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COMMISSION STAFF WORKING DOCUMENT
EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

COMMUNICATION FROM THE COMMISSION
on State Aid for films and other audiovisual works

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1. PROBLEM DEFINITION

1.1. Sector description

The EU is one of the largest producers of films in the world. Nevertheless, the market share of European works is low compared to non-European works. In particular, US films attract a high share of audiences and revenues.

On average, each European film is only released in two countries, or between 4 and 5 countries in the case of co-productions involving producers from several countries. European films do not benefit from the same distribution and exhibition conditions as those distributed for example by major US producers, which are released on a much larger scale. European films usually have smaller budgets.

1.2. Why is Commission action considered?

State aid to the film industry became a firmly established phenomenon in Western Europe by the end of the 1950s. It has aim of ensuring that Europe's national and regional cultures are expressed in audiovisual works (cultural diversity) and to generate the critical mass of activity that is required to maintain production undertakings and a pool of human skills and experience. The current Communication expired on 31 December 2012. It is therefore necessary to reflect on a possible successor regime.

1.3. Problems linked to the specific characteristics of the sector

The European audiovisual industry is subject to problems and challenges which are mainly linked to the structure of the sector. European audiovisual markets are fragmented along linguistic and cultural lines. This results in a culturally diverse and highly independent production industry. However, it has a negative impact on the industry's competitiveness, compared to US films which can count on strong production companies and an important homogeneous domestic market to recoup the costs of production.

Furthermore, unlike other industrial products, cinema and other audiovisual works are generally not mass-produced. Every film can be seen as a unique prototype.

The fragmented structure of the sector and the high risk of single audiovisual productions makes it difficult for audiovisual projects to obtain upfront financing.

1.4. Issues identified in past practice and during the consultation process

The following issues have been identified to be relevant for the future application of State aid rules in the audiovisual production sector:

1.4.1. The cultural test

The compatibility of aid to film production is assessed under Article 107(3)d TFEU which provides for the possibility to grant aid "to promote culture".

Film funding supports cultural diversity and the preservation of cultural European identity and heritage. Member States and the sector suggested abolishing the burdensome "cultural test", which the Commission is currently applying.

1.4.2. Territorial spending obligations

Regarding territorial spending obligations, the current Cinema Communication allows Member States to tie 80% of the film budget to local spending. However, territorial requirements fragment the Internal Market for audiovisual production.

The Commission accepted that Member States may require that part of the film production budget is spent on their territory to ensure the continued presence of the human skills and technical expertise required for cultural creation. The high mobility of the film industry and the promotion of cultural diversity may justify this. But such restrictions should be limited to the minimum required to promote these objectives. However, the proportionality of the current rules is questionable.

In the public consultation several smaller Member States were against such conditions. However, most Member States, as well as the sector, supported territorial spending obligations. These obligations are apparently also needed to justify spending public funds on film production.

1.4.3. Subsidies to attract foreign film productions

The phenomenon that several Member States introduced incentive measures to attract major foreign film projects to be produced in their territory seemed to suggest that there is a subsidy race among them.

In the consultation, the Commission suggested introducing a lower aid intensity for aid to foreign films. In particular large Member States claimed that there was no evidence of a subsidy race and that film production would not shift in the EU due to aid. If it existed at all, this would be a problem of minor importance. The main issue would be the competition between Europe and third countries, not among Member States.

Member States and the sector underlined how important these productions would be for the competitiveness of the European film sector. Foreign production has a lasting impact as it usually makes wide use of local infrastructure or of local actors. Therefore, such productions should remain to be eligible for aid like European film productions.

1.4.4. Scope of activities

The Cinema Communication only addressed aid for the production of audiovisual works. Nevertheless, aid schemes of Member States traditionally also include support measures for film distribution and for cinemas which have been approved by analogue application of the Cinema Communication.

Stakeholders agreed that new rules should cover all aspects of film creation, from story concept to delivery to the audience. Some Member States and sector representatives also asked for the inclusion of rules on aid to cinemas or for video on demand (VoD) platforms.

1.4.5. Scope of audiovisual products to be supported

In the recent years the issue came up what products may be considered an audiovisual work being eligible for aid under the Cinema Communication. In the consultation, some Member States and parts of the private sector suggested extending the scope from film and TV productions to interactive products like "transmedia" or video games.

However, other Member States considered that it is in general difficult to design lasting rules for the rapidly changing scope of new media. In particular games would have other characteristics regarding production, distribution and consumption than films.

1.4.6. Aid intensities

All comments were in favour of maintaining current possible aid intensities. Also the suggestion to allow a higher intensity of 60% for productions involving at least two Member States was welcomed.

2. ANALYSIS OF SUBSIDIARITY

EU State aid control is the exclusive competence of the Commission according to Articles 107 and 108 TFEU. A particular aspect in the assessment of aid to promote culture is that according to Article 167 TFEU culture and the definition of what constitutes a cultural activity are primarily a responsibility of Member States.

3. OBJECTIVES

EU State aid control is aimed at ensuring that Member States only implement State aid that does not distort competition and trade between Member States contrary to the common interest.

3.1. General objectives of aid to audiovisual production

Audiovisual works reflect the cultural diversity of the different traditions and histories in the EU. The objective of State aid is to help them fulfilling this role. The preservation of a solid infrastructure is also essential to attain this objective.

Article 167 TFEU recognises the importance of promoting culture. Article 107 (3) d TFEU recognises the importance of that objective and provides for a specific possibility of aid to promote culture.

3.2. Specific objectives of the planned Communication

The specific objectives of any future regulatory framework for aid to audiovisual production are:

- a) Preservation of European film production and cultural diversity;
- b) Quality and range of choice for audiences;
- c) Promotion of the transnational circulation of European audiovisual works; and
- d) Preservation of a solid infrastructure for audiovisual creation and of the competitiveness of the European audiovisual sector.
- e) Transparency;
- f) Legal certainty
- g) Reduced administrative burden for Member States and the Commission;
- h) Reduced distortion of competition and trade between Member States;
- i) Respect of internal market principles;
- j) Respect of the principle of subsidiarity;

4. POLICY OPTIONS

A considerable film production in Europe could not be sustained without public support. The Commission will not object in principle to this kind of sector-oriented aid. With this perspective there are three principle possibilities how to proceed:

4.1. **Baseline Scenario: Option 1: No policy change**

This would mean extending the current rules.

4.2. **Discarded Option: No new Communication**

The 2001 Cinema Communication will expire by the end of 2012. The "no action" option would mean that the Commission would assess State aid for audiovisual production directly under Article 107 (3) d TFEU as aid to promote culture. The Commission would not necessarily simply continue applying the assessment criteria used since 2001. Under Article 107 (3) d, the Commission may revise its assessment approach in light of the identified need to address certain issues.

In the absence of sector specific rules, the decisional practice would be considerably more labour-intensive. Transparency, predictability and legal certainty would be reduced. Planning and preparation of national aid schemes would be hampered by lack of upfront orientation on how to design the rules.

Therefore this option is discarded.

4.3. **Option 2: Amendment of the current rules for certain or all of the issues identified in a new Communication**

An amendment would require that the Commission concludes that certain issues have to be addressed by a change of rules.

4.3.1. *Issue 1 - The cultural test*

Culture is a responsibility of Member States. The respect of the principle of subsidiarity limits the role of the EU to supporting and complementing the actions of the Member States.

Sub-option is to clarify that the Commission will not assess each and every criterion a Member State is applying to qualify a film as cultural.

4.3.2. *Issue 2 - Possible approaches towards territorial spending conditions*

Territorial spending conditions may violate internal market principles. Under the current rules, Member States are entitled to impose that 80% of the aided film production budget is spent locally, no matter the actual amount of aid. Restrictions on the exercise of the fundamental freedoms may be acceptable for reasons of public policy, like the promotion of culture and cultural diversity.

Sub-option 1 is a strict approach in defence of internal market freedoms. This would mean not to accept any condition regarding the place where the film budget is spent.

Sub-option 2 is to seek to further open up the internal market and duly consider the specificities of the audiovisual sector. This would mean not to abolish but to reduce the level of territorial restrictions. A possibility would be to make it proportionate to the level of the actual financial commitment by the Member State granting the aid, e.g. by submitting the aid amount or a percentage of it to local spending obligations.

4.3.3. *Issue 3 - Possible approaches towards subsidies to attract foreign film productions*

The possible existence of a global competition of film production locations could call for Commission action to avoid undue distortions of trade and competition.

Instead of treating foreign films in the same way as European productions, sub-option 1 is to take a strict approach towards possible subsidy competition among Member States and to prohibit such incentives.

Sub-option 2 is to introduce a lower aid intensity for aid to foreign films than for aid to European productions.

4.3.4. *Issue 4 - Scope of activities eligible for State aid*

In view of the objective to increase audience choice and to improve the circulation of films among Member States, the scope of activities covered by the new rules could be extended from production to all aspects of film creation, from story concept to delivery to the audience.

Sub-option 1 is to include in a new Communication aid for the distribution of individual audiovisual works. This would acknowledge past practice which applied the current rules by analogy.

Sub-option 2 consists in further extending the scope of the rules to include aid to cinemas or video on demand (VoD) platforms. A possibility would be in particular to include wording in the Communication which clarifies that the Commission would not in principle object to aid to cinemas as aid to promote culture where the necessity of such aid has been demonstrated.

4.3.5. *Issue 5 - Scope of audiovisual products falling under sector specific rules*

This issue concerns the inclusion of video games in the scope of supported products.

Sub-option 1 is to specify that games are excluded from the audiovisual products falling under the Communication.

Sub-option 2 is to specify that games will be treated like other audiovisual products under the Communication or to include specific rules for aid to video games.

4.3.6. *Issue 6 - Aid intensities*

The current rules provide for a maximum aid intensity of 50% of the production costs and no limit for low budget or difficult productions.

Sub-option 1 is to lower this intensity threshold.

Sub-option 2 is to raise the possible aid intensity for European co-productions.

4.4. Option 3: Temporary extension of the current rules with a view to include them into a future block exemption regulation

If a change of the current rules would appear necessary, it could be an option to include new rules in a possible new Block Exemption Regulation on aid to promote culture and to extend the current rules until its entry into force.

5. ANALYSIS OF IMPACTS

5.1. Option 1: The baseline scenario

The baseline scenario will not lead to changes for the sector but maintain a situation of legal fragility because a central part of the current rules, the territorial spending obligations, is in violation of internal market principles.

5.2. Option 2: Amendment of the current rules for certain or all of the issues identified by way of a new Communication

5.2.1. Issue 1 - The cultural test

The heavy workload involved in the current detailed scrutiny of "cultural" criteria is administratively burdensome and entails the risk of the Commission intruding into the Member States' prerogative to define what they consider to be culture.

Therefore the current practice should be abandoned. New rules should clarify that the Commission will not assess each and every criterion a Member State is applying to qualify a film as cultural. This would simplify the assessment of State aid schemes for Member States and the Commission.

5.2.2. Issue 2 - Territorial spending obligations

Territorial spending conditions violate internal market principles. If the conditions justifying this type of restriction are not met, it would be contrary to the Treaty to continue permitting the current level of territorial spending obligations. A tangible advantage of the current limitations could not be demonstrated.

5.2.2.1. Sub-option 1: Strict enforcement of internal market freedoms

This approach would exclude the possibility to link State aid with territorial spending obligations. However, territorial conditions contribute to maintaining a critical mass of infrastructure for film production in the various Member States. Their absence would also limit the willingness of governments to invest public funds in film production.

5.2.2.2. Sub-option 2: Applying the internal market rules with a view to the specificities of the sector

This option seeks a solution which further opens up the internal market, ensures the achievement of the objectives of film funding, and takes into account the specific characteristics of the sector. A possibility would be to allow submitting 160% of the aid amount to local spending obligations. This level offers Member States a multiplier effect sufficient to encourage them to further on disburse subsidies for film production.

If Member States have less room for imposing territorial restrictions, internal market freedoms will be enhanced and the positive effects of funding films may be shared more easily among the sector throughout the internal market.

5.2.3. Issue 3 - Subsidies to attract foreign film productions

Applying the same rules to foreign production as to European productions is likely to have an overall positive effect on the European film sector. European producers are benefiting from high profile productions which require large studio capacities and modern equipment which would not be sustainable with European productions alone. European actors find additional chances to get roles in these productions.

Sub-options 1 and 2 (no aid or lower aid intensity for aid to foreign films) would be likely to lead to a loss of many high profile productions which would then be produced outside Europe. They would require a difficult and burdensome distinction between European and non-European Films.

5.2.4. *Issue 4 - Scope of activities eligible for State aid*

5.2.4.1. Sub-option 1: Including in a new Communication aid for the distribution of individual audiovisual works

Aid for film distribution will help films to reach an audience. It would also acknowledge past Commission decision practice and thereby increase transparency and predictability.

5.2.4.2. Sub-option 2: Further extending the scope of the rules to include aid to distribution platforms like cinemas and video on demand (VoD) platforms.

Aid to distribution platforms may support better circulation of films and maintaining a theatrical infrastructure. However, it is not apparent what general market failure would need to be addressed by sector specific rules covering all platforms. Member States may demonstrate in certain cases the necessity of aid for cinemas. It is less evident why VoD platforms should require aid. Many of them do already exist without funding.

5.2.5. *Issue 5 - Scope of audiovisual products falling under sector specific rules*

5.2.5.1. Sub-option 1: Specify that video games are excluded from Communication

This option would give a clear signal to Member States that games are not among the audiovisual products falling under the Communication. It does not exclude that aid may be approved directly under the Treaty on a case-by-case basis. Not to address the issue at all in a Communication would lead to lack of transparency and legal certainty, because Member States notify aid for games production and expect an assessment under the Cinema Communication

5.2.5.2. Sub-option 2: Specify that games will be treated like other audiovisual products under the Communication or develop specific rules for aid to video games

Games have other characteristics regarding production, distribution and consumption than films. Therefore, the rules designed for film production cannot apply automatically to games. No market failure could be demonstrated which justified aid. The games sector has enjoyed steady growth since two decades and European companies active in the sector compete globally.

5.2.6. *Issue 6 – Aid intensities*

All Member States and stakeholders agreed that the current level of the permitted aid intensities serve well to ensure the production of a large number of European films. An increased 60% aid intensity for productions involving funding by more than one Member State may increase the number of European co-productions, which in turn may foster the circulation of European films in more than just one Member State.

5.3. **Option 3: Temporary extension of the current rules with a view to include them into a future block exemption regulation**

The option to include new rules in a new Block Exemption Regulation would require extending the current Communication. The adoption of a relevant enabling regulation and the amendment of the General Block Exemption Regulation will not take place

before 2014, well after the expiry of the present rules. This would for a certain further period leave open all the issues which had been identified as meriting to be addressed.

6. COMPARING THE OPTIONS

6.1. Option 2: Amendment of the current State aid assessment criteria for the identified issues

Under the assumption that the current rules should be changed, one possibility would be to define a package of amendments which imposes itself due to the need to ensure a better respect of the principles of the internal market and of subsidiarity in the area of culture (Package 1). Alternatively, the set of amendments could include, in addition, the elements which are subject to Commission discretion in the assessment of State aid (Package 2).

Accordingly, package 1 would include:

6.1.1. Issue 1 - The cultural test

Giving up the present practice will reduce the current level of administrative burden for Member States and the Commission and acknowledge the principle of subsidiarity in this field.

6.1.2. Issue 2 - Territorial spending obligations

Not tackling the territorial criterion would risk Commission decisions being in breach of the internal market rules. A limit to the possibility for the territorial spending obligations is therefore necessary.

Abolishing them altogether could jeopardise the willingness of Member States to fund films at all. Compared to this, a lower admissible level of territorial spending obligations linked to the aid amount will enhance the internal market and at the same time preserve the achievement of the objectives of film funding.

Package 2 would add the following further amendments:

6.1.3. Issue 3 - Subsidies to attract foreign film productions

As regards aid for foreign film productions, the option not to allow aid at all or only a reduced aid amount for non-European productions would require a complicated distinction between European and non-European films and may lead to a weakening of the industrial base for major film productions. The effect on trade of such subsidies is probably not huge enough to justify such a differentiated approach.

6.1.4. Issue 4 –Scope of activities eligible for State aid

Aid to distribution of individual films and to cinemas has been approved in the past by applying the Cinema Communication by analogy because it is serving the objectives of aid to film production. An explicit inclusion in future rules increases transparency and legal certainty. Regarding aid to VoD platforms, the Commission has no case practice to develop the necessary new set of rules; furthermore it has doubts regarding the general necessity of such aid.

6.1.5. *Issue 5 – Scope of products falling under sector specific rules*

Regarding the coverage of video games by the rules, an explicit mention in future rules that they are not covered increases transparency and legal certainty. Including games would not be justified because a general necessity of this aid is doubtful.

6.1.6. *Issue 6 - Aid intensities*

In the interest of improving the circulation of European films in several Member States, a higher possible aid intensity for European co-productions appears to be justified.

6.1.7. *Result*

It is preferable for stakeholders and for the services of the Commission to adopt rules which draw on past experience and address identified shortcomings for the benefit of transparency and legal certainty. As the rules have to be reviewed in any case, due to their expiry, there is no reason not to address all the possible improvements identified.

6.2. **Option 3: Temporary extension of the current rules with a view to include them into a future block exemption regulation**

Eventually, the Commission would have to address in any case the identified shortcomings. A temporary extension would leave them open for an uncertain period of time. A transposition of the current rules in a possible later block exemption regulation would be more difficult if these shortcomings persist. Therefore it is preferable to address the issues now.

If, at a later stage, culture aid may be covered by a block exemption, it will be easy to transpose the revised rules. Otherwise, with the identified deficits of the current rules, it will not be possible to simply take them over into a Regulation.

6.3. **Summarising the comparison**

Therefore, **option 2**, package 2, with amendments according to issues 1, 2 (sub-option 2), 4 (sub-option 1), 5 (sub-option 1), and 6 (sub-option 2), and no changes regarding issue 3, offers most benefit in terms of effectively achieving the objectives of film funding, of more efficiency through transparency, legal certainty and less administrative burden, and of coherence with Treaty principles.

Option 3 would leave legal uncertainty regarding the cultural test and the scope of the rules. For an unknown period, decisional procedures would be slower, increasing the workload for Member States and the Commission. The transparency would be lower.

7. **MONITORING AND EVALUATION**

Progress will be monitored by Member States, the Commission and the European Audiovisual Observatory. Member States are obliged by Article 21 of Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty¹ to submit annual reports on the application of their schemes. Furthermore, the European Audiovisual Observatory is constantly collecting relevant data on the film sector.

¹ OJ 1999 L 83, p. 1.