DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

NJS

Econ Pol

✓ MS

From the Secretary of State

The Rt Hon Norman St John-Stevas MP
Chancellor of the Duchy of Lancaster
Cabinet Office
Whitehall
SW1

13 March 1980

Dear Norman,

? rets on string O/O in Private Office

Thank you for your letter of 4 March seeking my views on the likely Parliamentary reaction to the Films Bill. I did not reply earlier as I knew that Norman Tebbit would be dealing with the points you raised at the Legislation Committee meeting on 11 March. In view of the decision at that meeting to defer giving the Bill a place this session until after Cabinet discussion of the programme, I think it might be helpful to explain in some detail why the Bill is needed in this session.

I listed in my letter of 22 February the three imperatives that compel us to put the Bill forward at this time. They are:

a) to renew the power to impose the levy, which expires in September and which is required for future financing of the National Film Finance Corporation (NFFC), in place of the public money which has hitherto supported it;

b) to give effect to the announced financial reconstruction of the NFFC, which is almost out of funds;

c) our undertaking to the Commission to include in the Bill our solution to their Article 169 proceedings.

While all these points are both vital and interdependent it is the film levy, (collected at the box office and thus trade money not Government finance), which is at the heart of the matter. Not only is it to finance

From the Secretary of State

the Corporation in the future, but its distribution provides the strongest incentive we have for foreign financed films to be made in our studios. The producers and the unions would be up in arms if the levy were to lapse. Even if the hiatus were to last only a few months, makers of films contracted to be released in that period could justifiably complain that they had been deprived, by what would appear to be Government ineptitude, of the levy earnings they had budgeted to receive. To restart the machinery of collection would also present practical problems.

I believe that the vital nature of these measures means that there should be no untoward obstruction in either House. Those - and there are not a few - who have the interests of the film industry at heart, will not I think wish to delay what constitutes an essential transfusion for the NFFC and the extension of two powers (the other in the film quota which expires this year) that assist the whole industry.

I do not think any opposition can be long sustained on the case for a British Film Authority (BFA). This is a quite separate and major subject, which is not precluded by this short Bill. I had a formal meeting with Harold Wilson and some of his colleagues a fortnight ago and he accepts that under the present financial circumstances I have taken no decision on a BFA and that the first priority is to sustain the NFFC. Their reaction would however be quite different if we now failed to carry out the reconstruction of the NFFC that I announced in the House last July.

You ask if the Bill could be reduced in scope to give it a clearer financial focus. It already does no more than provide finance for the NFFC and extend the two expiring powers - on one of which the NFFC will depend. The Bill is as lean as it can be, although we have had to add the new very short clause honouring the Treaty obligation on freedom of movement of labour. We undertook to include this if it was accepted

From the Secretary of State

by the Commission, which Davignon has now confirmed. It represents a very generous compromise on the Commission's part. We obtained it after putting considerable pressure on the Commission to the effect that they would be holding up vital UK films legislation if a decision was delayed. If we did not include the short clause giving effect to the compromise arrangement we would be in breach of the understanding with the Commission, not to mention the Treaty, and would run the risk of Article 169 proceedings being re-opened. The detailed provisions arising from the agreement with the Commission have been put aside to be dealt with later by Statutory Instrument so as to keep the Bill as short as possible.

Another problem that would arise from the delay to this Bill is that no other member State has yet reached agreement with the Commission on its film aids. If other States appear to be obdurate the Commission is likely to take a tougher line on film aids, but if our legislation has already gone through with their blessing, desirable but possibly contentious aspects of our system will be safe.

It was suggested at "L" Committee that the exclusion of the EC clause would enable the Bill to be certified as a money Bill, which would speed up its progress through the Lords. I understand that even without the EC clause the Bill could not be so certified as it would still include provisions for the Eady levy. This money is not exchequer money. It represents a system of redistributing film industry money within the industry. As the levy provisions are the main reason for legislating during this session, clearly there is no possibility of excluding them from the Bill.

I appreciate the problem the legislative programme now presents, but I believe that this short Bill, delayed by our successful negotiations with the Commission, cannot be allowed to fail to achieve Assent this session without incommensurate damage to our credibility.

From the Secretary of State

My policy statement last July in the House explained the basis for the present Films Bill, and certainly the industry interpreted it as such. You agreed in your letter of 28 September to Norman Tebbit to the introduction of a Bill which would secure Royal Assent by September 1980. In response to an oral PQ in November I confirmed that we were hoping to present a Bill this session. I have little doubt that failure to enact a Bill during the present session will so disappoint the reasonable expectations of legislation within the film industry, Parliament and in the Commission that we will suffer much time-consuming and often bitter criticism.

I am copying this letter to our Cabinet colleagues, to the Chief Whips in both Houses and to Robert Ferrers. I am also sending a copy to First Parliamentary Counsel and to Sir Robert Armstrong.

Yours ever

John.

JOHN NOTT

Econ Pol.

CONFIDENTIAL

PCC (80) 6

✓ MJS

FILMS BILL

It is hoped that Members will find the attached notes useful for the debate at Second Reading on Friday, 25th April 1980.

Contents

Conservative Research Department,
32 Smith Square, London SW1

RN/JV
24.4.80

1. Purpose of the Bill

The purpose of the Bill is essentially two-fold:-

i) To prolong to 1985 the existence of the National Film Finance Corporation with additional powers, and to put it on a new and more sound financial footing, by writing off its accumulated debts of £12.9 million which it has no prospect of repaying, by diverting to it at least £1.5 million a year from the Eady levy, and by permitting it to borrow increased sums on the market without Treasury guarantee, thus discontinuing the 30 year drain on public expenditure whilst providing improved assistance for British films;

ii) To extend to the end of 1985 the quota system and the Eady levy, which would otherwise expire this year, for the benefit of the British film industry, and to allow for the suspension of the quota in certain circumstances, to redefine the quota entitlements as required by the Treaty of Rome, and to make certain technical changes.

2. The National Film Finance Corporation

The NFFC, which took over the assets and liabilities of the National Film Finance Company Limited, was established by the Cinematograph Film Production (Special Loans) Act 1949 for the purpose of making loans for the production and distribution of films. It was itself funded by loans from the Board of Trade, with the maximum aggregate amount of principal outstanding at any one time fixed at £5 million, and was intended to operate thereafter on a self-financing basis. If the Treasury were satisfied that there was no sufficient reason for the NFFC to continue in being, it was empowered to dissolve it. The provisions were expressed to run for 5 years.

It was not - and never has been - required to confine its assistance to British films, although in practice it has always done so. But it is important to note that the Bill was designed to provide only a temporary boost to the British film industry, and not a continuing means of subsidy, at a time of acute dollar shortage and balance of payments constraints which would have been aggravated by an excessive import of American films. As the President of the Board of Trade, Mr. Harold Wilson, said on Second Reading:

> "The money that is being provided is limited to £5 million, and the duration of the scheme is limited in time. All loans must be repayable within five years, and after five years from the passing of this Bill new lending must cease. These limits were, of course, set quite deliberately. The industry must so manage its affairs that in five years' time it can raise money on its own credit in the normal way, just as any other industry needing large-scale finance must do. The Government have no intention of subsidising the film industry. I have said that on a number of occasions, and I hope that fact has been well marked in the industry itself" (Hansard, 2nd December 1948, Col. 2188).

The repayment limit was increased to £6 million by the CFP (Sp. L) Act 1950, the NFFC was permitted to borrow on the private market up to a limit of £2 million by the CFP (Sp. L) Act 1952, and the provisions were extended for 3 years by the CFP (Sp. L) Act 1954. However, s.1(i)(b) of the 1948 Act had imposed a condition on the NFFC that its loans could be made only to those who "while having reasonable expectations of being able to arrange for the production or distribution of cinematograph films on a commercially successful basis, are not for the time being in a position otherwise to obtain

..../

adequate financial facilities for the purpose on reasonable terms from an appropriate source". This made the NFFC inherently unprofitable from the beginning. As the President of the Board of Trade, <u>Sir David Eccles</u>, explained on the Second Reading of the Cinematograph Films Bill 1957:

> "When the Labour Government set up the National Film Finance Corporation there was no levy. The risk was, therefore, great that a film would fail to earn enough to cover the cost of production. Under those conditions it was not surprising that the Corporation was to lend only to producers who could not get their money elsewhere and that in doing so the Corporation made losses" (<u>Hansard</u>, 27th February, Col. 1237).

The prime objective of the 1957 Act was thus to assist film producers and employees by making the levy (which had existed since 1950 on a purely voluntary basis) statutory, in consequence of which it was supposed that the NFFC would receive more adequate returns on its loans to producers. The condition in s.1(i)(b) of the 1948 Act was repealed, and s.11 obliged the NFFC to pay its way in respect of loans received after the passing of the Act. As <u>Sir David</u> reiterated, "It is necessary to make this clear - that the Governemnt do not intend to subsidise the production of films through the Corporation" (Col. 1238). It was further envisaged that British producers, enriched with receipts from the levy, might render the NFFC obsolete, and s.12 accordingly provided for the possibility of a British company buying it up. The relevant provisions in previous Acts were renewed for 10 years, and the Films Act 1966 extended them for a further 3 years.

The Labour Government's Films Act 1970 increased the NFFC's repayments limit to £11 million, provided for it to participate in joint ventures with private capital, permitted it to make loans to producers and distributors for the additional purpose of acquiring script copyrights, and wrote off its liability to repay interest on loans made between 1954 and 1964 falling due after the passing of the Act. The joint venture arrangements led to the establishment of a Consortium, a partly owned subsidiary with a total fund of £1.75 million, of which £750,000 was contributed by private sector partners. Another subsidiary, the National Film Development Fund, was set up by the Cinematograph Films Act 1975, with limited funding from the levy for the purpose of financing pre-production work, mainly script-writing.

The NFFC has now reached its ceiling of £11 million principal owing to the Government, and owes a further £1.9 million in interest. There is no practical possibility of this money being repaid. In order to decide whether the NFFC should continue in existence, and if so with what source of finance, one has first to consider the overall position of the British film industry and other existing means of support.

..../

3. The Quota

The most ancient means of support for the British film industry is the quota system, which was established by the Cinematograph Films Act 1928 and subsequently consolidated in the Films Act 1960, to run for 7 years. The 1966 Act extended the provisions for 3 years, and the 1970 Act prolonged them to the end of 1980. They obliged exhibitors to ensure that at least 30 per cent of the films they showed were British. A film was defined as British if (i) its makerwas a British subject or company, and if the latter, that the majority of directors were British; and (ii) it was made in a British studio or on location in Britain; and (iii) a specified proportion of labour costs were payments to British subjects. "British" was taken to include the Republic of Ireland and the Commonwealth, and s.8 of the European Communities Act 1972 added Community films to the beneficiaries.

The quota has been understandably popular with British film producers and particularly with the trade unions, but resented by the distributors and exhibitors, as much for the excessive bureaucracy involved in complying with the requirements as for the smaller audiences resulting. It does seem to run counter to what one would normally expect of a market, as was noted by the Second Report of the Interim Action Committee on the Film Industry:

> "To the extent that the quota obliges cinema exhibitors to replace foreign films with British films which bring in less money, the exhibitors are bearing a financial penalty for supporting domestic production. Ironically the Eady fund thereby receives less money than it otherwise would, and thus the benefit of the quota to the producer is to some extent diminished."

The addition of Community films to eligbility and the use of cheap sex films to achieve the quota prompted the Cinematographic Films Council to set up a sub-committee to review the system. In its latest annual report (30th October 1979, HC218), it made the following recommendation:

> "The sub-committee considers that the quota system does not fulfil its original purpose of stimulating British film production and can require the screening of films that exhibitors consider undesirable. It therefore recommends the introduction as soon as parliamentary business allows, of legislation which would suspend quota requirements, with power to review such suspension and to reintroduce some such requirements if it were found necessary. It additionally recommends that this suspension should not preclude consideration of the levy or of other means to encourage the production of British films."

While renewing the existing quota obligations to the end of 1985 in Clause 5 of the Bill, the Government are giving effect to this advice with careful qualifications in Clause 7, and it should be seen as an experiment the results of which would be valuable in themselves, not as a final decision taken without regard to its practical consequences. In addition, two technical amendments are being made. The first arises from the recent growth in multi-cinema complexes. It is an obvious absurdity that films have to be moved from one screen to another within the same building in order to satisfy the quota requirements for each individual cinema, and Clause 6 therefore enables the requirements to be satisfied by the building as a whole. The second change relates to the restriction of quota benefits to films with British labour costs, which is in breach of Article 48 of the Treaty of Rome. Clause 8 therefore enables the labour costs of a film registered as British to include payments to citizens of other member states. The regulations will subsequently be amended to confine eligibility to British films which are actually made or processed in Britain, so there is little danger of EEC films gaining at British expense.

..../

4. The Eady Levy

The Eady Levy, named after a civil servant called Sir Wilfred Eady, is a levy on exhibitors' takings which is distributed to British film producers and various bodies. It was set up on a voluntary basis by Mr. Wilson in 1950 and put on a statutory basis for 10 years by the 1957 Act, which set up the British Film Fund Agency to distribute the proceeds after making a small grant to the Children's Film Foundation Ltd. It yielded £3.25 million in the following year. This was extended for 3 years by the 1966 Act and for a further 10 years by the 1970 Act, i.e. until October 1980, which attests to the urgency of the Bill. The latter also enabled the BFFA to make grants to the British Film Institute and the National Film School, and the 1975 Act enabled it to make grants to the NFDF, as mentioned above.

The annual yields from the levy remained steady at about £5 million for a number of years in the early mid-1970s as higher seat prices offset a fall in cinema attendances. The BFFA's latest annual report (24th July 1979, HC189) showed that the levy yielded £6.6 million in the year to September 1978, of which £248,000 was given to the CFFL, £80,000 to the NFFC on behalf of the NFDF, £33,000 to the BFI and £26,000 to the NFS. It subsequently rose to about £7 million, despite changes in the regulations in 1978 which were estimated to cut the yield by £2 million.

The regulations under the Acts which govern the collection and distribution have recently been amended (Lords Hansard, 13th December 1979, Cols. 1396-1404). In order to provide relief for hard-pressed exhibitors, the exemption threshold of weekly takings was raised from £1,100 to £1,400, the marginal rate of levy was reduced from 25 to 20 per cent and the normal rate was changed from one-ninth of the ticket price less 1½ pence to one-twelfth of the price, in both cases net of VAT In order to prevent immensely successful long films, and short films which had the good fortune to be featured with them, from taking a disproportionate share of the levy, maximum ceilings of £500,000 and £50,000 were introduced for each. And the 2½ times multiplier for low-cost long films, which was originally designed to benefit films made specially for second features but now gives notorious assistance to cheap sex films, has been abolished. As Lord Trefgarne said: "It has understandably been suggested that such films should receive no levy, but the levy system is not an appropriate for censorship" (Cols. 1404-2). Censorship already exists: it originated under the Cinematograph Films Act 1909, and is now exercised by the GLC and district councils elsewhere as licensing authorities, whose normal practice is to go along with the recommendations of the British Board of Film Censors.

The new regulations were welcomed by the Opposition and are estimated to cut the yield by £1½-2 million in a full year. Nevertheless, the levy is expected to yield an annual £6-7 million and to boost the average gross receipts of qualifying films by about half. Nor (unlike the quota) does it extend to Community films. It is thus an extremely important and reasonably popular source of finance to the British film industry.

5. Financial Reconstruction

Sir Leo Pliatzky's Review of Policy on Film Finance, published in June 1979, revealed that since the war the number of screens had dropped by two-thirds and the number of admissions by over 90 per cent, owing mainly to the rise of television. Flea-pits in the provinces have disappeared almost entirely, and only parts of the West End can guarantee full capacity. Nonetheless, there were 127 million cinema admissions in 1978 (with box office takings of £120 million), which is 3 to 4 times the number of theatre admissions and 5 times the number of football league admissions. Employment is impossible to estimate, apart from about 12,000 people employed in exhibition, partly because the industry is internationally very mobile and partly because of the interchange between films and television. It is

..../

dependent far more on American investment, which amounts to some two-thirds of British film production, than on Government support. For example, American investment dropped from £173 million between 1965-71 to £66 million between 1972-77, which resulted in drastic cuts in the permanent staff at the studios. No Government could ever contemplate making up that level of difference.

The question of whether the state should have any business at all in the financing of British films has been much discussed, and most people conclude that it should, not for reasons of job "creation" but because certainly the quality and probably the existence of genuinely British films, reflecting a British way of life and satisfying British tastes, would be endangered if commercial success depended solely on the giant American distribution circuit, which generates 60 per cent of world gross receipts as against 4 per cent for the UK. Support from the NFFC and the Eady levy can make all the difference between whether a film is or is not made, and the very prospect of support is a catalyst for development. The NFFC has advanced over £31 million and contributed to the financing of more than 750 feature films and 170 short films, at a net cost to the taxpayer of £70,000 a year, which may be considered an impressive record. But public expenditure constraints rule out a continuing Government subsidy, and there is no question in any case of the NFFC now supporting 50 films a year as it did in the 1950s.

Sir Leo's review pointed clearly to the eventual solution, which was announced by the Secretary of State for Trade, Mr. John Nott, on 26th July 1979 (*Hansard*, Cols. 395-6) and incorporated into the Bill. The NFFC's debts will be written off, and a £1 million loan was announced on March 4th to enable it to function until the proposals are enacted. It will receive a final grant from the Government of £1 million, and an annual grant of £1.5 million or 20 per cent of the Eady fund, whichever is the greater. Its commercial borrowing limit will be raised from £2 to £5 million, and there will be no Treasury guarantee aside from the possibility of dissolution. Various Government controls over its activities will be removed, and it will be empowered to make loans or otherwise give financial assistance for pre-production purposes. The arrangements will come up for renewal at the end of 1985.

This package gives the NFFC two things it has always lacked - an assured annual income, and one which will not have to be repaid. The NFFC, in its latest annual report (3rd March 1980, HC456) reckoned that it will be enabled to support 4 or 5 films a year, which is an improvement on the average of 3½ over the past 5 years. Although its commercial borrowing powers were used only once in the 1950s, its new structure will be conducive to regular short-term borrowing. The most important decision the Government had to make was to determine the proportion of the Eady fund to be distributed on a fixed basis under the regulations as against a discretionary basis by the NFFC, and the vast majority of the film industry has strongly welcomed the continuation of the fixed basis of allocation of the greater part of the fund. The Government's decision also follows the recommendation of the Prime Minister's Working Party in January 1976 that " it would be wholly in keeping with the principles on which the Eady levy was based for one-fifth of its total annual yield not exceeding £1 million to form part of any new resources".

6. Other Matters

The first major review of films policy was initiated by Mr. Wilson's appointment of the Prime Minister's Working Party, chaired by Mr. John Terry, in August 1975. Its report 'The Future of the British Film Industry' (January 1976, Cmnd. 6372) contained 39 recommendations including the proposal that a British Film Authority should assume responsibility for film functions at present exercised by the Departments of Trade and Education. It would absorb the Cinematographic Films Council (established by the Cinematographic Films Act 1938 as an advisory body with representatives of all the different

..../

nterests, which has proved detrimental to a united approach), and lso the NFFC. This was supported by the first report of the Interim ction Committee on The Film Industry, 'Proposals for the setting up f a British Film Authority' (January 1978, Cmnd. 7071), which had een appointed by Mr. Edmund Dell in April 1977 with Sir Harold Wilson s its chairman. The British Film Producers' Association also avours the proposal on the grounds that it would be a strong voice or the industry in overseas promotion, e.g. at the Cannes film estival. The Government have not yet come to a conclusion, but it ould require major legislation for which there is no time in the resent Bill.

The IAC'ssecond report was entitled 'The Financing of the ritish Film Industry' (June 1979, Cmnd. 7579), and its third report as entitled 'Statistics, Technological Developments and Cable elevision' (March 1980, Cmnd. 7855). There are 2 more reports to ome. The fourth, expected in the summer, will cover trade practices nd the barring and allocation of product, and will doubtless also e concerned with the consequences of four distributors (EMI, Rank, lassic and Star) owning half the screens in the country, mainly he best ones. Producers frequently assign their pre-production rights nd profits to distributors, and there continues to be controversy espite the Monopolies Commission's 'Report on the Supply of Films or Exhibition in Cinemas' (1966, HC206) and the extension of estrictive practices legislation to services in 1976. The Commission aid that the only solution to the imbalance would be the drastic ne of breaking up the circuits; instead, an independent Trade isputes Committee was established as a means of appeal. While only tenth of all films make a profit, thus causing distributors to rely n recouping their losses from blockbusters, the Government are not omplacent about the present position. The IAC's fifth report will over relations between the film industry and television, such as hether part of the levy on the excess profits of the Independent elevision Companies should be diverted to film production, whether xpenditure by ITV companies on the production of films for initial howing in cinemas should be deductable for the purpose of the levy, nd what principles should govern the televising of films produced for he cinema.

onservative Research Dept.,
2 Smith Square, London SW1

RN/JV
24.4.80