

A “CLUSTERED” LOOK AT THE BRITISH COLUMBIAN FILM AND TELEVISION INDUSTRY

by

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ABSTRACT

BC's film and television production sector depends on a practical subsidy system for the capital to produce its product. Although the film and television funding system in Canada is adequate, it could certainly be improved.

This project will examine the film and television industry in BC. This maturing industry needs innovative strategies to create sustainable long term growth. Believing in the theory that it is necessary to understand the past before you can move forward, this project will look at the history of film and television tax incentives in Canada. With this base knowledge, a comparison of our history will be made against the current successful tax incentives in Belgium. Belgium's system was built based on the successes and challenges experienced by Canada, most often considered a leader in the industry and we have much to gain from incorporating the lessons learned to build a strategy for our future.

DEDICATION

For my family, especially my wife Elizabeth, who offered me unconditional love and support throughout the course of this MBA final project.

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1 IMPORTANCE OF THE INDUSTRY

1.1 Introduction to the BC Film and Television Industry

The film and television industry, from pre-production to distribution, plays a vital role in the British Columbia economy. It stimulates growth, generates substantial employment, and also provides a form of promotion for the province. In addition, the industry is potentially an area of innovation as companies look for opportunities to improve existing technologies. While not a traditional resource based sector of the economy for British Columbia, developing the maturing film and television industry provides a compelling argument for supporting economic growth in the province.

Film and television industry has social and political implications through the role it plays in communicating ideas, providing information and engendering debate. However, the industry's influence is not limited to these. It also has economic implications for companies involved in the industry such as post production, catering, casting, production equipment, set design and property supply. Indirectly, it also generates income and jobs in the support and hospitality industries, stimulating business in the hotel, restaurant and transport sectors. This industry cluster also boasts an average annual salary of \$63,740 or nearly double the current provincial average¹, and because of its unique nature, contributes higher than average levels of employment as a percentage of expenditures.²

Outside of the economic growth arguments for supporting further development of the film industry, there are many benefits to consider. One of these benefits is that the film and television

¹ Source: *Film and Television Industry Review* prepared by InterVISTAS for Ministry of Economic Development in 2005

² Source: *British Columbia Film Annual Activity Report 2004/2005*

industry is a “green” industry. The production of products creates few pollutants and little waste. Unlike many other traditional resource based industries, income generated from film and television production comes at no cost to the infrastructure. The government is not likely to need to construct roads, or sewage systems.

Other advantages include the fact that the film and television industry has mutually beneficial connections with tourism, an established and enduring industry in the province. In addition, film and television productions can have a marked positive effect on the economies of rural communities in a short period of time. In British Columbia, many of the smaller communities have recognized this fact and have actively promoted themselves for the business. In fact, the provincial government has nine major film commission offices throughout the province and several more local one person offices under each larger office.

With all these sectors benefiting from the film and television industry, it’s no surprise to hear about the extensive positive impact on employment and on specific skills development. With direct and indirect employment of more than 34,800 people³ in 2005, the film and television industry in British Columbia, and in particular the Lower Mainland, has a world-class skills base, a large variety of locations, generous tax credits and competitive rates for both labour and equipment. The local industry has the required competency to become a significant player in the international market. From its beginnings in 1978 with 4 productions and \$12 million in production it has become a maturing business cluster that has been built into a billion dollar industry, British Columbia has created a considerable presence in this global industry.

³ Source: *Profile 2006: An Economic Report on the Canadian Film and Television Production Industry* suggests this number but the *British Columbia Film Annual Activity Report 2004/2005* suggests more than 35,000

1.2 The Issue

The Canadian Film and Television Production Association (CFTPA) has expressed concern in recent years that Canadian independent production companies operate on project by project productions because they are under-capitalized. This in turn, makes it difficult for BC based companies to expand and maintain a corporate infrastructure.⁴ In particular, without the capital, this lack of infrastructure limits corporate and industry access to international markets and buyers, hence guaranteeing limitations on export volumes and their growth opportunities.⁵ Based on most cluster theories, exporting is critical to the growth of any industrial cluster. The limited product outlets and financing options in Canada dictate that producers develop businesses with the global industry in mind. Thus the success of the film and television industry is dependent on access to capital to create and sustain a business based on making contacts and forging working relationships internationally. Enhancing the access to capital in order to enhance export potential for companies has to be centre stage. Current export marketing programs, especially provincial programs, appear to be on the right track, however program budgets are limited.⁶ In particular, the British Columbia Film Society's "Passport to Markets" has been a successful venture but limited budgets restrict this program to 2 million per year.

1.3 Purpose

This paper breaks down the British Columbian film and television industry in several ways. First it will create an understanding of the unique characteristics of this untraditional manufacturing sector. Second, this paper will discuss the industry in the context of its existence as a cluster.

⁴ Source: *Out of the West: Export, Growth and the Western Canadian Production Industry* by British Columbia Film

⁵ Ibid

⁶ Ibid

Third, using a cluster as the foundation, it looks at the historical development of the sector through the use of tax incentives. Fourth, in an effort to look to the future, this project takes a look at the past with a review of governmental film policy, highlighting the Cost Capital Allowance tax shelter of the 1970's and 1980's. In this reflection, the new film tax shelter policies of Belgium are discussed as a potential model for the future.

1.4 Domestic Industry Snapshot

British Columbia is the third largest production centre in North America.⁷ Following only Los Angeles and New York, the city of Vancouver and the province of British Columbia have become an attractive location to produce both television and film.

In basic terms, the industry is driven by both domestic and foreign production. These terms generally refer to the locus of control. Domestic productions are controlled by British Columbia based companies. Foreign production is controlled by an individual or companies outside of Canada. Most people cite the best source of long term growth and sustainability for the industry as domestic production, however foreign production has dominated the landscape of the industry.

⁷ Source: As cited on the Industry Profile on BC Film Commission website http://www.bcfilmcommission.com/industry_profile/

Table 1: Defining Foreign vs. Domestic Production

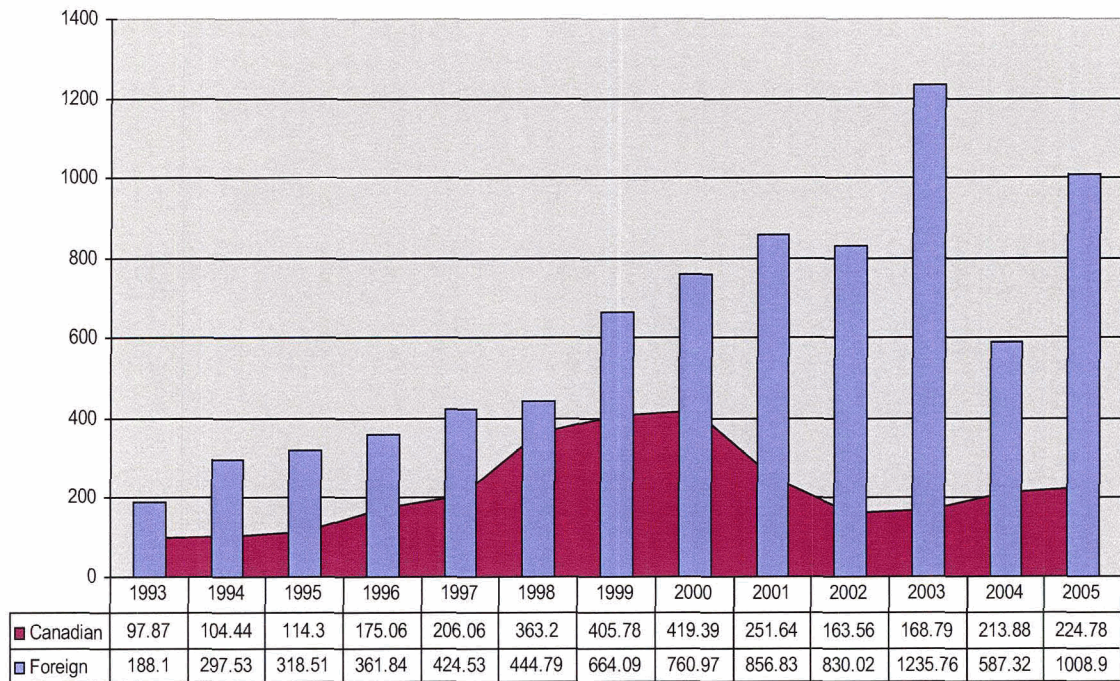
Foreign Production	Domestic Production
<ul style="list-style-type: none"> ξ Created, owned and controlled by producers or companies outside of Canada 	<ul style="list-style-type: none"> ξ Created, owned and controlled by producer or company from British Columbia
<ul style="list-style-type: none"> ξ Mobile Capital 	<ul style="list-style-type: none"> ξ Make investments for the long term in corporate infrastructure
<ul style="list-style-type: none"> ξ Creative Decisions made by the foreign Producer 	<ul style="list-style-type: none"> ξ Creative Decisions made my local personnel
<ul style="list-style-type: none"> ξ Provides employment when the conditions are right to shoot in the province 	<ul style="list-style-type: none"> ξ Provides stable employment levels
<ul style="list-style-type: none"> ξ Copyright is retained by the foreign producer 	<ul style="list-style-type: none"> ξ Copyright is retained by the local or domestic producer

Developed by the author based upon information from the BC Film Commission

Regardless of whether we are talking about foreign or domestic production, it is a general consensus that the access to federal and provincial production services tax credits was responsible for the growth in this area of the industry. Beyond the Canadian tax incentive system, B.C.'s strong foreign production industry boasts the following advantages: more diverse geographical options than Ontario or Quebec, a large inventory of studio facilities, strong post production infrastructure, talented and skilled labour and proximity to Los Angeles.⁸

⁸ Source: *Fairytales Comeback for B.C. Film Industry*, Toronto Star, September 2, 2006

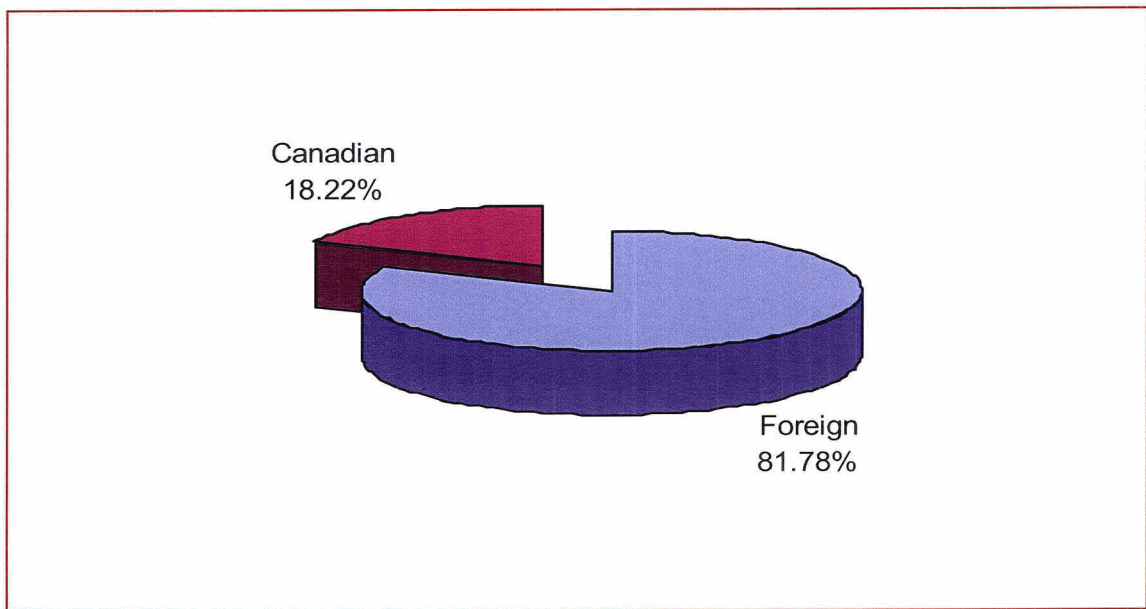
Figure 1: Production Expenses in British Columbia (\$CDN)



Developed by the author based upon information from the BC Film Commission

Data from the BC Film Commission shows that British Columbia's film and television industry has experienced an incredible growth rate. From 1993 to 2003, yearly production volume grew from \$286 million to \$1.405 billion or an amazing 491%. This growth has been dominated by foreign location production. According to the July 28th 2006 edition of BC stats report, *Infoline*, of the 1.2 billion dollars, spent on film and television in British Columbia in 2005, nearly 82% was generated from foreign production. These numbers are increasing because if we look at the trends, from 2000/2001 through 2004/2005, the average value of foreign location production as a percent of total production was 70% in BC. This high level of dependence on service production in BC is quite unique within Canada. By contrast, the five-year average of foreign location production for Quebec was only 22% of overall spending and 27% for Ontario and approximately 37% of all film and television production spending in Canada.

Figure 2: Production Breakdown 2005



Developed by the author based upon information from the BC Film Commission

In a system that Canada pioneered⁹, domestic and foreign filmmakers have access to tax credits from both the federal and provincial governments. These incentives can greatly reduce the labour costs of a film or television production. These credits often play a deciding role in where a film or television production will be shot.

Many have attributed the growth of the foreign location production industry in British Columbia to the tax credit system. However, even this excellent system is not without its drawbacks; some significant. For example, with such a high reliance on this type of incentive system, British Columbia's productions are placed in a very vulnerable position given the mobility of the industry. This, combined with a willingness of the producers to locate productions wherever costs are lower, has the potential to create an economic crisis. (Drache and Gertler, 1991; Barnes, 1996) For an example, we do not have to look too far.

⁹ Source: *Runaway Drain?* Variety, July 31st 2006
<http://www.variety.com/article/VR1117947748?cs=1&s=h&p=0>

One period of time serves to illustrate the vulnerability argument. In 2004 the film and TV production industry in British Columbia dipped in overall production. Total domestic and foreign production spending within the province dropped from \$1.4 billion in 2003 to roughly \$801 million in 2004. This 43 % drop created some concern within the industry as the workforce dropped from a high of 42,400 to 24,200 people in both direct and indirect full time equivalent jobs.¹⁰ In addition, British Columbia dropped to 3rd for production volume in North America to 3rd in Canada behind Ontario (1.006 Billion) and Quebec (842 Million).¹¹

Why the drop? Many attributed it to the rise of the Canadian dollar against the American, which in 2003 rose by a third against the U.S. dollar. This factor led to a reduction in the cost competitiveness of the industry in Canada as a whole. But with such an extremely high reliance on foreign production this factor led to a larger drop in business in British Columbia than in any other province. In 2004 other factors and trends that had influence included a U.S. reaction against so-called "runaway" production in Canada and the subsequent implementation of competitive state incentives in the U.S.; increased global competition; reality television; and competitive provincial incentives from within Canada.¹² By 2005, when both Ontario and Quebec increased the level of credit available to film and television productions, a number of high profile film productions threatened to leave BC to take advantage of the lower cost atmosphere in Ontario.¹³

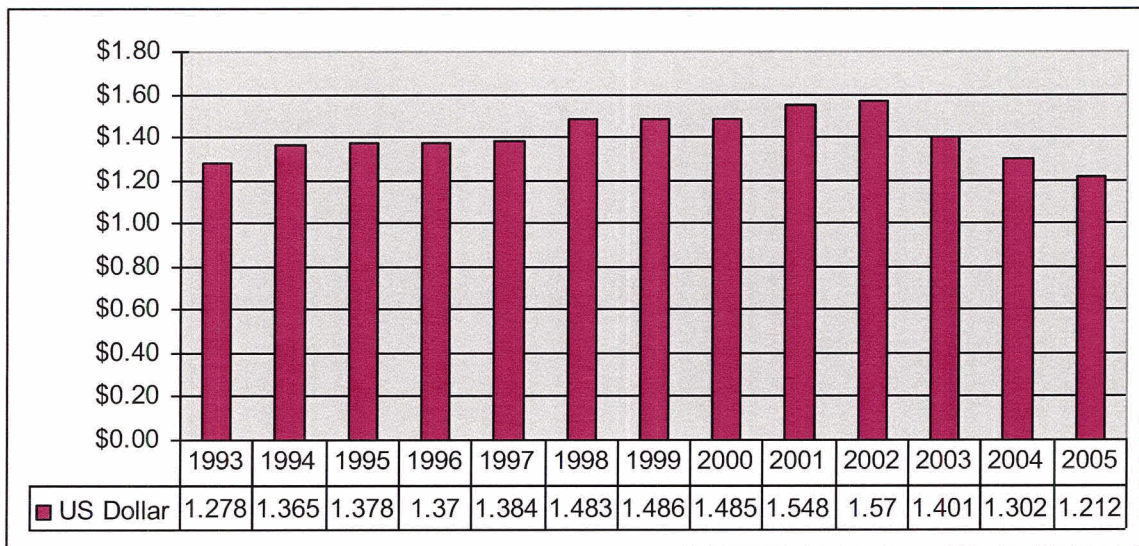
¹⁰ Source: *Profile 2006: An Economic Report on the Canadian Film and Television Production Industry* pp. 15

¹¹ Source: *Industry Profile: Film and Television* on the Ontario Media Development Corporation website - <http://www.omdc.on.ca/English/page-1-1325-1.html>

¹² Source: *Film and Television Industry Review* prepared by InterVISTAS for Ministry of Economic Development in 2005

¹³ Source: *Brightlight Eyes Ontario*, Playback Magazine, January 17, 2005 – In the article Brightlight Pictures suggests that they will move \$100 M worth of production to Ontario if British Columbia does not match the subsidies available in Ontario.

Figure 3: The American Dollar Vs. The Canadian Dollar



Developed by the author based upon information from the Bank of Canada

The result? The British Columbian industry began an intense lobby effort for an increase in the tax credit subsidies. These were granted in 2005 and the industry was revived and production spending recovered to over \$1.2 billion. This increase of 71 % over the previous year was attributed directly to the increase in tax credits.¹⁴ In 2004, the British Columbia Production Services Tax Credit (PSTC) was 11%. With the external factors facing the province, they were forced to increase the PSTC to 18 % by 2005.

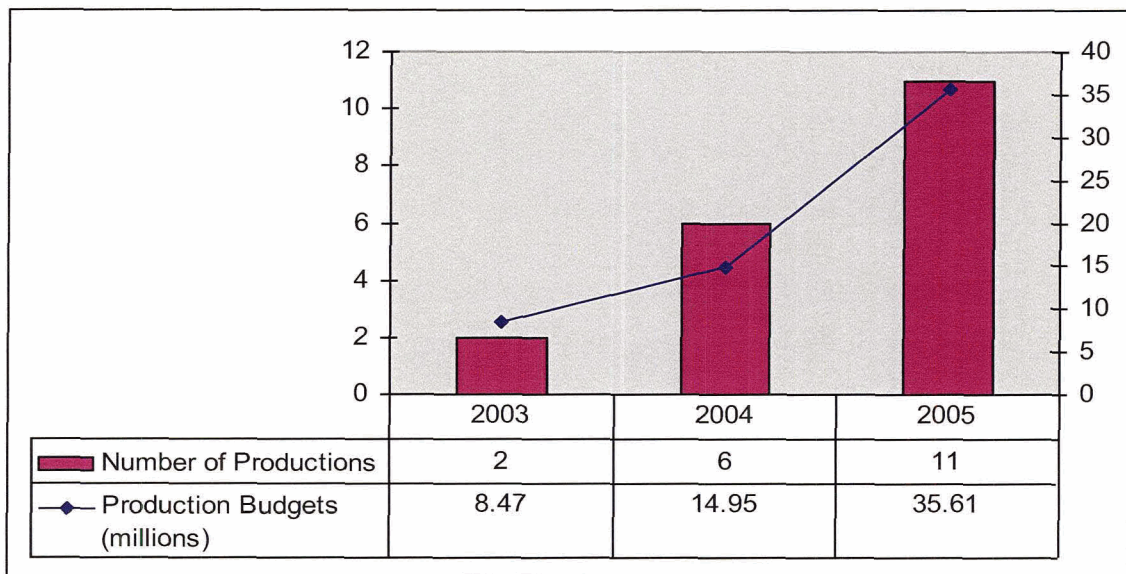
On the domestic side of the industry, local productions have not risen like foreign driven service production. In 2004, British Columbia producers created \$268 million worth of film and television production or 18% of domestic volume nationwide. In contrast, Ontario produced \$748 million worth of domestic production or 50% of national volume.¹⁵

¹⁴Source: *B.C. Extends Tax Credits*, Variety, January 23rd 2006
<http://www.variety.com/article/VR1117936651?categoryid=1279&cs=1>

¹⁵ Source: Profile 2006: An Economic Report on the Canadian Film and Television Production Industry

In contrast, the animation industry in B.C. has proven to be an interesting industry segment that has quietly been growing. While animation and digital production make up only 7% of total industry revenues, it has risen from only 10 productions in 2001 and spending of \$47 million to 24 productions and spending of \$85 million. These increases have included both foreign and domestic productions.¹⁶ Of particular interest is the increase in domestic production which increased from \$8.47 million with 2 productions in 2003, to \$35.61 million from 11 productions in 2005. Many cite the ability for these producers to find domestic sources of financing for this increase. This capacity attracted the productions to the province.

Figure 4: BC Animation Productions



Developed by the author based upon information from the BC Film Commission

1.5 Global Snapshot

The global film and television production industry totals in the billions of dollars annually. Beyond Canada, almost every country around the world competes for its share of this growing market. With all of the attractive elements of this value cluster many countries have created

¹⁶ Source: *British Columbia Film Commission Production Statistics 2005*, British Columbia Film Commission, 2006.

similar tax credit programs in an attempt to attract this business. The global firm, Price Waterhouse Coopers, tracks worldwide trends in the entertainment and media industries. They believe that global film entertainment spending will increase at a 7.1% compound annual rate from \$84 billion in 2004 to \$119 billion by 2009. They also believe that global broadcast television expenditures are projected to increase at a 6% rate compounded annually to \$204 billion in 2009 from \$152 billion in 2004.¹⁷

From the Canadian and British Columbian perspective, the industry is a small player on the international scene. According to Price Waterhouse Coopers, Canadian filmed entertainment expenditures are expected to increase at an annual rate of 8.4% from \$4.8 billion in 2004 to \$7.2 billion by 2009. Television broadcast spending in Canada is expected to grow at 6% or from \$1 billion in 2004 to \$1.4 billion in 2009.¹⁸

Since the 1990s, the Hollywood based firms, much like other industries, have had a shift from their traditional models of in-house production to more of an outsourcing model. (Aksoy and Robins, 1992). This is a direct response to a combination of factors including a number of tax breaks and financing incentives offered globally, especially Canada. In addition, increased globalization, technological advances, rising production costs and foreign wage and currency rates are other factors leading to “runaway” film and television production. According to a 2001 U.S. Department of Commerce report, these elements have combined to account for the transformation of what has been a quintessentially American industry into an increasingly global and much more widely dispersed industry, albeit still headquartered in Hollywood. American filmmakers have increasingly moved the production of films abroad as a method to control cost

¹⁷ Source: *Global Entertainment and Media Outlook, 2005-2009*, Price Waterhouse Coopers, New York, June 2005.

¹⁸ Ibid.

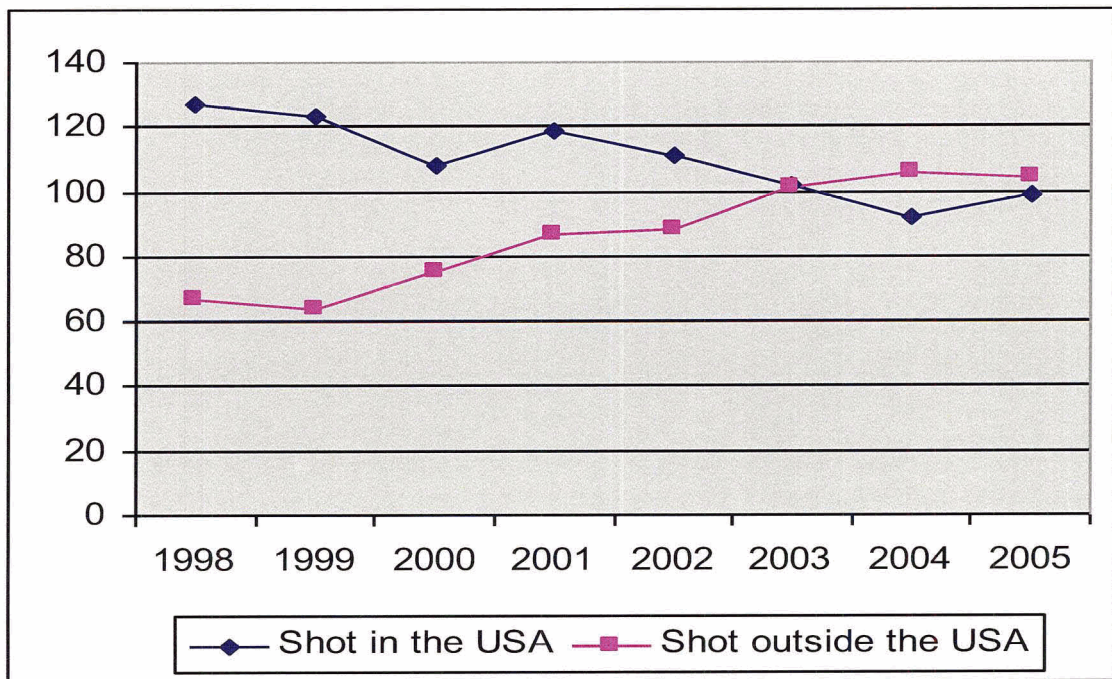
and enhance the revenue potential of the product. This has meant an increasing number of film and television productions have been shipped to other destinations around the globe.

Spurred by rapid advances in new technology as well as foreign cash incentives, “runaway production” has had an impact on America's film industry. A 1999 study conducted by Cambridge, Massachusetts-based “The Monitor Group” found that from 1990 to 1998, U.S.-developed productions abroad almost doubled, from 14 percent to 27 percent of theatrical productions, while U.S. economic losses increased fivefold, from \$2 billion to \$10 billion.¹⁹ This is a continuing trend as noted in the more recent study from 2005 done by the Center for Entertainment Industry Data & Research. Their numbers show that production outside the United States has surpassed production within. This research shows that 53% of the theatrical production originating from the United States is now shot outside the country.²⁰ The study also points out that Canada is still the main destination for these “runaway productions” but with the UK, Ireland, Australia, New Zealand and Eastern Europe, gaining quickly. However these “runaway productions” are a concern for American employees, unions and the government bodies. (Gasher, 1995; Coe, 2000). With the outsourcing of Hollywood becoming more common, fierce competition has developed among countries to attract the revenues associated with major motion pictures.

¹⁹ Source: *U.S. Runaway Film and Television Production Study Report*, Monitor Group for The Directors Guild of America. http://www.dga.org/news/pr_expand.php3?143, 2001

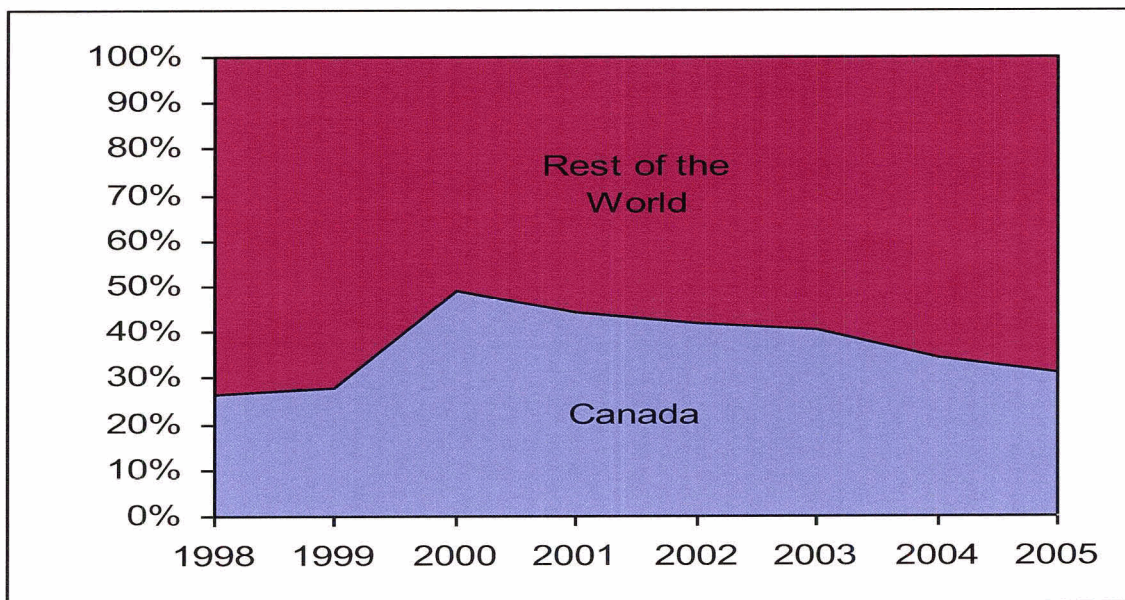
²⁰ Source: *The Global Success of Production Tax Incentives and the Migration of Feature Film Production From The U.S. to the World*, Center for Entertainment Industry Data & Research, 2005

Figure 5: Number of American Domestic Theatrical Films



Developed by the author based upon information from the The Center for Entertainment Industry Data & Research

Figure 6: Percentage of Dollars Spent on the Production of American Domestic Theatrical Releases



Developed by the author based upon information from the The Center for Entertainment Industry Data and Research

Beyond the numbers, the Price Waterhouse Coopers publication, *Global Entertainment and Media Outlook 2002-2006*, points out the international film and television industry has seen substantial changes in the last few years. A number of these trends have important implications for the industry in British Columbia, the most important being:

- ξ Film has been characterised by increased levels of horizontal and vertical integration, resulting in concentration of ownership and raised entry barriers for new players. This can be seen best in Canada with the control of the distribution of film and television. This supply chain has increasingly been concentrated. The entertainment firm Alliance Atlantis has ownership stakes in production, broadcasters, theatrical film distribution and theatres. This makes finding an outlet for product produced outside this system more difficult.
- ξ The spread of digital and satellite technology has resulted in increased audience fragmentation making finding an audience for product increasingly hard.
- ξ A secondary pricing system is evident in some developed countries, especially the United States. Under this system, producers recoup most of their costs distributing to their large domestic market and are able to sell their films and programs at a discounted price to other countries. This means that locally produced products in countries with smaller domestic markets are at a constant cost-disadvantage when competing with foreign offerings. This is comparable to dumping of excess production in other manufactured goods sectors.
- ξ There is an organizational shift away from hierarchical production to a looser network production structure, where studios act as financing and distribution hubs, mobilizing resources from outside. Although this often means greater flexibility and lower overheads, it also makes assembling resources more problematic and reduces innovation in film-making itself. This has contributed to the development of the industry but at the same time this outsourcing of production has created the competitive environment.

The sector needs to ensure that it remains aware of these global movements and develops the flexibility to remain competitive at all times. Innovation needs to be constantly encouraged and investment in quality training and skills diversification is vital. With the limited outlets and increased domestic and international competition the inflow of capital becomes more fundamental.

2 UNDERSTANDING THE CREATIVE INDUSTRIES

2.1 Introduction to Creative Industries

To better understand the unique nature of this industry, we must take a look at the properties that differentiate it from the rest. Creative industries can be defined as the area of overlap between cultural and commercial activities. They involve the supply of goods and services that contain a substantial element of artistic, imaginative or intellectual effort, or that are associated with and play a vital role in sustaining cultural activities. (Turok, 2003; Scott, 2000). For better understanding of the film and television industry it is important to be aware of the dynamics that are unique to this sector. The following are the key characteristics, as defined by Economist Robert Hogue of the Bank of Montreal, which demonstrate this distinctive nature.

2.2 Distinctive Properties

Creative activities have distinctive properties that affect their organization, economic impact and geography. First, and most importantly, there is great uncertainty about how consumers will value a new product because of its original, often unique character (Caves, 2000). This makes the informational flow between producers and the end users paramount and it has created a power base for middlemen like agents and distributors. (Hogue, 1997) The knowledge base in consumer preferences for creative properties is crucial for the producer. The distributors and middlemen understand the current trends and tastes and of the consumer. This understanding is critical to maximizing the price for the product throughout the world. The ambiguity of consumer reaction also means a high risk of product failure, so attracting investment is difficult and ways of sharing risk are important. The American system is well defined with common ownership and alliances that exist between producers, distributors, foreign buyers and cinema owners to share the risk and obtain buy-in from distributors early on in the production process.

This vertical integration gives the alliance market power to control what films are shown. (Turok, 2003) Internal economies of scale also reduce the cost of production and help to spread the risk of failure. This is something that former internet mogul, Mark Cuban, has created with his ownership in film production, distribution and exhibition on broadcast and theatre screen.

2.3 The Balance

There is an inherent balancing act suggested in the term “show business”. As such, producers are often put into a situation of contradictory goals between the ‘show’ and ‘business’. A distinctive entertainment property has a high degree of individual skill, talent and commitment involved. The creative individuals involved in the production of these properties often put more effort into the product than consumers notice or value. This can create a tension between cultural and commercial objectives, especially for ‘high’ or ‘alternative’ cultures rather than ‘popular’ forms. It tends to make income generation and business viability more difficult than in many other industries where individual, cultural and political values do not feature as prominently. (Hogue, 1997).

2.4 Intellectual Property

Intellectual property (IP) is the base for the industry. Producers have to get the IP for the story, distributors have to acquire the IP for distribution, and the broadcasters have to acquire the IP from the distributor to show the property. Intellectual property is the aspect of film and television production that generates the revenue as these products are sold from territory to territory and from year to year. (Turok, 2003) The owners of the IP will have a revenue stream from the property through a variable “shelf life”. A film or television production can continue to generate revenues from both the domestic and foreign markets and other exhibition windows. (Hogue, 1997) It should be noted that new delivery formats have also generated additional returns for the IP holders.

2.5 Target Market

To drive income, the products generated by film and television production must reach an audience. Much like any business, the success or failure of the product is dependent on the ability of the product to engage the target audience. Where film and television differ from other industries is that the target group must “emotionally connect” with the product. This emotional bond is unique and hard to generate. (Hogue, 1997)

2.6 Project-Oriented

In Canada, project-oriented production is the nature of the business model. Film and television production generally consists of a project or a string of productions (Enright, 1995) which has repercussions on the size and variability of business revenues. Income tends to swing with the production flow and performance of new projects. Creative products require very diverse and specialized skills and knowledge to be brought together temporarily. (Enright, 1995) This complicates their organization and can be very costly. This is generally cited as the factor that has created the perception of a high degree of risk and the reason for the lack of investment and financing for companies. (Hogue, 1997) Without this backing the industry has a major impediment to long term sustainability creating barriers to entry for new producers on an ongoing basis.

Also these creative products are often heterogeneous and irregular in scale and character, which creates awkward and inefficient discontinuities in production.²¹ Flexible organizational arrangements and labour markets can assist the process, including project-based teams and freelancers. Business and social networks among individuals and associated institutions may facilitate essential exchange of ideas and information, and reduce some of the difficulties of coordination that result from fragmentation (Scott, 2000).

²¹ Source: *Out of the West: Export, Growth and the Western Canadian Production Industry* from British Columbia Film

The creation of sustainable income is a crucial factor in creating long term growth. If British Columbian companies could move away from the single project focus to a more slate or several projects driven companies the risk is reduced.

2.7 Government Policy

The Canadian film and television industry has been shaped and developed by a path of dependence that is characterized by federal and provincial government interventions. These have included tax shelters, subsidies, domestic content regulation and tax credits. By and large the government is responsible for the creation and support of the industry. (Hogue, 1997) The inference from this is that the industry is susceptible to any change in policy.

2.8 The Importance of Marketing

The constant, fierce competition among and between films and television programs, as well as against other cultural products, stresses the importance of effective marketing. It is often not sufficient to receive critical acclaim. In markets that move as rapidly as those of film and television, the necessity to make an instant positive impact is imperative. There is little time for word-of-mouth support to set in, yet word of mouth is crucial for success. The promotional build-up for the release of a motion picture or television series is an integral element of the project. Promotion campaigns, especially for Hollywood blockbuster films, can be quite spectacular and almost as expensive as the movie itself.²² The need for a successful opening weekend drives these expenditures.

²² Source: On Point Marketing <http://www.onpoint-marketing.com/movie-marketing.htm>

3 INDUSTRIAL CLUSTERS

3.1 Clusters Introduced

An industrial cluster is a group of companies or entities that, through their communications and interactions with each other and with their customers and suppliers, develop products and processes that differentiate them in the market place from firms in the same industry found in other places. The term "cluster" in industrial development is used purposely to spotlight on the activities within an industry in a specific geographic location, usually a metropolitan region. These activities often result in economic development and the creation of new knowledge and wealth. It is these new understandings and relationships that present a competitive advantage for the firms and in turn, the region.

Harvard Professor, Michael Porter defines industrial clusters as follows:

“A cluster is a geographically proximate group of interconnected companies and associated institutions in a particular field, linked by commonalities and complementarities. The geographic scope of clusters ranges from a region, a state, or even a single city to span nearby or neighboring countries [...] More than single industries, clusters encompass an array of linked industries and other entities important to competition. They include, for example, suppliers of specialized inputs such as components, machinery, and services as well as providers of specialized infrastructure. Clusters also often extend downstream to channels or customers and laterally to manufacturers of complementary products or companies related by skills, technologies, or common inputs. Many clusters include governmental and other institutions [...] that provide specialized training, education, information, research and technical support. Many clusters include trade associations and other collective bodies involving cluster members.”
(Porter, 2000, p. 16-17)

It is important to keep in mind that a cluster is not simply the result of the existence of a large firm, or in the case of the British Colombian film and television production sector, of multiple smaller firms in the same industry. Rather, identifying the existence of a cluster in a

community refers distinctively to the capability of the firms in an industry to interact in ways that create competitive advantages through the creation and integration of new knowledge into the resulting products and processes. (Porter, 2000)

Therefore, cluster strategies focus on the interaction amongst firms, not just on the individual businesses themselves. In industrial development, cluster strategy is often based on the assumption that creating new knowledge confers advantages on all firms in that industry in the same geographic region. (Porter, 2000)

According to Michael Porter, the customary model of economic industrial development was driven by government-directed policy decisions and incentives. More recently the model of economic industrial development is a much more collaborative process. Cluster development now involves governments only as a facilitator at multiple levels, with policy and incentives driven more by private sector companies. (Grace, 2004)

3.2 Cluster Development Stage

To set the stage for further analysis it is important to differentiate between established and emerging clusters.

Maturing or established clusters show evidence that the industry segment is well established in a region versus nationally. The cluster is capable of generating new knowledge and creates internationally competitive products. For these existing clusters, there is strong evidence of formal and informal interactions among firms. Under this definition the British Columbia film and television industry is a mature cluster.

Emerging clusters can be detected using national industry metrics and qualitative data. They show some evidence of knowledge creation and links to existing regional knowledge

strengths. Firm interactions, however, are not as developed as in existing clusters. Often emerging technologies and industrial strengths are not easily detectable from outside the region. The British Columbian film and television industry is far beyond this definition.

In the context of this maturing cluster, Porter's diamond framework is composed of four major components including factor conditions, related and supporting industries, and the context for firm strategy, and rivalry. These have been covered in depth in several publications including the *Film and Television Industry Review* prepared by InterVISTAS for Ministry of Economic Development in 2005, so only the basic components will be covered to provide context for further analysis.

3.3 Strategy and Rivalry

The presence of strong local rivals is an extremely powerful stimulus to the creation and sustainability of competitive advantage, and Porter contends that domestic rivalry is potentially the most important element of the diamond. This is due to the stimulating effect it has on all other elements in the framework.

Currently, however, the environment for rivalry is more of one where British Columbia is competing against other Canadian provinces, American states and European countries for film production, rather than one where firms within British Columbia's private sector are in heavy competition. These other territories have generally followed the Canadian model but set up agencies or governmental bodies that have been built with the mandate to woo this business. This international rivalry has driven competitive pressure on others to continue to up the ante.

3.4 Government's Role

The provincial government plays the central role in recruiting production, primarily through the use of incentives and the marketing of the province on the international scene. British Columbia currently offers a one of the world's most competitive tax credit incentive packages. Foreign and domestic productions in British Columbia can access a variety of provincial and federal tax credit programs.

If eligibility requirements are met, a foreign or local producer can combine tax credits to access excellent savings. Foreign productions receive basic rebates of 18 percent of qualified BC labour expenditures from the British Columbia Production Services Tax Credit (PSTC). An additional 6 percent on labour expenditures can be added if the producer shoots the production outside a predetermined zone. On top of these, are a digital animation and visual effects tax credit of 15 percent of qualified BC labour expenditures for this portion of the project.

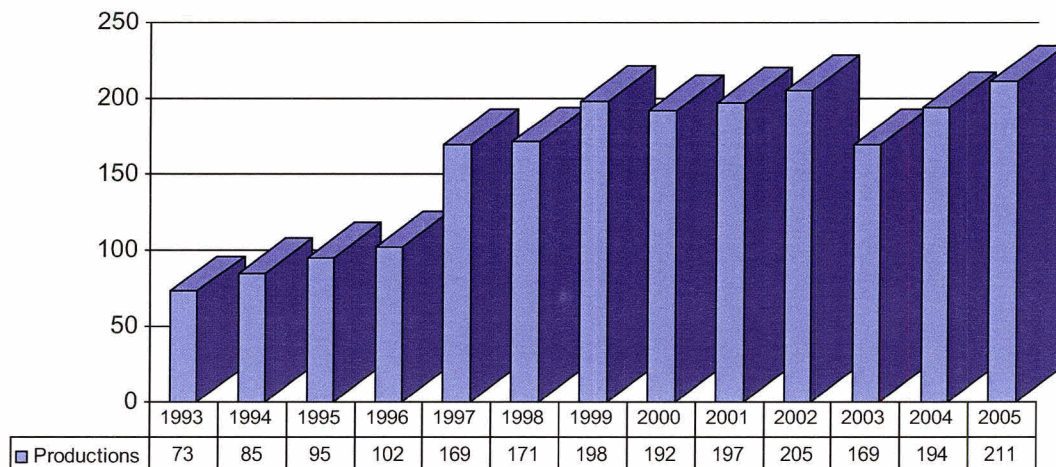
For the domestic producer there is Film Incentive BC (FIBC). These tax credits are 30 percent of qualified BC labour expenditures and an additional 12.5 percent for shooting outside the zone. The domestic production also has access to the digital animation and visual effects tax credit at the same level. Additionally local Canadian producers have a training tax credit of 30 percent for British Columbian based individuals who are registered with the program.

From the federal government, producers have access to even more tax credits. For the foreign producer the Canadian government offers the Film or Video Production Services Tax Credit (PSTC). This program gives these productions a 16 percent tax credit on Canadian labour costs. For the domestic production the federal government offers the Canadian Film or Video Production Tax Credit (CPTC). This credit is available at the rate of 25 percent of the qualified labour expenditure of an eligible local production.

These tax credits are a refundable corporate income tax credit. So when the production entity files tax returns, the production may claim the specified percentage of the labour costs incurred in making film, television, digital animation or visual effects productions. The tax credits are applied to reduce tax payable, and any remaining balance is paid to the corporation.

Based on the increase in production numbers both the marketing and the incentive packages have been very successful in attracting projects to this region (see Figure 7).

Figure 7: Number of Productions in BC



Developed by the author based upon information from the BC Film Commission

3.5 Beyond the Tax Incentives

Realizing that government-driven policies and incentives are not the ideal route by which to establish an enduring cluster, a longer-term goal is for sustainability. This would also include the development of a context for rivalry within the domestic private sector.

According to most of the experts, in a proper cluster, incentives would not be necessary as the driving force in recruiting production. Rather, suppliers, producers and factor conditions

would be the drivers. This makes nurturing the domestic or indigenous side of the industry sector paramount if a true cluster is going to develop. This objective has been part of Provincial government plans but more proactive efforts and planning are needed to stimulate more domestic development and production. Looking at the numbers, domestic production is dwarfed by service production. (See Figure 1)

One bright spot in this direction is the establishment of the Motion Picture Production Industry Association. This association is promoted as the “voice and vision” of the sector. Established in April 2002, this NPO is representing a group of stakeholders in the development of industry competitiveness. These types of groups are very useful for providing an opportunity for more specific networking and knowledge sharing among the professionals in the industry. As the private industry and many of the firms are in what can be considered in a mature stage, the provincial government is playing a less prominent role than the private sector. Thus, the British Columbia Film Commission has passed the torch to other bodies such as the Motion Picture Production Industry Association and its’ network of local film contacts to lobby for the development of provincial legislation. This organization has created several committees to tackle the issues that the industry has identified as problems.

3.6 Factor Conditions

With respect to the film and television industry, the factors of production such as a skilled labour force, specialized infrastructure, educational institutions and capital are the utmost important. Porter states that "to increase productivity, factor inputs must improve in efficiency, quality, and (ultimately) specialization to particular cluster areas." (Porter, 2000, p.20) With specialization comes increased productivity and competitiveness. The key to industrial development is if specialized factor conditions are only available at one location, then it is less likely that the same set of conditions will be available elsewhere. Thus, demand for services and

products from firms in this specific cluster will rise because no other region provides the same set of services and products.

Factor conditions for the film industry in British Columbia do not presently give the province a competitive advantage. The weak link in these factors is capital. Currently many cite the skilled labour, higher education and specialized infrastructure as stronger here than in several competing locations²³, but as other areas increase production efforts, these conditions become less of a draw. In his writings, Michael Porter contends that the pace and competence by which factors are formed, improved, and used can be more important than the existing stock of factors at a given time. British Columbia has seen in recent years that their competitive advantage was the value of the tax credits and Canadian dollar. These conditions are out of a locus of control of the cluster and as such should be minimized.

3.7 Demand Conditions

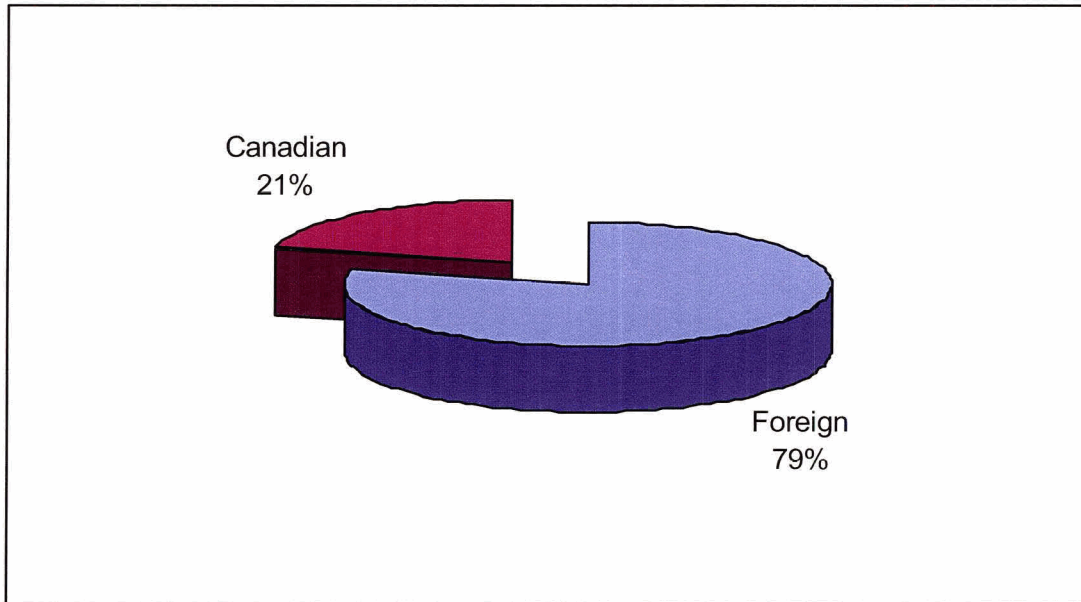
Porter argues that the presence of sophisticated and demanding customers will force industry cluster firms to continuously innovate and stay on the leading edge. Cluster firms must cooperate with their customers in order to meet their needs. For this industry, the innovation has come as policy changes and increases in the tax credits. The driving force in filmed entertainment, Hollywood, is on a constant search for efficiency and this means the lowest price with the best conditions.

To its credit, BC has adapted to pricing demands using the tax credit structure and this has driven business to the province in enormous quantities. Currently, the vast majority of demand for

²³ Source: *Film and Television Industry Review* prepared by InterVISTAS for Ministry of Economic Development in 2005

production services comes from outside of the country. Looking at the numbers British Columbia relies heavily on production services for growth in the sector.

Figure 8: Production Average of Foreign vs. Domestic 2001 to 2005



Developed by the author based upon information from the BC Film Commission

Outside of the pricing responsiveness, BC's overwhelming foreign demand has actually been created in two ways. First the efforts of the British Columbia Film Commission to encourage production in the province have been very successful. They maintain lines of communication with existing and potential clients. In addition the British Columbia Film Commission uses advertising, newsletters, and trade shows to attract more prospects. Second, several local production entities actively market themselves and their service to their client list.

3.8 Related and Supporting Industries

In addition to meeting demand conditions such as competitive pricing, film and television production relies heavily on a diverse set of elements in the production of the product. Porter's diamond looks at the "related and supporting industries" for analysis of the presence or absence

of competitive supplier relationships. The capabilities of these supporting industries are important in creating a competitive advantage.

This is one area that British Columbia clearly dominates over several of its international competitors. BC has created internationally recognized animation, special effects and post-production houses. In addition, the province is the home to over 60 sound stages including some of the largest in North America.²⁴ Obviously these related industries have been a catalyst to the industry.

3.9 The Creative Class

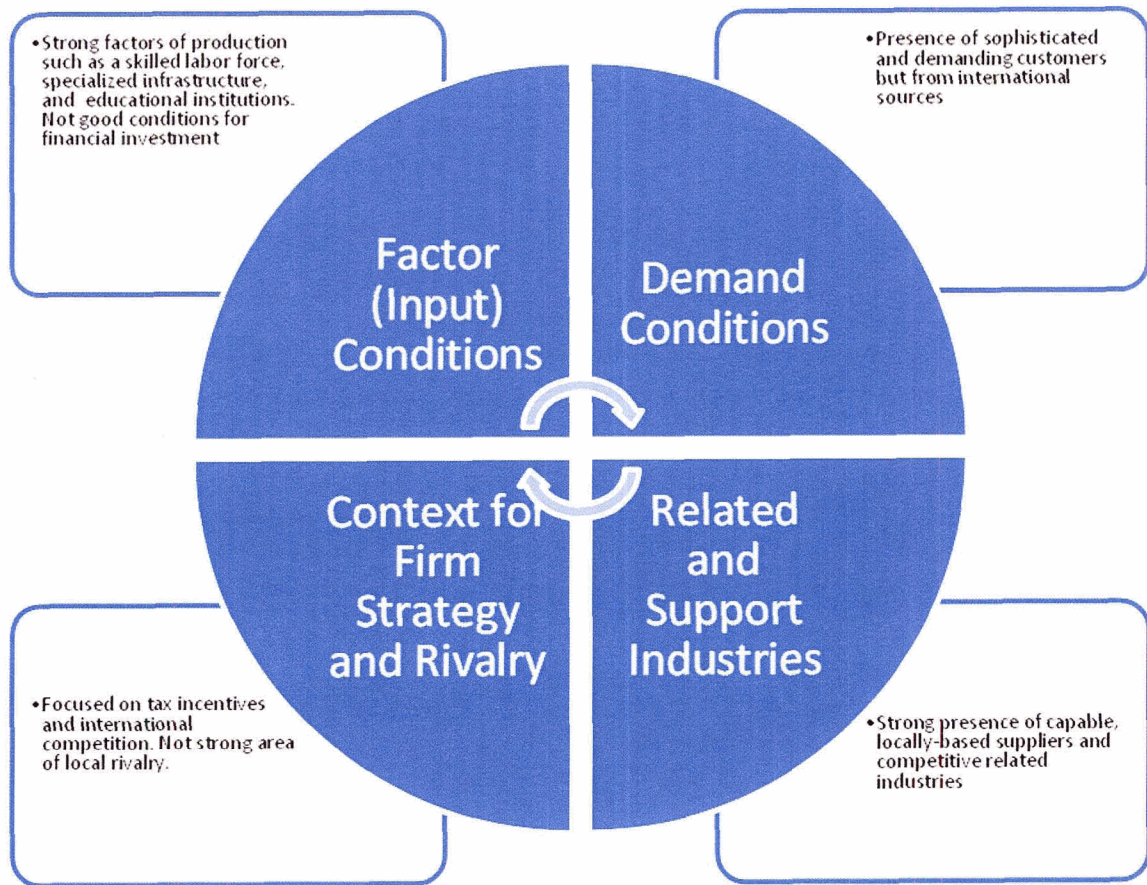
On a side note, a very important aspect of this conversation is the creative class and this should be discussed prior to moving on.

According to Richard Florida (2003), the creative class is considered to be a new force in developing an economy. The film and television industry in British Columbia is a draw for these individuals. Within creative industries, these people tend to locate in areas that can provide a high quality of life and an environment in which creative-minded people and businesses can flourish.

Efforts to recruit and retain a more innovative and creative workforce in British Columbia should be strongly encouraged. Like other industries within the creative economy, film and television tend to attract a fast-growing, highly educated, well-paid segment of the workforce. From the economic standpoint the “creative class” provides both high quality jobs and strong tax revenue. This is the basis for developing this type of industry (Florida, 2003).

²⁴ Source: BC Film Commission website http://www.bcfilmcommission.com/industry_profile/

Figure 9: Applying Porter's National Competitive Advantage Model to the BC Film Industry



Developed by the author based upon Michael Porter (1979)

4 CLUSTER DEVELOPMENT

4.1 Cluster Development Introduced

Canadian governments have been influenced by the cluster model since the early 90's. (Smith et al, 2004) Cluster-based economic development focuses on the cluster as an interconnected system rather than a physical gathering of businesses in a specific location. It must deal with the entire value chain from start to finish that affects the cluster as a whole. (Friedman, 1994) This starts with the raw materials to the delivery of the final product to the consumer. Viewing the cluster as an integrated production and social system rather than a collection of individual businesses, companies or individuals enables a cluster development policy to identify the gaps in the system as a whole that could inhibit its growth. Cluster development therefore enhances the development of individual enterprises by enabling the local system to work more efficiently and effectively. (Friedman, 1994) In our context this means that any cluster development initiatives need to understand everything from the development of a script through production to the delivery of the product to a broadcaster or distributor.

Economist Robert D. Grace (2004) believes that the government should take a “collaborative approach” to cluster development. This economic development should involve all industry stakeholders including SME's, academia, industry associations and all three levels of government. The goal is to avoid on-going financial commitments to the sector that can distort the marketplace.

As an instrument of economic development, the government and industry stakeholders should find a way to link cluster competencies and differentiations to develop a defensible strategy. (Porter, 2000) This has been the real issue with the industry in British Columbia. The differentiators that have been the source of the success and growth of the industry are easily

replicated. This is the dilemma for the government and industry stakeholders. Without any unique fingerprint, BC's advantages of proximity, the exchange rate and tax credits are easily overcome by competitors. The fear from an economic point of view is that the industry has become too dependent on the current subsidies structures.

Robert Grace (2004) suggests that the path to create a real improvement in a cluster's performance has to be led by the private sector. This initiative has to be sustainable and have a high level of commitment from the industry. The government's role as facilitator should be to ensure a high level of consensus with the stakeholders and then quick implementation of the recommendations.

4.2 Understanding and Crafting Incentives

Advocating for a stronger cluster does not always mean eliminating all the incentive systems in the short term. This is any area within the industry that has become entrenched. Removal of this element would create cost disadvantages and in the short term without something other to replace it, the industry would open the door to more potential rivals, thus creating more instability to an already volatile situation. Looking to the long term, some incentives can help create a unique fingerprint for the domestic industry if crafted properly. (Waits and Heffernon, 1994) These have to be lead by the private sector as a way to differentiate British Columbia.

In the history of film policy in Canada incentives have been used with both success and failure. While carelessly crafted incentives packages can easily backfire, this does not mean that all incentives are inherently bad for the development of an industry. If certain conditions are met, some incentives can represent very good public policy. According to the article *Forging Good Policy on Business Incentives* (Waits and Heffernon, 1994) good conditions exist when incentives are:

1. Used to accomplish clearly defined goals based on an overall economic development strategy,
2. Subjected to a rigorous cost-benefit analysis in both the short and long terms,
3. Configured as investments in the region so that they retain their value even if the business departs, and
4. Made legally binding so that businesses are held accountable for their promises and performances.

This paper will use these guidelines for further analysis as a method of comparing the old policies that the Canadian Government employed with the Cost Capital Allowance and the newer tax shelter film policies that have emerged in Belgium.

5 CAPITAL COST ALLOWANCE

5.1 The Capital Cost Allowance Introduction

The builders of the Canadian and provincial government film policies have often looked at comparable nations to consider alternatives to grow and sustain an environment that is often overshadowed by the overly dominant Hollywood cluster. These policy makers look to these nations to anticipate new trends. The assumption behind such policy development is that successful policy development in one country will suggest that the strategic directions are transferable to another. This has been why the tax credit policy that Canada created has been replicated throughout the world. Canada has been the leader in this system for many years and in this spirit British Columbia should look to the past to create the future. This history is outlined below.

5.2 The Capital Cost Allowance History

According to the history laid out by Telefilm Canada²⁵, it was not until the 1960's that Canada's feature film industry came into its own. Although the National Film Board (NFB) was created in 1939, the production of films was limited to four to five annually.

In 1967, the Canadian Government created the subsidized public agency, Canadian Film Development Corporation (CFDC), which was the first real effort by the federal government to create and promote a bona fide Canadian film industry. The results were immediate and overwhelming. Production levels jumped from a low of four films to over an average of 20 films annually from 1968 to 1974.

²⁵ Source: The Telefilm website <http://www.telefilm.gc.ca/01/12.asp?lang=en&>

In the Liberal Federal budget of 1974, a special capital cost allowance (CCA) for Canadian films was announced. The goal of this new policy was to build on the efforts that were being undertaken by the Canadian Film Development Corporation. The objective was very simple -- increase demand for Canadian cultural products. Between 1974 and 1978, the number of government-assisted Canadian productions grew to 37. (Bird, 1991) In addition, during this time, minimum Canadian-content provisions for television were being implemented by the Canadian Radio-television and Telecommunications Commission (CRTC) as instruments for furthering Canadian culture. These policies were directly opposite in their goals. The CRTC policy was designed to maintain a Canadian identity and the Capital Cost Allowance had commercial and economic development objectives.

Many cite the introduction of the co-production agreement in the late 1970's as the next phase of policy development. The policy developers felt that this network of treaties would reduce the tension built by other cultural protection strategic directions. This network would allow Canadians access to foreign markets and capital without losing the Canadian status or Canadian financing tools for the broadcaster. As a result, Canada has built the world's largest and most extensive catalogue of co-production treaties.

In 1984, the federal government introduced the National Film and Video Policy. Under the policy's umbrella, Telefilm Canada, previously known as the Canadian Film Development Corporation, instituted the 1986 Feature Film Fund. The fund was aimed at fostering and financially supporting high-quality, culturally rich Canadian films. This new direction moved development away from the private investor model to the public investor model.

In 1995, the Canadian government announced the replacement of the Capital Cost Allowance with the Canadian Film or Video Production Tax Credit (CFVP). The government

believed that this system was better-targeted to grow the industry as it would reimburse producers for a portion of their expenses based on the territorial spend.

In 1996, the Government announced the creation of the Canada Television and Cable Production Fund. This public- private-sector partnership was designed to fund Canadian French- and English-language television programs. This fund provided a mechanism which targeted the production of feature films. With a budget of \$15 million annually, this funding is intended for films that eventually find their way to television broadcast.

In 1997 the Federal government introduced the Film or Video Production Services Tax Credit (FVPSTC). This program was designed to encourage more foreign film-producers by providing tax incentives to employ Canadians for production services performed in Canada.

By 2003, the Telefilm Canada budget had reached \$230 Million and the tax credit system was heralded as a success. Film production in Canada had jumped to close to \$4 billion. Much of this achievement was credited to the creation of Telefilm and to the tax incentives undertaken by the Canadian government. This success, however, was created by and sustained by taxpayers.

5.3 The Capital Cost Allowance Described

During the time period between 1974 and 1988, the CCA policy included an opportunity for an individual to apply a 100% allowance to reduce income generated from other sources. This tax shelter began with promotion of production of feature films but the definition was broadened to other forms of filmed entertainment as time passed. (Bird, 1994)

To qualify for the incentives, the property would have to receive certification from the Solicitor General and later the Department of Communication (CAVCO). These qualifications had two components. The first was employment, with significant job functions such as writer, producer and director assigned points. The production required a high proportion of Canadians

employed in these positions to meet a level of “Canadian Content”. The second component was financial. At least 75% of the production budget would have had to be spent on Canadians or Canadian inputs and services. The specific targets of these requirements shifted slightly throughout the lifetime of the program but the goals did not. The government wanted to stimulate both employment and investment in Canada. (Bird et al, 1985)

The tax shelters were sold mostly as limited partnerships with buy back provisions. A unit would have option of repurchase at a future date. This date was dependant on the speed of depreciation of the film asset. At the buy back date the investor would be able to claim their share of the total investment as a capital gain or loss. A loss would allow the investor a lower total tax liability. These units also had leveraging possibilities until 1986 when this loop hole was closed.

26

5.4 The Capital Cost Allowance Concerns

These tax shelters were difficult to monitor for both the federal and provincial governments. At the federal level, the government found it tricky to assess the audited statements that were provided by the limited partnership. Some expenses had varying levels so benchmarks were hard to create. This meant that areas could be much higher than expected values on some budget lines allowing for excessive financial gain.

On the provincial level, these tax shelter investments fell under security laws and this meant that local securities commissions had an interest in their sale. Their concerns stemmed from the amount of fees charged and the quality of information that flowed from the sellers.²⁷

Quality was always an issue debated concerning the films that were produced during this time. Scholar, Maurie Alioff, described the Canadian cinema in the early 1980s as: “... a strange

²⁶ Source: *Hollywood dreaming*, Capital News Online, March 5, 2004 by Rym Ghazal

²⁷ Source: *Give me (tax) Shelter*, The Fifth Estate, Broadcast Dec. 4, 1979

land, where sportswear manufacturers and government bureaucrats, periodontists and psychiatrists were gripped by a primitive and irresistible impulse to hurl money into production of excruciatingly empty movies" (Alioff, 1988, p. 9). During this time the government did not have a method to monitor the quality of production. The Capital Cost Allowance policies were non-subjective. This meant that Canadian certification brought the incentives. This left the motivations of producers and the balance between commercial and creative objectives up to broad interpretation.²⁸ In the publication "Tax Incentives for the Canadian Film Industry" the authors state; "... the incentive fostered industry has been castigated by the critics for such sins as failing to produce sufficiently 'good' films or sufficiently 'Canadian' films" (1981, p. 5). The Capital Cost Allowance policies made the financing of films easier but governments could not regionalize these tax policies and as such, they could not control where these films were produced. These incentives stimulated the industry but only within certain areas of the country. Notably the French Canadian production community benefited very little from the creation of these policies. (Bird et al, 1985)

5.5 The Capital Cost Allowance Benefits

While the Capital Cost Allowance film policy had its critics, it also had proponents. In a May 1985 interview with Cinema Canada magazine Mordecai Richler stated; "I think they squandered a grand opportunity and it's largely the fault of producers who were shameless and greedy, people of dismal taste, who were more interested in making deals than films and who made a lot of money for themselves. And so Canadian films do not enjoy a larger reputation anywhere and it's a pity...a lot of damage has been done"(Cinema Canada, #118, May 1985, p 16) Although most films in the era were considered critical disasters, two real stars came out of that time period. Ivan Reitman and David Cronenberg are two successful filmmakers that had films

²⁸ Source: *Hollywood dreaming*, Capital News Online, March 5, 2004 by Rym Ghazal

produced under the CCA policies. Cronenberg produced a series of cult favourite horror movies including *Shivers*, *Rabid*, and *Scanners* and Reitman made the camp comedy *Meatballs*. With these films Reitman and Cronenberg would go on to achieve financial success but they were harshly criticized at the time of their release. In a famous article "*You Should Know How Bad This Film Is. After All, You Paid For It.*" Critic Robert Fulford called *Shivers* "the most repulsive movie I've ever seen." Fulford goes on to suggest that if movies like "Shivers" were necessary for the development of a Canadian film industry, it would be better for the country not to have one.²⁹ However, the opposite opinion was also promoted; to quote Salon.com: "'Shivers' made money. Grateful taxpayers were reimbursed. A star was born."³⁰

The evidence is clear that there was an impressive increase in the production of "Canadian" films during this time and on basic terms this increase had a positive short term economic impact on the industry. (Bird et al. 1985)

5.6 The Capital Cost Allowance Epilogue

Both the old Capital Cost Allowance policies and the current tax credit and Telefilm programs stimulate activity but the difference lies in the gate keeper. In the old system, the hurdles involved meeting the guidelines set out in the legislation. (Acheson and Maule. 1991) With the current system the hurdles have added the discretionary power of a bureaucrat. Do we make better films now? Taste is subjective. The main failures of these policies were investor and producer system abuse and the films not reflecting Canadian culture. There was an increase in production but at what cost? There is evidence of an influx of unsophisticated investors (Bird et al, 1985) without proper knowledge who could have been taken advantage of by the investment dealers. A high level of knowledge is needed to truly understand this industry.

²⁹ Source: *Celebrating 30 years in the film biz*, Playback Magazine 2005, <http://www.playbackmag.com/articles/magazine/20050815/30.html>

³⁰ Source: Salon.com <http://www.salon.com/people/bc/1999/11/30/cronenberg/index.html>

“A film is an extremely risky undertaking. Each film is a unique entity produced by a team which forms for the project and then disbands. Resources are mobile and new working coalitions are constantly being developed in the industry. The outside investor has to assess the prospects of an often vaguely perceived project which will receive clearer definition only as production proceeds. Only a small set of informed investors are knowledgeable of the capabilities of the set of individuals forming the production team and of the market for the type of film that should emerge from the process. Most investors lack the necessary information and assessment ability. The creativity involved and the absence of a clear benchmark from which to judge a project also makes it difficult to separate projects that are fraudulent or at least misrepresented from those that are not. The industry attracts and rewards both the genius and the opportunist. An investor not only has to assess the technical, creative and marketing aspects of the film but the probity of those involved.” (Acheson and Maule, 1991, p. 2)

However, it is important to keep in mind that there was clearly an impressive increase in the output of Canadian films and this time period is credited for creating the base of the large industry that Canada now boasts.

6 BELGIUM TAX SHELTER

6.1 Belgian Tax Shelter Introduced

Belgium is a small patchwork of a country in the European Union. Similar to Canada, Belgium has a diverse makeup. It is divided into three strong communities; the French-speaking citizens, the Dutch-speaking ones and a small German population. In terms of administrative division, it falls into three regions: Flanders, Wallonie and the capital, Brussels. These three major cultural communities deal with 'cultural' matters with some political and economic functions. The federal State government of Belgium is responsible for the general national policies including taxes, health, etc..³¹ This context makes film production rather complex, since traditionally producers have depended on at least both the communities and on the State governments for finance. Because of the rising cost of production, Belgium filmmakers have had to look internationally to finance their productions. This has led to the growing popularity of co-production structures, comparable to Canadian co-production deals. To address some of the issues faced by this industry the government has taken additional actions. (Quaghebeur, 2005)

The Belgium tax shelter mechanism was introduced by the Programme Act of August 2nd 2002. The initial version of the new article in the Belgian Income Tax Code was amended several times. The government worked with numerous industry stakeholders to design wording that has worked on many levels. Firstly they needed to comply with the European Law so the government worked with the European Commission to implement some essential amendments. Secondly they worked with the industry to ensure that the new laws had practical application as an incentive. The law was launched to great fanfare in 2004. (Frater, 2004)

³¹ Source: The Belgium website <http://www.visitbelgium.com/>

This young incentive has seen early success. Four films that were co-financed through the Belgian Tax Shelter were selected in 2006 for the prestigious Cannes Film Festival. In this group was “L’Enfant from the Dardenne brothers and “Free Zone” from Amos Gital. These films took home two of the top prizes at Cannes, the Palme D’Or and the prize for the best actress, respectively. Quality and culture have not been criticized at this point. (Frater, 2004)

6.2 Belgian Tax Shelter Explained

The Belgian system is different from the current Canadian tax relief system. The Belgian government designed a program similar to tax shelter program of the 70’s and 80’s in Canada. It was created to encourage investors who do not traditionally invest in film and television to invest in production. In addition, the structure has some flexibility most notably the policy has no language restrictions to allow for combinations with outside incentives from other countries. (Frater, 2004)

This system allows corporations to cut tax bills by investing in individual film projects on a single film basis. These films need to be registered with and approved by the ministry of culture before the investment is approved. These corporations can be either foreign or domestic as long as the company has a Belgian tax liability.³²

The program was designed to develop investment from companies outside the entertainment industry. These companies can invest up to 20 percent of its profits before taxes, for a maximum of €300,000 a year. This investment entitles the company to a share in the receipts of the film. In addition to the investment, this company may also add a loan to the total sum equivalent to maximum of 2/3 of the total amount invested or a maximum € 200,000. The sum of loans and investments (a maximum of € 500,000) from the outside company is fiscally

³² Source: Belgian Government website <http://www2.vlaanderen.be/ned/sites/media/TaxShelterEnglish.htm>

deductible at 150 percent, the total annual qualifying amount being € 750.000 or 50 percent of the total amount of profit before taxation.³³

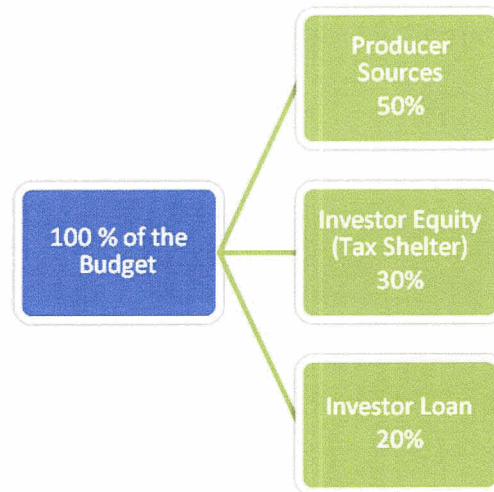
What makes this scheme interesting for investors is the loan portion of the investment. This allows the backer to maintain the fiscal advantage and reduce their risk at the same time. The Belgian government also has strict punishment in place for any abuse of the system. They have also limited the potential for exploitation of loopholes with ongoing industry stakeholder discussions. This has allowed the government to maintain a strong incentive system. In fact, the government has made minor changes to the legislation to allow for maximum effect. (Frater, 2004)

In a simplistic example, a film would have a financing structure like the one in the figure below. The producer share would make up 50 percent. They have the freedom to find this money from many sources including international soft money sources, presales, distributor advance, and others. The investor stake would make up the other 50 percent and this would be split between equity and loan. The 20 percent loan allows the producer to reduce investor ownership stake and it also allows the investor get the benefit of the tax relief on the 50 percent with only 30 percent at risk. The caveat to this investment is that the producer, a Belgian company, must spend 150 percent of the equity investment in country.³⁴

³³ Source: Belgian Government website <http://www2.vlaanderen.be/ned/sites/media/TaxShelterEnglish.htm>

³⁴ Ibid

Figure 10: Belgian Tax Model



Developed by the author based upon information from the The Vlaams Audiovisueel Fonds

6.3 Belgian Tax Shelter Epilogue

Clearly the Belgian government has taken some proper steps in the construction of their tax incentive policy. When placed side by side with its Canadian predecessor the Belgian successes are understandable. The country has seen both some critically successful films and some financially successful films (Frater, 2004). In addition, the industry has seen a new influx of capital into the sector. However the industry and government have been cautious of the early achievements. The head of the Vlaams Audiovisueel Fonds office has had to maintain tight control on both the volume and origin of production (Frater, 2004). The goal is to maintain an output of Belgian films without increasing the costs and overwhelming the audiences (Frater, 2004). All the evidence points to the fact the Belgian government has learned from the mistakes of the past.

Table 2: Film Tax Shelter Comparison between Canada and Belgium

	Canadian Capital Cost Allowance	Article 194 and Article 416 of the Belgian Tax Code
1. Used to accomplish clearly defined goals based on an overall economic development strategy.	Maybe. The system was designed to build a film and television industry in Canada. It did accomplish that goal by ensuring local spending. However the stated goal of "aimed at financially protecting Canadian cultural endeavours" remains unclear. (Bird, 1985)	Yes, Built for the very clear "Television without Frontiers" Directive.
2. Subjected to a rigorous cost-benefit analysis in both the short and long terms.	Unclear. The government did change policy during the existence of the incentive, which points to analysis but no real formal study was undertaken (Alioff, 1988 Bird, 1985)	Yes. The government and industry stakeholders have an ongoing series of discussions about the policy. The result of these decisions was a change in policy suggested by industry to allow for better threshold. (Frater, 2004)
3. Configured as investments in the region so that they retain their value even if the business departs.	Yes and No. The investments did have lasting effects on the Ontario region but little elsewhere in the country. (Bird, 1985)	Yes. The government has taken steps to ensure that the three distinct communities have access to the incentive. (Frater, 2004)
4. Made legally binding so that businesses are held accountable for their promises and performances.	Yes and No. This policy was notoriously financially abused (Alioff, 1988) but projects did have to be certified by CAVCO for "Canadian" status.	Yes. The government has taken several steps to certify both the company and the project both on financial and cultural terms
5. Consulting the stakeholders in the industry.	No. This was a political project using an older incentive policy.	Yes. The Belgian government built the policy with the consultation of both the film and investment industry. (Frater, 2004)

Developed by the author based upon the article "Forging Good Policy on Business Incentives"

7 CONCLUSIONS/ DISCUSSIONS

British Columbia has long reaped the benefits from tax incentives that both the federal and provincial governments have given to foreign producers. While this outlay is seen as attractive by local stakeholders for the benefits that it provides, the current degree of dependency on foreign financing is alarming. This type of capital is highly mobile and this puts the province in a precarious situation. With the unique nature of film and television production and fluctuating economic conditions, this high a level of foreign production does not provide the industry cluster with any stability. The best illustration of this point was the dramatic drop in production volume in 2004. With the rise of our exchange rate and the increasing availability of tax incentives in other parts of the globe, producers found cheaper locations for their projects. The ripple effect was a large job and investment loss.

The Vancouver film industry cluster, with over 80% reliance on foreign production, is in a unique and troubling position in the Canadian market. This problem is further exacerbated by the lack of local ownership in the production which does not return any of the government incentives from proceeds of the revenue generated by the final product to the region. Thus there are two arguments for building a stronger domestic film and television industry cluster in British Columbia. First to diminish the overwhelming effects of potential loss of foreign production and secondly, to contribute to the government tax income base through revenue provided by the exploitation of the property.

An additional inference of the analysis is that the commercial film and television business is highly competitive. Improving the competitiveness of British Columbia's film and television industry cluster requires building a system that will make films and television that more people will want to see. Using a quote from the movie *Field of Dreams*, "Build it and they will come". If

the British Columbian domestic film sector is given the resources to create films that are commercially promising, then they will be distributed around the world. If the system creates commercially unviable films they will require government subsidy to garner an audience.

Thus the creation of effective and attractive taxation mechanisms requires a direct relationship between filmmakers and the 'market'. The goal is to encourage and contribute to the development of a profit and market driven cinema. In the review of Belgian policies, it has been noted that their policy has created a mechanism that has been able to increase the role of the private sector, and foster true entrepreneurship among filmmakers.

With the benefit of hindsight and over a decade and a half of experience after the demise of the CCA, the problem with the incentive at the time had more to do with the structure of the policy, rather than with incentive itself. No filmmaker would like to see a tax incentive that is open to abuse, as this would clearly not be in the best interests of the industry. However, if it was possible to restructure the Cost Capital Allowance on a federal or provincial level in a way that was attractive and provided certainty to investors, but adequately addressed issues of transparency, including a capping mechanism for deductions and fees, and dealt with the government concerns about loss to revenue, then such a system would be a positive step in the creation of a larger market driven domestic industry.

There is certainly a growing consensus within the British Columbian industry that getting the private sector to return to the production sector is crucial to its future. The scarcity of private capital in the British Columbian film and television production sector has been identified as one of its most significant barriers to the industry's growth and development.

Although it is impractical to suggest that a simple policy change will forever increase production and distribution of Canadian/British Columbian-made films, several points seem fairly obvious. Long term sustainability of the industry is rooted in the domestic sector. Also, public subsidies have created a strong service industry in British Columbia. Thirdly, what was once an American industry has rapidly become ``globalized". Fourth, policies that have built that industry in the Canadian market have been replicated throughout the world and created a very competitive market for the outsourced portions of the production process. Fifth, for Canadian producers to have long term returns on the services they provide, they need to have resources in play. This means that they need to have financial resources in the production, outside of the Canadian subsidies, to have ownership in the intellectual property.

One of the main presumptions of this paper is that every film bears an indelible imprint from its financing structure, and that a uniformity of financing models and sources will lead to uniformity of product. While this may be a positive in other industries, this is absolutely not the case in creative industries such as film and television production, where innovation, diversity and novelty are vital commodities.

David Gonski, stated in his review of the Australian system, that maintaining a number of financing doors is crucial to the sustenance of a diverse and robust film industry.³⁵ The more investment doors open to filmmakers to access, the more the players. And the more the players, the better the chance that the best and most creative ideas will reach the screen, the more innovation is encouraged, and the more chance there is that truly independent and indigenous filmmakers will be able to prosper.

³⁵ Source: The Gonski Review: <http://www.afters.edu.au/go/library/research-tools/reports-and-papers/film/tv-industry>

In order to achieve innovation, there needs to be a range of independent voices, and these voices need to be able to access different sources of financing. To have, for instance, a few large players financing films in the same manner or from the same pot, is most likely to result in conservatism and a slate of films that are virtually the same.

The following are the constructive steps that public policy makers should take:

1. Maintain the current Telefilm system for the creation of culturally driven product;
2. Maintain the current service production tax incentive for the short term;
3. Facilitate a review of current film production incentive practices, guidelines and costs;
4. Create a new tax incentive policy with the help of the industry to augment the current system for the development of market driven domestically produced product;
5. Create a co-operative, sustainable and integrated approach from all stakeholders to facilitate this new policy.

The goals of these steps are to maintain the current business and minimize the disruption to the industry while creating a system where the British Columbia cluster can continue to grow. The obvious benefit to this is it will also reduce the reliance on foreign production and create a system that will generate sustainability and tax revenue for the governing bodies.

This adds to a double bottom line of creating a stronger cluster. In the analysis of the industry, it is apparent that the sector needs better financing resources. With this element in place the cluster rivalry will turn inward as competition for this capital will make stronger companies. Porter found that firms facing intense home-country pressures will respond by investing continuously in order to upgrade their competitive advantage. This leads to an industry that will gain greater competitiveness and prosper internationally.

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