

# Competition *policy brief*

Occasional discussion papers by the Competition Directorate-General of the European Commission

## State aid rules for films and other audiovisual works

### 1. Introduction

On 16 November 2013, the Communication on State aid for films and other audiovisual works entered into force<sup>1</sup>. This new "Cinema Communication" provides an updated set of rules for assessing whether Member States' audiovisual support schemes comply with EU rules on State aid. It gives clarity to market players on the criteria that the Commission will apply when examining notifications by Member States.

#### In a nutshell

The new state aid rules:

- modernise the Commission's criteria to assess audiovisual support schemes;
- exempt from prior notification schemes below 50 million euros per year
- strike the right balance among economic, cultural and legal concerns, ensuring continued legal certainty.

The review of the rules in the Cinema Communication of 2001<sup>2</sup> was extensive and reflects the important role films and other audiovisual works play in Europe at the crossroads of culture and the economy. On the one hand, European audiovisual production is an important source of creativity and cultural diversity – one that contributes to defining European identity. On the

other hand, cinema is an industry, which has a European dimension. Its activities, just like those of other sectors, are embedded in the EU Single Market. While the EU film sector is dependent on state support – whether at sub-national, national or supranational level. – a common framework for State aid is

needed to ensure such subsidies are in the common interest and a level playing field is preserved.

State aid to promote culture is allowed by the Treaty on the Functioning of the European Union (TFEU) through a specific derogation (Article 107(3)(d)). Taking into account the particular nature of the audiovisual sector, the Commission established specific criteria in the Cinema Communication for assessing the compatibility of audiovisual support. These criteria aim to achieve a balance among economic, cultural and legal concerns.

By tackling a number of recent sector evolutions and support trends, the new Cinema Communication ensures continued legal certainty, to the advantage of Member States, sector professionals and – ultimately – European audiences.

### 2. The European film industry

The European film industry is characterised by a number of important strengths and weaknesses.

First of all, the EU is one of the largest film producers in the world. In 2011, its film industry produced 1,336 feature films, compared to 817 in the US, 1,255 in India and 588 in China. The European film consumption market is large as well, with 954 million cinema admissions in 2011, compared to 1,285 million in North America, 370 million in China and 3,000 million in India.<sup>3</sup>

However, the European film sector suffers from an apparent disconnection between supply and demand, as the United States is the largest presence in Europe's audiovisual markets. In terms of cinema admissions, for instance, US films typically account for 60-65% of the market, versus 25-30% for European films<sup>4</sup>.

<sup>1</sup> Communication from the Commission on State aid for films and other audiovisual works, OJ C 332 of 15 November 2013, p. 1.

<sup>2</sup> Communication from the Commission on certain legal aspects relating to cinematographic and other audiovisual works, COM/2001/0534 final, OJ C 43 of 16 February 2002 p. 6.

<sup>3</sup> European Audiovisual Observatory (2013). *Focus 2013 – World Film Market Trends*. Cannes/Strasbourg: European Audiovisual Observatory.

<sup>4</sup> Source: European Audiovisual Observatory. Lumiere Database (May 2013 data).

### EU market shares by origin 2008-2012 (in % of total cinema admissions)<sup>5</sup>

Region	2008	2009	2010	2011	2012 (estimates)
US	65.5%	67.0%	68.4%	61.8%	62.8%
EUR inc/US co-productions	4.4%	4.1%	5.0%	8.1%	2.1%
Films EU total (excluding EUR inc films)	28.4%	26.4%	24.9%	28.0%	33.6%
Other European films	0.4%	0.2%	0.4%	0.3%	0.1%
Other regions	1.3%	2.2%	1.4%	1.8%	1.5%

The causes and origins of this imbalance are multiple and complex, but it is clear that the European audiovisual sector is hampered by a number of structural weaknesses. The market for European films is fragmented along linguistic and cultural lines and market players are predominantly SMEs<sup>6</sup>. While this fragmentation reflects positively in the culturally diverse output, it represents a significant challenge for access to finance and markets. The audiovisual sector is a high-risk, prototype industry, so the integrated nature of the major US studios, their large domestic market as well as their much higher production and marketing budgets are very difficult for these small European players to challenge. The linguistic and cultural differences add to this and limit the cross-border circulation of European audiovisual works within Europe even further.

Out of concern about this situation, a tradition of public support for audiovisual production took root in Europe shortly after World War II<sup>7</sup>. A 2011 study estimates that, in 2009, the total amount of audiovisual support spent in Europe reached almost EUR 2.1 billion<sup>8</sup>. This figure does not take into account tax incentives for production, which represent an estimated annual EUR 1 billion<sup>9</sup>. The level of audiovisual spending varies among countries, however, with five Member States (France, Great Britain, Germany, Italy and Spain) accounting for 37% of total support granted in 2009. In addition to national support schemes, a large number of funds at sub-national levels (community, regional and

<sup>5</sup> Ibidem.

<sup>6</sup> According to a *Study on the Entrepreneurial dimension of the Cultural and Creative Industries*, around 80% of CCI enterprises are sole traders or small enterprises employing only a handful of people (Utrecht School of the Arts et al. (2011), available at [http://ec.europa.eu/culture/key-documents/doc/studies/entrepreneurial/EDCCI\\_report.pdf](http://ec.europa.eu/culture/key-documents/doc/studies/entrepreneurial/EDCCI_report.pdf)).

<sup>7</sup> For details cf. European Audiovisual Observatory Report 2011, *Public Funding for Film and Audiovisual Works in Europe*, Strasbourg, 2011, p.131 et seq.

<sup>8</sup> The study could not collect data for all 280 public funding bodies identified, so these figures are based on an analysis of 249 funds. European Audiovisual Observatory (2011). *Public funding for film and audiovisual works in Europe*. Strasbourg: European Audiovisual Observatory.

<sup>9</sup> European Audiovisual Observatory (2011). *Op.Cit.*; Cambridge Econometrics et al. (2008). *Study on the economic and cultural impact, notably on co-productions, of territorialisation clauses of state aid schemes for films and audiovisual productions*. Available at [http://ec.europa.eu/avpolicy/docs/library/studies/territo/final\\_rep.pdf](http://ec.europa.eu/avpolicy/docs/library/studies/territo/final_rep.pdf).

local) offer film support which accounts for 23% of the overall available funds (2009 data)<sup>10</sup>. Moreover, European support measures (mainly the MEDIA<sup>11</sup> programmes (EU) and Eurimages (Council of Europe)) were developed at the supranational level, particularly targeted at tackling the limited cross-border circulation of European audiovisual works.

### 3. Why control State aid for films?

The Treaty recognises the importance of promoting culture for the EU and its Member States. Films are an important form of cultural expression, but they are also an economic good which is traded via various platforms. The UNESCO Convention on the Protection and Promotion of the Diversity of Cultural Expressions of 2005<sup>12</sup> notes that the fact that a film is commercial doesn't prevent it from being cultural. But being a cultural activity also doesn't exclude its commercial character. Thus the State aid rules apply to financial support for the sector.

Even if the transnational distribution of European audiovisual works is limited, it's clear that the sector also has an important international dimension. As audiovisual works are traded internationally, support granted at Member State level is liable to affect trade between Member States. The undertakings and audiovisual works that receive support are likely to have a financial and therefore competitive advantage over those that do not. Consequently, such support may distort competition among market players and is considered State aid according to Article 107(1) TFEU. So the Commission, as the EU's State aid control authority, has to assess Member States' support mechanisms for the audiovisual sector.

The Commission has always fully recognised the value and necessity of public support to film production. It assessed such support schemes under Article 107(3)(d) TFEU, which provides for the possibility to grant aid to promote culture. By developing an assessment framework, the Commission ensures that cultural audiovisual support does not unduly disrupt the EU internal market. The Cinema Communication, together with the new General Block Exemption Regulation<sup>13</sup>, forms the main pillar of this framework. All audiovisual support schemes fall under one of these two sets of rules.

<sup>10</sup> European Audiovisual Observatory (2011). *Op.Cit.*

<sup>11</sup> Now integrated under the Creative Europe banner.

<sup>12</sup> The Convention states in Article 4(4): "Cultural activities, goods and services refers to those activities, goods and services, which ... embody or convey cultural expressions, irrespective of the commercial value they may have. Cultural activities may be an end in themselves, or they may contribute to the production of cultural goods and services."

<sup>13</sup> Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, OJ L 187 of 26 June 2014, p. 1.

#### 4. An evolving sector in need of evolving guidelines

The Commission's State aid control practice in this area (around 20 decisions per year) started to take shape following a 1998 decision on a French aid scheme for film production<sup>14</sup>. In this decision the Commission first established specific criteria to assess audiovisual aid under the culture derogation of Article 107(3)(d) TFEU. More specific criteria to assess this kind of State aid were described for the first time in the 2001 Cinema Communication. Those criteria were in force until the end of 2012. On 16 November 2013, the successor regime, the 2013 Cinema Communication, entered into force.

A thorough review had become necessary because the audiovisual sector had evolved considerably in the preceding decade.

New (digital) technologies have been introduced across the traditional value chain. They have affected the production, distribution and exhibition of works, right up to their preservation for future generations. Many of the sector's core elements, such as screening films publicly on 35 mm film, are undergoing a digital transition that brings with it new and redefined business relationships. Linked to this, consumer behaviour and audience expectations have changed significantly. As a result, the traditional underpinnings of film circulation, including the release windows system, are challenged as new ways of distributing and consuming audiovisual works come to the fore.

From a European perspective, these digital evolutions offer new opportunities to increase cross-border circulation of films. But they bring with them a number of challenges as well, as traditional film financing and business models are being reconfigured.

At the policy level, these challenges and opportunities may translate into setting up new aid schemes or modifying existing ones. For instance, some Member States set up support schemes to assist rural and/or art-house cinemas in completing their transition to digital projection, whereas others introduced support schemes for trans-media works or games.

More generally, a comparison of 2009 and 2002 data on audiovisual support allocation in Europe shows a gradual reduction in support for production, while support for promotion, for example, increased its share.

#### Evolution in funding body spend 2002-2009<sup>15</sup>

Activity	2002		2009		2009/2002
	EUR thousand	%	EUR thousand	%	%
Creation	813 495	77.1%	1 339 636	73.9%	65%
Distribution	109 688	1.4%	169 949	9.4%	55%
Exhibition	104 313	9.9%	125 096	6.9%	20%
Promotion	14 949	1.4%	71 560	4.0%	379%
Training	8 539	0.8%	36 074	2.0%	322%
Company development	2 416	0.2%	12 414	0.7%	414%
Film culture/R&D	1 195	0.1%	56 839	3.1%	4657%
Total	1 054 595	100.0%	1 811 567	100.0%	72%

Moreover, while many schemes follow the model for which the 2001 assessment criteria were designed (direct grants, the size of which is determined as a percentage of production budget), a growing number of Member States introduced schemes that define the aid amount as a percentage of the production expenditure within the territory (often in the form of a tax incentive).

In many cases, the 2001 Cinema Communication didn't cover such types of aid. The Commission applied the criteria of the Cinema Communication by analogy in order to assess the aid's necessity, proportionality and adequacy, but it was clear that this situation did not offer sufficient legal certainty. Consequently, the 2013 Cinema Communication is an important update to the audiovisual State aid assessment framework. It takes account of how the European audiovisual industry has evolved. The new rules will contribute to the continued viability and competitiveness of the European audiovisual sector.

#### 5. The main issues of the Cinema Communication review

The 2013 Cinema Communication covers State aid for a wider scope of activities, highlights the principle of subsidiarity in the area of cultural policy and respect of internal market principles, introduces a higher maximum aid intensity level for cross-border productions, and caters for the protection of and access to film heritage.

An extensive review process preceded the adoption of this new set of rules. This review was launched on 20 June 2011 with the first of three rounds of public consultation.

<sup>14</sup> Commission Decision of 29 July 1998 in case N 3/98, *Soutien à la production cinématographique*, OJ C 279, 8.9.1998, p. 4.

<sup>15</sup> European Audiovisual Observatory (2011). *Op.Cit.*, p.55. In order to make the figures for 2009 and 2002 comparable, the 2009 data were adjusted. As a result they do not correspond to the total funding spend mentioned elsewhere.

The Commission set objectives for the review:

- Preserving European film production and cultural diversity;
- Competitiveness of the European audiovisual sector;
- Quality and range of choice for audiences;
- Promoting transnational circulation of European audiovisual works;
- Transparency and legal certainty;
- Reduced administrative burden for Member States and the Commission;
- Respect of internal market principles; and
- Respect of the subsidiarity principle.

### **The scope of the rules**

The 2013 Cinema Communication takes into account the fact that Member States may grant aid to activities other than film production, like script-writing, development, film distribution, promotion, or for cinemas. The old rules focused on aid for production, whereas these other types of support didn't pose a competition problem. Yet the aim of protecting and promoting Europe's cultural diversity through audiovisual works can only be achieved if audiences see these works. Aid to production alone risks stimulating the supply of audiovisual content without ensuring that the results are properly distributed and promoted.

Therefore, the new rules cover all aspects of film creation, from story concept to delivery to the audience. They also clarify that aid to cinemas will be assessed under Article 107(3)d) TFEU as aid to promote culture.

Conversely, the new rules do not include provisions on aid to video games. They represent a fast-growing form of mass media, and this market is evolving considerably without needing the help of large amounts of State aid. Furthermore, not all games necessarily qualify as audiovisual works or cultural products. Their characteristics regarding production, distribution, marketing, and consumption are also different from those of films. Such aid therefore needs closer assessment of its justification and merits<sup>16</sup>.

<sup>16</sup> See Commission Decision of 27 March 2014 in case SA.36139, UK video games tax relief (IP/14/331, [http://europa.eu/rapid/press-release\\_IP-14-331\\_en.htm](http://europa.eu/rapid/press-release_IP-14-331_en.htm)) and the decisions in case SA.33943, France - Prolongation du régime d'aide C 47/2006, Crédit d'impôt en faveur de la création de jeux vidéo, OJ C 230, 1.8.2012, p. 3 (IP/12/399, [http://europa.eu/rapid/press-release\\_IP-12-399\\_en.htm?locale=en](http://europa.eu/rapid/press-release_IP-12-399_en.htm?locale=en)), and in case C 47/2006, France - Crédit d'impôt en faveur de la création de jeux vidéo, OJ L 118, 6.5.2008, p. 16 (IP/07/1908, [http://europa.eu/rapid/press-release\\_IP-07-1908\\_en.htm](http://europa.eu/rapid/press-release_IP-07-1908_en.htm))

### **The territorial spending conditions**

Territorial spending obligations in film funding schemes require that a certain part of the supported film budget be spent in the aid-granting Member State. The 2001 Cinema Communication allowed Member States to tie 80% of the entire film budget to local spending. While such requirements may be justified to ensure the continued presence of the human skills and technical expertise required for cultural creation, they also fragment the EU internal market for the provision of goods and services and contradict the principles of free movement. So it is important to strike the right balance when setting up such conditions.

During the public consultation on the Cinema Communication, many Member States and in particular the film producers ardently defended the high level of possible territorial restrictions and argued against the full application of internal market freedoms in this area. It is not established whether such an approach really helps the local film sector and better achieves the cultural objectives of public support. Yet the main stakeholders were concerned that without guaranteed local economic benefits, it would be difficult to convince governments and parliaments to agree to make public funds available for film production.

The Commission has always accepted the legitimacy of some territorial spending conditions, in light of the need to preserve know-how at national and local levels in a context where film production is extremely mobile. However, to comply with Treaty rules, territorial restrictions may be acceptable only when they pursue an overriding reason of general interest, and when they are necessary and suitable for securing the attainment of that objective. Promoting cultural diversity may constitute an overriding requirement of general interest. However, in order to make sure that the restrictions are not excessive and comply with the requirements of EU law, the amount of expenditure subject to territorial spending obligations should at least be proportionate to the Member State's actual financial commitment.

For these reasons, in the new Communication the Commission limited the maximum level of territorial production activity that can be required as an eligibility condition to 50% of the production budget. Moreover, if the aid amount is calculated as a percentage of the budget, the territorial spending obligation cannot be higher than 160% of the aid amount. The Commission will also continue to accept aid awarded as a percentage of the expenditure on production activity in the granting Member State. In both cases, the expenditure that can be subject to territorial spending obligations remains limited to 80% of the production budget. These provisions will ensure that territorial obligations remain proportionate and do not risk infringing Treaty rules, in the interest of all players in the sector.

### **The cultural test**

One of the criteria of the 2001 Cinema Communication, the application of the "cultural test" requiring verifiable cultural

criteria, had raised issues in practice. The cultural test is there to ascertain that the aid goes to cultural activities and products, and is not misused for other purposes. This is one of the conditions for aid to be compatible under Article 107(3)(d) TFEU as aid to promote culture. However, the Commission's detailed scrutiny of cultural criteria in film support schemes had been controversial with Member States. Under the Treaty, cultural policy falls primarily under the responsibility of Member States, and thus also the determination of what qualifies as cultural activity.

The new Communication clarifies that in assessing an audiovisual support scheme, the Commission's role is limited to verifying whether a Member State has a relevant, effective verification mechanism in place. This would be achieved through the existence of either a cultural selection process to determine which audiovisual works should benefit from aid, or a cultural profile to be fulfilled by all audiovisual works as a condition of the aid. The Commission will not review the detailed criteria used by the Member States in their assessment.

### ***The aid intensity levels***

The 2013 Cinema Communication confirmed the appropriateness of the established maximum aid intensities of 50% of the production budget, and no limits for difficult and low budget films whose impact on trade and competition is very marginal. There are no limits on aid intensities for script-writing or film project development, as long as this aid is subsequently taken into account for the calculation of the maximum aid intensities of the resulting audiovisual productions.

It noted, however, a shortcoming in the European film market: only a few European films are distributed outside their production territories. But the likelihood of a European film being released in several Member States is higher in the case of co-productions involving producers from several countries. Hence co-operation among producers from different Member States for producing European works is important. This led the Commission to allow a higher aid intensity of 60% for co-productions funded by more than one Member State and involving producers from more than one Member State. This will support audiovisual creation with a genuinely European dimension.

Distribution and promotion activities may be supported with the same aid intensities as they were (or could have been) for their production.

### ***Luring large film productions***

When the 2001 Cinema Communication was adopted, few Member States tried to use film aid to attract major foreign film projects to be produced in their territory. Since then, this has become a major issue. Several Member States introduced schemes – in particular tax advantages – with the aim of attracting high profile productions to Europe, in global competition with locations and facilities elsewhere, such as in the United States, Canada, New Zealand, or Australia. The public consultation on the new Communication addressed this issue

because the Commission feared a damaging subsidy race among Member States.

The majority of Member States and stakeholders argued that these productions were necessary to maintain a high quality audiovisual infrastructure, to contribute to the use of high class studio facilities, equipment and staff, and to contribute to transfer of technology, know-how and expertise. The partial employment of facilities by foreign productions would also contribute to realising high quality and high profile European productions.

In practical terms it is also difficult to make a reliable distinction between European and non-European works. Apart from the fact that the label "European" alone doesn't make a film more "cultural" than others, many of the films which seem to be major third country projects are in fact co-productions involving European producers.

For these reasons, the Commission decided not to include specific criteria on this issue in the new Cinema Communication. However, it will continue to monitor further development of this type of aid to ensure that competition takes place primarily on merits rather than on the basis of public aid. In the meantime, aid for foreign productions may be compatible with Article 107(3)(d) TFEU as aid to promote culture under the same conditions as aid for European productions.

## **6. Conclusions and outlook**

The new rules have an extended scope, allowing aid for all stages of an audiovisual work from concept to delivery to audiences. The updated provisions of the Communication are in line with the sector's developments in the digital age and improve legal certainty. The Communication also does not limit the duration of its applicability. This meets the sector's expectations of a more stable legislative environment. Finally, the proportionality between the available aid and the restrictions tied to the use of that aid is improved, striking a balance between economic, legal and cultural considerations while preserving the internal market.

The more explicit acknowledgement of the Member States' prerogative to define their own cultural policy will reduce the administrative burden for notifying and assessing State aid schemes. Moreover, as of 1 July 2014, the Cinema Communication has been supplemented by State aid rules on the audiovisual sector in the revised General Block Exemption Regulation. State aid schemes with an annual budget below EUR 50 million will no longer need to be notified to the Commission. This will further reduce the administrative burden and speed up procedures, in particular for regional aid schemes.

Taken together, the updated rules will contribute to the continued viability and competitiveness of the European audiovisual sector, with a view to ensuring that European audiences will continue to have access to Europe's cultural creativity and diversity.