THE RISE OF CO-PRODUCTIONS IN THE FILM INDUSTRY

THE IMPACT OF POLICY CHANGE AND FINANCIAL DYNAMICS ON INDUSTRIAL ORGANIZATION IN A HIGH RISK ENVIRONMENT

NORBERT MORAWETZ

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For my parents.

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Abstract

The main aim of this study is to examine the interrelationship of finance and government intervention in explaining the rise of co-productions in the international film industry in the time period between 1997 and 2004.

Mainstream economic geography literature presents the film industry typically as a case study for embeddedness and agglomeration effects, with successful industry clusters drawing their strength from process knowledge, networks and local interaction. However, there is an increasing disparity in the literature between what mainstream theory suggests, and what empirical studies find with respect to the importance of cluster-external relations and dynamics. This, as I will argue, is particularly evident when looking at the picture of the whole film industry production system that emerges from the literature, which fails to include the alternative and complimentary pattern of co-productions.

Co-productions are collaborations between film producers from at least two different countries, pooling their resources across distance to produce a feature film project. In the past fifteen years, the number of films made as co-productions has risen continuously in Europe, with co-productions accounting for more than 30 per cent of European film production activity.

As a mode of production based on temporary, cross-border collaboration that is supported in its coordination by temporary clusters, such as trade fairs and industry events, the co-production phenomenon poses a conundrum to economic geography literature and challenges its explanatory framework. As I will argue, in order to arrive at a satisfactory understanding of the phenomenon, it is necessary to look beyond social factors associated with locality, and to examine instead dynamics impacting on the industrial organization of the whole production system.

I will argue that in the context of the pervasive demand uncertainty characterizing the film industry, the analytical focus should be on financial dynamics, as production activity

and its organizational form are ultimately dependent on finance as an enabling force. Based on a description of the film financing process as the primary process in which the relationship between the economic categories of financial and production capital are played out, I propose that in order to explain the growth of co-productions empirically, it is necessary to examine changes in the film financing environments of the increasingly interrelated European and US film industries.

As the State is the most important provider of financial capital in the European film industry through the provision of public aid, the focus will lie in particular on the consequences of a paradigm change in the rationale of State intervention in Europe moving away from funding film for cultural reason, to supporting the industry on economic grounds since the mid 1990s. As will be shown, the most important consequence of this paradigm change has been the introduction of tax incentives to encourage investment into film in a number of European and international countries within a short period of time. As will be demonstrated, this has led to the formation of significant, locally confined capital pools that can dis-embed production; and to the emergence of a distinct capital cycle in international film financing, which has strongly impacted on the productive system of the film industry.

Finally, a dynamic explanation for the growth of co-productions in Europe in the time period between 1997 and 2004 will be provided. I will argue that co-productions have firstly grown in order to overcome a lack of finance, but have in the context of a capital cycle based on tax incentives from Germany and the UK, increasingly become driven by the opposite dynamic, namely an abundance of financial capital seeking profitable investment opportunities.

The study will conclude with a discussion of policy implications, a summary of contributions to the literature and a brief overview of future research opportunities.

Acknowledgements

In *La Nuit Americaine* (1973), director Francois Truffaut compares filmmaking to a stagecoach ride in the old west: “When you start, you are hoping for a pleasant trip. By the halfway point, you just hope to survive.” The same is very much true about writing a doctoral thesis.

Evidently, it would be entirely impossible to complete such a demanding journey, were it not for the continuing support of some special people, who I want to thank deeply:

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"You're never really done for, as long as you've got a good story, and someone to tell it to."

Max, in *"The Legend of 1900",*
directed by Giuseppe Tornatore,
1998.

1. THE RISE OF CO-PRODUCTIONS

1.1 Introduction

In the past thirty years, neo-liberalism has "swept across the world like a vast tidal wave" (Harvey, 2006:145), breaking down trade barriers, de-regulating financial markets and driving back the sovereignty of the state in pursuit of the "free market" ideal. In the financial realm, the liberalization of capital markets has led to an enormous growth of financial wealth, fuelled by the institutionalization of savings, a decade of low interest rates and the global redistribution and repackaging of risk (Dicken, 2003; OECD, 2007). While global capitalism has remained geographically and nationally mediated (Hall and Soskice, 2001; Goyer, 2006; Deeg and O'Sullivan, 2006; Deeg and Jackson, 2007), the mobility of de-regulated financial capital has facilitated the spread of the Anglo-Saxon model of capitalism (Busch, 2004; Vitols and Engelhardt, 2005), and the satisfaction of shareholder value as a central system of governance. In an environment of global competition and accelerating financialization (Clark, 2005; Pike, 2006; *Froud et al*, 2006), trans-national companies obliged to cost efficiency (*Morris et al*, 2008), can thereby easily redistribute economic activity between nation states, to take advantage of lower wages (Dicken, 2003).

In order to stay competitive and secure productive investment, governments in advanced economies have therefore welcomed the proposition that they should facilitate the transition from primary and secondary production to a knowledge-intense service economy. This development rests on the widely held view in policy and economics that knowledge is the most powerful engine of economic progress and competitive advantage, with knowledge being increasingly perceived as "magic" (Grabher, 2004:103) and "the historical a priori of the age" (Scarborough, 2001:204). The efforts of policy in this respect are most visibly expressed in the EU's Lisbon Strategy (2000), aiming to make the EU "the most dynamic and competitive knowledge-based economy in the world" by 2010 (Kok, 2004:6).

Of key importance in this respect is the idea that the conditions of knowledge exchange are highly localized, and that successful industries tend to form geographically distinct, clusters, in which firm performance is improved by reducing transaction costs (Maskell and Malmberg, 2006). Co-location not only facilitates the physical flows of inputs and outputs, but also the exchange of business information, know-how and technological expertise in traded and untraded form (Malmberg *et al*, 1996). Cluster formation has therefore been found to be particularly characteristic of knowledge-intensive high-tech industries, such as the archetypical IT cluster in Silicon Valley (Saxenian, 1994). Furthermore, it has been proposed that globalization is strengthening the development and specialization of clusters, as firms and specialized labour are attracted to successful agglomerations providing a competitive advantage in factor conditions (Porter, 1990; 1998). Encouraging the growth and clustering of such innovative, knowledge intensive industries, has consequently been recognized as best practice for states to add high value added jobs to their economy (Malecki, 2004; Hospers, 2006).

In the wake of enthusiasm for the new economy, the focus on knowledge intensive businesses has furthermore been expanded to include the so-called creative industries (Caves, 2000; Florida, 2002), which likewise produce intangible products, protected by intellectual property rights. The label of creative industries thereby includes diverse industries such as advertising, architecture, the art and antiques market, craft, design, designer fashion, interactive leisure software, music, the performing arts, software and computer services, television and radio, and film and video (DTI, 2006; DCMS, 2008). In 2003 the World Bank estimated that in G7 countries more than 50 per cent of consumer spending was on outputs from these creative industries (Ryan, 2003), and consequently identified the creative industries as one of the fastest growing sectors of the world economy. Similar to other high-growth knowledge intensive industries, cluster formation has also been identified as a key characteristic of cultural production (Scott, 2004), a claim that has been supported particularly by economic geographer's studies of film production, with clusters being identified in the US film industry (Scott, 2005), Canada (Coe, 2001) the UK (Nachum and Keeble, 2003; Bassett *et al*, 2002), Hong Kong (Kong, 2005) and Germany (Bathelt, 2001; Krätke, 2002; Kaiser and Liecke, 2007). With

Hollywood, Los Angeles, the film industry has furthermore provided one of the most convincing case studies of how a successful regional production complex can come to dominate the global market for a prolonged period of time.

In Europe, cultural production thereby represents one of the few areas of economic activity, where the state has successfully resisted neo-liberal advances of free trade in the past thirty years, and maintained the right to actively intervene through industrial policy on the ground of cultural protectionism (UNESCO, 2005).[1] This is strongly exemplified, again, by the case of the film industry, with audiovisual services being excluded from World Trade Organization (WTO) trade agreements (Pauwels and Loisen, 2003), and governments actively subsidizing national film industries since the 1920s (Westcott and Lange, 2004). With the recognition that cultural production is not just a worthy activity in its own right, but that it can also be a viable business sector, subsidy policy has shifted in the past decade in many countries from support on cultural grounds, to subsidizing industries such as film on the grounds of economic growth and job creation.[2] Due to its significant size[3], and its strategic role in facilitating growth in other creative industries (Miller *et al*, 2005), the film industry has thereby received special attention from policymakers, and has been targeted with new neo-liberal policy measures[4], such as tax incentives, to address the lack of risk-friendly financial capital needed for production - a typical problem associated with high-risk innovative industries.

The film industry thus provides an interesting case study for critical economic enquiry in several respects. Firstly, as an industry for which economic geography literature has

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1 The reason for this might be that culture is inextricably linked to the very concept of the nation state, and provides a fundamental legitimization for its existence.

2 Arguably this is also in line with States being increasingly seen as economic units whose focus lies on providing competitive factor conditions, rather than entities bound together by a common culture.

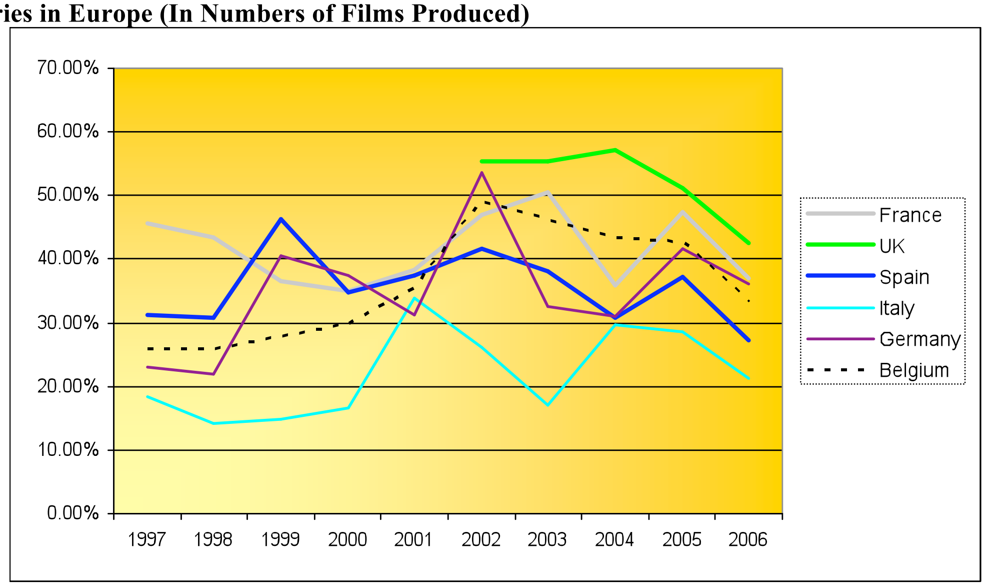
3 Its turnover in 2006 was more than USD 70 billion (Price Waterhouse Coopers Global Media Outlook, 2007).

4 Tax incentives seek to encourage private investment into the film industry by offsetting the risk of film investment with a reduction in tax for the investor. As a policy measure, tax incentives require a minimum of active state intervention, with the total amount of funding to the industry being determined by the market, as opposite to more traditional state funding through film commissions. As such, they represent a form government intervention that leaves governance and coordination to the market. For these reasons, the re-regulation of film policy in the late 1990s can be seen as characteristic of the wider neo-liberal economic context, with tax incentives incorporating the neo-liberal ideal of a free market laissez-faire policy to a far greater extent than any previous form of public aid.

proposed that production takes place ubiquitously in clusters, and which has become a highly influential case for the argument that cultural production and industrial agglomeration are inextricably linked. Secondly, as an industry which is strongly dependent on finding risk-friendly financial capital, and is thus susceptible for dynamics in its direct, and in the economy's wider financial environment. Thirdly, and closely connected to the second point, as an industry of the creative sector, in which governments of advanced economies have strongly intervened with neo-liberal policy measures, amid wider efforts to transition their economies towards growth in knowledge intensive sectors, to compensate for the loss of jobs in traditional manufacturing industries.

In this thesis, I will explore these themes by focusing on a form of film production that has previously received little attention from academics, namely co-productions. Co-productions are collaborations between film producers from at least two different countries, and are not a recent phenomenon, but have been a stable part of the European film production landscape since the 1950s (Lev, 1993). In the past fifteen years, the number of films made as co-productions in Europe has risen continuously, and co-productions now account for more than 30 per cent of overall film production activity in most European countries (see **Figure 1.1**).

Figure 1.1: Share of Co-Productions of Total Feature Film Production in Major Film Producing Countries in Europe (In Numbers of Films Produced)



Source: Compiled from the EAO 2002, 2005; 2008; SPIO 2007; UKFC, 2008)

As a recurring industrial pattern, co-productions range from typically small budget, arthouse European films such as *Irina Palm* (Sam Garbaski, 2006; France/ Belgium/ Luxembourg/ Germany/ UK) and *Die Fälscher* (Stefan Ruzowitzky, 2007; Austria/ Germany, 2007), to medium budget commercial projects such as *Perfume, The Story of a Murderer* (2006, Tom Tykwer), and to high budget films with strong US participation such as *The Aviator* (Martin Scorcese, 2004; Germany/ US), *Kingdom of Heaven* (Ridley Scott, 2005; Spain/ UK/ Germany/ US) and *Alexander* (Oliver Stone, 2004; Germany/ France/ UK/ Netherlands). The example of *Perfume, The Story of a Murderer*, which was co-produced by companies from Germany, France, Spain and the US can ideally illustrate the nature of a typical co-production. In line with the financing of the film, which has come from public funders such as the German Federal Film Board, the Council of Europe's Eurimages, the French Centre National de la Cinematographie, and private sources such as German Mediafunds, and a US private equity film financier, the film was shot in Spain and Germany, with the Parisian fish market and the outdoor shots of perfume town Grasse being filmed in Spain. A studio in Munich doubled for the Parisian interiors. The film was directed by a German director, designed by French artists and features a mainly British cast to appeal to international audiences. Finally, digital effects and model making for the film were supplied by a company from Prague.

Despite their prominence and significance for international feature film production, co-productions have remained a largely under-researched area in economic studies, with economic interest in the film industry coming from mainly three perspectives, namely (1) neo-classical economics ("Hollywood economics"), (2) the political economy perspective and (3) economic geography/ organizational studies. The failure to capture such a key structural feature of the film industry thereby reveals two major shortcomings of the present literature. Firstly, concerning all three perspectives, the interest of previous studies has nearly exclusively remained focused on the US film industry. This has resulted in a situation where in the existing literature the term "film industry" is largely used synonymously for the activities of the Hollywood studios (Disney, Paramount, Warner Bros, Sony Pictures, Universal, Fox), reflecting their global dominance, and thereby continuing and transferring this dominance to academic discourse. This strong focus on the US industry may be one reason why the increasing intertwining of international production patterns has received so little attention from academics in the field of economics. Secondly, with respect to the accounts of economic geographers, I propose that the close alignment of research into creative industries (and especially the film industry) and agglomeration studies, has led to an overly narrow research focus on linkages and social benefits at the local level in studies on the film industry. By emphasizing that film production takes place predominantly in clusters, these studies have neglected other patterns of production based on cluster-external relations, and hence co-productions.

This, as I will argue, is not a coincidence, but the consequence of limiting theoretical suggestions from mainstream economic geography literature. Economic geographers have argued that firms will pursue temporary, cluster external relations, such as co-productions, mainly in the pursuit of superior rents or to tap into distant knowledge pools. This conception, however, provides an empirical contrast to co-productions, that; (1) are typically *not* more profitable than films produced by a single-firm; (2) do not usually have a larger international market potential than domestic productions; (3) typically do not lead to a superior product, but historically have often led to films that lack cultural identity and have been received poorly by critics; (4) do *not* represent a cost efficient mode of production (5) typically do not serve knowledge exchange; (6) usually result in a split rights ownership, and therefore limit the potential for superior rents. From an economic geography perspective, co-productions, as a mode of production based on temporary cross-border collaboration, thus appear as a conundrum, posing a challenge to its explanatory framework.

1.2 Aims of the thesis

The main aim of this thesis is to explore this conundrum and explain the rise of co-productions in the film industry in the past fifteen years. As I will argue, in order to answer this question, it is necessary to examine interrelated developments in finance and industrial policy that have facilitated this form of production. The main research question of this thesis therefore is; what is the interrelationship of finance and government intervention in explaining the rise of co-productions in the film industry? In close relation to this question, I will explore a number of sub-themes, with the main aims being; (1) to demonstrate that the characterization of film production as taking place predominantly in clusters is empirically incomplete, and that other patterns of production exist and are thriving; (2) to answer how the rise of co-productions can be explained within existing frameworks of economic geography; (3) to analyze and conceptualize the interrelationship between demand uncertainty, financial risk and production organization in the film industry; (4) to examine interrelated developments in the European and the US film financing environments, and their impacts on the spatiality of production patterns. Furthermore, this study seeks to arrive at a more complete picture of the film industry than has been given by previous academic studies, by investigating developments in both the European, as well as the US film industry; and aims to provide a solid foundation for a critical evaluation of recent industrial policy measures targeted at the film industry. Empirically, this study will firstly seek to demonstrate that co-productions are a consistent and integral part of international film production. Secondly, it will examine in detail, developments in industrial policy in the European film industry, and changes to the film-financing environment of the US industry. Thirdly, it will describe the emergence and the impacts of a capital cycle in international film financing, based on financial capital raised in Germany and the UK, in the period from 1997 to 2004. The data gathered for this research come both from primary and secondary sources, with primary data being gathered partly by using an innovative method, as will be described in chapter two.

The novelty of the thesis thus lies in identifying an alternative pattern of cultural production (co-productions) to localized production that has not been examined in the literature previously, and in exploring it empirically and theoretically. In order to explore the co-production phenomenon, I have developed an innovative data gathering method, and have developed and applied a novel research focus that extends previous studies on the film industry by taking financial dynamics and industrial policy changes into account, to arrive at a more dynamic analysis of changes to spatiality and industry organization. The thesis contributes to previous critique on present mainstream economic geography literature with respect to cluster external relations, and extends this critique to highlight shortcomings with respect to the conceptualizations of finance. Based on an original analysis of how demand uncertainty and financial risk shape the film financing process, the thesis furthermore sums up and develops a fresh narrative of how major developments in the European and the US film financing environment have concurred, leading to the emergence of distinct capital cycles as drivers of film production. Finally, the thesis offers a detailed analysis of the impacts of tax incentives on the film industry, and provides a critical and topical evaluation of industrial policy measures applied to the film industry.

1.3 Definition of the film industry

In this thesis I will frequently refer to the *US film industry*, the *European film industry*, and the *film industry,* which I will use as a general term that includes the former two industries. By European film industries in turn, I will refer mainly to the major film producing countries within the European Union member states, and as primary case studies, the UK and Germany. In addition, I will use the term *international film industry*, by which I mean film industries producing for the international market (as opposed to national film industries producing for domestic markets), and as such includes internationally orientated film production in Europe, Canada, Australia, New Zealand and South Africa, and the US. The term does not include (vibrant) film production in India ("Bollywood"), Africa (i.e. Nigeria's "Nollywood), the Middle East (Iran) and Asian cinema (Hong Kong, Korea, Japan, China). Developments in these territories have consequently not been considered for this thesis. Furthermore, while this research understands the film industry to be generally comprised of three sub-sectors, namely film production, distribution and exhibition, the word film industry will, in this thesis, primarily refer to the production sector, and to a lesser extent distribution, in correspondence with the research focus on the (spatial) organization of production.

Finally, while some film production and production services companies are also active in television production, and it is not uncommon for crew and talent to work in both and thereby interlink the two sectors, the broadcasting sector and its production system will also be excluded from analysis in this thesis. This has two main reasons; Firstly, the broadcasting sector is in itself highly diverse, with for example, television drama series production exhibiting an entirely different production pattern to in-house game show production (see also Lukinbeal, 2004). As such, within the sector, only TV movies and drama production can be said to closely resemble cinema production. Secondly, television drama production is nearly always guaranteed distribution by the commissioning broadcaster, a significant difference to film production, where revenue streams are uncertain, but potentially also uncapped. This is reflected in the budget size, the international scope and also the financing structure of television and film productions. While they can share the same production infrastructure, the dissimilarities in development, financing and exploitation set two industries fundamentally apart; they may sometimes use and organize the same resources, but they do so differently.

1.4 Outline of the thesis

This thesis continues with an introduction and a review of the three main economic perspectives on the film industry [chapter 2], with an emphasis on economic geography studies. It will be shown how the clustering of firms has become the dominant research focus in mainstream literature, with film production being analyzed mainly as a local phenomenon. However, as will be highlighted, there is an increasing disparity in the literature between the suggestions of mainstream theory and what empirical studies find with regards to the importance of cluster-external relations and dynamics. This, as I will argue, is particularly evident when looking at the picture of the whole production system that emerges from the literature, which fails to include the alternative and complementary pattern of production that exists in the form of co-productions. In order to arrive at a satisfactory explanation of co-productions and industrial developments in the film industry, I therefore argue that a new research focus is needed, that goes beyond agglomerative forces as key industry dynamics.

Chapter 3 seeks to establish the phenomenon of co-productions as a significant, persisting and growing part of worldwide film production. Firstly, a definition of what is understood by a co-production will be given, followed by an overview of how co-producers meet, how co-productions perform financially and artistically in comparison with single-nation productions, and what motivates producers to pursue co-productions. Furthermore, I will demonstrate in chapter 3 the historical significance of co-productions, and provide a statistical assessment of co-production activity in the last fifteen years.

Chapter 4 presents the research methodology that has been adopted for this research. Here, firstly epistemological questions will be covered in brief, followed by a discussion of the challenges associated with studying co-productions. I will then outline my research approach, and present the innovative data gathering method that has been employed and developed in the course of this research, in detail.

Chapter 5 builds on the critique and findings of the previous chapters to suggest that film production is strongly dependent on finding finance, and that hence financial dynamics are a key explanatory factor for the growth of co-productions. As the relationship between finance and production in the film industry is generally an under researched topic, the main aim of this chapter is to establish and conceptualize the characteristics of their relationship, in order to provide the foundation for further analysis. Chapter 5 characterizes the film industry as an industry in constant search for finance, marked by high capital costs and a high degree of uncertainty that translates into a high financial risk for investors. Distinguishing between embedded industry (production capital) and essentially footloose financial capital, the specific features of the film financing process will be examined, and two basic industry dynamics that result from the relationship between financial and production capital proposed. Finally, I will argue that in order to explain the growth of co-productions empirically, it is necessary to examine changes in the film financing environments of both the European and the US film industries.

In chapter 6, I will describe parallel and interrelated developments in the European and US film financing environments that have formed the context for the growth of co-productions in the past decade. As the state is the most important provider of financial capital in the European film industry through public aid, the focus lies in particular on the consequences of a paradigm change in the rationale of state intervention in Europe away from funding film for cultural reason, to supporting the industry on economic grounds from the mid 1990s. As I suggest, the most important consequence of this paradigm change was the introduction of tax incentives to encourage investment into film in a number of European and international countries within a short period of time. I will demonstrate that this has led to the formation of significant, locally confined capital pools that can dis-embed production; and to the emergence of a distinct capital cycle in international film financing, which has strongly impacted on the productive system of the film industry.

Based on the context of developments in the European and US film financing environments, I will provide in chapter 7 a dynamic explanation for the growth of co-productions in Europe in the time period between 1997 and 2004. I will argue that co-productions have firstly grown in order to overcome a lack of finance, but have, in the context of the capital cycle based on tax incentives from Germany and the UK, increasingly become driven by the opposite dynamic, namely an abundance of financial capital seeking profitable investment opportunities. I will examine the impact of the resulting financial dynamics on the film industry and give a brief outlook on how the "tax incentive disease" has spread to the US. Finally, I will discuss a number of policy issues that have emerged as a result of this enquiry.

In conclusion [chapter 8], I will summarize the main points I have made in the thesis, highlight its main contributions to film industry literature, as well as to studies of the creative industries and to economic geography theory, and outline a number of questions that have emerged in its course for future economic enquiry.

2 FROM “NOBODY KNOWS ANYTHING” TO “EVERYBODY KNOWS A LITTLE BIT” – REVIEW OF LITERATURE ON THE FILM INDUSTRY

2.1 Introduction

The film industry is the subject of three broad strands of academic literature, namely neo-classical economics or “Hollywood economics” (occupying with the economic “laws” underlying the US film industry), the political economy perspective (focusing on power structures and their impacts on the film industry), as well as economic geography and organizational literature (occupying with the [spatial] organisation of industrial activity).[5] In addition to the main perspectives, a fourth body of relevant literature can be identified in studies exploring the so-called “creative industries”, of which the film industry is a part of. Following the aim of the thesis to explore the production pattern of co-production, economic geography and organisational studies will be at the centre of this review. In addition, I will draw, to a lesser extent and where fitting, on the other three strands, to enrich and complement my understanding of industrial developments.

As I will show, within the present economic geography literature, very little has been written on film production outside of North America, and even less on cross-border film production. As a consequence, co-productions are a widely under-represented topic, with the majority of the studies failing to capture this important industrial phenomenon at all. As I will argue, the failure of the existing literature to recognize the importance of co-productions cannot, however, be simply explained with the strong pre-occupancy of researchers with the US industry, and the overall neglect of the European and international film industries. Instead, I will argue that the lack of literature on co-productions points towards shortcomings in the theoretical foundations of economic geography frameworks that have been applied to the film industry by previous studies.

[5] The film industry has also particularly attracted the interest of studies concerned with labour issues (Blair *et al*, 1998; Blair and Rainnie, 2000; Randle and Culkin, 2005; Randle and Morawetz, 2005), marketing (Kerrigan and Özbilgin, 2004; Zufryden, 2000), the impact of technological change on competition (Wasko, 1994; Culkin, Morawetz and Randle (2006), and studies concerned with the theory of the firm, with the project nature of the industry raising interesting question with respect to the building of firm capabilities (Miller and Shamsie, 1996; DeFillippi and Arthur, 1998; Phelan and Lewin, 1999; Whitley, 2006).

Following suggestions from mainstream theory, previous studies on the film industry have nearly exclusively concentrated on analyzing film production as a local phenomenon, seeing clustering of firms as a characteristic pattern of film production, and concentrating in research mainly on how firms interact with each other on the local level. However, increasingly these studies have found that relations and factors that transcend the local are equally important for film producers. Therefore, I will argue that there is a disparity in the literature between theoretical suggestions and the findings of empirical studies with respect to industrial organization. Furthermore, I will suggest that this is particularly apparent when investigating co-productions, which represent an alternative pattern of production based on external, distant inter-firm relations.

I will begin with a brief review of non-organisational accounts of the film industry, pointing out the main contributions and shortcomings of the neo-classical and political economy perspectives, and how they can enrich and complement the understanding of industrial developments from an economic geography perspective. In addition I will briefly outline how I see the relationship between the film industry and the creative industries literature, and discuss how they can contribute to each other.

In the main section of this chapter, I will then focus on the key body of relevant economic geography literature on the film industry. I will firstly revisit the debate around flexible specialization, which has formed in many respects the basis for all subsequent research on industrial organization in the film industry. I will then explain how the process of clustering has become inextricably linked with film industry studies, and summarize the main arguments put forward by mainstream theory as to why clustering occurs in film production. Secondly, I will show how subsequent empirical studies have repeatedly produced evidence that suggests that extra-local linkages are as important in film production as local interaction – in contrast to suggestions from mainstream cluster theory. However, as the research focus of these studies has also focused on spatiality and locality, the extra-local dimensions of film production that impact on industrial organization, but transcend the regional level, have remained underdeveloped in the literature. This, as I will argue, is evident in the picture of the whole production system that emerges from the literature that misses the alternative and complementary pattern of production that exists in the form of co-productions. Finally, I argue that in order to arrive at a satisfactory explanation of co-productions and industrial developments in the film industry, a new research focus is needed that goes beyond agglomerative forces as key industry dynamics.

2.2 Perspectives from Economics

2.2.1 "Nobody knows Anything" - Hollywood Economics

> *"A studio can go broke if it goes just one year without a hit. And movies are financed in unusual ways. These are hard problems, but the hardest one of all is that nobody really knows how much a movie will gross at the box office."*
>
> **De Vany (2007:619)**

The film industry has been famously described by screenwriter William Goldman (1983) as an industry where "nobody knows anything". This high demand uncertainty is the central interest of a group of neo-classical economists (De Vany, 2004; Walls, 2005; De Vany and Walls, 1996; 1997; 2002; 2004; 2005; Litman, 1998, Ginsburgh and Throsby, 2006; Vogel, 1998, 2007), who have self-termed their line of work "Hollywood economics". The primary aim of Hollywood economists is to uncover the economic principles underlying the US film industry, mainly by means of quantitative analysis, such as historical box office analysis, with their main finding being that revenues are indeed unpredictable. However, it has to be noted that the data used by Hollywood economists such as De Vany (2006) to prove that "nobody knows" typically does not include international box office of films (usually 60 per cent of the total theatrical box office), and typically also does not take ancillary revenue streams such as DVD sales and rental revenues into consideration, which account for about half of a film's total revenues. As data therefore encompasses only 20 per cent of all revenues derived from a film project, real revenue outcomes might look considerably different from what Hollywood economics depicts and are only pertinent to the US industry. The problem with respect to data is further aggravated by the industry's notorious accounting standards ("creative accounting"), putting the "nobody knows" proposition under further scrutiny. This has been criticized particularly by Wasko (2004), who has fundamentally challenged the reliability of data available to Hollywood economists, which "depend mostly on inconsistent trade press reports and unsystematic data from lawsuits and other sources" (2004:135).

Paying little attention to power structures, business practices, social and place-bound factors, non-quantifiable industrial developments, and work from other perspectives, the findings of Hollywood economics can be overall criticized for bearing little resemblance to the actual business reality in "the movies", but instead, being based on a highly idealized view of the US film industry. This is exemplified by De Vany's proposition of how the film industry principally adjusts to high demand uncertainty for its products. As De Vany argues, high demand uncertainty has necessitated the film industry to become an information industry, "arguably the first of the twentieth century" (2006:618), which produces information, for this is "all that a film really is, and it lives on it". Based on an "elaborate reporting of film revenues and reputations" (with box office revenues acting as a pure quantity signal of demand for studios), the film industry is, according to the De Vany, able to flexibly adjust prices and quickly supply demand, when the audience reveals it. However as prices for theatre tickets are fixed, supply and demand cannot as easily be matched in the film industry as in other industries. As De Vany proposes, studios solve this problem by adjusting *internal prices* through the rental contract (the contract between exhibitors and distributors), and the distribution fee (the fee distributors charge producers for distributing their film).

However, the proposition that demand uncertainty is addressed by the industry through adjusting internal prices is highly debatable, both on empirical as well as theoretical grounds. Firstly, the mechanism De Vany proposes can only set in once a film has already been produced – that is after production costs (and presumably marketing costs) have already been incurred. Thus Hollywood's reporting system can be seen as a very effective way of optimizing supply after a film's launch, but not as a mechanism to manage demand uncertainty, as it does not address the problem of determining initial demand at all. Secondly, if one assumes that future positive performance of a film can indeed be predicted, then these potential revenues can only be realized if exhibitors have free capacities (to show the film on multiple screens), or the distributors have enough market power to crowd out competitors. De Vany's proposal that *"the supply of theater seats [in cinemas] is perfectly elastic because the run [of a film in cinemas] can be extended to increase supply until it equals demand"* thus fails to address the problem of competition. Thirdly, when one considers that empirically both the distribution fee and the rental fee are usually fixed or vary only to a small degree, it is highly questionable whether any internal price adjustment takes place at all.

On the whole, this suggests that arguments about market structures, power relations and business practices are more suitable to explaining how demand and supply match in the film industry, than the principles of internal price adjustments advanced by Hollywood economics. While the propositions from Hollywood economists have to be seen in a critical light, they can nevertheless provide some strong insights into film industry principles. In this thesis, I will draw on findings from Hollywood economics in particular in chapter five, with respect to the conception of risk and demand uncertainty in the film industry.

2.2.2 "Somebody Knows Something" - The Political Economy Perspective

In stark contrast to the highly simplified portrayal of the film industry by Hollywood economics, a strand of literature that Wasko (2004) has labeled a political economy approach, has examined issues in the film industry with a strong foundation in empirical findings and from a critical perspective. Following Wasko (2004), proponents of the political economy perspective are hence interested in questions of market structure and performance, analyzing these issues within a wider social, economic, and political context, with the aim of critiquing the industry in terms of its contribution to maintaining and reproducing structures of power:

> *"For instance, when looking at the international popularity of US films, rather than celebrating Hollywood's success, political economists are interested in how US films came to dominate international film markets, what mechanisms are in place to sustain such market dominance, how the state becomes involved, how the export of film is related to marketing of other media products, the consequences for indigenous film industries in other countries, and the political/ cultural implications."*
>
> **Wasko (2004:132)**

While more prominent in communication and media studies, the political economy strand on the film industry comprises a wide range of research, that can be traced back to Klingender and Legg's (1937) study of finance capital in the film industry, and Huettig's (1944) work on power in various industry sectors. A seminal work in this area is Guback's (1969) study on the post-war relationship between Hollywood and European cinema, in which he examines both financial and wider socio-economic factors. Wasko, completing her doctoral dissertation with Guback, has continued this tradition by firstly examining the relationship between Hollywood and financial institutions in *Movies and Money* (1982), then focusing on the impact of technological developments on the film industry in the 1980s and early 1990s (1994), and finally (2004) scrutinizing distribution practices and contractual "agreements" in the film business, which are for her clearly revealing how the US majors use their market power to transfer risk onto other players in the industry. As is recognized by Daniels *et al* (1998:5), studios are able to maintain a high level of control even over independent productions, through financing;

> *"The studios have Oz-like power over the motion picture industry and cash in abundance. Or perhaps more properly, access to abundant capital."*
>
> **Daniels *et al* (1998:5)**

The relationship between US studios and the Canadian film industry is explored by Pendakur (1990), who also emphasized the role policy changes have played in the Canadian film industry, with respect to industrial development and labour issues. In his work he stresses particularly the international ties of the Canadian film industry, both to the US and Europe. Into this category also belongs Aksoy and Robins' work on concentration and globalization in the film industry (1992), and Miller *et al.*'s (2005) rich overview of "Global Hollywood", which aims to expose Hollywood's power structures in its international division of labor and intellectual property rights exploitation. Their open agenda to "unmask" how Hollywood studios are colonizing the world and in the process destroy local film culture, thereby leads the authors to recount the history of international cinema as a narrative of burgeoning cultural American imperialism, describing Hollywood as a "floating signifier, a kind of cultural smoke rising from a US-led struggle to convert the world to capitalism" (2005:51). While their work is informative with respect to the international dimension of national industries and shedding light on the importance of institutions and regulation, it can also be criticized for a nearly total neglect of the role of the producer in the film industry, consequently depriving their analytical framework of a key agent. Furthermore, their depiction of greedy US studios stands in stark contrast to a very idealized view of the European film industry, that leads them to marginalize competition between studios, independents and European states. In his seminal article, Phillips (2004) has finally shed some light on the financing practices of US film companies, describing how Hollywood studios have exported financial risk to foreign investors to maintain the viability of their production system. While not denying that the film industry is characterized by a high degree of demand uncertainty, Phillips' argument exemplifies a shared distrust of authors belonging to the political economy perspective in Hollywood economics' central premise, namely that "nobody knows anything". As Phillips' work can be interpreted, "somebody knows something", and this makes Hollywood not a risky business, but an industry shaped by asymmetrical power structures.

While the Hollywood economics perspective can be criticized for being largely ignorant of the other two strands, there is some cross-referencing to political economy studies in economic geography accounts, as economic geographers recognize that industrial structures need to be considered within their institutional and political contexts and history. References to economic geography accounts in political economy perspective are more rare, with political economists indicating little interest in explaining spatial distribution and organizational patterns of production. In this study I will repeatedly draw on work from authors which can be attributed to the political economy perspective, particularly to inform my understanding of film financing, market structure, regulation and business practices, to the extent that these factors can provide insights into changes in production patterns.

2.3 Creative Industries Literature

Besides the literature that directly deals with film production, the industry is also the subject of research in academic work on the so-called creative industries - a group of industries sharing a number of common characteristics, which taken together, are said to form an important and fast growing sub-sector of the wider economy. Scott (2004:462), drawing on Bourdieu (1971), has defined creative industries (cultural product industries) as industries that produce "goods and services whose subjective meaning, or, more narrowly, sign-value to the consumer, is high in comparison with their utilitarian purpose". The outputs of these sectors have social symbolic connotations, allowing cultural-products industries to be identified in concrete terms as an:

> *"Ensemble of sectors offering (1) service outputs that focus on entertainment, edification, and information (e.g. motion pictures, recorded music, print media, or museums) and (2) manufactured products through which consumers construct distinctive forms of individuality, self-affirmation, and social display (e.g. fashion clothing or jewellery)."*
>
> **Scott (2004:462)**

In a similar vein, Caves (2000) has defined creative industries as industries that supply goods and services that are broadly associated with cultural, artistic, or entertainment value. As such, the creative industries include a variety of heterogenic sectors such as book and magazine publishing, the visual arts, the performing arts, sound recording, fashion, toys and video games, TV films – and the film industry.

Scott (2004) has argued that, taken together these industries constitute what he calls the modern cultural economy, and are bound together, as an object of study, by three important common features. (1) Firstly, and in correspondence with the other definitions given above, activities in these industries are associated with the creation of aesthetic and/or semiotic content. (2) Secondly, he argues that these industries are subject to Engels' Law, meaning that as disposable income expands, so does consumption of cultural goods and services (Scott, 2004:462; Beyers, 2002).[6] This observation is in line with recent World Bank reports (2003) which have identified the creative industries as one of the fastest growing, most skilled and IT-intensive sub-sectors of the world economy, with Ryan (2003) estimating that in G7 countries more than 50 per cent of consumer spending is now on outputs from creative industries, as global demand for creative products continues to surge. Rifkin (2000) has furthermore proposed that there is a wider economic shift from industrial capitalism to a form of cultural capitalism, in particular where economic growth is based on deriving economic rents from intangible

[6] This second characteristic is in line with the above mentioned observation by Ryan (2003) that consumer spending rapidly increases in developed countries.

assets and intellectual property. As a result, cultural production has been heralded both by industrialized and developing countries as a new engine for economic growth, with the OECD millennium report anticipating the coming of "the creative society of the 21st century" (OECD, 2000; Keane, 2004:3). (3) Thirdly, and of great relevance to this study, Scott proposes that as distinct feature of this cultural economy, the production of these goods and services are typically found in specialized clusters or industrial districts, thus taking a very distinct form of industrial organization.

Caves (2000) lists a number of other common features of creative industries, such as that (4) creative workers care about their product, (5) products are usually differentiated and require both creative and "humdrum" skills to be produced, and (6) most importantly that nearly all creative industries can be described as being shaped by a high degree of demand uncertainty. A seventh characteristic (7), not explicitly expressed by Caves but prevailing through his work, is the strong importance of contracts and business practices in these industries, as formal and informal forms of governance.

With respect to these seven criteria (Scott and Caves), the film industry can be considered as an archetypical creative industry, possessing all the characteristics outlined above.[7] Miller *et al* (2005) have further argued that among the creative industries the film industry should be considered as the most important, as it strongly influences the other sub-sectors, and is by far the most popular, even if the television or games industry might generate more revenues in total. This view is also held by Lukinbeal (2004), who has argued that in particular the American film industry is central to the concept of cultural industry (duGay, 1997), as the messages films transport occupy a prominent role in our cultural system (Jowett and Linton, 1989), acting as signifiers for both social and cultural space.

In this respect, I see this study as informative for the wider creative industries literature, and propose that its findings can form the starting point for similar enquiries in related

[7] In this thesis I will in particular explore and contribute to the ideas that film production takes a distinctive form of industrial organization (3), the film industry is facing a high degree of demand uncertainty (6) and that contractual agreements and business practices play an important role in the industry (7).

industries. However, as it is not the main aim of this research to contribute to comparative industry analysis, creative industries literature, and literature on other creative industries will not be reviewed in depth.

2.4 Economic Geography Approaches

2.4.1 From Flexible Specialization to the Cluster

I will begin my review of organizational literature on the film industry by briefly discussing the debate around flexible specialization in the film industry (Christopherson and Storper, 1986; Storper and Christopherson, 1985; 1987; and Storper, 1989), which in many respects has formed the basis for all subsequent studies interested in the organization of industrial production in the film industry. The "Christopherson and Storper story" (Scott, 2005:37) begins with a description of film production in the "golden age" of Hollywood, which lasted from around 1920 until the late 1940s (Schatz, 1988). Christopherson and Storper describe film production in the studio system as a factory-like process of mass production, under the control of the seven large, vertically integrated major companies. Having control over the entire motion picture commodity chain, ranging from development to production, distribution and exhibition, the majors had in this time period a guaranteed outlet for their films irrespective of quality, and were therefore able to reduce risk and provide stability in the organization of production (Christopherson and Storper, 1987). In 1948, the Supreme Court undercut the studio system with the so-called "Paramount decision", forcing studios to divest themselves from exhibition chains. Without a guaranteed outlet for their product and new competition from television, studios suddenly found themselves exposed to a high degree of instability in the industry, which rendered, as Christopherson and Storper argue, studio based mass production unsustainable. From 1950s to 1960s, the major studios continued to dominate production within a hybrid structure of independent and studio production, but increasingly the mode of production in the industry began to shift in a process of vertical disintegration: according to the authors, the majors divested themselves from production and contractual agreements, and began to outsource production to independent companies, assuming instead the role of "nerve centres" of vertically integrated production networks. This outsourcing process, was followed by a phase in which a large number of small, flexibly specialized firms sprang up to provide direct and indirect inputs to the majors.

This heralding of a whole industry's transitioning from mass production to *flexible specialization,* by replacing vertically disintegrated large firms through an associated rise of specialized small firms, has led some authors to claim that the film and television industries were not just part of international changes in the modes of production, but ahead of them (Shapiro *et al*. 1992; Barnatt and Starkey, 1994). However, the application of the flexible specialization concept to the film industry also spurred the strong critique of a number of academics, such as Aksoy and Robins (1992), Balio (1998), Gomery (1998), Litman (1998), Schatz (1997), and Blair and Rainnie (2000), who have convincingly shown that Christopherson's and Storper's characterization of organizational developments in the film industry was severely flawed in both empirical and theoretical respects. Askoy and Robins (1992) in particular, have criticized the flexible specialization thesis as being overly simplistic and inadequate in recognizing or emphasizing the forces driving restructuring in the US film industry. They have criticized Storper and Christopherson for overemphasizing the production process, while at the same time neglecting distribution, exhibition and finance – which for them are the crucial stages of the whole media production process. This has been also criticized by Wayne (2003:3), who argues that it is *"highly misleading to apply the term vertical disintegration to the production sector alone, when questions of market dominance are assessed by the vertical links across production, distribution and exchange*".

Aksoy and Robins have particularly blamed Christopherson and Storper for failing to recognize that the independents never operated on the same power level as the studios. Highlighting the importance of distribution, Askoy and Robins (1992:6) argue instead that oligopolistic control never ceased to be a distinguishing feature of Hollywood, and although more production was conducted by independents from the 1950s onwards, Christopherson and Storper have failed to take into account that films from the independent sector were in turn increasingly financed and distributed by the majors:

> *"By holding on to their power as national and international distribution networks, the majors were able to use their financial muscle to dominate the film business and to squeeze or use the independent production companies. Independent production was used to feed the global distribution networks that the majors had built."*
>
> **Askoy and Robins (1992: 9)**

Ultimately, they blame Christopherson and Storper therefore, for failing to recognize the economics at work in cultural industries, as they are only interested in applying their flexible specialization concept to the film industry, even if their argument becomes simplistic and over-generalized (Askoy and Robins, 1992: 6-7). Blair and Rainnie (2000) have further argued that the relationship between majors and independents as outlined by Christopherson and Storper is far from being new, pointing towards the relationship of British independents and US studios. Instead of being equals, the role of independents in the film industry is according to the authors mainly to attract risk capital and creative talent that the majors can then exploit through their control of distribution (2000:191; Wasko, 1982; 1994). Blair and Rainnie (2000) have further highlighted that Gordon (1976), predating the debate on flexible specialization, had already observed that disintegration was in fact not taking place, as production, finance and distribution of films remained irrevocably linked.

> *"Institutions that had gone into film financing and production without having control over a distribution organization outfit had not lasted. Equally, those distribution organizations that gave up film financing and production (e.g. the Rank Organization in the UK) have ceased to be significant world distributors. Furthermore, bringing a welcome breath of reality to the new independent producer mythology, Gordon concluded that 'on the whole, producers have found that the one thing worse than being involved with a major was not being involved with a major'. (Gordon, 1976:461)"*
>
> **Blair and Rainnie (2000:192)**

In addition, Blair and Rainnie (2000) have also called Storper and Christopherson's description of the studio area as Fordist production an outright mischaracterization, blaming the authors for creating a mis-directed historical trajectory for organizations in the US film industry. Blair (1999), with respect to Staiger (1995:93), has in particular argued that in filmmaking mass production has never reached "the assembly-line degree of rigidity that it did in other industries". Instead, film has always been a highly differentiated product, requiring a high degree of specialization even in the studio system. While there is a certain tension within film production between standardization and differentiation, following Staiger (1995), it can be argued that specialization is a longstanding response to increasing product complexity in Hollywood, due to the introduction of sound and other technical innovations.

2.4.2 Film Production as Project Organization

Although Christopherson and Storper's application of the post-Fordist flexible specialization thesis to the film industry, has been heavily criticized, it has formed the starting point for nearly all subsequent studies on the film industry, most notably by establishing the research focus on *inter-firm relationships*, and not the firm, as the primary locus of action in the film industry. Underlying this focus on inter-firm relations is the recognition that film productions are essentially one-off *projects*. Lorenzen and Frederiksen (2006) have defined projects as constituted by different skill-holders (economic agents with specialized competencies) collaborating over a pre-determined time period with the aim of completing a pre-specified (and sometimes one-off) complex task. Because of the complexity of a task that necessitates the coordination of multidisciplinary skills, they argue it is usually not economically efficient to bring these skill holders together on a permanent basis. Hence, after the completion of the project, the project team is usually disbanded. As each film project requires a novel combination of creative and "humdrum" competencies, the project is favoured as the dominant form of coordination in cultural production, as it offers advantages in terms of flexibility and experimentation (Cole, 2004:6). In the studio era, with distribution guaranteed, film projects were carried out under a studio umbrella, as the economics of scale of ongoing project organization allowed to bring skill holders together on a permanent basis within one *firm*. However, with the break up of the studio system and the ensuing increase in demand uncertainty, production inputs were assembled for projects on a more flexible basis, and the project has been more clearly recognized as the key characteristic organizational unit of the film production sector.

Besides creative and economic reasons facilitating project organization, Lorenzen and Frederiksen (2004) have furthermore attempted to explain project organization in industries characterized by product experimentation and high demand uncertainty, from an evolutionary standpoint, arguing that in such industries economic selection operates on the project level rather than on firm level. By "weeding out unsuccessful products"

(2004:5) rather than agents, economic selection on project level is therefore more rapid and cheaper for the whole industrial system than economic selection on firm level. A high degree of selection consequently allows for a high rate of experimentation, which is identified as a factor for success in industries ruled by economies of speed (Galbraith, 1995), with short product life cycles and short time-to-market. As Lorenzen and Frederiksen argue, with reference to Carlsson and Eliasson (2001):

> *"For example, even with many films flopping in the film industry, most firms and artists survive by spreading risks, participating to parallel projects and thus experimenting with several products at a time. Hence, their managerial and artistic competencies are not lost to the film industry, even with a high rate of product failures. Project organization means that agents who may be tomorrow's winners are not weeded out together with today's losers."*
>
> **Lorenzen and Frederiksen (2004: 7-8)**

This observation furthermore points towards the argument that in creative industries inter-firm networks are strongly dependent on inter-personal networks, particularly on the local level (Grabher, 2002). While Lorenzen and Frederiksen have not drawn a clear link between project organization and the legal and financial status of projects[8], setting up individual companies thereby also fulfils the function of shielding the producer and parent companies from financial debt and legal consequences. The film industry can thus be seen as an archetypical project based industry that is strongly reliant on inter-firm networks. [9] This form of organization is seen by some authors as progressive, with, for example, Whitley seeing the film industry as being ahead of other industries:

> *"The growing use of projects as coordinating mechanisms, project-based firms (PBFs), in which the company as a legal and financial entity becomes project specific, and is often dissolved upon successful completion of project goals, seems to be spreading from the*

[8] It is therefore also left completely unclear in Lorenzen and Frederiksen's model who finally bears the financial consequences of failed projects.

[9] In film production, typically a new firm is set up for each individual film project, and crew and talent are recruited for this project mainly through personal networks (see also Blair *et al,* 1998). In this context, the producer as a person is often more important as a project anchor than the transient company entity under which he operates. Given the significance of personal relations for getting work and for choosing collaboration partners in production, the question might arise whether it would not be more accurate to describe relations in the industry as inter-personal, rather than inter-firm? However, as I would argue, such a view wrongly ascribes what can be beneficial for collaboration as a precondition for collaboration. Furthermore, in large sub-sectors of the industry, and particularly in production services (e.g. equipment rental, post-production), in film financing, film sales and film distribution, company entities are stable and transactions take place between them, and not individuals. For this reason, I have described relations as inter-firm and not as inter-personal throughout the thesis.

> *feature film and other entertainment industries to new media and similarly highly dynamic sectors such as computer software development".*
>
> **Whitley (2006:78)**

In organizational studies on the film industry, the shift in research focus to inter-firm networks has raised the question as to how the project-by-project co-operation of firms in the film industry is reflected in the industrial organization of its productive system. The answer that has been given by mainstream theory is that project organization facilitates industrial agglomerative forces, leading to the formation of *clusters* in the film industry.

2.4.3 The Cluster Concept

As a theoretical concept, the regional concentration and spatial agglomeration of firms in related industries was first observed by Marshall (1890), and has since been explored by numerous authors such as Hoover (1948), Myrdal (1957), Krugman (1991), Amin and Thrift (1992) and Markusen (1996). The cluster has become a popular concept particularly through the work of Porter (1990, 1998), who has defined a cluster as a "geographic concentration of interconnected companies, specialized suppliers, service providers, firms in related industries, and associated institutions in particular fields that compete but also co-operate" (Porter, 1998:197). As Martin and Sunley (2003) have criticized, the cluster concept has so far eluded exact definition, being adopted by academics as it is appropriate, with the authors seeing the cluster increasingly becoming "a world wide fad, a sort of academic and policy fashion item" (2003:6).

A number of arguments have been put forward to explain why clustering occurs, and why co-location is beneficial for firms, particularly in creative industries. Firstly, it has been argued that the viability of a production system based on projects, depends highly on the efficiency of the underlying labour markets, and that specialized labour markets are facilitated by clustering. In a cluster, the risk of investing into building specialized skills is reduced for workers, as the presence of multiple employers enables them to find work on an ongoing basis and move from project to project, without "having to sell the house, move the kids, and create a new social network" (Cole, 2007:8). Project coordinators, on the other hand, are dependent on a specialized labour pool, as project organization, especially in creative industries, requires the repeated reconfiguring of project teams, sometimes on an ad-hoc basis. By co-locating, firms in an agglomeration thus have an advantage over firms not located within a cluster, through better access to labour markets.

Secondly, economic geographers have argued that spatial proximity in a cluster facilitates knowledge exchange and accelerates the spread of best practice in the territorial innovation model[10]. This has been theoretically explained with reference to Granovetter's (1985) concept of embeddedness, which sees the relations between individuals or firms as being embedded in actual social networks. Economic geographers in turn have argued that strong links between firms accrue mainly on the level of the local (within the cluster), whereas external links are usually thought of as weak ties, as Ettlinger observes;

> *"Economic geographic attempts to map the strong/weak-tie dichotomy onto spatial scales regularly result in an ascription of strong ties and social coherence to the local level, while sparse networks are instead associated with the non-local realm."*
>
> **Ettlinger (2003: 160)**

The distinction between strong local ties versus weak external links is emphasized as an argument for clustering, in particular with respect to the spatiality of knowledge exchange. As Grabher (2004:106) notes, dense patterns of local interaction can be read as:

> *"The vital economic assets for 'tacit' knowledge exchange, while the sparse global networks are conceived as the pipes that convey 'codified' knowledge."*
>
> **Grabher (2004:106)**

Thus, with respect to knowledge exchange it is argued by cluster proponents that there is a split of *tacit = local versus codified = global* (Bathelt *et al*, 2004:32), as only through face-to-face (local) communication subtle forms of information can be exchanged. While this somewhat crude split has been increasingly questioned, with for example Coe and Bunnell (2003:441) naming such a conception "dubious", the main assumption that physical closeness facilitates tacit knowledge remains a key argument for explaining clustering though social benefits of agglomeration.[11] The diffusion of knowledge is

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[10] Grabher (2002:246) lists clusters, industrial districts, innovative milieus, learning regions, regional innovation systems and project ecologies as territorial innovation models.

[11] Given the high importance attributed to knowledge exchange as a key driver of economic progress and competitive advantage, or as Grabher has noted: "the historical a priori of the age" (2004:103), it is

furthermore found to be accelerated in project-based industries, as staff takes knowledge from firm to firm while working on different projects (Henry and Pinch, 2000). Thirdly, as Grabher (2004) has observed, within localized communities, firms benefit from 'buzz' or 'noise' (Scott and Venables, 2004), describing information and rumours about market developments generated and picked up by workers, without firms having to search the environment for it. As Bathelt *et al* note, firms do not even have to be organizationally linked to benefit from buzz:

> *"These firms do not necessarily have close contacts to one another or intensive input-output relations involving substantial physical transactions. Rather the respective firms benefit from their co-location through which they are well informed about the characteristics of their competitors products and about the quality and cost of the production factors they use."*
>
> **Bathelt *et al* (2004:36)**

The buzz is transported through a multiplicity of organizational and personal networks that is, according to Grabher (2004:105), the outcome of constant networking in project-based industries, which effaces the distinction between the private and business. Drawing upon a key idea from the literature on situated learning (Lave and Wenger 1991), Grabher (2002a; 2000b) further notes how co-location facilitates the kind of "hanging out" and peripheral participation that allows newcomers to become enculturated into the norms and conventions of the industry, especially in creative communities. In this respect, dense local patterns of interaction within clusters can also be seen as an inexpensive form of governance, reinforcing factors such as trust, social familiarity, institutional coherence and a sense of local belonging (Banks *et al*, 2000). These forms of governing organizational processes in turn play a vital role in industries, where the integrity of the firm is undercut by project organization.[12] In addition, a complementary explanation for

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arguably that this argument in particular has made the cluster such a popular concept with policy makers, as it emphasizes the importance of the local in a globalized world.

[12] While the firm is typically seen as "the elementary unit of collective commercial agency that minimizes transaction costs (Williamson, 1975), and optimizes learning processes", in industries characterized by project organization these organizational boundaries stretch across different firms, and are often only loosely tied to the central management of their home-base. This has raised tangible questions about the nature of the firm as learning organization, and in particular how firm-specific problem solving capabilities can be developed if skilled staff has only very short term and temporary commitments. In case of the film industry, DeFillippi and Arthur (1998) have, in particular, questioned how project-based enterprises can create competitive advantage when their knowledge-based resources are embodied in highly mobile project participants. However it has to be noted that DeFillipi and Arthur's paradox largely stems from a failure to

clustering has also been given from a transaction cost perspective (Coase, 1937; Williamson, 1975). Investigating how the degree of uncertainty an industry faces impacts on industrial organization, Maskell and Lorenzen (2004) have argued that clusters are typical for industries facing high uncertainty. Rather than seeing firms and markets as two forms of diametrical opposed organizations, they argue that firms try to limit their transaction costs through *organizing the market* – and they achieve this through the creation of institutions. They further suggest that depending on the industry's environment (*ceteris paribus*) either network or cluster formation will ensue as the outcome of market organization: Firms that operate in a stable, low uncertainty industry will engage in network formation, while firms belonging to a high uncertainty, unstable industry will tend to form clusters. As the authors propose, firms become "insiders" by investing in building or joining networks in cases of low uncertainty, or cluster-building in cases of relatively high industry uncertainty (2004:993). The reason for cluster formation is thereby straightforward:

> *"With high levels of uncertainty, it makes little sense for firms to engage in network-building with what will soon become yesterday's partners."*
>
> **Maskell and Lorenzen (2004:995)**

Co-location, on the other hand, offers firms a high degree of flexibility without carrying the full costs of a spot-market transaction. This, as Maskell and Lorenzen emphasize, is especially the case in creative industries, where production is non-continuous, project organization dominates and firms need to cooperate with each other only for a given period of time. Clustering is also found to bring down the information costs of firms that are reliant on a high number of weak ties (Granovetter 1985), by spreading information through meetings, gossip and direct observation. Transaction costs are further minimized as clustering encourages "cognitive alignment" which is understood as the development of a "social codebook" that includes collective beliefs, values, conventions and language, and trust. Illustrating their argument on the examples of the furniture industry and the pop music industry, they conclude that:

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understand how film production is organized practically, probably by being too concentrated on its abstract treatment. Phelan and Lewin (1999) have furthermore vehemently rejected DeFillippi and Arthur's argument from a resource based view of the firm.

> *"The spatial arrangement of these industries in industrial clusters represents one particular form of market organization that, over time and through market evolution, has proved to be advantageous for the performance of these kinds of economic activity."*
>
> **Maskell and Lorenzen (2004: 1001)**

While Maskell and Lorenzen's (2004) explanation represents an important and noteworthy theoretical attempt to draw a connection between industrial organization and the degree of demand uncertainty, I suggest that their conception also has a number of shortcomings, namely:

- firstly, it ignores the importance of large vertically integrated companies, possessing significant market clout and the ability to transfer risk within the industrial system;
- secondly, their model is generally overly-deterministic, and allows firms only a very limited degree of agency;
- thirdly, the focus on the firm underplays the importance of the project in structuring the market[13];
- fourthly, the model suggests that only two quasi-optimal market organizations exist, with little scope for other organizational arrangements;
- finally, the categorization is generally highly abstract and simplistic, and thus empirically not sustainable.

In summary, the main theoretical explanations for clustering revolve around social factors and knowledge exchange: Agglomeration is beneficial in project-based industries as it reduces transaction costs on labour markets and facilitates knowledge exchange, learning and innovation. Co-location furthermore reduces the risks of opportunistic behaviour through a combination of non-economic factors such as trust and reciprocity based on familiarity, face-to-face exchange, cooperation, embedded routines, habits and norms, and local conventions of communication and interaction (Hadjimichaelis, 2006:692). With a strong focus on locality, the overall aim of cluster studies lies in identifying

[13] Lorenzen and Frederiksen (2006) have criticized that the literature on the "economics of organization" as represented by authors such as Richardson (1972, competence perspective), Williamson (1985, 2000: transaction cost perspective) and authors representing other contract perspectives (Grossman & Hart, 1986; Holmstrom & Milgrom, 1994; Holmstrom & Roberts, 1998), paying too little attention to how markets become organized.

industrial agglomerations and showing that spatial proximity is important for firms, by studying local inter-firm relations with respect to agglomerative forces.

In the past decade, the theoretical framework of the cluster has been repeatedly applied to the film industry, firmly establishing that clustering is a key characteristic of cultural production (Scott, 2000). In the following section, I review these empirical studies and argue that the focus on local relations has increasingly become a limitation, with studies repeatedly finding that relations transcending the agglomeration are equally important for film producers. An increasing disparity between theory and empirical findings in cluster literature has resulted from this.

2.4.4 The Cluster in Film Industry Studies

Following the extensive work of Scott on the film production complex in Hollywood (1997, 1999, 2002, 2004, 2005), agglomerative forces and clusters have been observed and described as a dominant characteristic of the productive system of the film industry by nearly every study on film and creative industries in the last decade. Besides Hollywood, film industries have been found to be organized in clusters for example in Vancouver (Coe, 2000; 2001), Hong Kong (Kong, 2005), London (Nachum and Keeble, 2003), Bristol (Bassett *et al*, 2002), Toronto (Vang and Chaminade, 2007), Munich (Kaiser and Liecke, 2007), Leipzig (Bathelt, 2001), and Potsdam (Krätke, 2002).

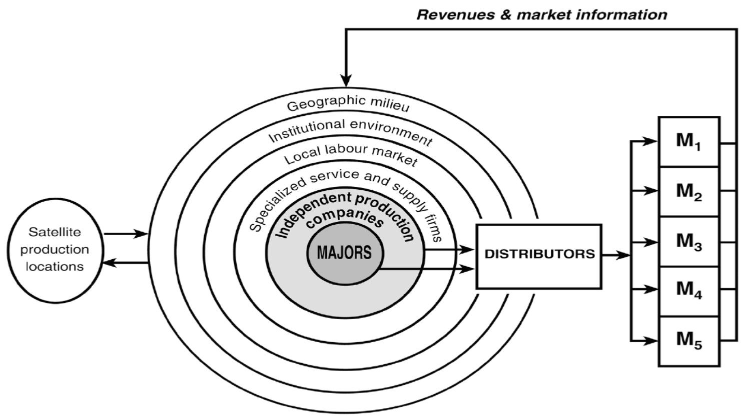
For Scott (2005), understanding agglomerative forces is therefore crucial for understanding creativity and innovation in the cultural economy. Mapping film companies in the LA region and demonstrating their spatial proximity, Scott (2005:35) has described Hollywood as a "distinctive geographic phenomenon, which, right from its historical beginnings, has assumed the form of a dense agglomeration of motion picture production companies and ancillary services, together with a distinctive local labour market". At the heart of the Hollywood production system made up by co-locating firms, is as Scott proposes, an essentially bifurcated system, consisting of a "prevailing pattern of major and independent film production companies, intertwined with ever-widening circles of direct and indirect input suppliers" (Scott, 2005:41). In this bifurcated model, firms interact with each other in complicated ways, as film projects move through the production stages from pre-production to production and finally post-production. On the whole, film production can be seen, in this system, as consisting of two groups; firstly the majors and their subsidiaries, and secondly a mass of independent production companies whose "sphere of operations rarely or never intersects with that of the majors" (2005:47).[14] Since the beginning of the 1990s this bifurcated system has however "gradually given way to a trifurcated pattern" due to the expansion of the mini-majors (2005:149). The mini-majors (the majors' subsidiaries - New Line, Miramax, etc) are described by Scott as quasi-independent production and distribution entities, functioning in "intermediate markets" between the majors and the more traditional independents. They act as "scouts" (2005:147) for their corporate owners to identify market trends early on, but are also carving out a "very definite middle-range market niche" for themselves. Overall, Scott describes competition as high within each of the three layers, but more limited between them, with the majors having a tight oligopolistic hold over the upper levels of the market, strengthened by using the subsidiaries as an intermediate buffer zone.

Ultimately, for Scott, Hollywood is not just a business model, but a unique geographical entity, with a distinct structure as a production locale comprising distinct functional and organizational features. In contrast to Miller *et al* (2005), who have described Hollywood by quoting director John Ford as, "a place you can't geographically define. We don't really know where it is," for Scott, Hollywood is exactly the opposite, a distinct place that is defined by a series of overlapping production networks in various states of vertical disintegration, supported by a strong local labour market that is continuously replenished by new talent from the rest of the world. These production networks are furthermore supported by a number of organizations (such as the unions), forming an institutional

[14] Scott underpins this argument with a speculative model of hierarchical market relations in the film industry that is based on two assumptions. Firstly he assumes that it is possible to identify different types of films in terms of different market segments (low budget films for limited audiences, middle-range films for selective but wider audiences and blockbusters for mass audience appeal). The second assumption is that the expected gross box office receipt is correlated with the amount of money invested in a film. The production budget has been identified among other factors as an important element for expected returns by de Vany and Walls (1997). Where this investment is coming from (the film finance) is, however, not clarified to great extent, with Scott ascribing the finance function either to the majors, or treating it as inherent to the production process.

environment that can exert "considerable influence over the developmental trajectory of the industry" (Scott 2005:47) and a regional milieu that is a repository of crucial resources for the industry. **Figure 2.1** sums up Scott's schema of the Hollywood motion picture production complex and its external spatial relations.

Figure 2.1: Schema of the Hollywood Motion-Picture Production Complex and Its External Spatial Relations



M1 – M5 represent markets, differentiated by niche and by geography

(Source Scott 2002:964)

With respect to the external relations of Hollywood, Scott is mainly interested in "satellite production locations". These satellites represent film industry centres in North America and internationally that have grown by servicing incoming runaway productions from Hollywood. Runaway productions occurs, according to Scott (2002), mainly for two reasons, namely in search for realistic outdoor film locations (creative runaway) or to reduce production costs (economic runaway). The main external relations described by Scott are thus sought from within the cluster from a position of power.[15] With a strong focus on locality, Scott's treatment of the external relations of the cluster in Hollywood is arguably less extensive than his analysis of cluster internal relations. This, as I will elaborate on later, is the consequence of similar shortcomings in cluster theory, which

[15] *Vice versa*, the relations of satellite production clusters to Hollywood can therefore be assumed to be characterized by dependence, and in film industries that are dependent on Hollywood, external relations can be assumed to be at least as important as local relations to firms.

overemphasizes cluster internal relations at the expense of relations and dynamics, which transcend the agglomeration.

As Hollywood is widely regarded as the archetypical centre of global film production, the majority of subsequent studies on the film industry have attempted to replicate Scott's theoretical framework and findings for other industries. These studies have thereby largely followed the same research pattern of firstly identifying a cluster, and then describing its internal relations and dynamics, with film production occurring outside this paradigm (such as co-productions), largely being left out of the analysis. The study of the film industry in organizational literature has thus increasingly been narrowed to the study of film production in clusters. Despite applying a cluster framework, these studies have however increasingly produced empirical evidence, that extra-local linkages are equally important to firms in the agglomeration as are local connections. Therefore, an increasing disparity between empirical studies on the film industry and theoretical explanations for clustering has become apparent in the literature. As Britton has commented:

> *"Mainstream theory explains empirically observed local networking, but regional industrial enquiries generate evidence of important extra-regional linkages."*
>
> **Britton (2004:371)**

Of key importance in this respect is the work of Coe (2000a, 2000b, 2001), who has made the significance of external linkages and cluster-transcending dynamics for industrial development explicit in his work on the Vancouver film industry.

2.4.5 External Relations

In a series of articles (2000a, 2000b, 2001) Coe described the evolution of the Vancouver film industry as the development of a satellite production location to Hollywood.[16] In contrast to the Hollywood production complex, which rests in Scott's depiction largely on strong internal linkages, Coe argues that the Vancouver film industry is characterized equally by its strong external linkages: the industry is dependent on servicing incoming film and television runaway productions from Hollywood, with US capital accounting for

[16] With respect to the type of cluster, he classifies the film industry thereby as a hybrid agglomeration between a Marshallian district and a satellite platform (Markusen, 1996).

some 80 per cent of the financing sources since the industry emerged in the late 1970s. As both the total level of location shooting and the relative fortunes of different production sites tend to fluctuate from year to year, this puts the film industry in Vancouver into a precarious existence, as its rise and fall largely depend on fluctuations that are governed by external factors, such as exchange rates, labour costs, restrictions on foreign earnings, and available tax shelters (Coe, 2000a, see also Gasher, 1995).

In order to reduce this dependency, Coe describes a number of cluster-internal dynamics emerging to adapt to production fluctuation. The most important development in this respect is a re-orientation of production companies, which move from being simple suppliers of services to developing their own film projects. This leads, according to Coe, to a growth in indigenous innovative capacity that reduces the reliance on "cost-driven vertically disintegrated Hollywood projects, towards progressive small-firm networks with external economies" (Coe, 2001:1768). This development is accompanied by an increasingly "progressive institutional environment", represented through seven unions, the British Columbia (BC) Film Commission, the BC Motion Picture Association and a BC branch of the Canadian Film and Television Producers' Association (CFTPA). However, as Coe observes, even when producers succeed in developing their own projects, they mostly have to turn to outside financing sources to make projects viable (2000b: 398), while (and) in the process, often have to cede distribution rights and therefore commercial independence to third parties.

As Coe points out, one way for producers to get access to financing while circumventing the dependence on the US market and US financing, is to *co-produce* films with other countries, a strategy embraced by Canadian producers since the 1960s (Pendakur, 1990). As Coe notes, managing co-productions requires, however, the establishment of new inter-personal relationships, which in turn is costly as it requires a considerable amount of travelling and self-marketing (Coe, 2000b). While Coe sees "soft" economic factors, such as physical proximity, a common language and a similarity in both physical and cultural landscapes to the US, as favouring Canada as a runaway location, and his main research interest is how internal relations within the agglomeration evolve to meet the dependence on external relations, he acknowledges that the development and precarious existence of the cluster ultimately depends on attracting and managing increasingly mobile capital. This capital in turn is attracted to Canada mainly because of the two "hard" economic factors of a favourable exchange rate and the Canadian tax incentives for film production. Canada offered tax incentives for film production as early as 1954, and has adapted its system ever since. The longevity of such financial schemes reflects for Coe, the importance placed on attracting runaway productions at a national level, even if public funds are in essence used to subsidise wealthy US studios and production houses (Coe, 2001).

In summary, Coe's study of the Vancouver film industry can be seen as a clear demonstration that extra-local linkages are as important to producers as local relations. In addition, it becomes apparent in Coe's description of the industry, just how dependent film production on the whole is on gaining access to financing sources, and how internationally mobile capital can easily re-distribute production to locations such as Vancouver. Furthermore, he has also acknowledged the importance of state intervention as a factor that can mediate this capital flow. Besides being a study of the evolving internal relations of a distinct production cluster, Coe's work can thus also be seen as a study of cluster external dynamics, and here in particular as the dis-embedding forces of globally mobile financial capital and state intervention, which have laid the foundation for the emergence of the cluster in the first place.

2.4.6 Disparity Between Theory and Empirical Findings

Subsequent studies on the film industry outside the US have largely concentrated on corroborating and contributing to the idea that film production is organized in clusters, following Scott's proposition that clustering is universally characteristic for cultural and hence film production.

Bassett *et al*. (2002) for example, investigate the natural history filmmaking cluster in Bristol with respect to beneficial agglomeration effects. They characterize the strength of the cultural cluster in terms of traded and untraded interdependencies[17] (Huggins, 2000), "institutional thickness" (Amin and Thrift, 1995; Giordano, 2001)[18] and knowledge transfer facilitated by spatial proximity. Underlying this line of research is Scott's (2000) argument that the survival and growth of cultural industry clusters often depends on various forms of more formal, institutional support, ranging from public-private partnerships to media development agencies, professional bodies and export promotion agencies. Although they do not conceptualize it further, Bassett *et al* highlight especially the importance of a film festival for the cluster, which brings together experts in the niche area of nature documentaries from around the world, providing a source of information about forthcoming commissions, new-filmmaking techniques and emerging broadcasting technologies.

Kong (2005) identifies a cluster in the film industry in Hong Kong. Aligning the discussion to the wider debate on cultural industries, she follows Pratt's observation that one of the most important assets of cultural producers is their address book (2000:14), that is to say, their network of contacts. Examining social networks in the Hong Kong film industry, she finds that these networks are densest within Hong Kong itself, but also have a clear international dimension through co-productions. Kong also briefly makes the high risk of investing into film the subject of her discussion. As she notes, this high risk "is evident in the difficulties that firms of all sizes and ambitions have in securing bank loans to finance their ventures" (Kong, 2005:66). She explains this aversion of banks to invest into film with a lack of familiarity with the industry, the decline of the Hong Kong film industry in general, as well as uncertain revenues and high competition because of imports and high levels of piracy. In summary, Kong therefore proposes that the main reason why producers in the cluster develop external links, is to overcome the lack of financing at the local level.

[17] Traded and untraded interdependencies describe various aspects of informal networking which underlie relationships of trust and reciprocity as well as tacit codes of conduct.
[18] A web of supporting organizations such as financial institutions, chambers of commerce, trade associations, training organizations, local authorities, and marketing and business support agencies.

This work corresponds with the findings of Nachum and Keeble (2003) who have studied the nature of external linkages in the media cluster in central London. They suggest that local business clusters are increasingly drawn into a web of global corporate networks, and are not confined by local ties only. This development goes hand in hand with a narrowing of "functional competencies" undertaken locally, and an internationalization of the scope of interaction of firms in clusters. As they note, these processes suggest that:

> *"Local relationships on their own may be insufficient to understand the nature of external linkages of firms. Rather firms are subject to a combination of local and global forces and relationships, with the distinction between them becoming blurred."*
>
> **Nachum and Keeble (2003:461)**

However, both local and international relations follow a distinct logic. On the one hand Nachum and Keeble see a clear advantage in being located in a cluster that provides an "exceptional pool of creative employees" (2003:465), with Soho firms relying heavily on this local pool. However, in order to reap the benefits of scale and respond to global competition and demand, firms increasingly have to extend the geographic scope of their external linkages. A major function of external relations is found again in acquiring finance; as the authors observe, for film producers who maintain high local linkages and moderate international ones, the "major drivers beyond their international linkages are the search for sources of finance and access to knowledge needed for shooting films in other countries" (2003:470). Likewise, the success of many media producers is heavily dependent on financiers and distributors. Although the source and control of these resources is often global, they note that arrangements in this area are often based on personal knowledge and trust, adding a dimension of locality and embeddedness to external relations. Nevertheless, they conclude that the "dependency of Soho on Hollywood is likely to give global linkages critical value, in part eliminating the importance of local ones" (Nachum and Keeble, 2003:36).

When comparing cluster theory with the empirical findings of these studies, several shortcomings of the current literature become apparent. The first disparity, as observed by Britton (2004:371), is that "mainstream theory explains empirically observed local networking, but regional industrial enquiries generate evidence of important extra-regional linkages", or as Coe and Johns (2004:188) have strongly criticized, the preoccupation with industrial districts and clusters of studies on the film industry runs into the danger of "over-privileging the importance of local institutional and organizational network relations", and downplays "the significance of a range of extra-local network relations upon which the nature, or indeed the very existence, of these formations may depend". The second disparity is that cluster theory has directed the research focus of empirical studies mainly towards social factors of agglomeration, such as knowledge exchange as a key industry dynamic; but that these empirical studies show that factors which have their origin on higher aggregate levels (the national and international level) can impact strongly on industrial organization, facilitating both agglomerative and dis-agglomerative developments. These two points can be exemplified by comparing, for example, the suggestions of the "localized learning perspective" as put forward by Maskell and Malmberg (2001; 2002) with Coe's empirical findings on the Vancouver film industry. The localized learning perspective is in many ways a summary of the key arguments put forward for clustering by economic geographers, in an attempt to develop a general knowledge-based theory of the cluster and the benefits that may accrue from close geographic proximity in terms of innovation and learning. As Maskell and Malmberg propose:

> *"Once a dominating knowledge base and institutional pattern has been created, it will attract those firms and individuals most compatible with it. Together, they both utilize and, by doing so, reinforce the existing knowledge base and institutional pattern, thereby setting the frame for the kind of activities that might be likely or even possible to perform presently or in the future. In an aggregate setting, the process of cumulative causation favors industrial specialization and territorial differentiation and helps explain why no competitive region or nation can remain a jack-of-all trades."*
>
> **Maskell and Malmberg (2006: 3-4)**

This emphasis on clustering stands in contrast to Coe's analysis of the Vancouver film industry, where knowledge exchange plays only a very secondary role. Instead, the importance of external relations, the Canadian tax incentive legislation and a favourable exchange rate are highlighted as being crucial for attracting international production to Vancouver. With a strong focus on local linkages, it can thus be contended that the economic geography framework as it is presently applied to the film industry, is not only restricting empirical research but also leads to a misconception of cultural production through an overemphasis of social factors and locality. This shortcoming with respect to the conception of cluster external relations and industry drivers is particularly apparent when looking at the picture of the whole production system of the film industry that emerges from the literature.

2.4.7 The Global Production Landscape

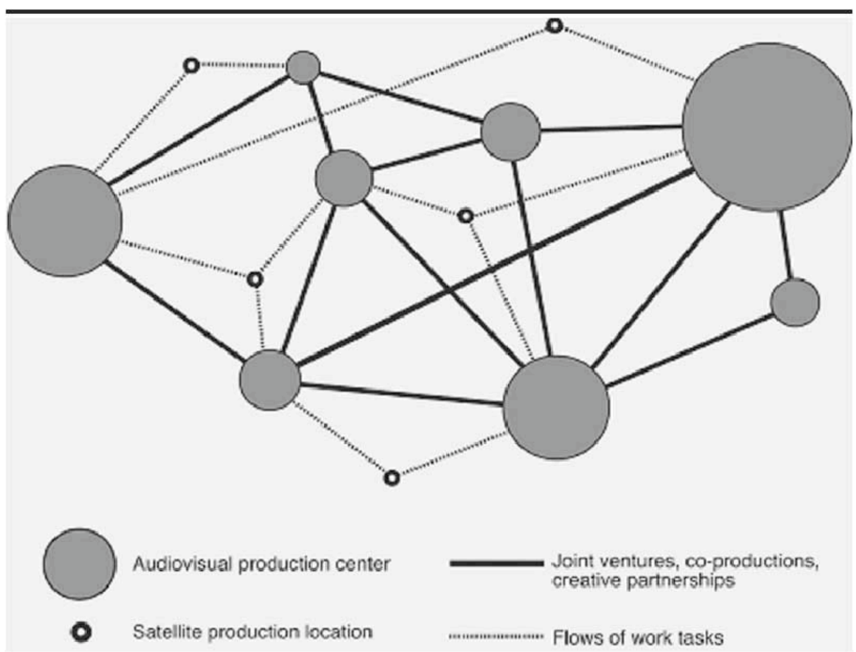
With respect to the global production landscape, two tiers can be distinguished in the current literature. The first one, enacted from Hollywood, includes the film production complex in Los Angeles and its satellite production locations, which develop through the re-distribution of production from this cluster. The film industry in LA, as well as its satellite production locations, are thereby made up of spatially proximate firms which in line with cluster literature, benefit from dense local relations, a developed institutional environment, specialized labour markets and local knowledge exchange. Following Coe (2001:1760), these clusters have also important external links, with especially satellite locations being dependent on finance from Hollywood.

According to the literature, the pattern of film production observed in North America is also typical for the second tier of non-US film production. Internationally, films are also found to be produced in agglomerations with strong local links, although nearly all studies specifically point towards the importance of external relations with respect to finance. The analyzed clusters can be said to fall into two broad categories, namely into clusters which predominantly develop their own product (LA, Bristol, Hong Kong) and clusters which are to a certain extent dependent on servicing incoming productions (Vancouver, London). While the former clusters grow more organically through internal production, the latter's growth is more dependent on re-distributing production from elsewhere. This suggests that film production is, to a lesser degree, embedded as the theory suggests. Instead, as Coe has proposed, the flexible nature of the film industry production system encourages runaway productions in North America and internationally, while in the US the territoriality of the overall production system must be considered to be shifting towards a more dispersed pattern (Coe, 2001:1759). Overall, the global production landscape extrapolated from the literature can be described as an atomistic "multiplicity of local production centres" (Scott, 2004) in different countries.

As these centres are mostly studied in isolation and as local phenomena, there are rich findings available on their inner linkages, but little information available on their external links, other than that they are important too.

In an attempt to predict the global landscape of the audiovisual industries in the "not-too-distant future" (2004:474), Scott has speculated that production is shifting towards a more dispersed pattern, with this multiplicity of production centres flourishing alongside Hollywood in a "landscape of global extent punctuated by occasional dense production agglomerations". **Figure 2.2** sums up Scott's hypothesized view.

Figure 2.2: Hypothesized Global Production Landscape



Schematic Representation of a Hypothesized Global Production Landscape in the Audiovisual Industries

(Source: Reproduced from Scott, 2004:474)

Driven by the opening up of global trade in cultural products, Scott suggests that:

> *"Different centers in different countries will probably not remain hermetically sealed off from one another but rather will tend progressively to become enmeshed in global networks of commercial and creative interactions. In addition […] a greatly expanded system of satellite production locations may come into being in the future on the basis of widening flows of work decentralizing from major creative agglomerations. Some of these satellite locations may even develop in the course of time to the point where they, too, become full-blown creative centers in their own right."*
>
> **Scott (2004:475)**

Against his earlier work, Scott therefore proposes that an alternative system of production may come into being, in which the importance of agglomeration is to a certain extent undercut. As I have already indicated, and will further elaborate in the following sections, such an alternative pattern of production will, however, not be a novelty in the film industry, but has already existed for a considerable period of time in the form of co-productions.

2.4.8 Co-production – An Alternative Pattern of Film Production

Existing literature on film production has proposed that clusters are a common feature of cultural production, with competitive pressures encouraging "individual firms to agglomerate together in dense specialized clusters or industrial districts" (Scott 2004:462). Thus cluster theory suggests that an efficient pattern of film production is one that is predominantly based on local inter-firm relations.

Co-productions on the other hand, are temporary inter-firm networks over a distance, cross-border collaborations pursued by producers for the duration of a film project. As I will show in detail in the following chapter, the volume of film productions that are carried out in this form is significant, and I therefore propose that co-productions represent an alternative (but complementary) production pattern to cluster organization in the film industry, that is built predominantly on external relations.

In order to initiate a co-production, co-producers do not need to be located within a *permanent* industrial agglomeration. Instead, as I will describe, co-producers take advantage of international professional gatherings and trade fairs to meet potential partners, build relationships and initiate projects. Maskell *et al* (2006) propose to view professional gatherings as "temporary clusters" or "temporary nodal networks", arguing that these gatherings are characterized by "knowledge-exchanging mechanisms similar to those found in permanent clusters, albeit in a short-lived and intensified form" (2006:999). The designation is an expression of Maskell *et al*'s (2006) view that temporary and permanent clusters are like "close cousins" which are "both in the same knowledge game"; "have both become important phenomena"; and "both show that geography matters" (2006:1008):

> *"Were it not the case that personal meetings and face-to-face contacts support certain forms of knowledge creation and exchange, presumably neither permanent nor temporary clusters would exist."*
>
> **(Maskell *et al*, 2006:1008)**

According to the authors, temporary markets are thereby not only a rich resource to inform companies about recent market trends, experiences and future product or service requirements, but also serve as primary meeting points for firms on the lookout for suitable partners for future joint innovative efforts and knowledge creation.

The concept of the temporary cluster has not yet been applied to the film industry, however it is possible to identify a description of such a temporary clustering in the literature, namely in Bassett *et al's* (2002) portrayal of the film festival in Bristol. In their study, they particularly stress the importance of the festival as a key event for knowledge exchange and for bringing together professionals from around the world. In retrospect, Bassett *et al* have therefore wrongly ascribed the beneficial outcomes of the festival to the permanent cluster in Bristol. Instead, it can be argued that the benefits for filmmakers travelling to the festival are the same as that for local producers, and that as such, the film festival could easily take place in any other city with the same outcome.

As I will describe in more detail in the next chapter, professional gatherings are the primary meeting place for co-producers. As such they are integral to the coordination and the viability of an industrial system that is based on cluster-external collaborations. However as I contend, this does not mean as Maskell *et al* conclude that temporary clustering is evidence that "geography matters" (2006:1008). While temporary clustering is evidence that human relationships are best formed by face-to-face contact, temporary clusters prove that these relationships can be formed in any generic place, and do not require a distinct place, and that hence, geography matters far less than has been proposed by theory. If knowledge can be exchanged and if partnerships can be initiated in a professional gathering during a short period of time, the need for permanent co-location for these purposes is strongly questioned.

In this respect, co-productions – an industrial pattern in which spatially distant firms enter a temporary collaboration (a temporary inter-firm network) that is initiated at temporary clusters – provide evidence for proponents of the "relational camp", who argue that organizational proximity – referring to the closeness of actors in organizational terms - matters more than geographical proximity.[19] As Amin and Cohendet (2004:93) state: "There is no compelling reason to assume that 'community' implies spatially contiguous community, or that local ties are stronger than ties at a distance." To illustrate the argument that geography in itself is neither a necessary, nor a sufficient condition for creating the relational conditions required to transmit tacit knowledge or build trust, Rallet and Toure (1999) have given the example of two neighbours who share a common wall between their apartments, but may never talk and may indeed have very little in common, whereas either of them can have friends scattered all over the world. Maskell et al (2006:1003) have acknowledged that empirical work has clearly shown that firms "seem fully capable of developing and handling spatially extended network relations", but have argued that these relations "normally follow the value chain of the industry", with value chains overall becoming more global. Co-productions which are horizontal links between producers, are however not relations along the value chain, and thus deviate further from traditional production patterns.

Figure 2.3 sums up the industrial system based on co-productions. In this system, co-producers meet at a professional gathering/ temporary cluster, and then initiate either bi-lateral co-productions connecting two production centers in different countries, or multi-lateral co-productions including three or more co-producers from different countries. Co-producers can come from an established production centre or a satellite production location, but need not be embedded in a production centre at all.

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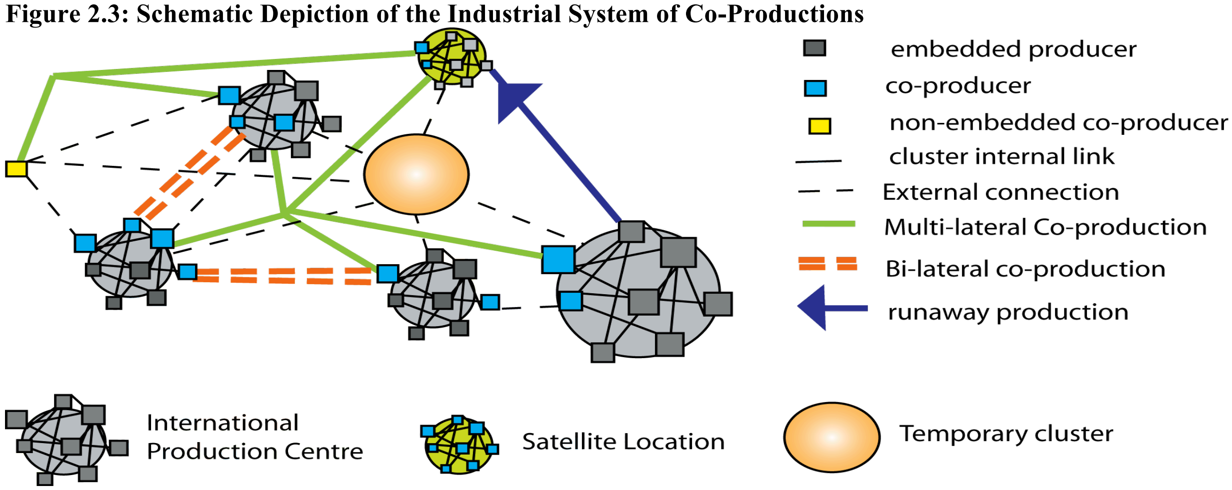
[19] Kirat and Lung (1999) have added the notion of institutional proximity to this concept, and Boschma (2005) has further elaborated this distinction to include the *cognitive, organizational, social, and institutional* dimensions of proximity (Cole, 2007).

Figure 2.3: Schematic Depiction of the Industrial System of Co-Productions



(Source: Norbert Morawetz 2008)

It has to be noted, that the exploration of co-productions in this thesis is not the first case of an alternative pattern of cultural production that has been presented in the literature, but that Cole (2004) has already indicated that an alternative geography of cultural production exists in the European feature film animation industry.[20] As he found, in the animation industry European producers have managed through strategies of co-financing, co-production and outsourcing to compete successfully with Hollywood, leveraging their resources and handling large animation feature film projects, by "stitching together teams of laborers from different countries", while exhibiting no obvious tendencies to localize (2004:6). The result is a production system that shares many qualities of tightly agglomerated clusters, despite being dispersed across production sites in different countries. Cole has named this industrial pattern *"distant networking"*, and has noted several characteristics which enable this mode of production. Firstly, similar to co-productions in the film industry, Cole observes the importance of periodic markets that become temporary centres of the industry, and a crucial factor for producers to maintain "far flung social networks", as they allow a strong cognitive alignment of the industry. A second pre-condition for the viability of distant networking is for Cole, that the labour process of animation can be split up and outsourced, through the use of new information and communication technology (ICT). Currah (2003) has proposed in this respect that

[20] Cole himself credits Norcliffe and Rendance's (2003) examination of comic book production in America as an earlier study that has also found that the social underpinnings of production can stress across great distance.

ICT has a strong potential to impact on the spatial organization of the film industry, and will facilitate network building between clusters, as well as empower new sites of production. A third precondition, as Cole notes, is to be found in the way projects are financed in the European animation industry. Each of the co-producing partners is responsible for raising finance - often from public institutions - in their respective home territory, and is thus also obliged to spend some of the capital in the country. Therefore, two driving factors of this organizational arrangement can be seen, firstly, in producer's lack of, and hence search for, finance as well as in industrial policy that intervenes in the industry to provide this finance. While he has not explored the causes that give rise to this system to great detail, the preconditions facilitating distant networking identified by Cole can also serve as an indication of what factors give rise to co-productions in the film industry.

2.4.9 What Drives Co-productions? Comparing Cluster Theory With Empirical Findings

Cluster literature sees film production as typically taking place within an industrial agglomeration (and thus within a single country), predominantly under the ownership of a single firm, which in the course of the project, subcontracts work to, or collaborates with other companies within the cluster. Firms in a cluster thereby benefit in multiple way from agglomeration effects, with the cluster in general representing an efficient form of production. Why then, in the face of a propagated efficient production method, does an alternative pattern of production exist, that in the case of co-productions, consists of (mainly one-off) temporary inter-firm networks over a distance, and why does it grow? In order to answer this question, I will firstly examine what mainstream cluster literature suggests with respect to why firms seek external relations, and then compare these findings with the suggestions of empirical film industry studies.

One of the most stringent conceptions of firm's cluster external relations and how these connections impact on cluster internal linkages has been proposed by Bathelt *et al* (2004), who refer to trans-local linkages as "global pipelines", borrowing the term from Owen-

Smith and Powell (2002).[21] In line with cluster literature, they focus their discussion mainly on knowledge exchange, and see firms initiating external relations mainly in order to access knowledge pools outside their cluster. With reference to Scott (1998) and Maillat (1998) they note that:

> *"It is the quest for superior rents that compels firms in clusters not to rely on internal or local assets only, but to pursue systematically and sometimes vigorously potentially useful knowledge pools residing elsewhere."*
>
> **Bathelt *et al* (2004:33)**

Maskell *et al*. (2006:998) point out that identifying, selecting, approaching and interacting with new partners is a tricky and costly process, as cooperating firms have to overcome the socio-institutional and cultural environments they are embedded in (see also Schoenberger, 1997; Gertler, 2001; Coe and Bunnell, 2003; Morgan, 2004). Partners can be found through numerous mechanisms such as reputation effects, a mobilization of weak ties or through the use of regular conventions and trade fairs to establish contact with potential partners (Bathelt et al, 2004:43-44). To justify the high investment costs and the allocation of precious resources for trans-local relation building, Bathelt *et al* argue that firms seek to establish long term, stable inter-firm networks ("global pipelines"), as one-off projects do not yield the necessary rents to make such an investment worthwhile. Following their agenda to find positive knowledge effects, the authors furthermore propose that the most important value of external linkages lies in their potential to create value for the firms by enabling access to less familiar bodies of knowledge. With respect to stimulating innovation in a competitive environment, trans-local linkages are therefore crucial for the long term survival of firms within the cluster:

> *"The more firms in a cluster engage in the build up of translocal pipelines the more information and news about markets and technologies are "pumped" into internal networks and the more dynamic the buzz from which local actors benefit."*
>
> **Bathelt *et al* (2004:41)**

Global pipelines are further found to enable local actors to go beyond the routines of local clusters, and therefore prevent lock-in. As Bathelt *et al* conclude, a well-developed system of pipelines connecting the local cluster to the rest of the world benefits individual

[21] Cole (2007) has criticized the term as an inappropriate metaphor, as pipelines usually only flow into one direction.

firms by gaining competitive advantage, as well as the cluster in general, as the knowledge is likely to spill over to other firms in the cluster through local buzz. Bathelt *et al*, therefore argue that the more developed the pipelines between the cluster and distant sites of knowledge, the higher the quality (and value) of local buzz benefiting all firms in the local cluster. However, while external linkages can support regional growth processes, the authors also warn that pipelines can lead to a segmentation among the members of a cluster, reducing its coherence and thus threatening its long-term future (Bathelt and Taylor, 2002). Bathelt *et al*'s treatment of external relations can be seen as exemplary for their conception in the mainstream cluster theory. External relations are conceived of as mainly costly and difficult to build and maintain. They are either pursued by firms for superior profits, or for tapping into distant knowledge pools. In both cases, however, relations over distance are mainly conceived as strong ties that are built with a longer term horizon to warrant the high costs of establishing the relation in the first place. As relations between clusters, external relations serve, according to the literature, the facilitation of innovation, and help to prevent lock-in and over-embeddedness (Uzzi 1996, 1997).

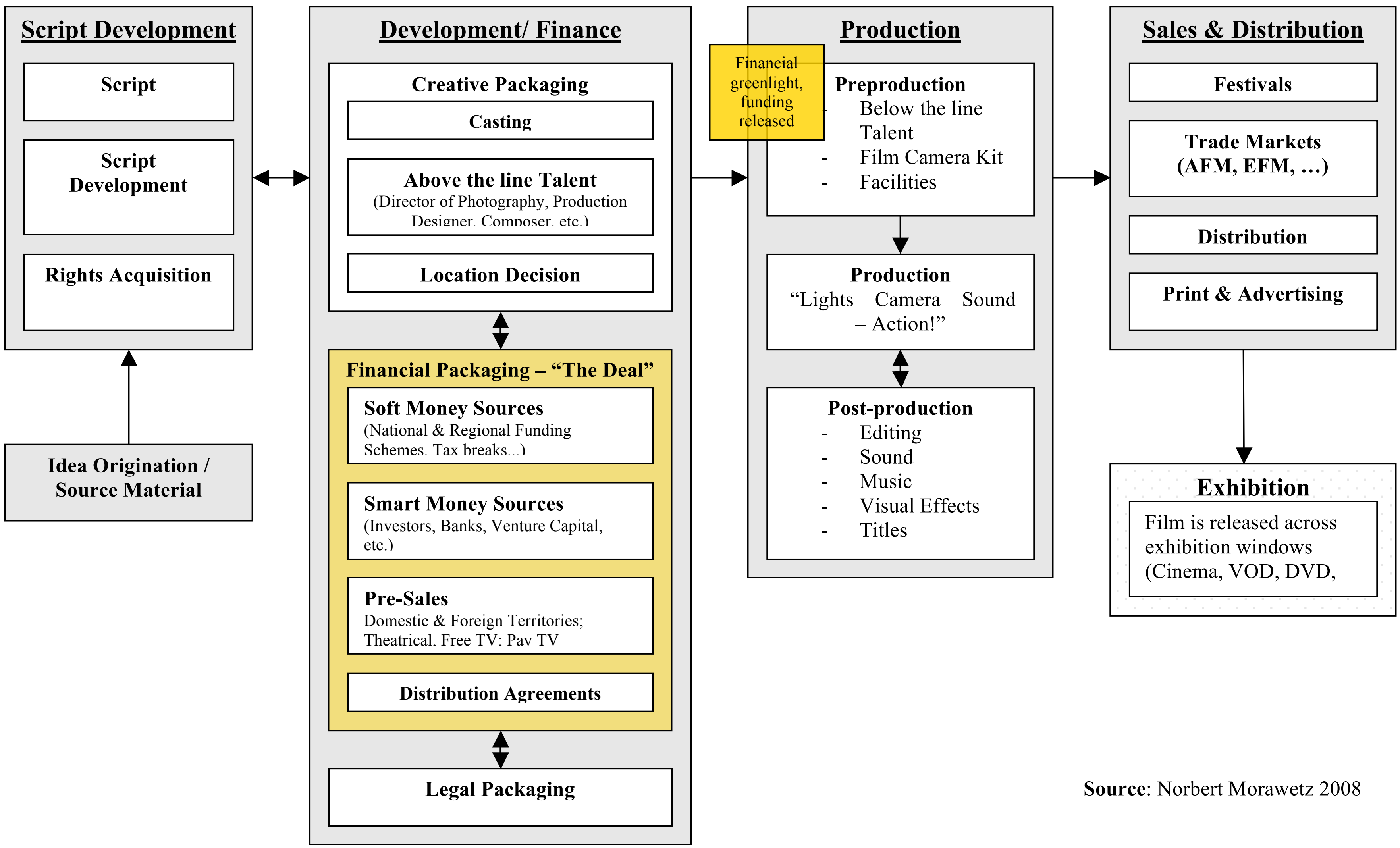
Comparing these suggestions with the presentation of co-productions in the previous chapter, a number of disparities become apparent: Firstly, co-productions do not represent long term connections. While future collaborations between the *same* co-producers are possible, this is not necessarily the case in an industry where firms are short lived, and each project requires a unique combination of inputs. However, in accordance with the literature, co-productions are more expensive to produce than local productions (usually about one third *more expensive* than if production had been carried out by a single firm), and as such do not constitute a cost-efficient form of film production. Secondly, co-productions are typically not more profitable than films produced under single ownership, and thus are not pursued by film producers for superior profits. In this respect, co-productions again challenge the suggestion of the theory, that one-off projects with little guarantee for future cooperation are usually pursued by firms *only for superior rents (*the outsourcing of production for cost reasons, can be subsumed under this goal), especially when the "identification and interaction with new partners across space is a "tricky and costly process" (Maskell *et al*, 2006:998), which is the case with co-productions. Thirdly, and against the repeated suggestion from mainstream cluster literature, neither empirically nor in the existing literature on co-productions is there any indication that co-productions are carried out by producers to tap into foreign knowledge pools or to exchange information – a central explanatory factor of agglomeration studies. While there is certainly an element of first time co-producers learning from more experienced partners, this has to be seen as a side effect rather than the primary objective of co-producing. Taken together, the notions that (1) co-productions are generally *not* more profitable than single-firm productions; (2) co-producers have to share the ownership of the produced film rather than having sole ownership; (3) co-productions do *not* appear to have more international market potential than single nation productions; (4) co-productions are *not* a superior product, but historically have often led to a product that lacks cultural identity and is poor from a creative point of view; (5) co-productions are *not* a cost efficient mode of production, and (6) co-productions do not serve knowledge exchange; they appear as a paradox in the current analytical framework based on cluster literature.

In contrast, as I have already indicated, co-productions are predominantly pursued by producers as a means to pool financial resources, taking advantage of subsidies for film production in multiple countries. Thus, as a pattern of production organization, co-productions can be understood as a reaction of producers to overcome an apparent lack of financing in domestic film industries, by collaborating with distant partners. The key explanatory factors for the spatial dimension of co-production structures seem to be related to the (1) financial aspects of film production, and (2) state intervention into the film industry through specific industrial policies to encourage film production.

2.4.10 Moving Analytical Focus Beyond the Production Phase

Figure 2.4 depicts the filmmaking process from idea origination to exhibiting the completed film in the cinema diagrammatically. As indicated, filmmaking is not a linear process, but particularly in the development phase an iterative process, in which

Figure 2.4: Phases of the Filmmaking Process



Source: Norbert Morawetz 2008

creative, location and financial elements are frequently renegotiated, until the film project represents a viable business proposition for the financiers, and they "greenlight" the film. It is only then that a film enters the production phase. This further underlines the necessity to shift the analytical focus away from production towards activities such as financing in the development phase, as it is here where the spatial dimensions of the production are ultimately decided. As recognized by previous authors, the two decisive relations in development are thereby connections to public institutions/ state funders and private financiers. This is reflected for instance in Coe's work (2000b, 2001) on the Vancouver film industry, in which he notes that producers search for extra-local linkages mainly for financing sources, with the whole Vancouver film industry being driven by logics of trans-national capital on an aggregate scale. Coe also specifically mentions the importance of state intervention through tax incentives for the emergence and growth of the local industry in the first place. Nachum and Keeble (2003) have likewise stressed that global connections in Soho are mainly sought for financial reasons, and Kong (2005) has discussed how difficult it is for film producers in Hong Kong to raise finance, while commenting on the failing industrial policies introduced by local government. Cole in his study on the animation feature film industry has found that each of the co-producing partners is responsible for raising finance from public institutions in his home territory, and thus also obliged to spend some of the capital in the country. His findings suggest that industrial policies are a pre-condition for this alternative pattern of production, and represent a key institutional barrier to agglomeration in this industry. Finally, Coe and Johns argue that an industry's extra-local connections to financiers are of key importance for understanding its territoriality (2004), and have stressed that power within the film production system largely resides with those that have the resources to finance and distribute films (2004).

Following suggestions of empirical studies on the film industry, it is thus necessary to examine (1) financial dynamics and (2) changes in state intervention/industrial policy as the two key industry forces that facilitate the pursuit of extra-local linkages in the film industry, and consequently a production pattern that is predominantly built on such linkages. Building on the critique of the cluster framework in this chapter, I therefore propose that in order to arrive at a satisfactory understanding of why co-productions have grown, analysis needs to move beyond the production phase and its focus on the spatiality of local production, and concentrate instead on spatially intersecting relations and dynamics that impact on production organisation in the film industry.

2.5 Summary

In this chapter I commenced with a brief general overview of literature on the film industry, and then proceeded to review in detail previous studies occupied with the economic geography and the organization of production in the film industry. Here I have firstly re-visited the debate around flexible specialization, which has established the research focus on inter-firm relations in the film industry for subsequent studies. I have then outlined how previous studies argued that social factors and project organization facilitate agglomeration in the industry, resulting in the proposition that cluster formation is characteristic for all film (and cultural) production.

As has been shown, cluster formation and local industrial dynamics have become the dominant theme in research on the film industry, following the work of Scott on the production complex in Hollywood. However, increasingly, a disparity between cluster theory and the findings of empirical studies on the film industry has become apparent, with theory emphasizing the importance of local interaction, while empirical studies have repeatedly pointed towards the importance of extra-local linkages.

Overall, the literature can be criticized for being very US centric, with international film production being mostly analyzed in comparison to the archetype of the industrial cluster in Hollywood. The depiction of the overall production system can be described as a multiplicity of regional production centres, which are connected through runaway productions, or by extra-local links, mainly in search of finance. However, as film production is largely analysed as a local phenomenon, without reference to wider dynamics, attempts to further explore these external links, or even describe the whole system and parallel developments that affect multiple production sites, have been stalled.

I have proposed that an alternative, complementary production pattern exists to production in clusters that is built predominantly on temporary, distant, infer-firm networks, which are coordinated through temporary clustering. As I have argued, the failure of the literature to capture the co-production phenomenon highlights the shortcomings of its preoccupation with clusters and spatiality. Finally I have argued that in order to arrive at a satisfactory explanation why there has been an increase in co-productions, a new research focus is necessary that places the emphasis on financial dynamics and changes in state intervention, as two of the key forces which impact on production patterns in the film industry.

3 CO-PRODUCTIONS IN CONTEXT

3.1 Introduction

In this chapter I will give an overview of the co-production phenomenon to provide a context for its subsequent discussion. I will begin with defining what constitutes a co-production, followed by a description of what motivates producers to pursue co-productions, how co-producers partner up for a collaboration, and how co-productions perform financially and artistically in comparison with single nation productions.

In the second section of this chapter I will demonstrate that co-productions have been and continue to be a significant, persisting and growing part of worldwide film production. To this end, I will firstly explore the historical significance of co-production, and then present statistical data from major film producing countries around the world, to document that there has been a surge in co-production activity in the past fifteen years.

3.2 Definitions of Co-Production

A co-production is a form of film production whereby at least two producers from different countries enter a co-production contract[22], in which they agree to collaborate and pool their (financial) resources in order to produce a joint film project, that "either of the co-producers alone would find difficult to achieve in any other way" (Enrich, 2005:2). Pendakur (1990) has distinguished between four basic categories of co-production:

(1) public- and private-sector co-productions in a given country;
(2) public- and private-sector co-productions of different countries;
(3) private capital from different countries
(4) treaty co-productions.

[22] The clauses that are usually found in international co-production agreements concern the parties to the contract, their contributions, the ownership of the copyright, the division revenue from exploitation, the attribution of specific rights for given markets or countries and the credits in the film (Enrich, 2005).

While for Pendakur co-productions do not necessarily involve the participation of more than one country, in this thesis the term co-production will exclusively refer to *international* co-productions. These international co-productions are typically carried out in line with bi-lateral or multilateral co-production agreements between countries ("treaty co-production").

An important distinction has to be made between a co-production and co-financing, in which the "financial partner" participates in the results of exploiting the audiovisual work, without being a co-owner of its constitutive elements (Enrich, 2005; see also Goettler and Leslie, 2005). In contrast to co-financing, the ownership of the rights and the ensuing profits are usually shared in a co-production. Pendakur (1990:221) has called international co-productions that are not covered by an existing co-production treaty or with producers in other countries where no treaties exist *co-ventures*. As the US has no co-production treaties, he suggests that all US co-financed films can automatically be regarded as co-ventures. Likewise, Lev (1993) has made a strong distinction between European and European-American collaborations, categorizing the latter not as a true co-production as they are not structured by specific government-to-government agreements and do not include reciprocal subsidy programs.

An important structural feature of contemporary co-production organization is the increasing institutionalization of how co-producers meet and build trust. The primary loci of building relationships are thereby professional gatherings such as industry trade fairs and film festivals. The two largest professional gatherings in the European film industry are the European Film Market (EFM) during the Berlin Film Festival, which attracted more than 5,750 industry participants in 2007, and the Marché du Film during the Cannes Film Festival, which attracted some 10,500 industry professionals in 2007, buying and selling more than 5,000 completed films, and discussing about 2,250 projects in development (Marche du Film, 2007).

During these markets, special attention is given by the organizers to forging networks between potential co-producing partners. The EFM for example hosts a special co-production market, which is organized in the form of a speed dating event, and matches project partners (potential co-producers, sales agents, television buyers, distributors and financiers) for about 30 pre-selected co-production projects (in 2007, 418 professionals from 48 countries participated). Similar co-production markets also exist in Pusan, Hong Kong, Buenos Aires, at the Sithengi Film and Television Market, in Paris, and in Rotterdam. The Rotterdam Cinemart was the first to host such an event, and has over the course of 20 years led to the completion of more than 315 co-productions (Cinemart, 2007). While not the main focus of this research, the high sophistication of these temporary clusters for matching partners, has to be seen as a highly effective institutional innovation in the European film industry that is propelling co-productions.

As Guback (1969) noted, co-productions are typically significantly more expensive to produce than single firm productions. The increase in costs thereby results from the higher legal and financial costs, as well as the higher coordination and travelling costs that accompany the complexity of managing a film production across several partners and countries. As the increased overhead costs do not typically show in the film, and thus do not increase its appeal to the audience, co-productions can therefore be considered to represent a non cost-efficient form of film production, especially in comparison with simple domestic productions, or runaway productions[23] carried out under the ownership of a single firm.

Pendakur (1990:194) thus sees co-productions being mainly motivated by film and television producers who seek to gain international market access to increase their revenues. In their study of Canadian co-productions, Finn *et al* (1996:157) have found only mixed evidence for the claim that international collaborations are commercially more successful than domestic films. As they note, co-producers themselves even rate the project recoupment from co-productions as less satisfactory than from single country productions. Jaeckel (2001:15) has arrived at a similar conclusion, stating that in most

[23] There are two forms of runaway production: a “creative” runaway production refers to a film projects which shoots outside the country of the producer following story requirements; an “economic runaway production” refers to project which is shot in another country to take advantage of lower wages, a favourable exchange rate or subsidies.

cases "co-producers' expectations have not been rewarded with huge box-office successes". Similar concerns were also raised by the report of the European Think Tank on European Film and Film Policy (2007:79), in which the authors maintain that a co-production might find it even more difficult to enter a minority co-producer's country, than a 100 per cent foreign national film. Despite co-producing about 10 films a year with each other, for example, French-German co-productions have hardly ever succeeded in both territories and are in nearly every case a very one-sided affair. Overall, the Think Tank report therefore suggests that international audiences appear to prefer national productions over co-productions. [24]

Following Enrich's definition above ("to produce a project either of the co-producers alone would find difficult to achieve in any other way") the primary reason why co-productions occur can therefore be seen as overcoming the problem of financing projects, in an industry which is characterized by a constant lack of financial capital, through resource pooling by multiple countries. The most prominent advantage of co-productions in this respect is that they enjoy national status in each of the co-producing countries, and thus allow producers to access public funding sources in each of the partnering countries. As such, cross-border collaborations in the film industry point towards the importance of finance and state intervention as two important factors for industrial organization in the film industry. In order to ensure that film producers from one country do not take advantage of another one's subsidies through co-production, co-production agreements usually demand that film producers meet certain criteria, such as spending a certain amount of the budget within the country (minimum spent criteria), or employing key creative staff from each nation. This has historically led to an ambiguity of co-productions as a cultural product, with co-productions being called "cultural bastards" and often failing to achieve critical success, as will be described in the next section.

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[24] While I would have preferred to carry out a statistical assessment of profitability of co-productions versus single country productions for this research, industry secrecy and the lack of any officially available data has rendered such a comparison unfeasible. As such the claim that co-productions are not more profitable than single country productions has to rely on previous studies, the report of the European Think Tank and indications from the qualitative primary research. However, as I will argue in chapter 5, the vast majority of film production (single country and co-production) in Europe is not profit orientated in the first place, and thus there is little point in assessing projects according to a criteria they have no intent of scoring a high value with in any case.

3.3 A Short History of Co-Production

3.3.1 The 1950s and 1960s: The First Boom in Co-Production

Co-productions are not a recent phenomenon, but have been a part of the film industry as early as the 1920s[25] (Lev, 1993). Their rise in the European film industry began in the aftermath of the Second World War, when governments in Europe[26] introduced a number of measures to protect their national industries from the heavy competition of Hollywood. While this state intervention was often argued for on the grounds of protecting culture, a major reason for introducing measures such as quota systems, subsidy programs, import taxes, capping the earning of foreign distribution companies ("blocked funds") and passing legislation to encourage co-productions, was that the war-struck European nations simply could not afford a negative balance in audiovisual trade.

France and Italy signed the first co-production treaty in 1949. Throughout the 1950s and 1960s, bilateral and trilateral co-production treaties proliferated among more and more national partners, extending beyond Europe to include Canada, Latin America, and North Africa, increasingly becoming "a necessity for countries with a modest film industry and a small market potential" (Jaeckel, 2001:155; Betz, 2007). During the 1960s approximately 67 per cent of French, 53 per cent of Italian, 40 per cent of Spanish and 35 per cent of German films were co-produced, with Guback (1969) noting that in 1966, purely national film production had been eclipsed by co-production in each of these nations.

Co-production was, in particular, a consistent and popular feature of the French and the Italian film industries, where in the heyday of each nation's art cinema production, co-productions at times equalled, and in the case of France, surpassed national productions. As Betz (2001) has observed, prototypically "French" and "Italian" films of the period directed by the most celebrated auteurs[27] were in fact the products of French and Italian

[25] However without formal legislation.
[26] Such legislations were passed in the larger West European countries (Britain, France, Italy, Spain, West Germany) and smaller nations such as Belgium, Netherlands and the Scandinavian countries.
[27] "Auteur" is the French word for "author". In the 1950's, French film critics developed the auteur theory which holds that a director's films reflect that director's personal creative vision, as if he or she were the primary "Auteur" (BFI, 2002.

(and West German and British and Portuguese and Swedish and Spanish) co-productions: Louis Malle's *The Fire Within* (France/Italy, 1963); Alain Resnais's *Last Year at Marienbad* (France/Italy, 1961); François Truffaut's *La Peau douce* (France/Portugal, 1964), and *Mississippi Mermaid* (France/Italy, 1969); all of the films of Antonioni's tetralogy starring Monica Vitti (1960–1964); all of Luchino Visconti's films; all of Fellini's films from *Il Bidone* (Italy/France, 1955) through to *Satyricon* (Italy/France, 1969); and most of the 1960s films directed by Jean-Luc Godard, Claude Chabrol, Vittorio De Sica, and Bernardo Bertolucci.

3.3.2 US – European Co-Productions

One measure adopted by European nations (France, Italy, Germany, the UK) to counter Hollywood hegemony in the 1950s was to "freeze" the earnings of American film companies (Gasher, 1995). The UK was the first country in Europe to block funds, allowing US film companies to withdraw only USD 17 million annually from their earnings (Balio, 1985:407). Unable to transfer their revenues back to the US, studios therefore had to look for alternative investments for their blocked funds, which they quickly found in re-locating film production from the US to Europe. By shooting films in Europe advantage could be taken of highly skilled, low-wage workers, as well as national subsidies through co-producing European films. Thus in the 1960s, the growth in co-productions became increasingly driven by Hollywood studios, despite being initially a policy measure designed to counter their hegemony. As Lev has noted, the films resulting from such US-European collaborations were however typically far from being a "high quality synthesis of the best of both industries" (1993:22), amounting in the best case to "spectacle films" such as *The Ten Commandments* or *Ben Hur*. Guback (1969) has been particularly weary of such US- European co-productions:

> *"So many of the new international films border on dehumanization by brutalizing sensitivity, often deflecting attention from reality. They count on developing audience response with synthetic, machine-made images. Their shallowness and cardboard characters are camouflaged with dazzling colors, wide screens, and directorial slickness. Of course, undistinguished pictures have always been made, but now the context in which they are produced and marketed is substantially different. Films of this genre are not a form of cultural exchange. In reality, they are anti-culture, the antithesis of human culture."*
>
> **Guback (1969:199)**

Nevertheless US runaway production to Europe and US-European co-productions continued into the 1960s with some of the most critically acclaimed and spectacular "Hollywood" films being made in Europe such as *Lawrence of Arabia, The Longest Day, The Great Escape, Dr Strangelove* or *A Man for all Seasons*. As Lev has noted**,** the drivers for the "Hollywood-financed, made-in-Europe films" were by this time clearly subsidies and "co-production benefits designed to support local film industries" (1993:23).[28] The boom in American financed European films and co-productions came to an end in the 1970s**,** when American companies shifted their investment strategies back to the US, turning their attention to domestic filmmakers, such as Steven Spielberg, Francis Ford Coppola, George Lucas or Terence Malick, taking advantage of US tax credits, and later the booming video and foreign sales markets. For Lev**,** the economic relationship between the US and European cinemas in the 1980s returned to a situation comparable to the immediate post-war era of US dominance and European insignificance.

3.3.3 Euro-Pudding and Cultural Identity Issues: The 1980s

The 1980s saw a decrease in the popularity of co-productions, which were increasingly criticized for blurring the cultural identity of films[29], and denounced as so-called "Euro-puddings": projects whose creative elements are driven only by financial requirements, and appeal only to "the lowest common denominator of cultured interest with little hope

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[28] This was most evident in the UK, where the British Eady Fund subsidy was particularly generous in funding American films. The Eady Fund was originally set up as a statutory levy on cinema seats, distributed among British producers in proportion to their success at the box office (Connolly, 2004:249). However in the course of a short period of time this fund let to a distortion of the market, as it allowed American owned subsidiaries to access the fund, becoming the "lure to foreign finance" (Kelly et al, 1967). In early 1966 Variety estimated that "upwards of 80 per cent of the fund coin will be paid out in the current financial year to American major companies", becoming a "valuable source of revenue to American companies" (Cowie, 1967:63). As a result the number of British features which were British financed declined from 53 out of 79 (1960) to 32 out of 69 (1965) with the remaining pictures being wholly financed by America.

[29] Such criticism had accompanied co-productions already in the 1960s and 1970s, when co-production treaties required that at least one important part in the film should be played by an actor from the minor co-producing party (Lev, 1993; Betz, 2001). In order to produce a coherent film with two or three international stars (from different countries, and most probably different mother tongues), filmmakers therefore typically resorted either to dubbing or subtitling films. The hazards of co-production are famously satirized by Godard's film "Masculine-Feminine" (1966) in which the participation of the Swedish actors imposed on the film under the co-production contract, are represented only by a film in the film, in which the whole Swedish dialogue consists only of a series of grunts.

for broad social or political resonance" (Halle, 2002:33). Jaeckel gives a prime example for such a Euro-pudding:

> *"Directed by the late (Paris-born) Austrian film-maker Axel Corti and scripted by French director Daniel Vigne, the film [The King's Whore, 1990] claimed a much criticized multinational cast in which a British actor played an Italian king who falls in love with a French countess (played by an Italian-born American actress) married to an Italian count (played by a French actor)."*
>
> **Jaeckel (1988:14-15)**

As Jaeckel has further observed, negative connotations were in particular associated with co-productions when details of a film's budget were known by the public, or the choice of an actor was clearly perceived as being influenced by the sources of financing. As she states:

> *"While, in Canada, a mention of the word 'co-production' often leads to a count of nationals in the film credits, in Britain, a country where co-productions are a fairly recent phenomenon[30], films produced by partners from different countries are said to show all the constraints of international financing. In France where the 'co-prode-syndrome' is deemed to affect mainly large budget movies, it is the film director who is seen as 'succumbing to commercial pressures' and losing his/her integrity."*
>
> **Jaeckel (2001:163)**

Consequently filmmakers in the 1980s were not very enthusiastic about co-productions, as producers strongly preferred to shoot their own films, rather than "a vague European notion" of it (Leo Pescarolo, quoted by Finney, 1996:91), with Pendakur describing Canadian co-productions as the outcome of an "inherently flawed policy" (1990:194). This "dislike" of co-productions is also reflected in Betz' (2001) summary of the discussion in cultural and film studies:

> *"The past two decades have witnessed a growing concern over the development of a European cinema arising through co-production, much maligned Euro films whose policy driven mixing of performers from various countries and cultural traditions yields a so-called Euro-pudding that collectively bespeaks contemporary fears of US cultural and economic imperialism and predicts the erosion of national cultures in the wake of globalisation."*
>
> **(Betz, 2001:10-11)**

According to this narrative, European film industries are forced to compete on Hollywood's terms by increasing film budgets and "opting for high production values,

[30] During the 1980s and until the early 1990s co-productions did not play an important part in the UK film production landscape. In 1988 for example, the UK produced only two majority co-productions. After 1988 this number increased steadily to 32 in 1994 (EAO, 1996).

popular stars, elaborate and expensive costumes and sets, and so on." (2001:8). As Betz notes, European co-production activity emerges in cultural studies therefore mainly as a "forced swerving away from natural national traditions, and as an aberrant industrial and economic response that holds little interest for stylistic or aesthetic national histories."

3.3.4 The Revival of Co-Production in the 1990s

Faced with the continuing decline of the European film industry, many European governments decided to revive co-productions in the late 1980s, bringing co-production agreements in line with the European Economic Community's (EEC) "open market" philosophy and allowing director, writer, cast or crew to come from any (then) EEC country. In the context of the burgeoning home video market and increased foreign sales, "co-production became a buzz-word on the tips of virtually every European independent producer's tongue" (Finney, 1996:91). From 1987 to 1993 the share of films made as co-productions increased from 12 per cent to per cent of the total number of productions in Europe (1996:92). In the UK co-productions were worth more than £92 million in 1994, a 100 per cent increase on the figure of 1993, and representing a doubling of overall co-production activity within a decade. Similar to the "golden age" of co-productions in the 1960s, the drivers of the increased activity emanated, according to Finney (1996:92), "less from choice, and more from financial imperatives".

Growth of co-production was further encouraged in the mid 1990s with the ratification of the European Convention on Cinematographic Co-production (Council of Europe, 1992). In force since 1994, the agreement is a legal umbrella under which the 38 signature members of the Council of Europe can co-produce freely with each other. The convention has since largely rendered bi-lateral treaties between signatory countries in Europe obsolete.[31] The relative ease (in comparison to previous decades) with which projects can be set up legally as co-productions under the convention has certainly contributed, at least in part, to the continuous growth of co-productions in the last decade. Another important institution that has facilitated co-productions in Europe is Eurimages, the Council of

[31] This was seen for example, when the UK terminated its bilateral co-production treaties with Germany, Italy and Norway in 2005 in favour of the convention. The convention also allows the involvement of co-producers from non-signatory countries as a fourth co-producer (e.g. the USA), provided that their total contribution does not exceed 30 per cent of the total production cost of the film (UKFC, 2007).

Europe's fund for the co-production, distribution and exhibition of European cinematographic works. Set up in 1988/89, Eurimages has 33 member states and has financially supported more than 1,100 films since its inception (Eurimages, 2007). Although criticized for being bureaucratic and having an elitist bias, Miller *et al* (2005) suggest that Eurimages has greatly expanded the range and diversity of film projects (mainly though co-productions) in Europe over the past decade.

3.4 Current Co-production Activity

As Lange and Westcott (2004:93) have noted it is "not easy […] to provide a financial or even a statistical assessment of co-productions", as there is a lack of detailed information about the implementation of bilateral co-production agreements, co-productions made under the Convention and multilateral funds; there is no database that lists precisely which films were made under a co-production agreement and which were co-financed; and there exists very little information about co-producers contributions, outlays from aid bodies and where money was spent, thus rendering the assessment of production flows nearly impossible. Finally, as some European countries do not clearly distinguish between minority and majority co-productions[32], when counting the number of co-productions, it is difficult to compare industry data across Europe. While data is limited and not consistent across Europe, it is nevertheless sufficient to gain a broad understanding of how co-production activity has developed in the past decade. In this section, I will present some key statistics on co-production activity in the major European film producing countries France, Germany, Spain, Italy and the UK, as well as on major international territories such as Canada, Australia and the US. In correspondence with the available data, the focus lies on giving a general overview, based on highlighting key data from individual countries.

[32] The majority of co-productions are not based on a perfect balance in financial and creative contributions from the project partners, but typically one partner takes a lead in the development and financing of the project, thus being the majority co-producer. In order to avoid double counting co-production activity in statistics, typically co-productions are counted as film production activity only in the country of the majority co-producer.

3.4.1 Co-Production Activity in Europe

Table 3.1 shows the development in the number of co-produced, as well as co-financed films released in Europe[33] between 1997 and 2002. As can be seen, while the number of released co-productions has been volatile on a year-by-year basis, on the whole co-production activity is a consistent and increasing feature of European film industries.

Table 3.1: Number of Co-Produced/ Co-Financed Films Released in Europe 1997-2002

Co-producing countries	1997	1998	1999	2000	2001	2002
US - EUR	13	13	23	23	33	42
US - UK	5	7	10	5	9	15
US - France	3	2	4	8	11	3
US - Germany	2	1	3	7	7	19
Majority Co-pros Germany	17	11	25	32	12	18
Majority Co-pros Spain	25	12	15	9	25	33
Majority Co-pros France	41	41	57	46	45	61
Majority Co-pros UK	25	16	20	33	27	40
UK- US	10	5	5	19	9	10
Majority Co-pros Italy	15	12	22	16	24	20
Other Majority Co-pros	71	52	76	72	51	71
Total majority Co-pros EUR	194	144	215	208	184	243
Total	**207**	**157**	**238**	**231**	**217**	**285**

Source: EAO (2004:97)

This is also reflected in **Table 3.2**, showing how the number of co-produced films, and the share of co-production with respect to total production activity, have increased in the largest European film producing countries, Germany, Italy, Spain, France and the UK between 1997 and 2006. Co-production is furthermore also of vital importance in smaller countries such as Cyprus, Denmark, Ireland, Latvia, Lithuania, Luxembourg, Portugal, Sweden, as well as Austria. In these small countries co-production typically accounts for more than half of all production activity, and as is exemplified by the case of Belgium, can dominate the production landscape. Overall the number of co-produced films has nearly doubled in the top five film producing countries since 1997, increasing from 127 to 242 in 2006.

[33] For the 15 European Union countries.

Table 3.2: Total Number of Feature Films Produced in Europe/ Share of Co-Production and Domestic Production Activity of Total Production Activity in Number of Films

Belgium	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Total no film produced	24	35	33	28	23	27	32	46	36	46
Share of domestic films	25.00%	25.71%	18.18%	35.71%	17.39%	22.22%	15.63%	17.39%	25.00%	17.39%
Share of co-productions	75.00%	74.29%	81.82%	64.29%	82.61%	77.78%	84.38%	82.61%	75.00%	82.61%

Germany	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Total no film produced*	61	50	74	75	83	84	80	87	103	122
Share of domestic films	77.05%	78.00%	59.46%	62.67%	68.67%	46.43%	67.50%	68.97%	58.25%	63.93%
Share of co-productions	22.95%	22.00%	40.54%	37.33%	31.33%	53.57%	32.50%	31.03%	41.75%	36.07%

Italy	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Total no film produced	87	92	108	103	103	130	117	138	98	117
Share of domestic films	81.61%	85.87%	85.19%	83.50%	66.02%	73.85%	82.91%	70.29%	71.43%	78.63%
Share of co-productions	18.39%	14.13%	14.81%	16.50%	33.98%	26.15%	17.09%	29.71%	28.57%	21.37%

Spain	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Total no film produced	80	65	82	98	107	137	110	133	142	150
Share of domestic films	68.75%	69.23%	53.66%	65.31%	62.62%	58.39%	61.82%	69.17%	62.68%	72.67%
Share of co-productions	31.25%	30.77%	46.34%	34.69%	37.38%	41.61%	38.18%	30.83%	37.32%	27.33%

UK	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Total	104	83	92	80	74	119	173	131	131	134
Share inward features*	19.23%	19.28%	23.91%	35.00%	31.08%	13.45%	13.45%	17.34%	19.08%	20.15%
Share of domestic films	80.77%	80.72%	76.09%	65.00%	68.92%	31.09%	31.09%	25.43%	29.77%	37.31%
Share of co-productions	0.00%	0.00%	0.00%	0.00%	0.00%	55.46%	55.46%	57.23%	51.15%	42.54%
Number of co-pros***	29/0	15/0	26/0	26/0	27/0	37/66	39/99	36/84	32/67	33/57

France	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Total no film produced	158	180	181	171	204	200	212	203	240	203
Share of domestic films	54.43%	56.67%	63.54%	64.91%	61.76%	53.00%	49.53%	64.04%	52.50%	63.05%
Share of co-productions	45.57%	43.33%	36.46%	35.09%	38.24%	47.00%	50.47%	35.96%	47.50%	36.95%

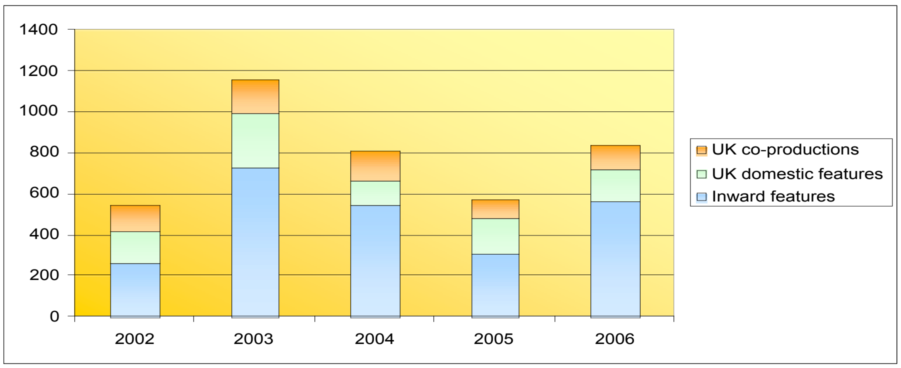
* The total number of films in Germany has been adjusted to exclude feature documentaries that are included in the figure by the German SPIO.
** Inward features include inward investment co-productions from 2002.
*** UK co-production data not available by shoot date prior to 2002.

(Source: Compiled from the EAO 2002, 2005; 2008; SPIO 2007; UKFC, 2008)

Figure 1.1 (page 13) charts the development of co-production activity in the major film producing countries graphically. As can be seen, co-productions have accounted since 2000 on average for more than a third of total film production in the top five film producing countries in Europe.

Among the top five film producing countries in Europe, the UK has the highest level of co-production activity, despite categorizing UK-US co-productions and other inward-co-productions *not* as co-productions as other countries do, but as "inward features", alongside US film shot in the UK. **Figure 3.1** depicts the value of UK production activity. Detailed official co-production data are only available for the UK for the time period after 2002[34], with overall co-production activity roughly matching the production value of domestic production value in the time period available.

Figure 3.1: Production Value of UK Productions (In £ Million)



(Source: UK Film Council, 2007).

The significance of co-productions for the UK film industry is most apparent when considering the median budgets[35] of UK film projects (**Table 3.3**) with the budget levels of "inward feature co-productions" almost dwarfing domestic feature film budgets. The budgets of "official" co-productions are lower, but still exceed domestic feature film budget levels on average by nearly 60 per cent.

Table 3.3: Median Feature Film Budgets 2003-2006

	2003	2004	2005	2006
Inward features (single country)	12.1	16.5	15	18.7
Inward features (co-productions)	46.6	38.1	33.6	51.9
Domestic UK productions	3	2.9	2.3	1.5
Co-productions (other than inward)	3.5	4.4	4.3	4.5

(Source: UK Film Council, 2007)

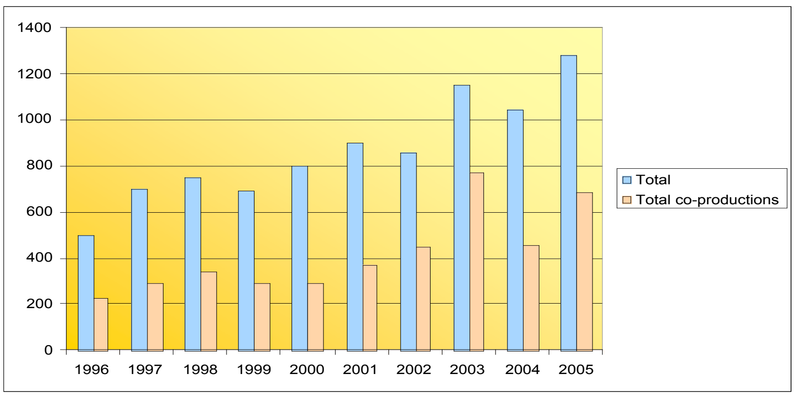
[34] The UK Film Council, which is also responsible for film industry statistics in the UK, was set up by the Labour government in 2000. Prior to the UK Film Council, data was collected by the BFI, resulting in an inconsistency in data.

[35] The Median budget represents the middle value (ie there are equal numbers of films above and below the median). The median, as proposed by the UK film council, is a better measure of central tendency than the average as it avoids the upward skew of small number of high budget productions.

The most prolific co-production partner of the UK is thereby Ireland, where between 2001 and 2006, 90 per cent of domestic films, and 100 per cent of incoming films were structured as co-productions, on nearly every occasion with the UK as a co-production partner (Irish Film Board, 2005)

In France co-production has a longstanding history, with the number of films made as co-productions being consistently high, and matching the number of domestic films closely. This is also reflected in the total investment amount of French theatrical films, with French co-productions accounting in the past five years three times for more than half of all production investment (**Figure 3.2**).

Figure 3.2: Total French Film Investment and Investment in International Co-Productions



Figures include Majority and Minority Co-productions (In Million EUR)
(Source: Adapted from CNC, 2007)

The number of co-productions also increased strongly in Germany, Spain and Italy, however no detailed data are available for these countries with respect to the contribution to overall production value in these countries. In Germany the number of co-productions increased particularly strongly between 1997 and 2002, mainly due to an increase of co-productions (co-ventures) with US participation (**Table 3.4**).

Table 3.4: Increase in the Number of Co-Productions in Germany, Spain and Italy

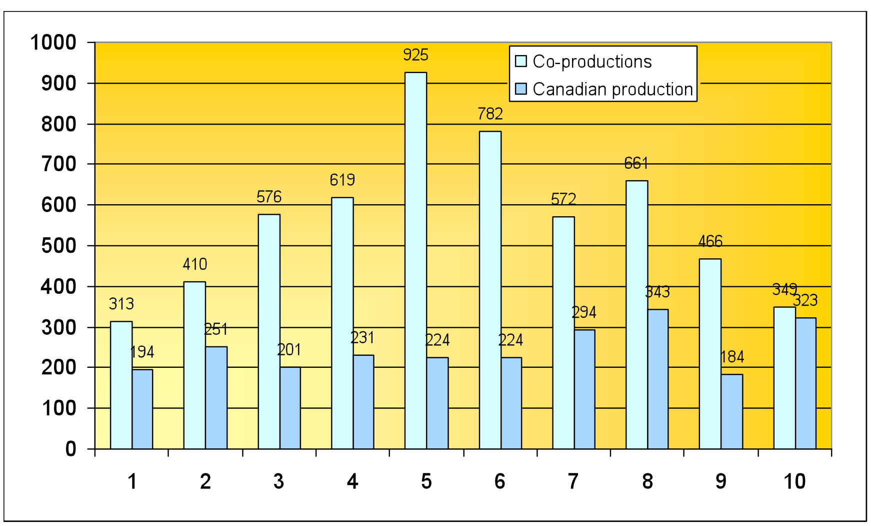
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Spanish co-productions	25	20	38	34	40	57	42	41	53	41
Italian co-productions	16	13	16	17	35	34	20	41	28	25
German co-productions	14	11	30	47	50	78	53	61	43	44

(Source: EAO 2002, 2005, 2008)

Another way to measure the importance of co-productions in Europe is to look at their box office success and critical acclaim. With respect to box office success, out of the 50 top grossing films in the 25 European countries covered by the EAO's Lumiere database between 1996 and 2002, ten were European co-productions and fifteen were US-European co-productions. Furthermore, of the fifty European films with the largest number of admissions in Europe in 2002, 21 were co-productions and three were US-European co-productions. With respect to critical acclaim, it also appears that co-productions have in the past decade overcome their ambiguous reputation of cultural identity loss and creative compromise. At the annual Cannes film festival, in the past decade, films that were made as co-productions were awarded the prestigious Palm d'Or seven times, and four films in the past decade the Grand Prix of the Jury. At the Berlinale, co-productions were awarded Golden Bears as often as single country productions (a detailed list of the films can be found in **Appendix II**).

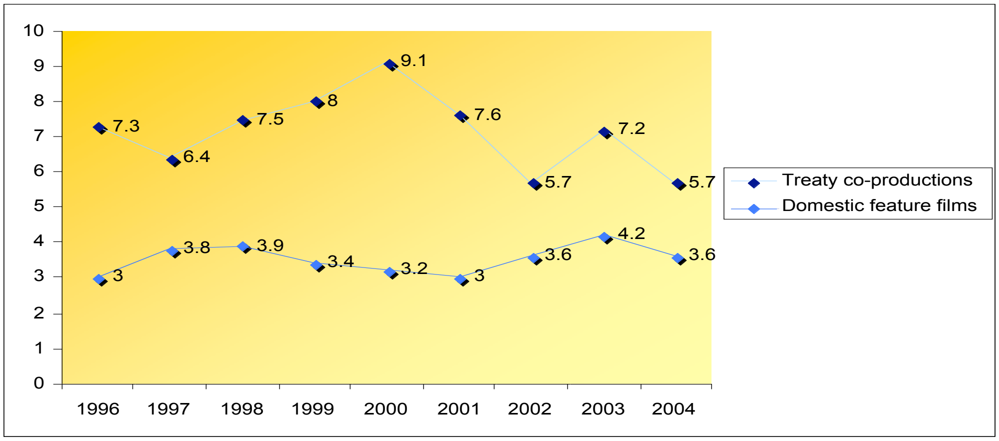
Co-productions are also of significant importance outside Europe, and here most notably in Canada, where 64 out of 116 produced films in 2005 were co-productions. Between 1996 and 2005, furthermore, both the total volume (**Figure 3.3**) and the average budgets (**Figure 3.4**) of Canadian co-productions exceeded domestic production by far**.**

Figure 3.3: Total Volume of Canadian Domestic Production and Treaty Co-Production (In CAD Million)



(Source: CFPTA *et al*, 2007)

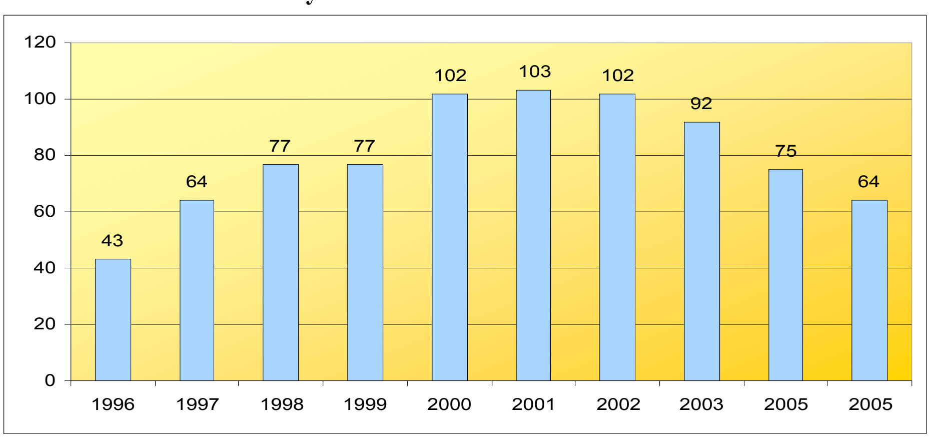
Figure 3.4: Average Budgets of Canadian Domestic Productions and Treaty Co-Productions



(Adapted from CFPTA et al, 2007)

As the number of Canadian co-productions has decreased steadily since 2001 (**Figure 3.5**), the Canadian film industry has found it hard to compensate for the loss of co-production activity. However, by maintaining co-production agreements with 53 countries (Telefilm Canada, 2006), Canada is still the foremost co-producing nation in the world.

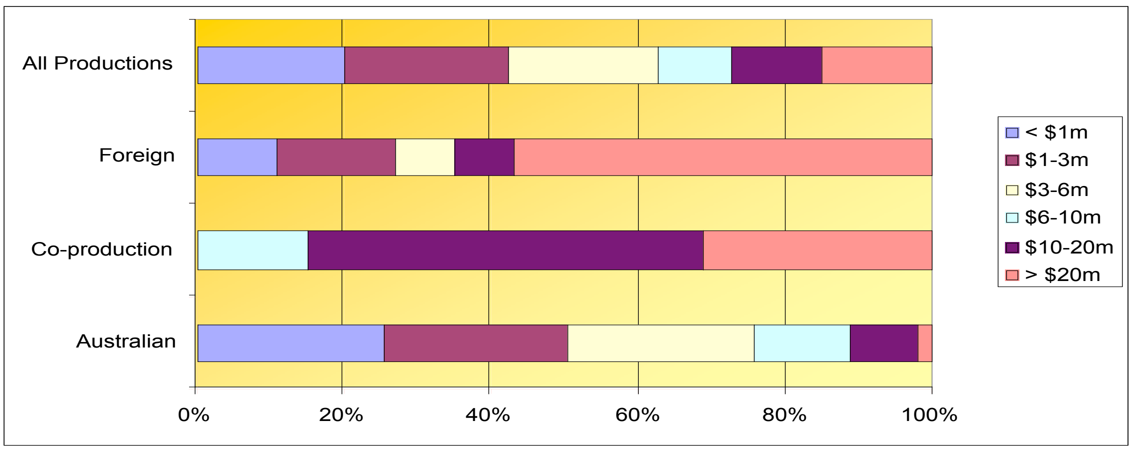
Figure 3.5: Annual Number of Treaty Co-Productions



(Source: CFPTA *et al*, 2007)

Of lesser, albeit still significant importance, are co-productions also for the Canadian film industry. Although Australian co-productions only account for on average five per cent of produced films between 1995-2005, the budget levels of co-productions are significantly higher than that of Canadian productions (**Figure 3.6)**, with domestic films costing typically between AUD 1 million and AUD 6 million, while co-production typically cost AUD 10 million and more.

Figure 3.6: Budget Ranges of Australian Feature Films (In AUD Million)



(Source: Australian Film Commission, 2007)

Finally, co-productions are also of significance in the US film industry, with a high number of US motion pictures being structured as co-productions or co-ventures each year. I have included an exemplary list of US-foreign co-productions for the year 2006 in **Appendix III**. US production companies mainly enter into co-production agreements with non-domestic partners in order to take advantage of foreign film support schemes, and here particularly automatic support mechanisms such as tax incentives. While no country has signed an official co-production treaty with the US, US companies can become official co-producers; (1) by co-producing a film through a subsidiary (e.g. Working Title in the UK); (2) by being a fourth party[36] co-producer under the European Convention on Co-production in Europe; (3) through extensive location shooting in a

[36] The European Convention on Cinematographic Co-production (1992) allows the participation of a fourth co-producer from a non-signatory country (such as the US) of up to 30 per cent of the budget.

country (e.g. Harry Potter in the UK); (4) through co-financing agreements. A more in depth account of what is driving the increasing interrelation between the US and European film industry through co-production activity will be given in chapters six and seven.

3.5 Summary

In this chapter I have outlined the importance of co-productions for international feature film production. Historically, co-productions firstly rose to prominence in the 1950s and 1960s, with US studios trying to take advantage of subsidies in Europe through co-production structures. After the decline of the European film industry in the 1970s, co-productions acquired the dubious reputation of being "Euro-puddings", but were revived by European Union legislation in the late 1980s and entered a second period of growth at the beginning of the 1990s. As I have shown, in the past decade more than 30 per cent of all films in Europe have been made as co-productions, although they are significantly more expensive than single firm productions, more complicated to execute, and do not necessarily enhance a project's potential to gain international market success. Building on the contextual background of co-productions given in this chapter, I will, in the next chapter, discuss how the phenomenon of co-production can be explained within present theoretical frameworks applied to the film industry, and will ask to what extent previous accounts can contribute to our understanding of why there has been an increase in this form of production.

4 TAKING ADVANTAGE OF TEMPORARY CLUSTERS - RESEARCH METHODOLOGY

4.1 Introduction

"That's all very well in practice, but how does it work in theory?"

Groucho Marx

In the context of the financial and time constraints associated with PhD level research, the geographical dimension of co-production (co-producers are dispersed across multiple countries), and the relatively secretive culture of the film industry have posed a major challenge to this research with respect to gaining access to relevant data. In this chapter, I will describe how I have sought to address this problem by firstly taking advantage of temporary clustering in the film industry to minimize travel costs, and secondly, by observing industry panel discussions as a rich source of data, using them as a proxy for focus groups.

The main aim of this chapter is to demonstrate the thoroughness and rigour of the research design, and to enhance the understanding of its findings, by illustrating how they have been arrived at. I will begin with a brief discussion of the research strategy, followed by a description and critical assessment of the research process. I will then present the observation of panel discussions as a viable data gathering method, and critically evaluate the method, as well as the other methods used to collect qualitative and quantitative data for this study (semi-structured and unstructured interviews, secondary data). Finally, criteria of trustworthiness and authenticity relevant to the research will be addressed.

4.2 Research Methodology

4.2.1 Developing the Project

As I have shown, very little has been written on the phenomenon of co-production to date, with the European film industry being in general an under-researched topic in economic and business studies. Thus, this study is firstly exploratory in nature, aiming to find out “what is happening” (Robson, 2002:59). Exploratory studies can be characterized as being highly flexible and adaptable, however as Adams and Schvaneveldt (1991) argue, this does not imply an absence of direction, but rather an initially broad research focus that becomes progressively narrower. Secondly, in order to lay an empirically rich foundation for data analysis, this study is also partly descriptive in nature, attempting to provide an accurate picture of ongoing developments in the film industry. Finally, this study also serves to inform and test theoretical developments, and as such comprises strong explanatory elements.

To guide my research, I have firstly consulted and immersed myself in the present literature on the film industry and the underlying literatures, such as economic geography, political economy and the literature on industrial dynamics. Using these theories as a starting point, I have compared their theoretical approaches and empirical work with my existing conception of the co-production phenomenon, in order to help me shape my research question and proceed with a broad hypothesis. My own conception of co-productions and their context - industrial dynamics in the film industry - was largely informed by anecdotal, secondary data from trade journals and industry trade fairs. To develop my understanding, I started with a more systematic approach to gathering secondary data about co-productions, followed by the collection of the first primary data at the Co-Production Market 2005 in Berlin and the Screen International Film Finance Summit in Berlin 2005. Thus, at the beginning of my exploration of co-productions, I largely followed a deductive approach, by making assumptions about their nature on the basis of what is known about the particular domain and the theoretical considerations related to this domain. However, given the complexity of the topic and the questions that arose, it did not appear sensible to adopt a linear deductive approach of formalizing my research interests into a number of hypotheses that could then be “subjected to empirical scrutiny” (Bryman and Bell, 2007:11). Moreover, while there is a surge of academic interest into creative industries, the literature in this field is not comprehensive, making a highly formalized deductive approach unsuitable for the explorative nature of this study.

Instead of a deductive approach, I therefore adopted a more iterative method of gathering data and developing theory. An iterative research strategy describes a "repetitive interplay between the collection and analysis of data" (Bryman and Bell, 2007:582). Data is collected, then analyzed, with the findings shaping the next steps of the data collection process. Once theoretical reflection on a set of data has been carried out, the researcher is likely to adopt again a more deductive approach by starting to test whether the findings stand against further empirical data. This weaving back and forth between data and theory (and deduction and induction) continues, until a satisfactory level of understanding for the subject of research has been reached. As there has been little research on co-productions before, I decided that rather than being restricted in my exploration by existing theories that have not been developed to explain this phenomenon, it would be more sensible if the theory would be developed alongside data collection, to the benefit of empirical accuracy. In addition, generating data, and analyzing as well as reflecting upon the theoretical themes emerging from it in a continuous interplay, has allowed me to adopt a more flexible research focus, especially in the early phases of my research.

4.2.2 A Mixed Methods Approach

As indicated by Bryman and Bell (2007:642), it has become increasingly popular in social sciences to combine both quantitative and qualitative approaches in one research project, with the aim of capitalizing on the strengths of each method while offsetting their respective weaknesses. Moreover, Burgess (1984) has claimed that adopting only one research strategy can now be seen as narrow and inadequate, especially when it comes to field methods, as researchers need to be flexible and able to select a range of methods appropriate to the research problem under investigation. For Brannen (1992), quantitative methods - where they are subservient to qualitative methods – can provide quantified background data to contextualize studies, particularly where data is derived from official statistics, or from secondary analysis of large-scale data sets. In this case quantitative data can be "qualitised" (Saunders *et al*, 2007:146), referring to the conversion of quantitative data into narrative, which can then be analyzed qualitatively. For Tashakkori and Teddlie (2003) a multiple methods approach is furthermore particularly useful when it comes to data evaluation: Through "triangulation" - crosschecking the results of one method with the results from a second - the researcher is in a better position to evaluate the extent to which research findings can be trusted. As Zamanou and Glaser (1994:478) argue, triangulation implies that “the specificity and accuracy of quantitative data” are combined “with the ability to interpret idiosyncrasies [behavioural characteristics] and complex perceptions, provided by qualitative analysis”. Corroborating findings through triangulation can thus help to address the problem of generality, often associated with qualitative research. As Silverman (1984, 1985) states, the critique that findings from qualitative research are often presented in an anecdotal fashion, with little indication of their relative importance of the themes identified, can be circumvented through a quantification of research findings. Bryman (1988) further suggests that triangulation can be particularly useful when different aspects of a phenomenon are studied, and where the relationship between “macro” and “micro” levels of a phenomenon is explored. He suggests that when analyzing the more macro levels, researchers will find quantitative research more useful, and vice versa.

In this thesis I have adopted such a mixed method approach, drawing both on qualitative methods (interviews, observation) as well as on quantitative methods (secondary analysis of statistical data). The quantitative data have thereby been particularly informative in the first stages of the research, when the research questions were refined and contextualized. Theory was developed by looking for patterns of thought, action and behaviour in the data sources, and interlinking them. Firstly, key words and concepts were defined, and then typologies and explanations were developed from the triangulated data. Furthermore maps, tables and diagrams were developed to provide a visual representation of themes and crystallize the information. In addition, key quotes were identified that can summarize concepts and identified themes. Following Bryman (1988), I have found a mixed methods approach as particularly suitable to “bridge the macro-micro gulf” – a major issue when examining industrial dynamics – with the level of the industry lying somewhat in between the level of the firm and the economy. While the qualitative data has helped me here to understand the picture on a micro level, abstraction would not have been possible without using quantitative data to frame it. Further, the mixed method approach allowed me to contextualize changes in the industry over time, by corroborating qualitative accounts from interviews and panel discussions with statistical data to abstract (historical) key developments and dynamics in the industry. Likewise, statistical data were qualitized and developed into narrative, to further strengthen the main arguments, as well as to underline the generality of my research findings.

It has to be noted that the mixed method approach has strongly been questioned by authors such as Kuhn (1970), Burrell and Morgan (1979) and Morgan (1998), on the grounds that different research methods are inextricably intertwined in different epistemological assumptions, values, and methods ("research paradigms") and are thus essentially incommensurable and incompatible. Smith and Heshusius (1986) have likewise criticized mixed methods for bearing the risk of transforming qualitative inquiry into a simple procedural variation of quantitative inquiry. Bryman and Bell (2007) have however strongly rejected these arguments, maintaining that there is no deterministic relationship between research strategy and epistemological and ontological commitments, and that "it is by no means clear that quantitative and qualitative research are in fact paradigms" (2007:644), and thus the view that research methods carry with them a fixed epistemological and ontological implication is very difficult to sustain. As drawing on multiple methods has given me the flexibility to study different aspects of co-productions, I furthermore contend that only by using qualitative and quantitative methods have I been able to reach a satisfying understanding of the phenomenon. In this respect, triangulation has helped me to cancel out the "method effect" (Saunders *et al*., 2007:147) that is inevitably associated with using just one form of method, and therefore has lead to a greater confidence in my findings.

4.3 Developing the Research Design

Following Charmaz (2006:18-19), the quality and credibility of a study starts with the data, with a study ideally being based upon rich, substantial and relevant data. However, getting access to such relevant data has posed a challenge for this investigation of co-productions in several respects. Firstly, exploring international collaborations is challenging, because the subject under study transcends a local geographical scope. While the focus of the research is on the European film industry, a major theme, which emerged quickly once data collection commenced, was how the European film industry becomes increasingly intertwined with the US film industry, thus further aggravating the issue of geographical scope. In order to fully explore co-productions and the growing interrelationship between different national industries, it was therefore regarded as crucial to get access to key informants from a number of different national film industries.

Secondly, this research on co-productions deviates somewhat from other studies on the film industry, as it focuses not exclusively on film production and film producers, but highlights the relationships between production, finance and policy. In order to cover financial and policy developments in the film industry, access to high level representatives of public sector organizations, and film financiers was therefore considered to be highly important for the research. As early, informal exploratory interviews have indicated, representatives and film financiers could also be assumed to possess a more coherent and aggregated knowledge and understanding of ongoing developments in regards to finance, policy and industry structure than producers. These intermediaries were hence identified as possessing a particularly relevant specialist knowledge gained by working with a high number of producers, as opposed to the more anecdotal, highly case-specific accounts given by producers themselves.

The desirability of having high-level informants with highly diverse professional backgrounds, which have furthermore different national backgrounds, has ruled out a number of data gathering methods from the beginning. For instance questionnaires were discarded for this research on the grounds that it would not have been possible to produce a representative sample for the study. Given the time and cost constraints associated with PhD level research, a classical qualitative research based on a number of interviews also had to be ruled out, as it would not have been economically feasible with regards to travel costs to visit informants on an individual basis. Finally, the use of telephone interviews as a data gathering method was ruled out for two reasons: Firstly, given the somewhat secretive culture of the film industry, gathering rich data by contacting and interviewing high level professional by telephone did not appear to be a feasible option. Secondly, as telephone interviews demand a high degree of structure, this would have limited the scope of the study largely to a set of predefined questions.

Confronted with the aforementioned issues, I decided to take a “fresh” approach in modelling the research design for this study, by firstly asking how the dispersed European film industry educates itself about developments in film financing and film policy.

As described in the previous chapters, co-producers meet each other, and information is shared in the industry predominantly at “temporary clusters” - industry markets and professional gatherings. Industry markets such as the Cannes Film Market during the Cannes Film Festival or the European Film Market during the Berlinale Film Festival condense the otherwise dispersed global film industry into a confined space and time (from three days to two weeks), attracting key industry professionals (such as distributors, sales agents, co-producers, film financiers, studio executives, national and regional film institutions, film funds) from film industries around the world to network and “do business” with each other. A program of training events and panel discussions, in which industry professionals debate illustrative case studies to inform their peers and share their experiences, typically frames these events. A second form of temporary clustering, albeit on a smaller scale, can be identified in one-day-events such as film finance summits organized by trade journals, as well as industry conferences hosted by public industry support institutions. Similar to industry markets, these events bring together a diverse range of high level, key industry figures, to debate industry developments and network. The events are usually structured into a series of panel discussions, in which experts discuss specialist topics of relevance to film professionals.

To visit such temporary clusters in order to study and observe industry practices at the very “locus of action”, has thereby presented itself to me as a viable solution to the problem of getting access to industry professionals from multiple countries, within the time and budget constraints of PhD level research. Over the course of three years, I have therefore collected primary data for this research at the following events:

Table 4.1: Events Attended for Data Collection

Industry markets	• Berlinale Co-Production Market 2005 • Berlinale Co-Production Market 2006 • European Film Market, Berlinale 2006 • Berlinale Co-Production Market 2007 • The Cannes Market, at the Cannes Film Festival 2006
Industry events	• Hollywood Reporter in London Presentation 2005 • Screen International Film Financing Summit Berlin 2005 • Screen International Film Financing Summit London 2006 • Hollywood Lectures, February 2007 • Media Program Presentation, Berlin 2007
Industry workshops	• Copenhagen Think Tank on European Film and Film Policy 2006 • Strategics Film Finance Forum 2007

A comprehensive list of the industry panel discussions and workshops I have attended during these events can be found in Appendix I:

In order to limit access to these industry gatherings, and thus, draw a dividing line between the general public, amateurs, and "the aspiring interested", entry to both film markets and industry conferences is restricted through a combination of providing evidence of professional track record, and a financial barrier, through participation fees. While access to most single-day events such as Film Finance Summits, as well as multi-day events such as the Berlinale Co-production Market and the Copenhagen Think Tank on European Film and Film Policy was granted to me in my role as a researcher, access to the Cannes Film Market and the Strategics Film Finance Forum had to be negotiated with the organizers, and was granted to me on the basis of my previous experience in short-filmmaking.[37] The participation fees and travel costs associated with attending these industry events have been funded for this research through a Vice Chancellor Grant from the University of Hertfordshire, with the kind support of Dr Keith Randle, Professor Jane Hardy and Professor Colin Haslam. During these events, I have employed a combination of data gathering methods, including ethnographic and unobtrusive approaches (Lee, 2000), passive observation, unstructured and semi-structured interviewing, as well as the gathering of documents. In the next section I will describe each of the methods I have employed to gather data at these events in more detail.

[37] In 2005 I was selected as a writer/ director for the "Digital Shorts Scheme" of regional film agency Screen East. My project "Eggsistence" was screened at the Cambridge Film Festival, the Brief Encounters Festival and the Cannes Short Film Corner 2006. Prior to my PhD studies in the UK, I have also completed four short film projects in Austria.

4.4 Data Collection

4.4.1 Observing Panel Discussions - The Illustrative Focus Group

As stated above, a central element of the markets and events attended were industry panel discussion, involving typically three to eight industry professionals discussing a topical industry issue in depth under the direction of a moderator. These panels usually lasted between one, and one-and-a-half hours, and mostly took place on a heightened platform/ stage in a conference hall or auditorium, so as to make the discussion easier to follow for the audience. Visiting these industry events, I have found panel discussions to be a rich source of highly relevant data for my research, and consequently decided to make their observation a key data gathering method for this study.

In academic terms, I propose that panel discussions can be likened to the qualitative method of focus groups. Focus groups denote a form of group interview in which several participants (in addition to a moderator/ facilitator) explore a specific theme in depth. The focus group comprises elements of two methods, namely the group interview (several people discussing one topic), and secondly the focused interview (in which interviewees are selected because they "are known to have been involved in a particular situation" (Merton *et al*., 1956:3). The panel discussions I observed for this research consisted on nearly all occasions exclusively of renowned experts in the respective fields discussing a specific topic, thus matching both in format as well as in the course of events very closely the concept of a focus group.

As I propose, the main difference between panel discussion and the typical focus group lies in the number of observers following the discussion, with the number of observers in traditional focus groups often being very limited (or the observer may even be hidden), while panel discussions are played out in front of an audience. However, as Stewart and Shamdasani (1990) note, even non-public group interviews and discussions can be seen to inherently contain a public element, as even when no observers or audience are present, participants speak in front of each other. Stewart and Shamdasani (1990) have therefore argued that focus groups are not very reactive to being observed by external parties, stating that it is very common for focus groups to be observed by others, and for sessions to be recorded or videotaped. An increase in the number of observers, as is the case with panel discussions, can therefore be assumed not to compromise the format of a focus group.

This argument can prompt a key critique that has been made on focus groups in general, namely that as participants are aware that they are being observed, they might alter their behaviour (hold back information, portray a likeable image of themselves), calling the findings derived through focus groups into question. However, as can be argued, in this respect focus groups and panel discussions alike do not differ greatly from other qualitative methods, and can certainly be assumed to be not less problematic than individual interviews, where an “interviewer effect” is equally observable. Moreover, precisely because it is the purpose of a panel discussion to be informative, and this is known to both participants and observers, observers and discussants are aware that hidden agendas might exist and can thus discount statements for such a bias. For instance in the panels observed, typically the audience was provided with biographical data on the discussants in print in advance, as well as with a verbal introduction before the discussion, in order to ensure that the observers fully understood the context of the participant’s statements.

In addition to the discussion moderator, the audience itself therefore plays an important role in framing the panel discussion through constantly assessing and evaluating the statements of participants, and becoming directly involved in the discussion at the end of the panel, when the “floor is opened for questions”. The participation of the audience at the end of the panel discussion thus reflects strongly upon a key aim of focus groups, namely the joint construction of meaning (Stewart and Shamdasani, 1990). In the geographically dispersed film industry, temporary clustering during markets or industry events can be seen as a viable form of cognitive alignment. By observing the discussion between what are in effect individual accounts of reality (case studies), the panel discussants jointly construct a form of objectified reality that is formulated through discussion. This joint creation of meaning is then further objectified through the ensuing question and answer session, and continued after panel discussions, when discussants and observers meet for the (somewhat obligatory) "networking" coffee break. Here the audience typically disintegrates into smaller groups, sharing their view on, and confirming their understanding of the topic further with peers.[38] Following these observations, I argue that the openly public setting of panel discussions does not change the behaviour of the panellists in a more significant way than the presence of a limited number of observers would in traditional focus groups, but that on the contrary the presence of a large number of observers can even facilitate the very purpose of a focus group, and that for these reasons it is legitimate to use panel discussions as a proxy for focus groups.

As Stewart and Shamdasani (1990) note, the main advantage of focus groups is that they allow coverage of a wider range of topics, with diverse group of individuals in a relatively short period of time. As such, focus grous/ panel discussions provide a cost and time efficient method for the researcher, to gain data from a group of people than through individual interviews. Furthermore, the open response format of a focus group/ panel discussion provides an opportunity to obtain large and rich amounts of data in the respondents' own words. The "synergistic effect of the group setting", resulting from the interaction of participants, is moreover likely to "produce data or ideas that might not have been uncovered in individual interviews" (1990:16). Based on the experience of carrying out this research, I have found the observation of professional panel discussions an excellent method for data collection. Observing panel discussions can generate rich, reliable and highly relevant qualitative data, and I therefore contend that this – to my knowledge – innovative method is ideally suitable for exploratory research and as a confirmatory tool.

Nevertheless, there are several limitations that apply to observing focus groups in general, and to the method as used for the purpose of this study in particular.

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[38] The joint construction of meaning at panel discussion thus also corresponds well with the social constructionist perspective adopted for this study.

Firstly, as discussed by Stewart and Shamdasani (1990:17) focus groups can be criticized for being not representative of the larger population, and that data gained through focus groups therefore have limitations in regards to generalization. For the panel discussions at issue, this critique is partly valuable in so far as groups were often comprised of individuals who were either considered to be in key gate-keeping positions (by their considerable financial or political power), or had been part of an innovative project, or possessed a strong relevant expertise or experience in regards to a special topic, and can thus be considered to be ahead in knowledge of the average producer or film financier in the audience. Consequently, the focus of discussions has usually revolved around a case study, for instance a new industry practice and its implications for the wider industry. Given this "case study characteristic" of panel discussions, the sampling of the expert panel can therefore be justified with reference to case study methodology, and in particular to what Yin (2003) has referred to as the presentation of an "extreme case", a "unique case" or a "typical case" (Yin, 2003). The "typical case" (2003:41) thereby informs its audience, by being informative about the experiences of the *averag*e person or institution, while unique and extreme cases allow the researcher to learn more about a phenomenon that otherwise would be inaccessible to (scientific) observation; even if just a single case exists, information about it can be revelatory and valuable. (Yin, 2003). The claim that the data collected during panel discussions is not representative can be further refuted on the grounds that a multitude (55 panels/ sessions), of such panel discussions (case studies) has been attended with Yin suggesting that evidence from multiple cases is more robust than single case studies (2003).

A second general limitation of focus groups/panel discussions put forward by Stewart and Shamdasani is that group discussion can be uneven, as individual group members might dominate the discussion, and consequently responses are not made independent of each other, but are biased by the dominant group member. This can often be attributed to an unevenness of perceived and real power within a group (1990:40). This however, was not a major concern in the panels observed: Panelists were typically confident experts, and the topics discussed were not of private, but of professional concern. Furthermore, as the panels usually aimed to portray the widest possible spectrum of opinions on a given subject, little attempt from group members to dominate the discussion were witnessed during my observation. Such behaviour might have been further curbed by the presence of a large number of observers, with the discussion taking place in a public, and typically polite, professional setting. Since the main objective of the discussions was to inform the audience, participants were usually very open and frank in their accounts, sharing often insights of mistakes made during their professional career, and thus revealing unpleasant experiences. In this regard, it has to be noted that the language used by participants nearly always presupposed a high level of insider knowledge of the subject, reflecting on both the professional status of the panel, as well as of the audience.

Besides these general concerns, there are also two interrelated criticism that can be brought forward particularly against the method as used for the purpose of this study. The first, and probably severest critique against the method applied is that the panel discussions observed have not been organized by the researcher, but by a third party; as such I have neither been able chose the topic of the discussion, nor the participants (problem of sampling). In the same vein, a second criticism that can be made is that I was not the moderator of the discussion, and thus have not been able to interfere in the ongoing debate, but relied instead on an independent moderator (problem of discussion direction).

With respect to the first critique, I argue that while it is certainly true that in this method the researcher has no direct influence over the selection of the participants, he can choose which panel discussion to observe, thereby indirectly choosing participants and discussion topic. Secondly, the 55 panels discussions/session observed for this study, have brought together more than 140 very high profile industry professionals (not counting the professionals in the audience) from all over Europe, India, Russia and the US to discuss and share their knowledge and expertise, generating very relevant data, which – as I maintain – could not have been produced, or accessed in any other way. Thirdly, by assuming only an unobtrusive observer role, this approach has avoided the problems typically caused by the researcher’s presence (Webb *et al*., 1981). Instead, this method has taken advantage of observing high level peer discussion on topics, which the industry considers itself as the most pressing and relevant (self-selected instead of suggested by the researcher), and has preserved the authenticity of knowledge exchange between industry professionals. Fourthly, post-panel observation during breaks has offered a further chance of learning, in a "micro-ethnographic" way, which themes resonated in particular with the audience, thus offering the opportunity for unstructured interviews and a second level of data collection.

While not a condition, typically the researcher is also the moderator of the focus group he wants to study. However, in the panel discussion observed, this moderating role has usually been assumed by an expert in the respective field (e.g. the chief editor of a trade journal), and thus the researcher could not directly influence the structure and direction of the panel. While it would be possible to answer to the second critique with the same set of arguments as outlined above, I will firstly evaluate the role of the moderator in the group discussion in more detail, in order to have a foundation to fully address the critique. As noted by Stewart and Shamdasani (1990), a good moderator can usually discern between what is important to members of the group and what is important to the observer, thus directing the discussion in such a way as to be rich in data for the observer. As the purpose of the panel discussions was to inform the audience of ongoing development (of which the researcher was part of), it can be argued that the moderator has directed the group to match the researcher's interest (to learn about ongoing developments in film financing and film policy). In addition, a good focus group moderator can be described as being generally interested in the participants' stories, being animated and spontaneous, possessing a sense of humour, being flexible and able to express ad hoc thoughts clearly and effectively (1990:79). For the panel discussions observed, the moderators can generally be described as fitting the characteristics outlined above. Typically, the moderator of observed panel discussions was a leading expert in the field, directing the discussion confidently. The main focus of moderators observed, was on promoting interaction, otherwise letting the discussion flow as long as it remained on the topic of interest. Due to the professional setting of the panel discussions, moderator bias such as "the all-too human predisposition to welcome and reinforce the expression of points of view which are consonant with our own" (1990:84) was therefore hardly noticeable.

4.4.2 Observation and Unstructured Interviews

With respect to actual data gathering process, Fontana and Frey (1994) have noted that a key consideration of observation is deciding how to present oneself, and how much detail to reveal to informants about the nature of the research. In the course of this study I have adopted two main roles during observation. Firstly when observing panel discussions, the role of *observer as participant* (Saunders *et al*, 2007:288) was adopted, wherein I was mainly a "spectator", having little or no interaction with panel discussants and professionals in the audience. In this role, I have taped panel discussions with a digital tape recorder and have taken notes of key statements, as well of my own questions that arose with respect to the discussion. As not all material I have recorded during panel discussions has been pertinent to the research, recordings have typically not been transcribed in full, but have first been listened to twice, to identify relevant sections, and then these relevant sections have been transcribed (an approach suggested by Saunders *et al*. 2007 and Bryman and Bell, 2007).

During breaks between sessions at single day events, and at multi-day events such as the Cannes Market, the Copenhagen Think Tank on European Film and Film Policy, and the Film Finance Forum in Luxembourg, the role I have adopted corresponded closer to that of a *participant observer*. Here, more emphasis was placed on gaining the trust of industry professionals and developing relationships. As informants during single day industry events were not always readily accessible or identifiable, an approach suggested by Fontana and Frey (2000) was adopted, namely that anyone the researcher meets, can become a valuable source of information.[39] During multiple day workshops and industry markets, a more "micro-ethnography" (Wolcott, 1995) approach was adopted, as the longer time period allowed to build stronger relationships with other participants than at single day events. Thereby, I mostly followed Wax's (1960) suggestions to "humbly" present myself as a "learner" in order to gain trust, but still being able to focus on my

[39] This approach has been championed by Fontana (1977) in his study on the elderly poor, which was largely based on wandering around and talking with people (Denzin and Lincoln, 2000:654).

research role. My background and experience of making short films, and thus possessing both practical craft experience, as well as a strong interest in the business side of film, also proved to be very helpful in getting access to informants. During these markets and workshops, I observed informal banter, and listened to conversations between professionals, as well as participating in conversations. As my aim to learn was made clear to informants, I was flexible enough to ask questions in order to enhance my understanding of ongoing policy developments, developments in film finance and questions related to co-productions. In conclusion it may be said that the distinction between unstructured interview and a more ethnographic approach often became fluid. This corresponds with Lofland (1971) who has pointed out, that in-depth (ethnographic) interviewing and participant observation go hand-in-hand, with much of the data gathered in participant observation coming from informal interviewing in the field.

4.4.3 Sampling

As Goulding (2002) has stated, of key importance for the quality of the research is the sampling process, regardless of the methodological perspective and approach adopted by the researcher. For this research a purposive sampling approach has been adopted (Saunders *et al*. 2007), using mainly personal judgement to select which industry events/ panel discussions, and which industry professionals to interview partner could be assumed to be particularly informative to answering the research question. The sampling approach adopted (for selecting both observed panel discussions and interviewees) could further be described as theoretical (Glaser and Strauss, 1967), as it was an ongoing process (rather than a single stage of random sampling) that was largely influenced by the emerging theoretical conceptions. For Charmaz (2000), theoretical sampling is concerned with the refinement of ideas, rather than boosting sample size. As the overall emphasis therefore lies on theorizing rather than on statistical adequacy, this can "limit the sample selection in many instances" (Bryman and Bell, 2007). Coyle (1997) has, in this respect, described theoretical sampling as the purposeful selection of a sample, according to the developing categories of the research and the emerging theory. Following Strauss and Corbin (1998), the theoretical sampling approach can be summed up as:

> *"Data gathering driven by concepts derived from the evolving theory and based on the concept of "making comparisons", the purpose is to go to places, people, or events that will maximise opportunities to discover variations among concepts and to densify categories in terms of their properties and dimensions."*
>
> **Strauss and Corbin (1998:201)**

In an iterative process of data collection and reflection, the emphasis of theoretical sampling is therefore upon theoretical data reflection, guiding the decision whether more data is needed or not. Data collection and sampling is ended, when a satisfactory level of data to answer the research question is reached.

4.5 Interviews

As Bloch has noted:

> *"In social research the language of conversation, including that of the interview, remains one of the most important tools of social analysis, a means whereby insight is gained into everyday life, as well as the social and cultural dimensions of our own and other societies."*
>
> **Bloch (1996:323)**

To complement data collection through observation of panel discussions, as well as through informal unstructured interviews, a further 10 semi-structured interviews have been conducted for this study. Semi-structured interviews were thereby seen as a useful complementary method to clarify and confirm themes that have arisen through observation. The interview partners were chosen with respect to their professional and national background using a purposeful sampling approach (see **Table 4.2** below).

Table 4.2: Semi-Structured Interviews

	Role of Interviewee	**Date and Location of Interview**
1	UK producer	21 May 2006, Cannes
2	UK producer	11 March, London
3	French producer	14 February 2006, Berlin
4	Bulgarian producer	25 March 2007, Luxembourg
5	Hungarian producer	16 February 2005, Berlin
6	CEO US Venture Capital Fund	21 May 2006, Cannes
7	Entertainment Banker, US bank	20 May 2006, Cannes
8	MD of Regional German film fund	20 May 2006, Cannes
9	CFO of Portuguese film fund	22 June 2006, Copenhagen
10	Trade journalist	14 Feb 2006, Berlin

The interviews were based on a list of specific questions that nevertheless allowed the interviewee a great deal of leeway in how to reply. In addition a number of questions were usually asked that were not in the interview guide, but were picked up in response to issues mentioned by the interviewee (probing). Interviews lasted between thirty minutes and two hours, and were either recorded with a digital tape recorder and then transcribed, or notes were taken during the interview. In order to protect the identity of participants in the research, anonymity was assured to all involved. Therefore, where quotes from interviewee's are used in this thesis, the identity of participants has been disguised using only their job titles. Furthermore, although panel discussants made their statements in public, I have decided to likewise use only their job titles for quotations, firstly because the emphasis of the statements quoted lies on the professional role of the discussants, and not their personality, and secondly for matters of coherence.

4.6 Secondary Data

Secondary data – quantitative and qualitative in nature – plays a significant role for this research, having not only been used to corroborate primary research findings and increase the reliability and validity of the overall study, but also to provide important evidence for some of the main arguments made in this thesis. The statistical and qualitative secondary data used for this research have thereby mainly been collected in print and online from the following sources;

- Public sector organizations and film support institutions with a high authority, such as the Council of Europe's European Audiovisual Observatory, the UK Film Council, the German FFA, the Motion Picture of America's Research Department, the CNC, the DFI (statistics and reports);
- The International Movie Database (box office data);
- Trade journals, such as Screen Finance, Screen International, The Business of Film, Variety and the Hollywood Reporter; (statistics and trade reports)
- National government institutions, such as the UK HM Treasury, the DCMS, the German Kulturstaatsministerium (legal and policy documents);
- Production companies (outlines of financing structures, sample and actual production budgets of film projects)
- Industry markets and events attended for this research (statistics, presentation handouts, workshop notes, draft policy documents)

In the course of this research, I have found the boundary between primary and secondary data often more fluid than the distinction suggests. This was particularly evident in the documents I have obtained at industry events, either by gaining access to previous unavailable data on the mere merit of participation, or by specifically asking participants and discussants for documentation and notes.

As documents, the “mute evidence” (Hodder, 2000:703), have usually not been created for the purpose of the research, I have placed strong emphasis on evaluating the reliability of all secondary data sources, and where data was aggregated (for example in statistics from trade journals), have also sought to evaluate the underlying data sources. Furthermore, the context in which data has been originated has been sought to be taken into account.

4.7 Trustworthiness and Authenticity

While it is possible to adapt concepts of reliability and validity with little difference from quantitative methods for qualitative research (Mason, 1996; LeCompte and Goetz, 1982), such application is severely limited (for instance by the impossibility to “freeze” social settings and therefore replicate studies), and therefore Lincoln and Guba (1985) and Guba and Lincoln (1994) have suggested an alternative set of two criteria for evaluating qualitative research, namely *trustworthiness* and *authenticity*.

The first criterion, trustworthiness, comprises four sub-criteria that are (1) credibility, (2) transferability, (3) dependability and (4) confirmability. Credibility can be ensured for qualitative research, both when the research is carried out according to the canons of good practice of social science, and the research findings are then submitted to the members of the social world studied for confirmation; or by employing methods of triangulation. Transferability, which refers to generalizing findings from one context to another, can be ensured according to Guba and Lincoln by providing “thick descriptions” (Geertz, 1973). Dependability of research can be achieved by keeping complete records of all phases of the research process, from problem formation to selection of research participants, fieldwork notes, interview transcripts, data analysis description. Finally, the criterion of confirmability demands that the researcher acts in good faith throughout the research process, and has not overtly allowed personal values, or theoretical inclinations to impact on the conduct of the research and the findings from it.

Tested against these criteria, I contend that this study satisfies the criterion of trustworthiness, as I have acted in good faith throughout the research process, kept records of all phases of the research process, sought to provide an accurate empirical description of the film industry to allow judgements whether it is possible to transfer findings to a different context, have used qualitative and quantitative in a mixed method approach to support my argument, and have presented my research findings to an academic audience through a journal article, paper presentations at academic conferences, and in a seminar open to industry professionals.

The second criterion outlined by Guba and Lincoln (1994), authenticity, suggests that research should also be evaluated with respect to its fairness (representing different viewpoints), as well as the impact it has on informing the milieu studied and prompting impetus for change. I contend that this research satisfies this criterion, by seeking to understand developments in the film industry from different viewpoints, taking into account the perspectives and agendas of public institutions, producers and financial intermediaries. Furthermore, as is evidenced by the penultimate section of this thesis, I have outlined a number of issues arising from this research that can be pertinent to inform future policymaking and film industry professionals. However, recognizing that my research interests might be quite different from industry professionals, another suitable form to evaluate the impact of this research can be found in Hammersley's (1992) criterion of relevance, that assesses the importance of a topic within its substantive field or the contribution it makes to the literature of that field. In this respect, I would like to point out that the article "*Finance, Policy and Industrial Dynamics – The Rise of Co-productions in the Film Industry"* based on this research was publishing by the journal *Industry and Innovation* (Morawetz *et al*, 2007), and that I am committed to further disseminate the findings of this research at academic conferences and through publication.

4.8 Summary

In this chapter, I have outlined the research philosophy and methodology I have adopted for this study. Starting from a literature-informed hypothetical explanation of co-productions, I have adopted an iterative approach to collecting and analyzing data, with the emerging theory guiding, and being tested by further data collection. In order to cross-check and frame the qualitative data gathered, a mixed methods approach has been employed, with quantitative data increasing the overall validity and trustworthiness of the findings. This method of triangulation is also a reflection of the realist research philosophy adopted in this thesis.

With respect to data collection, I have addressed the challenge of getting access to a wide range of professionals from different national film industries by taking advantage of professional gatherings, such as film markets and industry workshops. During these temporary clusters, data have been collected in a multi-method way, through observation, structured and unstructured interviews and collection of documents. As I found at these events, observing panel discussions can provide a rich source of relevant data. In this chapter I have likened the observation of panel discussions theoretically to the method of focus group discussions, and discussed this approach as an innovative and effective method for data collection.

The overall aim of this chapter has been to demonstrate that the data upon which the findings of this research are based, have been gathered in a sound and rigorous way, and are reliable and valid. As such, I contend that the final proof for the suitability of the applied methodology ultimately lies in the richness of the data that has been uncovered, as presented in this thesis.

5. FINANCE AND INDUSTRIAL DYNAMICS

5.1 Introduction

> ***"Bob Woodward****: The story is dry. All we've got are pieces. We can't seem to figure out what the puzzle is supposed to look like [...]*
> ***Deep Throat****: Follow the money."*
>
> **From the film *All the President's Men*, directed by A.J. Pakula, 1976.**

In the previous chapters I have highlighted the importance of co-productions in international feature film production, and have argued that this production pattern based on temporary, distant inter-firm networks, coordinated through temporary clusters is a distinct, although complementary, system of production to industrial organization in clusters. The cross-border nature of co-productions therefore suggests, that rather than analyzing the film industry as a local, isolated phenomenon, it is necessary to analyze industrial development in the context of the whole, international production system.

A central argument of this thesis is that the role of finance is critical to film production, and that hence financial dynamics are a key explanatory factor for the growth of co-productions. As the relationship between finance and production in the film industry is generally an under researched topic, the main aim of this chapter is to establish and conceptualize the characteristics of their relationship, and thus provide the foundation for further analyzis.

I will begin by firstly characterizing the film industry as an industry in constant search for finance, marked by high capital costs and a high degree of uncertainty that translates into a high financial risk for investors. Based on a critique of previous conceptions of the relationship between demand uncertainty, finance and industrial organization in the film industry, I propose that changes in film production are strongly contingent on changes in the amount of financing supplied to the industry, and suggest that in the context of financial scarcity, production is organized in such a way to gain access to finance.

In order to reflect the crucial importance of finance for production theoretically, I propose to see financial dynamics as a driver of industrial change in its own right, and will propose to make a theoretical distinction between essentially footloose financial capital and embedded production capital. Based on this general distinction, I then look at the specific features of the film financing process, in order to show how it is used in the industry to transfer a spectrum of risk between parties, how its contractual agreements reflect industry power structures, how it provides producers with an incentive to maximize budgets, and how it makes the film industry as a whole highly receptive to variations in the amount of capital provided to it.

Finally, I outline two basic industry dynamics that result from the relationship between financial and production capital, and argue, that in order to explain growth in co-productions, it is necessary to examine changes in the film financing environments of both the European and the US film industries.

5.2 The Importance of Finance in the Film Industry

5.2.1 Demand Uncertainty and Financial Risk

> *"The improbable happens in the movies and these are the main events."*
>
> **De Vany (2006:241)**

As Frederiksen (2004) notes, all industries face problems of uncertainty in the market, which in the worst case results in a situation where it is unclear whether a product can be sold at all, but the degree of uncertainty varies. Knight (1921) has distinguished in this respect between the concept of risk versus the concept of uncertainty. For Knight, *risk* can be described to cover incidents of lack of information and knowledge, which can nevertheless be calculated and therefore be taken into account, resulting in some form of insurance. As Frederiksen notes,

> *"In other words, risk refers to situations where the decision-maker can assign mathematical probabilities to the randomness which is faced."*
>
> **Frederiksen (2004:20)**

In contrast to risk, for Knight *uncertainty* refers to a situation in which individuals and firms are not able to calculate the uncertainties, as the degree of randomness is so high, that it cannot be expressed in terms of specific mathematical probabilities. Therefore, uncertainty can be dealt with mainly by the exercise of judgement (Stinchcombe, 1990).

As Caves (2000) suggests, in contrast to more traditional manufacturing industries, the creative industries face a high degree of demand uncertainty, as 'sleepers may unexpectedly turn into smash hits, and sure-fire-successes flop' (Throsby 2001:957). Among the creative industries in turn, high demand uncertainty has, in particular, been claimed to be a salient characteristic of the film industry (Maskell and Lorenzen, Scott). Using statistical methods on various box office datasets, authors such as De Vany and Walls (1996, 1997, 2002, 2004, 2005), Litman (1998) or Vogel (1998) have demonstrated that a film's box office success is highly unpredictable, with De Vany (2006:619) even declaring that the foremost principle of the motion picture industry[40] is that "*Nobody knows anything"*, referring to a famous quote by screenwriter William Goldman (1983). While this claim may be exaggerated, film production certainly must be considered as a high-risk entrepreneurial activity. As Frederiksen (2004) notes, uncertainty in the market can usually be reduced by acquiring information about market dynamics, such as consumer preferences and trends. This, however, is only possible to a limited degree in the film industry. As De Vany (2006) notes, film is an experience good, meaning that consumers (and producers and investors as well) can only decide whether they like the product after they have seen it, that is, after the costs of production have already been incurred. While test screenings can provide an indication to whether a film will be a success or not, and scenes can be re-shot following such a screening to increase audience appeal, demand for a single picture, and therefore revenues, remain nearly impossible to predict.

As a consequence, investment into film carries a high financial risk that is exacerbated by the high capital requirements of film production. This makes the financing of films a

[40] American authors refer to the film industry usually as the motion picture industry, the movie industry, or in the case of De Vany, simply as "the movies".

major issue for film companies, which are typically characterized by low capitalization. Whether it is a £3 million UK domestic production, a £40 million European co-production or a £100 million studio picture, a production company hardly ever possesses the financial resources to self-finance its projects. In order to finance the high production costs of a film, producers are dependent on outside financing, while at the same time the majority of traditionally "conservative", risk-averse financing sources (such as banks) shy away from an industry where "nobody knows anything". A longstanding history of failed investment endeavours into film (see Phillips, 2004) further aggravates this situation, as investment into film has gained the reputation of being "casino" or "silly money". The result is an overall scarcity of finance in the industry that ultimately makes production dependent on finding finance.

This, as Wasko (1982) has shown, is even true in case of the majors, which have been dependent on *outside financing* since the 1970s, and have not been able to finance increasing production outlays from their retained earnings since that time (Phillipps, 2004:106)[41]. In a critique of the wide spread assumption that the film industry has always been concentrated in Hollywood, Bakker (2005) has furthermore argued that the US film industry emerged in the 1920s as the winner over the then market-leading European film industry mainly because European film companies found it increasingly difficult to obtain the vast amounts of venture capital needed to compete with American product, as investment money was limited because of risk adverse European financial markets. In contrast to Europe, the US film industry experienced a small investment boom in the mid-1910s, as "nearly every company with the word 'motion picture' in its name was able to launch an IPO" (2005:336). Film companies such as Warner Brothers found early financial backing from financial institutions such as Goldman, Sachs & Co, Paramount from the bank Kuhn, Loeb & Co, RKO from Merrill Lynch, and William Fox from a group of New York investors and an insurance company. At a time when studio distribution power was not yet fully developed and big European film companies still

[41] While in 1980 studios could potentially recover production expenses from their domestic box office with a positive differential of roughly USD 1 billion in 1980, the increase in production costs has shifted the relationship of box office carrying cost to expenditure to a negative USD 12 billion differential in 1997 (2004:106).

existed, Bakker's study suggests that access to extra-industry financial capital can be isolated as the single most important factor in the competition for global screens, with knowledge spill-overs, shared inputs, network externalities and thick markets for specialized supply and demand only beginning to be of importance, once Hollywood's global hegemony was already firmly established.[42]

5.2.2 Perspectives on Finance and Industrial Organization

While empirical studies (Coe, 2000b, 2001; Nachum and Keeble, 2003; Coe and Johns, 2004) have certainly recognized that finance plays a crucial role in the film industry, the conception of finance and uncertainty in mainstream cluster literature has remained largely theoretically underdeveloped. It can therefore be criticized for paying only little attention to how uncertainty translates into financial risk, leading to a confused understanding of how uncertainty is related to industrial organization.

As already mentioned in the previous chapter, Maskell and Lorenzen (2004) for example have suggested that firms tend to form clusters in cases of relatively high industry uncertainty, and engage in building or joining networks in cases of comparatively lower industry uncertainty. Their definition of industry uncertainty thereby refers back to Knight (1921) and denotes "unforeseeable changes in technology, supply and demand" (2004:993). However in their analysis the authors pay little attention to demand uncertainty ("market ambiguity (2004:995)) and consequently financial risk, but focus instead mainly on variations in supply, and in particular on the degree of stability of inter-

[42] As Miller *et al* (2006) have noted, an important role in the American film industry's rise to power was furthermore the fact that US players understood very early on that intellectual property protection and support from the state can be a powerful means to build business empires. This is evidenced by their example of the Motion Pictures Patent Company, through which *The Edison Company* alongside *Biograph* tried to establish a monopoly for camera equipment and threatened the distribution of foreign films in the US in the mid 1910s. Although the cartel was soon broken by US antitrust legislation, Miller *et al* argue that this led to an "Americanisation" of the US domestic market, as French film equipment was confiscated by US customs (see also Kerrigan and Culkin, 1999). As US film exports rose sharply between 1915 and 1916 while imports from Europe declined, the US Congress passed the Webb-Pomerance Act which permitted overseas trusts that were illegal domestically and enabled an international distribution cartel for nearly 40 years. The Motion Picture Export Association centrally determined export prices and the terms of trade and was also involved in business practices such as blind bidding and block booking (see also Trumpbour, 2002; and Sedgwick and Pokorny, 2005), thus suggesting that investment risk into the US industry was also strongly reduced by securing international markets through the use of coercion and political power.

firm relations. As such the term "industry uncertainty" represents a conflation of what can be termed the "risk of (creative/innovative) production", that is the result of product experimentation in the production process, and the financial risk of the production activity that results from uncertainty of demand.

However, while it is possible to reduce, as the authors suggest, industry uncertainty in the sense of risk of production through industrial organization, it is important to note that a change in the (spatial) organization will not lead to any change in the degree of industry uncertainty with respect to uncertainty of demand. This is evident in the film industry, which faces both a high degree of demand uncertainty, and a high degree of risk with respect to the outcomes of creative production. Following Maskell and Lorenzen's suggestion, clustering in the film industry can indeed be seen as a way to reduce the latter, as it facilitates knowledge exchange, networking, and the building of trust, which in turn facilitate the reduction of transaction risks between collaborators, the exchange of best practices and hence arguably lead to an efficient execution of film projects. Furthermore, within a cluster, soft factors of governance such as reputation, track record of the producer and the talent involved ("A-list" stars), can act as quality signal to collaborating parties. However, *ceteris paribus*, the way production is organized can not have an impact on the *overall* uncertainty of demand the industry faces, and will therefore have no impact on the overall financial risk of the productive system. Industrial organization can serve though, to transfer risk between individual players within the production system. This is demonstrated by the work of Christopherson and Storper (1987), who have shown how the increase in demand uncertainty through the Paramount decision[43] has led to the restructuring of the industry towards inter-firm networks, as the dominant industry players (the majors) have outsourced the risk of financing film production (Wasko, 2004).

In a context of high demand uncertainty, industrial structures can therefore be assumed to firstly represent power structures in the industry, as dominant organizations seek to

[43] See also section 4.3.1.

outsource their financial risk exposure down the line. Secondly, as high demand uncertainty leads to a scarcity of finance, and production is dependent on finding finance, production can be assumed to be organized in such a way that it can maximize the inflow of financial capital. This is firstly reflected in empirical studies on runaway productions in the film industry (Coe, 2001), which have shown that producers are willing to establish external links to access financial capital pools even across significant distance and at significant cost, and secondly, is strongly apparent in the organizational form of co-productions, which have historically emerged to enable the pooling of financial resources.

In addition to neglecting finance as an important factor in the conception of the relationship between production patterns and uncertainty, mainstream cluster literature can also be criticized for paying very little attention to finance as a factor for the spatiality of production in general. In cluster literature, finance is typically assumed to be either inherent to production (self-financing entrepreneurs, who re-invest retained earnings and their own capital into production), or to be an external factor, which is more or less automatically provided by the market (the entrepreneur seeks finance from a financial institution). [44] As I have indicated above, in case of the film industry, finance cannot be considered to be inherent to production, which points to the second conception. In case of the latter, mainstream cluster literature sees traditional entrepreneurial activity as being enabled by financial institutions such as banks, with finance overall forming part of the institutional environment, or the social economy (see for example Hayter's landscape of dissenting institutionalism, 2004:97). With respect to high risk, innovative industries, such as the film industry, cluster literature suggests that the problem of finance is solved by the emergence of a (local) set of financiers, who possess specialist knowledge (for example specialist venture capital funds) to finance such activities. Therefore, financing can be seen to benefit from spatial proximity, and even to contribute to cluster formation (Zook, 2002; Martin *et al*, 2003; Babcock-Lumish, 2003, 2004).

[44] This is in line with neo-classical perspectives, which in the case of the film industry for example assumes that the market will provide exactly the right amount of capital to pitch the right budget against the right audience. From a producer's perspective, this has been proposed by Ilott (1996) who has argued that there should be a match between a film's budget and the audience it seeks to attract: A European art house picture with a small audience appeal should have a lower budget, than an American blockbuster..

Such a conception is however problematic in several respects. Firstly it avoids important questions with respect to the overall viability of the production system, such as where investment comes from, and who ultimately carries the risk of film production. Secondly it wrongly equates the emergence of a specialist institutional environment, with the actual existence of financial capital that is eager to invest into the industry. However the presence of financiers who possess specialist knowledge of investing in film, does not necessarily mean that there is risk-friendly financial capital available that is interested to invest. Thirdly, with respect to the notion that film production is highly dependent on financial capital, it can be assumed that an increase or decrease in the amount of finance flowing into film production, will also result in a reduction or expansion of production, and can lead to a change in industrial organization. By assuming that industrial activity will automatically find finance, finance is wrongly conceived of a mostly static factor, and the impact of financial dynamics on production is not captured. In order to address these shortcomings, I therefore propose that instead of treating finance as being part of the institutional environment, finance should be treated as dynamic factor equal to production.

5.3 Production Capital and Financial Capital

To base analysis on a clear distinction between finance and production is not a novelty in economics, but is for example already a key element in the work of Karl Marx (Harvey, 2004). Likewise Veblen (1904) has stressed the difference between the "captains of finance" who want to accumulate monetary wealth and the "engineers" (the "captains of industry"), who develop technology and make things. For Veblen the word capital thereby has a double meaning: On the one hand, it denotes the equipment for making things; on the other hand capital refers to monetary accumulation used to secure a gain. Furthermore, as money, capital can be divided into small allotments and exchanged, while when meaning equipment, it is non-divisible and often not mobile (Gudeman, 2001). As Veblen has shown, the two meanings are often confounded in the application of the term, a critique that is still tenable for most neo-classical economics, and also economic geography studies.

Another economist, who has emphasized the importance of financial capital is Schumpeter (1939:223), who has particularly focused on the dynamic relationship between innovation and financial and production capital, defining capitalism overall as "that form of private property economy in which innovations are carried out by means of borrowed money".

Combining key ideas of Veblen and Schumpeter, Perez (2002, 2004) has proposed the terms financial capital and production capital to highlight the difference between finance and production.[45] Production capital is thereby understood to embody the motives and behaviours of those agents who *generate* new wealth by producing goods or performing services (including transport, trade and other enabling services). As Perez defines it:

> *"By analytical definition, these agents do this with borrowed money from financial capital and then share the generated wealth." The objective of production capital is to "accumulate greater and greater profit-making capacity, by growing through investment in innovation and expansion. […] Their power stems from the power of the specific firm and their personal wealth will depend on the success of their actions as producers."*
>
> **Perez (2002:71-71)**

As a result, production capital is tied to concrete products, "both by installed equipment with specific operational capabilities and by *linkages in networks* of suppliers, customers or distributors in particular *geographic locations* [emphasis added]." For production capital, knowledge about products, processes, and markets is the very foundation of potential success: whether this knowledge is managerial, technical, scientific, an innovative entrepreneurial drive or social capital, it will always be only partly mobile.

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[45] It is important to note that Perez is particularly interested in techno-economic paradigms, and how the dynamic relationship between financial and production capital in an economy enables risky, innovative entrepreneurial activities. However I contend that her definitions are widely applicable to other areas of economic research, and also propose that they are particularly fitting for research on the film industry, as film production closely matches the characterization of the risky, innovative entrepreneurial activity that is the central subject of innovation literature. While the film industry has been in existence for more than a hundred years, and film is a technically mature product, the creative nature of film production (idea-driven, unique projects) allows for the categorization of it as an innovative industry. The innovative nature of film production is also represented in the industry structure, with the production sector consisting of a plethora of innovative entrepreneurs (producers) who are constantly looking for financiers to enable their projects. On these grounds, also Davenport's (2006) proposition that the film industry lacks entrepreneurship and innovativeness, as the whole system hasn't "changed in decades" and "producers strive for "repeatable solutions" rather than "rupture" or originality" (2006:256), can be rejected, representing a misunderstanding of both theory and the film business.

This description also matches the understanding of economic activity in economic geographer's accounts very closely, as it highlights the importance of local ties, embeddedness, specialization and tacit process knowledge. Transferred to industry level, the category of production capital spans across the organizational and spatial boundaries of the firm, the project and the cluster, emphasizing the importance of entrepreneurial activity over its organizational form. A particular industry such as the film industry is then defined by a set of skills, resources, contacts or special knowledge, which are directed by agents in this industry towards producing particular goods or services. With the producer's knowledge in the film industry being tied for instance to producing films, growth of production capital in the film industry can be assumed to be aimed at growing film production, and can for this reason be assumed to be path dependent.[46]

Financial capital on the other hand represents the agents who possess wealth in the form of money or other paper assets (Perez, 2002). In order to increase their wealth, these agents might acquire deposits, stocks, bonds, oil futures, derivatives, diamonds or whatever, but their purpose remains tied "to having wealth in the form of money ('liquid' or quasi-liquid) and making it grow". In contrast to production capital, financial capital is not tied to a specific industry, but is understood as being essentially footloose in nature - wherever money can be made, money will flow. The most attractive investment opportunity is thereby one that yields high returns and has little risk attatched. In general however, the higher the risk attached to an investment opportunity, the more profit investors expect from their investment as a compensation for the risk. Money can be invested in a firm or a project on the other side of the world, without significant knowledge of the economic activity invested in. Likewise, financial capital can exit from the investment far easier than production capital, seeking alternative investments while

[46] The notion of path dependence, which can be traced back to Menger's (1883) analysis of 'institutional emergence', refers to the incremental, self-reproducing and continuity preserving development (see North, 1990; Setterfield, 1995; 1997) of different institutional arrangements, such as firms. In economic geography, path dependence emphasizes the context-specific, locally contingent nature of self-reinforcing economic development. As such path dependence can be understood as the 'quasifixity' of geographical patterns of technological change, economic structures and institutional forms across the economic landscape (Martin and Sunley, 2006). It is important to stress that path dependence does not mean "past dependence" (Hakansson and Lundgren, 1997) but is best understood as a probabilistic process.

production capital remains tied to its industry, and "must find alternative actions within a limited range, often needing to lure financial capital or face failure" (Perez, 2002:73).

Clark (2005) has noted in this respect, that historically the pooling and channelling of finance has been such that the vast majority of financial assets stays within the confines of national jurisdictions (2005)[47], thus highlighting the importance of the state and his framework setting role for directing financing flows. This institutional dimension of financial systems has also been stressed by Hollingsworth, Schmitter, and Streeck's (1994), who have suggested that production patterns are in general marked by their historical and institutional development.[48] However, as Clark has proposed, in the context of the ongoing European capital market integration and the switch to Anglo-American financing systems, locality matters increasingly less as a factor in the relationship between financial capital and production, and hence finance becomes more and more detached from the local and the national, and less place-bound, as once distinctive financial systems are converging to a global "best practice". This, as Clark suggests, makes local geographies, and thus industries increasingly reliant upon remote financial institutions and practices that can only partially be influenced by local financial institutions or governments. To achieve their aim of growing wealth in the form of money, financial capital uses the services of *financial intermediaries* such as banks or brokers, who provide information about investment opportunities. These financial intermediaries in turn fall into two categories, namely firstly into the majority group of

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[47] This is in line with La Porta *et al*'s (1997, 1998), who have mapped global finance through linking nation-state legal traditions and the scope of investor protection to domestic stock market liquidity. They have shown that the landscape of finance is differentiated and segmented by history and geography as reflected in national institutional structure and legal practices (see also Wood 1997).

[48] The authors have argued, up to the first half of the 1990s the production regimes of most advanced economies fell into one of two main patterns. The first group, belonging to the "European model", included most northern European economies (Germany, Sweden, Switzerland) and was characterized by a considerable non-market coordination directly and indirectly between companies, with the state playing a framework setting role. The institutions of finance in this European model were orientated towards long-term financing of companies, hindered hostile takeovers and especially smaller companies relied on bank finance. The second main pattern, namely that of uncoordinated or liberal market economies, was dominant in the Anglo-Saxon economies such as the US, UK and Ireland, with the state playing a minor role and little non-market coordination between companies. The financial system of the Anglo-American model imposed relatively short term horizons on companies but also allowed high risk taking (see also Soskice, 1999:103).

risk-averse, conservative bankers, and secondly into a small group of "innovative" financiers, who are driven by a constant search for above the market returns, and are thus prepared to finance risky entrepreneurial activities that can yield such returns. ("wildcat or reckless" finance). **Table 5.1** sums up the distinction between production capital and financial capital in the film industry.[49]

Table 5.1: Production and Financial Capital in the Film Industry

Production Capital Film Producers	**Financiers**	**Financial Capital** Investors
Aim: Interested in producing films and to grow their production capacity. Seeking a financier that can enable them to pursue the high risk, entrepreneurial activity of film production	*Aim:* Conservative Financiers (i.e. banks) Interested in above the market returns, but limited willingness to take risk. Innovative Financiers (i.e. venture capital funds) Interested in above the market returns, and willing to take more risk to achieve this aim.	*Aim:* Interested in growing wealth in the form of money, ideally by investing into a low risk/ high return investment opportunity.
embedded, path dependent	footloose, "profit dependent"	footloose, "profit dependent"

(Source: Norbert Morawetz 2008)

As can be seen, the group of film financiers plays an important intermediary role between financial capital and production capital, and it is in the financing process that the two economic counterparts of producer and investor are connected. I therefore propose that the relationship between production capital and financial capital can best be observed when analyzing the financing process in more detail[50], as the key process in which the interest of financial capital and the interest of production capital meet and are played out.

5.4 Specific characteristics of Film Finance

> *"It is of vital importance to communicate the opportunities and more importantly the risks. Serious investors are more concerned about understanding the risks, than they ever are exploring the upside. You might as well start with acknowledging a few fundamentals. The risks of film are far higher than other business sectors and therefore needs to be carefully managed."*
>
> **Chairman, Leading UK Film Fund**
> **(Source: Discussion, Film Finance Summit, October 2006)**

[49] It has to be noted that this is a conceptual distinction; players in the film industry might belong to more than one category

[50] I herein follow Perez (2002:71) who notes with respect to financiers, "It is the behaviour of these intermediaries while fulfilling the function of making money from money that can be observed and analyzed as the behaviour of financial capital."

As I have noted, film production is a high-risk entrepreneurial activity, because of demand uncertainty, and the uncertain nature of creative production. However, if a film is successful, the potential for high revenues is equally high. In case of a box office success the returns on investment in film can be a multiple of the original investment (for example the *Blair Witch Project* (1999), produced for an estimated USD 60,000, has collected more than USD 240 million at box offices worldwide, giving the project a theoretical return on investment ratio of 1:4,000, without taking DVD rentals and sales into account). Film can therefore be classified as a high risk/ high potential revenue investment, which is – if it were to be financed by just one source of capital – mainly interesting for very risk-friendly investors, in search for above the market returns.[51] The caveat to the above statement already points towards the observation that films are typically not financed by a single source of financial capital, but by a mix of investors (contracting parties), each with a different risk profile and interested to maximize his or her share of the revenues.

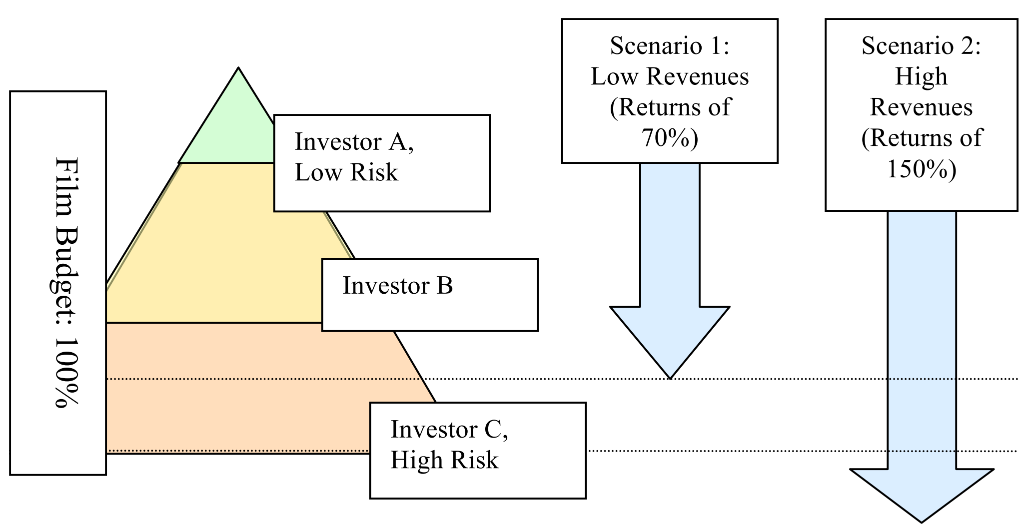
In essence, film as a form of investment is a bundle of rights for a number of platforms (cinema, DVD, television, video-on-demand) in a number of markets, with each right representing a distinct stream of revenue (for example the right to exploit the film through DVD sales in Spain; the right to theatrical release in the UK; the Free-TV rights to Germany). A basic distinction can be made between revenue streams that are *linear* (Tavares et al, 2003), referring to revenue streams that are directly associated with box office success, such as domestic and foreign theatrical box office, or video and DVD sales and rental; and *non-linear revenue streams,* which refer to fixed revenues, such as for example an advance minimum guarantee paid by a distributor to distribute the film in a certain territory, or the pre-selling of rights to a sales agent. While linear revenues are by their nature uncertain, their revenue potential is uncapped and can, in the best case, be a multiple of what a sales agent is willing to pay upfront (non-linear revenue stream). Thus a film producer, who is trying to raise finance for a film project, has two fundamental options of how to use his bundle of rights to raise finance. Firstly, he can

[51] In addition to this investor class, the film industry has, throughout history, also time and again attracted "casino investment" from "high-net worth individuals", seeking to "gamble" a certain amount of money on projects in an industry that is attractive for its glitz and glamour.

pre-sell the right to a certain territory and distribution window (e.g. the rights to distribute the film on home video in France for a time period of seven years) to a distributor or sales agent for a fixed amount of money (non-linear revenue). As the revenues are still uncertain, the amount of money distributors or sales agent are willing to pay for the rights, will however, be only a fraction of what the potential revenues might turn out to be. Secondly, he can seek equity investors (or be an equity investors in his own project), who are willing to share the full risk associated with a bundle of rights, but in turn can also fully participate in potential revenues (linear revenue).

Typically films are financed through a combination of both pre-sales and equity investments, which requires producers to carefully trade-off financing sources with each other, in order to achieve an attractive combination of risk and return. Of crucial importance for investors with respect to risk exposure is thereby the recoupment position, as set down in the contract ("the deal"). The recoupment position determines in which order investors are repaid once money flows back from the box office. **Figure 5.1** depicts this point in a simplified way.

Figure 5.1: Aristocracy of Deal Money: Risk and Revenue Distributions



(Source: Norbert Morawetz 2008)

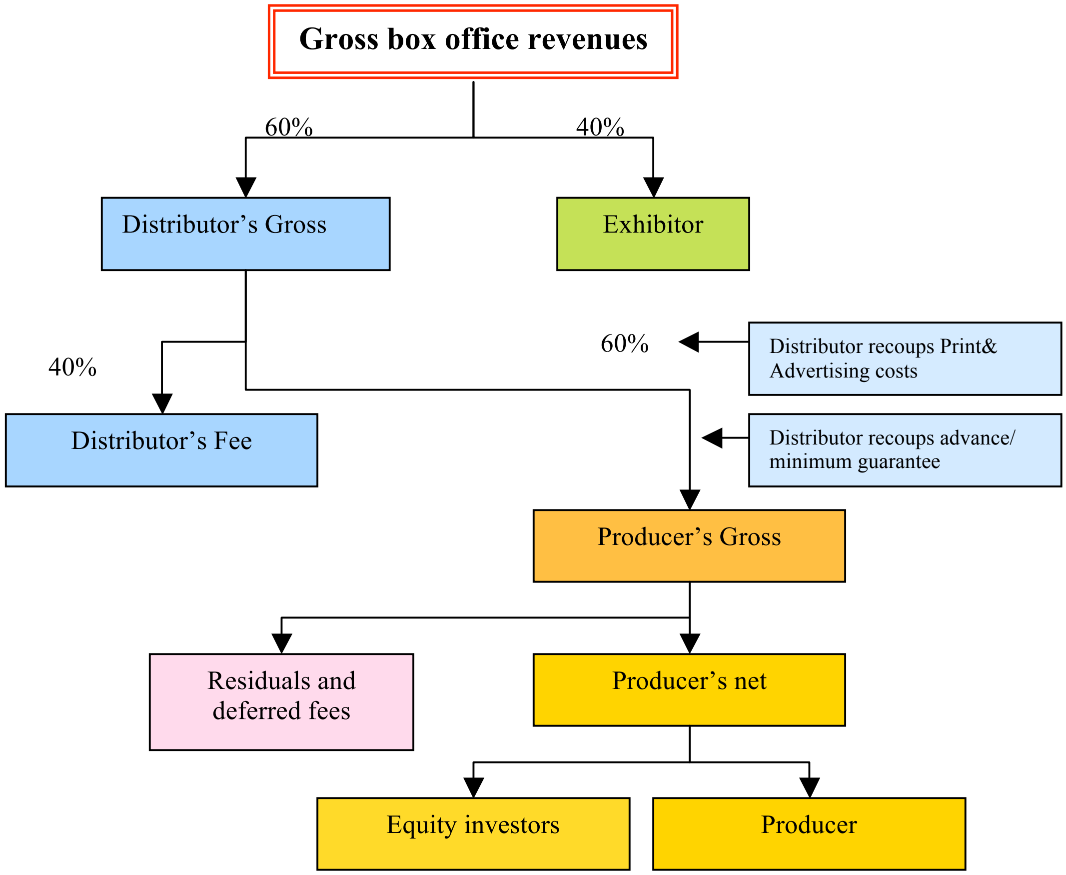
In this case a film is financed by three investors (A, B and C), each with a different risk profile. Investor A, a bank, is only prepared to take a limited amount of risk, and is prepared to finance 20 per cent of the budget if it can recoup its money plus a fixed interest in first position. For the bank this means (Scenario 1) that even if the film does not break even (the film recoups only 70 per cent of its production budget), it will have secured its investment, and its exposure to risk is thus significantly lower than that of investors B and C. In contrast, investor C is interested in high returns on his investment, and he provides the "bottom money" of the budget. In the case of a box office success, the risk-friendly investor will be rewarded with a multiple of his investment, however as statistically the chance for such an event is low, his exposure to risk is very high. Thus, while it is possible for some contracting parties to be totally risk-free or substantially risk mitigated, "other investors in a project can face freefall risk positions of unknown dimensions." (Tavares *et al,* 2003:13). Investment in a film has for this reason been described as an "aristocracy of deal money" where "the further down you sit in the pecking order, the higher the risk of non-recovery and/or net profit participation" (2003:44). The risk exposure of contracting parties determined in the film financing contract is thereby also a key indication of their relative position of power in the industry, with film financing being a key mechanism through which dominant industry players (particularly the studios) can transfer risk to less powerful parties.

A true assessment of an investor's risk exposure is, thus, only possible when the other contractual agreements and business practices in the film industry are taken into consideration. Of particular importance, in this respect, are distribution agreements, which can have a strong impact on how costs and risks are distributed along the value chain. This holds true especially for agreements with the major studios. As Daniels *et al*. (1998:85) have noted, "…theatrical distribution involves a complex web of business relationships, market demands and arcane custom and practice", referring to the abuse of market power by the major studios. Wasko (2004) has examined distribution agreements between US studios and production companies in detail, finding "boilerplate clauses", for example, which assign distributors a non-negotiable distribution fee, in addition to distribution expenses, thus essentially double-charging producers for the same service. One of the most controversial business practices in this respect is how studios account for distribution fees in the home entertainment (DVD) market. The rights to exploitation in the home entertainment market are typically arranged as part of the initial distribution deal, with studios often insisting on these rights as part of the deal. However, for purposes of calculating profit participation, home video revenues are reported as a standard of 20 per cent royalty on wholesale sales – which means in essence that "the studio includes only 20 per cent of videocassette revenue in gross receipts and puts most of the remaining 80 per cent in its pocket" (Baumgarten *et al*, 1992:53; see also Vogel, 2007). Beside the contractual agreements, it is furthermore common practice for the majors to misallocate or misreport revenues if a film is successful, in order to further increase their distribution expenses and distribution fee, as only few players have enough market clout to challenge them. The most widely publicized case in this respect was Art Buchwald's plagiarism suit against Paramount in 1988/1990, in which he claimed that the film *Coming to America* (1988) earned a sizable profit and he deserved to participate in the revenues (Meyers, 1994). In a seminal article Phillips has shown how the studios have used film financing practices to transfer the financial risk of film production to outside investors, noting on the business practices of the majors:

> *"Risk is not simply an abstract financial magnitude, as investors like to think – the net present value of their exposure level proportionate to the possibility of a future gain or loss. Nor is it some statistical divination rod to predict box office 'blockbusters' from 'flops', as much empirical research on film performance has sought. Such notions fail to appreciate fully one of the most highlighted quandaries of the business - namely the fact that even so-called blockbusters such as Batman [1988], Forest Gump [1994] and The Matrix [1999] can be both performance successes and yet financial failures. In this case, each of these films is not only among the most successful films of all time in terms of market appeal and gross box office attendance but each has also seen litigation over the fact that they were reported as financial failures to producers and their investors."*
>
> **(Phillips, 2004:107)**

Figure 5.2, showing the typical profit generation from a theatrical release in a UK film financing structure, illustrates the problem of hold up between distributor and producer in the film industry.

Figure 5.2: The UK model of Profit Generation From a Theatrical Release



(Source: Debande, 2004; Strategics, 2007)

As illustrated in the figure, firstly gross box office revenue is split between distributors and exhibitors. The distributor then deducts a distribution fee (up to 40 per cent), *plus* the expenses incurred for distributing the film. The remainder (producer's gross) is split between the investors of the film project. In order to fully recover production costs through a theatrical run, a film therefore needs to earn about three times its "negative costs" at the box office, an unlikely scenario for most films[52], particularly European films.

[52] As the European Audiovisual Observatory notes, the lack of transparency in the film industry and the unwillingness of companies to disclose their balances (see Lange, 2007), make it difficult to assess the profitability of production companies. On a picture by picture basis, De Vany (2006) and Vogel (1998) have shown that the probability for a box office success is statistically very low. However it has to be noted that these authors have not considered ancillary revenue streams, such as foreign territories, DVD and television in their analysis. Amram (2003) has attempted to calculate the value of film libraries, finding that film production can be a profitable business, albeit mainly through steadiness of production.

Overall, the notions that film producers (1) do not typically possess the financial resources to finance their own films, and thus (2) need to cede significant shares of their right ownership in the film financing process to other parties, and (3) are open to hold up from distribution, put film production companies in a weak position in the value chain (Porter, 1985). This weakness to attribute revenues generated from their work, is as I propose, consequently reflected in the business model of film production companies, which do not expect to survive by producing profitable films, but instead earn their living through a producer's fee that is typically contained in the financed budget.[53] As this producer's fee is in turn usually a percentage fee of the overall budget, this gives the producer a clear incentive to maximize budgets, in order to maximize their fee, but not necessarily to efficiently produce profitable films.[54]

Besides satisfying producers' profit interest, it is an important characteristic of film production that there exists, in addition, an incentive from the market to increase production budgets. This peculiarity accrues from an apparent preference of audiences for higher production values: As the price for a cinema ticket is typically fixed, a purely rational spectator choosing between films in a cinema can be assumed to choose the film with the highest production value, as he can expect to see more value for his money.[55] The proposition that a higher budget attracts a larger audience is partly corroborated by a study from De Vany and Walls (2003), who have found a correlation between budget size and box offices success.[56] However as the authors make clear, while higher budgets can increase the initial audience of a film, audiences still need to like the film to make it a success. In this respect they note that higher production costs also do not necessarily lead

[53] This situation is particularly true in Europe, where most production companies are undercapitalized and large parts of the budgets are financed by pre-selling rights, mainly to broadcasters. As a consequence of this reduced right ownership the attractiveness to maximize profits is significantly reduced for producers.
[54] This, in turn, is a rather different conception from both neoclassical and economic geography accounts on the film industry, which misrepresent the producer as a profit-maximizing risk taker.
[55] This could also be explained with (1) the assumption that production value acts as quality signal, (2) with respect to the notion that the most expensive films typically have the largest marketing campaigns and audience preference for large budget films thus is a result of persisting studio market power, or (3) with respect to the argument that a higher budget will allow the creative talent more freedom, resulting in a creatively superior product.
[56] As deVany (2006:651) has found, the elasticity of mean box-office revenue with respect to production budget is 0.54, suggesting that there are decreasing returns to production budgets with respect to box office take (about 50 cents on each dollar spend).

to visible, higher production values (particularly if budget levels are already high), and that it is furthermore completely unclear, to what extent a higher production budget draws a bigger total audience, as opposed to shifting audiences between films.

Consequently, as increasing the budget maximizes the producer's fee, and can potentially increase a project's commercial prospects, when obtaining finance for a specific film project, producers have a clear incentive to, firstly, raise as much finance as possible, and secondly, to spend all the money they have raised. The producer sets the budget for a film, and this budget will be equal to the maximum amount of finance he believes he can raise. Film production can therefore be characterized by a variation of "Parkinson's law", which when applied to the film industry, can be interpreted as "a film's budget will expand to meet the amount of financing available". [57]

5.5 Financial and Industrial Dynamics

Parkinson's law, therefore underlines the importance of finance for the film industry. If production expands and contracts on the level of the project with the amount of finance provided, then the same also has to be true on the aggregate level of the industry. Vogel has anticipated this point already, by applying Parkinsons' law directly to the industrial level, commenting that:

> *"[…] it is significant that the number of potential film projects on Hollywood's drawing boards always far exceeds the number that can actually be financed. Parkinson's law applies here: The number of projects will always expand to fully absorb the capital available, regardless of quality, and without regard to the quantity of other film scheduled for completion […].*
>
> **Vogel (2007:79)**

Thus on an industrial level, the overall volume of production activity will expand and contract with the level of financial capital provision to the industry. In the financing of risky entrepreneurial activities such as film production thereby two basic forms of the dynamic relationship between financial capital and production capital become apparent; An innovative entrepreneur (the film producer) wants to undertake an economic activity

[57] The law is originally stated as "work expands so as to fill the time available for its completion", and was refined in order to describe bureaucratic expansion in public administration in a famous essay by historian Cyril Northcote Parkinson (1958). The law has since been applied to a variety of contexts, and here most notably project management literature.

that is high risk, but has the potential to generate above the market returns. As conservative financing sources shy away from the high risk of the business proposition (there is a lack of financing), the entrepreneur seeks an enabling, risk-friendly financier (risk-friendly financial capital). The financier invests into the risky endeavour and production expands. If the activity is successful, then more financial capital will flow into the industry from other financiers, who likewise want to make above the average profits, more producers will find finance, and production will expand further *("production pulling finance")*.

However, apart from this typical pattern, financial dynamics themselves can be the starting point for changes in production activity in a high risk industry, as the volume of risk-friendly financial capital in the wider economy varies independently of growth and decline of production capital in this industry. If financial capital flows into an industry that is in constant search of finance, then production will expand in order to meet the finance available *("finance pushing production"*), but this increase in production will not necessarily occur because additional economic activities are viable. While not unique in this respect, I propose that the film industry is in particular receptive to the second dynamic, as (1) the contractual nature of the business allows financial capital to easily enter and exit the industry, (2) production budgets will increase to match the financing available (Parkinson's law), and (3) films are largely produced independently of each other[58]. This allows the film industry to easily absorb an increase in available risk-friendly financial capital.

Based on the analysis above, it can therefore be assumed that *growth of co-production activity* likewise has its foundation in either or both of these dynamics. A change in production activity must be matched by corresponding financial dynamics and vice versa; therefore asking where the money has come from, and why it has facilitated this form of production, are key questions that need to be answered to explain their growth. An empirical investigation of co-productions, therefore has to pay close attention to changes

[58] Following Vogel (2007) this means that films are produced virtually without regard to the quantity of other films scheduled for completion and release at around the same time, and sometimes even without regard to similar storylines.

in the film financing environment with respect to these two dynamics, and to what extent they have facilitated their growth.

5.6 Film Financing Environments

In line with their distinctive historical and institutional developments, it is thereby possible to distinguish broadly between two basic financial environments for film production, namely a European national system of financing film, and a US studio model of film financing. This categorization is not intended to suggest that film production is following such a narrow pattern, rather these two models represent two opposite ends of a spectrum, differing most notably in the type and geographical scope of their financing sources. **Table 5.2** sums up the key characteristics of the two film financing environments.

Table 5.2: Characteristics of Film Financing in Europe and the US

	US Studio/ Affiliate production	**Co-productions/ co-ventures**	**European national (cultural) production**
Market aimed	global	international	national
Commercial viability	high	medium	low, cultural criteria
Type of Financing sources	predominantly private financial capital (capital markets, specialized bank, private investors)	Mixture of private and public financial capital	predominantly public financial capital (state funding)
Finance sourced	Global	Global	National
Type of financing	Slate financing	Slate and single picture financing	Single picture financing
Size of prod. companies	large, economies of scale	small to medium	small companies
Dominant Players	Large Firms		Film Support Institutions
Average production budgets 2008	USD 70 million (MPAA) USD 40 million studio affiliate		USD 13.8 million (UK) USD 7.4 million (France) USD 6.3 million (Italy)

(Source: Norbert Morawetz 2008)

In Europe, production companies have typically struggled to recoup their investment costs[59], are thus rated as non-investment grade by banks[60], and have remained typically

[59] A common explanation put forward to explain why European films struggle to succeed at the box office is the argument that the fragmented European market does not allow producers to raise the budgets necessary to compete with US firms benefiting from the economies of scale of a large integrated home market. Other arguments put forward by economists to explain the weak performance of European films

small in size[61], financing films on a picture-by-picture basis. Consequently private investors have typically shied away from the risk of investing into European films and film companies. In order to facilitate national production, the state has therefore assumed the role of the key financial investor (public financial capital) in most European film industries, making production consequently highly dependent on changes in state intervention.

In contrast to Europe, the film industry in the US (studio production) has historically grown on a commercially viable basis, with new production activity being financed in the studio era until 1948 through retained earnings from previous productions and through bank lending. Even after the break up of the studio model through the Paramount decision, production capital and financial capital continued to be closely aligned in the US industry, as long as studios were able to self-finance production budgets. This situation changed however in the 1970s, when growing production budgets began to exceed the risk-taking capabilities of studios. In the past 30 years or so (see Dale, 1997; Bardeen and Shaw, 2004), film financing in the US has consequently gradually shifted from intra-industry financing to an increased dependence on outside financing sources, and led to an increasing separation of production capital and financial capital (See also Wasko, 1982). Taking advantage of economies of scale, US studios have mainly addressed the volatility of film revenue streams by focusing on *slate financing*: 12-18 films are bundled into a portfolio, in which the blockbuster hits compensate for the loss making of less successful films. By hedging returns, the US industry has thus managed through a financial innovation to remain a relatively attractive investment target for risk-friendly financiers, such as investment banks.[62]

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and the resulting lack of financial capital flowing into the industry, are the absence of major European film distributors, Baumol's "cost disease" (Baumol and Bowen, 1965), and the asymmetry in marketing information through heavy advertising by the studios.

[60] Film companies in Europe are usually C–rated, referring to distressed/classified investment.

[61] In 2005, 97.1 per cent of film production companies in the UK had between 1-10 employees (UK Film Council, 2007:175).

[62] Specialized investment banks such Chase Manhattan, Citibank, Dresdner, ING, and ABN Amro operate revolving credit facilities for A-rated entertainment companies.

With respect to the scope and type of financing sources accessed, co-productions and co-ventures fall in between these two generalized models, combining private and public financial capital sources in multiple countries. Therefore, although co-productions are predominantly a European phenomenon, it would not be sufficient to merely examine the growth of co-productions in the context of changes to the European film financing landscape. Instead, in order to take the nature of financial flows and dynamics into consideration, it is necessary to look at parallel, and interlinked developments in both film financing environments, for a dynamic analysis of co-productions in the context of the whole industrial system.

5.7 Summary

In this chapter I have firstly given a rationalization as to why, in order to understand industrial dynamics in the film industry, it is necessary to consider financial dynamics. I have argued that the high demand uncertainty in the film industry, translates into a spectrum of high financial risk, which makes production dependent on finding risk-friendly finance. With respect to the organization of production, I have thus proposed that production is organized in such a way to maximize the inflow of finance, and is shaped by power structures in the industry, as stronger players use organization to outsource risk down the line.

Critically reviewing previous theoretical conceptions of finance in mainstream economic geography literature and studies on the film industry, I have proposed to distinguish between production capital and financial capital, to highlight the importance financing plays in the film industry.

I have then examined the film financing process in more detail, noting that different investors face different risks in a film project; that revenue streams put producers at a disadvantage; that producers aim to maximize budgets and not profits; and that budgets in the film industry can easily expand to meet the financing available. As production is strongly dependent on finding risk-friendly finance, I have then argued that a growth of production activity necessitates a corresponding growth in financial capital (production pulling finance) or the opposite dynamic, that an increase in the finance supplied to the industry will lead to a growth in production capital (finance pushes production). Finally, I have argued, that in order to investigate the growth of co-productions, it is necessary to examine changes in both the US and the European film-financing environment with respect to these two dynamics.

6. DEVELOPMENTS IN THE EUROPEAN AND US FILM FINANCING ENVIRONMENTS 1990 - 2004

6.1 Introduction

The aim of this chapter is to describe parallel, and interrelated changes in the European and US film financing environments that have formed the context for the growth of co-productions in the past decade. I will begin with a brief analysis, setting out the difference between the state and private financial capital as investors into film, followed by a historical overview of how public funding structures in Europe have evolved on a regional, national and pan-European level. I will then describe how the motivation for state intervention has changed from the mid-1990s, away from funding film for cultural reasons, to supporting the industry on economic grounds. As I will describe, the most important consequence of this paradigmatic change was the introduction of tax incentives to encourage investment into film in a number of European and international countries within a short period of time, which has led to an increasing competition between states for international production.

I will then describe developments in the US film-financing environment in the period from 1990 to 2007, demonstrating how US production has increasingly become dependent on readily available, foreign financial capital. As I will argue, this has led to the formation of distinct capital cycles in international film financing, and an increasing financial interrelation between financial capital from Europe and the US film industry. This development is furthermore driven by an increase in risk-friendly financial capital in the global economy, resulting in a growing demand for higher risk, higher return alternative investments, such as film. Finally, I will outline, how the changes in state intervention in Europe and the dependency of US production have together led to the emergence of a capital cycle based on tax incentive money, which, as I will argue in the following chapter, has strongly impacted on the productive system of the film industry, and hence contributed to the growth of co-productions.

6.2 The State as Investor

In the previous chapter, I have made the observation that in the European film industry producers are strongly dependent on public aid, and proposed that an account of developments in European film financing needs to be a narrative about investor rationale of public budgets to a certain extent. Underlying this proposition in turn is the assumption that the investment of public bodies differs significantly from the investment of private capital. While private financial capital is essentially footloose and profit dependent, public financial capital is tied to supporting production capital *in a particular place*, and only follows a limited or indirect profit aim.[63] Where funding is awarded to projects not on cultural merit, but on economic grounds, public aid is typically tied to a set of economic criteria that have been designed to ensure that the public expenditure benefits *local* production capital, and generates employment locally through minimum spent requirements. [64]

This adds a second spatial dimension to the film industry in Europe, as industrial activity develops not only in relation to its physical, historical past, but also in close relation to the development of a *multitude of locally confined public financial capital pools*, which have emerged in Europe on a regional, national and transnational level and together make up the European film financing landscape. In order to finance their films, producers in Europe have to tap into and combine these confined pockets of public money, which is ultimately reflected in the organization of production in the European film industry. Hence, in order to understand the phenomenon of European co-productions, it is necessary to examine the development of these public financing structures. Moreover, as will be shown in this chapter, a paradigm change in the justification for state intervention in Europe in the past decade (*a shift from funding on cultural grounds to funding on economic grounds*), that has affected both the scope of intervention (*extending the*

[63] In the case of cultural production the state has financed films often without any regard to the financial performance of its investment, as in the case of commercial production, the state does not invest into film in search of profits, but to generate higher taxes through higher production activity and employment.

[64] Minimum spent conditions require producers to spend a multiple (typically between 100 –200 per cent) of the received funds within the territory providing it. For a detailed survey of Territorialisation Clauses see the study by Cambridge Econometrics *et al* (2007), prepared for European Commission, DG Information Society and Media.

funding to commercial film production), as well as the industrial policies used to achieve its goals (*most notably through the introduction of tax incentives*), has extended the influence of institutional developments in Europe beyond its borders to the financial environment of US and international feature film production. Describing the historical development of public funding structures on regional, national and pan-European level, and how these structures have changed since the 1990s, is therefore a pre-requisite for understanding changes in international film production in the past decade.

6.3 Historical Development of Public Intervention in the European Film Industry

"European film industry? I'm sorry guys, there is no industry."

Studio Executive Warner Bros
(Source: Panel Discussion, NFT, October 2004)

States began to directly intervene in the European film industry for the first time in the 1920s, by imposing screen quotas for foreign films (introduced in Germany in 1921, in the UK in 1927, in Italy in 1927). In the run up to WWII, film was increasingly seen as a powerful tool for propaganda by fascist regimes, and film industries were nationalized (Italy, 1931; Germany, 1933; Spain, 1938; the French Vichy Regime in 1940), and started to receive economic support. While introduced by totalitarian regimes, the economic and cultural protectionist justification for this intervention was not questioned after the war by democratic governments, and intervention schemes continued to spread quickly across Europe (Westcott and Lange, 2004:11).

In the first phase (1950-1957) of public support expansion in the European film industry, governments largely introduced *automatic* film aid mechanisms on a national level. Automatic funding schemes work by distributing funding according to predefined success criteria, such as a film achieving a certain amount of sold tickets, or winning a prize at a major film festival. The main aim of automatic support systems was to encourage private investment into films with a broad commercial appeal, thereby creating a "virtuous circle" when revenues and subsidies are reinvested by producers in their next film.[65]

[65] Automatic systems continue to be of significant importance in France, and to a lesser extent in countries such as Germany and Austria.

However, automatic funding schemes are not ideally suited to lead to the production of "culturally valuable" films. As the justification for state support rested mainly on cultural protectionist arguments, governments started to introduce, in a second phase of public support expansion (1959 – 1981), mainly *selective* film aid mechanisms. Selective funding schemes were usually operated by film commissions (film boards, film councils), and award subsidies (or grant preferential credit) to "worthy" film projects on the basis of a decision by a committee of selected experts. Although selective funding mechanisms can be highly effective in implementing cultural policy, they are however prone to nepotism and can stifle innovation (Westcott and Lange, 2004; Autissier and Bizen, 1998).[66]

From the late 1970s to the 1990s, film policy ceased to be a simple matter of national authorities and increasingly acquired both a supra-national and a regional dimension. On a pan-European level, in particular, it was co-production regulation that received political attention, leading to the establishment of a special committee for the Council of Europe's Council of Cultural Co-operation in the late 1970s. The findings of this Committee consequently led to the foundation of the Eurimages co-production fund in 1988, and the development of the European convention on Cinematic Co-production in 1992 (coming into force 1994) (Eurimages, 2007). Industrial policies and public aid for the film industry also became the subject of discussion in the context of the European Union integration process, and especially international free trade negotiations such as GATT,[67] with the US demanding that Europe should adopt a laissez faire policy for audiovisual goods. Although public industry subsidies are generally against European Union ideals of free competition and open markets, the EU nevertheless took the standpoint that film aid should be exempt from EU provisions because of its "special economic and cultural nature". Moreover, based on the argument that supporting film is necessary to safeguard cultural diversity, the EU has itself begun to inject further funding into the film industry

[66]As is apparent, most sector support is targeted at the financial level (subsidies, credit). This is also manifest in regulation that seeks to organize financial transfers from one sector to the other within the audiovisual industry, such as for example regulation demanding that broadcasters need to buy and show a certain amount of domestic films. Whilst certainly of great importance, funding from television – and the financial relationship between the film industry and television in general – will not be discussed in length in this thesis.
[67] See Miller *et al* (2005:85f) for a comprehensive overview of trade negotiations.

at the beginning of the 1990s through its MEDIA program (MEDIA, 2006). Initiated in 1991, with a budget of ECU 200 million until 1995, the MEDIA program has been continued ever since with growing budgets (Media, 2006).[68]

In this respect European Union regulation reflects widely held beliefs that subsidies are the last resort against global domination of US product. Internationally, the latest expression of these beliefs is the UNESCO's (2005) Convention on Cultural Diversity, signed globally by 148 countries. Based on the principle that culture cannot be reduced to a commodity and should therefore be exempt from free trade treaties such as the WTO, the treaty has also been criticized as a "thinly disguised attempt […] to offer a shield against the spread of American culture … [and]… in particular Hollywood movies" (Pauwelyn, 2005). However while the EU has taken a positive stance towards public aid for the film industry, it has to be noted that the EU demands that national public authority intervention complies with European Union regulation, and thus needs to be approved by the European Commission. In particular, in the past decade, the role of the European Union in setting regulatory frameworks has become ever more important, and the new incentives had to be revised on several occasions to comply with European Commission State aid rules (Broche et al, 2007).[69]

On a regional level, funding structures for film first emerged in the 1980s (Autissier and Bizern, 1998) and were mainly introduced by regional authorities with legislative autonomy and specific powers in the area of cultural policy, such as the Länder in Germany and Austria, Cantons in Switzerland, Autonomous Communities in Spain, Communities in Belgium, and nations in the United Kingdom (Westcott and Lange, 2004). Similar to the growth of public support for film production on national level, the growth of regional support bodies in this time period can therefore be assumed to have been motivated primarily on the grounds of cultural protectionism.

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[68] The budget for the MEDIA program 2007-2013 is EUR 755 million.

[69] The first law to come under scrutiny was the Greek subsidy system in 1986, where the commission found that the granting of aid subject to nationality was incompatible with several Union articles.

6.4 From "Subsidy trap" to "Attracting FDI" – The Changing Rationale of Public Intervention Since 1990 [70]

Despite the generous increase in public support, the European film industry remained, however, largely commercially unviable from the 1970s until the mid-1990s, and failed to attract mass audiences for its films. As Dale (1997) has argued, an apparent reason for this market failure was that European producers were caught in a "subsidy trap" mentality. In order to qualify for subsidies, film producers had to prove that their films were not too commercial, as commercial films should find finance through the market. As a consequence most national films failed to find an audience in their home market, let alone achieve a European impact (Dale, 1997). According to Dale, the lack of box office revenue streams consequently resulted in producers becoming even more dependent on public subsidies. With the risk of investment being transferred onto the state, producers had little incentive to change their situation, making a living from their producer's fee instead of trying to produce commercial films. Overall the industry was trapped in a self-confirming circle of market failure and state intervention.[71]

As it became ever more apparent in the early to mid 1990s that direct subsidies could not solve the financing problem at the heart of the European film industry, government institutions gradually began to re-evaluate their support mechanisms, searching for a new balance between the economic and cultural aspects of the film industry. Recognizing that films needed to be more commercial to expand their market base, the "*protect the national culture"* paradigm that had permeated most film support policies in Europe in the decades before, was extended and refocused to a new paradigm of building a viable domestic film industry based on *commercial success*. In order to justify the funding of commercial production, the argument for public aid to the film industry was therefore adapted from intervention on cultural grounds, to public aid for economic reasons. This was achieved in the context of job losses in more traditional manufacturing sectors to new competitors in Asia, by repositioning the film industry as a key industry of the high

[70] FDI stands for Foreign Direct Investment.
[71] For a more detailed account see Finney (1996a, 1996b), Eberts and Ilott (1990) and Moran (1997).

growth new economy[72] and creative industries (DTI, 2006). Heralded by policymakers, the film industry was ascribed the potential to create desirable, knowledge intensive, high value added jobs, and to bring additional benefits to the economy in the form of multiplier effects, audiovisual trade and spin-off benefits in terms of tourism and image.

This line of reasoning was first advanced in the UK, where proponents of the so called "Cool Brittania" thesis (Oakley, 2004) argued in the late 1990s that the loss of "traditional" jobs in the UK would be compensated for, by the growth in new (and, by implication, glamorous) work in the knowledge industries (Blair and Rainnie, 2000). This economic strategy is best summed up and illustrated by a statement of UK culture minister Tessa Jowell, who in a keynote speech in 2005, said:

> *"We can't compete with 'pile them high sell them cheap' trade strategies. But the truth is that we don't have to. We need to concentrate our efforts on where our strengths lie - in adding value through innovation and creativity. We need to invest in the skills and potential of our people, and to create an environment where creativity can flourish, and enterprise is rewarded."*
>
> **Jowell, 2005**

In 2000, the European Commission likewise identified innovative, knowledge intensive industries in their Lisbon strategy as the "economic pillar" to achieve full employment and its goal to become the most competitive economy in the world by 2010 (COM, 2005). Although initially strongly focusing on research and technology, the Lisbon strategy was extended in 2004 to include, among other areas, the creative industries.

> *"However, the knowledge society is a larger concept than just an increased commitment to R & D. It covers every aspect of the contemporary economy where knowledge is at the heart of value added — from high-tech manufacturing and ICTs through knowledge intensive services to the overtly creative industries such as the media and architecture."*
>
> **KOK, 2004:19**

> *"The information society and media sectors are core industries for the sustainable future growth of our economies."*
>
> **Neelie Kroes, European Commissioner for Competition, 2006**

[72] The characterization of the film industry as "new economy" was ironic in so far as the invention of film through the brothers Lumiere had just passed its 100th anniversary in 1995.

This reflects on an increasing alignment of creative industries with the ICT sector in the thought of policymakers, that is otherwise most strongly expressed in the suggestions of lobbying groups such as the International Federation of the Phonographic Industry (IFPI):

> *"The creative and media businesses are more than a mere driver for technology deployment or an 'added value' to the Lisbon Agenda. They are the true value of the Information Society."*
>
> **IFPI (International Federation of the Phonographic Industry), 2005**

In the context of these arguments, it has become possible to justify support for the film industry as a measure to drive growth in the wider creative industries, and help the economy to transition to the information society. As film industry consultants Olsberg SPI state:

> *"Many of the skills, including technical skills, used in filmmaking can also be used in other creative industries, and the opportunity to work on creative projects can act as an impetus to creative activities in other sectors. Since many creative industries are increasingly related to high level technology, they are in most developed countries recognized as a core element of the new "knowledge economy" […]."*
>
> **Olsberg SPI 2006:17**

The change in the rationale of public authorities at the end of the 1990s, towards supporting the film industry on economic grounds, instead of subsidizing it on the grounds of cultural protectionism is reflected in a number of policy changes, such as;
(1) a redefinition of the role national film support institutions should play in the industry throughout Europe, resulting in the introduction of selective funding schemes for commercial production and an expansion of support activities;
(2) the growth of regional support bodies in Europe supporting film projects for economic reasons;
(3) the introduction of neo-liberal industrial policy measures in the form of tax incentives to support film in a number of countries in Europe.

Mathieu (2006) has provided an interesting case study for the first area of change in his study of how the Danish Film Institute (DFI) redefined its role, and expanded its activities between 1998 and 2005. He describes how the DFI greatly expanded – due to the "intermediary entrepreneurialism" (Mathieu, 2006:245) of its CEO – its influence both in the Danish film industry as well as in the government, and adopted the role of a "super agency", by obtaining the central mediating position. However as an agent of change, it was not capitalizing on rents but;

> *"[…] according to a political-bureaucratic logic, has leveraged the various resources generated on each respective side of it [the film business] and prized on the other to expand its budget, control over allocatable resources and influence over proximate actors."*
>
> **Mathieu, 2006:245**

Gradually expanding its activities into marketing, distribution, and audience development, the new self-image of the DFI was that of a co-developer. As an "assertive" institution, the film institute could also campaign for a change in self-understanding of the whole Danish film industry, challenging the dominant view that art is equal to a small audience, whereas commercial (i.e. little artistic quality) means a large audience. The new paradigm of the DFI was that meeting an audience as large as possible should be an ambition and not an irrelevance. This was enforced in the industry with a "no marketing budget, no development and production subsidy" policy. Similarly, other policies and the new role of the DFI as developmental partner was enforced in the industry as a condition for giving out subsidies.

Similar developments were also found, for example, in the UK, where the UK Film Council was set up in 2000, and quickly adopted the role of a super-producer in the British film industry.[73] The strategy of film funders to move away from simple managers of funds to service providers, for both domestic and incoming film productions, is also reflected by a survey carried out by the Think Tank on European Film and Film Policy (DFI, 2007) in 2005/ 2006. Among support institutions of 29 European countries, more than three quarters cited the building of a sustainable film industry as one of their objectives next to managing public aid, and half saw it as their mission to stimulate employment and commercial activity. With respect to the second point, Westcott and Lange (2004) note that in the 1990s regional support agencies were

[73] In the course of research for this dissertation, the complaint of producers that film institutions mainly follow their self interest, and aim to grow their influence rather than helping film industries to become sustainable in their own right was repeatedly encountered. This was also admitted by a high level executive of the UK Film Council during a session of the Copenhagen Think Tank, who critically looked back at his time managing a fund, and concluded that by acting as a super-producer the UK Film Council had probably taken skills out of the film industry, and thereby furthered the dependence of film producers.

mainly set up by authorities, *without* constitutional autonomy in terms of cultural policy, seeing film funds as a tool for regional development, job and tourism growth. As the director of a German film fund described the mission for her fund;

> *"There is a lot of competition from other regional funders. If films get only prizes – this is not enough. Politicians want their regions to prosper. For politicians it's the percentage of money left in the region that matters […]."*
> **Managing Director, Regional German Film Fund (Source: Interview, May 2006)**

This type of regional film funds emerged right across Europe, with their growth being described by the head of regional film fund, Wallimage, as a "a total mess", and being likened to the growth of mushrooms, which keep "popping up" with little consultation between them, no harmonization of their rules, and no exchanges of good practice. The main reason for this uncontrolled growth is that a more central planning approach of regional film funds is a priori against their centripetal nature, as each fund "wants films to be shot on its own turf" (Reynart, 2007).

The rapid growth of regional support agencies in Europe can thereby be seen both as an antecedent and a result of growing international competition in film production. Especially within the larger European countries, having a film fund in place has quickly become a prerequisite for regions to be attractive for domestic and international film productions. As film is already a highly subsidized industry, regions can leverage national incentives even with small amounts of money to steer production expenditure onto their "turf", taking advantage locally of inward investment financed by taxpayer money on national level. As I will show, the growth in public aid through tax incentives, which is largely free of any cultural criteria, has further contributed to this form of decentralization of film production. Overall, the amount of public aid spend directly by regional and national support bodies in the European Union increased from ECU 500 million in 1995, to about EUR 1.2 billion in 2002, with EUR 916 million being administered on national level, and EUR 248 million on regional level. Since 2002, growth of public aid had slowed down, reaching EUR 1.3 billion in 2005, provided through 181 support bodies in Europe[74] (EAO, 2006; Westcott and Lange, 2004).

[74] In the 32 countries listed by the EAO database KORDA.

However this slow-down in the growth of direct public aid has to be seen in the context of the introduction of tax incentives in multiple countries in Europe, through which a multiple of the EUR 1.3 billion was additionally injected into international film production.

6.5 The Spread of Tax Incentive Financing in International Film Production

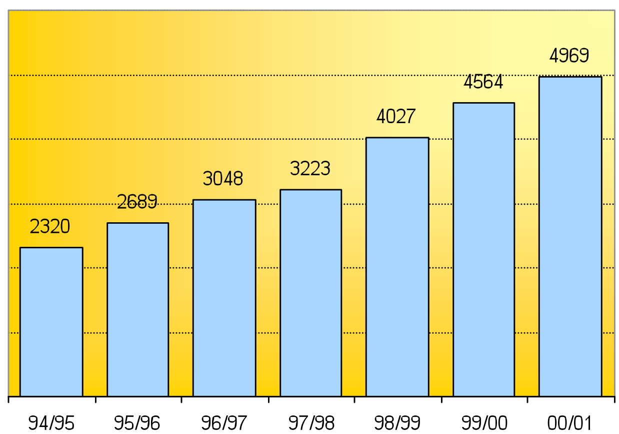
A key policy idea put forward to grow domestic film industries quickly was that countries should try to take advantage of foreign (runaway) productions[75], which can provide the local industry with valuable experience and investment. In this context, more neo-liberal industrial policy measures such as financial incentives in the form of tax credits and tax relief were identified as an ideal policy measure, that can both boost domestic, commercial film production and can attract high budget, foreign film projects. In Europe, countries such as Luxembourg (1988), Ireland (1993) and the UK (1992) experimented with tax incentives at the end of the 1980s, finding early success through attracting runaway productions in a relatively non-competitive environment. In the UK production expanded from 40 films produced in 1988 to 70 in 1994, with the number of co-productions (including inward US productions), that is part of this figure, increasing from 2 to 32 – thus accounting for the whole growth in production. In Ireland, production increased from two films produced in 1993 to nine films produced in 1995, of which four were collaborations with foreign countries. In Luxembourg production remained volatile but increased on its low levels (between 0-4 films produced annually between 1998 and 1995). In comparison to these figures, growth in other major film producing countries remained more stable in the period from 1988 - 1995, with film output increasing in France from 137 to 141, in Germany from 57 to 63, in Spain decreasing from 63 to 59, and in Italy falling from 124 to 75 (EAO, 1997; 2003).

The potential success of a strategy to attract production through tax incentives was however in particular evident in the case of the Canadian film industry, which re-

[75] The International mobile production market consists of a small number of high budget film productions each year, that "runaway" mainly from Hollywood for creative (location shooting) or economic reasons (i.e. shooting in a lower wage country).

introduced tax credit schemes in 1995 and 1997, targeted at US companies in an attempt to make Canada attractive for US runaway productions (see also Coe, 2001).[76] In combination with a favorable US/Canadian dollar exchange course the tax credits led to a rapid growth of the Canadian film industry within a short period of time, with the Film and Television Action Committee (2004a)[77] claiming that out of the 51,000 jobs the Canadian film industry generated in 2002, 38,000 jobs were lost directly from Hollywood as result of the Canadian tax credit.[78] **Figure 6.1** shows the growth of production volume in Canada between 1994 and 2001 (on average by more than 13 per cent annually).

Figure 6.1: Total Volume of Film and Television Production in Canada



(Source: CFTPA, 2003)

In the context of changing strategic aims for film support in Europe, the evident success of Canada further contributed to the idea that tax incentives are the best practice policy to

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[76] In Canada the government experimented with tax credits as early as 1974, but reduced the system significantly in 1982, after heavy exploitation, with Globerman (1983:77) commenting on the system that it "stands as a monument to irresponsible policy making and comes as close to being a pure taxpayer 'rip-off' as one is ever likely to find".

[77] The FTAC is a lobbying group for below-the-line Hollywood workers in California.

[78] The "Monitor report" of the Directors Guild of America and the Screen Actors Guild (DGA/SAG 1999) suggested that in 1998, 80 percent of runaway productions, totalling USD 2.8 billion worth of film and television work, 23,500 full-time entertainment jobs, and USD 10.3bn in direct and indirect revenue, went to Canada (see also Morrison, 1999). A subsequent report by the Californian Center for Entertainment Industry Data and Research proposed that since 1998, when the Canadian Production Services Credit (PSTC) was introduced, production value in Canada rose by USD 635 million, while the US suffered in the same period a corresponding fall in annual production expenditures of USD 683 million (CEIDR, 2002). The claim that Canada has "stolen" production from California has in turn been strongly disputed by Canadian institutions such as the CFTPA, describing the *Monitor Report* as a document full of "unverifiable data, exaggerated economic multipliers and unsustainable conclusions" (Neil Craig Associates, 2004:3).

create jobs, grow the film industry and bring inward investment to the country quickly. As tax incentives furthermore reduce the tax income of the households, but do not appear as a direct cost to budgets (such as subsidies), the increase in public spending could be largely hidden from taxpayers at first, and thus contribute further to the attractiveness of tax incentives. The argument for the financial incentives was straightforward, as the mission statement for the Hungarian system and the preface to the new German film financing scheme introduced in 2006[79] reflect:

> *"The new system is intended to increase the number of films produced - partly or entirely - in Hungary, therefore to strengthen the Hungarian audiovisual industry, to increase the production capacity of the country and the number of experts employed in this sector, thus to generate a positive impact on the entire economy."*
>
> **Film Hungary, 2007**

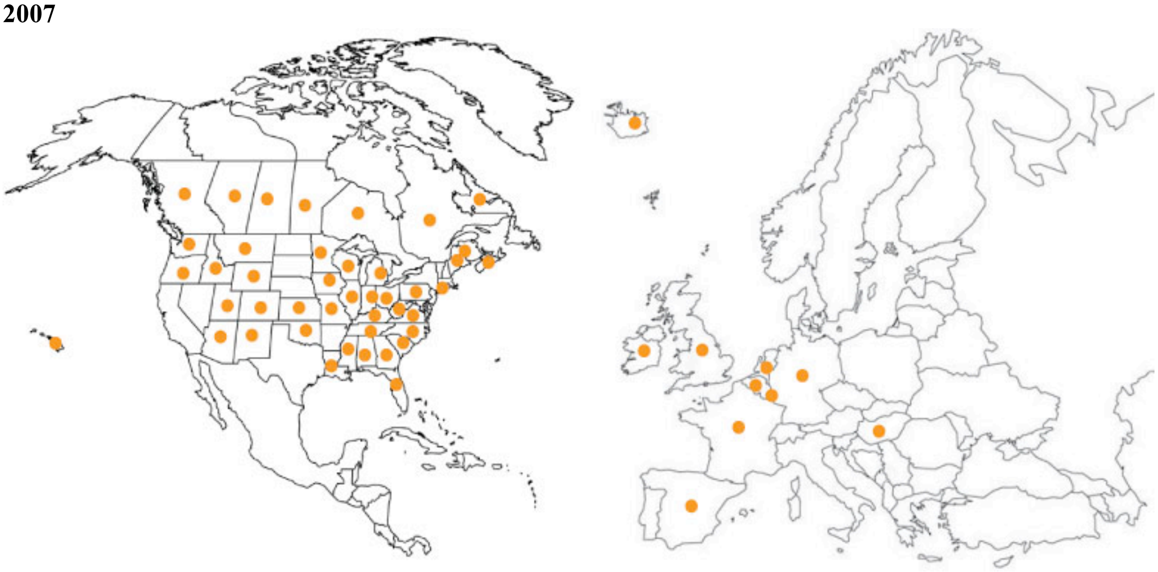
> *"The objective of the measure is to improve the economic framework conditions for the film industry in Germany, to preserve and promote the international competitiveness of enterprises in the film industry with the object of achieving long-term effects for Germany as a production location in conjunction with further effects on the macro economy. The particular objective of the measure is to facilitate the financing of films as a cultural good, for producers in Germany. The measure is aimed at enabling higher production budgets in order to further the artistic scope, the quality, attractiveness and hence the dissemination of films. At the same time the costs spent in Germany in connection with the production of films are increased, leading to a better utilitization of the capacity of technical film businesses. An improvement in film financing for production companies and the existence of the corresponding technical infrastructure constitute the prerequisites for a German and European film culture which is both creative and successful in the long run."*
>
> **Kulturstaatsminister, 2006:3**

The strategy can be summed up in the following way: The introduction of tax incentives will attract foreign production filming in the country, which will generate jobs, provide local production crews with valuable experience and facilitate the building and upgrading of local production infrastructure. These factors will in turn facilitate domestic production and thus strengthen cultural production in Europe. While it was obvious that a production lured to one country because of a financial incentive was lost somewhere else, this somewhere else was however most likely to be the US, and as such did not necessarily hurt countries within the trading block of the European Union. The same view was also held by other cultural protectionist countries, with the Canadian government, for

[79] While the new German system that followed the closure of the German tax incentives in 2004 is not based on tax incentives, its preamble "principles and objectives" from which this quote is taken, is an excellent example to illustrate the shift in the policymakers' arguments towards supporting film largely on economic grounds, and achieving cultural goals by facilitating commercial film production.

example, trying to garner its taxpayer's support for production incentives with the slogan "we are creating the jobs your children want" (FTAC, 2004b). In New Zealand, the Minister of Economic Development, Jim Anderton, put it even more bluntly, saying that he would "subsidise the devil incarnate if there is a net economic benefit to New Zealand" (Calder, 2004). Thus - in an almost ironic turn - public aid for film in Europe, that was originally intended to counter Hollywood hegemony, began to actively subsidize US productions through tax incentives under the condition that they generate jobs in Europe. As decades of cultural funding had failed to build a commercially viable film industry in Europe, European nation states resorted instead to attempting the relocation of commercially viable US film production to Europe through subsidies and declare it as their own. Between 1997 and 2005 financial incentives for film production were henceforth introduced or extended in European countries such as Germany, the UK, France, Italy, Hungary, Malta, Luxembourg, Belgium, Ireland and Iceland, and internationally in Australia, Canada, New Zealand, Fiji and since 2004, in a countermovement, in the US and US federal states. **Figure 6.2** sums up the spread of tax incentives in the international film industry. In **Appendix IV** I have summarized these tax schemes comprehensively.

Figure 6.2: Countries Operating Film Tax Reliefs or Tax Incentives in the Period Between 1997 – 2007



(Source: Norbert Morawetz 2008)

However, as **Table 6.1** shows, instead of encouraging the viability of film production in Europe, the expansion of public aid through tax incentives increased the dependence of producers on the state even further.[80] As is reflected in the typical financing mix of feature film production in Europe, between 1998 and 2003 the decline in financing from presales, broadcasters and bank gaps was substituted by an increase in public spending, with on average 45 per cent of budgets being financed by public financial capital in Europe in 2003, compared to 20 per cent in 1998.

Table 6.1: Financing Mix of Commercial Feature Films in Europe 1998 - 2003

	1998	2003
Public funding	20%	30%
Distributor pre-sale	20%	10%
Sales agent's MG	10%	5%
Equity[81]	10%	15%
Bank loan (gap)	10%	5%
Broadcaster	15%	5%
Tax-based financing	0%	15%
Facilities/ services/ supplies[82]	5%	5%
Deferrals[83]	5%	10%
Insurance based financing	5%	0%
TOTAL	100%	100%

(Source: Strategics, 2007:59)

6.5.1 The Vicious Circle of Tax Competition

"[...] tax incentives can play an important role in creating a favourable environment within which the market can determine what kind of cultural products are made, and how, with minimal distortions".

UK HM Treasury, 2005:7

When looking at film funding structures in Europe, it is apparent that their historical development is characterized by the adoption of best practice and the imitation of industrial policy measures. Hospers (2006) has argued in this respect that the trend of

[80] Average contributions to production budget, including financing costs, made in two samples each comprised of 59 English language films and 22 foreign language films produce in Europe with production budgets between USD 1 and USD 10 million.

[81] Typically in-kind investment by the producer in the form of free work. Only very few European companies are able to invest cash into film production.

[82] Some companies such as equipment rental companies or laboratories are prepared to contribute their services at favorable rates or in-kind for a share of ownership.

[83] In order to finance a film, producer, director, principal cast and scriptwriter can be asked to defer their fees to a later stage originally agreed. A form of deferral is a deal including back-end-profit-participation, in which key talent is offered a share of future profits to participate.

public authorities to copy "best practices" can be seen as a political variant of the tendency among economic actors to imitate innovations of successful entrepreneurs. By imitating "policy innovations" (such as the installation of a regional film fund), policy makers try to share the profits gained from this practice, which as Hospers points out, is possible for some time. As more and more regions/nations adopt the best practice, the chances to make profits from trying to replicate the success story erode (2006:5). An overcapacity of regions competing in the same activity is built up, followed by a shake out. While funding strategies have been copied between states in Europe previously, the focus of these strategies was mainly local and thus they did not lead to significant cross-border impacts. This however, has been different in the case of tax incentives, which differ from previous schemes in that: Firstly, they were designed with the clear aim to not only interfere in the relationship between financial capital and production capital in the domestic industry, but also to unbalance the relationship in other countries in favor of the country providing the incentive. Secondly, they were aimed at commercial film productions, and thirdly, the amount of financial capital provided to the industry through tax incentives was significant,[84] especially since it was cumulated through the spread of the policy measure. The spread of tax incentives has thereby occurred in waves that are characterized by an increasing level of competition between states. Following the first wave (1988-1996) of tax incentives described above (England, Ireland, Luxembourg, Canada), tax incentives entered a boom period with the overhauling of the incentive schemes in Canada (1997) and the UK (1997), and the spread of tax incentives to Australia (1997: 2007(overhauled), Iceland (1999) and Germany in 2000.

Initially, tax incentives were a winning strategy to grow domestic film industries quickly. However with the spread of tax incentives in a third wave to France (2003), Belgium (2003), Hungary (2003/2004), and New Zealand (2003; 2007), and finally in a fourth wave to South Africa (2005), Malta (2005), and the US and US federal states since (2004 ongoing), competition for the limited number of high budget internationally mobile

[84] The total amount of money supplied to the film industry through tax incentives, that is the total amount the state has foregone by reducing the tax for private investors, can only be estimated. Adding the estimates for the UK, France and Germany for the year 2002, it can be estimated that between 2000 and 2004 in addition to other subsidies another EUR 2.5 billion has flown into the industry per year.

productions has become increasingly intense. The competitors for inward feature film investment thereby fall into two basic categories. The first group of countries, incumbents such as the UK or Canada, has been forced to maintain and increase tax incentives to *stay competitive*, driven by a fear of losing their built up production service industry to new competitors. The second group of countries, in turn, has found that the introduction of tax incentives is a necessary precondition to *become competitive* in the first place, required from any country that takes its film industry serious:

> *"Tax incentives are a pre-requisite for any location wishing to attract international productions."*
>
> **Olsberg SPI, 2006:13**

Or as the manager of a US film fund explained, there is a shared realization among countries that:

> *"[...] production is globalized, and that its chasing the money, and if the money is coming from Canada, production is going to Canada, if the money is coming from sales lease back in the UK, it going to the UK, or Australia or wherever".*
>
> **CEO, US Regional Film Fund**

In order to build their production infrastructure and attract production to their territory, new entrants typically have to offer an incentive that exceeds existing rebates, which in turn puts pressure on existing schemes to match the new entrants' offer, as they can easily be held up by studios threatening to move their productions elsewhere. The result is a vicious circle of tax competition, in which countries bid up their incentives driven by (1) the fear of losing production and secondly the wish to participate in "profitable" film production.

The dynamics of this competition became apparent in Canada in 2004 and 2005, when Canadian provinces entered an upward spiral of tax competition in an attempt to out-compete each other. The crisis of the Canadian film industry was triggered by a 20 per cent increase in the Canadian dollar against the US dollar, which made Canada a less attractive destination for runaway productions. The exchange rate resulted in an immediate fall in production by 25 per cent in 2004, with an industry expert commenting: "People know that the industry is in free-fall now, and if something isn't done, we're heading for disaster" (Tillson, Nov 21, 2004). Desperate not to lose production to other competing nations, the established production centres in Canada (British Columbia, Ontario) reacted to the crisis with an increase in their tax credits to compensate for the exchange rate change.[85] However the decision to increase their tax credits was not entirely voluntary for all provinces. British Columbia for instance was practically forced to step up its tax credit for foreign production from 11 to 18 per cent in order to match Ontario's credits, after the film and TV production industry threatened to move projects out of the province. In a similar way, at the beginning of 2005, tax credits for local productions were also increased from 20 to 30 per cent in order to neuter similar increases in tax credits introduced by Ontario in December 2004. Although the government of BC declared that is was "confident that the revenue generated from these credits will far outweigh the costs" (Townson, Jan. 20, 2004), production never recovered to its initial levels since, resulting in a situation where a smaller amount of production is now subsidized at a higher cost.[86]

In this respect, it also has to be noted, that tax incentives were not necessarily designed to be a permanent industrial policy, but rather as a measure to "kick-start" national industries, to be revoked and reduced later on when the domestic film industry had forged lasting relationships internationally and had become more sustainable. However, in an environment of pervasive tax competition, should a country decide to opt out of the tax competition, it not only stands to lose incoming investment for its production service industry, but also faces a very tangible threat that parts of its traditionally domestic production will become footloose, and take advantage of tax incentives in the neighbouring country. This was seen in the UK, where the government desperately tried to repair the incentive scheme in order not to lose existing production, keep facilities busy and prevent the built up workforce from plunging into unemployment – despite the clear evidence that the tax relief had become an unjustifiable strain on the public budgets. When the UK finally announced that it would close down its existing tax incentives because of heavy abuse in 2004, production fell immediately by 40 per cent (Minns, 2005; Dawtrey, 2004; Dawtrey 2005).

[85] Naturally, the tax credit was not reduced when the exchange rate became more favourable again.
[86] Some research in this section stems from my contribution to the paper "A perfect world for Capital" by Randle and Culkin (2005).

The pressure to match other countries' tax incentive is thereby especially high in countries bordering each other. Thus when the "tax-incentive disease" was finally imported to the US in 2004, tax incentives were readily embraced by federal governments at the border to Canada, who had experienced production loss before. Montana for example, struggled hard to compete with Alberta and British Columbia on the Canadian border, seeing state revenue from film production dropping from USD 16 million in 1997 to USD 6.8 million in 2002, until it was one of the first US states to offer a tax incentive (Tavares, 2005). Nevertheless, tax incentives also continued to produce success stories. When Hungary, for example, started to offer tax incentives in 2004 it was the first in East-Central Europe and could claim a genuine competitive advantage that led to an immediate increase in production (**Table 6.2** and **Table 6.3**).

Table 6.2: Number of Films That Have Benefited From the Tax Scheme in Hungary

	2004	2005
Service work	7	15
Co-production	11	21
Hungarian	70	126
Total	**88**	**282**

Table 6.3: Hungarian Spending (In EUR Million)

	2004	2005
Service work	7	45,4
Co-production	4,9	21,2
Hungarian	17,9	21,5
Total	**29,8**	**88,1**

(Source: Strategics, 2007:93)

In the US, a similar success story is Louisiana, which introduced tax rebates already in 2003, boosting its production activity from USD 20 million in 2002 to USD 210 million in 2003, and to USD 335 million in 2004. (Hawaii Film Office, 2005).

Such success stories have perpetuated the spread of tax credits, and have continued to draw new territories into the competition, often out of opportunism. For these states, which previously did not have a substantial film industry of their own, tax incentives have become an inexpensive way of signalling that their country is "ready for business" and "film friendly" (Olsberb SPI, 2007:15), even if this is at the expense of other states. As a consultant for the Hawaii Film Office notes in her blog:

> *"Some states have all the luck, some states have all the pain, some states get all the breaks, some states do nothin' but complain. That in a nutshell [...] sums up the fierce domestic competition for non-polluting, location-promoting, job-creating film and TV production business."*
>
> **Hawaii Tax Incentive Blog, 2007**

By the beginning of 2008, the majority of US states had introduced incentives for film, either in the form of tax incentives, tax rebates or cash subsidies, with the overall development of the tax incentive landscape largely following the same pattern of a self perpetuating upward spiral that has already become apparent in Canada and internationally. From 2005 to 2007, the tax incentives given by US states increased from an average of 15 per cent to 25 per cent (Hawaii Film, 2007), with states such as New York being forced to raise their tax credits from 10 per cent in 2005 to 30 per cent in 2008. Reacting to the new competition from domestic US tax incentives, in Canada some provinces now offer tax credits of up to 55 per cent of a film's budget (Manitoba), or up to 60 per cent on labour expenses (Nova Scotia) to attract producers.

Taken together, the continued spread of tax incentives has provided international film production with a new, important source of finance since 1997. Of particular interest is thereby the time period between 2000 and 2004, when the German and British incentive schemes cumulatively represented a significant pool of new money dedicated to film production. The emergence of this new film financing source coincided with the drying up of two major film financing sources in the US industry at the same time. As I will show in the next section, this has formed an important precondition for the eager acceptance of tax incentive money in the film industry, with the developments in the US film financing landscape prior to 2001, already foreshadowing the pattern of boom and bust the international film financing capital cycle based on European tax shelter capital underwent between 2000 and 2004.

6.6 Developments in the US Film Financing Environment

In this section, I will briefly summarize and conceptualize developments in the US film financing environment in the time period from 1980 to 2001, which have formed the preconditions for the emergence of a capital cycle in international film financing based on European tax incentives.

As described in the previous chapter, finance for film production in the case of US studio production historically has come from retained earnings and bank lending. This situation changed, however, in the 1970s, when growing production budgets for the first time began to exceed the risk-taking capabilities of studios and the industry started to move from intra-industry financing to an increased dependence on outside financing sources (Dale, 1997; Wasko, 1982; Bardeen and Shaw, 2004). To help smaller independent film production companies, and to counter European subsidies, the US government introduced in the 1980s a tax incentive scheme for film production. The ITC (Investment Tax Credit) scheme was, however, mainly used by the majors to re-capitalize themselves, and as Dale (1997:297) has noted, played a major role in establishing Hollywood's hegemony over world cinema. Until the scheme was closed in 1987, the majors raised more than USD 1.7 billion through the ITC, with Disney's Silver Screen Partner alone accounting for USD 1 billion of this sum (Dale, 1997). At the end of the 1980s, the financing gap of Hollywood studios was for a brief period filled by Japanese companies awash with risk-friendly capital, amidst the Japanese asset price bubble (1986 to 1990). Japanese institutional investors, such as the securities firm Nomura directly invested on a large scale in Hollywood production companies (Screen Digest, 1990; Stevenson, 1990), with the interest of Japanese companies in Hollywood culminating in the buyout of Columbia Pictures Entertainment Inc. by Sony Corp. in 1989 for USD 5 billion (Alexander, 1997).

At the beginning of the 1990s, in the context of (1) a steady expansion of Hollywood production budgets (and thus financing risk) and (2) a shift in preferences of studio parent companies towards off-balance sheet financing[87], the demand for extra-industry financing accelerated further, with studios sourcing ever larger amounts of finance for their film

[87] Off-balance sheet financing is a form of financing in which large capital expenditures are kept off a company's balance sheet through various classification methods. Companies will often use off-balance-sheet financing to keep their debt to equity and leverage ratios low, especially if the inclusion of a large expenditure would break negative debt covenants (Investopedia, 2007).

slates from private investors willing to share risk. [88] The gaps in the increased budgets of major and mini-major production, which could not be financed by banks, were in the early 1990s bridged by pre-selling rights to European media companies, such as the Kirch Group, PolyGram, BMG or Studio Canal. The increasingly high fees paid for US product in European markets, thereby allowed US studios to green-light ever more expensive pictures. However, as became apparent with the rapid decline of the pre-sale market at the end of the 1990s, the fees paid for the acquired assets (distribution rights) increasingly did not represent actual demand but were the result of an overvaluation by these companies (Dale, 1997). Production expansion in the US in this period can already be seen, as being increasingly driven by an over-provision of financial capital to the industry or, as I have described in the previous chapter, by a *dynamic of finance pushing production*. Despite the drying up of the presales market, US production levels therefore did not contract but continued to expand, as the US film industry took advantage of the mobility of financial capital and turned itself into a rallying point for idle risk-friendly finance from foreign economies, in search for above the average returns.

Between 1997 and 2001, a significant amount of financial capital for US productions was sourced from media companies listed on Germany's Neuer Markt. The Neuer Markt was set up in 1997 as a high-flying technology market for German companies belonging to the "new economy" (Vitol and Engelhardt, 2005). German media companies such as the Kirch Group, Senator, EM-TV, Kinowelt or Helkon capitalized themselves during the boom on the stock exchange, using their access to risk-friendly financial capital to buy

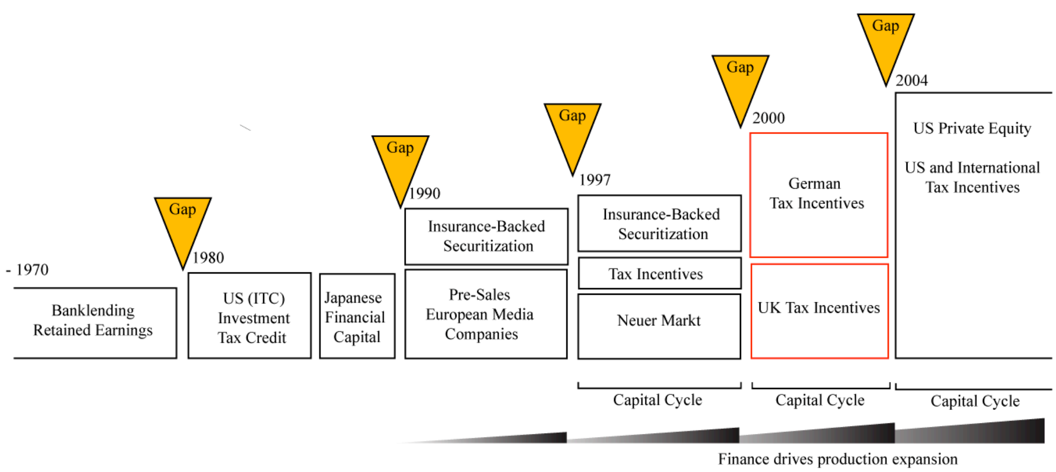
[88] Between 1995 and 2003, average studio production budgets increased from USD 36.4 million to USD 63.8 million, with marketing costs rising in the same period from USD 17.7 million to USD 39 million (MPA, 2006a). Besides this growth, the majors also diversified in the early 1990s into independent film production through acquiring or building independent distribution companies. These "mini-majors" (e.g. New-Line Cinema, Miramax) significantly increased the scope of their spending in the following decade, to meet a growing demand for high budget independent motion pictures (Thompson, 2004; Perren, 2001). The average negative cost of a mini-major peaked in 2003 at an average of USD 46.9 million, a 154 per cent increase on production budgets since 1999. Films such as Martin Scorscese's USD 100 million epics *Gangs of New York* (2002) or *The Aviator* (2004) reflect how profoundly the image of independent film changed in this period (Grove, 2005). In this environment of increased costs, the parent companies of the major studios were under increased pressure to manage their balance sheets effectively, in order to prevent their credit ratings and their share prices from being scrutinized. In a situation where the provision of financial capital from internal sources was therefore limited (parent companies directly funding film production would have negative impacts on their balance sheets), while at the same time studios needed to invest into production to maintain levels of production and feed their distribution infrastructure, they increasingly turned to outside investors to fund their film slates (Russo, 2007).

rights and pre-finance Hollywood product. In 2000, *Time International* reported that approximately USD 3 billion or 20 per cent of the entire US expenditure of film and video was sourced from media companies listed on the Neuer Markt (Time International, 2000). The Neuer Markt reached its peak in March 2000 when companies had a combined market value of EUR 234 billion, but collapsed to less than EUR 13 billion as the market was hit by the global slump in hi-tech stocks and a string of corporate scandals (Milner, 2002). In the same period (1993-2001), another distinctive source of finance entered the film industry, namely money sourced from international financial institutions in the global insurance industry (mainly from Europe and Australia), through a financial innovation called insurance-backed securitization (Phillips, 2004). In an insurance backed deal, the risk of film production was transferred to these financial institutions which insured a slate of film projects against an unexpected shortfall in revenues against a premium. The risk spreading system originated from the London financial milieu and had emerged after the stock market in the UK had developed an aversion to the film business, following the collapse of leading British studios Goldcrest, Palace Pictures and Virgin Films (Phillips, 2004). However, abuse and the failure of insurance companies to assess their risk accurately led to a series of bankruptcies and court cases and made insurance-backed film financing "one of the major issues facing the insurance industry" (Freshfields Bruckhaus Deringer, 2002). The London market's exposure to the escalating film financing losses has been reported to be around £2 billion; Crédit Lyonnais, once the largest bank in the world, reportedly lost roughly USD 5 billion on its film financing before going under state administration. A detailed analysis of how risk was exported from Hollywood through this system can be found in Phillips (2004).

Each of the two investment sources has thereby formed a distinct *capital cycle* – here understood as a period, in which the relationship between financial capital and production capital is characterized by finance coming from a distinct source – that has followed a recurring pattern, whereby risk-friendly financial capital firstly streamed into the US film industry in anticipation of above the market profits, followed by a rapid exit when these profits failed to materialize. The causes for the investor shakeout can in both cases be identified in unsupportable forecasts of asset values by unscrupulous brokers, an ignorance towards real investment risks and a lack of leverage of investors against the major studios (Russo, 2007).[89] As a consequence, at the beginning of the new millennium the US industry faced again a significant gap in the financing of its production activity, which at this point had already continuously grown for a decade, fuelled by foreign, risk-friendly financial capital.

It is therefore not surprising, that the emergence of a new significant source of finance, in the form of financial capital raised through tax incentives in Europe, was readily embraced by US studios; a new capital cycle in international film financing was initiated based on tax incentive money mainly from Germany and the UK. As indicated, this capital cycle has likewise followed a pattern of boom and bust, albeit with public households substituting for the role of the risk-friendly investor. The capital cycle ended consequently with the (temporary) closure of the tax incentive schemes in the UK and Germany in 2004/2005. **Figure 6.3** sums up the developments in the US film financing landscape.

Figure 6.3: Distinct Sources of Finance in the US Film Industry



Source: Norbert Morawetz 2008

With respect to the spatial dimensions of these capital cycles, the financial flows from the Neuer Markt and the insurance backed securitization capital cycle can be described as

89 In this respect, the increases of production budgets outlined above can equally be interpreted to represent an attempt by studios to take advantage of the readily available foreign financial capital, as they can be seen as the consequence of natural cost increases (such as wage rises) or a reaction to increased demand.

mainly unidirectional, and enforcing existing patterns of production in the US and its satellite production locations. This, however, has been different in the case of the European tax incentive capital cycle in which financial sources were partly tied to local spent criteria, leading to a number of industrial dynamics in both European and international film production. It is therefore this period and capital cycle that will receive the main attention in the next chapter, in which I will examine its inner workings and discuss its impact on international feature film production, in particular with respect to growth in co-production.

6.7 Global Growth of Risk-friendly Financial Capital

The arising gap in the US film industry has, since 2003/2004, come to be filled by a new capital cycle, based on an oversupply of risk-friendly financial capital in the global and particularly the US economy, pooled in private equity and hedge funds, and leveraged by US federal tax incentives. In this thesis, I will not discuss this latest capital cycle in great detail for two main reasons; firstly, the capital cycle has only emerged in the course of this study, and thus has not been the primary target of empirical research; secondly, it did not impact strongly on film industries outside of the US, and as such has not been of significant relevance to exploring the phenomenon of co-productions. However, in one respect, the latest capital cycle in US film financing is nevertheless interesting for this study, as it strongly reflects on a development that has already been present in previous investment cycles, albeit to a lesser degree, namely the influence of growth of financial capital in the wider economy on film financing. As is illustrated by **Table 6.4**, the lasting inflow of financial capital into the US industry has mainly come from institutional investors, with more than USD 8.7 billion in private equity flowing into the US industry between 2003 and January 2007 (not counting slate deals).

Table 6.4: Recent Transactions of Third Party Financing in the US Film Industry

Date	Deal Name	Studio	Arranger	Deal Size (in $ million)	Est # of films	Notes/Comments
Aug 04	Melrose investors 1	Paramount	Merrill Lynch	$300.00	26	Slate of consecutive films, modest performance, significant management changes at studio during release of films
Jul 05	Legendary Pictures	Warner Bros	Perseus Capital/ JP Morgan	$500.00	25	Select 3-5 films per year to co-fi with Warner, ability to develop films internally as well.
Aug 05	Kingdom Funding	Disney	CSFB	$500.00	39	Consecutive slate, excluding all animated films and Pirates franchise.
Sep 05	Marvel Funding	Marvel/ Paramount	Merrill Lynch	$450.00	10	Slate of Marvel films, secured by value of IP rights related to characters, Paramount rent a system structure
Oct 05	Weinstein Co. (2)	Weinstein Co	Goldman Sachs	$1,000.00	NA	Equity and debt raise to start new production studio
Nov 05	Intrepid Pictures	Rogue Pictures/ Universal	JP Morgan	$120.00	8-20	Small budget films, 3-5 per year
Dec 05	Virtual Studios	Warner Bros	Stark Investments	$528.00	6	Slate of pre-selected films, performance has been lacking for many of the released films, low expectations for the remainder of slate
Jan 06	Gun Hill Road	Sony and Universal	Deutsche Bank	$600.00	16	Slate of pre-selected films, performance has been lacking for many of the released films
Jan 06	Dune Fox 1	20th Century Fox	Dune Capital/ Dresdner	$325.00	28	Slate of consecutive films, strong performance X-Men 3, Devil Wears Prada, Walk the Line
Mar 06	DreamWorks Library	Viacom/ Paramount	Soros Fund Mgt./ Dune Capital	$900.00	59	Purchase of DreamWorks live action film library

Date	Deal Name	Studio	Arranger	Deal Size	Est # of films	Notes/Comments
April 06	Gun Hill Road II	Sony and Universal	Deutsche Bank	$700.00	19	Slate of pre-selected films, currently in syndication, films are yet to be released
Sep 06	Dark Castle	Warner Bros	CIT/ JP Morgan	$300.00	15	Low budget horror films, produced by Joel Silver
Sep 06	Melrose II	Paramount	Dresdner	$250.00	25	Slate of pre-selected films
Sep 06	Coldspring	Dreamworks	Merrill Lynch	$400.00	2	Indie Developed & Produced through DW/Paramount
Oct 06	Radar	Various	JP Morgan/ DE Shaw	$300.00	25	Independent slate w Int'l & Dom pre sales
Oct 06	Dune Fox II	20th Century Fox	Dune Capital/ Dresdner	$400.00	40	Re-financing of Dune 1 plus a new 20 film slate
Oct 06	Cruise Wagner	United Artists	Merrill Lynch	na	na	na
Jan 07	Focus Features	Universal	Dresdner	$200.00	15-20	Co-finance slate of films with Focus, subject to certain criteria
Jan 07	Lions Gate	Lions Gate	Goldman Sachs	$210.00	23	Reportedly includes all films, except Saw franchise, films from Tyler Perry, 15 per cent distribution fee
Jan 07	Relativity Media	NA	Citibank	$550.00	40-50	Co-finance slate of films with studio, subject to Relativity criteria
Jan 07	New Line	New Line	Royal Bank of Scotland	$350.00	20	Co-finance all New Line films for the next two years

(Source: Russo, 2007)

The amount of money invested in the latest capital cycle, as well as investment flows in previous capital cycles, are thereby arguably related to the amount of risk-friendly financial capital in the wider economy. As demonstrated in chapter 5, film production is highly dependent on finding risk-friendly financial capital. Changes to the amount of available risk-friendly financial capital in the wider economy are therefore likely to impact and be reflected in film production activity. While it is not the aim of this thesis to contribute in great detail to discussions about developments in global capitalism, the growth of global financial capital in the period under study (2000–2004) and beyond, has to be seen as an increasingly important factor that has motivated investors to participate in risky film business transactions, and therefore should be assessed in brief.

Following the tech-bubble and the attacks of 11 September 2001, the global economy has been, firstly, characterized by record low interest rates, particularly in the US (FRB, 2008); and secondly, by low yields from traditional investments, resulting in excess global saving and liquidity (OECD, 2007:61).[90] In an environment of deregulated, internationalized financial markets (Eatwell and Taylor, 2000), accelerating cross-border flows of financial capital (IMF, 2007:64) searching for profitable investment opportunities, and competitive offerings from the non-bank financial sector, banks have found themselves under increasing pressure to expand more into non-traditional, fee-generating areas of intermediation, such as loan securitization; and to make greater use of financial innovations, such as asset-backed securities and alternative investment vehicles, such as private equity[91] and venture capital (IMF 2006:6). In search of higher profits, increasingly also institutional investors, such as pension funds, turned towards such alternative investment opportunities, with low interest rates generally opening up a massive arbitrage opportunity for companies and investors to buy higher yielding assets using debt as a leverage (OECD, 2007). As a film financier summed up the development;

[90] In mature markets, assets under management by institutional investors (pension funds, insurance companies, foundations, endowments, banks, investment banks, providers of investment vehicles) increased from USD 13.8 trillion in 1990 to USD 39 trillion in 2000, and to USD 55 trillion in 2007 (IMF, 2005; 2007), a figure that represents more than 160 per cent of OECD countries' GDP.

[91] The European Private Equity & Venture Capital Association defines private equity as a "transformational, value-added, active investment strategy." In general, private equity can refer to any type of equity investment in an asset, in which the equity is not freely tradable on a public stock market. Investment is usually leveraged with debt and/or tax credits, and short term profit orientated.

> *"The cost of raising funds for risky borrowers has fallen reflecting the benign credit market, and the returns for higher quality assets have been so poor that many funds are looking for ways to raise their returns by seeking alternative investments."*
>
> **Managing Director Media Finance, Major French Investment Bank**
> **(Source: Panel Discussion, Film Finance Summit, October 2006)**

The increasing willingness of institutional investors to accept higher risks is thereby best exemplified by the growth of the private equity and hedge funds industries. Since 2003, private equity funds have raised approximately USD 580 billion (Dow Jones Equity Analyst, 2007), while the hedge fund industry grew between 1998 and the end of 2006 from USD 240 billion in assets under management to USD 1.4 trillion assets under management (OECD, 2007)[92].

In the context of an abundance of risk-friendly financial capital in the global economy, opposite a limited amount of highly profitable investment opportunities, it is not surprising that the film industry has become a "compelling investment thesis" (Russo, 2007) for idle money, in line with other "casino industries" such as the real estate market, the arts market, or the commodities and currency markets.[93] As a fund manager explained;

> *"There is a lot of liquidity in the market. Hedge funds, pension funds are awash with liquidity. Traditional investments are generating only very low returns, so investors have been looking for homes in alternative assets, and film is an industry with such assets, if you can smooth the volatility."*
>
> **Managing Director, US Private Equity Fund 1**
> **(Source: Panel Discussion, Film Finance Summit, October 2006)**

As I will show in the next chapter, tax shelter funds in Germany, the UK and the US have found a way of "smoothing this volatility", by taking advantage of tax incentives, and hedging investment risks through slate financing and the application of financial simulation techniques.

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[92] While the total figure of assets under management by hedge funds is comparatively low to the total figure of assets under management by institutional investors, hedge funds are assumed to account for between 30 per cent and 60 per cent of total market turnover, due to their leverage and rapid and focused trading style, and thus play a crucial role in modern financial markets (OECD, 2007:42).
[93] See also Perez (2002:75f; 2002, 100f).

6.8 Summary

In this chapter, I have examined developments in the European and US film financing environments, with a particular focus on the period between 1990 and 2004. I have firstly argued that the growth of funding structures in Europe on regional, national and international level can be seen as the growth of a multitude of locally confined capital pools, that are provided to the film industry upon fulfilling a set of predefined criteria. As I have detailed, up to the 1990s these criteria were predominantly cultural in nature, as the state intervened into the film industry on the grounds of cultural protectionism. In the context of a pervasive lack of other financing sources, production capital in Europe has grouped around these local capital pools, facilitating national cinemas. In an attempt to revive the commercially failing European film industry, the rationale of public financial capital has undergone a paradigm change towards supporting the film industry on economic grounds in the mid 1990s. In this context the volume of locally confined funding structure has been increased and the eligibility for funding has been extended to commercial production. The most notable of these changes has been the introduction of tax incentives to encourage film in a number of European and international territories. This has added a new layer of large scale, nationally confined capital pools to the international film financing environment and has extended the parameters of European film financing to the US industry. The rapid spread and cumulative volume of tax incentive policies have consequently led to self perpetuating (vicious) circle of tax competition for internationally mobile film production between nation states, that has continued to characterize the global film industry ever since.

In the US, the film industry was characterized in the 1990s by a steady expansion of production budgets, with US studios increasingly sourcing the finance for these budgets globally. The development of the US film financing landscape in the past decade can thereby be described as a sequence of overlapping capital cycles, which are formed by a distinct source of finance, and have undergone a recurring pattern of boom and bust. At the end of the 1990s, the expansion of public financial capital in the European film financing environment and the drying up of previous capital sources in the US industry have concurred, and have given rise to a new capital cycle in international film financing, based on a combination of private and public financial capital raised through tax incentives in Europe (and here, in particular, in Germany and the UK). The increasing investment flows of risk-friendly capital into the film industry are thereby in line with developments of financial capital in the wider economy, with low interest rates and low yields on traditional assets leading to an overall high demand for alternative investments.

In the next chapter, I will discuss the growth of co-productions in the context of the changes to the European and US film financing environments outlined in this chapter, and will show in more detail how the financial dynamics that have resulted from the tax incentive capital cycle have impacted on the organization of the production system in the film industry.

7. EXPLAINING THE GROWTH OF CO-PRODUCTIONS

7.1 Introduction

"Uccello che ha mangiato, vola via" (The bird that has eaten, flies away).

"*Il Postino*", directed by Michael Radford, 1994

Based on the outline of changes in government policy and film financing in the European and US film industries, provided in the previous chapter, the aim of this chapter is to give an explanation for the increase in the number of co-productions in Europe, in the time period between 1997 to 2004. I will begin with a "straightforward" explanation, arguing that the immobility of locally confined capital pools in Europe has necessitated that film projects are structured around these funding sources, resulting in European film producers seeking cross-border co-operations *driven by a search for finance*. Further, I suggest that the growth of co-productions in turn contributes to the growth of funding schemes aimed at co-productions, creating a self confirming circle that has made co-productions an integral part of the European cinema landscape.

The second part of the chapter seeks to integrate the observations and analysis from the previous two chapters, by explaining the growth of medium-to-high budget co-productions as the result of changing financial dynamics, caused by the introduction of tax incentives. Here I will illustrate how the financing practices of tax based film funds in Germany and the UK have in particular targeted investment into high concept co-productions. I will then describe how the predisposition of the tax incentive schemes to be abused for reasons of tax avoidance has led to an increasing oversupply of financial capital, that has become a driver for film production in its own right. Finally, I will provide a brief outlook on developments in international film financing that have succeeded the closure of the German and the UK tax schemes, and will discuss how the findings from this research can influence future policy making.

7.2 Growth of Co-Productions in the Search for Finance

So far I have argued that film production is dependent on finding finance, and suggested that in a context of a scarcity of finance, production will be organized in such a way to gain access to finance. Furthermore I have proposed, that in the case of the European film industry, the dependence on financial capital translates into a dependence on public aid, as the state is the primary investor in European film industries. In the previous chapter I have therefore examined the development of public funding structures on regional, national and trans-national level in Europe. As was found, the European film financing landscape can be described to consist of a multitude of locally confined capital pools, which are typically tied to local spend or cultural criteria.

In order to raise the budget for a film project, European film producers therefore have to find a way to combine these local soft money pools. As the provision to spend public aid locally does not allow co-financing structures, the primary way to raise finance for feature films in Europe therefore is by planning the film as a co-production:

> *"The growing financing needs of European productions mean that co-production is becoming a model generally adopted even in the case of projects whose inspiration derives from just one country. "*
>
> **Council of Europe, (retrieved online 2007).**

As a consequence, film projects are often from their inception being designed to source finance from multiple countries, as is illustrated by the quotes of a film producer and a film commissioner:

> *"Today its using an international co-production structure, it's a disease, when you read a script you start to think about it like a jigsaw puzzle, you have all the pieces it is only the question whether you can put it together."*
>
> **UK Film Producer**
> **(Source: Panel Discussion, Film Finance Summit, October 2006)**

> *"There are productions that don't look like obvious co-productions. But because we can't raise the finance in the UK, we have to make them into co-productions. And then there are the other ones that come to us from other countries. Co-producers come to us to get the last part of the financing."*
>
> **Film Commissioner UK National Film Fund**
> **(Source: Panel Discussion, Film Finance Summit, October 2006)**

Even film projects for which the finance could be raised in a single country, are increasingly structured into co-productions, as the peculiarities of film production outlined in chapter five (budget maximisation is profit maximisation for the producer) encourage producers to leverage their budgets with "free money". As I have argued, the increase in public spending to encourage the viability of film production in Europe in the past decade has increased the dependence on public aid even further (see **Table 6.1**). Collaborating with producers from another country in search of finance has thus become the expected form of raising finance for a film.

With every source of soft money being usually tied to a set of criteria, producers have to be careful to structure the project in such a way that different financial sources can be stacked together, and where possible – double dipped – without conflicting with each other. In practice, this leads, for instance, to employing key crew in country A to meet creative criteria, but paying the salaries in country B to meet expenditure criteria: For example, a Belgian crew working on a shoot in Luxembourg is eligible for both tax schemes. Likewise renting equipment in a German region to be used on a shoot in Luxembourg is eligible for both territories, plus for UK sale and leaseback. The complexity further increases, when production shooting moves between different countries to access soft money, sometimes with changing crews for each new location. Where possible, co-productions are usually structured in such a way that the majority co-producer is shooting the film in his territory, while post-production or laboratory work is done in the partner's country. The film *Irina Palm* (Belgium/Germany/UK/France/Luxembourg, 2005) provides a good example for such a co-production. While the script was originally in French and set in Brussels, it was then re-drafted to take place in London, where most of the exteriors where shot. In order to meet expenditure criteria, however most interiors were rebuild and shot in studios in Germany and Luxembourg, with the crew coming from the other co-producing countries. While the projects costs increased quite significantly through this structure, it would not have been possible to raise the finance for the film without accessing the different soft money sources in Europe, as the producer explained:

"Once you have five countries, the crew has to travel, your hotel spending will be huge and your travel costs will be huge, this you know from the beginning [...]. If we shoot everything in Brussels, of course it would have cost that much less, at the same time we would have had that much less financing that we would have never been able to make the film, its always strange to say that the film costs lets say 30 per cent more but you do get 70 per cent more financing – that's the life of European co-production."

French Producer
(Source: Panel Discussion, Co-Production Market, February 2007)

This "creative financing" is however not confined to lower budget co-productions, but is representative even for such prestigious co-productions such as Lars von Trier's "*Dancer in the Dark*" (2000), for which the Danish production house Zentropa had to combine 50 different financing sources (broadcasters, tax-shelters, regional funding, public funding, pre-sales, distributors), partnering with co-producers across nine European countries (See **Table 7.1**). The critique that more attention is being paid to the co-production agreement than to artistic coherence, and too much time is being spent on "dealing with accountants, lawyers and government bureaucrats across several time zones" (Dhaliwal and Russell, 2005), than on telling a story to an audience, is partly admitted and partly dismissed by co-producers. As one co-producer stated with respect to filling out application forms for subsidies from European co-production fund Eurimages:

"If you do it several times, you know who you have to work with… Paperwork was never the issue… we got EUR 350 000 from Eurimages, that's free money, so we do these hours of work gladly."

German Producer
(Source: Panel Discussion, Co-Production Market, February 2007)

However, there is a general agreement among producers that their traditional professional profile is changing in the context of increasingly complex financing structures. As an industry analyst remarked:

"In today's marketplace, as a film producer the foremost thing to be is a financing specialist."

Industry analyst
(Source: Panel Discussion, Deutsche Bank, February 2007)

While between co-producing countries production expenditure is typically shared in line with the financial contribution of each country, regional film funds can play an important role with respect to the actual site of production or post-production in each country, as they can divert investment to their territory by providing additional locally confined incentives, even if they are small by comparison.

Table 7.1: Financing Sources "*Dancer in the Dark*" (Lars van Trier, 2000)

France		%
Arte	444,216.00 €	
Canal+	1,036,505.00 €	
Eurimages	80,767.00 €	
France 3	888,433.00 €	
Liberator	480,287.00 €	
Liberator deferred	206,565.00 €	
	2,136,773.00 €	**24.60%**

Germany		
Filmstiftung	511,522.00 €	
WDR	460,370.00 €	
Arte	306,913.00 €	
Constantin Film	329,420.00 €	
Eurimages	80,767.00 €	
Pain Unlimited	149,795.00 €	
	1,838,786.00 €	**13.90%**

Sweden		
Film | Vaest	706,708.00 €	
S-TV	302,875.00 €	
Swedish Film Institute	504,791.00 €	
Nordic Film & TV Fund	107,689.00 €	
TV-1000	70,671.00 €	
Eurimages	134,611.00 €	
Swedish Distributor	269,222.00 €	
Trust Film AB	31.00 €	
Trust Film Deferred	148,072.00 €	
	2,640,900.00 €	**19.70%**

Finland		
Finnish Film Fund	55,527.00 €	
YLE	45,431.00 €	
Distributor	134,611.00 €	
	235,569.00 €	**1.80%**

Italy		
Key Film	190,811.00 €	
	190,811.00 €	**1.40%**

Norway		
Norwegian Film Institute	53,844.00 €	
AV-Fund	215,378.00 €	
Nordic Film & TV Fund	107,689.00 €	
Eurimages	80,767.00 €	
Distributor	201,917.00 €	
Cinematograph	134,611.00 €	
Deferrals	113,073.00 €	
	907,279.00 €	**4.80%**

Iceland		
Icelandic Film Fund	124,515.00 €	
Nordic Film & TV Fund	107,689.00 €	
Eurimages	201,917.00 €	
Trust Film Sales	72,892.00 €	
Icelandic Film Corp.	130,102.00 €	
Deferrals	26,922.00 €	
	664,037.00 €	**4%**

Denmark		
Danish Film Institute	1,346,110.00 €	
Eurimages	80,767.00 €	
Nordic Film & TV Fund	107,689.00 €	
Angel Arena	201,917.00 €	
DR	403,833.00 €	
Zentropa	55,016.00 €	
Zentropa deferred	707,189.00 €	
	2,902,531.00 €	**23.90%**

Netherlands		
Netherlands Fonds	222,108.00 €	
Ned Televisie/COBO	377,584.00 €	
Eurimages	80,767.00 €	
What Else	67,306.00 €	
What Else deferred	26,922.00 €	
	777,687.00 €	**5.90%**
Total	**12,294,373.00 €**	**100.00%**

(Source: Olsen, 2007)

The regional Belgian film fund Wallimage provides a good example of such a regional film fund that facilitates and takes advantage of co-productions at the same time. The fund was set up in 2001 as a system of selective aid, with the purpose of generating "activity and employment in the region" (Wallimage, 2007). The main principle of the fund is that "every Euro entrusted to a producer should generate at least one Euro of audiovisual expenditure in Wallonia." This means that it requires a minimal obligation of 100 per cent in audiovisual regional expenditure from the film projects it invests in.[94] Wallimage invests on average around EUR 300,000 into its projects, certainly a small sum opposite average US budgets, but a noteworthy amount for European film budgets which usually range from one million EUR to five million EUR. The EUR 300,000 is provided to the filmmaker in the form of a 60 per cent investment through a co-production with a local producer (equity) and as a loan of 40 per cent. The loan proportion can be further reduced by increasing regional expenditure (an increase of five per cent in regional expenditure, reduces the loan proportion by one per cent). Taken on its own, the Wallimage fund does not appear to be very impressive, however its strength lies in allowing the double dipping of other public sources, such as the Belgian tax shelter system. If a producer spends for example one million EUR in Wallonia, he can firstly raise up to EUR 400,000 in Belgian tax shelter money, and can then tap into further regional funding from Wallimage of up to EUR 324,000[95], raising a total of EUR 724,000, or about 80 per cent of the expenditure in public funds. If the producer furthermore uses crew from nearby Luxembourg, he can access another EUR 200,000 in Luxembourg audiovisual investment certificates (tax incentive money), and potentially get further funding from the French CNC (at which point the producer would have however over-financed the budget).

[94] This spending criteria is typical for European regional funds, most of which require a minimum spent of 100 -150 percent of their investment in the film.

[95] The producer spends x amount in the region. For 100 percent of his expenditure he can get 60 percent from Wallimage in equity investment, and 40 per cent as a loan. If the producer spends for example EUR 300,000 in the region, he can get EUR 180,000 from Wallimage as equity investment, and EUR 120,000 as a loan. However, he can reduce the loan proportion of the investment further, to a minimum of 10 per cent, if he spends an additional 150 per cent of the funding provided to him in the region (the loan is reduced by -1 per cent for every +5 per cent in expenditure). Thus if the producer spends EUR 900.000 in the region, Wallimage will invest EUR 360,000 in the film (minus the 10 per cent loan (EUR 36,000) is EUR 324,000).

Thus while national frameworks like tax incentives are aimed at bringing international film productions to the country, by providing a further (comparatively small) incentive, regions can take advantage of these national financial capital provision, and redirect production to their territory. The increase of public spending through tax incentives on national level, has thereby further facilitated the growth of funding structures on regional level, and the competition between them. The competitive dynamics between regional film funds *("everybody should try to compete with the means he has!")*[96] are particularly high within larger states in Europe, such as Germany, France or the UK. Similar to the tax competition on international level, regional competition within states leads to a re-distribution of national production activity. As the managing director of a German Regional film fund observed:

> *"One effect of this regional funding system is that production is spread over many regions."*
>
> **Managing Director, Regional German Film Fund (Source: Interview, May 2006)**

On the whole, the funding structure in Europe can be said to contribute to the dispersion of production capital. By making territorial provisions to the supply of finance, the conceptualization of production capital and financial capital given in chapter five is partly reversed, with production capital becoming increasingly footloose, and moving to wherever finance can be obtained.

The ubiquity of co-productions in Europe is thus foremost a consequence of its financing landscape, which facilitates and is facilitated by co-productions that are driven by a search of finance. The paradigm change towards funding film on economic grounds has thereby facilitated co-productions for mainly two reasons: Firstly, as the provision of the additional soft money was in most cases tied to economic criteria such as minimum spent, this has given filmmakers more creative freedom than within previous co-production structures, and allowed them to overcome the "Euro-pudding" problem previously associated with this type of project. As a film financier underlined:

[96] Reply from the representative of a German federal film fund to a colleague, who complained that federalistic funding distorts competition.

"The structure [tax credits] that was in place encouraged co-productions, encouraged the opening of the market, encouraged operations with other countries."

UK Film Financier
(Source: Panel Discussion, Film Finance Summit, October 2006)

Secondly, the increase in public aid in the form of tax incentives has made it possible to raise finance for projects whose budget levels previously exceeded the funding capacity of film support bodies. While the increase of public aid through tax incentives has led to an overall expansion of production activity, it has thus, in particular, facilitated the growth of co-productions in search for finance with medium-to-high budgets levels.

In the next section I will examine the growth of these medium to high budget co-productions in more detail, and will argue, that in the boom period of the capital cycle based on European tax incentive money, the increase in these co-productions was increasingly less motivated by a search for finance, but instead driven by an oversupply of financial capital pushing production.

7.3 Co-Productions Driven by an Abundance of Finance

Having outlined the basic drivers facilitating the growth of co-productions in search for finance in the European film industry, I will in this section investigate in more detail the growth of co-productions in the context of the capital cycle in international film financing, based on capital raised through the German and the UK tax incentive schemes between 1997 and 2005. I will begin with a brief description of the operation of tax incentives in practice, followed by a description of some key characteristics of the UK and the German schemes. I will then explain how the mechanisms of tax based financing have facilitated the financing of medium-to-high budget commercial feature films. I will show how this has in the case of the German scheme, led to a diversion of public aid to the US industry, and in the case of the UK scheme, facilitated the growth of co-productions. Finally, I will briefly describe the consequences of the closure of the tax systems in both countries, and provide a brief outlook of how the capital cycle based on US tax incentives will impact on the industrial organization of international feature film production.

7.3.1 How Tax Incentives Work: Mixing "Smart" And "Soft" Money

As a policy measure, tax incentives seek to leverage public money by *reducing the risk* of investing into film for private investors, and thus encourage an inflow of private financial capital into the industry. It is this mixing of private and public investor rationale that distinguishes them most clearly from other forms of film finance, which either lean even more strongly on subsidies (cultural production), or are financed through the market (commercial production). On the level of the project, the reduction of risk for private capital can be shown with reference to **Figure 5.1**. With a limited interested in direct profit, public financial capital therefore typically assumes the bottom position in the "pecking order" of a financing structure for a commercial film. This means that investment by the state is the last source of finance to recoup, that is after e.g. private investors, banks or private equity funds. Where the public aid does not need to be repaid, producers can thus consider the state investment as essentially "free money". By assuming the bottom position, the state reduces the overall risk exposure of *all* other investors in the film project, and thus makes investing into the film more attractive to private investors. **Table 7.2** demonstrates the impact of soft money on a sample film budget.

Table 7.2: Financial Structure of a Film Project

Negative costs	
Pre Sales of Rights	35%
Bank Gap (Investor A)	20%
Bottom Money Equity (Investor B)	25%
Free Money (tax subsidy/ soft money)	20%
	100%

(Source: Tavares, 2003:41)

In this scenario, a film has achieved pre-sales of 35 per cent of the budget. An additional 20 per cent of the film can be financed through a bank gap financing, however the bank will demand to be repaid before all other sources of finance. This leaves the producer with a financing gap of 45 per cent of his budget, which is fully exposed to risk. In this situation only a very risk-friendly investor would provide the finance for the film.

However, if the producer can add public aid to the financing mix, the attractiveness of the investment opportunity is significantly improved.

Because of its readily availability and low demand with respect to financial performance, public financial capital has acquired in the film industry the term “soft money”, a concept whose definition;

> *“[…] ranges from simple handouts from national/regional film boards, through tax breaks which act like interest-free loans from the fiscal authorities, to more complicated schemes that give post-hoc rewards to box-office performance, but which in the hands of a clever lawyer can be harnessed to provide production cash upfront”.*
>
> **Frater, 2003**

In the same terminology, risk-friendly financial capital from private investors has consequently prided itself to be “smart money”, as it seeks out only those investment opportunities which are profitable and promise above the average returns. The distinction between private and public financing sources is best summed up by the statement of a film financier, commenting that:

> *“The truth is that there are many funding sources for film, but very few genuine investment sources. The distinction is that funders have often mixed motives for the provision of their capital whereas investors have a single requirement, and that is the profit.”*
>
> **Film Financier**
> **(Source: Panel Discussion, Film Finance Summit, October 2006)**

With another film financier arguing that:

> *“Funders have their own agenda. Investors just give money. Funders sit down and say I want you to film in our area, and employ our workers, and they all think their money is as good as investor’s money. Well this is not true! They come to the table with their own agenda and demand to be treated as equity. Equity comes from the word equal, equal partners, but as everybody knows, equity in the film industry never means equal.”*
>
> **CEO US Private Equity Fund**
> **(Source: Panel Discussion, Cannes Market, May 2006)**

As is evident in these statements and the rhetoric of “smart money” and “soft money, private investors welcome the reduction of risk through state intervention, but are reluctant to see the state as an equal investor into film, claiming that by making other provisions than profit, public aid has forgone its rights to profit participation.

7.3.2 The German and the UK Tax Incentive Schemes

There are two basic forms of fiscal incentives, namely tax reliefs and tax credits. Tax credits (operated in countries such as Canada, Luxembourg, and South Africa) are direct incentives, and refer to the reimbursement of qualifying expenses incurred in the country by the production company from the government. As such they comprise wage credits, sales tax rebates and reductions or waivers of capital tax. In contrast, tax reliefs are indirect incentives, which are designed to promote private investment into the film industry, such as accelerated or preferential depreciation allowances (Russell and Dhaliwal, 2005). The latter scheme was operated in countries such as Australia, Germany, Ireland, Belgium and the UK.

While the mechanisms of tax schemes can be quite distinct between countries (See **Appendix IV**), what is shared between systems is that the tax credit or tax relief is usually granted to a production company after the final audit of the film on the provision of receipts for expenses, that is *after* the expenses have been occurred. However, as producers need the finance for production *upfront*, the tax incentive is usually discounted with a financial intermediary or specialized fund to cash-flow the project. Thus, especially where tax incentives seek to attract private investors (i.e. high net worth individuals), this has led to the creation of specialized funds, pooling the capital from these investors, and brokering deals with producers. This has been the case both in the UK, as well as in the German tax relief scheme.

In the UK, tax reliefs were introduced by the *Finance Act in 1992* (Section 42) and extended in 1997 (Section 48). Section 42 (1992) relief thereby enabled a film producer to write off the full cost of their film over a period of three years, while Section 48 (1997) relief allowed producers to write off the full cost of any film costing less than £15 million within one year. As many producers did not have tax liabilities to write these sums off against, the tax benefit was typically sold under the scheme to a third party (the specialized fund) in return for a contribution to the film's production budget. This "*Sale and Leaseback"* structure[97] operates as follows*:*

> *"A production company sells a film as soon as it is completed to a third party, the purchase being funded partly by equity investment and partly by a bank loan. The third party then enters into a finance lease, usually for a period of 15 years, leasing back the rights to the original producer. The bulk of the sale proceeds that the film production company receives is put on deposit and is used, with the interest it generates, to cover the future lease payments whilst the remainder is set against the costs of producing the film.*
> *The sale and leaseback structure enables the third party - typically a partnership of high net worth individuals or a large corporate - to claim the benefit of the film tax reliefs against their own taxable income from other sources. Meanwhile, film-makers exchange the cash flow benefit offered by the film tax reliefs for an upfront payment which can be put towards the cost of making the film, the level of the payment being determined by the terms of the sale and leaseback agreement. In effect, the benefits provided by the film tax relief are shared between the film-makers and the third parties."*
>
> **HM Treasury (2007:12)**

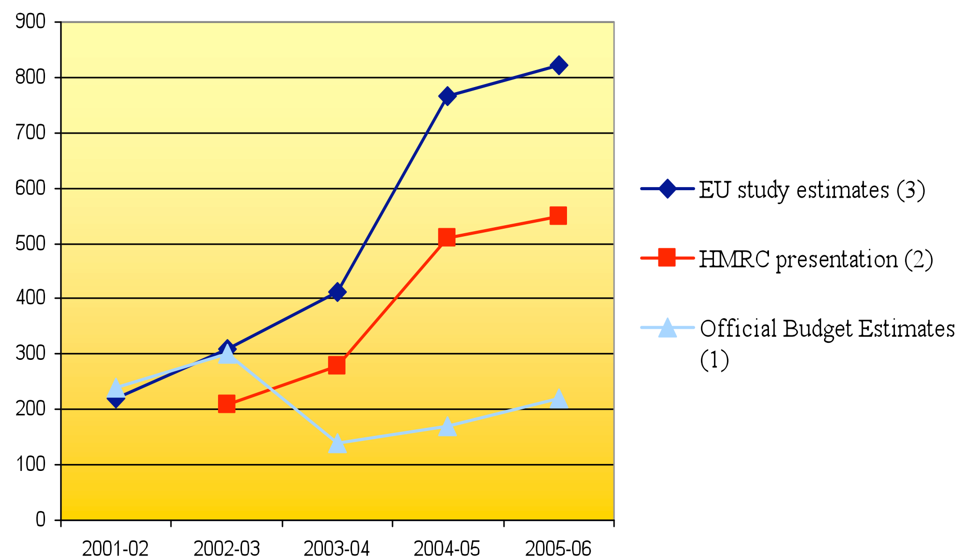
In Germany the tax law permitted the immediate deduction of the cost of creating "intangible" assets (such as films), enabling investors to immediately write off the entire cost of producing a film. Similar to the UK, this led to the creation of tax based media funds ("Medienfonds"), which entered a boom period in 2000 (with growth of funds commencing already in 1997). Although the tax law was re-designed in 2001 (Medienerlass) to counter abuse, the German film tax relief was especially heavily taken advantage of, as it was the only system internationally, which did *not* have local spend criteria, allowing German private capital to freely flow wherever the highest profits could be achieved.

It is difficult to assess the total amount of finance raised through tax incentives, as the "*loss of revenue from reliefs cannot be directly observed"*, and hence *"the estimates are often based on simplified assumptions"* (HM Treasury, 2006:4). For the UK, there are a number of estimates that vary quite dramatically, as illustrated by **Figure 7.1**, plotting the estimates of three different sources. The first line (1) represents the estimated costs given by HM Revenue in the official budget reports 2002 – 2006 (HM Revenue, 2002; 2003; 2004; 2005; 2006). In a parliamentary question in 2004, the Treasury confirmed the tax cost of Section 48 at £440 million for the period between 1997 and 2002, at £300 million for 2002-2003 and at £140 million for 2003-2004. They also noted however that in the

[97] See also McKenna (2007).

whole period an additional £70 million per year was provided to the film industry through Section 42 tax relief (Parliament, 2004). These figures do not, however, appear in the official budget report. The estimates provided in the budget contrast further with the estimates given by a representative of HM Revenue at a presentation to the British Screen Advisory Council in 2007 (Harris: 2007). The costs to the UK public household are thereby significantly higher, as is illustrated by Line 2.[98] Finally, Line 3 marks the estimates that have been given in a EU study in 2008, naming the UK Film Council and the trade paper Screen Finance as a source and representing the combined amount provided through Section 42 and Section 48 (EU Study, 2008:45). These figures represent nearly four times the amount given by the UK treasury in its official budget.

Figure 7.1: Estimated Costs of Tax Reliefs



(Sources: Compiled from HM Treasury Budgets 2002-2007; EU Study 2008; Harris, 2007)

In addition to estimates from official sources, industry sources indicate that the true volume of the UK tax reliefs was even higher. For 2000-2001 Grant Thornton, a global organisation of accounting and consulting member firms, estimated the cost of the scheme already at £400 million (Milmo, 2002; BBC, 2002) per year, exceeding the "*Treasury's budget plans by more than five times*" (Verity, 2001). In 2003, the specialist

[98] As the estimates were provided in the presentation in form of a graph, the data values in this chart are the author's own approximates as derived visually from the chart.

tax relief information provider Tax Efficient Review estimated the volume of investment in the schemes at £1.7 billion (Burgess, 2003), with the BBC finally estimating that when the scheme went into revision in 2004, its costs to the Treasury were running at £2 billion a year (BBC, 2005; see also Goff, 2007). Based on these sources, it can be assumed that the figures given in the EU study represent minimum estimates, while the figures given in the official budget report can only be interpreted as the result of *extremely* conservative projections by public authorities.

For Germany, there is likewise a lack of accurate data from official sources on the amount of finance provided to the film industry through tax reliefs. However statistics on the growth of German media funds, through which the tax incentives were mainly channeled can provide a satisfactory indication to this end. **Table 7.3** shows the estimates of a German industry analyst detailing the growth of German media funds between 1997 and 2003. This data closely corresponds with the estimates of trade journalists, estimating the capital raised by German media funds from private investors at EUR 2.3 billion in 2002, EUR 1.76 billion in 2003, and EUR 1.5 billion in 2004 (Blaney, 2005, Bardeen and Shaw, 2004; Happe and Otto, 2003).

Table 7.3: Growth of German Media Funds

Jahr	Capital Resources (in billion €)	Borrowed Capital (in billion €)
1997	0.12	0.21
1998	0.70	0.92
1999	1.20	1.65
2000	2.10	3.05
2001	1.96	2.67
2002	1.53	1.78
2003	1.70	2.50

(Source: Kurp, 2004)

On the whole, while the volume of the financial capital raised through tax schemes in the UK and Germany can not be determined exactly, it can be assumed that taken together, the German and UK tax schemes provided at least an additional EUR 2.5 billion a year in financial capital to the international film industry in the period between 2000 and 2004.[99]

7.3.3 Investment Strategies of Tax Funds

This significant amount of capital was channeled both in the UK and in Germany through specialized private funds, managing the pooled finance for private investors. For a number of reasons, the economic models and methods used by these funds were, however, not ideally suited towards financing typical small scale European film projects; Firstly, similar to US studio financing, these funds typically hedged investment risks by financing film slates. As a fund manager explained:

> *"XX is an asset management firm, 22 billion under management, the part of the business I manage, the special opportunities fund, has 5 billion under management. We don't do single picture financing, we only do slate financing. It helps us to put more money to work and has a better risk profile."*
>
> **Managing Director, US Special Opportunities Hedge Fund**
> **(Source: Panel Discussion, Cannes Market, May 2006)**

Similar to studios, the "smart money" investors thereby used statistical models to predict film revenues and to calculate the optimal risk distribution for the films they financed. Thus "smart investors" had little interest in the creative side of the film business. As an industry analyst explained:

> *"We have done over USD 1 billion in film finance over the past few years, and me and my colleagues have never read a single script. We don't read scripts. We are interested only in business plans."*
>
> **Film Financier**
> **(Source: Panel Discussion, Deutsche Bank, February 2007)**

Instead, smart money relied on the financial modeling skills of analysts. When it comes to financing studio slates, these models are usually made up in accordance with a database that matches the various elements of a film such as genre, stars or attached director in a risk-minimising way based on past experience. As the director of the entertainment finance department of a major bank stated:

---

[99] This was in addition to the EUR 1.3 billion already provided to the film industry in Europe through other forms of public aid.

> *"We have some very sophisticated modeling software now. We have a dataset of lets say 75 films, and we are going to finance 20 films, using the revenue cascade, what would I as the issuer make on that cascade? Then the computer picks out 20 films, My loss probability is x, my return is y. The computer runs this 10000 times, the results of that 10.000 iterations, which tell me what my loss probability is. The dataset is very small, however it is a tool and it is a useful one."*
>
> **Managing Director, Entertainment Division of a Major French Investment Bank**
> **(Source: Panel Discussion, Film Finance Summit, October 2006)**

Or as John Miller, head of JP Morgan Securities Inc (a major player in US bank film financing) has stated:

> *"The movie business on a single picture is volatile. Odds are that if you take a slate of 12 to 15 films, it's almost statistically predictable. It's quite amazing how predictable it is. You can get it within percentage points of accuracy."*
>
> **Cited in White (2005)[100]**

However, it is important to note that the major application of these tools lies in the financing of US studio films, as equivalent datasets are not available for the European film industry. The lack of data has consequently put European film producers at a disadvantage in the competition to source finance, with respect to the use of efficient financing techniques.

Secondly, for the management of the funds, as well as for the brokering of deals between investors and producers, the "stratum of intermediaries" (Strategics, 2007:57) of financiers typically charges a fee, which is ultimately passed on to the film producer. Thus a tax credit of 25 per cent is usually worth 15 per cent for the producer, with the remainder going to the fund. Because of the high associated costs of obtaining finance from these funds, this kind of financing consequently only made economic sense for producers looking to finance projects with medium to high production budgets.

In addition, funds themselves also preferred to invest into a small number of medium to high budget films, in order to put as much money as possible to work at once:

> *"[…]On the tax side of the business, I'll be very blunt. We have no criteria. The only question is, is the scale of the transaction big enough to put the machine in motion. We*

[100] As these statements suggest, the "nobody knows" principle is by far not as pervasive as proclaimed by Hollywood economists, and some investors are able to assess their risk of investment quite accurately.

are looking for volume to do a tax transaction. We are looking at Louisiana, at Connecticut, wherever we can do a deal, where we can get the machine going".

Managing Director, US Special Opportunities Hedge Fund
(Source: Panel Discussion, Cannes Market, May 2007)

However, as higher budgets also need to be recouped at the box office, the ideal film projects tax incentive funds sought to invest in, were high concept in nature, aimed at international audiences and featuring a bankable (read American) star to attract audience attention. Comparing these characteristics with the typical European film that features no stars, has an average budget of £3 million and is released at best in two or three countries, a certain disparity between ideal and actual investment opportunity in the European film industry is apparent. Consequently money raised from tax schemes in Germany and the UK was repeatedly diverted through co-financing and co-producing structures to medium to high budget US productions.

7.3.4 Diversion of Capital to the US and Relief tourism

The diversion of money into US production was particularly striking in the case of Germany, where the tax scheme lacked minimum spent criteria. It is estimated that between 1997 and 2004 German media funds provided more than EUR10 billion in finance to Hollywood studios, financing between 15-20 per cent of total Hollywood production costs (O'Brien, 2004). According to an independent German analyst, 2004 four out of every five Euros (78 per cent) raised through German media funds was channelled into North American-based productions, with only 10 per cent invested in productions in Germany and about 11 per cent in projects within Europe (Blaney, 2004; 2005). The lack of minimum spent criteria thus resulted in a drain of financial capital from Germany, with little impact on the German film industry and economy. For the studios, taking advantage of German tax shelter money was a welcome capital infusion:

"Pricing dictates that if foreign investors get tax benefits when investing in US films, it should be priced into the financing costs, making foreign financing attractive relative to other sources. Cross-border tax arbitrage dictates that US studios take advantage of this disparity by accepting the cheaper foreign money."

Bardeen and Shaw, 2004:3

In the UK, the diversion of funds to the US was less dramatic, as local spend criteria tied to the British tax relief at least required productions to spend a minimum of their budget in the UK. This in turn resulted in a strong growth of "US-UK co-productions" in the mid-to high budget range, with US partner productions accounting in 2003 for 90.3 per cent of all UK inward feature investment (£659 million out of £730 million) (UK Film Council, 2004:85).

From 2002 to 2003, the median budget of inward feature co-productions jumped from £25 million in 2002 to almost £47 million in 2003 (UK Film Council, 2004:77), with the number of inward co-productions with a budget above £30 million rising from one to eight and the amount of associated UK spend leaping from £26.1 million to £293.4 million (UK Film Council 2004:81), completing the picture of growth in co-productions which were mainly driven by financier rationales to put capital to work. The growth in the budgets of international productions thereby stands in stark contrast to UK domestic production, with budgets for domestic films increasing in the same period only from £2 million to £3 million, benefiting very little from the tremendous amount of financial capital available for film production in the UK.

While co-productions ideally represent "a technical and artistic contribution commensurate with the financial investment" from all co-producing countries, this was clearly not the case in the German incentive system, but also not in the UK scheme, which encouraged "relief tourism". As the Treasury noted:

> *"The fact that the current reliefs apply to worldwide expenditure can also have an undesirable distortive effect on decisions about where to base a film. In some cases it can encourage 'relief tourism' where film-makers seek to meet only the bare requirements of certification, thereby obtaining the maximum level of tax relief in the UK and then situating the remainder of the production work overseas to access film incentives in other jurisdictions."*
>
> **HM Treasury, 2005:15**

In 2003, at the height of the UK tax relief boom, the UK co-produced a record number of 99 films, as countries internationally sought to take advantage of the UK tax relief through co-production. Relief tourism was thereby in particular evident in the case of UK-Canadian projects, which attempted to take advantage of tax credits in both countries. Realizing that UK-Canadian co-productions were not based on reciprocity anymore, the UK government demanded in 2005 a change in the bi-lateral co-production agreement, requiring co-producers to spend a minimum of 40 per cent in the UK. This resulted in an immediate decline of UK-Canadian films, with the production volume generated by these co-productions falling in Canada from CAD 237 million in 2003 within two years to only CAD 79.5 million (CFTPA, 2006:63; 2007:75), a decrease of more than 66 per cent.

In close affiliation to the US studios, the abundance of capital for film production in Europe also led to the growth of a new type of medium-to high budget official European co-production, that was made for a wide international audience. Films such as Oliver Stone's *Alexander* (co-produced with German, French, British and Dutch tax money, 2004), *Kingdom of Heaven* (Spain, UK, Germany, 2005), or *the Black Dahlia* (Germany, US, France, Belgium, 2006) are representatives of these European co-productions with US participation, which were financed predominantly through a combination of soft and smart money from Spain, Germany, France, the UK and the US, reflecting on an increasing cultural and economic blurring of national filmmaking on both sides of the Atlantic.

The intertwining of the industries, as well as the diversion of public aid to the US is also visible in the market shares of films in Europe with respect to the country of origin. In 1997, 28.2 per cent of films watched in Europe (EU 15 member states) were of European origin (including domestic films), 70.5 per cent from the US and 1.3 per cent from the rest of the world (EAO, 1998). Ten years later, the market share of European films (EU 27 member states) had increased marginally to 28.8 per cent (plus 0.6 per cent), the market share of film from the rest of the world had risen to 2.2 per cent and the share of US productions had dropped to 62.7 per cent - due to an increase in co-produced and co-financed US-European film which accounted for 6.3 per cent of watched films (EAO, 2008). The growth of this segment can thus be seen as the result of the effort of European countries to redirect production from the US to Europe by subsidizing it. What is furthermore evident is that the increase in public funding has not been followed by a corresponding increase in the market share of European films at the box office. This is even more worrying when taking into consideration that in the same period the number of films produced in Europe increased from 571 (EU 15) to 921 (EU27), while in the US the number of produced films remained approximately the same.[101] However, while Europe has mainly seen an increase in the number of low budget films with limited international market potential, in the US production budgets of US studios expanded from USD 53.4 million in 1997 to on average USD 70.8 million in 2007. In absolute numbers, the growth of production value in the US was therefore in this decade at least two and a half times as high as the growth in Europe[102]. As detailed above, one can assume that the expansion of public aid through tax incentives has thereby mainly facilitated US productions by increasing their budgets, while a comparatively smaller amount of money has increased the number of low budget films in Europe, by being channelled through the dispersing funding landscape.

7.3.5 Tax Avoidance and Financial Dynamics

"Cinema is the most beautiful fraud in the world."

Jean-Luc Godard

"The crisis at VIP, Germany's leading film fund operator, deepened on Wednesday with the arrest of CEO Andreas Schmid in connection with the ongoing criminal investigation on suspicion of fraud and tax evasion. Munich's public prosecutor's office ordered the move to prevent Schmid from fleeing the country. Earlier in the day, VIP announced Schmid had stepped down as chief exec and would relinquish his duties during the probe. VIP said it was cooperating with the investigation."

Meza, 2005

A particular problem of tax incentives is their tendency to become tax avoidance schemes for high net worth investors. In the UK, the sales and leaseback system was in particular susceptible to this kind of activity, forcing the government to amend the respective law eleven times in five years to close down different ways of tax evasion (**see Table 7.4)**

[101] Decreasing marginally from 461 in 1997 to 453 in 2007, with approximately 200 films a year being US studio productions.

[102] Assuming for the US an increase in production value from USD 10.68 billion in 1997 (the average of 200 US studio films, times an average budget of USD 53.4 million) to USD 14.16 billion in 2007 (200 US studio films, times the average budget of USD 70.8 million), US production value increased by plus USD 3.48 billion); assuming that in Europe the 350 additional films produce in the EU 27 had an average budget of USD 4 million (a reasonably high estimate), the increase in European production value is USD 1.4 billion.

Table 7.4: Anti-Avoidance Legislation Enacted in Relation to UK film Tax Reliefs

- FA 2000. Action to prevent multiple dipping of film reliefs by sale and leaseback of subsidiary rights in a film (s113 FA2000).
- FA 2002. Restricted relief to Cinema films to prevent TV programmes claiming relief; (s99 FA2002).
- FA 2002. Restricted relief under Section 48 to actual payments made during film production; (s100 FA 2002).
- FA 2002. Restricted Section 48 relief to the first acquisition from the producer to prevent sale, and leaseback schemes claiming the relief more than once (s101 FA2002).
- FA 2004. Action to prevent individuals who had used the film relief to defer their tax, from turning the deferral into an outright tax gain (s119 to 123 FA2004).
- FA 2004, Action to prevent individuals acting in partnership avoiding tax by claiming losses greater than their contribution to the trade (s124 FA2004).
- FA 2004. Action to prevent individuals deferring and avoiding tax by investing in film partnerships which did not use the tax relief for British films (s125 FA 2004).
- FA 2004. Action to prevent individuals avoiding tax by using licence related losses followed by an exit (s126 to 130 FA 2004).
- FA 2005. Action to prevent Section 42 and Section 48 tax relief being claimed more than once on the same film (Schedule 3 FA 2005).
- FA 2005. Action to restrict relief under Section 42 to the actual production cost of the film (Sch. 3 FA2005).
- FA 2005. Action to prevent companies and partnerships from using Sections 42 and 48 to defer tax for more than 15 years (ss60 - 65 FA2005).

(Source: HM Treasure, 2005:13)

The complex operation of the UK scheme thereby resulted in a situation where investors in film funds ceased to take a real interest in the films they supported, as their investment risk and return were essentially safeguarded by the state. As a producer explained:

> *"From a producer's perspective tax credits have completely spoiled the landscape. We worked on this project, and we had these massive tax benefits, and it was nearly irrelevant for the investors to gain any upside, we have now reached a point where it is nearly irrelevant for the investors to gain any upside… it's like a self-fulfilling prophecy."*
>
> **UK Producer**
> **(Source: Panel Discussion, Film Finance Summit, February 2005)**

A legal loophole in the tax relief system furthermore allowed producers to "double dip" the tax incentives twice for the same film, once via a production fund and later via a sales-and-leaseback deal. For films made under Section 48 relief double dipping allowed producers to cover 25 to 40 per cent of the production cost. For bigger budget films using Section 42, such as the *Harry Potter* franchise, the value ranged from 15 to 25 per cent (Minns, 2005; Dawtrey, 2004; Dawtrey 2005).

Witnessing an opportunity for a profitable investment, ever more financial capital consequently streamed into the industry, seeking appropriate projects to invest in. With production expanding on an industrial scale to meet the finance available, the abundance of financial capital seeking profitable projects increasingly resulted in projects finding financial backing, which previously were discarded both on artistic and economic grounds:

> *"Advantage was taken of the money that was available. A lot of films were just made to get the money, which meant a lot of them weren't good films."*
>
> **Trade Journalist (Source: Interview, February 2005)**

Or as the Treasury itself has noted has led to:

> *"The production of poor quality products made solely for the purpose of claiming accelerated tax relief to shelter other economic activities from tax."*
>
> **HM Treasury, 2005:15**

The abundance of financial capital thus led to a distortion of the market for filmed entertainment through a glut of production, in particular towards the end of the financial year:

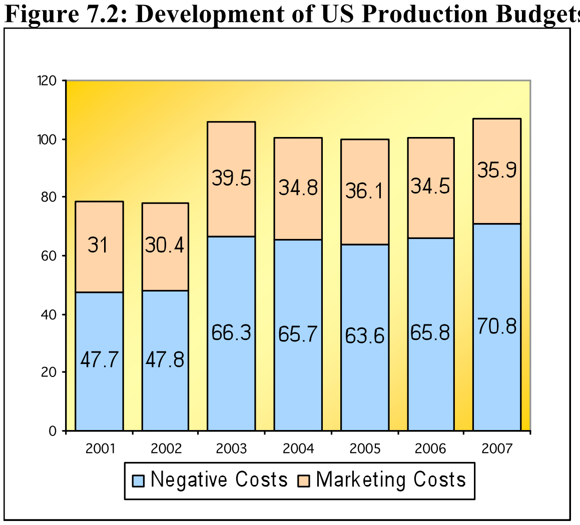
> *"The ability to transfer the benefit of film tax reliefs to high net worth individuals also distorts the film production cycle in the UK, as the market for sale and leaseback financing peaks towards the end of the tax year, with film projects forced to be designed around that deadline."*
>
> **HM Treasury, 2005:14**

Similar to continuous "bull" phase stock markets, the film industry in the UK and its co-production partners (most notably the US) were increasingly characterized by what could be described as a special form of asset price inflation, leading to a dislocation of the market. This distortion is, for example, reflected in the sales estimates of film sales agents and distributors, in which the production budget is usually taken as the basis for asset valuation and a primary indicator of future revenues. With budget costs becoming more and more inflated through the abundance of financial capital, this consequently resulted in inflation of the valuation of film assets. The market confusion resulting from the consequent growth of paper value over real value of film assets can be shown through the increase in systematic overestimation of sales values, which increased from 20 per cent in 1999 to about 40 per cent in 2005 (with sales estimates for films below 5 million

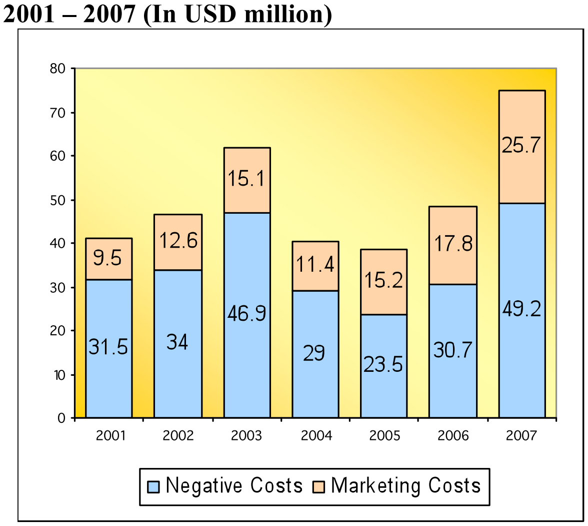
USD being twice as inaccurate) (Strategics, 2007:59). That the expansion of UK and US budgets between 2001 and 2004 (see **Figure 7.2** and **Figure 7.3**) were not the outcome of real cost increases, is also suggested by the Managing Director of a leading US film commission:

> *"Every tax deal is followed by an inflation of the budgets of the films that are being made in that country.[…] I can just hear the studio executives going: Well this film probably shouldn't cost more than 50 million dollars. But we have the UK tax deal, and we can do the German one and we've got a hedge fund, so we can spend 75 million."*
>
> **Managing Director US Regional Film Fund**
> **(Source: Panel Discussion, Cannes Market, May 2006)**

Figure 7.2: Development of US Production Budgets 2001 – 2007 (In USD million)



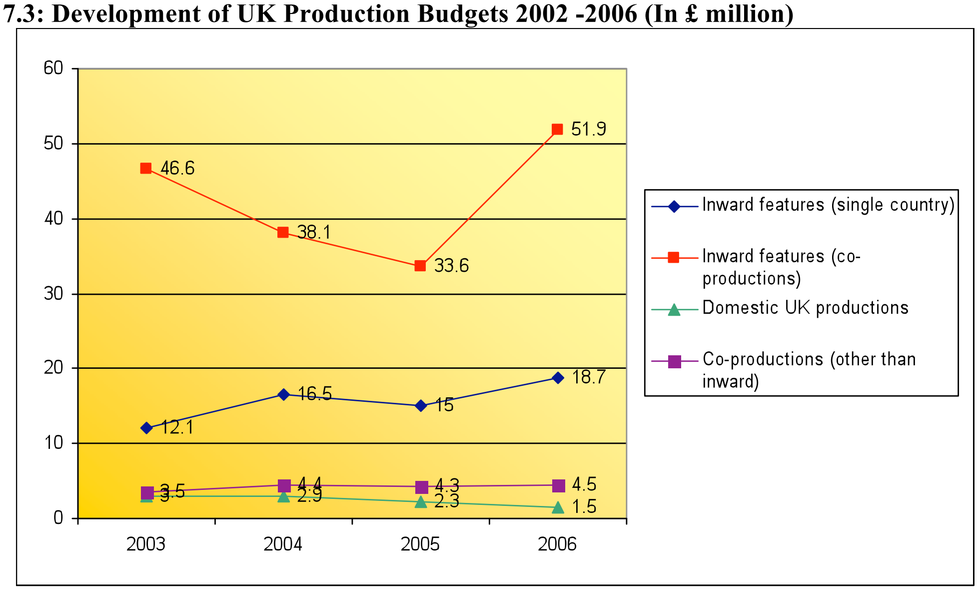
US studio production



US studio affiliate production

(Source: MPAA, 2008)

Figure 7.3: Development of UK Production Budgets 2002 -2006 (In £ million)



(Source: UK Film Council Statistical Yearbooks, 2002 -2007)

Increasingly producers themselves started to bemoan that the tax structures were "*corrupting the landscape*", "*everything gets confusing*" and that *"the less deals are done, the better for the industry".* A main point of critique from producers about the tax schemes, therefore, was that the very existence of projects that are subsidized by soft money - no matter how commercially viably they might be otherwise - means that if producers can not attach any form of soft money to their budgets, their projects become un-attractive for financiers: Even projects that would have been viable on their own were thus under pressure to attach soft money:

> *"It's very difficult to finance an independent movie, without some soft money. What the soft money does, is that it allows us to bring in equity […]finance for the rest of it."*
>
> **Independent Film Producer**
> **(Source: Panel Discussion, Film Finance Summit, October 2006)**

> *"It is a dramatic change. Somehow you have to find your 20 per cent tax credit in Europe, if its in the UK or Hungary it doesn't matter."*
>
> **Independent Film Producer 2**
> **(Source: Panel Discussion, Film Finance Summit, October 2006)**

Originally designed to attract private investment to the film industry, tax incentives were thus increasingly crowding out genuine investors and distorting the market.

On an industrial level, the abundance of financial capital in the UK became a major draw for film producers internationally, which in turn put more pressure on other countries to introduce tax incentives as well, or face the loss of production. In the context of international incentive competition, production capital thereby became even further dis-embedded, with producers becoming, what can be called, "incentive nomads" using co-productions to arbitrage soft money from different countries to maximise budgets. This process has been accompanied with a redistribution of bargaining power away from the state to a small number of big budget film producers and especially the major studios, who can easily hold up governments by threatening to move production to another country. As the managing director of a US Film Fund explained:

> *"I have been in meetings […]and I have heard studio executives say that they won't even consider a region now, if it doesn't offer incentives. If you are not offering it, you are not in the game."*
>
> **Managing Director US Regional Film Fund**
> **(Source: Panel Discussion, Cannes Market, May 2006)**

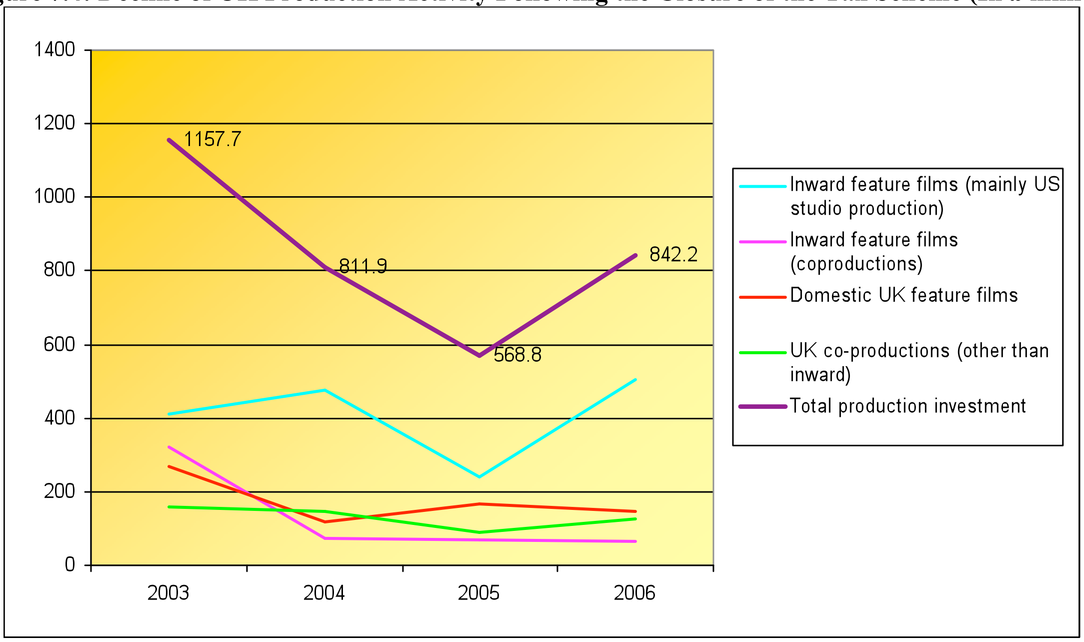
Or as the CEO of a Private Equity fund investing in film stated:

> *"[Soft money]… It's not just about helping films to get made, where there is not enough funding. It also about being competitive and stop them from going elsewhere. At XX we did YY recently with Nicole Kidman, it takes place in New York, and it's a great location, but guess what, if those benefits hadn't been there, we would have taken it elsewhere."*
>
> **CEO US Private Equity Fund**
> **(Source: Panel Discussion, Cannes Market, May 2006)**

This threat of production and investment loss also put pressure on the UK government, who despite early evidence of abuse, maintained the film tax relief in its then form until 2005. Fuelled by private financial capital attempting to use film tax reliefs to avoid taxation, a production bubble was built up in the UK that is most visible in the dramatic jump of total UK production value from £550 million in 2002 to £1,157 million in 2003. The increased production activity can at this point clearly be described as the outcome of a dynamic of finance pushing production. However, similar to the previous two capital cycles (Neuer Markt, insurance-backed securitization) in international film financing, the boom period ended abruptly with the shake out of the key investor, which in this case was the state.

As the heavy subsidization of the US film industry had little effect on the German economy, the roughly EUR 10 billion that has flown from Germany to the US can be described as a direct loss to the German tax payer. The closure of the German tax incentives at the end of 2005 (with two prior legislations making investment into media funds more unattractive in 2001 and 2003) hence had very little impact on the German film industry, as the scheme had never led to a strong increase in German film production in the first place. In the UK the then tax scheme was scrutinized in September 2004, when the Inland Revenue announced that section 48 would be replaced and a transitional period for the old scheme was announced. The closure of the old tax scheme resulted in a drop of production value from £1.157 billion in 2003 to £569 million in 2005 (UK Film Council, 2007:143) (See **Figure 7.4**).

Figure 7.4: Decline of UK Production Activity Following the Closure of the Tax Scheme (In £ million)



(Source: UK Film Council, 2007)

Likewise the median budget of inward feature co-production fell from £46.6 million in 2003 to £33.6 million in 2005. Particularly evident then, is the decline in inward feature co-productions (an official co-production that originates from outside the co-production treaty countries (usually from the USA) which declined from £319.9 million in 2003 to £71.6 million in 2004 and have not been revived since).

The revision of the UK film tax relief also led to repercussions in film industries which had been avid co-producers of Britain, and here most notably in Canada and Ireland. I have already described how the amendment of the co-production treaty with Canada has resulted in a decline of production activity that has also been accelerated by the reduction in soft money provision from the UK. The Irish film industry was likewise strongly dependent on UK-Irish (US) co-productions, which accounted for nearly 90 per cent of all Irish production until 2005 (Irish Film Board, 2005). This form of co-production was in particular attractive for US studios who could take advantage the Irish tax credit (10 per cent) and combine it with the UK tax credit for a total of 25 per cent of a film's budget.[103] With the closure of the UK tax scheme, the Irish film industry thus came under pressure as taken on its own its tax credit was not attractive enough for US studio production. As a result the total spend of projects certified under the Irish section 481 tax relief fell from EUR 282.7 million in 2003 to EUR 56.2 million in 2005 (DAST, 2007). In order to "maintain competitiveness within the dynamics of the international film industry", the tax incentive for Irish expenditure was hence expanded in 2006 to 20 per cent (Irish Film Board, 2007), to compensate for the decline of British public aid.

7.4 Outlook

Although tax incentives turned out to be a massive burden for public budgets both in Germany and the UK, new schemes were immediately under discussion after the previous ones had been shut down. Confronted with the failure of the German system, the head of the principle German producer lobby, for example, refused any critique, arguing instead that:

> *"We came from a position where we have been in no competition at all, so we should be happy to be in a location competition for the future-industry at all!" [emphasis added]*
>
> **Head of German Producer Lobby**
> **(Source: Panel Discussion, Deutsche Bank, February 2005)**

In both countries smaller producers were, however, not very enthusiastic about new tax incentives. In Germany, a producer criticized that the policies underlying the tax incentives were fundamentally confused:

> *"It could be a great re-distribution, but its an experiment, I still don't understand what is the aim of these policies, the policies are confused – do you want to attract Harry Potter here, do you want to keep national production in the country? "*
>
> **German Film Producer 2**
> **(Source: Panel Discussion, Deutsche Bank, February 2005)**

And in the UK, producers were likewise critical:

> *"We have seen gigantic chunks of money being thrown at the British production industry in the past few years, we can discuss what this has done to the British production industry, but in my view this has not produced an increase in quality. So I'm more interested in films, in business models, films that will make real money and not just making films because there is money thrown at it."*
>
> **UK Film Producer**
> **(Source: Panel Discussion, Film Finance Summit, October 2006)**

[103] Not taking into account the "double dipping" practice.

After a transitional period, the UK re-introduced tax incentives in 2006, with the new scheme becoming fully operational in 2007. Under the revised system, the number of co-productions has decreased continuously, falling from 99 in the peak year 2003, to 29 in 2007 (EAO, 2008). Germany decided to introduce, instead, in 2006 a film fund with a capped budget of EUR 60 million for three years, specifically targeting German film productions and co-productions, refusing explicitly to be any longer "the plaything of the smart accountant" (Screen Daily, 2005:4). The new scheme has, since then, increased German national productions, with the number of German national films rising from 60 in 2005 to 78 in 2006, and 2007 (an increase of 30 per cent), while the number of co-productions has remained stable at around 44 annually (EAO, 2008).

As discussed in the previous chapter, the problems encountered by Germany and the UK did not stop other countries, and particularly the US, from introducing new tax incentive programs. In the US, in a financial environment of low interest rates and low yields, film as an investment class had already attracted considerable interest from private investors awash with liquidity prior to the introduction of tax incentives. Financial intermediaries in the latest US capital cycle claim that they are more sophisticated (have stronger structuring, statistical analysis and negotiating abilities) and possess more leverage against the studios than any previous investor class (as some of the financial institutions operating special opportunity funds, are also corporate lenders to the studio's parent companies), with the reduction of risk through tax incentives further facilitating their investment.

The US industry has consequently seen a staggering inflow of finance from private US investors, with US studios sourcing between 2003 and January 2007 more than USD 8.7 billion in private equity, with private equity in any given year providing approximately USD 1 - 1.5 billion in single picture and revolving credit facilities for the film industry, not counting slate deals (Russo, 2007). This has led, in turn, to a further expansion of US production budgets, with studios making ever bigger bets on films and spending ever larger amounts of money to market films globally. The aggregate budget of the *five* summer “tent pole” studio pictures in 2007 alone is estimated to exceed USD 1.3 billion, with an average budget of USD 260 million per film, and with print and advertising costs exceeding USD 150 million *per film* (Russo, 2007). However, it remains to be seen how viable the latest inflow of financial capital into the US industry is. Even before the global credit crunch on financial markets in the second half of 2007, US investors were becoming increasingly concerned about making deals with studios. As a US film financier observed:

> *“Are studios ready to share the risk, yes. But the upside? Whatever deal is done with the studios, is in favor of the studios.”*
>
> **US Film Financier**
> **(Source: Panel Discussion, Film Finance Summit, October 2006)**

In order to avoid being taken advantage of by studios, a US film financier thus noted that US equity funds were increasingly interested to make deals directly with producers with a strong track record, and that the sourcing of finance was again shifting to foreign territories. As a US financier predicted in February 2007:

> *“Deal making is about to go overseas, enabling even more creative transactions.”*
>
> **US Film Financier**
> **(Source: Panel Discussion, Deutsche Bank, February 2007)**

In March 2008, the New York Times (NY Times, 2008) reported that Hollywood producers were attempting to source finance from wealthy Middle East countries, with finance from Abu Dhabi, Dubai and Qatar offering a solution to worries that hedge funds were tiring of Hollywood after several movie-financing deals had gone bust. As the journalist commented:

> *“The hedge funds are packing their bags? No problem. Send in the sheiks.”*
>
> **NY Times, 2008**

Thus there are strong indications, that also the capital cycle based on US private equity capital is drawing to an end quickly. However, given the history of film financing detailed in this thesis, and the self perpetuating nature of the “best” practice tax incentives, it does not appear unlikely from a studio perspective, that as soon as the current source of investment has been used up, another one will be found, just in time.

After all, film is a future industry: National cultures will always need to be protected by industrial policies, and there will always be an overheated part of the world economy, which can not resist the exciting temptation of a truly “creative transaction”.

7.5 Summary and Discussion of Policy Implications

In this chapter I have given two explanations as to why co-productions have increased in importance as an integral part of European and international film production. Firstly, I have argued that in the context of locally confined capital pools in Europe, co-productions have become a pervasive industry practice to raise finance. Secondly, I have examined the growth of medium to high budget co-productions in Europe in the context of a dynamic of finance pushing production, as the consequence of the boom period of a capital cycle in international film financing based on tax sheltered money. In line with these arguments, *three* broad types of co-productions (**Table 7.5**) can be distinguished.[104] [105]

Table 7.5: A Typology of Co-Productions

Type	Characteristics
(A) Co-production driven by creative reasons - “True Love”	- Creative elements of film demand cross border production (e.g. a Road movie), or strong benefit from creative inputs from multiple countries - Low-Medium budget films, predominantly European
(B) Co-production driven by search for finance (Industry driven) – “Marriage of Convenience”	- Film is structured as co-production to pool financial sources from different countries. Creative elements are adjusted in order to raise finance. - Low-Medium budget films - Single picture financing
(C) Co-production driven by international capital (capital driven) “Arranged Marriage”	- Film structured as co-production to exploit tax credits - Medium to high budget films, aimed at mainstream international audience, often studio distribution guarantee. - Films usually part of a slate of films

Source: Norbert Morawetz 2008

[104] It has to be noted that the categories may be more fluid than the taxonomy suggests, with projects not being made exclusively for one reason, but that usually a combination of creative and economic factors is taken into consideration.

[105] I have, in this thesis, mainly focused on the latter two categories, as co-productions made for creative reasons are an exception, and there has been no evidence during data collection there that there has been an increase in this type of co-production.

As an industrial phenomenon, co-productions have thereby facilitated, and have been facilitated by the expansion of public aid to commercial film production in Europe, and internationally. Producers and studios have facilitated co-productions by arbitraging public subsidies, while national and regional public authorities have encouraged co-productions in an attempt to arbitrage international investment.

The inflow of financial capital has particularly demonstrated the viability of the production pattern to produce medium-to-high budget level films for international audiences that are otherwise the sole domain of the US industry. While the revision of the tax incentive scheme in the UK has led to a partial decline of this type of co-production in Europe, the forces underlying the phenomenon continue to play an important role shaping the spatiality and industrial organization of the international film industry. With respect to the whole European production system, the increased co-production activity can be seen as restructuring film industries which previously operated pre-dominantly in a regional/ national context, towards a more integrated networked cross-border industry supported by temporary clustering, with strong links to the US industry. In line with previous empirical studies on the film industry, this internationalized industry is found to be built not on the pre-dominance of agglomerative forces and internal relations, but on a balance between locality and external relations: It is equally important for producers to have international links and attend professional gatherings, as it is to have access to local resources. Without access to the latter, co-producers are not attractive for potential international partners; without a co-producing partner, the local (financial) resources are in most cases not sufficient to compete for audiences used to high production budgets. A balance between local embeddedness and flexibility to access distant sources of capital is therefore necessary, as financial developments in other industries can have strong repercussions for local production.

Although it has not been the empirical focus of this research, I have found in the course of this research, strong anecdotal evidence that within the European production system co-production activity can contribute to an increasing specialization of regional production clusters. For example it was found that in co-productions with UK participation, co-producers often decided to complete post-production in the UK, taking advantage of, and reinforcing the strength of the London Soho post-production cluster (see Nachum and Keeble, 2003), while shooting would usually take place in a lower wage country. Ultimately, this could prompt the question as to whether co-production in Europe can be seen as a form of flexible specialization. In my view, such a thesis is, however, not tenable: Co-productions are collaboration of vertically dis-integrated production companies, who typically do not split the work process according to their specialization, or cost efficiency. Instead, work is mainly divided on the basis of creative decisions (location) and the amount of finance sourced locally (minimum spend criteria). While specialization of production centers might be the consequence of repeated transactions, it is not a dominant characteristic.

As this research has clearly shown, state intervention plays a substantial role in the film industry, making its economic well being ultimately strongly dependent on policy decisions. In the following section I will therefore discuss, whether based on this study's findings, any lessons can be drawn that can help to inform future policy-making. I will begin with a critical examination of tax incentives as a policy measure, followed by a discussion of whether in the light of this research, the film industry should be subsidized as a future growth industry at all. Finally I will outline the implications of the study for supra-national policymaking, and provide some recommendations.

7.5.1 Are Tax Incentives a Viable Industrial Policy for the Film Industry?

The first question that needs to be addressed is, whether tax incentives can be considered a viable industrial policy for the film industry? This question can – in view of the outcomes established in this thesis – only be answered negatively; Firstly, while the possibility of designing a tax incentive scheme that has no loopholes should not be excluded, at the same time the entrepreneurial spirit of finding such a loophole should never ever be underestimated, and as such tax incentives need to be closely policed and controlled continuously. Given, however, the notorious lack of transparency in the film industry, and that tax incentives themselves are a diffuse measure – in the sense that their true cost to the revenue can only be estimated, and remains largely hidden from taxpayers - the risk that the schemes lead to inefficiency and are used in a way not intended by the legislator are a major weak point of this sort of industrial policy. The UK is an ideal case to illustrate this point: As mentioned above, the cost of the tax scheme for the Treasury was estimated in 2003-2004 to be around £412 million, and in 2004-2005 to be around £765 million by the EU study (EU Study, 2008:45). In the same period, however, total production value in the UK was £809.7 million (2004) and £569 million respectively. Thus even when following the conservative estimates of the EU study – with the real costs to the Treasury most likely even being significantly higher – in 2005 the cost of the incentive scheme has exceeded the value of the whole film production activity in the UK.[106] Looking at these figures, it thus appears that the UK government might as well have funded the entire budget of films such as *Harry Potter* directly, as this would at least have entitled taxpayers to a share of the revenues, instead of letting public money seep away without owning anything of the investment.

Secondly, as has been detailed in chapter six, tax incentives can lead to a vicious circle of tax competition, and therefore to an imbalance between production capital and financial capital in the entire industrial system of a sector. While tax incentives for film production might encourage the domestic film industry, they are also likely to lead to redistribution of production activity from a neighboring country. Facing production loss, this leaves the second country with little other option than to introduce countermeasures itself, to protect its own industry. In doing so, the second country is thereby likely to benefit from opportunism by introducing a higher incentive, triggering a vicious circle of "incentive wars" – not unlike the customs and trade wars of seventeenth century mercantilism.

In this process, the economic value which policy makers have hoped to create with the incentive, becomes more and more eroded, to the point that the cost of maintaining the expensive schemes starts to exceed the economic value of the inflated production

[106] It has to be noted that some of the funds provided through tax incentives were channeled into TV production, and thus might have increased production activity in the television sector. However as the British television sector is a largely commercially viable industry, it can be assumed that the diversion of public support to television did not necessarily lead to additional production, but rather crowded out private investment that would have funded programs otherwise.

activity, becoming a burden to public households. The result is a zero sum – even a negative – game; an industrial system that is artificially inflated, where the relationship between production and financial capital is fundamentally distorted, and worse, the distortion is difficult to correct. The country which abandons the tax incentives first, stands to lose production to the others, and is under strong pressure from its artificially inflated workforce, leading to tax incentives being upheld as a policy tool for much too long. Thus with respect to public value, and when looking at the impacts of tax incentives on the whole industrial system, the logic to introduce tax incentives on economic grounds can only be strongly rejected, as they are built on a short term vision, that is unsustainable – and even potentially economically harmful – in the medium-to-long term.

Thirdly, although this has, in any case, never been an important ambition of industrial policy based on tax incentives, it has to be stressed that the inflow of tax incentive financial capital does not necessarily encourage culturally valuable, or high quality entertainment film production, but does often facilitate the production of medium to high budget film productions of low quality, made for the single purpose of taking advantage of public money. Thus also in this respect, the value for the public is kept within limit.

Fourthly, while tax incentives certainly do lead to an increase in production activity, the question arises whether they do so efficiently: if a tax credit worth 25 per cent is worth 15 per cent for the producer, after he has discounted it with a fund, then the scattering loss is nearly 40 per cent, money which leads to a growth in the financial and legal sector, but not in film production.

Fifthly, when examining existing tax incentives with a view to social equality, they must be strongly criticized for redistributing wealth away from average tax payers to a small group of financiers, rich individuals and corporate studios, who must be acknowledged as the true beneficiaries of this industrial policy. Ultimately, this can also put the film industry on the losing side: If it continues to serve as the willing pretext for high-net-worth-individuals to abuse its positive image for the sole profane reason of tax avoidance, the base for public support is undermined.

Sixthly, a major weak point concerning industrial policy that aims to grow its industry by growing production service industry, is that in the case of foreign producers, the value of production is ultimately attributed somewhere else but not in the site of production. The foundation of commercially viable film companies lies in building up a back catalogue of film assets and thus revenue streams. By simply servicing incoming productions, local film industry does not build up such a rights catalogue and is so deprived of its future economic foundation. In this light, subsidizing studio runaway productions, where no local producer shares ownership of the film assets, cannot be seen as contributing to sustainable industry growth.

7.5.2 Is Film a Future Growth Industry Without Government Intervention?

As is evident in co-productions and runaway production, the film industry is extremely mobile, and financing decisions can have a strong impact on where activity is located – both at an individual film level and for components of an individual film's production (e.g. principal photography, post-production). In an environment of pervasive tax incentive competition, the competition to attract and service incoming large budget productions is thus very high, and is likely to intensify even more. Furthermore, as the examples of Canada and the UK have shown, once the state withdraws funding, financial capital cannot be expected to show any further commitments to local production capital. Thus the idea, that relationships are built up between local producers and foreign financiers/producers that will lead to longer term collaborations – even when the incentives are withdrawn, must be criticized for being overly optimistic, failing to acknowledge that when it comes to the hard economic factors, the film business is just that – a business like any other.

Moreover, the film industry in general does leave very little physical infrastructure behind that could benefit future projects, other than a film studio. However, given that there currently exists an overcapacity of studio space internationally (as a result of countries trying to compete for film production), and there is increased competition from location shooting and virtual sets, the existence of a studio does neither increase the embeddedness of production capital, nor the competitiveness of a location significantly.[107]

Based on these three observations, it can be concluded that it is only to a limited extent possible to build a self-sustainable film industry with public support, as any publicly-funded increases in production can only be maintained with constant further provision of public financial capital. This is most evident where the aim of industrial policy is to grow national film industries by attracting foreign productions in order to grow its production service industry where dependency on state money is high.

This is also tellingly obvious in a recent speech given by the UK's Minister of State for Culture, Creative Industries and Tourism, Margaret Hodge to the UK film financing community (DCMS, 2007b). As she stated:

> *"And here lies Government's role in building sustainability. […] Some will argue that Government searching for sustainability is as futile as the Python's quest for the Holy Grail. […] two years ago the Treasury set out its policy to, and I quote, 'promote the sustainable production of culturally British films' through a new tax relief framework. This is, I think a really important contribution by Government. It is estimated that without the tax relief we could see a drop in UK film production of 75 per cent."*
>
> **Margaret Hodge, Minister of State for Culture, Creative Industries and Tourism at the UK Department for Culture, Media and Sport**

As the statement indicates, in a situation in which 75 per cent of production is dependent on state subsidies, the sustainability of production in the film industry has ceased to refer to economic viability, but to sustainability of public aid provision. In this light, the heralding of the film industry as a future growth industry must be strongly questioned: A true assessment of growth in the sector is, in my view, not feasible, as it is not possible to distinguish to what extent the sector has grown by itself, and to what extent growth is the result of public subsidies: Practically any economic sector could be heralded as "future industry" and show high growth rates if it had received the same financial injection as the

[107] It has to be noted that the degree of physical embeddedness varies across the production process and is at the highest in post-production, which provides stable employment and organizational structures, and at its lowest in actual film production, which typically leaves behind little machinery, or any type of infrastructure. Consequently, the effects of tax incentives are more sustainable in post production.

film industry has received through the provision of tax incentives. The promise of employment in the sector can therefore only be upheld if it is tied to a promise of future state support. Furthermore, if the film industry is an indication for growth in other creative industries, this also raises tangible questions about the workforce and training. The price for an industrial policy facilitating dependency rather than sustainability will ultimately have to be paid by young people, who are promised an exciting career in the sector. However between 1997 and 2006 – despite the massive funding injection - average annual employment growth in the UK film industry was – one per cent (DCMS, 2007a). In short, a dream is being sold that cannot be fulfilled.

The film industry thereby provides an excellent case study as to how the state has further increased the pressure on the workforce by artificially increasing capacity and supply of workers, and thus international competition. Already, employees in the film industry are marginalized and dependent on financial capital redistributing production, on producers shopping around for the best financial package to support the specific needs of each and every production. With regard to implications for the workforce, the development in the film industry, and in the wider creative industries, can critically be best described as the building up of an "industrial reserve army" (Marx, 1867) of creative workers, who upon completing degrees, will struggle to find a position they have been trained for. In the film industry, this will lead to the emergence of the next generation of struggling filmmakers in need of subsidies, which fits the self image of an industry, that takes part of its glamour from the fact that only a few can make it. Whether industrial policy should intensify this competition, or indeed proclaim this industrial model as desirable for the wider economy, is a question future critical research will have to answer.

7.5.3 Implications for Supra-national Policy and Recommendations

From a European perspective, there are also a number of other issues for supra-national policymaking arising from this research. With respect to policy, co-productions highlight the co-existence as well as the conflict of scales in Europe: There is both collaboration as well as competition within and between states, with each region and state seeking to divert production to its own territory. The result is, when looking at the whole of Europe, an overall inefficient industrial system, lacking economies of scale. Furthermore, the practiced regionalism, which is justified both on the grounds of cultural protectionism and economic arguments, must be criticized on a pan-European level to lead to an unnecessary, internal competition of production locations, which does not increase, but destroys public value. In this context, co-production structures appear as a necessity, and policy should aim to further reduce the high legal and bureaucratic costs associated with them, so more money and time can be spent on the actual making of films. Here the European Union is required to support the European Convention of Co-production with stricter guidelines for national film policy.

A second issue that needs to be addressed is how the European film industry can respond to the sheer amount of private financial capital flowing into the US industry. One way to increase the capitalization and thus competitiveness of the European film industry is, as the US industry has illustrated even prior to the tax incentive capital cycle, by taking advantage of an abundance of risk-friendly financial capital in the global economy, searching for profitable investment opportunities. While tax incentives can succeed in attracting this sort of capital, it has been proposed above that they are overall a short-sighted and highly expensive industrial policy, that does not lead to sustainable industry growth, and thus should not be considered as a viable policy option. Furthermore, as the continuous diversion of money raised in Europe to the US clearly demonstrates, the institutional environment of film finance in Europe is at the moment not sophisticated enough to accommodate large financial capital flows effectively: Firstly, in contrast to film finance in the US, which is based on business plans and globally oriented distribution models, the European film financing model is still in essence culturally-centric with an emphasis on submitting scripts to film funds, a disadvantage when it comes to institutional investors who are interested in business plans. Secondly, there exists no pan-European distribution structure that is capable of delivering films widely beyond domestic borders, making the European film industry dependent on US studios. Thirdly, with producers in Europe predominantly seeking single film finance, this does not allow institutional investors to put large amounts of financial capital to work, and thus does not allow them to spread their risk effectively. Finally, and connected with the first point, in order to calculate revenue cascades and develop the business plans necessary to attract financial capital, film financiers need access to rich data sets, allowing the application of statistical tools. However, this kind of data does not exist for film production in Europe, making the lack of transparency a major barrier for future growth. [108]

In order to increase capitalization and the competitiveness of the European film industry, and thus grow production and employment, it is in my view therefore necessary that policymakers address the abovementioned issues before, or at least alongside the provision of further public aid. Firstly, policy needs to be more specific about what it wants to achieve; it should try to avoid industrial policies without a clear aim, which are based on unrealistic expectations, or which are based on misconceptions, such as the heralding of the film industry as a model industry of the new economy. Secondly, public funders need to insist on accountability standards to address the hampering lack of transparency in the European film industry. This in turn can create the foundation for the application of modern financing techniques, and hence a commercial industry model. Thirdly, where applicable, public funders should place a greater emphasis on the development of viable business plans for film projects, rather than to exclusively focus on scripts. This in turn should be accompanied with measures to ensure that film producers (and film funders!) can develop their financial skills, or have at least access to financial expertise at a lower cost than at the moment. Fourthly, while the problems of distribution structure and slate financing ultimately have to be solved by the market, collaboration in this area could be encouraged in a similar way than as has been in the case with co-productions.[109] Finally, in order to take advantage of global risk-friendly financial capital, the development of a professional support system that allows production companies to take advantage of foreign financial sources should be encouraged. As can be contended, none of these measures is particularly cost-intensive, or difficult to implement, but would

[108] This has also been stressed repeatedly by Andre Lange, the Head of the Department for Information on Markets and Financing at the European Audiovisual Observatory (for example in DFI, 2007).
[109] For example by developing a "Eurimages" for the distribution sector, or supporting experiments with "virtual slates" (individual producers seeking finance together).

strongly contribute to the overall competitiveness of the European film industry and its long-term growth.

8 SUMMARY AND CONCLUSIONS

8.1 Introduction

In the concluding chapter, I will summarize the main arguments of this thesis briefly. I will then highlight what can be seen as its main contributions to film industry literature, studies of the creative industries and economic geography theory, and outline a number of questions that have emerged through this study for future economic enquiry.

8.2 Summary of the Main Arguments

In this thesis I have demonstrated the importance of co-productions for international film industries, outlining their historical significance and growth in Europe in the past decade. Based on a critical review of previous studies and the literature, I have proposed that in order to arrive at a satisfactory understanding of the co-production phenomenon, it is necessary to look beyond social factors associated with locality, and examine instead dynamics that impact on the industrial organization of the whole production system.

Following indications from the literature, I have particularly focused on the important role financing plays in the production process. Here I have found that in the context of pervasive demand uncertainty, production is ultimately dependent on finding finance, and projects are organized with the aim to maximise the inflow of financial capital. In order to conceptualize the industrial dynamics resulting from the dependence of production on finance, I have proposed to distinguish between financial and production capital as two basic economic categories. I have detailed that following Parkinson's law production activity can easily expand to meet an expansion of finance supplied to the film industry, and have outlined two basic dynamics, namely "production pulling finance", and "finance pushing production". Finally I have argued, that in order to explain the growth of co-productions empirically, it is necessary to examine changes in the film financing environments of both the European and the US film industries.

Following this suggestion I have firstly described how the state has become the key investor in the European film industry, detailing the growth of regional, national and pan-European funding structures. As I have argued with respect to industrial organization, the result of the expansion of public aid is thereby a multitude of locally confined capital pools, which contributes to the geographical dispersion of production capital in the European film production landscape, and discourages pan-European agglomeration tendencies. This structure facilitates and is facilitated by co-productions, which seek to combine these capital pools across borders in search of finance.

I have then described how a change in the rationale of public funding towards funding film on economic grounds in the mid 1990s, has led to a number of policy changes, of which the introduction of tax incentives in multiple countries within a short period of time has been the most significant. The rapid spread of the policy measure has resulted in a vicious circle of tax competition, which has contributed to the further dis-embedding of production capital ever since.

I have specifically looked at the consequences of the introduction of tax incentives in Germany and the UK. As I have argued, cumulatively financial capital sourced through these two tax schemes has formed a distinct capital cycle that has impacted on international film production. The notion of the capital cycle is thereby closely associated with the US film industry, in which investment from foreign risk-friendly capital sources has undergone a recurring pattern of investment boom and bust already twice before.

Examining the operational characteristics of the tax schemes in Germany and the UK, I have found that these schemes have especially facilitated medium-to-high budget co-productions. Legal loopholes in both the German and the UK schemes have led to an investment boom in these funds, resulting in a strong inflow of "smart money" into the film industry, seeking to take advantage of public "soft money". As illustrated by the case of the US film industry, the inflow of financial capital into the high-risk film industry is thereby arguably related to the growth of financial capital in the global economy, facilitated by low interest rates and low yields for traditional investments in the past seven years.

Co-productions therefore exemplify the importance of finance as a decisive factor for industrial organization that can easily redistribute production within the industrial system. This is visible in Europe, where the inflow of private financial capital has further facilitated the dispersion of production capital through co-productions, and in the US, where the ongoing "Europeanization" of the film production landscape through the spread of federal tax rebates and reliefs is likewise leading to a redistribution and further dis-embeddedment of production capital. On the whole, the findings from this research can therefore be said to underline the critique made on previous studies that the focus on agglomerative forces is too narrow, and provide convincing counter evidence to the claim that clustering is a defining criteria of cultural production.

8.2.1 Contribution to Studies of the Film Industry

In economic geography literature, the film industry is typically presented as a case study for embeddedness and agglomeration effects, with local industry clusters drawing their strength from process knowledge, networks and local interaction. However, as I have shown in this thesis, this suggestion does not correspond with empirical observations of organizational structures of film production in Europe and countries such as Canada, in which co-productions are of significant importance. The findings of this research thus suggest a second, alternative reading of the film industry to the one offered by previous accounts, seeing it as a case study for an increasingly dis-embedded industry, in which social factors retreat in importance behind finance as the key industrial force. This thesis can therefore enrich academic understanding of the film industry in several respects.

Firstly, this study has shed light on an alternative pattern of production – co-productions in the film industry – that despite its significance has previously been largely neglected in the literature. By filling this gap and offering a dynamic explanation as to why co-productions have grown in the past decade, this thesis has not only added to our empirical understanding of the film industry but also demonstrated that the research focus on individual production sites is too narrow, and that in order to understand empirical developments at the local level, it is vital to take developments that affect the whole production system into account.

Secondly, I want to point out that with the notable exception of Phillips (2004) there has been very little empirical work on finance in the film industry prior to this enquiry. The description of the film financing process in this thesis can therefore serve as a fruitful starting point for further research into one of the key economic forces shaping contemporary filmmaking.

Thirdly, by shifting the analytical focus onto the link between financial dynamics, regulation and industrial organization, this thesis has arrived at an enriched understanding of structural dynamics in the European industry, as well as at a novel interpretation of production growth through capital cycles in the US industry. While notions of tax incentive competition can be found in previous accounts, I maintain that this thesis represents the first attempt at critically examining the factors underlying tax competition, as well as its impact on the international production system. By describing the financial interdependencies between countries through co-productions, and the boom and bust mechanism linking financial capital in the European *and* the US film industries, this thesis has furthermore significantly extended the geographical scope of previous organisational studies.

This study has also produced a number of important points of critique directed at non-organizational studies on the film industry, and here in particular Hollywood economics. In particular the assumption of Hollywood economists that “nobody knows anything” cannot be sustained in light of this research. The existence of sales agents providing sales estimates for film projects, and the statistical modelling skills of institutional investors who can predict the returns on investment of studio slates quite accurately, are both empirical proof that at least “somebody knows something.” In addition, the “nobody knows” claim can also be discarded on analytical grounds. A major point of critique that I have made is that in both Hollywood economics and organizational studies producers are by and large assumed to be profit-maximising risk takers. As I have shown, this is a misleading conception, as producers are instead budget maximizers, earning their living from a producer's fee that is a percentage of the budget they have raised. With reference to the continuous production expansion in the US driven by an oversupply of risk-friendly financial capital, it can thus be assumed that datasets used by Hollywood economics contain a plethora of films that have not been made with a clear profit aim. In this light, it cannot come as a surprise that profit patterns emerging from these datasets are misleading.

Finally, I want to point out my discussion of policy implications, and in particular my analysis of the (negative) consequences of tax incentives. With respect to policy development, this research calls the notion of the film industry as a future growth industry strongly into question. It also demonstrates, that previous and current policy has failed to reduce the volatility of the film production sector in Europe, but has instead made it even more dependent on public subsidies. By taking a critical stance, and stressing the importance of regulation, this thesis can thus be seen as being in certain respects a continuation of work from political economists such as Guback (1969), Wasko (1982) and Phillips (2004), who have likewise attempted to situate the significance of their studies within a perspective to the wider economy, and ultimately society.

While this study has broken some ground to conceptualize co-productions and financial dynamics in the film industry, it has also raised a number of ideas and questions for further research projects. Firstly, more needs to be learned about the overall economic sustainability of co-production structures and how the right-splitting through co-production is affecting the viability of production companies in Europe. Secondly, future research needs to examine the extent to which the increasing international division of labour through co-productions is leading to local specializations within the spatiality of the European production system. Thirdly, a more in-depth study of the implication of financial outsourcing and production redistribution in the context of private equity growth in the US film industry is needed. Fourthly, future enquiry into the role of film sales agents as primary industry gatekeepers, and into their heuristic practices to estimate a film's success could provide interesting insights into the film financing process.

8.2.2 Theoretical Implications for Economic Geography Studies of the Cultural/ Creative Industries

This study has provided strong evidence for an alternative pattern of production to clusters that is based on temporary, distant inter-firm relations, connected and connecting the spatial arrangements of temporary and permanent clusters. I have supported the significance and viability of such a production system with the strong empirical case study of co-productions in the film industry. This research therefore sets a counterpoint to the supremacy given to spatial proximal relations and their associated benefits in creative industries research (Scott, 2004).

The research furthermore enriches the literature on creative/ cultural production with an empirically grounded understanding of the role finance and regulation play in the spatial distribution of production, and how these dynamics can lead to a restructuring of production within the whole production system of an industry. By arriving at a number of rich and interesting empirical findings, which previously have not been described by the literature, I have demonstrated the viability of a research focus on finance and regulation. I propose that this research focus could lead to interesting enquiries in other creative industries characterized by high demand uncertainty and high capital requirements, such as the video games industry. Future research on creative industries should also encourage the search for other dissenting cases of spatial production, not at least in order to highlight the strong heterogeneity that exists between creative industries.

8.2.3 Wider Theoretical Implications

This study can also contribute to a number of areas in the wider economic geography and economics literature. Firstly, this thesis underlines the importance of temporary clustering for enabling coordination and network building mechanisms between firms across distance. However, against the proposition by Maskell et al (2006), this study suggests that temporary clustering *can* substitute for permanent clustering, leading to alternative patterns of production.

By studying distant inter-firm relations, this study can also be seen as an empirical case in support of relational approaches in economic geography, and a case against an overemphasis of spatiality. In line with Amin and Cohendet (2004:93), co-productions demonstrate that "there is no compelling reason to assume that 'community' implies spatially contiguous community, or that local ties are stronger than ties at a distance". Thus this study is supportive of the argument that relational proximity is more important than (permanent) spatial proximity.

In addition, by demonstrating that industry forces such as financial dynamics and regulation can have a stronger impact in shaping local industries than social effects of agglomeration, this study puts recent attempts to develop a localized learning theory of cluster formation (Maskell and Malmberg 2006) under question and provides empirical evidence for theoretical criticisms made on dominant paradigms by authors such as Cole (2007). By pointing out the impacts changes in financial capital can have on the economic landscape, this thesis has also identified the need for further theory building in economic geography, to incorporate a more dynamic view of finance into the cluster concept.

With respect to specific studies, I have argued in this thesis that Maskell and Lorenzen's (2004) proposition that firms become "insiders" by investing in building or joining networks in cases of low uncertainty, or cluster-building in cases of relatively high industry uncertainty (2004:993) is misleading. As I have argued with a view to finance, the assumption that clusters reduce industry risk ("everybody knows a little bit"), stems from confounding demand uncertainty with the risk of production. While the risk of production can indeed be reduced through cluster formation, demand uncertainty – to which the authors largely refer – is not affected. Instead, I have argued that industry structures under demand uncertainty reflect predominantly power structures, as dominant players use market clout to outsource risk down the line.

Finally, the developments described in this thesis of an abundance of risk-friendly financial capital increasingly driving production in the US and the European film industry, can also serve as a case study for developments in the wider economy at the same time, in the run up to the worldwide financial crisis of 2007. The depiction of production growth in film industry being highly reliant on financial innovation and the packaging of risk thereby resonates well with developments in similar "boom and bust" industries, particularly the housing market, as well as asset price inflation in wider equities and commodities markets.

Ultimately, I want to highlight the innovative research approach I have adopted for this research that has allowed me to examine an industrial phenomenon of international scope by taking advantage of temporary clustering. This has enabled me to unobtrusively gain access to insider information from professionals with diverse national and professional backgrounds, while circumventing constraints of time and finance otherwise associated with PhD level research. As I contend, this represents a viable and effective research method, and as such could be used as a data gathering approach for similar qualitative studies.

8.3 Final Remarks

> *"From the darkness in the front, a spark of anticipation jumps from head-to-head, from row-to-row, from man to woman to child, and ignites the projector at the back. The screen alights. We all stare together at the film. No-one expects much. Everyone has seen everything. Twice. Even the kids. But now that the room is dark, and the spark has jumped, and the screen is alight, everybody seems to have forgotten. And then it gets me too, and I look, and I forget, and I laugh, and I cry, and I think, and I wonder, and I trust and I hope that I will not be delivered from this state anytime soon."*
>
> **Translated from Torson, 2008:29**

As the primary storyteller of our time, film fulfils an important – almost therapeutic – function in our society. However, in order for the big, glamorous story-telling machinery to weave its magic, it is necessary that its industrial system stands on a solid foundation. I claim this in particular for the European film industry: It might not be under immediate threat, but its production activity grows steadily – into global insignificance. Unfortunately, as suggested by this thesis, merely increasing the amount of public aid to the industry, is not a sensible way to awake it from its hibernation.

As somebody who greatly enjoys cinema, I thus cherish the hope that by contributing to our understanding of the dynamics affecting film production on an industrial level, this thesis can contribute to strengthening its future economic foundation. After all, from a consumer's perspective, there is little joy in uncertainty of supply, but much to gain from a vibrant and diverse production landscape pleasing our uncertainty of demand.

- THE END -

Appendices

Appendix I: List of Industry Events, Markets and Workshops Attended

INDUSTRY EVENTS WITH MULTIPLE PANEL EVENTS

Screen International Film Finance Summit: October 19th, 2006. London.

1. **Creating a More Confident and Self-sustaining Film Investment Culture in Britain**
   Moderator: Colin Brown, Editor in Chief, Screen International
   Lars Sylvest, Founder Brass Hat Films
   Bill Alan, Director Starbank Films

2. **Monetizing British Creativity**
   Patrick McKenna, Chairman Ingenious Media

3. **The Changing Role of Banks: How Traditional Models will Shift**
   Moderator: Premila Hoon, Managing Director Media Finance, Societe Generale
   Rob Sherr, Commercial Banking Manager, Bank Leumi (UK) Plc
   Ian Hutchinson, Associate Director Film Finance, Bank of Ireland
   Bernie Stampfer, Senior Vice President, Deutsche Bank AG

4. **Assessing the Impact of the New Tax Credit on the Industry**
   Moderator: Michael Gubbins, Editor, Screen International
   John Graydon, Managing Director, Tenon Media
   Steve Allan, Relationship Director, Barclays Capital
   Ivan Mactaggart, Managing Director, Meteor Pictures Ltd.
   Harry Hicks, Senior Film Advisor, Grant Thornton
   Robb Klein, Partner, SJ Berwin

5. **Hedge Funds and Private Equity Investors**
   Moderator: Colin Brown, Editor in Chief, Screen International
   Chip Seelig, Managing Director, Dune Capital Management
   Duncan Reid, Commercial Director, Ingenious Media

6. **Enterprise Investment Schemes & Venture Capital Trusts for Film**
   Alexander Joost, Structured Products Future Films

7. **Co-productions and International Soft Money**
   Moderator: Adrian Wootton, Chief Executive, Film London
   Julie Baines, Producer, Dan Films
   Chris Curling, Founder Zephyr Films
   Djordje Milicevic, Chief Executive Film Centre Serbia
   Clase Wise, Director International, UK Film Council

8. **How to Engineer an Attractive Investment Proposition for Your Film**
   Cameron McCracken, Deputy Managing Director Pathe
   Rupert Preston, Co-Founder Vertigo Films
   Andras Hamori, Founder H20 Motion Pictures
   Peter Watson, Chief Executive, Recorded Picture Company

9. **TV and Other Sources of Downstream Finance**
   Moderator: Michael Gubbins, Editor Screen International
   David Thompson, Head of BBC Films
   John Woodward, CEO, UK Film Council
   Tessa Ross, Head of Film Four

Screen International Film Finance Summit: 15 February 2005, Berlin.

10. **The New Deal: Hollywood and Europe's Increasing Convergence**
    Richard Fox, Executive Vice President International

11. **New Horizons, New Money, New Opportunities**
    David Linde, Co-President Focus Features
    Massimo Pacilio, Producer Movieweb
    Jonathan Olsberg, Chairman Olsberg SPI

12. **Private Equity: What kind of Funding is Coming on Stream?**
    Jim Stern, Founder and President Endgame Entertainment
    John Sloss, Cinetic Media

13. **Eurimages, Media 2007 and Beyond**
    Peter Aalbaek Jensen, Managing Director Zentropa Productions
    Jacques Toubon, Chairman Eurimages
    John Woodward, CEO UK Film Council

14. **Public Sector: Flying the Flag (Tax Backed Finance Systems)**
    Aron Sipos, President Hungarian Producer's Association
    Toine Berbers, Managing Director The Netherlands Film Fund

15. **The German Question (Germany's Tax Funds)**
    Georgia Tornow, Secretary General Film 20
    Stephen Margolis, Managing Director Future Films
    Franz Landerer, CEO Victory Media
    Eberhard Junkersdorf, President of German Film Fund

16. **Uncommon Currency: New Forms of Investment**
    Todd Wagner, Partner 2929 Productions
    Mark Boyd, Director of Branded Content BBH
    Jacques Bughin, Partner McKinsey

Strategics, Film Finance Forum Luxembourg: March 23 -25, 2007

17. **Debt Financing**
    Christian Kmiotek

18. **Revenue Streams: Production Finance and International (Pre)Sales**
    Mads Olsen

19. **Insurance Matters (Completion Bonds for International Productions)**
    Jean-Claude Beineix

20. **The Bank's Perspective and Typical Banking Products for the Media Sector**
    Bernhard Stampfer

21. **Legal Issues When Dealing With Film Financiers**
    Stephanie Trinkl
    Christian Kmiotek

22. **Tax Driven Instruments Luxembourg: Audiovisual Investment Certificates**
Christian Kmiotek

23. **Belgium: The Tax-Shelter System and Regional Funds in Europe**
Phillipe Reynaert

24. **Germany: How to Get Fnance From the Biggest European Market?**
Eckhart Schleifenbaum

25. **United Kingdom: What's Up and New in Finance From the UK?**
Alan Harris

26. **Finance for European Co-Productions – Combining Different Support Schemes in a European Co-production**
Alan Harris, Sebastien Delloye, Christian Kmiotek

Deutsche Bank. Hollywood Lectures 2007, Berlin, February 14, 2007

27. **The Future of the Motion Picture Industry in the Digital Age**
Dan Glickman, Chairman and CEO MPAA

28. **Film Financing in the US: Lessons From an Innovative Industry?**
Patrick Russo, Principal The Salter Group, Los Angeles

29. **Buergschaften und Bankenfonds: Neue Wege aus der Finanzierungsklemme**
Hansjoerg Kuch, LFA Foerderbank Bayern
Kristian Kreyes, ILB Beteiligungsgesellschaft
Harro von Have, Rechtsanwaltskanzlei Unverzagt
Sytze van der der Laan, Studio Hamburg
Uschi Reich, Bavaria Filmproduktion

30. **Filmfinanzierung Ueber Subventionen: Zukunftsfaehig oder Auslaufmodell?**
Alexander Jooss, Aramid Capital Partners, London

31. **Die Fonds Sind Tot: Es Lebe das "Sechzig Millionen Euro Baby"! Aber Was Kommt Danach?**
David Molner, Screen Capital International
Georgia Tornow, film 20
Alexander Jooss, Aramid Capital Partners, London
Bernhard Stampfer, Deutsche Bank
Carl Woebken, Studio Babelsberg

32. **Wie Positioniert Sich die Filmwirtschaft von Heute fuer das Filmbusiness von Morgen?**
Prof. Nico Hoffmann, teamworx GmbH
Martin Moszkowicz, Constantin Film
Martin Hoffmann, MME Moviement AG
Sytze van der der Laan, Studio Hamburg
Karl Ulrich, Roland Berger Consulting

SINGLE PANEL EVENTS

33. **The Hollywood Reporter Presents: Europe: Dealing in Dollars**
National Film Theatre, London, UK, Oct 22, 2004
Panelists:
Stuart Kemp UK Bureau Chief, The Hollywood Reporter

Teresa Moneo, Head of European Co-productions, 20th Century Fox
Andy Paterson, Producer of *Girl with a Pearl Earring*

34. **Co-Production Meeting ,Capital Regions for Cinema (CRC) - A European Network 2006**
Berlinale 2006 at the Berlinale Co-production Market

35. **MEDIA 2007 Information Day at the Berlinale 2007**
    - Presentation of the new MEDIA 2007 Programme
      by Aviva Silver, Costas Daskalakis
    - Production Workshop (Development, TV-Distribution)
    - Distribution -Workshop

36. **Why Do We Fund Film?**
Launch: The Copenhagen Think Tank on European Film and Film Policy
Presented by the Danish Film Institute
The Nordic Embassies, Berlin February 14, 2006

37. **Private Equity Funding in the US Film Industry**
Cannes: American Pavillion:2006
Moderator: Pat Swinney Kaufman, Executive Director New York State Governor's Office for Motion Picture and Television Development

MARKETS

<u>Berlinale Co-production Market, February 13-14, 2005</u>

38. **Case study of** *Paradise Now*
Moderator: Patrick Frater, Screen International
Bero Beyer (Augustus Film, Netherlands)
Claudia Droste-Deseaers (Filmstiftung North Rhyne Westfalia)
Amir Harel (Lama Films, Israel)
Gerhard Meixner (Razor Film, Germany)
Hengameh Panahi (Celluloid Dreams, France)

39. **Case Study of** *Asylum*
Moderator: Peter Cowie
David Mackenzie (film director)
Susan Wrubel (Paramount classics)
Patrick McGrath
Carsten Sommerfeldt

40. **Revitalising German-Canadian (German-International) Co-productions or How to Deal With the German Media Decree**
Moderator: Thorsten Poeck, European Motion Picture Association
Karyn Edwards, Brightlight Pictures
Jens Meurer, Egoli Tossell
Brigitte Monneau, Telefilm Canada

41. **How Miss Texas Came to Canada – or What Are the Advantages of Shooting Films in Canada?**
Doris Zander, Studio Hamburg Produktion GmbH
Elizabeth Yake and Henrik Meyer, TrueWestFilms

42. **A Walk Through the Tax Incentive System in Canada – Best Practices for Germany?**
Danny Chalifour, Telefilm Canada
Peter Whetherell, Quebec Film and TV Office
Robert Soucy, Canadian Audio Visual Certification Office
Georgia Tornow, Film 20

43. **Case Study of *The Sun***
Moderator: Andrei Plakhov
Antoine de Clermont-Tonnerre – MACT Production (France),
Igor Kalenov, Nikola Film (Russia);
Marco Mueller – Downtown Pictures (Italy);
Luciano Soveno – Institute Luce (Italy).

44. **Case studies and Views on Current Films from Eastern Europe in Co-operation with Sarajevo International Film Festival: Koktebel, Hukkle, Fuse**
Moderator: Blanka Elekes Szentagotai, Screen International

Berlinale Co-production Market, February 12-13, 2006

45. **"Co-Producing With…" Country Tables**
Individual presentations of Canada, Germany, Poland, South Africa, USA, World Cinema Fund.

46. **Case Study: The Great Match**
Moderator: John Durie, Cineuropa
Jose Maria Morales, Wanda Films
Sophokles Tasioulis, Greenlight Media
Michael Weber, The Match Factory

47. **Case Study: Elementarteilchen**
Moderator, Peter Cowie
Oskar Roehler (film director)
Hengameh Panahi, Celluloid Dreams
Martin Moszkowicz, Constantin Film
Patrice Hoffmann, Editions Flammarion

48. **Case Study: Grbavica**
Moderator: Amra Baksic, Sarajevo International Film Festival/ Cinelink
Jasmila Zbanic, Deblokada
Bruno Wagner, Coop99
Boris Michalski, Noirfilm
Joerg Schneider, ZDF das kleine Fernsehspiel

Berlinale Co-production Market: February 11- 13, 2007

49. **Case Study Irina Palm – Getting the Money Anyway You Can**
Moderator: Christophe Mazodier
Director: Sam Garbarski (Belgium)
Sebastien Delloye, Entre Chien et Loup (Belgium)
Karl Baumgartner, Thanassis Karathanos, Pallas Film (Germany)
Eric Lagess, Pyramide International (France)

50. **Co-Producing With… Country Takes**
Canada, France, Germany, Japan, South Africa, USA, World Cinema Fund

Copenhagen Think Tank. 21-13 June, 2006.

51. **Working Group 1 - Raising Expectations: The Objectives and Impacts of Film Funding**
    Leaders: Pete Buckingham, Head of Distribution, UK Film Council
    Neil Watson, Consultant UK

52. **Working Group 2 - Realizing the "Brand Value" of European Film**
    Erik Lambert, Director, The Silver Lining Project, Rome
    Albert Wiederspiel, Director, Hamburg Film Festival

53. **Working Group 3 - Cohesion: Driving Success Across the Value Chain**
    Alain Modot, Director, Media Consulting Group, France
    Nik Powell, Director, National Film and Television School, UK

54. **Working Group 4 - Identifying How Co-Production and the Spend-Driven Funding Mechanisms Can Contribute to Film Policy Objectives**
    Guy Daleiden, Director, Film Fund Luxembourg
    Philipp Kreuzer, Head of Co-Production, Bavaria Film Munich

55. **Working Group 5 - Decision Making in Funding**
    Simon Perry, CEO Irish Film Board
    Vinca Wiedemann, Artistic Director, New Danish Screen

Appendix II: Critical Acclaim of Co-Productions at Major Festivals

Winners of the Palm d'Or 1998 -2007

Winning film	***Producing country***	***Year***
4 Months, 3 Weeks and 2 Days	Romania	2007
The Wind That Shakes the Barley	Ireland / UK / Germany / Italy / Spain / France	2006
L'enfant	Belgium / France	2005
Fahreheit 9/11	USA	2004
Elephant	USA	2003
The Pianist	France / Germany / UK / Poland	2002
The Son's Room	Italy / France	2001
Dancer in the Dark	Denmark / Germany / Netherlands / USA / UK / France / Sweden / Finland / Iceland / Norway	2000
Rosetta	France / Belgium	1999
Eternity and a day	Germany / Greece / France / Italy	1998

(Compiled from imdb.com)

Winners of the Grand Prix of the Jury, Cannes Film Festival 1998 -2007

Winning film	***Producing country***	***Year***
The Mourning Forest	France/ Japan	2007
Flandres	France	2006
Broken flowers	France/ USA	2005
Oldboy	South Korea	2004
Uzak	Turkey	2003
The man without a past	Finland, Germany, France	2002
The Piano teacher	Germany / Poland / France / Austria	2001
Devils on the Doorstep	China	2000
L'Humanité	France	1999
Life is beautiful	Italy	1998

(Compiled from imdb.com)

Winner Golden Bear, Berlinale Film Festival 1998 -2007

Winning film	***Producing country***	***Year***
Tuya's Marriage	China	2007
Grbavica	Bosnia and Herzegovina/ Austria, Germany/ Croatia	2006
U-Carmen e-Khayelitsha	South Africa	2005
Head-On	Germany/Turkey	2004
In This World	United Kingdom	2003
Spirited Away	Japan	2002
Bloody Sunday	UK/Ireland	
Intimacy	UK / France / Germany / Spain	2001
Magnolia	United States	2000
The Thin Red Line	United States	1999
Central Station	Brazil / France	1998

(Compiled from imdb.com)

Appendix III: List of US-Co-productions in 2006

Garfield: A Tail of Two Kitties - US / GB 2006

The Da Vinci Code - US / GB

Flushed Away - GB / US 2006

Scoop - GB / US 2006

The Prestige - US / GB 2006

The Holiday - US / GB 2006

A Good Year - US / GB 2006

Crank - US / GB 2006

Starter for Ten - US / GB 2006

Breaking and Entering - GB / US 2006

The Good Shepherd - US / GB 2006

Apocalypto - US / GB 2006

Casino Royale - GB / US / GER / CZ 2006

Flyboys - FR / GB / US 2006

Happy Feet - AU / US 2006

United 93 - GB / FR / US 2006

Babel - US / FR / MX 2006

Bandidas - FR / MX / US 2006

Basic Instinct 2 - US / GB / GER

Superman Returns - US / AU 2006

Children of Men - US / GB / JP 2006

Miami Vice - US / GER 2006

Find Me Guilty - US / GER 2006

16 Blocks - US / GER 2006

Stormbreaker - GB / US / GER 2006

Snakes on a Plane - US / GER 2006

The Black Dahlia - US / GER 2006

Final Destination 3 - US / GER 2006

Mission: Impossible III - US / GER 2006

GB / US 2006 - US / GER 2006

All the King's Men - US / GER 2006

Barnyard - US / GER 2006

The Wicker Man - US / GER 2006

Tristan + Isolde - GER / GB / CZ / US 2006

A Crime - FR / US 2006

Slither - US / CA 2006

The Illusionist - US / CZ 2006

DOA: Dead or Alive - US / GER / GB 2006

Click - US / GB / GER 2006

RV - US / GB / GER 2006

Lucky Number Slevin - US / GER / GB 2006

Compiled from the EAO Lumiere Database 2007

Appendix IV: Tax Incentives Schemes in Europe and Internationally 1988 – 2008

EUROPE

Belgium **2003**	**Tax allowance for production expenses** Investors can access a tax exemption of up to 150 per cent of the amount they invest in Belgian audiovisual projects. Investors can make a maximum of 40 per cent of their investment in the form of a loan. Projects must have a Belgian production company involved, the tax investment must not exceed 50 per cent of the total budget and Belgian spend must be at least 150 per cent of the amount they invest in Belgian audiovisual projects.
France **2003/2004**	**System of SOFICA** (article 238 of the Code general des impots), introduced in 2003. Individuals and companies invest in SOFICAs to access tax deductions (25 per cent). SOFICAs then select film and TV projects for investment, and take a negotiated recoupment position. Revenues collected are reinvested exclusively in French films, thus making the system hard to combine with other incentive schemes.
Germany Boom **2000 - 2005**	**Model:** Law permitted immediate deduction of the cost of creating "intangible" assets, including films, so investors were able to immediately write off the entire cost of producing a film. Like the UK, this model has led to the creation of tax fund ("Medienfonds"): • Net-benefit funds (similar structure to sales-leaseback model). • Equity funds (Cash flow substantial part of the film's budget and take a true equity position in the success or failure of the film, can however accept more risk (and the possibility for a lower return) than other equity investors that do not have the German tax benefits. **Criteria:** Tax deduction for investors in German funds is predicated on copyright ownership. However funds can license back distribution rights or grant options to repurchase copyright upfront. German fund must legally be the "producer" of the film, in practice funds could however simply "hire" U.S. studio to produce the film. No local spend requirements. **Implications:** Encouraged direct co-financing (often of US studio pictures), or indirect co-financing through co-production structures to take advantage of tax loophole (no "local spend" requirement). **Status:** Closed in 2005, after amendments to legislation (Medienerlass 2001, 2003) failed to reduce tax avoidance effectively.
Hungary **2003/2004**	**The Hungarian Motion Picture Act** Under the Hungarian scheme a non-Hungarian producer enters a service agreement or co-production agreement with a local producer which is registered with the National Film Office (NFO). The local producer then registers the production with the NFO and is issued a tax certificate (20 per cent), which is disbursed by a local financier, resulting in a net incentive of 16-18 per cent. The system has proven relatively easy to combine with other soft money sources, such as the UK, Germany, or Canada.
Iceland **1999; 2001**	Iceland offers a rebate of 14 per cent on production costs for film and TV projects shooting in the territory. Already more than 30 international co-productions have shot in the region since 2001, including *Batman Begins* and *Flags Of Our Fathers*.

Ireland

1993; 2005

Section 481.

The attraction of the initial Irish scheme (10 per cent) was to combine it with the UK sales and leaseback scheme (15 per cent), and thus create a system that gives a total tax credit of 25 per cent for Irish-UK co-productions (these consequently accounted for 93 per cent of Irish feature film production).

With the closure of the UK scheme, Ireland was forced to increase its tax incentive from 10 per cent to 20 per cent in 2005, in order to stay competitive. Under the scheme, projects can derive a benefit, net of all fees, of up to 20 per cent of their qualifying expenditure. Qualifying expenditure is based on the cost of EU cast and crew working in Ireland, and goods and services purchased in Ireland, up to a maximum of 80 per cent of the total overall budget. There is a ceiling of US$46.8m (€35m) on qualifying expenditure per project. Section 481 benefit is made available to the production on the first day of principal photography.

The system encourages co-productions, not at least through the European Convention on Cinematographic Co-production. In 2006, 20 film and television projects with a total spend of US$173.1m (€129.8m) used the scheme. The Irish spend came to US$110.1m (€82.6m) and the amount raised in Section 481 investor funds was US$105.3m (€79m).

Luxembourg
First system:
1988-1992
Second system:
1993-1998
Current system
1999 – 2008

Audiovisual Investment Certificate Program (CIAV)

The Audiovisual Investment Certificate Programme is designed to encourage creativity and complement efforts to attract risk capital for audiovisual work. The assistance it provides can amount to up to a quarter of the production's budget incurred and spent in Luxembourg. The financial assistance is provided on completion of the production and following presentation of audited accounts.

Malta
2005

Malta Film Commission Act – Financial Incentives Regulations and Tax Credits Regulations; Business Promotion Act.

The Maltese government gives cash grants to qualifying productions on the portion of eligible expenditure spent in Malta. Up to 20 per cent of Maltese expenditure can be rebated. Tax credits amounting to 50 per cent of a project's spend in Malta can be obtained by companies established in Malta and working in the film industry. Under the *Business Promotion Act*, companies producing and distributing films from Malta have a corporate tax rate of five per cent.

UK

Tax relief on production expenditure brought in through *Finance Act* **1992** (Clause 48); Amended in **1997,** 2000, 2001, 2004; New system in place since April **2006.**

Boom
1997 - 2004

Model: Section 42 (1992) relief enabled the producer to write off the full cost of their film over three years while Section 48 (1997) relief allowed producers to write off the full cost of any film costing less than £15 million in one year. As many producers do not have tax liabilities to write these sums off against, the tax benefit is sold to a third party in return for a contribution to the film's production budget. This "*Sale and Leaseback"* structure operates as follows (quoted from HM Treasury (2007))*:*

- A production company sells a film as soon as it is completed to a third party, the purchase being funded partly by equity investment and partly by a bank loan. The third party then enters into a finance lease, usually for a period of 15 years, leasing back the rights to the original producer. The bulk of the sale proceeds that the film production company receives is put on deposit and is used, with the interest it generates, to cover the future lease payments whilst the remainder is set against the costs of producing the film.
- The sale and leaseback structure enables the third party - typically a partnership of high net worth individuals or a large corporate - to claim the benefit of the film tax reliefs against their own taxable income from other

sources. Meanwhile, film-makers exchange the cash flow benefit offered by the film tax reliefs for an upfront payment which can be put towards the cost of making the film, the level of the payment being determined by the terms of the sale and leaseback agreement. In effect, the benefits provided by the film tax relief are shared between the film-makers and the third parties.

Criteria to access tax credit: Certification under the 1985 Films Act as British film, or official co-production.

Outcome: The UK model in particular encouraged co-productions in search for finance and capital driven co-productions, as the film tax reliefs could be applied to all eligible expenditure, irrespective of the country in which the cost was incurred, and the level of required minimum UK spend was low. This provided at times even a disincentive to spend money in the UK, particularly where incentives from other jurisdictions was available.

Status: Closed in 2005, after 13 amendments to legislation (2000, 2002, 2004, 2005) failed to reduce tax avoidance effectively.

UK
2007

The new UK incentive is a tax relief scheme, payable directly to producers and has received full legal status from January 2007. The net relief for films under £20 million is 20 per cent, for films above £ 20 million 16 per cent. The new system is difficult to combine with other tax credits, and as such does encourage inward investment, but makes co-productions and "relief tourism" more difficult.

NORTH AMERICA & OTHER INTERNATIONAL TERRITORIES

Australia 1977;
1997; 2007/2008

Refundable tax offset; Division 10BA of the Tax Act

In Australia a system of enhanced write-offs for investor's capital expenditure into Australian films has been in place since 1977 (Division 10B). The system was updated in 1997, allowing producers to claim 12.5 per cent of what they spent in Australia, on a minimum budget of AUS$ 15 million.

In order to stay competitive, legislation passed the new AUS$300 million Australian Screen Production Incentive in 2007, which provides producers with a tax offset of 40 per cent of eligible Australian expenditure.

New Zealand
2003, 2007:

Large-budget screen production grant

In New Zealand producers could claim a 12.5 per cent rebate for production spending over NZ$35.7 million in New Zealand. In 2007, the incentive was raised to 15 per cent to stay competitive.

South Africa
2005

24F Large-budget film and television production rebate scheme.

South African films and co-production treaty films get a 25 per cent rebate, and foreign films get 15 per cent rebate of what they spend in South Africa if half of the principal photography is done in the territory over a minimum of four weeks. Producers can bundle together three productions within a continuous 12-month period to meet the minimum spend of US$3.4m (R25m).

Canada
1995 - ongoing

Model: Fully refundable tax credits for eligible labour expenditures.

- Canadian Film or Video Production Tax Credit Program (CPTC),
- Production services tax credit (PSTC);

Criteria

- Canadian producer must own copyright, point system to qualify as Canadian production (CPTC). Creative and technical participation must be in the same proportion as the financial contribution of each coproducer.
- For provincial tax credits usually no specifically Canadian content

requirements, co-productions eligible.

Implications

Encourages co-production in search for finance, and attracts production for reduced labour costs. Federal tax credit prohibits producers to take advantage of some soft money sources, as Canadian producer has to own copyright (e.g. Germany or US), however does not affect official treaty co-productions and, does not apply for provincial tax incentives.

Status: In effect. Tax credits increased in 2003.

Canadian Provincial Tax Credits

In addition, nearly all Canadian provinces have introduced their own incentive schemes to attract film production to their territory. Below I have listed the schemes, and the tax rebate granted to producers on local expenditure.

British Columbia

- Film Incentive BC, 30 per cent
- Production Service Credits, 18 per cent

Manitoba Film and Video Production Tax Credit

- 45 per cent of qualified Manitoba labour expenditures
- 5 per cent frequent filming bonus
- 5 per cent bonus for location filming outside of Winnipeg
- The foregoing bonuses may be combined with the basic credit for a total credit of 55 per cent

New Brunswick's Labour Incentive Film Tax Credit

- 40 per cent of eligible New Brunswick labour expenditures capped at 50 per cent of total production costs

Newfoundland and Labrador Film and Video Industry Tax Credit

- Lesser of 40 per cent of eligible labour expenditures or 25 per cent of the total eligible production budget

Nova Scotia Film Industry Tax Credit

- Metro-Halifax: 35 per cent of the eligible labour expenses capped at 17.5 per cent of the total production costs
- Regions: 40 per cent of the eligible labour expenses capped at 20 per cent of the total production costs

Ontario

- Film and Television Tax Credit, 30 per cent of eligible labour expenditures
- Production Services Tax Credit, 18 per cent of eligible Ontario labour expenditures
- Computer Animation and Special Effects Tax Credit, 20 per cent of eligible labour expenditures

Quebec

- Film and Television Production Tax Credit, 29, 17 per cent of labor expenditure
- Film Production Services Tax Credit, 20 per cent of qualified labour expenditures

Saskatchewan Film Employment Tax Credit (SFETC)

- 45 per cent of eligible labour expenditures capped at 50 per cent of total production costs
- 5 per cent bonus for a location base more than 40 kilometers from Regina or Saskatoon

5 per cent bonus for the use of Saskatchewan crew members in certain key positions

	Yukon Film Incentive Program - 35 per cent rebate for eligible Yukon labour to a maximum of 50 per cent of total expenditures incurred in Yukon
US, 2004	Federal Section 181 (of the American Jobs Creation Act) In 2004 the US government passed the American Jobs Creation Act, reacting to heavy lobbying from US production companies and unions, fearing job loss through runaway productions. Under the scheme, film and TV productions costing US$15m or less ($20m or less if made in 'distressed' areas of the country) and spending at least 75 per cent of that amount on services performed in the US, can immediately write off their entire production costs for tax purposes.
US State Tax Credits **2005-ongoing**	In addition, a number of federal states have introduced their own tax incentives for film production. Below I have listed the most significant schemes (as of November 2007), and the tax rebate granted to producers on local expenditure. - Connecticut, 30 per cent - Louisiana, 25 per cent - Massachusetts, 20 per cent - New Jersey, 20 per cent - New Mexico, 25 per cent - New York, 10 per cent - South Carolina, 20 per cent - Rhodes Island, 25 per cent - Montana, 14 per cent - North Carolina, 15 per cent - Oregon, 20 per cent - Florida, 15-22 per cent - Hawaii, 15-20 per cent

(Source: Screen International, 2007; HM Treasury, 2005; KPMG, 2007; Icelandic Film Commission, 2007; TBOF, 2004; Film Hungary, 2007; New Zealand Film Commission, 2008; SARS, 2004; Heenan Blaikie, 2007; AGDCITA, 2005; Gerstner, 2007)

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