tracks of the Canadian industry – domestic and international – thus took root in the earliest days and have continued ever since. The National Film Board, created in 1938, has been a world leader in innovative filmmaking. Since television came to Canada in 1952, we have produced all kinds of programming, from drama, comedy, music and variety, to news, sports and documentaries. Canadians continue to take the skills they have developed in this vibrant industry to New York and Hollywood. From Fay Wray to Mike Myers and Jim Carrey; Arthur Hiller and Norman Jewison to Ivan

Reitman, Canadians have played a role in shaping the U.S. industry. The first international production to shoot in Canada may well have been Alfred Hitchcock's *Confess*, produced in 1952 in Quebec City.

In the early days, Canada's production industry was centred primarily on the NFB and the Canadian Broadcasting Corporation (CBC), Canada's public service broadcaster. Since Canada's cinema screens and film distribution businesses were controlled by the Hollywood majors, there was little scope for theatrical release of either NFB productions or those from a slowly emerging independent sector. The television antenna made it possible for most Canadians, who live in close proximity to the border, to watch the newly-launched U.S. commercial broadcast networks. As private broadcasting came to Canada, the stations were relying heavily on imported U.S. shows, which meant that Canadians in the major cities were receiving the U.S. programs both directly and through the Canadian stations.

In 1958, the first *Broadcasting Act* was enacted and the Board of Broadcast Governors was created as the regulatory authority. The BBG announced that all private stations licensed in Canada would be required to show a minimum of 45 percent Canadian content (Cancon). Although these initial regulations were weak, they led to the far more effective regulations imposed by the CRTC, which took on the regulatory responsibility in 1968.

Canadian Producers Come of Age

Basic Cancon rules introduced in the early 1970s require television stations to broadcast 60 percent Canadian content during the program day and 50 percent in the evening hours, 6:00 pm to midnight. The CRTC has mandated a range of specific licence conditions on various conventional, cable and specialty broadcasters and other regulatory measures that direct funding to Cancon productions. The introduction of these rules coincides with a period of rapid development of Canada's film and television production capacity.

Cancon rules are now widely used for most government industry support measures. Basically, to qualify as Canadian, the production must meet basic requirements in three areas: i) producer ownership and control; ii) key creative points and; iii) production and post-production costs. The producer must be Canadian and must be the central decision-maker on the production from beginning to end. At least six out of a possible 10 points must be achieved in hiring Canadians in key creative positions, including scriptwriter, director, lead actors and director of photography. At least 75 percent of the production and post-production costs must be paid to Canadians.

Over the last three decades, federal and provincial governments have introduced a range of measures to encourage Canadian producers to create Canadian content television programs and feature films. The Canadian Film Development Corporation (now Telefilm Canada) was launched in 1968. A capital cost allowance provision first introduced in 1954, was increased to 100 percent in 1974 and it suddenly became lucrative and sexy to invest in Canadian movies and television. The Canadian Feature Film Fund was launched in 1986. Telefilm's Broadcast Fund, created in 1984, and the Cable Production Fund, started the following year, evolved into the Canadian Television Fund in 1996. The capital cost allowance provision, having been amended many times, was finally eliminated and replaced in December 1995 by the Canadian Film or Video Production Tax Credit (CPTC). This is a fully refundable tax credit available at the rate of 25 percent of the expenses paid to Canadian workers on an eligible production. Many provinces have programs that mirror the CPTC and thus increase the incentive.

These regulations, support measures and government funding programs are designed to build a production industry that can bring Canadian stories and perspectives to movie and television screens in Canada and around the world.

In the 1980s the Canadian industry began to transform. With rising production costs, pressures on the CBC budget, the expansion of the number of television and cable channels in many markets and supportive government policies, Canadian production began to shift outside the NFB and the broadcasters. Canada's independent producers became the predominant players in the Canadian industry and began to capture new markets domestically and internationally.

Despite these measures, Canadian producers remain at a competitive disadvantage. A 2004 study, *Through the Looking Glass,* confirms that Canada's broadcast licence fees are substantially lower than those in the United States. The study, commissioned by the Directors' Guild of Canada, the CRTC and several government departments reports that domestic licence fees in the United States cover on average 81 percent of the costs of a television production, while in English-Canada the broadcast licence fees cover only 18.4 percent of the costs of the production[xxx]. Thus, the Canadian producer must look to other markets and public sources for close to 82 percent of the financing, even when the production budget is only a fraction of the budget of the U.S. producer. The U.S. television producer will move into a profit position when their program sells abroad or in the domestic syndication or supplemental markets.

U.S. Producers Come to Canada

In the mid 1980s, U.S. producers began increasingly to look north of the border to mount their productions, in order to escape escalating costs and take advantage of an underutilized and skilled infrastructure. The Canadian dollar, which had a *higher* value than the U.S. dollar as late as 1978, began a long and sometimes rapid decline. By 1985, the U.S. dollar brought a 25 percent premium when it was spent in Canada and a decade later the premium was 40 percent. CBC production was cut back in British Columbia. Several U.S. television producers capitalized on the opportunity to move north, with series such as *MacGyver* and *21 Jump Street* and they were soon followed by a number of film producers. U.S. producers also began to shoot in Toronto and Montreal for the same reasons of cost competitiveness and fresh locations.

Already by the end of the 1980s, international production was a significant part of the Canadian production industry and accounted for virtually all of the production activity in British Columbia.

Accountants for foreign producers operating in Canada also began to take advantage of certain tax rules for limited partnerships that, when applied to film and television production, offered a tax break worth 6 to 8 percent of the production budget or more. In late 1996, the government announced it was closing this tax shelter for all sectors and it agreed to grandfather film and television productions already in the pipeline.

After heavy lobbying by the Canadian industry, the government created the Film or Video Production Services Tax Credit (PSTC) effective November 1997. This provides a tax credit against federal taxes otherwise payable, based on the amount of Canadian labour expenses. Some production companies discovered yet another tax provision that could be used to provide a further financial incentive to produce films and television programs in Canada, but this measure was eliminated on 1 April 2002. After more lobbying, the PSTC was increased to the present level of 16 percent of eligible labour expenses. The tax credit program has been mirrored by a number of provincial governments, allowing producers to receive credits against both provincial and federal taxes. Since the benefit is a credit against taxes otherwise payable, it can be claimed only by a Canadian company or a foreign company with a permanent Canadian establishment.

Conclusions

The volume of U.S.-based international production activity in Canada was $0.56 billion for a 12-month period ending in 1998. This represents the total amount spent by U.S.-based producers on salaries, wages, goods and services that remained in Canada. The volume of U.S.-based international production activity in Canada in each succeeding year was:

1999	$ 0.69 billion
2000	0.98 billion
2001	1.11 billion
2002	1.07 billion
2003	1.18 billion

The total direct and indirect economic impact of this activity on the United States in 1998 was $1.69 billion, only a fraction of the $10.3 billion claimed in a U.S. study. The frequently-cited Monitor Report contains contradictory claims, basic arithmetic errors, double counts figures and uses methodologies that are highly unusual in standard economic analysis. Its key data cannot be verified or independently reviewed and is derived from financial information that is not audited. The evident flaws are so serious as to undermine the integrity of the data.

The Canadian data on international production activity is, on the other hand, based on audited financial statements. Furthermore, an analysis undertaken by the United States Commerce Department Bureau of Economic Analysis confirms the veracity of the Canadian data for 1999. The U.S. Commerce Department has calculated that "total payments made in Canada for motion picture and non-news television production" in calendar year 1999 were $0.63 billion, a figure that is remarkably close to the Canadian-calculated total of $0.69 billion for a roughly equivalent period. And, despite claims of impending doom for the U.S. production industry that accompany the Monitor Report, employment overall in U.S. Motion Picture Production and Services grew by 6.6 percent between 1998 and 2003.

A key fact that is ignored in the U.S. studies is that billions of dollars are repatriated to the U.S. every year through revenues generated in Canada by the finished product. In 2003, more than $1.3 billion flowed out of Canada to the United States, as net revenues from cinema admissions, sales and rental of video cassettes and DVDs, broadcast licence fees and miscellaneous fees and revenues. This is how much of the money Canadians spent for the right to view U.S. movies and television programs that was returned to the U.S. film and television industry, net of distribution expenses.

Between 1998 and 2003, the net amount repatriated to the United States from the distribution of U.S. movies and television programs in Canada was more than $6.5 billion. The U.S. had a positive balance of trade in this period of more than $1.0 billion when you compare this outflow to the volume of U.S.-based international productions in Canada.

The Canadian data for the amount of money that flowed out of Canada in 2003 is confirmed by the Motion Picture Association of America. The MPAA reported that Canada was the sixth leading "all-media" market for U.S. movies and television programs, returning to the U.S. an amount of $1.35 billion in 2003.

U.S. producers are attracted to Canada for many reasons including the cost competitiveness of Canada compared to other locations, the size and skill of the talent pool, the availability of quality crews and equipment, government tax incentives, the openness with which international production is welcomed, safety concerns and locations that can substitute easily for the U.S.

A key factor in this competitive position is the value of the Canadian dollar relative to the U.S. dollar. International production slows as the dollar rises in value. Canada's competitive position has slipped recently as a result of the recent rise in the value of the Canadian dollar and aggressive efforts by other jurisdictions, including many U.S. states, to attract production.

In 2004, 42 states and territories in the United States offered some form of incentive to attract film and television production. These incentives include everything from exemption from sales and use taxes for purchases and spending in the state, through tax rebates, to refundable corporate and income tax credits.

ENDNOTES

Throughout this report, dollar values are presented in U.S. dollars. The exchange rate is a blended rate of the average of the official Bank of Canada rate on July 1 and September 1 (previous year) and January 1 and April 1 (the year reported). The rates used are: 1998 - .7230: 1999 - .6617: 2000 - .6830: 2001 - .6640: 2002 - .6393: 2003 - .6532.

[ii] Statistics Canada. *Market Opportunities: International trade of cultural goods and services, Focus on Culture.* Winter 2000. Ottawa.

[iii] Estimate assumes that average growth rates of imports continued as they were in the previous five-year period while exports grew at only 4.0 percent, given the collapse of the foreign television market, the general malaise in Canada's cultural industries and the rise in value of the Canadian dollar.

[iv] CFTPA. *Profile 2004, The Razor's Edge: Canadian Producers in the Global Economy.* Ottawa. January 2004. The 1999-2004 CFTPA studies are available at www.cftpa.ca

[v] Canadian Audio-visual Certification Office. *2002-03 Activity Report.* Ottawa. June 2004. Page 15. CAVCO documents are available at www.pch.gc.ca.

[vi] Keifer, Peter. *Report maps filming risks.* Hollywood Reporter. Los Angeles. 18 February 2004.

[vii] Department of Information Technology and the Arts. *Final Destination: A Comparison of Film Tax Incentives in Australia and Canada.* Canberra. June 2003. Page 2.

[viii] Miele, Angela, Vice President, State Tax Policy, *2004 State-by-State Tax Incentives.* Motion Picture Association of America, Inc. Washington. 10 August 2004.

[ix] CFTPA. Page 4

[x] Assumes a 10.0 percent growth from actual report by MPTAC for 1999 and 2003

[xi] Statistics Canada. *Film, video and audio-visual distribution, The Daily.* Ottawa. 14 May 2004. Available at www.statscan.ca

[xii] Industry Statistics and Analysis, Broadcasting Operations, CRTC. *Television. Statistical and Financial Summaries.* Ottawa. Years used: 1999-2003, 1998-2002, 1997-2001, 1996-2000, 1995-1999, 1994-1998.

[xiii] Statistics Canada. *Film, video and audiovisual distribution. The Daily*. Ottawa, 14 May 2004. The wholesaling costs are assumed to be 50 percent of the gross value, which is roughly the average for a five-year period reported by StatsCan. The ratios of growth over time and the volume of activity that is accounted for by foreign movies are also derived from the report.

[xiv] ibid. This includes sales to government, schools and other distribution licence revenues. It also includes an estimate of the net value of the U.S. share of the Retransmission royalty

established by the Copyright Board of Canada and payable to rights holders of programs incorporated in "distant" signals retransmitted by cable, satellite and other distribution undertakings.

[xv] Estimate of Neil Craig Associates

[xvi] Hollinger, Hy. *Worldwide Media Sales Hit High.* Hollywood Reporter. Los Angeles. 27 April 2004.

[xvii] Motion Picture Association, Worldwide Research. *U.S. Entertainment Industry: 2003 MPA Market Statistics.* Washington. Page 27.

[xviii] Kiefer, Peter. *Valenti Defends U.S. Production Abroad.* Hollywood Reporter. Los Angeles 19 April 2004.

[xix] Entertainment Industry Development Corporation. Data are available at www.eidc.com.

[xx] Film and Television Action Committee. *Letter to Mr. Ronald Lorentzen, U.S. Department of Commerce.* Studio City, CA. 28 June 2004. Page 13

[xxi] Kiefer.

[xxii] The Monitor Company, *U.S. Runaway Film and Television Production Study Report.* Santa Monica. June 1999. Page 11.

[xxiii] ibid. Page 11.

[xxiv] ibid. Page 12.

[xxv] ibid. Page 12.

[xxvi] This analysis is based on British Columbia production data for 2003 and available at www.bcfilmcommission.com/filminfo and on a search of various U.S. databases, including Variety, Entertainment Weekly, boxofficemojo.com, imdb.com and the-numbers.com.

[xxvii] CAVCO. Page 16

[xxviii] Wilson, William and Coalier, Chad. Ernst and Young Tax Services. *A Review of the Monitor Group Report on the Economic Multiplier for the U.S. Film and Television Production Spending.* May 2000. Chicago. Page 13.

[xxix] ibid. Page 17.

[xxx] Cox, Kirwin. *Through the Looking Glass.* Rigaud, Québec. March 2004. Page 1.