

A Contribution to ‘Assessing State Aid for Films and other Audiovisual Works’

Submitted by: Joe Karaganis
Vice President
The American Assembly
474 Riverside Drive
Suite 456
New York, NY 10115 USA

Sept.30, 2011

ID# 01800186835-88

This note is a contribution to the 2011 European Commission consultation on public support for audiovisual works in Europe. The note combines discussion of production subsidies and intellectual property policy in recognition that these are increasingly conjoined forms of state intervention in the audiovisual market. It argues that the EC and EU members lack a coherent *agenda for digital distribution*, and that this lack creates costly distortions in both the IP policy and public support strategies. A positive agenda for digital distribution, this note proposes, can be built around changes to licensing practices for audiovisual goods.

Summary Analysis

- The EU system of public support for movies is a success when measured in terms of numbers of films produced and the linguistic diversity of their production—at least for the wealthier EU countries. But it is a persistent failure at distribution outside of the countries of production. The largest challenge facing the European cinema, in this context, is not funding but obscurity, resulting first and foremost from a fragmented market in which transaction costs for multinational licensing are too high.
- These problems reinforce Hollywood’s dominance of European (and global) audiovisual culture. The only truly European cinema at present comes from Hollywood. All other cinemas are national, with very limited reach outside the countries of production.
- At present, the most important EC and EU-country interventions in regard to distribution are in the area of IP enforcement. This is a serious mistake because the piracy debate is a distraction. Piracy is fundamentally a sign of demand. Because demand for European movies is low, there is very little piracy of them. The economic effect of strong enforcement in Europe, in this context, is simply to send money to the US—exacerbating trade imbalances in the audiovisual sector and reinforcing Europe’s subordinate position in regional and global film markets.

- The tweaking of funding structures or territorialization requirements is unlikely to improve this situation. The European audiovisual sector will become competitive only if it changes how it reaches (and builds) larger regional and global audiences. The digital transition provides the context for this change.

Recommendations

- Promote a shift toward collective licensing practices for the audiovisual sector. Although there are several proposals for doing so, this note suggests creating a one-stop shop via a (voluntary) grants program to producers for the transfer of rights management to a new EU-wide organization. If producers feel that they can better manage their rights themselves, they need not participate in the program.
- Modernize how public funding agencies conceive their mission, with an emphasis on much wider and cheaper distribution of EU movies. We propose:
 - Making public funding contingent on *creative commons commercial use licensing* of the work after an initial period of commercial release (provisionally, five years). The CC license would allow works to circulate at no cost, without requiring permission from the rightsholder.
 - Allowing production companies to buy out of this clause if they choose to do so (notably if a film is a hit) by paying back the funding agency.
- Scale back EC and member country efforts against *non-commercial* file sharing. Such efforts come at growing economic and political cost with no measurable benefits.

Collectively, these measures are designed to:

- Dramatically increase the legal availability of European film in international markets, allowing producers to focus on building audiences and creating a feedback loop between international reception and production.
- Slowly defuse the anxiety around piracy (as there are no starving auteurs with violated rights at the end of this process—only well fed ones).

- Create a probably permanent competitive advantage over Hollywood in regard to international transaction and licensing costs (for most work, after five years, the cost falls to zero).
- Provide an ex-post way out of the public funding of blockbusters (while protecting small market films and riskier productions).
- Provide a clearer sense of the public funding mission in the digital era: to maximize not only the production of culture, but also the ability to experience and enjoy it. Public funding should maximize public utility.

These changes would represent a major shift in the strategies of public support for the audiovisual sector. Properly constructed, they need not represent a decrease in the revenues of that sector—and indeed would provide a massive opportunity to build new audiences and associated revenue streams. Because the current model has many beneficiaries, such steps would be politically difficult. But it seems clear that absent this or some similar shift toward greatly expanded distribution, the European audiovisual sector will remain a marginal, nationally-bounded enterprise and audiovisual policy will devolve further into an intra-EU competition for Hollywood productions. The latter phenomenon is what I describe as The Curse of Harry Potter, in reference to the UK tax breaks created in 2005 to keep Warner Bros from taking Harry Potter production to the Czech Republic. It is time to lift the curse.

Contents

Importer vs. Exporter IP Policies.....	4
Follow the Money	4
Whose Piracy is It?.....	7
The Top 99 Pirated Movies on BitTorrent	7
How the European Commission Took Up the Cause of Hollywood	10
The Curse of Harry Potter	13
References	18

Importer vs. Exporter IP Policies

Most of the time, the international politics of intellectual property law are relatively easy to follow: countries that are large exporters of intellectual property usually favor stronger international IP agreements that help exploit international markets. Countries that are large importers of IP, in contrast, generally favor lower levels of IP protection that minimize the outflow of royalties, licensing fees, and other payments for foreign-owned products and technologies—whether software, drugs, movies, or books. Whatever other rhetorics are in play, from the rights of authors to the right to development, political positions usually line up with those underlying incentives.

The turn toward the use of trade agreements to set IP obligations—from the early bilateral agreements of the 1980s to the WTO's TRIPS agreement in the early 1990s—more or less formalized this instrumental approach to IP law. Trade agreements, at the end of the day, are about economic deals—not morality or even fairness. It is for this reason that we should take an instrumental view of the European Commission's position on IP rights and enforcement. Over the past two decades, the EC has been a very active proponent of higher IP standards and stronger enforcement, from the ACTA agreement, to the upcoming revision to the Enforcement Directive, to the recent extension of copyright on recordings. Let's ask the obvious question: why?

Follow the Money

Piracy's ostensible impact on audiovisual markets is the driving force behind the EC and wider EU push on enforcement. Media piracy—not counterfeits—are why EU governments are undertaking major changes to the emerging digital infrastructure of public life, including Internet surveillance, '3-strikes' disconnection laws, public and private censorship of websites, and a host of other measures.

So where do the EU's economic interests lie? The numbers tell a striking story:

- According to the World Bank, Europe's audiovisual imports exceed its exports by a ratio of around 4-1. In 2008, Europe (EU 27) imported roughly \$14.7 billion in audiovisual and related services (basically, licenses for movies, TV, radio, and sound recording). In contrast, it exported about \$3.9 billion, for a net trade deficit of \$10.8 billion (World Trade Organization 2010:156)

- About 56% of those imports (\$8.35 billion) come from the US. The EU, in turn, exports about \$1.7 billion to the US, resulting in a net negative trade balance of around \$6.65 billion. This does not include software licenses, where US companies monopolize larger parts of the European consumer and business markets.
- The US, in contrast, is a large net exporter of audiovisual goods, with roughly \$13.6 billion in exports and \$1.9 billion in imports.

For countries or regions that are net importers of copyrighted goods, higher IP standards and stronger enforcement will result in increased payments to foreign rights holders. Because the US dominates European audiovisual markets, stronger enforcement in these areas is, in practice, enforcement on behalf of Hollywood.

This is the model at its simplest. In practice, this story is more complicated. The vast majority of European audiovisual production services domestic or intra-European consumption. Exports from European countries to each other significantly outweigh exports outside the EU (by about 50%). Won't stronger IP laws and enforcement capture more benefits for European industry? Probably, but these should not be confused with overall benefits to the European economy.

We describe this distinction in our recent report on *Media Piracy in Emerging Economies*:

Domestic piracy may well impose losses on specific industrial sectors, but these are not losses to the larger national economy. Within a given country [or in this case, region], the piracy of domestic goods is a transfer of income, not a loss. Money saved by consumers or businesses on CDs, DVDs, or software will not disappear but rather be spent on other things—housing, food, other entertainment, other business expenses, and so on. These expenditures, in turn, will generate tax revenue, new jobs, infrastructural investments, and the range of other goods that are typically cited in the loss column of industry analyses.

To make a case for national economic harms rather than narrower sectoral ones, the potential uses of lost revenue need to be compared: the foregone investment in the affected industries needs to represent a better potential economic outcome than the consumer surplus generated by piracy (Sanchez 2008). The net impact on the economy, properly understood, is the difference between the value of the two investments. Such comparisons lead into very complicated territory as marginal investments in different industries generate different contributions to growth and productivity. There has been no serious analysis of this issue, however, because the industry studies have ignored the consumer surplus, maintaining the fiction that domestic piracy represents an undiluted national economic loss. For our part, we take seriously the possibility that the consumer surplus from piracy might be more productive, socially valuable, and/or job creating than

additional investment in the software and media sectors. We think this likelihood increases in markets for entertainment goods, which contribute to growth but add little to productivity, and still further in countries that import most of their audiovisual goods and software—in short, virtually everywhere outside the United States. (Karaganis 2011b:16)

The EC speaks for the European audiovisual industries on these issues, who stand, in theory, to gain from stronger IP enforcement.¹ But who speaks for the massive and very real consumer surplus? No one. The subject is taboo. I'm aware of only one study that makes any effort to model it: the Dutch government funded "Ups and Downs: Economic and Cultural Effects of File Sharing on Music, Film and Games," which estimated the annual welfare benefit from music filesharing in the Netherlands at around 100 million euros (Huygen et al. 2009). Crude extrapolation by population across Europe would put the figure at around 3 billion euros.

¹ Although this benefit is usually treated as self-evident, research on consumer practices paints a more uncertain picture. Numerous studies show that high rates of digital piracy correlate closely with high rates of legal digital consumption. Accordingly, penalization of this group, especially through Internet disconnection, is also penalization of the industry's best customers (HADOPI 2011; Karaganis 2011a).

Whose Piracy is It?

Can we determine to what extent piracy actually impacts European movies? For better and for worse, the answer appears to be: very little. The news website Torrentfreak regularly compiles lists of the top ten films downloaded via BitTorrent, which generally track recent Hollywood hits. Torrentfreak furnished me a ranking of the 99 top downloaded movies for the first half of July (99 because the top 100 included *Thor* under two different titles). Although it not a rigorous sample, it provides a starting point for looking at the geography of global demand for film. Among these 99 films:

- 74 were solely US productions
- 3 were solely European productions
- 3 were Indian productions
- 17 were jointly produced by the US and one or more other countries, including 14 with European companies.
- UK production companies were solely responsible for 2 films, and partnered in 11 more.
- German companies co-produced 4 films.
- Canadian companies co-produced 3 films.
- South African and New Zealand companies were sole producers of 1 film each.
- Japan and Romania co-produced 1 each.

French production is an interesting case given the leading French role in promoting both strong IP protection and Europeanist cultural politics—including the well known 'cultural exception' for trade in audiovisual goods and services. French companies figure in only 4 films on the list—and in no cases for movies filmed in France, in French, or prominently involving French actors or filmmakers. The No.1 film on the list, *Source Code*, was co-produced by Vendome Pictures—a relatively new French production company dedicated to producing, by all appearances, American movies. *Source Code* stars Jake Gyllenhaal and was filmed in Chicago.

Another feature of this list is that 97 of 99 of the films are in English (the two non-English films are Indian). The list makes a strong case that, in the absence of licensing

The Top 99 Pirated Movies on Bittorrent

July 5-15, 2011

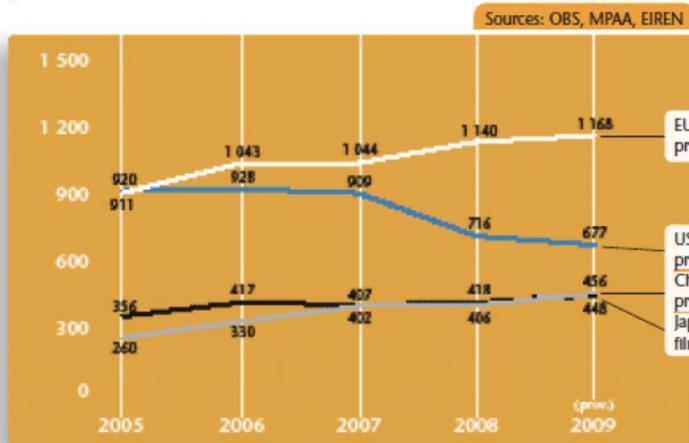
Source Code
X-Men First Class
Bad Teacher
Ironclad
I Am Number Four
Sucker Punch
The Adjustment Bureau
The Next Three Days
The Way Back
TRON: Legacy
The Chronicles of Narnia: The Voyage of the Dawn Treader
Fast Furious 5
How Do You Know
Thor
Kill the Irishman
Rio
Unknown
The Kings Speech
Elephant White
Just Go with It
Hall Pass
The Fighter
Season of the Witch
Transformers 3 Dark of the Moon
Gnomeo and Juliet
Bridesmaids
Inception
Delhi Belly
Fast Five
Cars 2
200 MPH
Jackass 3D
Water For Elephants
Battle: Los Angeles
Pirates of the Caribbean: On Stranger Tides
Unstoppable
Due Date
Green Lantern
Paul
Faster
Arthur

barriers, the international market is an English language market and more particularly a Hollywood market that occasionally involves foreign production partners.

Even the long tail (down to #99 at least) isn't European. For the most part, it's composed of B and C list Hollywood movies from the last year: the Kevin Bacon film *Elephant White*; the Dennis Quaid movie *Soul Surfer*; the Russel Crowe/Elizabeth Banks film, *The Next Three Days*; the Topher Grace/Anna Faris flick, *Take Me Home Tonight*, and many others. According to the MPAA, 677 film were produced by US production companies in 2009. Hundreds of these movies go straight to the back catalog. And even that number is well off the peak of 2006-2007.

Is this the sign of a European cinema in decline? Not if we look at the number of feature films produced, which should certainly factor into any account of piracy's effects on incentives to produce. The number of feature films produced in Europe has increased every year in the last five. Almost 1200 were produced in 2009 (European Audiovisual Observatory 2010)

Number of feature films produced in the European Union, the United States and Japan | 2005-2009



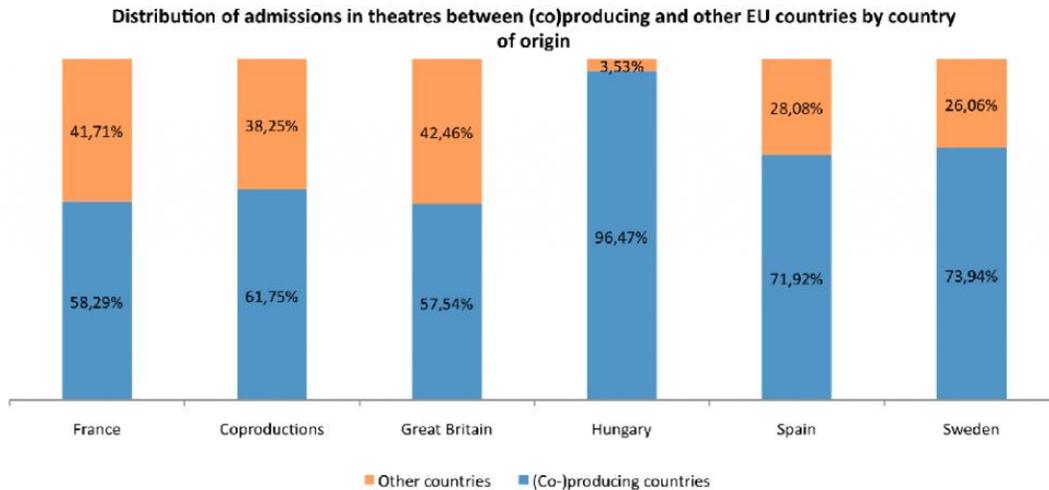
(1) Revised series.

For better and for worse, European film operates within a system of high public subsidies, low budgets, and persistent cultural and institutional market barriers at the national level.

- Kung Fu Panda 2
- Murder 2
- 127 Hours
- Little Fockers
- Insidious
- Yogi Bear
- Thor Tales of Asgard
- A Lonely Place for Dying
- Limitless
- The Mechanic
- The Tourist
- The Hit List
- Age of the Dragons
- Beastly
- Rango
- Wake Wood
- Black Swan
- The Hangover Part II
- Priest
- The Warriors Way
- True Grit
- Sniper: Reloaded
- Burlesque
- The Social Network
- No Strings Attached
- Morning Glory
- Hereafter
- The Lincoln Lawyer
- Blood Out
- Despicable Me
- Harry Potter And The Deathly Hallows Part 1
- The Roommate
- The Witches of Oz
- The Dilemma
- Take Me Home Tonight
- Wrecked
- Wolf Town
- Big Mommas: Like Father, Like Son
- Inside Job
- Megamind
- Jackboots on Whitehall
- Horrible Bosses
- 5 Days of War
- The Rite
- Scream 4
- Scott Pilgrim vs the World
- The Chaperone
- Tangled
- Gullivers Travels
- Three Kings Malayalam
- Jumping The Broom
- Robin Hood
- Paranormal Activity 2

The resulting industry is a major success if measured by the quantity of production, and arguably also in terms of cultural diversity and 'quality' of the kind associated with the auteur tradition. But the European cinema also remains resolutely 'national,' with a high proportion of revenues coming from domestic distribution and relatively few films attaining wider European (or global) success.

Its Kind of a Funny Story
Waiting For Forever
Soul Surfer
Iron Man 2
Hanna
Easy A



Source: film distributors, EAO²⁰⁶

The blue part of the chart is the percentage of a film's total audience that it receives in its home country (vs. the rest of Europe). (KEA European Affairs 2010)

Some of this insularism reflects linguistic and cultural differences within Europe. And some of it reflects the fragmentation of the European market. The burden of rights clearance across 27 countries and innumerable production companies makes it very difficult to distribute European films widely within Europe—and far more difficult, in particular, than licensing large catalogs from the six US studios. The EC has made reducing these market barriers a high priority, but has shown less certainty about how to move forward. As a 2008 EC report on the subject noted:

the practice of territorial licensing has a lot to do with commercial decisions based on the structure of a European market that is characterised by linguistic and cultural differences, as well as by high transaction costs in distributing local content across borders. (KEA European Affairs 2010:185)

In other words, it's not clear where the market obstacles stop and the mismatch of product with demand begins.

Here, our list of downloaded films points to the future—and to one of the main dilemmas facing European cultural policy. The emergence of a more unified audiovisual market suits both the political project of European unity and the culturalist project of making more European productions available to more Europeans. Given the current constraints, lower barriers to licensing will certainly increase the range of European offerings to European consumers.

But there's a catch. So far, the European market (and beyond that, the global market) has had little to do with expressions of cultural specificity or auteur-driven visions. It has to do, above all, with making films in English that minimize those particularities. It means producing a Europe built around historical epics (*Ironclad*), sci-fi/fantasy (*Inception*, *Harry Potter*) or, often quite literally, the perspective of the universal (American) tourist, like last year's *The Tourist* (Johnny Depp in Venice) or *Unknown* (Liam Neeson in Berlin). All of the above were joint US/EU productions on our July download list. And it means a European film industry reorganized further into an investment vehicle for Hollywood movies, like Vendome Pictures, the now defunct publicly-funded Medienfonds in Germany (*Battlefield Earth*, *Terminator 3*), or Luc Besson's massive, soon-to-be opened Cite du Cinema north of Paris.

There are, of course, benefits to greater integration into global markets, both in business and cinematic terms. But it is important to be clear about the future that follows from current EC IP policies. It is not a defense of European heritage or—primarily—a vision of the French auteur able to bring his or her distinctive vision to a global audience. It's a vision of European production companies as slightly better integrated junior partners in global Hollywood.

It's this junior partnership that should be weighed against the wider sacrifices of privacy and freedom of speech built into so many recent national and EC-level IP enforcement policies, such as the French '3-strikes' plan, which will cut French citizens off of the Internet for the piracy of Hollywood productions. Strong enforcement reinforces status quo positions in the market, but at an escalating public cost as consumer behavior becomes the real focus of enforcement activities. There is nothing in these policies will alter the balance of cultural power or change the direction of payments. That's why I've characterized EC enforcement plans as: "send money to the US."

How the European Commission Took Up the Cause of Hollywood

How did Europe get here? Tellingly, there was little initial European enthusiasm for a broad trade agreement on IP in the 1980s. By most accounts, lobbying by US tech and pharmaceutical industries made the difference, capitalizing on a wider overestimation of—and nostalgia for—Europe's role as a cultural superpower, when it was the primary beneficiary of stronger international IP laws. More narrowly, the European Commission's IP activism can be traced to the actions of a handful of American CEOs, who convinced their European counterparts of the

benefits of a global IP deal in the run-up to the WTO agreement in the 1980s. Those counterparts, in turn, applied pressure on their national governments and, through them, the EC.

This gambit has been described in several histories of the WTO negotiations, including Peter Drahos and John Braithewaite's excellent *Information Feudalism* (2007).

EC bureaucrats were less keen on trying to harmonize intellectual property standards via the trade regime. They had had some experience of the difficulties of trying to harmonize intellectual property standards in Europe. Some states, such as Germany and the UK, were keen on higher standards while others, such as Spain and Italy, were not so inclined. The view coming out of the EC at this time was to press on with the initiative on counterfeiting in the GATT (a lot of luxury European trade marks were the subject of counterfeiting) and make a general IP code a much longer-term priority....

The problem facing Pratt and Opel [*Edmund Pratt, CEO of Pfizer and John Opel, Chairman of IBM*] was clear enough. They had to convince business organizations in Quad countries [*the US, the EU countries, Japan, and Canada*] to pressure their governments to include intellectual property in the next round of trade negotiations. That meant first convincing European and Japanese business that it was in their interests for intellectual property to become a priority issue in the next trade round.....

Pratt and Opel's response was swift. In March 1986 they created the Intellectual Property Committee (IPC).²⁴ The IPC was an ad hoc coalition of 13 major US corporations: Bristol-Myers, DuPont, FMC Corporation, General Electric, General Motors, Hewlett-Packard, IBM, Johnson & Johnson, Merck, Monsanto, Pfizer, Rockwell International and Warner Communications. It described itself as 'dedicated to the negotiation of a comprehensive agreement on intellectual property in the current GATT round of multilateral trade negotiations' (pp.117- 118)

Enrolling European business in the network was the essential first step for the IPC... The IPC had established a line of dialogue with the Union of Industrial and Employers' Confederations of Europe (UNICE) in November 1986. It proved vital. In Europe's more hierarchically ordered world of business lobbying, UNICE was the key portal of European business influence on the EC. During 1986 and 1987 close cooperation developed between UNICE representatives and EC officials; UNICE was given the opportunity to comment on the EC's negotiating position and drafts. In May 1987 UNICE produced its own position paper on GATT and intellectual property arguing that the EC's approach was 'deemed too narrow by European industry' and that the 'scope of the negotiations must be broadened' to include other areas of intellectual property where European industry was making heavy R&D

investments. In the following months this became the position of European Community negotiators (p.128)....

Perhaps what US CEOs were able to sell to their European and Japanese counterparts was a vision of a globally secure business future. Ultimately, US corporations might do best out of the globalization of intellectual property standards. A world in which US corporations were dominant but European and Japanese corporations still remained powerful players and strategic partners was preferable to a world in which corporations from all these countries faced competition from increasingly efficient developing country manufacturers. It made sense for the most powerful corporations from the world's three strongest economies to collaborate on a project that would enable them to lock up the intangible assets of business in the new millennium and allow them to use those assets to set up production facilities wherever it suited them best. The international character of their production along with their need to capture new markets became the basis of the mutual interest needed for an alliance between them. (p.119)

Although they never quite grasped the fact, European trade negotiators had more in common on intellectual property standards with their developing country counterparts than they realized. The US initiative on intellectual property was aimed at European and Japanese markets as much as it was at the tiger economies of Asia. (p.83)

That's the past and arguably the present. But what would a disenchanted, liberated EC do in the future?

It could start by distinguishing more clearly between the broader welfare interests of EU citizens and the commercial interests of junior production partners in global Hollywood. In an earlier era, it was plausible to think of these commercial and public interests as substantially the same. Movies were cheap and played a much larger role in public culture. French or German or Swedish cinemas made stronger claims to being globally-relevant, distinctive national cultural champions. Copyright infringement was harder, less frequent, and generally industrially organized, which made enforcement a relatively painless proposition.

Today is different. As IP enforcement targets individual behavior and comes into conflict with other basic values (privacy, freedom of expression), commercial and public interests have begun to diverge. How can we realign them?

The EC could also think differently about Europe's opportunities in the larger digital media transition. Where some parts of the EU audiovisual industries lose from piracy, the larger impact is chronically exaggerated in EC statements² and mitigated

² The continued use of the TERA/BASCAP study "Building a Digital Economy: The Importance of Saving Jobs in the EU's Creative Industries" (TERA Associates 2010) as the standard for economic

(if not completely overshadowed) by public subsidies for production. This may be an inefficient system that produces a lot of movies that relatively few people want to see, but it's arguably a pretty good model for managing the transition to a more fully realized digital media economy, in which piracy drives the development of cheap, legal, digital access (e.g., Spotify) (Greeley 2011), and public subsidies ensure that there's a lot of relatively rich European content to distribute. That is a reasonable basis for a digital media economy that leverages Europe's strengths, rather than reinforces its weaknesses. Equally importantly, it provides a basis for ending the costly war on non-commercial file sharing, which threatens to become a more generalized war on unmonitored Internet use.

Creating a more unified European audio-visual market is an important goal in this context, but also an achievement that is likely to be built on the homogenization of EU production. The public subsidy model is probably the only counterweight—at a continued cost to wider commercial prospects. As we argue in the next section, struggling to adopt the fragile economics of Hollywood blockbusters is a risky bet that should probably be left to the commercial sector. Leading the way in strengthening digital enforcement against non-commercial filesharing seems like an especially bad choice in this context since its short term effect is just to send money to the US. Europe has little to lose from a wait-and-see approach.

Finally, it is important to de-moralize the IP debate. At the Americans' insistence, it's a trade policy debate now, and nothing should be freely conceded by the lesser partner in those trades. What, in other words, do the French get in return for enforcing Hollywood's copyrights? The answer should not be limited to: the dignity of the French auteur. Don't bring a knife to a gun fight.

The Curse of Harry Potter

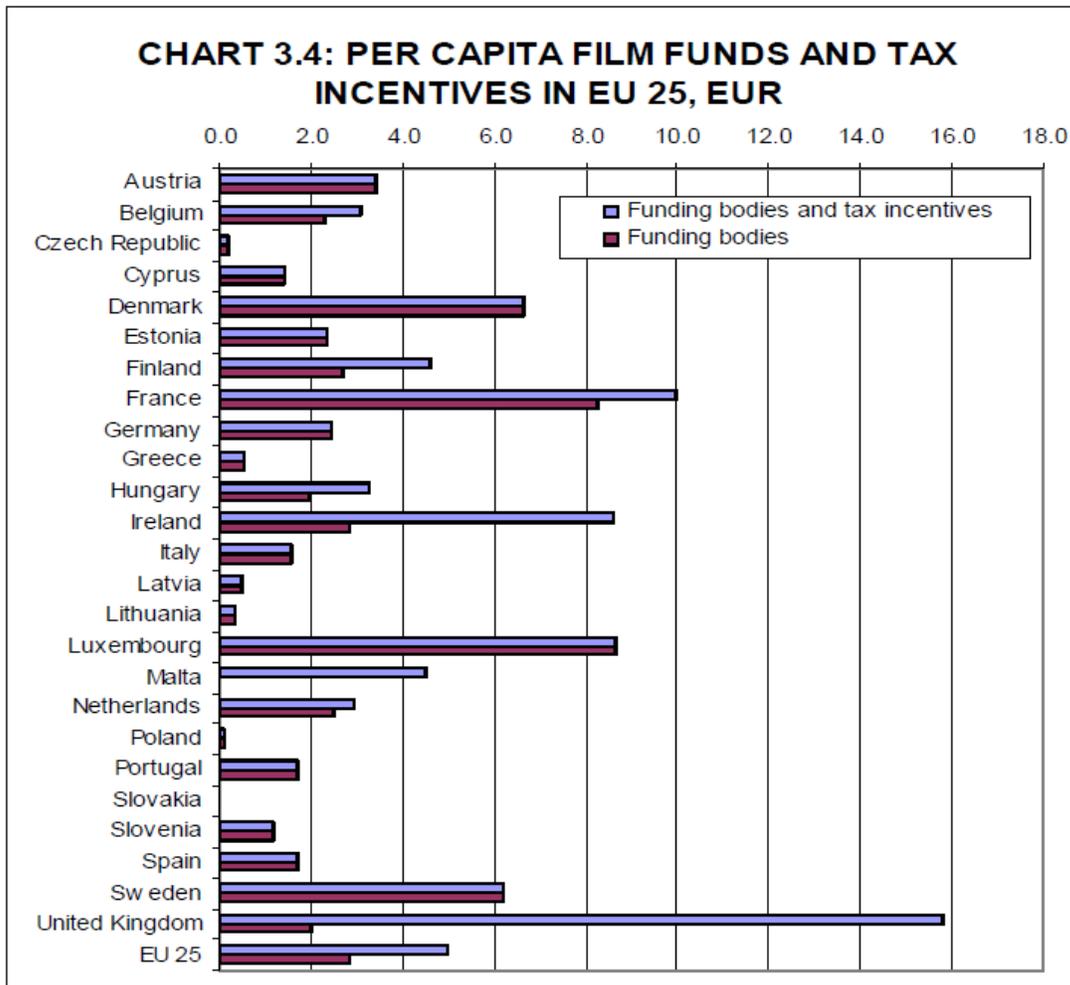
IP policy and audiovisual subsidies are commonly treated as separate subjects. But both regimes structure and regulate the audiovisual market in Europe. As digital technologies proliferate, a functional (if unintentional) division has emerged between public subsidy policies governing production and enforcement policies governing digital distribution—with the results we have described above. This section is an attempt to outline a modernized policy framework for distribution that addresses the distortions in both regimes and puts EU cinema on a more competitive footing for regional and global audiences.

As noted earlier, Europe produces a very large number of movies, but few that reach sizable audiences beyond the national markets in which they are made. This localism has an obvious linguistic component. People want to see movies in their

impact analysis is particularly egregious in this regard. The study has been repeatedly debunked, including in Karaganis (2011b) and the recent 'Supporting Document CC' of the Hargreaves review (Hargreaves 2011).

own language. But localism is also built into the elaborate system of public support for European film, in which dozens of national funding bodies subsidize literally thousands of small production companies: 600 in France, 400 in the UK, 200 in Germany, and so on. These subsidies are very unevenly distributed across the EU, but add up to roughly €1.3 billion in direct grants (see chart below and Brettell, Gardiner, and Robins 2008) and about another billion in tax breaks. According to the EC, roughly 80% of films receive some public subsidies.

The chart below presents this data as a per capita subsidy. Restoring nominal figures, France provides the most in grants and the UK the most in tax breaks. The UK leads overall with a total public subsidization of film production of around €1 billion. France follows at around €600 million; then Germany at around €200 million. Figures for other countries drop off quickly from there (this was in 2004).



Most of this funding is contingent on the money being spent in-country, subject to various formal and informal territorialization requirements. Territorialization is a complex issue that manifests the tensions in the EU cultural mandate. On the one

hand, territorialization runs, by definition, against the common market principles of the EU. The various conditions and rewards act as market barriers, defending local players but also underwriting competition among EU members for Hollywood production dollars—a race that, in this instance, the EC views as a destructive competition to, yes, send money to the US (European Commission 2011). On the other hand, such rules prioritize the linguistic and cultural diversity agenda that is also basic to EC audiovisual policy. Local productions are more likely to be in local languages, use local actors, reflect local circumstances, and so on. Territorialization rules thus blend cultural policy with industrial policy at the national level. For these reasons, most people in the business believe that territorialization is also key to the more general case for audiovisual subsidies, since these decisions are still made nationally (Brettell et al. 2008).

The Brettell/Cambridge Economics study makes clear, however, that the overall effects of territorialization are basically incalculable given the current data. The existing funding system is strongly dominated by the UK, France, and, to a lesser extent, by small countries like Ireland and Sweden, which provide high levels of per capita support. But Brettell et al found that, with the exception of Ireland, none of these had strong formal territorialization rules. Also clearly present, however—but harder to measure—are an array informal factors, such as the need for mastery of the language, bureaucratic culture, and social networks surrounding different national funding bodies. These played—and surely continue to play—a large role in de facto territorialization.

Given these complexities, there would appear to be little to do on this front short of creating an EU-wide funding body as a counterbalance—both to territorialization and to the sharp funding inequalities among EU members. On a list of problems with the EU audiovisual market, however, this is probably a low priority.

The primary goal of such arrangements at all levels should be the subsidization of small market and/or niche market products systematically underproduced by the commercial system. Territorialization is a blunt instrument for achieving these goals, but diversity—cultural, linguistic, or other—is an appropriate goal for audiovisual policy in a profoundly multicultural polity.

The subsidization of large commercial productions, in contrast, has no such justification. As the EC paper for this consultation notes, subsidies to such productions "distort competition among European production locations. In these cases, the question is not whether the film will be produced but only where this will be done." There is, in short, no compelling EU public interest here. Quite the contrary: there is a strong public interest in ending the race to the bottom among EU countries to attract Hollywood productions. I describe this phenomenon as The Curse of Harry Potter in reference to the UK tax breaks created to keep Warner Bros

from relocating Harry Potter production to the Czech Republic in 2005.³ Since individual countries are unlikely to unilaterally disarm in this competition, this is a prime candidate for EC-level guidelines. Although some countries have implemented tiered support levels, based on budgets, we have what we believe to be a more elegant and encompassing solution below.

Ultimately, the central issue is whether European audiovisual culture can move toward a model that isn't as sharply defined by subordination to Hollywood on the one hand, and by the cultural and organizational fragmentation of the EU market on the other. There's nothing new in this question, but the persistent failure to resolve it over at least two decades of coordinated EU/EC policy suggests that some rethinking of the state's role in promoting culture may be needed. Traditionally, public funding has been built around two goals: encouraging local production and attracting external investment. Distribution strategies, in turn, have been mostly the province of state-funded broadcasting. Neither set of investments solves the basic challenge facing most European movies: obscurity. Neither exploits the vast new potential of the Internet and digital distribution. It is, I would argue, impossible to characterize this as a funding problem, a content problem, a filmic sensibility problem or anything else until the EU addresses the licensing issues that block international distribution and the cultivation of wider audiences. And licensing in two respects:

Collective rights management. At present, European films are difficult to distribute within Europe because rights clearance involves so many different companies. Unlike in music, there is very little collective rights management in the audiovisual sector. That there should be more, in some form, is uncontroversial at this point. There are a variety of proposals to address this problem, many of which are stymied by the lack of incentives for producers to do anything about the issue. Here's a suggestion.

- The EU could create a transitional program to *make grants to production companies in return for turning over management of their rights to an EU-wide collective rights organization*. This would be voluntary: if a company felt it could do a better job managing its rights, it need not apply. If the rights organization did its job properly, these incentives could be phased out.
- Such grants could also come with requirements to *share production budget information*, which would partly address the lack of data around practices like territorialization and begin to create the evidentiary basis for the next round of rationalization of EU cultural policy.

³ See Oxford Economics (2010). This support includes a 16% cash rebate on any UK based expenses for films with budgets over 20 million pounds and tax indemnity for the full domestic budget. (Milmo and Martinson 2005). Oxford Economics documents (and plays into) this competitive dynamic in its 2010 report on the value of the UK film industry—notably by hyping Hungarian public subsidies as a danger to British production. Because there is almost no information in this lengthy report on the cost of these tax breaks in the UK, I rely here on the older 2003 data.

Creative Commons licensing. EU funding bodies must think more creatively about how to enable the widespread digital distribution of European works—in and outside of Europe. The perceived value of perpetual commercial exploitation in this context is a myth for all but a few classics and consequently an obstacle to this rethinking. Few of 2009's 1200 films made money. Most suffer first and foremost from obscurity. And the wider European and international markets are already locked up by American movies and TV. How, under these circumstances, can producers and distributors build an audience for European movies? Here is a two-part proposal:

- Make significant public funding contingent on Creative Commons commercial use licensing of the work *after an initial period of commercial exploitation*.⁴ Provisionally, five years after first release—leaving sufficient time for the film to pass through all the major commercial distribution windows. The CC license would allow works to circulate at no cost, without requiring permission from the rightsholder.
- Allow the production company *to buy out of this clause* if it chooses to do so (notably, if the film is a hit with prospects for longer term returns) by paying back the funding agency.

These proposals have five interrelated goals:

- Dramatically increase the availability of European film in international markets, thereby creating a feedback loop between international reception and production.
- Defuse the anxiety around piracy (there is no starving auteur with violated rights at the end of this story—only well fed ones).
- Create a probably permanent competitive advantage over Hollywood in regard to transaction and licensing costs.
- Provide an ex-post way out of the public funding of blockbusters (while still protecting small market films and riskier bets).
- Provide a clearer sense of the public funding mission in the digital era: to maximize not only the production of culture, but also the ability to experience and enjoy it. Public funding should maximize public utility.

These changes would mark a major shift in the strategies of public support for the audiovisual sector. Properly constructed, however, they need not represent a decrease in the revenues of the sector—and indeed would provide a massive opportunity to build new audiences. Because the current model has many stakeholders, such steps would be politically difficult. But it seems clear that absent this or some similar shift toward greatly expanded distribution, the European audiovisual sector will remain a marginal, nationally-bound enterprise within

⁴ <http://creativecommons.org/licenses/by-nd/3.0/>

Europe and beyond it. Audiovisual policy will devolve further into intra-EU competition for Hollywood productions. It is time to lift The Curse of Harry Potter.

References

- Brettell, Saxon, Ben Gardiner, and Ian Robins. 2008. Study on the Economic and Cultural Impact, notably on Co-productions, of Territorialisation Clauses of state aid Schemes for Films and Audiovisual Productions. Cambridge Economics.
- Drahoš, Peter. 2007. Information Feudalism: Who Owns the Knowledge Economy? New Press, The.
- European Audiovisual Observatory. 2010. Focus 2010: World Film Market Trends. Retrieved (http://www.obs.coe.int/online_publication/reports/focus2010.pdf).
- European Commission. 2011. Assessing State Aid for Films and other Audiovisual Works.
- Greeley, Brendan. 2011. "Daniel Ek's Spotify: Music's Last Best Hope." Bloomberg Businessweek, July 18 Retrieved (<http://www.businessweek.com/magazine/daniel-eks-spotify-musics-last-best-hope-07142011.html>).
- HADOPI. 2011. Biens culturels et usages d'internet : pratiques et perceptions des internautes français.
- Hargreaves, Ian. 2011. Digital Opportunity A review of Intellectual Property and Growth. UK Government Intellectual Property Office Retrieved (<http://www.ipo.gov.uk/ipreview.htm>).
- Huygen, Annelies et al. 2009. Ups and downs - Economic and cultural effects of file sharing on music, film and games. TNO Information and Communication Technology.
- Karaganis, Joe. 2011a. "HADOPI Says: Let's Try Cutting off Nose to Spite Face." Retrieved (<http://piracy.ssrc.org/hadopi-says-lets-try-cutting-off-nose-to-spite-face/>).
- Karaganis, Joe. 2011b. Media Piracy in Emerging Economies. SSRN Retrieved (<http://piracy.ssrc.org>).

KEA European Affairs. 2010. Multi-Territory Licensing of Audiovisual Works in the European Union. European Commission Retrieved (<http://www.keanet.eu/en/multiterritory%20licensing%20study.htm>).

Dan Milmo, and Jane Martinson. 2005. "Harry Potter offered new tax break to stay in UK." The Guardian, December 5.

Oxford Economics. 2010. The Economic Impact of the UK Film Industry.

TERA Associates. 2010. Building a Digital Economy: the Importance of Saving Jobs in the EU's Creative Industries.

World Trade Organization. 2010. International Trade Statistics. Retrieved (http://www.wto.org/english/res_e/statis_e/its2010_e/its10_toc_e.htm).