U.S. RUNAWAY FILM AND TELEVISION PRODUCTION STUDY REPORT

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I. EXECUTIVE SUMMARY

Background

In January 1999, the Directors Guild of America (DGA) and Screen Actors Guild (SAG) retained Monitor Company, a leading management consulting firm, to conduct an investigation into the phenomenon of "runaway" film and television production from the U.S. The Guilds (on an anecdotal basis) had been noting an accelerating runaway phenomenon, and the need to create an objective quantitative analysis led to the study being commissioned. Partial funding for the study was provided by a grant from SAG-Producers Industry Advancement & Cooperative Fund. The study has two objectives - quantify the extent to which runaway production has been occurring since 1990, and identify the major causes.

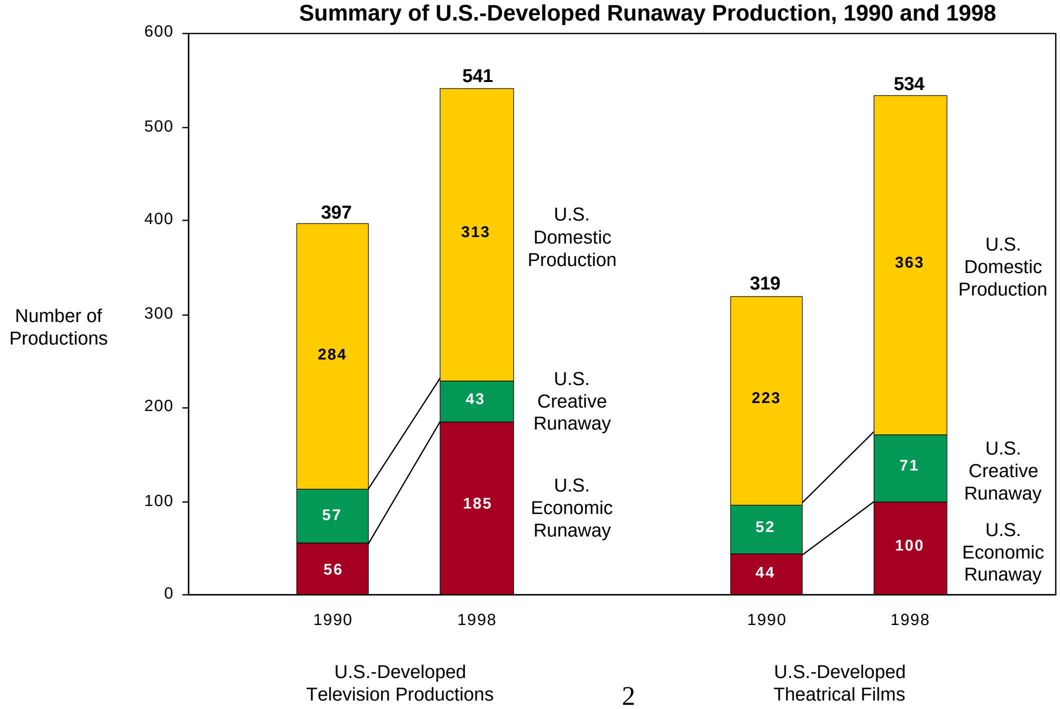
U.S. runaway productions are those which are developed and are intended for initial release/exhibition or television broadcast in the U.S., but are actually filmed in another country. There are two major types of runaway productions – "creative" runaways, which depart because the story takes place in a setting that cannot be duplicated or for other creative considerations, and "economic" runaways, which depart to achieve lower production costs. The study's focus was on these "economic" runaways. Note that the study's scope included theatrical films, films for television, television mini-series, and thirty and sixty minute television series. Other types of productions such as commercials, and news and sports programming were not included.

What Is The U.S. Runaway Production Problem?

The study results show that economic runaway film and television productions are a persistent, growing, and very significant issue for the U.S. In 1998, of the 1,075 U.S.-developed film and television productions in the study's scope identified by Monitor Company, 285 (27% of total) were economic runaways, a 185% increase from 100 (14% of total) in 1990. When these productions moved abroad, a $10.3 billion economic loss (lost direct production spending plus the "multiplied" effects of lost spending and tax revenues) resulted for the U.S. in 1998 alone. This amount is five times the $2.0 billion runaway loss in 1990.

Of these 285 economic runaways in 1998, 100 were theatrical productions, and 185 were television (films for TV, TV series, and mini-series) productions. The most prevalent type of economic runaway television productions were movies for TV. A total of 308 movies for TV were produced in 1998; 139 (or 45%) of these ran away for economic

Summary of U.S.-Developed Runaway Production, 1990 and 1998



reasons in 1998, up from only 30 productions in 1990. Out of a total of 534 theatrical productions in 1998, 100 (19%) were economic runaways, up from 44 in 1990.

In terms of economic impact on the U.S., economic runaway TV films have the largest ($2.7 billion) impact, followed by feature films with budgets larger than $25 million ($2.4 billion impact), and with budgets smaller than $25 million ($2.3 billion impact). It is noteworthy that feature films have such a significant economic impact. Conventional wisdom held that economic runaways are a television movie phenomenon and that larger productions would tend to remain in the U.S. since the infrastructure required to produce them wasn't available abroad. This data may indicate the leading edge of a trend with larger-budget productions running away.

To Where Do These Productions Run Away?

Canada captures the vast majority of economic runaways, with 81% of the total. Australia and the U.K. capture another 10%. In 1998, 232 productions ran away to Canada, up from 63 in 1990. TV movies have had the highest propensity to runaway to Canada, with 91% of the 139 TV movie economic runaways landing there. The 127 U.S. economic runaway TV movies filmed in Canada in 1998 is more than five times the 23 in 1990. The study found that countries other than Canada, Australia, and the U.K. have a small share of U.S. runaways, although recent high-profile runaway productions in Mexico such as "Titanic" highlight the need to monitor developments in selected other countries on an ongoing basis.

These productions are leaving at a time when U.S. domestic production has been growing, so the runaway phenomenon has gone relatively unnoticed. Although the number of U.S.-developed feature productions grew 8.2% annually since 1990, the number of U.S.-developed features that ran away to Canada grew 17.4% annually. Similarly, the number of U.S.-developed television programs produced in the U.S. grew 2.6% annually since 1990, but the number of U.S.-developed television productions that ran away to Canada grew 18.2% annually during that time.

What Is The Impact of U.S. Economic Runaway Production?

The labor impact of these economic runaways is profound. In 1998 more than 20,000 full time equivalent jobs were lost; 11,000 were positions usually filled by SAG members (such as supporting actors, stunt and background performers) and 600 usually by DGA members (directors, assistant directors, unit production managers, associate directors and stage managers). The balance were jobs in other production skills or trades, such as camera, sound, production design, wardrobe, make-up, set construction and drivers.

When the effects of these employment and spending losses are totaled, the impact on the U.S. of film and television economic runaways in 1998 was $10.3 billion: $2.8 billion in lost direct production spending, plus $5.6 billion in multiplier effects and $1.9 billion in lost tax revenues. The economic impact extends beyond the entertainment industry, affecting local merchants and hotels. In 1998, economic runaways represented almost 15% of the $74.3 billion total impact of U.S.-developed film and television productions in the scope of the study.

There have been notable regional impacts as well. Production expenditures in core production centers such as LA and New York City have been growing, but at slower rates than those of Canadian production centers. Other U.S. production centers have experienced declines in production expenditures since 1995 - North Carolina (-36%), Illinois (-20%), Washington state (-37%) and Texas (-31%).

Forecasts of future U.S. runaway production show that under all basic scenarios examined, without actions to stem economic runaways, economic runaway production remains significant, potentially increasing in impact to $13-$15 billion annually by

2001. A scenario with slower U.S. growth and a stronger Canadian dollar keeps the U.S. impact at approximately $10 billion annually. Many foreign production infrastructure investments have been made by U.S. studios; these investments will serve to continue attracting additional productions abroad. Furthermore, the increased globalization of the entertainment industry and incidence of international co-production arrangements will also likely stimulate U.S. runaway production.

What Are the Causes?

Why have productions been leaving at an accelerated rate since 1990? The location decision for a production balances factors such as expected revenues with the cost of production (labor, services, etc.) as well as with the quality of talent, directors, and production crews. Historically, countries such as Canada and Australia had limited production capabilities, making them fundamentally unattractive despite potential savings. Recently, however, the quality of Canadian and Australian crews has improved to a point where most productions can be filmed in these countries without a major difference in quality/productivity.

As foreign crews and infrastructure have improved through experience and direct investment, their ability to handle larger, more complex productions increases. For example, British Columbia and Ontario combined have well over 1 million square feet of sound stage space, as much as the space in New York and North Carolina combined. Canadian film commissions have also been very aggressive in promoting their locations to the U.S. entertainment industry.

In addition, the value of Canadian, Australian and U.K. currencies all have declined by 15% to 23% since 1990 relative to the U.S. dollar, reducing production costs abroad. Factor costs (wages/rates) in these countries, which were generally lower than those in the U.S. in the early 1990's, have also increased at a slower pace than in the U.S. As a result, producers realize at least a 15% reduction in production costs from lower labor costs and costs of goods and services when filming in Canada.

Very visibly (for example, by having Revenue Canada (the Canadian IRS) representatives at the recent Locations '99 trade show in Los Angeles), foreign federal and regional governments have also been offering rich tax incentives/rebates on production activity in their jurisdictions. Canada offers federal and provincial tax credits of 22% to 46% of labor expense (yielding up to a 10% reduction in overall production expense), and Australia offers more than a 10% labor tax credit in some cases. Note that these are not credits for national or cultural content productions; they are available to any qualifying production employing foreign nationals. In addition, Canada, Australia and the U.K. offer up to a 100% tax credit for qualifying "national"/ "cultural" productions, and many other countries offer generous tax credits to producers.

The combined result of the exchange rates, lower costs and government incentives allows the producer of a typical TV movie (production budget of $3 million) to reduce production costs by 25% or more by choosing to film in Canada. Similar percentage savings are available to the producer of a $20 million feature who chooses to film in Canada.

It is important to note that Canada has followed an integrated approach to launching its film/television production-oriented initiatives during the past several years. This approach begins with a relatively undeveloped production industry, and launches a series of (usually tax credit-centered) initiatives to attract production activity/investment, but often creates qualifying requirements for those incentives that stimulate hiring of local personnel. As a result, local production crews, actors, production managers and assistant directors gain valuable experience/training and are therefore more capable and attractive to other producers. At the same time, investments in physical infrastructure are sought so that more and more productions can be accommodated. As these production capabilities expand, other tax incentives such as those for local

labor expenditures are offered to further stimulate demand for local production resources. Ominously, this approach to capture productions is readily replicable by other countries; in fact, Australia is moving along a very similar path to that pursued by Canada.

How Large Is The Gap To Be Closed?

Clearly the U.S. faces major challenges in stemming the tide of runaway production. The solutions will not be simple because the causes are several and very complex. However, the cost gap to be closed to retain production in the U.S. may not be the entire 25% production cost disadvantage. Several producers interviewed mentioned that if the budget for U.S. productions were brought to within 10% to 15% of costs in Canada, then they would make the argument to keep that production in the U.S. Producers generally want to work where they live, and most live in the U.S. production clusters. Furthermore, these clusters contain all the resources required, as well as access to financing, development, and distribution resources, which provide a distinct advantage to producers. Obviously, certain productions cannot afford even a 10% cost disadvantage; recapturing these productions will be the greatest challenge.

It is important to note that U.S. film and television economic runaway activity is at a high level, and that large productions are running away. The significantly lower total production costs achievable abroad are compelling to producers. The experience that foreign production crews, actors and directors have gained in filming U.S. runaway productions represents an ongoing source of advantage for these producing locations. Similarly, infrastructure investments abroad represent permanent improvements that will continue to draw productions out of the U.S. Without a meaningful response (or some unforeseen development abroad), production employment opportunities and associated economic benefits will continue to leave the U.S. at a significant rate.

II. THE U.S. RUNAWAY FILM AND TELEVISION PRODUCTION PROBLEM

A. Runaway Activity/Trends

The study's first task was to define the scope of the U.S. runaway problem. To accomplish this task, Monitor consultants created a database of film and television productions extending from 1990 through 1998. Note that certain types of productions are included or excluded (see Exhibit 1). The study included independent and studio productions. Several sources were used to create this unique database, as described in the Methodology section.

Another critical item was the definition of a "runaway" production. This study defines a "runaway" production as a production that was developed in the U.S. and was intended for initial release/exhibition or television broadcast in the U.S., but filmed partially or entirely outside of the U.S. There are two distinct types of runaway productions: "creative" and "economic." A "creative runaway" is defined as a runaway production that was filmed partially or entirely outside of the U.S. due to script or setting requirements, or actor/director preference. On the other hand, an "economic runaway" is a production that was filmed primarily abroad to reduce costs incurred during production.

While it is important to understand all runaways, the study focused on economic runaways because they represent a more prevalent and addressable issue than productions moving abroad due to the creative preferences of artists. Nevertheless, the runaway production story would be incomplete without a brief examination of all runaways, including creative.

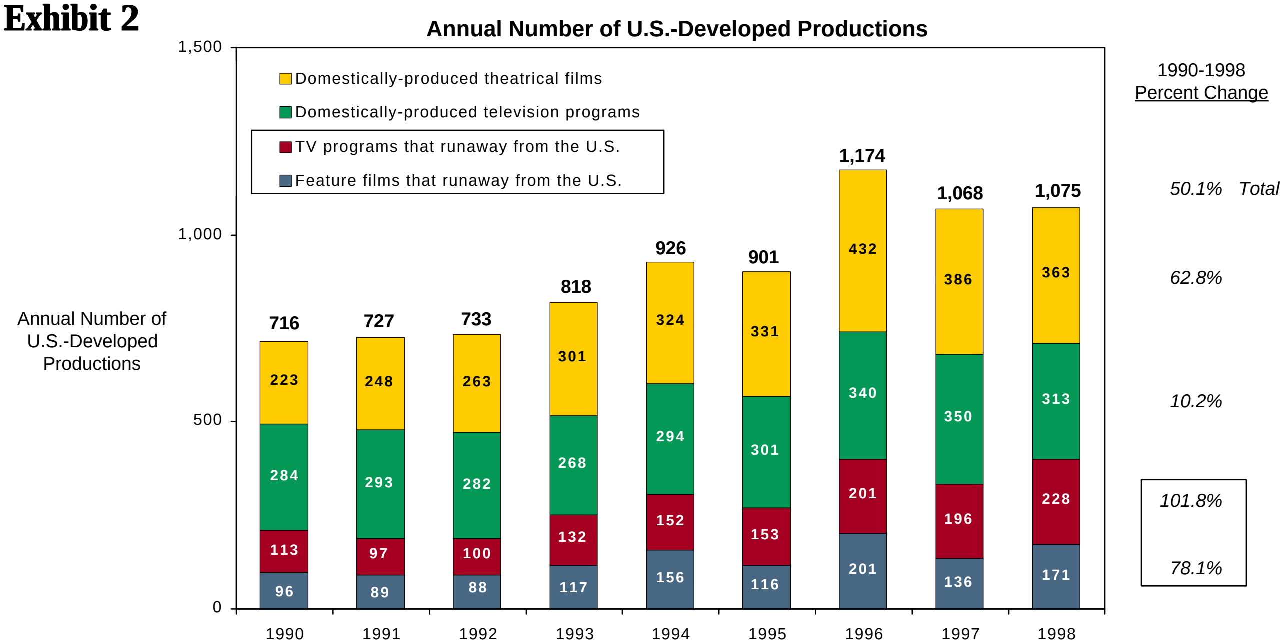
Exhibit 2 shows overall production volumes of U.S.-developed productions included in the study's scope. This Exhibit also shows the rapid growth in the number of all runaway (creative and economic) productions. In 1998, 1,075 U.S.-developed productions in the study's scope were filmed, up 50.1% from the 716 filmed in 1990. 399 productions ran away from the U.S. in 1998, up 91% from the 209 that ran away in 1990.

In 1998, a total of 534 theatrical films in the study's scope were produced; 171 of these ran away from the U.S., for either creative or economic reasons. The number of runaway theatrical films grew from 96 in 1990 to 171 in 1998, an increase of 78.1%; during this time the number of domestically-produced theatrical films grew 62.8%.

Exhibit 1

Productions Included	Productions Excluded	
• Feature films produced for U.S. theatrical release	• Animation	• News programs
• Direct to video productions	• Commercials	• Public access
• Movies for Television/MOW/Telefilms	• Daytime soap operas	• Religious programming
• Series for television	• Documentaries	• Sports Entertainment
	• Foreign films	• Talk shows
	• Foreign language television	• Television specials
	• Game shows	• Training films
	• Infomercials	
	• Music videos	

Exhibit 2



Total U.S. Runaway as a Percentage of Total U.S.-Developed Production

1990	1991	1992	1993	1994	1995	1996	1997	1998
29%	26%	26%	30%	33%	30%	34%	31%	37%

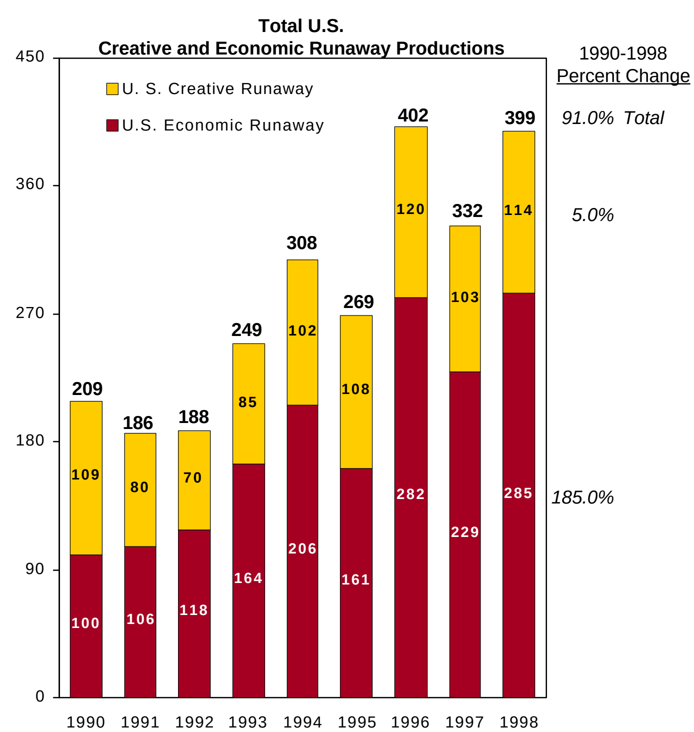
Source: Hollywood Reporter; Variety; Baseline; DGA / SAG Databases; IMDB; Monitor Analysis

The extent of the runaway situation becomes more apparent in television productions. In 1998, a total of 541 television programs were filmed; 228 (or 42%) ran away from the U.S., for either creative or economic reasons. The number of runaway television programs grew from 113 in 1990 to 228 in 1998, an increase of 101.8%, while the number of domestically-produced television programs only grew 10.2% during this time. Note that runaway share of total U.S.-developed production grew during the 1990's.

However, the real understanding of the U.S. runaway phenomenon lies in the examination of economic runaways and specific types of productions: feature films, movies for television, or telefilms (also known as movies of the week), 30-minute television series, 1-hour television series, and television mini-series.

First, the economic runaway summary. Exhibit 3 shows that the U.S. runaway production growth is driven overwhelmingly by economic runaways. In 1998, 285 productions were filmed abroad for

Exhibit 3

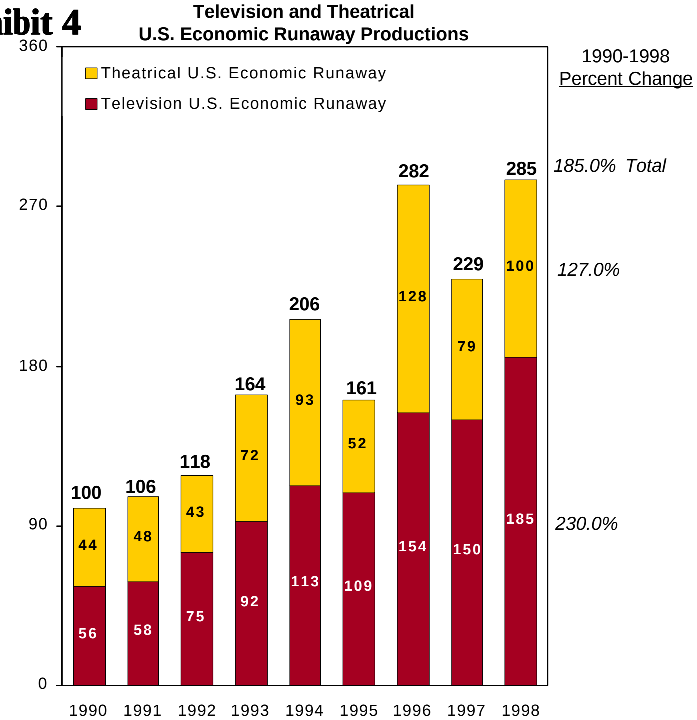


Source: Hollywood Reporter; Variety; DGA / SAG Databases; IMDB; Monitor Analysis economic reasons, an increase of 185% since 1990. During the '90's, the number of creative runaways grew a modest 5%. As a result, economic runaways grew from 48% of total runaways in 1990 to 71% in 1998.

Next, it is important to note the composition of economic runaways with regard to theatrical features versus television. Exhibit 4 shows that U.S. economic runaway production is being driven increasingly by runaway television productions. While the economic runaway of theatrical features was 127% greater in 1998 than in 1990, television is the main driver of the total, representing more than half of economic runaways, with a 230% increase since 1990. Only 56 television productions left for economic reasons in 1990; this number grew to 185 by 1998.

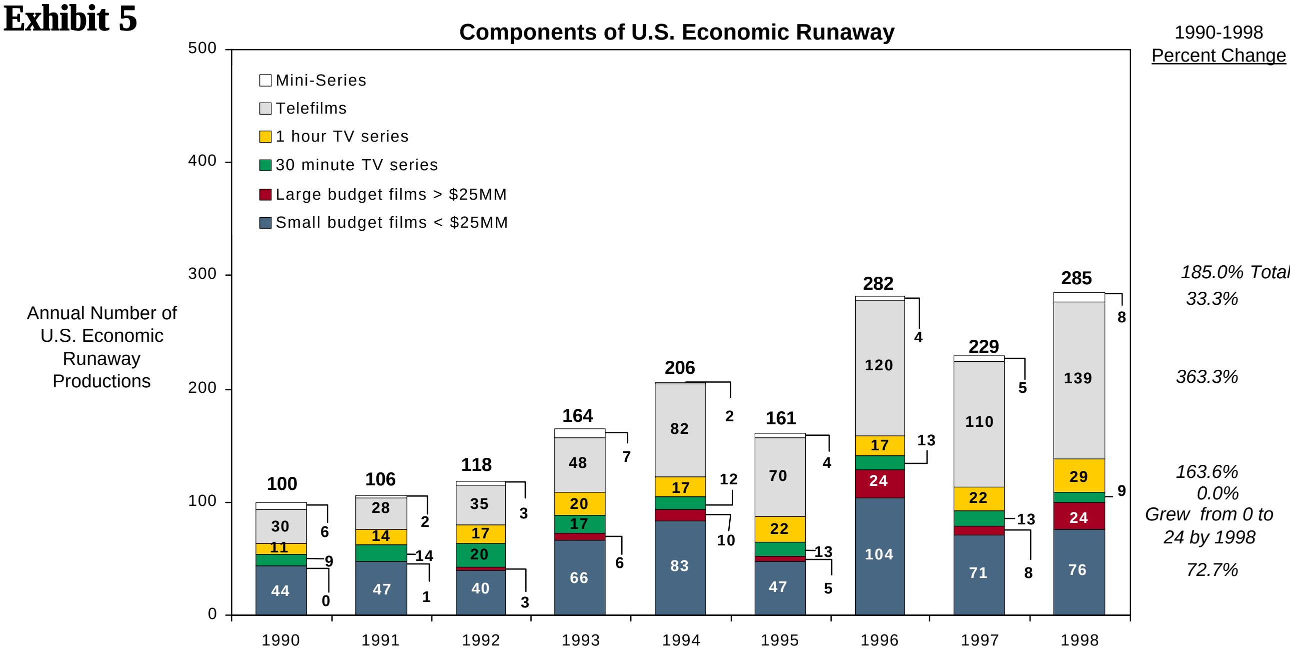
Of these economic runaways, more than 80% are telefilms and feature films. Exhibit 5 shows the number of feature films that ran away more than doubled during the '90's (from 44 to 100), but the number of economic runaway telefilms more than quadrupled, from 30 to 139 between 1990 and 1998. In general, productions that are running away are smaller-budget productions, (telefilms and feature films with budgets under $25 million),

Exhibit 4



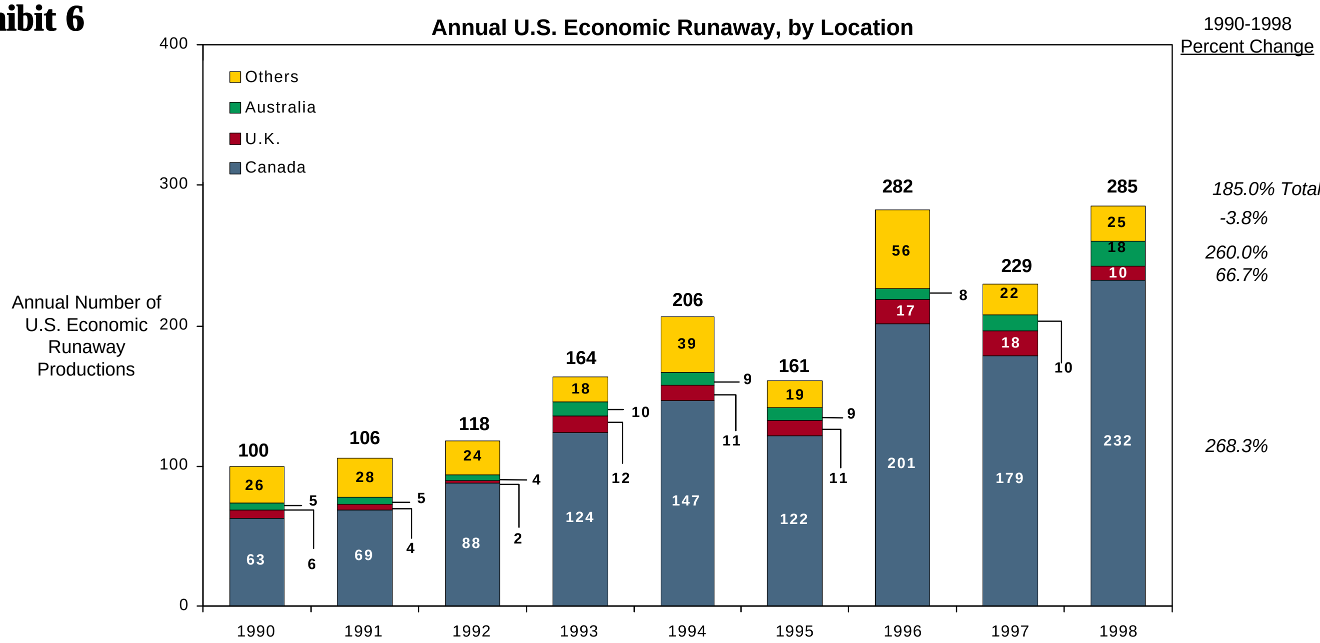
Source: Hollywood Reporter; Variety; DGA / SAG Databases; IMDB; Monitor Analysis

Exhibit 5



Source: Hollywood Reporter; Variety; Baseline; DGA / SAG Databases; IMDB; Monitor Analysis

Exhibit 6



Canada Share of Total U.S. Economic Runaway

63%	65%	75%	76%	71%	76%	71%	78%	81%

which represent 75% of the total number of economic runaways. One-hour series are also growing significantly at 163%, yet represented only 10% of all economic runaways in 1998.

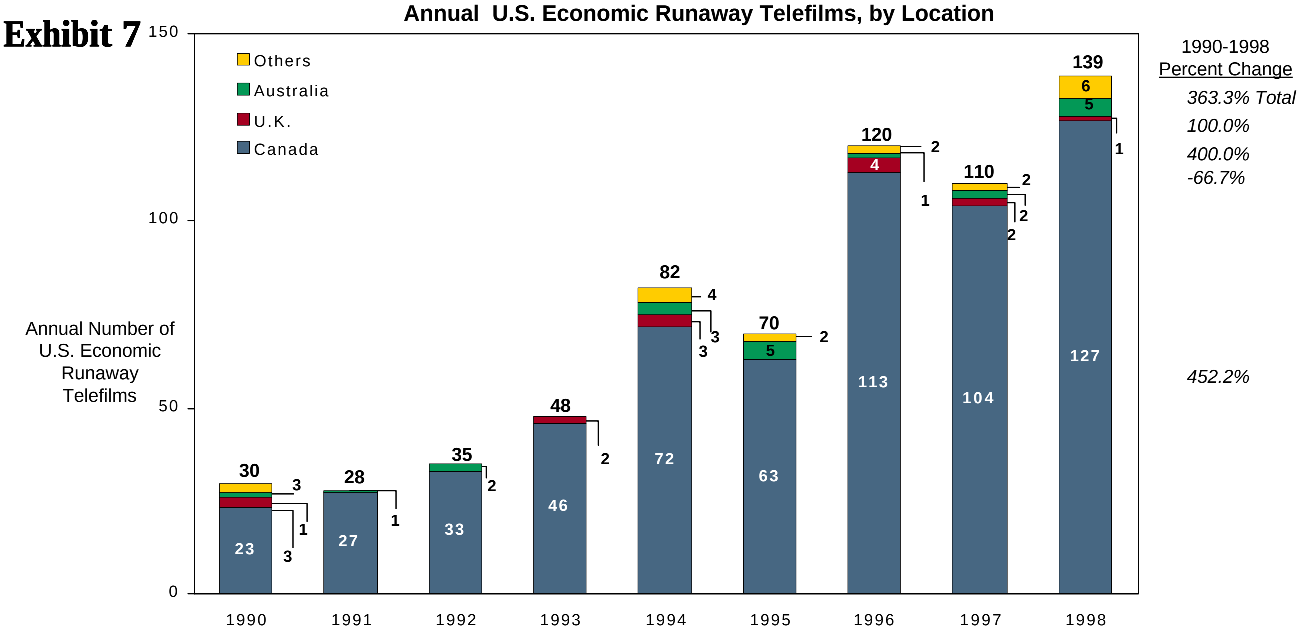
To where do these runaways go? Exhibit 6 demonstrates that since 1990, the majority of U.S. economic runaway production goes to Canada. Section III of this report examines the reasons for Canada's success in attracting U.S. productions.

In 1990, Canada captured 63% of all U.S. economic runaways; by 1998, Canada captured 81%. The number of U.S. economic runaway productions captured by Canada grew phenomenally from 63 in 1990 to 232 in 1998, a 268.3% increase. Australia and the U.K. also captured some economic runaways; Australia's total grew from 5 productions in 1990 to 18 in 1998. The study examined all major global production locations and found that no other country consistently captured a meaningful percentage of U.S. economic runaway productions. Obviously, high-visibility runaways such as "Titanic" which filmed in Mexico are noteworthy, but do not appear to indicate that Mexico will replace Canada as a significant destination.

Canada not only captures the majority of all economic runaways, but also successfully captures nearly all telefilm economic runaways as seen in Exhibit 7. In 1990, only 23 telefilms ran away to Canada for economic reasons; by 1998 this number was 127, representing a 452% increase. The 127 telefilms Canada captured represent 91% of all runaway telefilms.

In the discussion of economic runaway trends, it is important to note that the number of U.S. – developed domestic film and television productions has been growing since 1990, (8.2% annually for feature films, and 2.6% annually for television), illustrating why some U.S. production locations are reporting increases in production days. To a certain

Exhibit 7



Canada Share of Total U.S. Economic Runaway Telefilms

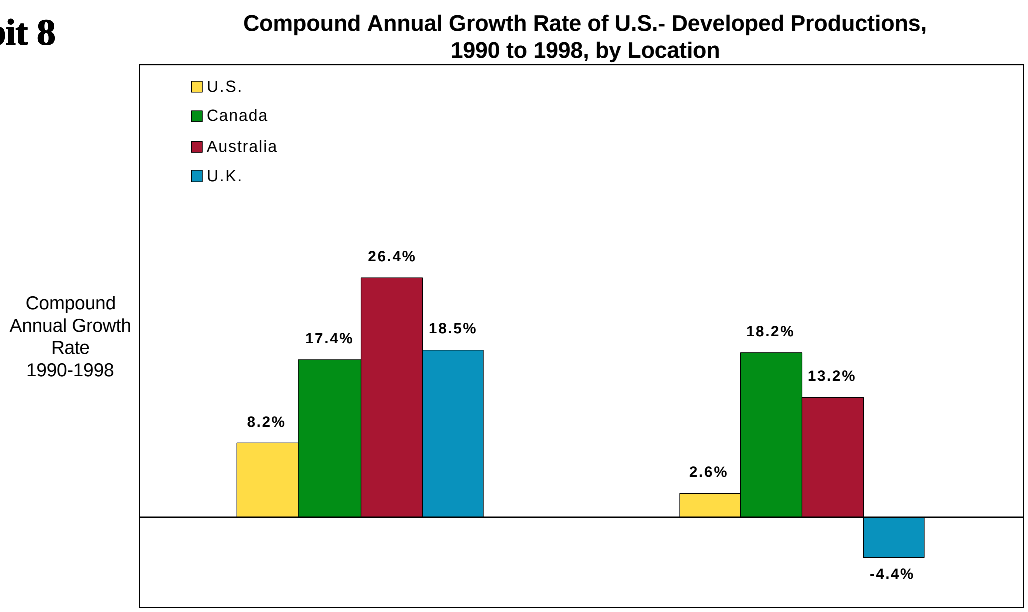
77%	96%	94%	96%	88%	90%	94%	95%	91%

Source: Hollywood Reporter; Variety; Baseline; DGA / SAG Databases; Monitor Analysis

extent, this growth has masked the true impact of runaway production by creating a "rising tide" for the domestic production industry.

However, Exhibit 8 shows that this U.S. growth is not commensurate with the growth occurring in the top U.S. runaway production locations such as Canada, Australia, and the U.K. For example, Australia is growing 26.4% annually (1990-1998) in production of U.S.-developed feature films, or more than three times the U.S. growth rate. Similarly, Canada is growing at 18.2% annually in production of U.S.-developed television projects, more than double the U .S. rate.

Exhibit 8



Source: Hollywood Reporter; Variety; Baseline, DGA / SAG Databases; IMDB; Monitor Analysis

B. Total Economic Impact

The number of productions that runaway for economic reasons is notable, but the real impact to the U.S. is economic, the result of lost production direct expenditures plus the lost "multiplier" effects of those expenditures.

Exhibit 9 shows the methodology used to estimate the impact on the U.S. economy when productions leave the U.S. Again, it is important to note that only economic runaways are considered, not creative runaways. Note that nominal dollars used throughout the study's analyses.

The sum of the total direct production costs of these economic runaways represents the total size, in dollars, of economic runaway production for both theatrical films and television. In 1998 U.S. economic film and television productions had $4.0 billion in direct production expenditures. This figure represents the "negative costs" for the 285 U.S. economic runaway productions in 1998.

Since economic runaways typically do most of the pre- or post-production work in the U.S., and usually bring the lead actors and director from the U.S. to the foreign location, not all of the production expenditures have in fact "runaway." As a result, the production expenditures that remain in the U.S. and the wages paid to U.S. talent are "repatriated" back to the U.S. This "repatriation" more accurately captures the true direct spending lost to the U.S. from economic runaway productions, because it reflects actual practice by producers. In 1998, of the $4.0 billion in economic runaway direct production expenditures, $1.2 billion remained in the U.S., yielding a net $2.8 billion direct production expenditure abroad.

A majority of this direct spending lost to the U.S. would have been "multiplied" through the economy to further stimulate business in the motion picture industry, and in related and peripheral industries. The U.S. Bureau of Economic Analysis has developed widely accepted multipliers to estimate

Exhibit 9

Component	Description (Source)
Total direct production expenditures of U.S. economic runaways [Note that creative runaways are not included]	• Total expenditures to produce a film / show (Baseline; Variety; Hollywood Reporter)
minus	
Direct spending recaptured by the U.S.	• Payments made to U.S. companies and citizens were allocated back to the U.S. since the money returns to the U.S. economy • Payments include principal actors and director salaries and post production (Production Executive Interviews, Sample Budgets, Monitor Analysis)
equals	
Total direct spending lost from the U.S.	• Total production cost net of spending returned to the U.S.
plus	
Multiplier effect of direct spending lost	• A multiplier of 3.1 was applied to wages and salaries (Bureau of Economic Analysis) • A multiplier of 3.6 was applied to goods and services (Bureau of Economic Analysis)
plus	
Tax revenue lost	• Tax rates of 30%, 8.5%, 10% and 7.2% were used for federal income tax, state income tax, payroll tax and state sales tax, respectively (IRS, Sales Tax Institute, Dept. of Labor and Industry)
equals	
Total economic impact	• The total amount of money not realized by the U.S. economy as a result of U.S. economic runaway

the re-spending of direct production dollars. These multipliers were applied to relevant subsets of the total direct spending lost to the U.S. ($0.88 billion of goods and services and $0.85 billion of wages and salaries). In 1998, the multiplied effect of lost production expenditures totaled $5.6 billion ($0.8 billion multiplied by 3.6 plus $0.8 billion multiplied by 3.1).

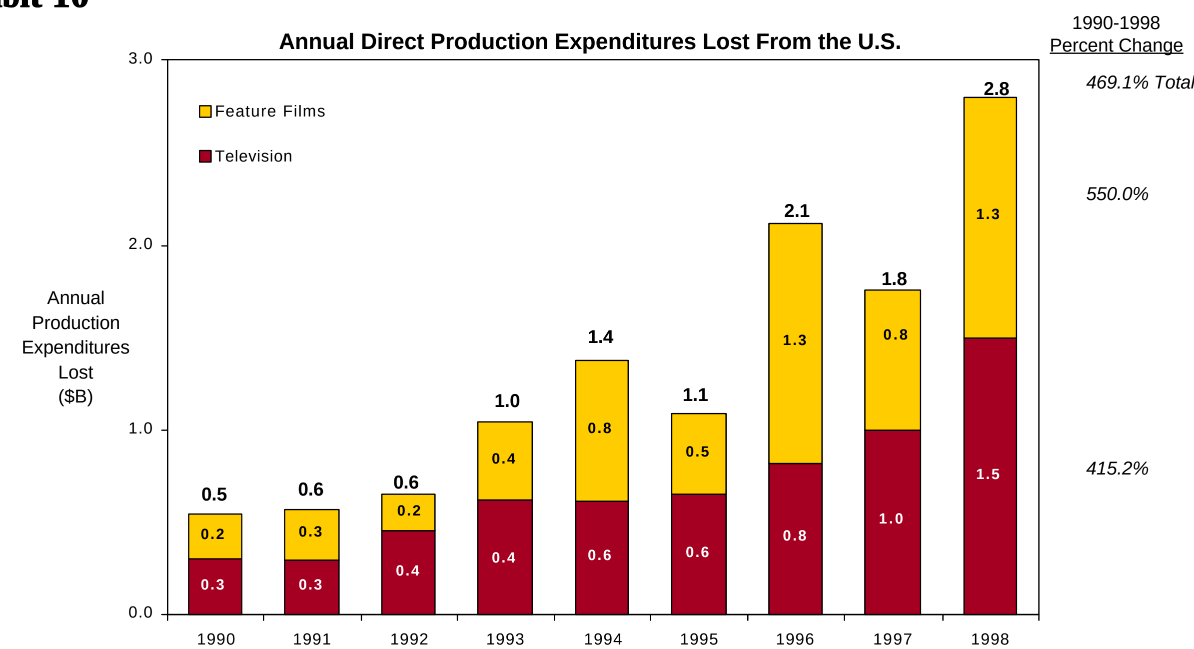
Furthermore, when a production runs away, the payroll, income and sales taxes on the direct spending and multiplier spending are also lost to the U.S. National and state average tax rates were applied to calculate the total tax revenue lost to the U.S. at the Federal and state level in addition to the direct spending and multiplied spending lost. The lost tax revenues totaled $1.9 billion in 1998.

As Exhibit 10 shows, $2.8 billion in direct expenditures were lost to the U.S. in 1998 from both theatrical films and television economic runaways. This figure is almost six times the annual impact on the U.S. in 1990. There is a generally balanced split between television and theatrical film direct expenditures. Note that while the number of economic runaway television productions such as telefilms increased more rapidly since 1990, the larger budgets of feature films make the comparison of expenditure levels appear more balanced.

Exhibit 11 shows the economic impact calculation for 1998. $4.0 billion in direct production expenditures on U.S. economic runaway productions occurred; the U.S. retained $1.2 billion for reasons mentioned above. The remaining $2.8 billion then triggers the multiplier effect discussed above, to yield a total multiplied impact of $5.6 billion in 1998. Taxes lost on the direct production expenditures and multiplier effects yield another $1.9 billion in impact. The total economic impact (combined effect of direct spending lost, multiplied dollars, and tax revenues lost) was $10.3 billion in 1998.

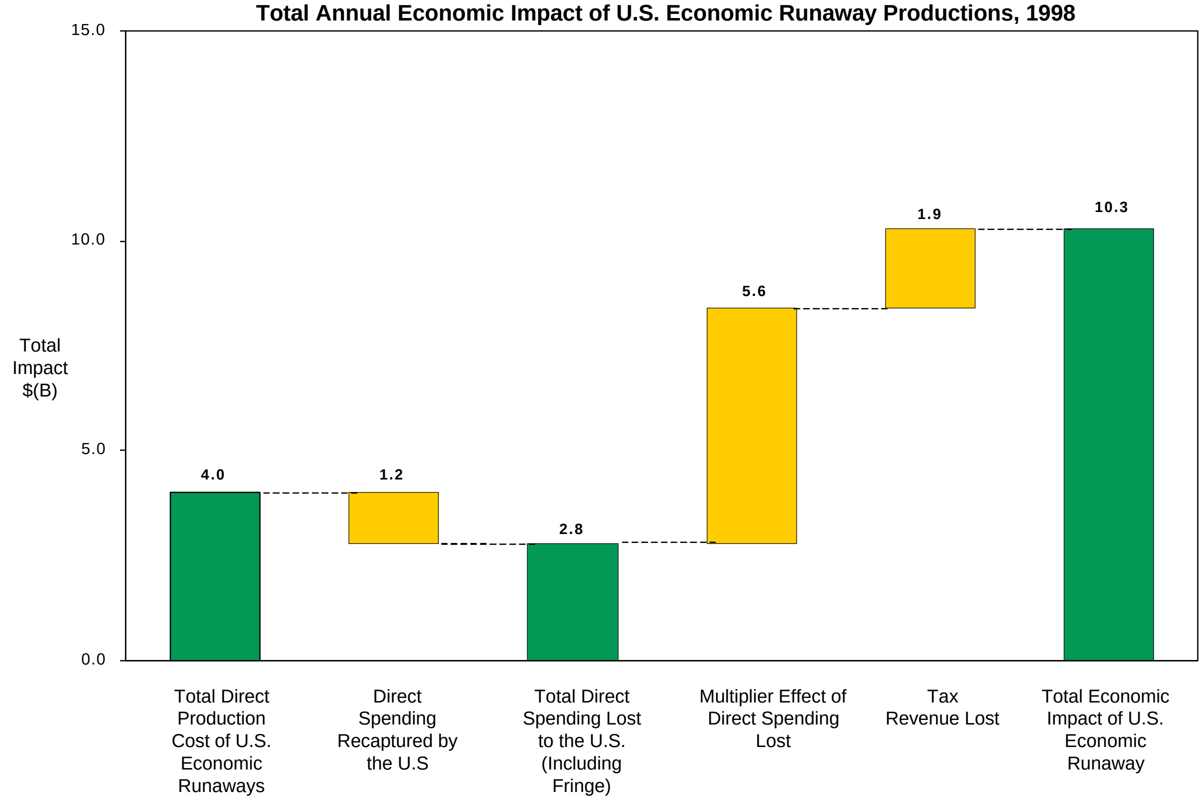
As shown in Exhibit 12, the 1998 $10.3 billion impact is five times the $2 billion economic impact in 1990. The split of this impact between theatrical films and television production is roughly even. The impact on the U.S. economy of both film and television runaways has grown consistently and rapidly. The impact of feature films grew

Exhibit 10



Source: Hollywood Reporter; Variety; Baseline; DGA / SAG Databases; IMDB; Monitor Analysis

Exhibit 11

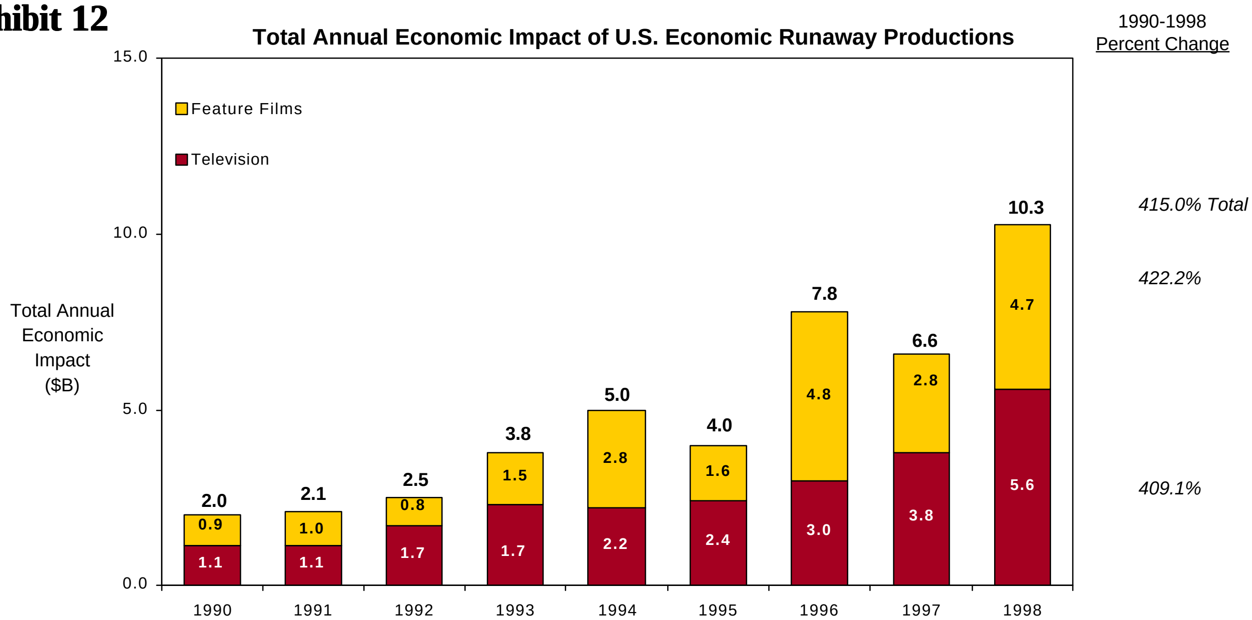


Source: Hollywood Reporter; Variety; Baseline; DGA / SAG Databases; Veronis, Suhler Associates; BEA; IRS; Federal Reserve; Monitor Analysis

422% between 1990 and 1998; the impact of television production grew 409%.

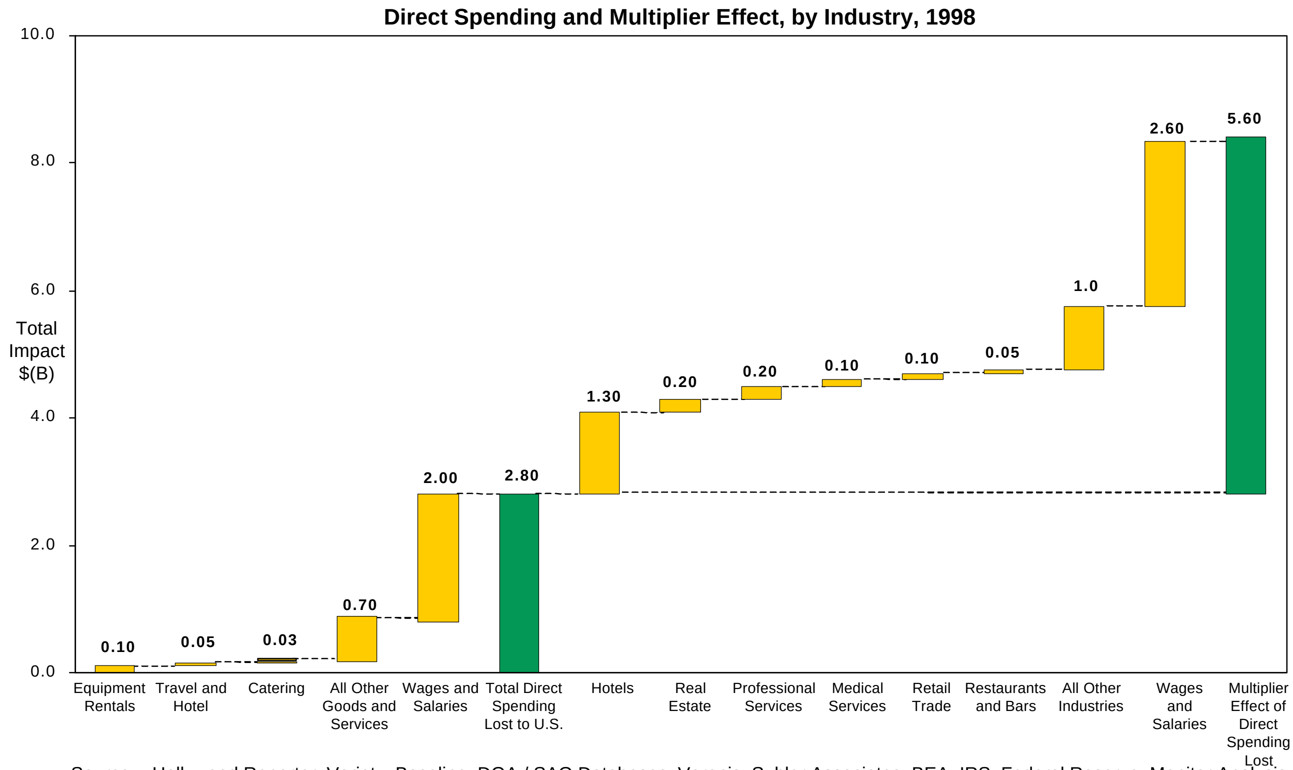
It is important to place this $10 billion impact in the context of total U.S. film and television productions. In 1998, the impact on the U.S. economy from direct production expenditures on U.S.-developed theatrical films and television

Exhibit 12



Source: Hollywood Reporter; Variety; Baseline; DGA / SAG Databases; Veronis, Suhler Associates; BEA; IRS; Federal Reserve; Monitor Analysis

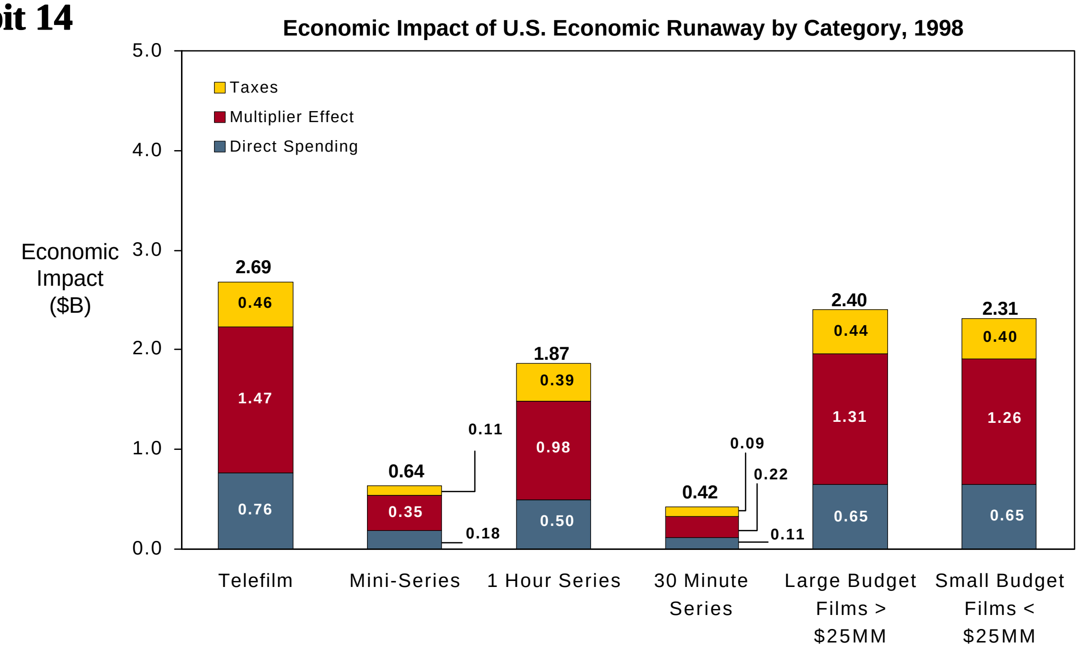
Exhibit 13



Source: Hollywood Reporter; Variety; Baseline; DGA / SAG Databases; Veronis, Suhler Associates; BEA; IRS; Federal Reserve; Monitor Analysis

included in the study's scope is estimated at $74.3 billion. This includes expenditures on projects that were filmed wholly or partially in the U.S. The $10.3 billion lost due to U.S. economic runaway productions represents almost 14% of the total impact of film and television productions. This 14% is lost from the U.S.

Exhibit 14



Category Share of 1998 U.S. Economic Runaway Impact

26%	6%	18%	4%	23%	22%

Source: Hollywood Reporter; Variety; Baseline; DGA / SAG Databases; Veronis, Suhler Associates; BEA; IRS; Federal Reserve; Monitor Analysis

Economic runaways impact the U.S. economy both directly through the loss of direct spending, and indirectly through the loss of multiplied dollars. With regard to direct spending, $800 million that would have been spent on goods and services in the U.S. were lost in 1998 due to economic runaways. The industries that most significantly felt the effects of this direct spending loss were the equipment rental, travel and hotel, and catering industries as seen in Exhibit 13, amounting to almost $200 million in 1998 alone. In addition to the loss in goods and services, the loss in wages and salaries paid to those working on film and television productions amounted to an additional $2 billion in 1998.

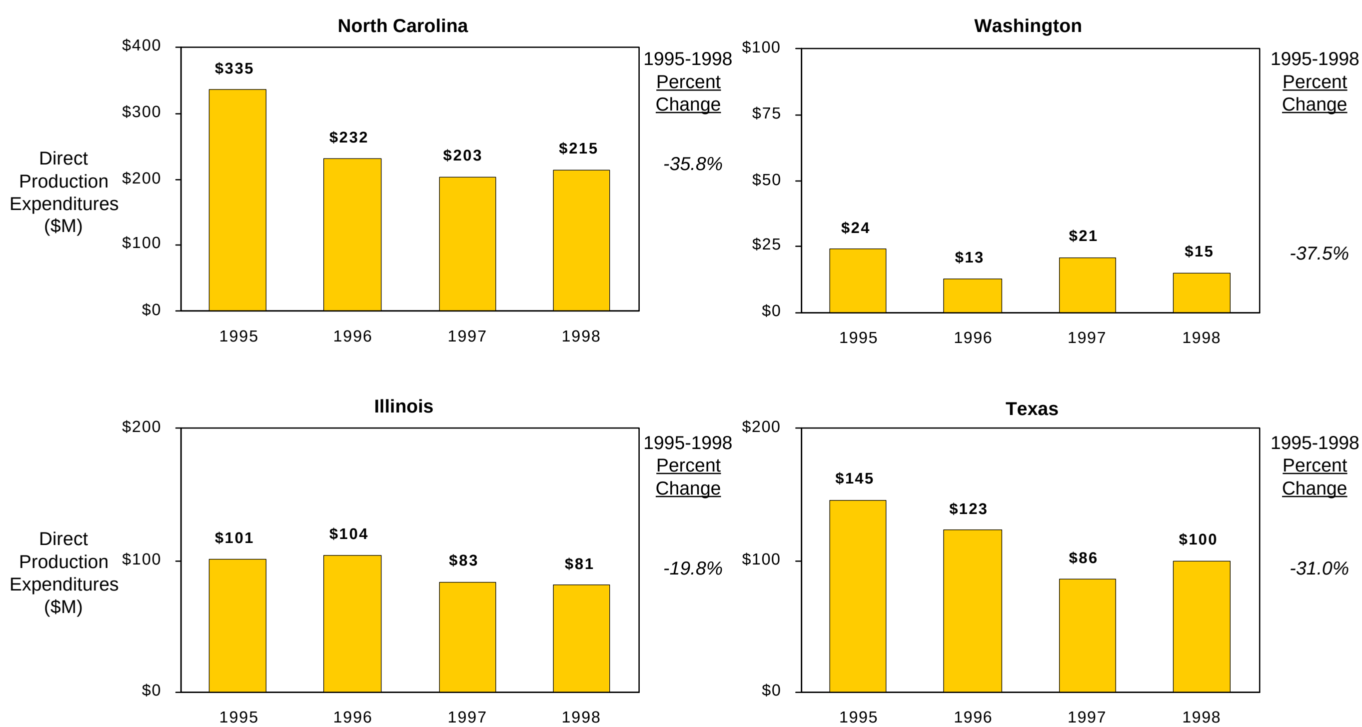
Also in Exhibit 13, the multiplied dollar impact shows $3 billion in goods and services lost due to economic runaways. For example, the hotel industry suffered an estimated loss of $1.3 billion in 1998. Other industries that felt the effects of runaway production were real estate, professional services, medical services, retail trade, and restaurants and bars. Wages and salaries in these and other industries are also lost when productions move abroad, and result in a loss of $2.6 billion that would have been paid in the U.S. had the productions not runaway.

The most significant economic runaway impact comes from telefilms and feature films. Exhibit 14 shows the 1998 impact by type of production, and shows telefilms representing more than a quarter of the impact, or $2.7 billion. Smaller-budget feature films represent about the same as telefilms, at $2.3 billion, but a surprisingly large portion (23%) of the economic runaway is from feature films. Almost half of the $10.3 billion economic impact, or $4.7 billion, is from economic runaway feature films. One-hour television series, television mini-series, and thirty-minute television series represent 18%, 6% and 4% of total economic runaway, respectively.

C. U.S. Regional Impact

While larger U.S. production centers such as New York City and Los Angeles have experienced growth in production expenditures during the past several years, this growth has not been experienced in all U.S. film and television production centers. U.S. production locations outside Los Angeles and New York City are often involved with smaller-budget projects which have been particularly affected by runaway productions. As noted earlier, 75% of the economic runaways in 1998 were smaller budget projects such as telefilms and feature films with budgets under $25 million. Exhibit 15 shows that

Exhibit 15



Source: State Film Commissions; Monitor Analysis direct production expenditures in North Carolina declined 35.8% from 1995 to 1998, a decrease of $120 million. Washington state, Illinois and Texas also experienced declines of 37.5%, 19.8%, and 31.0% respectively since 1995. Collectively, these four states lost almost $200 million in direct production expenditures since 1995.

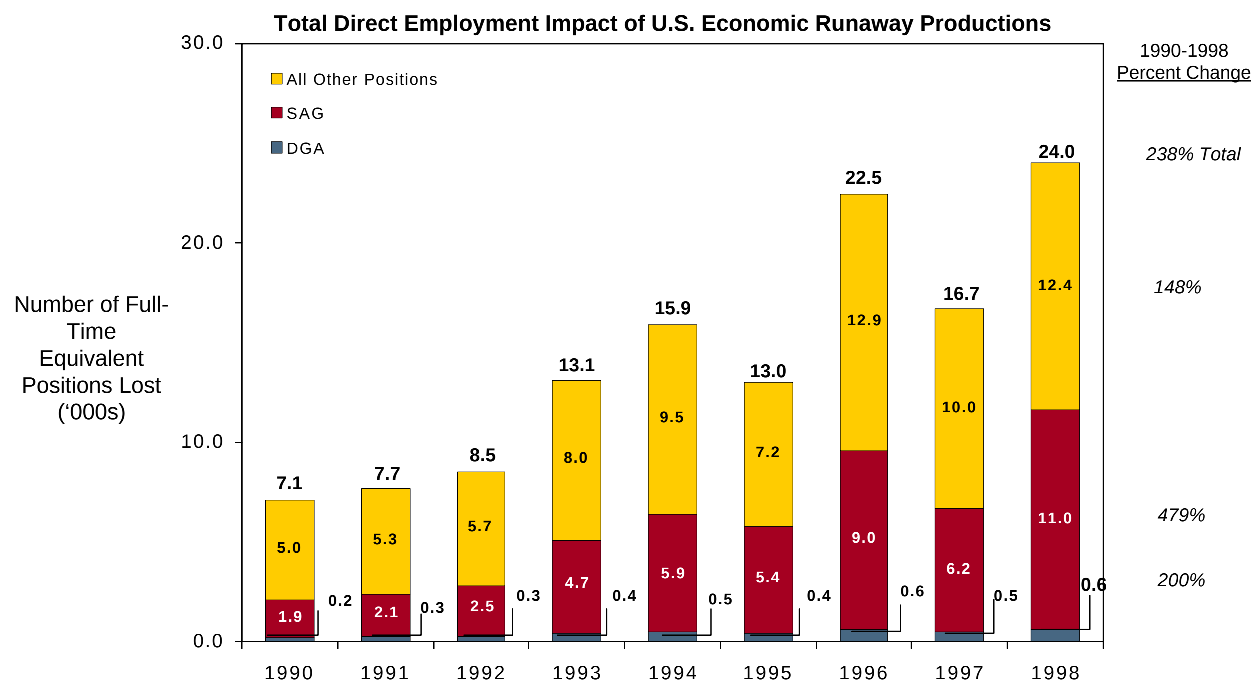
D. Direct Labor Impact

When a production leaves the U.S., virtually all the work is performed by non-U.S. production staff and crew. For example, 10 to 30 supporting actors, stunt and background performers, and 40 to 150 crew members are hired in a foreign location, on average, each time a film or television production leaves the U.S. Had the production not been a runaway, those positions would have been filled by U.S. artists and craftspersons. Runaway productions result not only in an immediate direct job loss in the U.S., but also in a broader loss of employment through the multiplier effect. State and federal governments also lose income and payroll tax revenues.

It is a challenge to classify job losses in the film and television production industry. Generally, there is not a specific event affecting full-time employees such as a plant closing as occurs in other industries. However, there are approximate numbers of full-time equivalent positions lost when a production runs away from the U.S. Exhibit 16 shows the loss of full-time equivalent positions to SAG, DGA, and other union and non-represented people employed in film and television productions. Overall, nearly four times as many jobs were lost in 1998 than in 1990; 23,500 full-time equivalent positions were lost in 1998, compared to 6,900 in 1990. During the last ten years, a total of 125,100 full-time equivalent positions were lost due to economic runaway. These figures are reinforced by the many anecdotal examples of those involved in U.S. production activity either having to leave the industry, or scaling back their activity as fewer opportunities are available.

Of the 23,500 lost full-time equivalent positions in 1998, approximately 11,000 were lost to SAG and 600 to DGA, an increase of 479% for SAG and 200% for DGA over 1990 figures. During the last ten years, 52,500 full-time equivalent positions were lost to DGA and SAG: 48,700 to SAG and 3,800 to DGA. The bulk of full-time equivalent losses (12,400 in 1998 and 76,000 over the last

Exhibit 16



Source: Production Executive Interviews; SAG; DGA; Monitor Analysis

ten years), affects people other than SAG or DGA members, such as members of the International Alliance of Theatrical and Stage Employes (IATSE) U.S., other union members, or non-represented labor.

SAG positions affected include supporting actors, stunt and background performers. DGA positions affected include directors, assistant directors, unit production managers, associate directors and stage managers.

E. Future Impact

The study also sought to assess the likely future impact of U.S. economic runaway production through 2001. A number of future scenarios were evaluated, reflecting several potential environments for production volumes. For example, positive U.S. economic growth, a slowing of U.S. economic growth, and relative strength/weakness in key foreign exchange rates and production incentives were considered in gauging the likely future impact of U.S. runaway economic production. Note that these scenarios assume no major U.S. response to the economic runaway problem.

Under these scenarios, without major intervention to address the causes outlined in Section III, the level of runaway production will remain significant. The total number of U.S. economic runaways could range from 327 to 476 by 2001, but will not likely decline from the 285 economic runaway productions in 1998. The annual economic impact on the U.S. could range from $10 billion to $15.1 billion by 2001. By 2001, lost full-time equivalent positions could total between 22,500 and 36,000 annually.

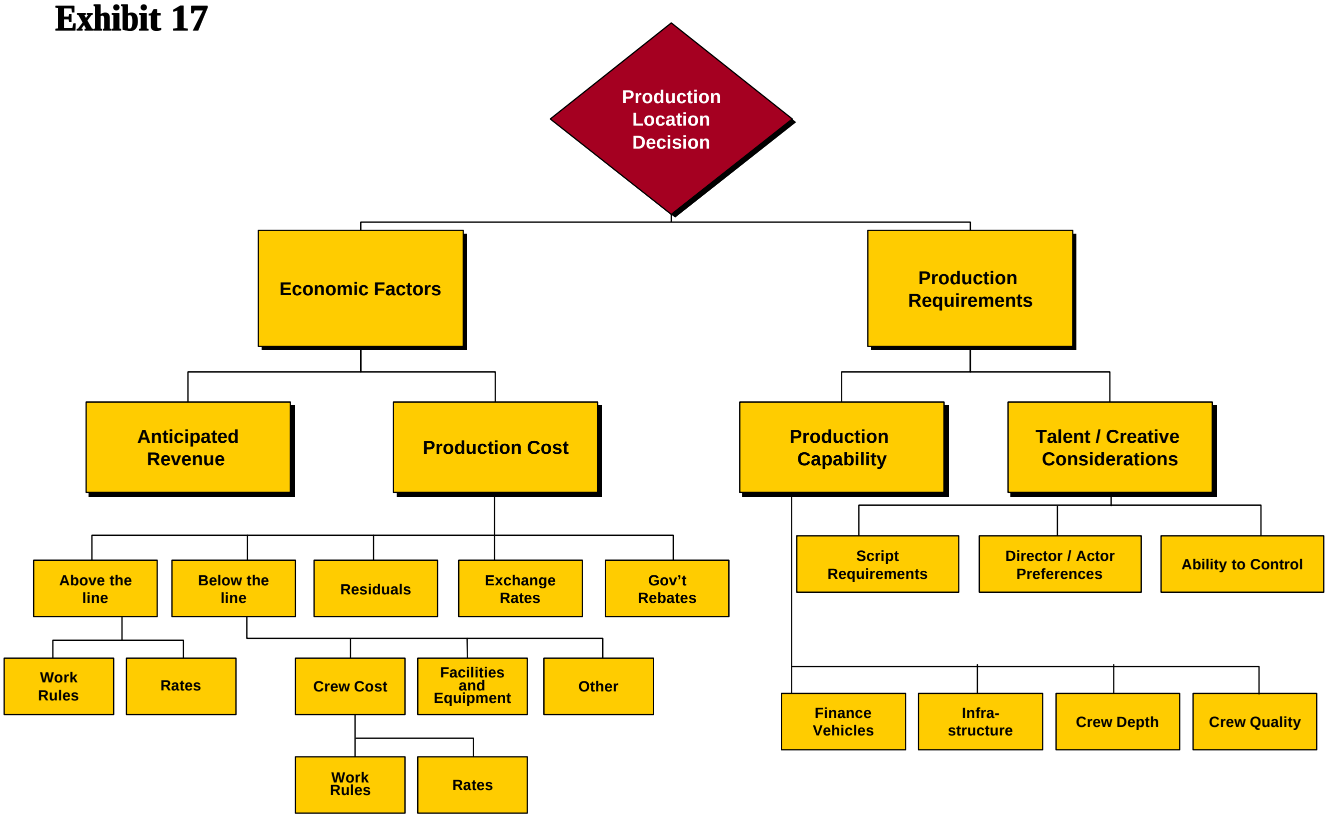
III. THE CAUSES

A. Production Location Decision Drivers

As illustrated in Exhibit 17, the process of determining a production location involves balancing a set of complex economic factors against an equally complex set of production requirements. The exact tradeoff is also determined by the philosophy with regard to cost sensitivity and creative values of the company with which a producer is affiliated. The needs of the financier(s) also determine the importance placed on each set of factors.

13% annually from 1990 to 1998. In developing a production budget, the producer must estimate how much revenue the project will generate. Costs are then considered relative to this anticipated revenue. Several types of costs must be considered. "Above the line" costs (such as principal actors and directors) can represent a large portion of the total production costs but in many cases much of the "above the line" cost is predetermined by outside entities such as financiers who require certain kinds of talent with box office value. There is often considerably more flexibility in how "below the line" costs (such as supporting actors, production crews, etc.) are achieved.

Exhibit 17



Economic factors have always been important to producers but they have taken on increased importance as the evolution of the entertainment industry creates greater pressures to reduce production costs. These costs have been steadily increasing; average feature production budgets in data gathered by Monitor Company increased by

Production requirements broadly include any creative considerations as well as production capabilities at the location under consideration. Creative considerations include limitations placed on a project by the script or the preferences of the talent, director, and/or producer involved. Certain high-profile directors and actors are often given more influence over these decisions, but many others only have a limited or no voice. The need of the producer, studio or financier to control the project also constrains the number of location choices. For example, a key barrier to producing in Australia is the physical distance and time zone differential. Although technology will enable dailies from Australia to be quickly available in the U.S., several producers indicated that there is no substitute for "on the ground" production oversight. In addition to the talent and creative considerations, the ability to secure a talented crew and to have access to required infrastructure such as soundstages or production equipment weighs heavily on the decision.

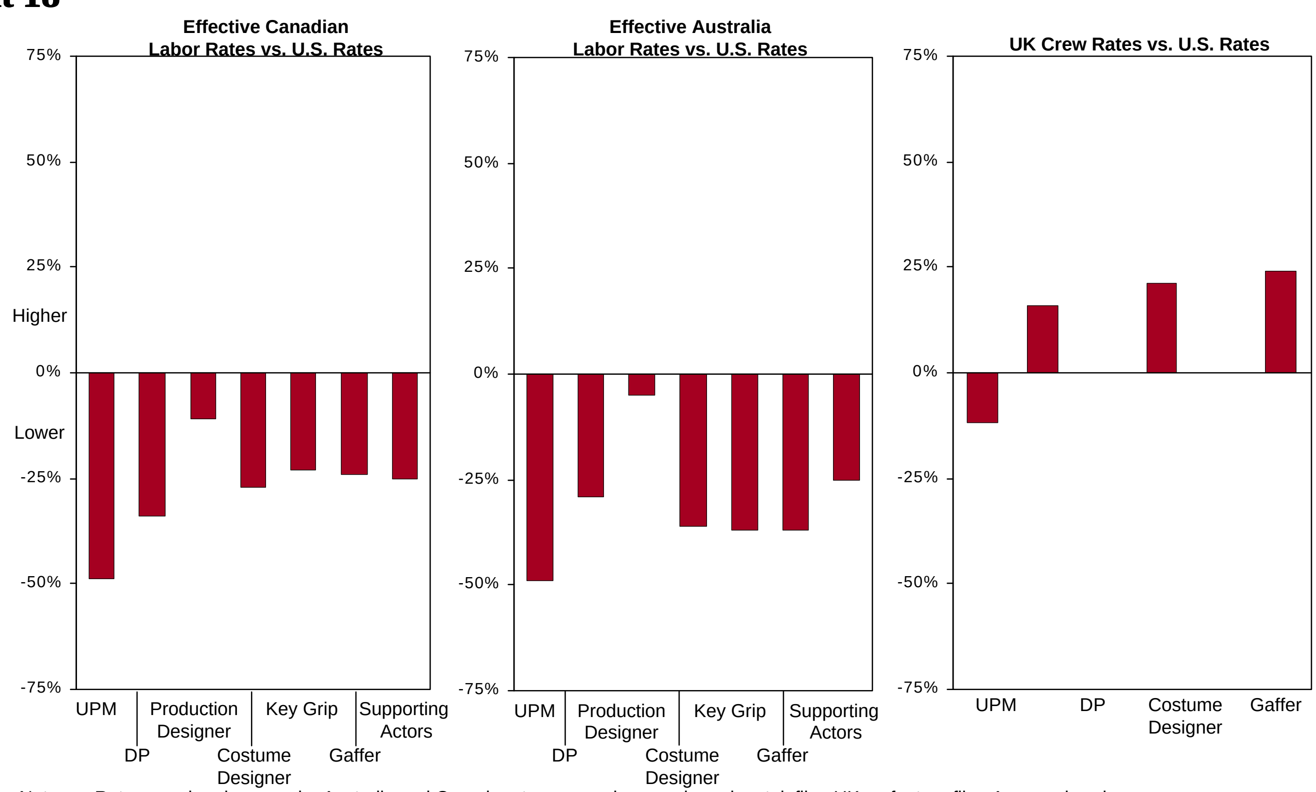
B. Exchange Rates and Factor Costs

Producers noted the differences in wage rates and scale between the U.S. and Canada as particularly significant. These differences are due to a combination of exchange rate and wage rate differences. Wage rates in Canada, Australia and the U.K. have consistently been lower than the U.S. during the past few years (see Exhibit 18). The largest differences between the U.S. and foreign rates have been for positions such as unit production managers and assistant directors. These differences have only been exacerbated by rapidly declining exchange rates in these key countries (see Exhibit 19). In particular, since 1988 the Canadian dollar has declined in value by more than 20%, and the Australian dollar by almost as much.

Despite tremendous demand for cast and crews in Canada, Australia and the U.K., wage rates have not risen significantly over time. In fact, even after adjusting for exchange rates, scale in Canada, for example, is increasing at a slower rate than in the U.S (see Exhibit 20).

Other production cost items, while mentioned by some vocal industry players, do not appear to have a large impact on the decision to produce in a foreign location. For example, for many productions the ability to prepay residuals to actors in Canada can

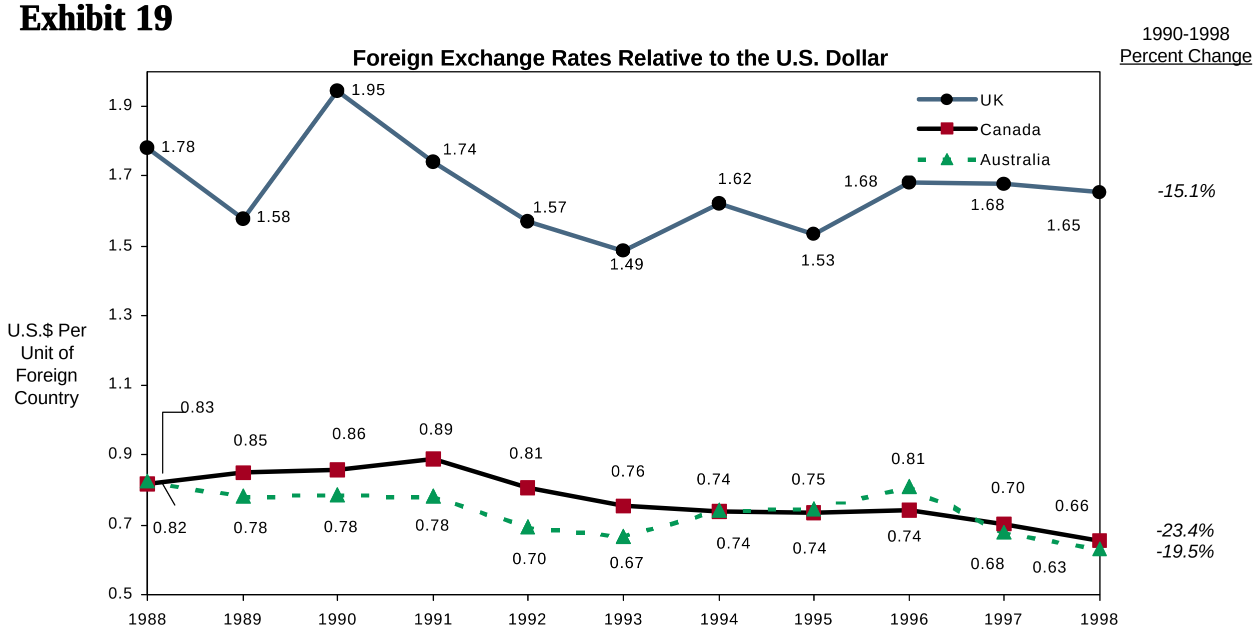
Exhibit 18



Note: Rates may be above scale. Australia and Canada rates comparison are based on telefilm, UK on feature film. Assumed exchange rates: C$ = U.S.$ 0.68, A$ = U.S.$ .64, £ = U.S.$ 1.61

Source: OECD Main Economic Indicators, Interviews, Monitor Analysis

Exhibit 19



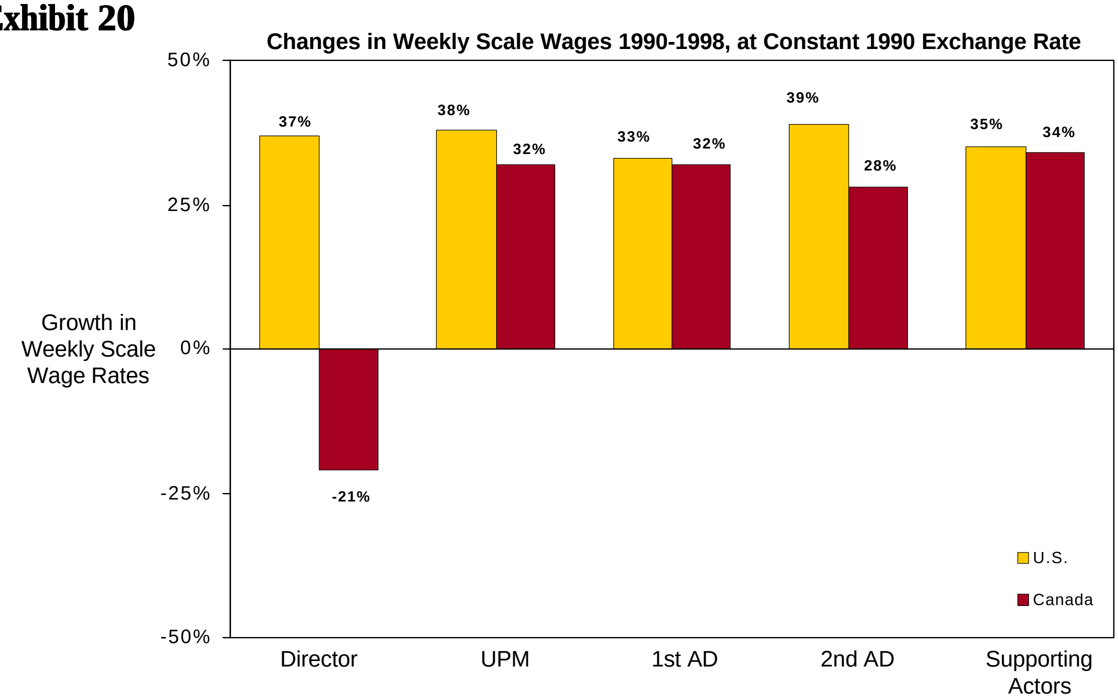
Source: OECD

be more expensive than paying SAG residuals. Furthermore, many producers do not consider the residual stream while budgeting a production because residuals are frequently paid by another entity. Other factors such as differences in union work rules between the U.S. and Canada, while visible to producers, do not appear to generate consistently material savings.

C. Foreign Tax Incentives

Historically, government tax incentives have targeted projects that promote cultural content. Typically these incentives were complex, required extensive paperwork and had onerous qualification requirements. As state and national governments recognized the economic importance of U.S.-

Exhibit 20



Source: DGA; SAG;OECD; Statistics Canada

Exhibit 21

	1988 – 1994	1995 – 1998
Incentives Available for Canadian Content	• Capital Cost Allowance (tax shelter) used to attract private financing • Nets **4-8%** of budget	• Canadian Film or Video Production Tax Credit (**25%** of eligible labor costs) • Canadian content requirement* (CAVCO) • Provincial Government: Film or Video Production Tax Credit (**20-35%** of eligible labor costs) • Canadian content requirement* (CAVCO)
Incentives Available for Foreign Production	• Capital Cost Allowance available to foreign producer if in co-production through sales and leave back arrangement • Nets **4-8%** of budget • High transaction costs; more difficult to access than current credits	• National Government: Film and Video Production Services Tax Credit (**11%** of eligible labor costs) • No content requirement, paperwork easy • Provincial Government: Services Tax Credit (**11%** of eligible labor costs in BC, Ontario, Quebec; Up to **35%** in Manitoba and Saskatchewan) • No content requirement, paperwork easy

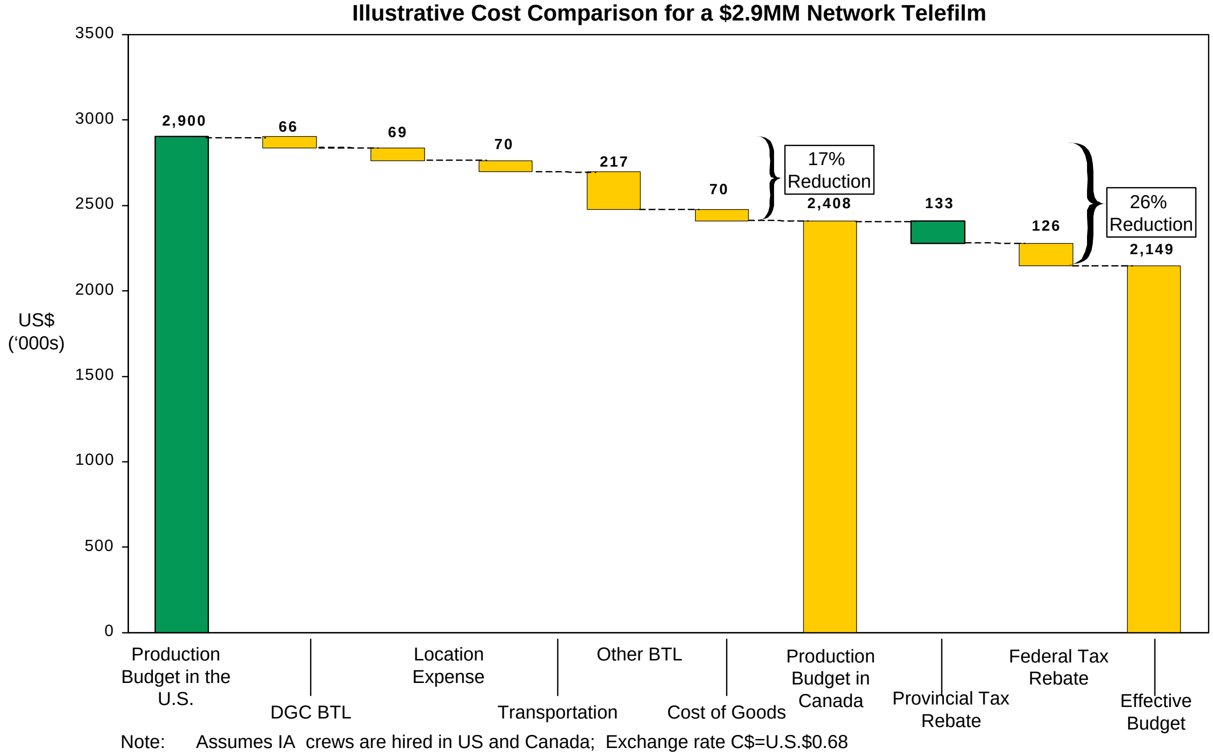
*Note: U.S. productions can take advantage of the credit by co-producing with a Canadian company and hiring mostly Canadian key crew (8 out 10 CAVCO points)

developed productions, significant efforts were made to expand their incentive programs. Not surprisingly, Canada has led the charge by offering federal rebates since 1996 of 11% on spending for all Canadian labor involved in a production, regardless of content. Provincial governments were quick to supplement these incentives, creating a total of a 22% to 46% rebate on Canadian labor expenditures (see Exhibit 21). Some advantages of these incentives are that they are available to all productions, have no annual limits to the number of rebates being offered, greatly simplify paperwork, and are structured as direct rebates, not tax credits. Several companies have entered into the business of filing paperwork and providing advances on the incentives to producers in exchange for a fee, helping producers address cash flow issues.

Unlike other countries, Canada has gone out of its way to ensure that producers are aware of the incentives and their subsequent savings. It is not uncommon for Canadian government officials and film commission representatives to fly to Los Angeles, New York City, or other U.S. production centers to attend events or meet directly with film and television producers to advertise their incentive structure. For example, representatives of Revenue Canada (the Canadian IRS) were at the recent "Locations `99" show in Los Angeles, promoting the Canadian incentives. Canadian labor and industry representatives have indicated that incentives are geared to attract foreign productions. Recent initiatives in Canada to discontinue the incentives for foreign producers have been met with strong opposition from Canadian labor and government officials, who note that these productions represent several thousand jobs and millions of dollars in economic impact, more than offsetting the money paid in incentives.

Once production is completed, additional savings can be realized by applying for tax rebates associated with Canadian labor spending. The exact amount realized is determined by the amount of

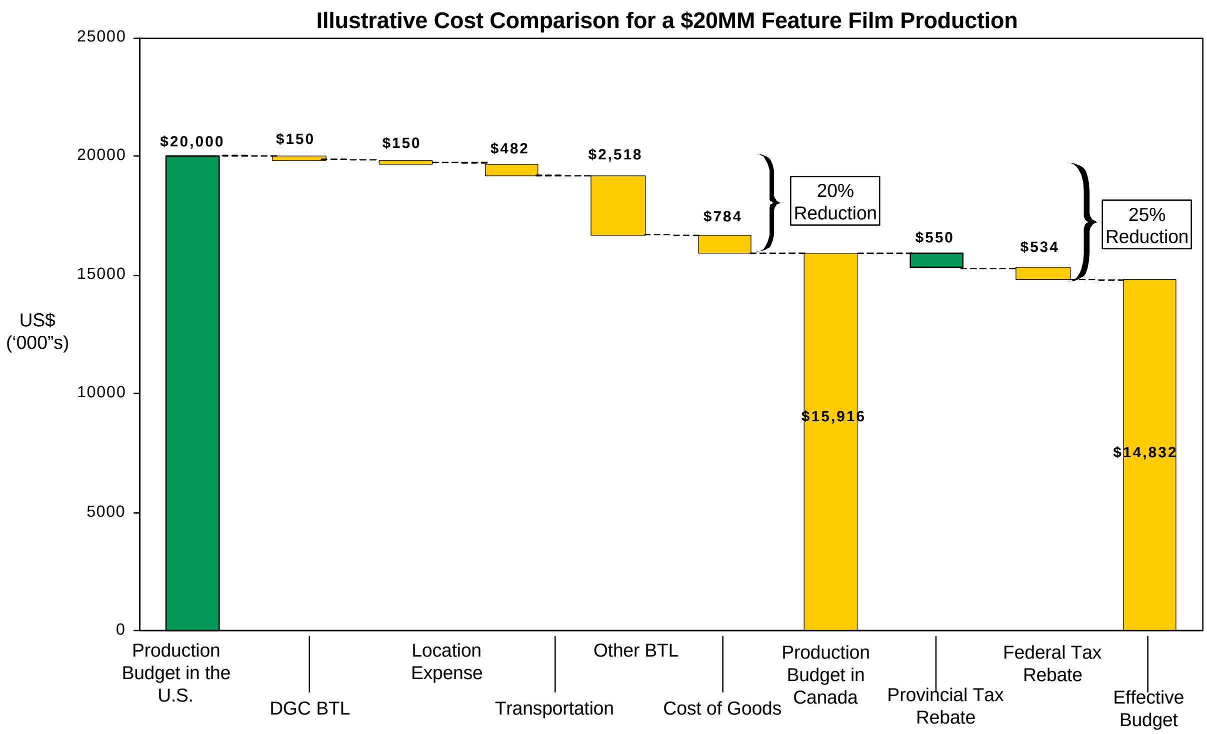
Exhibit 22



Note: Assumes IA crews are hired in US and Canada; Exchange rate C$=U.S.$0.68
Source: Producer and executive interviews; sample production budgets; Monitor analysis

Canadian labor used. In a typical case, the incentives would increase the total budget savings to 25% - 26%. However, payment of rebates can take up to a year. The first wave of payments of the Canadian rebates are only now being received by producers.

Exhibit 23



Note: Assumes IA crews are hired; DGA director and staff; U.S. location costs priced for Boston; Exchange rate C$=U.S.$0.68
Source: Producer and executive interviews; sample production budgets; Monitor analysis

D. Total Cost Differences

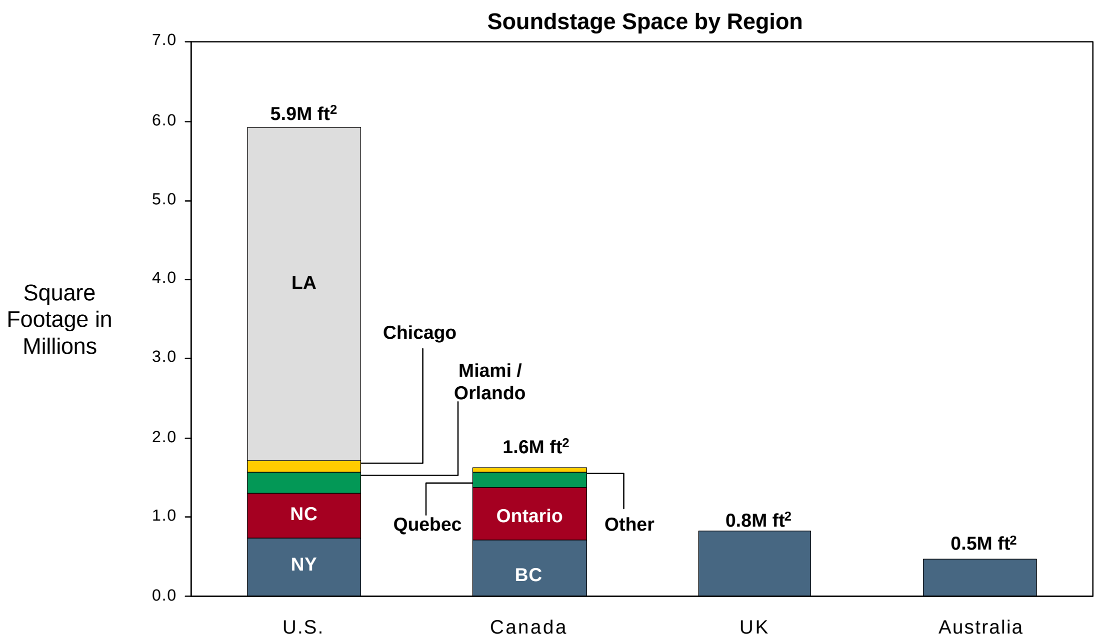
As a result of the above conditions, U.S.-developed productions located in Canada have been able to realize direct savings of approximately 17% to 20% and total savings including incentives of up to 26% (see Exhibits 22, 23). Approximately 60% of the direct savings come from "below the line" labor cost differences. These cost savings can be achieved because all of the "below the line" crew is sourced in Canada. In addition, labor rates and fringe benefits are less expensive in Canada. For productions in and around Toronto and Vancouver, location expenses are cheaper because much of the crew is local and does not require accommodations. An additional 14% in savings can be realized in transportation expense. The final element of direct savings comes from differences in the cost of goods and services such as sets and equipment. Other differences in Canada versus the U.S. exist but are either minimal or are typically offset by related cost increases. One example is the savings in "above the line" cast expenses that come from hiring supporting actors in Canada. However, the increased travel expenses associated with using American actors, directors, and producers offset the majority of these savings.

E. Foreign Infrastructure

Historically, film and television productions have tended to locate in or near large production clusters such as Los Angeles or New York, due to their well-developed infrastructure and access to experienced cast and crew, and despite the relatively high cost of production. Until the mid-to-late 1990's, going to a foreign location required that producers import most of the cast, crew and equipment to the location. Such significant logistics and travel expenses generally more than offset any differences in exchange rates and wages.

One critical outcome of the U.S. runaway production phenomenon is the emergence of several countries as significant production "clusters." The most notable examples are in British Columbia and Ontario, Canada, where significant experience bases have developed and investments in infrastructure have been made. Exhibit 24 indicates that British Columbia and Ontario now have almost 1.5 million square feet of sound stage space, as much as New York and North Carolina combined. The volume of production in these areas has generated the start-up of numerous service companies including post-production companies, catering companies, equipment rentals and other key support services.

Exhibit 24



Source: Film Commissions; Interviews; Reel West; Playback International; Montreal Shooting Guide

Exhibit 25

U.S. Studio	1994	1995	1996	1997	1998
Viacom (Paramount)	• June, 1994 — Viacom establishes Viacom Canada, which will spend $1 million a year over five years on “Canadian culture.” It is rumored the investment was a “sweetener” to encourage the government to pass the CAVCO tax credit.	• September, 1995 — Paramount opens production support companies in Vancouver and Toronto to service the equipment rental needs for Paramount and other Viacom holdings		• June, 1997 — Paramount Studios invests over $10 M to construct four sound stages and production office space in Vancouver. The facility is 166,000 square feet.	
Disney			• October, 1996 — Disney purchases a 12,600-square-foot multimedia studio in Victoria, British Columbia • December, 1996 — Walt Disney Animation Canada opens a 17,000-square-foot studio in Vancouver		
MGM				• May, 1997 — MGM and Bridge Studios jointly open 25,000-square-foot Studio 5/6 in Vancouver. The BC government invested C$3.5 million.	
Warner Brothers	• 1988 Warner Roadshow studio opens in Queensland, Australia (76,347 sq. ft)				
Fox			• Fox builds $125M water-tank-based studio in Rosarito Beach, Mexico.		• Fox Studios Australia opens in Sydney, valued at $130.5M

Several studios have publicly stated their intention to increase production abroad; the increased globalization of entertainment companies is likely to stimulate further runaway production

Source: Annual Reports; Variety; Screen Digest; Film Commissions

The development of these production clusters accelerated as U.S. companies made sizeable infrastructure investments in many of these locations (see Exhibit 25). U.S. investment abroad creates short term support for these production locations and a long term incentive to ensure that production continues.

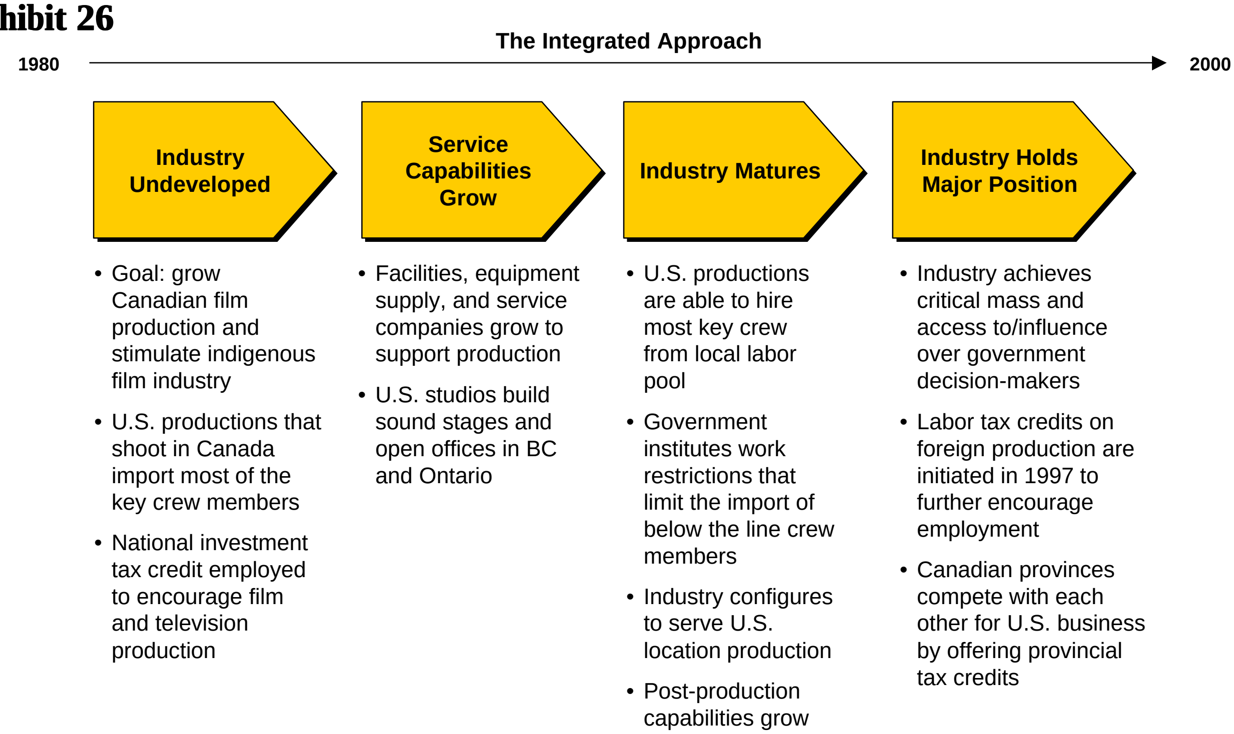
Demand for the new Canadian production clusters has been so high that many producers complain about the difficulty of securing crews or facilities to start production. In fact, there have been instances in which a U.S. producer has hired a crew only to discover later that crew members have moved over to higher paying or more prestigious projects.

Another factor stimulating the development of production clusters in certain areas is the availability of diverse settings and their proximity and similarity to the U.S. Many productions are set in generic (often American) towns or cities, which can easily be replicated in Canada but are more challenging to replicate in other parts of the world such as the U.K. Many settings and scripts also require actors to look and sound American, and the cars and signs to look familiar to the American audience. Mexico, despite its proximity and indisputable cost advantages, cannot easily meet the need for U.S.-oriented settings, and has thus developed more slowly as a production location. However, the production of “Titanic” in Rosarito Beach demonstrated that large, complex projects can be completed in Mexico. Moreover, the facilities constructed for that production are now being marketed to other producers.

F. The Integrated Approach and Canada

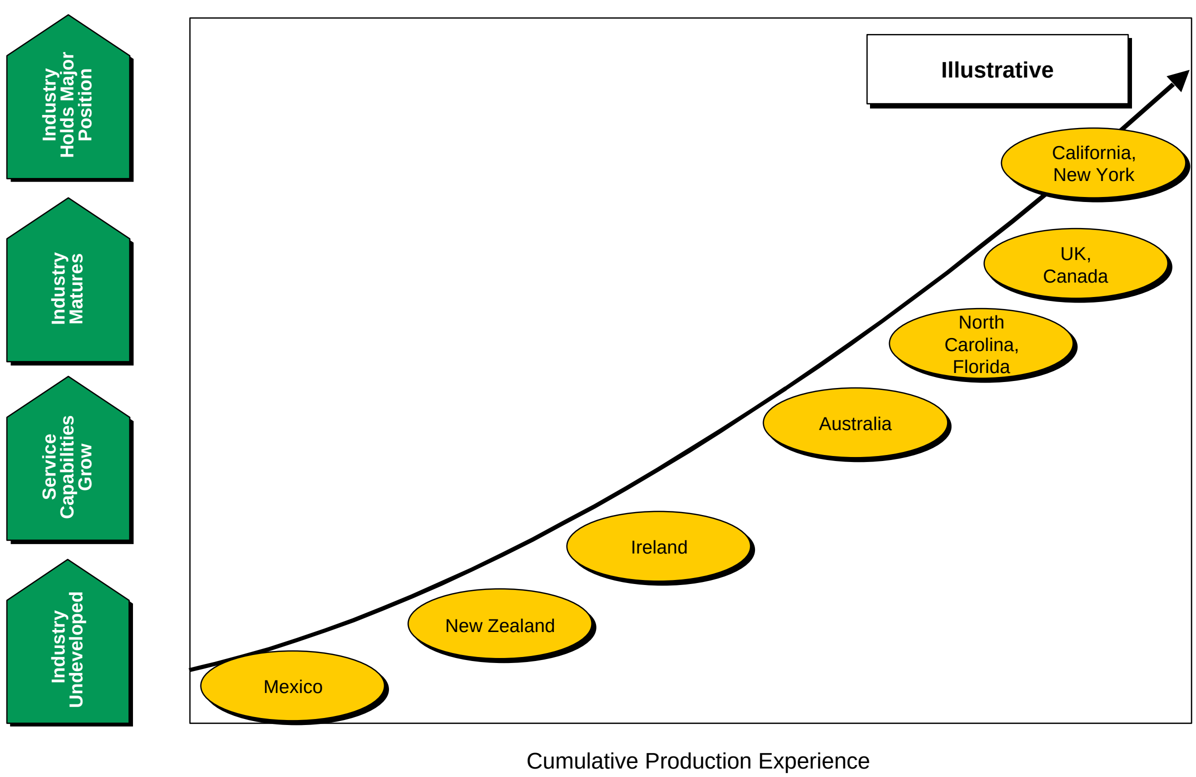
It is important to note that Canada has followed an integrated approach (see Exhibit 26) to launching its film/television production-oriented initiatives during the past several years. In this approach a country begins with a relatively undeveloped production industry. It then launches a series of (usually tax credit-centered) initiatives to attract production activity and investments, and often

Exhibit 26



creates qualifying requirements for those incentives that stimulate hiring of local personnel. As a result, local production crews, actors and production managers gain valuable experience and training and are therefore more capable and attractive to other producers. At the same time, investments in physical infrastructure are sought so that more and more productions can be accommodated. As these production capabilities expand, other tax incentives such as those for local labor expenditures are

Exhibit 27



offered to further stimulate demand for local production resources. Ominously, this approach to capture productions is readily replicable by other countries; in fact, Australia is moving along a very similar path to that pursued by Canada (see Exhibit 27).

How Large Is The Gap To Be Closed?

Clearly the U.S. faces major challenges in stemming the tide of runaway production. The solutions will not be simple because the causes are several and very complex. However, the cost gap to be closed to retain production in the U.S. may not be the entire 25% production cost disadvantage. Several producers interviewed mentioned that if the budgets for U.S. productions were brought to within 10% to 15% of costs in Canada, then they would make the argument to keep that production in the U.S. Producers generally want to work where they live, and most live in the U.S. production clusters. Furthermore, these clusters contain all the resources required, as well as access to financing, development, and distribution resources, which provide a distinct advantage to producers. Obviously, certain productions cannot afford even a 10% cost disadvantage; recapturing these productions will be the greatest challenge.

It is important to note that U.S. film and television economic runaway activity is at a high level, and that large productions are running away. The significantly lower total production costs achievable abroad are compelling to producers. The experience that foreign production crews, actors and directors have gained in filming U.S. runaway productions represents an ongoing source of advantage that for these producing locations. Similarly, infrastructure investments abroad represent permanent improvements that will continue to draw productions out of the U.S. Without a meaningful response (or some unforeseen development abroad), production employment opportunities and associated economic benefits will continue to leave the U.S. at a significant rate.

IV – STUDY METHODOLOGY AND KEY TERMS

Study Methodology

The U.S. Runaway Production Study was conducted from February 1999 to the end of May 1999; the study's key activities included:

- The development of a feature-length and television program database for all U.S.-developed productions since 1990, to quantify the scope of U.S. runaway production. For this analysis, Monitor Company used a broad range of sources (Hollywood Reporter, Variety, Baseline, SAG/DGA databases, Internet Movie Data Base (IMDB)) to understand which entities were involved in the production and where it was filmed, as well as budget information where available. Monitor used a number of sequential criteria to determine the runaway status of productions, for example: Did the production involve a U.S. production company and/or have an English language title, use English-language directors/actors, have an American writer and/or American producer, have its first release in the U.S.? Monitor used setting/plot information or input from producers to determine whether the production was a creative as opposed to economic runaway.
- More than 70 interviews with a cross-section of production industry participants (producers, Guild members and executives, film commissioners, etc.) to discuss current U.S. runaway situation and causes.
- Calculation of total U.S. economic impact. Actual or estimated budgets for each production were used to define production expenditures. Once Monitor quantified the production expenditures, expenditures on economic runaways were totaled and certain components multiplied using Bureau of Economic Analysis (BEA) multipliers to calculate total impact. Monitor Company also used average actual tax rates to calculate the tax revenue effects of lost direct production expenditures and multiplier effects.
- Creation of forecasts for production volumes, expenditures and impacts. Monitor analyzed historical production volumes and identified some explanatory variables. Monitor then used available forecasts for those variables to project production volumes under various scenarios.
- Full-time equivalent positions were derived by dividing the number of runaway productions by the average number of projects a director, production manager, artist or craftsperson, etc. completes in a year. SAG full-time equivalent positions, on the other hand, were based on an average annual utilized member income.

Monitor Company, Directors Guild of America and Screen Actors Guild would like to extend their sincere appreciation to the many individuals and groups who contributed their time, experience and perspective to this study: directors, actors, producers, executives, film commissioners, and various industry associations. Many thanks also to the SAG-Producers Industry Advancement & Cooperative Fund for the grant that partially funded this study.

Definitions of Key Terms

Following are some key terms used in this report and their definitions:

U.S. Runaway Production (Film): A runaway production is any feature-length film intended for U.S. initial theatrical release and developed in the U.S. but filmed in another country by either a U.S. or foreign-based production company.

U.S. Runaway Production (Television): A runaway production is any TV show, series or television film first intended for exhibition in the U.S. but filmed in another country by either a U.S. or foreign-based production company under license agreements with broadcast networks, basic/pay cable, networks, syndicators, etc.

U.S. Economic Runaway: A U.S.-developed feature-length film or TV show, series or television film which is filmed in another country for economic (cost reduction) versus creative (primarily setting) reasons.

U.S. Creative Runaway: A U.S.-developed feature-length film or TV show, series or television film which is filmed in another country for creative (setting, director/actor/producer preference) reasons.

Above The Line: The portion of a film's budget which covers major creative elements and personnel, i.e., those which are creatively unique and individually identifiable. These are primarily story, acquisition, screenplay rights, script development, writer, executive producer, producer, director and principal members of the cast. The phrase "above-the-line" refers to the location on the film budget of the specific expense items/person. (from Cones, John W. Film Finance and Distribution: A Dictionary of Terms)

Below The Line: Film budget items relating to the technical expenses and labor (other than above-the-line) involved in producing a film, i.e., relating to mechanical, crew, extras, art, sets, camera, electrical, wardrobe, transportation, raw film stock, printing and post-production. Below-the-line personnel include the production manager, cinematographer, set designer, special effects persons, wardrobe person, and make-up artist. The phrase "below-the-line" refers to the location of the specific expense items/person on the budget. (from Cones, John W. Film Finance and Distribution: A Dictionary of Terms)

V. ABOUT MONITOR COMPANY

Founded in 1983 by Professor Michael Porter and colleagues at Harvard Business School, Monitor Company is a leading global management consulting firm of more than 900 consultants in 25 offices around the world. Since its founding, Monitor Company has remained focused on a core mission: combining leading-edge analysis with proprietary processes to help its clients define robust, compelling strategies, as well as take the necessary actions to transform these strategies into sustainable competitive advantage. Monitor works with private- and public-sector clients. Monitor Company is headquartered in Cambridge, Massachusetts; the U.S. Runaway Film and Television Production Study team is from the firm's Santa Monica, California office.