



TE MANGAI PAHO DISCUSSION PAPER ON THE 'NATURE OF THE SUBSIDY'

PREPARED FOR THE DISCUSSION WITH KEY STAKEHOLDERS IN THE INDUSTRY

This paper is a follow up to a discussion that The Te Māngai Pāho Board has undertaken. It is intended that this paper be circulated to key stakeholders in the industry with a view to broadening the discussion.

The underlying premise is generating better 'value for money'. Te Māngai Pāho considers that a re-consideration of 'the nature of the subsidy' and the intellectual property rights created as a result of the taxpayer subsidy is well overdue. This paper seeks to clarify the rationale for taxpayer investment in our sector and point to ways in which the sector could produce significantly better value for the taxpayer.

BACKGROUND

Successive governments have supported and funded entities such as The New Zealand Film Commission (1978), New Zealand On Air (1989), and Te Māngai Pāho (1993). Why do these entities exist and why does the government provide funding for them? On the most simplistic of levels, to compensate for a market weakness; the New Zealand market is too small to sustain local film and television production without taxpayer support. Without getting into a lengthy academic discussion countries all around the world subsidise their film and television industries essentially so that 'they can see more of themselves on air'. Of course Te Māngai Pāho (and Māori Television) exist, to compensate for a further market weakness; the inability of the 'mainstream' to appropriately allocate money and airtime to *ngā tangata whenua me o mātou reo rangatira tikanga hoki*.

So much for the rationale for the existence of these entities, what about the actual 'nature of the subsidy'? Is it time to re-examine the precise nature of the subsidy to ensure that it is underpinned by sound logic and that its operation is generating the expected benefits? Certainly there are timely incentives; a new government whose mantra is 'better value for money', a once in a lifetime economic crisis that will in all likelihood rule additional funding for the foreseeable future, a review of the Māori Television Act, a review of the New Zealand Film Commission Act, a fast evolving digital broadcasting landscape and a five yearly review of the Māori Language Strategy.

What do we mean by the 'nature of the subsidy'?

Some broad brushstrokes in terms of what happens now:

- In general terms all the agencies in the sector operate in the same way; the funding made available by the government agencies is provided in return for an 'equity' position in the individual production.
- Initially, because the government agency was generally the largest or only funder, the agency took not only a significant backend equity position, but also had an absolute priority in terms of recoupment of the initial investment. Thus an early recoupment position would have seen the government agency taking 100% of net sales revenue (revenue less distribution fees and expenses) until it had recouped its equity investment and then sharing all further revenue with the producer on a 50/50 basis.
- Over the years the production community has argued that the 'subsidy' be regarded as a subsidy of the production business. Broadcasters on the other hand might argue that it exists as a subsidy for broadcasters to correct the market weakness that means they cannot afford the desired quality and quantity of local content. While, both of these notions are to some degree true, it is important that the discussion should be allowed to go wider than producers and broadcasters.
- The producer lobby has been successful in improving what they call 'the terms of trade' with all of the government agencies; but the principal remains the same, the agency takes an equity position in the individual programmes.
- The producer then licences the rights on a territory by territory basis.
- A New Zealand broadcaster is a pre-requisite of agency funding, and producers generally licence to a broadcaster for a standard 3 to 5 plays over a 3 year period. There may also be an initial exclusivity period. ▼



The producer is able to re-licence a programme to broadcaster(s) once initial licence terms permit.

- In the case of the more expensive (and successful) local content, the funding agencies may require the broadcaster to contribute to the cost of the production. They generally do this by way of a 'licence fee' which is paid to the producer. There are some instances where the broadcaster may agree to contribute additional equity on top of the licence fee.
- Again in broad brushstrokes, since the establishment of the New Zealand Film Commission, the taxpayer has directly 'invested' between \$1.5 billion and \$2 billion dollars (excluding tax driven financing of films in the 1980s and Lord of the Rings) in programme production. It has recouped less than 5% of that investment.

The big question then is why does the taxpayer subsidise this business?

It is difficult to see how it could be argued that it was supporting the growth of a new business that will begin to repay the taxpayers' soft equity investment. After 30 years of virtually nil recoupment, the taxpayer cannot sensibly believe that this is going to change in the foreseeable future.

Of course there is a more complex economic modelling job that can be undertaken:

- The film and television sector has a relatively high economic activity multiplier, some suggest around 3.0. So expenditure in the sector is a good contributor to GDP. But are there other industries that would provide a better financial return to the taxpayer and a comparable boost to GDP per dollar invested.
- There can be a tourism spin-off from expenditure in the sector. The spin-off for tourism from Lord of the Rings was huge and Whalerider also had a significant impact.
- The industry has (with considerable additional tax payer support) produced one 'star asset' that has remained in New Zealand and developed a major international business which generates both export dollars and economic activity.
- There are two or three television production companies that have a level of export earnings that is most likely reinvested in industry development.
- Other 'assets' have been created and consistently work off-shore with variable 'payback' for the taxpayer investment.

However, despite these benefits it is difficult to see how the taxpayer can characterise the subsidy as a 'business subsidy' for a start up industry; particularly in relation to television. And if it were a business subsidy wouldn't one expect that there would be a strategy for the phasing out of the subsidy once the industry had found its feet. There is no discussion around phasing out the subsidy. The taxpayer appears to accept that if they want 'local content' they will have to fund it.

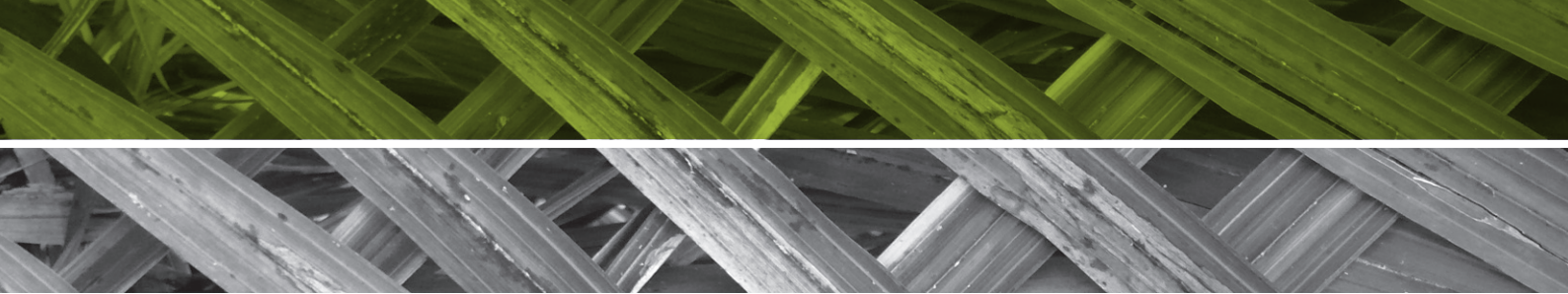
So, if it's not a 'business subsidy', then what is the nature of the subsidy? We believe it has to be termed a 'cultural subsidy'. Of course in the case of Te Māngai Pāho that cultural subsidy carries a Māori Language imperative; if there were not a Māori Language imperative as a result of government failure to deliver on Treaty of Waitangi obligations, there would be no need for Te Māngai Pāho to exist.

It is important to keep in mind that underpinning this thinking is the government's mantra of 'value for money'. For the next financial year Te Māngai Pāho and other agencies in the sector have escaped unscathed, but it is to be expected that during the course of the next financial review there will be a 'line by line' review of expenditure in the sector. (Some agencies expect to lose funding). A line by line review may identify small savings but it makes more sense for us to take a step back and reconsider the nature of what we do and how we might do it better.

So, if we accept that the funding we dispense is a cultural subsidy rather than a business subsidy then it might change our thinking in terms of what the taxpayer actually receives for that expenditure. It might also help clarify our thinking around 'intellectual property rights' and where they sit.

Pending the determination of WAI 262, the copyright in individual programmes almost invariably rests with the producer pursuant to the Copyright Act 1994 and subject to the specific terms upon which the producer has been authorised to use previously copyrighted material and the work of key contributors in the production of the programme.

As outlined above, for its investment, the taxpayer (via the relevant funding agency) currently receives an equity position of rather dubious economic value. From 2002 to 2008 (inclusive) Te Māngai Pāho had total expenditure of \$344,913,000 and recouped just \$161,165 from sales income (less than 0.05%). Not a great business return but a reasonable cultural return from the 500,000 hours of Māori broadcasting created by that investment. It is probably also of concern to the taxpayer that most of that revenue was derived from producers re-licensing the taxpayer funded programmes to local broadcasters or government agencies (Education and Health). ▼



Since the broadcaster is, generally, one or other of the two taxpayer owned broadcasters the net result is that the bulk of all sales income is derived from the taxpayer paying a second time for something that it has already fully funded.

This suggests a number of questions:

- ? Why bother taking the equity position?
- ? Is the taxpayer happy with the value it is getting from this cultural subsidy?
- ? Why should the taxpayer pay twice for something it has fully funded (with a profit margin for the producer)?
- ? What does the taxpayer really want for this cultural subsidy?
- ? How can the return to the taxpayer be improved?

On the evidence thus far there is very little value for the taxpayer in the equity position. New Zealand television has not had a significant international success (Australia by contrast has had several, *Home and Away*, *Neighbours*, *The Wiggles*, *Beyond 2000*). Perhaps the taxpayer equity position exists purely to guard against the possibility of adverse criticism as a result of an individual producer/production company being the sole beneficiary of a taxpayer funded success. Whatever the historical rationale for its existence, there seems little logic in continuing the practice.

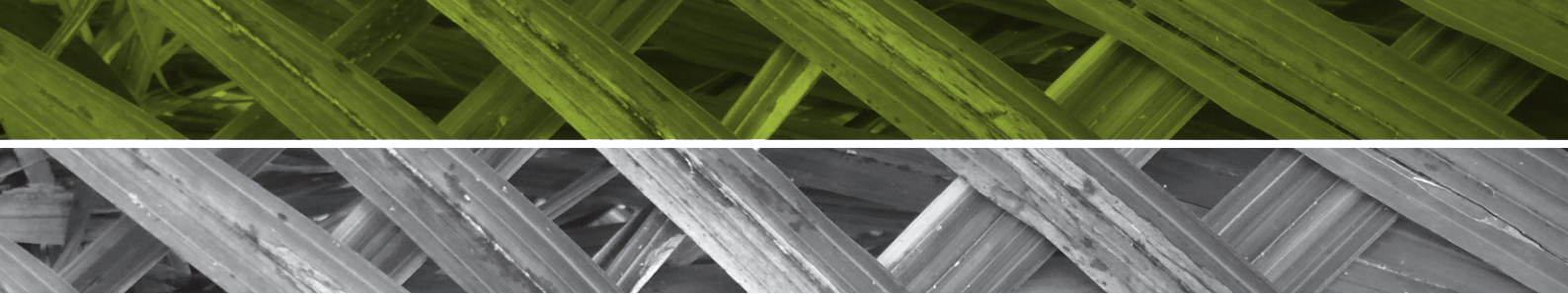
So is the taxpayer happy with the cultural return? On the face of it, it seems so. But we should recognise the risk that the taxpayer may not fully understand the true cost of the cultural subsidy and the paucity of the financial return. Successive governments have maintained the current investment levels and there has been no indication that there is an intention to radically restructure the sector. Nonetheless, it is prudent that we fully understand the logic that supports the subsidy, the nature and quality of the returns the taxpayer receives and how that might be improved. We don't believe the taxpayer would be happy if they understood they often end up paying for the same programme more than once.

What does the taxpayer want for this cultural investment? It is a given that the Te Mangai Paho funding has the primary objective of a Maori language imperative. But put simply in return for its investment in the sector the taxpayer wants to see more of New Zealand on screen. So, what does that mean and is the taxpayer getting the value that it might expect from the investment? It's logical to conclude that more of New Zealand on screen, means ensuring taxpayer funded programmes are available to be seen by as many eyes, as many times, as soon as possible, for as long as possible, and, in this digital age on as many platforms as possible.

How can the existing regime be improved to better serve this definition of more of New Zealand on screen?

First, the taxpayer should secure New Zealand rights in perpetuity. It may need to trade part or all of the equity position it currently takes but based on current returns it will not be losing much. The important benefit that is gained by this change is that all programmes made with taxpayer assistance would be preserved in perpetuity for future generations of New Zealanders. This is currently not the case and there are a number of New Zealand films that are now owned by offshore entities with the result that they are no longer readily available for screening in New Zealand. It would also improve future access to archival material. There are a number of programmes in archives (particularly the TVNZ archive) that are not readily available to screen for various reasons. It makes sense that the bottom line for any taxpayer investment in a programme is that the taxpayer owns in perpetuity the New Zealand rights. ▼





It follows also that as a condition of taxpayer investment the producers are required to secure the necessary clearances to ensure they can rightfully assign New Zealand rights to the taxpayer.

This works equally as well for NZFC and NZOA. In the case of the NZFC the bottom line for NZFC investment should be that the taxpayer (NZFC) gets a licence in perpetuity of the New Zealand rights. One would expect that this would result in a renegotiation of the backend and that the producer would logically be able to secure a greater share of the earnings from outside New Zealand.

The NZFC might also agree to some revenue sharing with the producer from the initial exploitation of the film within New Zealand, although if you take the argument to its logical conclusion you might make the film available free to the taxpayer. We are talking about direct investment by the NZFC and not the incentives provided under the large budget film scheme. The thinking here is that the taxpayer has determined that the incentives under that scheme (and perhaps the SPIF loan scheme) represent what the taxpayer has determined an acceptable cost of buying the economic activity and offshore investment.

In the case of NZOA, there would be a need for minimal change. Where a broadcaster contributes a licence fee as a part of the production financing they would merely pay it to NZ On Air.

Secondly, in the light of the emerging new media there is a need to further review the current 'terms of trade' to ensure that they serve the taxpayers' over-arching goal of seeing more of New Zealand on air. Specifically, this review needs to consider the issue of broadcaster exclusivity periods in respect of both free to air television and new media. Twenty years ago when there were only three television networks one play on a free to air network would in all likelihood deliver a satisfactory return ("audience") on the taxpayer investment. With the audience fragmentation that exists today (and that will, despite blips caused by factors such as an economic downturn, continue to gather pace in the future) one play on a free to air network is unlikely to deliver a satisfactory return. It should be noted that NZ On Air has already moved to a position where programmes that are fully funded by the taxpayer are available for multiple play by any other broadcaster 24 hours after they have been broadcast by the commissioning broadcaster and must be made available to the NZ On Air funded digital domain, NZ Onscreen. By insisting that as a condition of funding producers grant the New Zealander taxpayer a licence of all New Zealand rights in perpetuity, funding bodies will be in a position to ensure that taxpayer funded programmes are available for multiple play across all platforms without further cost to the taxpayer.

All of this of course makes even more sense in respect of funding that comes with a Māori Language imperative. It makes no sense at all to have taxpayer funded language programming locked away from the taxpayer; it needs to be accessible to anyone who wants to see it.