Government Failure: The Ineffectiveness of Italian State Subsidies to Film

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1 Do State Subsidies Help at the Box Office?[1]

The Italian State along with other European countries continues to provide public financial support for their film industries, as well as other media industries such as newspapers and public broadcasting (Aydin, 2007; Brandt & Svendsen, 2009). In their paper investigating the determinants of box-office returns generated by Italian produced films released in the Italian market from 1985 to 1996, Bagella and Becchetti (1999, p. 238) set out five criteria for justifying the allocation of public finance intended to support indigenous film production, each conditional on criteria that perceives film outputs to be 'works of art'. Using econometric techniques, one of their key findings is that subsidised Italian films do not underperform, once account is taken of the lesser talent employed in such productions. They write: 'A result of particular interest also shows that subsidized movies do not exhibit significantly lower performances in terms of total admission, net of other factors, while they clearly underperform on average vis-à-vis non-subsidized movies because of the significantly lower ex ante popularity of their hired cast' (p. 239).

Sourced from the trade journal *Gazzetta del Cinema*, the preferred measure of performance adopted by Bagella and Becchetti is the box-office revenue generated by films in the Italian market. However, while revenue is an indicator of film

[1]An earlier version of this article was published under the title 'An Offer They Couldn't Refuse (But Probably Should Have): The Ineffectiveness of Italian State Subsidies to Moviemaking' in *Public Money & Management*, *34*(3), 2014, pp. 181–188. The authors thank Taylor and Francis for permission to reprint this amended version and Marina Nicoli for research assistance.

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P.C. Murschetz et al. (eds.), *Handbook of State Aid for Film*, Media Business and Innovation, https://doi.org/10.1007/978-3-319-71716-6_19

popularity, it does not reflect the resources embodied in film production and distribution, and, hence by implication, the alternative societal uses (opportunity cost) to which those resources might be put, such as the provision of extra hospital beds, or classroom teachers, or operatic productions. Bagella and Becchetti's argument concerning the subsidy seems to boil down to the counterfactual: had more recognised talent been employed in those subsidised films, the box-office performance of those films would not have been significantly different from those Italian films that were not subsidised. However, as the cost of employing 'minor' talent could be expected to be less than employing 'major' talent, the relative costs of production of subsidised films could also be assumed to less, meaning that the revenues necessary to cover those costs need not have been be so high. On this basis, film profitability represents a better measure of public policy evaluation than box-office revenue alone.

In this respect, the conclusion reached by Bagella and Becchetti stands in stark contrast to the results of this study. Again historicising the research, by drawing on data for the later period of 1995–2003, evidence is produced to show that only three of the 135 state subsidised films in our dataset, irrespective of the subsidy, generated sufficient box office to cover their production costs, with a further 14 films needing the subsidy to break even, implying that the bulk of films were extremely unprofitable. The poor performance at the box office is compounded by the fact our estimates of profitability do not include distribution costs.

That the average revenue performance of subsidised films in relation to costs of production was very poor indeed, leads us to question the efficacy of the Italian film subsidy regime operating during the period 1995 and 2003. Indeed, it is difficult not to come to the conclusion that the effect of film subsidy was largely to misallocate resources, demonstrated by the simple fact that Italian film audiences showed very little interest in the resulting films. Furthermore, the subsidised films do not appear to have contributed very much in the way of prestige to Italian Cinema, which as will be shown was an avowed intention of the legislation establishing the subsidy regime. This chapter is structured as follows: some theoretical considerations that emerge from the literature are briefly set out in the next section, followed by an explanation of the subsidy regime in Italy in the years 1995–2003. The next section explains the dataset and methods used in this chapter and raises some data issues. Section 5 presents the results and is followed by a discussion and some concluding remarks.

2 Film Subsidies: A Brief Contextual Retrospect

While there is an extensive literature exploring the determinants of box office revenue and film success (see the surveys of Chisholm, Fernandez-Blanco, Ravid, & Walls, 2015; Hadida, 2009; McKenzie, 2012), the role of public state subsidies in supporting films at the box office has been given little attention, exceptions being Bagella and Becchetti (1999), Meldoni, Paolini, and Pulina (2015) and Meloni, Paolini, and Pulina (2018). In comparing the box-office performance of subsidised and unsubsidised Italian, Bagella and Becchetti (1999) identify five generic objectives for state support for the film industry:

(1) To broaden cultural options—were films of artistic merit not made, the artistic scope of future filmmaking would be restricted.
(2) To redress the commercial imperative, which puts entertainment before cultural enrichment.
(3) To foster cultural identity and national prestige.
(4) To generate positive externalities for the community and businesses tied to the film industry.
(5) To compensate the low productivity associated with 'art' films.

If fulfilled, each of these objectives would impact upon movie supply in that the films made as a consequence would embody characteristics that are 'publically' desirable and thus enrich the movie offer for audiences (Towse, 2010). It will be noted that the intended outcomes are both indivisible and non-excludable—they cannot be divided up and their effects cannot be consumed separately—they are what economists call 'public goods'. In that policy makers perceive them to be desirable; their addition to the stock of films released and available for is beneficial to the general welfare—they function as "merit" goods (Throsby, 2001). Implicit in the policy recommendations listed by Bagella and Becchetti is the idea that if left to itself the market would undersupply films that incorporated these meritorious characteristics and that given each contributes positively to the general welfare of the community, society as a whole would be worse of. The case for the subsidy is thus normative, based upon the positive externalities in consumption that occur as a consequence of audiences seeing films with particular characteristics that otherwise wouldn't have been made.

Public Choice Theory aims to apply positive economic reasoning to political decision-making (Djankov, McLeish, Nenova, & Shleifer, 2003; Netzer, 2006; Prat & Strömberg, 2010; van der Ploeg, 2006). Essentially, scholars in this tradition are concerned with who benefits from making policy. And commonly they come to the conclusion that it is not only the recipients of the subsidy but also the politicians who make the policy and the bureaucrats who administer the policy, rather than consumers or the body politic who benefit from subsidy regimes. Thus, in many cases, the allocation of subsidies is likely to lead to inefficient outcomes, meaning that resources could have been better deployed. Reasons for inefficiency in the subsidy allocation system find their roots in the work of Tullock (1965), Downs (1967) and Niskanen (1975) along with public policy commentators such as Coyne and Leeson (2004), Grampp (1986) and Austen-Smith (1986). While the stated objective of public fund allocation lies in the social and cultural policies pursued by public administrations (Grampp, 1989; Pinnock, 2006), the economic rationale behind any increase in a discretionary budget designed to maximise the quantity of services and products offered should be that of 'deadweight loss': meaning, the value of the output lost by transferring resources to the beneficiaries of the subsidy should not lead to a lowering of social welfare enjoyed by the community as a whole (Olszewski & Rosenthal, 2004). Commonly, policy makers do not adhere to such guidance.

Following Niskanen (1975), biases and inefficiency in budget allocation can be explained by two main elements. First, bureaucrats aim to expand budgets to increase their influence, role and their perceived ‘sensation’ of wealth and authority and that budget maximisation is a tool to that end. Second, a sort of bilateral monopoly is established between politicians and bureaucrats, giving bureaucrats a status similar to a monopoly organisation. Further, once the funds are assigned, politicians do not have specific instruments or information flows to assess the way the budget is then assigned to the subsidised products, making the allocation procedure even more contentious (McKay, 2011).

Thus, irrespective of the objective to which the funds are actually allocated, and the finance set aside for this purpose, the intrinsic characteristic of bureaucracy is the drive towards expanding the budgets at their disposal (Acemoglu, 2001; Easterly, 2012). Put differently, inefficiency in budget allocation procedures is sustained by a lack of political authority and responsiveness (Downs, 1967), coupled to a tendency for public organisations to have expansion as a primary aim, rather than to follow specifically the objectives for which they are established (Tullock, 1965). Miller (1997) supports these findings, emphasising that allocation inefficiency is strictly related to bureaucratic incompetence and natural inertia. He draws specific attention to the ‘self-interested choices of political actors’ (p. 1195).

The body of work under the Public Choice banner has been influential in policy analysis and discussions and could be deemed to have discernibly and positively affected government action in many English-speaking and Northern European countries well before the year 2000, with the implementation of various new reforms aimed at reducing bureaucratic inefficiency arising from budget allocation (Aucoin, 1991). Arguably, however, the strength of these ideas had not reached Italy during the years covered by this study. The findings of this study illustrate one high profile policy context in the recent past, in which even an elementary level of public policy thinking was conspicuously absent.

Government Failure

As alternative resource allocation mechanisms, it makes sense to admit the possibility that if markets fail to produce socially optimum outcomes, so might governments. That is, in promoting what government might deem to be “desirable” outcomes, public policy can lead to an oversupply of the product in question. For this to be the case, economic reasoning proposes that at the margin an assessment is necessary as to whether the value of the personal (excludable) and external (non-excludable) benefits that accrue from consumption exceeds the private (excludable) and (non-excludable) external costs entailed in subsidised production. Essentially, the decision to subsidise is an issue as to whether the resources entailed in production could have been better utilised. Government failure will occur where a government persists in supporting the production of a type of product for which there is no strong economic imperative, or, to put it differently, imperatives other than the economic dominate.

Principally, non-market or *government failure* is the case when the costs of intervention are greater than the benefits (Dollery & Worthington, 1996). Government failure in film funding may occur when the costs of setting up, operating and controlling the scheme exceed the benefits (Stiglitz, 1989). *Regulatory capture*, another form of government failure, refers to collusion between firms and government agencies assigned to regulate them (Dal Bó, 2006; Laffont & Tirole, 1991; Zerbe & McCurdy, 1999). Here, rent-seeking behavior is an important explanatory concept in economics. In public choice theory, rent-seeking is the attempt of people to obtain economic benefit for themselves through lobbying the government for privileges.[2] They typically do so by getting a subsidy for a good they produce or for belonging to a particular group of people, by getting a tariff on a good they produce or by getting a special regulation that hampers their competitors. In fact, from a theoretical standpoint, the moral hazard of rent-seeking may considerably endanger any potential efficiency gains public subsidies are about to initiate in the first place (Tullock, 1967). There are various instances of government-beneficent relations which result in a negative net effect of rent-seeking. Then, total social wealth is reduced, because resources are spent wastefully and no new wealth is created. When applied to state aid for newspapers, if lobbying for a favorable regulatory environment is cheaper than building a more efficient production, a newspaper may opt for the latter, and money is thus spent on lobbying activities rather than on improved business practices.

A larger issue concerns the impact that subsidies have on market signals and their supposed self-regulating qualities (a phenomenon that Adam Smith referred to as the *invisible hand of the market*). An alternative perspective comes from Coase's (1937) theory that firms exist in order to economise on the transaction costs inherent in using the market, which in turn provided a platform for Chandler (1966) and Williamson (1975) to develop a modern theory of the firm serving as a *visible hand* of resource co-ordination. Thus, the intervention of government may alternatively be seen in this benevolent light: as a resource coordinator serving to enhance public welfare. Hence, while governments may fail: in our case to design a policy that enhanced the cultural well-being of Italian, this is far from being a rule and more an issue of design.

3 Italy: Subsidies to Film Producers

In 1965, the Italian State recognised the film industry to be of cultural, economic and social importance. The Law established the FUS (*Fondo Unico per lo Spettacolo—Performing Arts Fund*) as the exclusive legal institution responsible for supporting different artistic and cultural activities, including opera, cinema, music, dance, theatre and drama and circus arts.

[2]Tullock, who originated the idea in 1967, was first to point to the negative externalities through rent-seeking behaviour (Tullock, 1967).

The 1965 law was followed in 1994 by Law No.153, in which the distinction was made between films that were of 'national cultural interest' and films that were 'national productions', establishing different supportive financial regimes for each. According to this law, for a film to be recognised as a 'national production' required that it was made by a company that was registered, held the majority of its capital stock, did most of its business in Italy and which paid taxes to the Italian State. In addition, a newly formed "Advisory Committee for Cinema" (*Commissione consultiva per il cinema*) was given the remit to declare films to be of 'national cultural interest' and thus entitled to a subsidy. Determined by Law No. 153, Table 1 lists the criteria the Advisory Committee was to base its decisions upon. It is evident that the status of the artistic talent involved was paramount in this process, with by far the greatest weight (0.7) given to the past artistic achievements of directors and the actors they selected.

Once selected, films of 'national cultural interest' were then referred to the "Committee for Cinema Credit" (*Comitato per il credito cinematografico*), which made decisions about the loan-worthiness of their producer(s) and the maximum loan to which they were entitled. In financial terms, productions recognised as 'films of national cultural interest' could take advantage of the "Participation Fund" (*Fondo di Intervento*), assisted by the "Guarantee Fund" (*Fondo di Garanzia*). The Guarantee Fund was established to support the costs of films of 'national cultural

Table 1 Films of 'national cultural interest' (criteria, threshold value and relative weight)

Ref. Code	Parameter	Threshhold value[a]	Score
A	*Director's artistic contribution*		70[b]
A1	Awards won by the director for direction or best film	1	20
A2	Contribution of previous films directed by the director to festivals or nominations as award finalist for direction or best film	1	10
A3	Number of films directed by the director with box-office revenues >800,000€ in the last 10 years	2	10
A4	Awards won for best acting by main actors of the cast selected by the director	1	20
A5	Nominations for best acting by main actors of the cast selected by the applying director	1	10
B	*Screenwriter*		20
B1	Awards won by the screenwriter for screenplay	1	15
B2	Screenwriter's nominations as finalist in awards for screenplay	1	5
C	*Screenplay*		10
C1	Screenplay drawn from a work of literature	Yes	5
C2	Original screenplays	Yes	5

Source: Ministerial Decree dated 27th September 2004, Table A

[a]The "Threshold value" refers to the minimum number of awards, nominations or other criteria previously received by the artistic talent associated with the qualifying films

[b]Relative weights given by law

interest', and its capital endowment consisted of contributions allocated by the State to the industry. The sum of money not spent by the Guarantee Fund was added—through 6-month adjustments—to the Participation Fund, thus serving as a reserve for future financial needs. Through this system, the State guaranteed 70% of any finance granted, which producers were not required to pay back. An aspect of this loan guarantee scheme catered for those films of 'national cultural interest', which were the first or second works of Italian directors.

By contrast, "national film productions" were not submitted for assessment to the Advisory Committee for Cinema. Rather, such films were able to benefit from low interest credit facilities up to a value of 3.2€ million (subsequently raised in 2004 up to a maximum of 5€ million). However, unlike films of national cultural interest, national productions could not take shelter under the umbrella of the Guarantee Fund, meaning that the State did not underwrite the loan and the producer was required to repay any loan in full.

For the purposes of this chapter, 'subsidy' is understood to be those loans granted to films of 'national cultural interest', including the 'first and second works' of directors, which did not require repaying, while 'national productions', although able to access low interest credit facilities, are categorised as non-subsidised films, since whatever State support granted had to be repaid. Short films are not included. Since 'national cultural interest' is a much more subjective requirement than 'national production', quarrel is originated on the potential biases behind the valuation carried out by the Advisory Committee for Cinema.

An overview of annual public aid to the Italian film industry in the period 1995–2003 is presented in Table 2. Aggregating the data for the 9 years, 680.1€ million were assigned to 445 films that took advantage of the Guarantee Fund (columns (A) + (C)), comprising 357 films of 'national cultural interest', which were supported by 607.1€ million in loans, and 88 'first and second works', supported by 73€ million loans. The 131 'national film productions', deemed not eligible for the Guarantee Fund, obtained loans totalling 136.2€ million. Thus, in the 9 years examined, 83.3% of public resources were given to productions that were not bound to make repayments to the State (680.1€ million out of 816.3€ million): 74.4% to films of 'national cultural interest' and 8.9% to 'first and second works'. Only 16.7% of these loan facilities went to films that did not have their finances to some extent guaranteed by the State.

4 Italy: Data and Approach

During the 9 years 1995–2003, 914 Italian films were released into the Italian theatrical market. Of these films, reliable records of production cost and box-office revenue is available for 566 films, 135 of which were films of 'national cultural interest'—films that received loans guaranteed by the Guarantee Fund. The data were provided by the *Osservatorio di Cinecittà* (operating branch of the Ministry of Cultural Heritage), which serves as the centre for the collection, analysis and diffusion of economic, qualitative and personnel information on the Italian film

Table 2 State financing of the Italian Film Industry, 1995–2003

Year	Films of National Cultural Interest (A)		National Films (B)		First and second works (C)	
	Expenditure (€)	Films	Expenditure (€)	Films	Expenditure (€)	Films
1995	47,754,704	40	20,674,286	24	0	0
1996	41,006,667	40	29,128,169	27	0	0
1997	55,260,888	41	21,830,633	18	8,396,039	14
1998	80,163,923	44	16,991,431	16	7,139,500	11
1999	75,402,707	45	9,761,035	11	6,186,637	10
2000	40,025,409	25	22,362,583	19	11,516,988	13
2001	47,227,401	24	6,736,147	6	14,238,407	15
2002	110,844,380	52	403,869	1	11,337,096	11
2003	109,442,473	46	8,324,063	9	14,178,156	14
1995–2003	607,128,552	357	136,212, 216	131	72,992,823	88

Source: FUS reports from 1995 to 2003 to the House of Parliament (*Relazione al Parlamento*), *Direzione Generale per il Cinema*. Ministry of Cultural Heritage

industry. *Cinecittà* obtained the data about box office revenues and production cost from the *Banca Nazionale del Lavoro*.

A measure of profitability is derived by deducting production costs from box-office revenues, and the rate of return is obtained by expressing this as a percentage of production costs. Thus, these measures of performance do not contain distribution and promotion costs and hence overestimate profitability. Nor do they reflect further downstream revenue flows from DVD rental and sales and television sales.[3] However, given that the focus of this chapter is on the relative performance of subsidised films with the purpose of establishing how effective the State subsidy has been, these limitations are not critical.[4]

5 Results: Subsidies—No Positive Returns

Tables 3 and 4 set out the main results. From Table 3, it is clear that although the public subsidy attenuates the financial exposure taken by producers, the collective failure of the subsidised films at the box office means that the subsidy fell far short of assuring them positive returns on their investments. Across the 9-year period, the Italian State contributed over 40% of the production costs of the 135 films of

[3]See Sedgwick and Pokorny (2010) for a methodology for estimating profits using estimates of distribution costs and non-theatrical revenue streams.

[4]The euro has been in force in countries belonging to the Economic and Monetary Union since 1st January 2002. Accordingly, a large part of the costs and revenues of films included in the initial raw data are expressed in the pre-euro Italian currency unit, the lira. Therefore, all the monetary values of such films have been converted into Euros, at the fixed exchange rate of 1€ = 1936.27 Italian lire and expressed in 1994 prices.

Table 3 Profitability analysis of films of 'National Cultural Interest' (subsidized films) in Euros, using 1994 prices

Year	Subsidised films	Total box-office revenues	Mean revenues	Total production cost	Public subsidy	Proportion of costs subsidised	Net production cost	Mean rate of return, excluding subsidy	Mean rate of return, including subsidy
1995	13	5,744,793	441,907	29,854,799	10,711,066	0.36	19,143,733	−0.81	−0.70
1996	18	6,198,865	344,381	29,682,059	14,352,994	0.48	15,329,065	−0.79	−0.60
1997	13	5,565,301	428,100	21,085,495	8,934,311	0.42	12,151,184	−0.74	−0.54
1998	11	9,899,387	899,944	33,628,855	16,071,228	0.48	17,557,627	−0.71	−0.44
1999	17	3,686,625	216,860	35,939,660	14,905,518	0.41	21,034,142	−0.90	−0.82
2000	10	5,227,105	522,711	18,522,111	10,859,926	0.59	7,662,185	−0.72	−0.32
2001	21	9,877,491	470,357	54,797,227	19,668,615	0.36	35,128,612	−0.82	−0.72
2002	13	1,616,991	124,384	19,647,866	8,996,861	0.46	10,651,005	−0.92	−0.85
2003	19	10,090,803	531,095	50,379,694	22,549,458	0.45	27,830,236	−0.80	−0.64
Total	135	57,907,361		293,537,766	127,049,977		166,487,789		

Source: FUS reports from 1995 to 2003 to the House of Parliament (*Relazione al Parlamento*), *Direzione Generale per il Cinema*. Ministry of Cultural Heritage

Note: Rates of return calculations are exclusive of distribution and promotion costs

Table 4 Profitability analysis of the non-subsidised films (in Euros, using 1994 prices)

Year	Non-subsidised films	Total box-office revenues	Mean revenues	Total production cost	Mean rate of return
1995	41	76,655,785	1,869,653	79,093,699	−0.03
1996	38	101,632,814	2,674,548	99,797,168	0.02
1997	53	147,409,949	2,781,320	110,955,908	0.33
1998	48	98,137,329	2,044,528	118,009,493	−0.17
1999	58	66,535,406	1,147,162	168,448,585	−0.61
2000	40	59,374,934	1,484,373	79,982,476	−0.26
2001	51	84,087,760	1,648,780	125,259,164	−0.33
2002	55	101,339,175	1,842,530	206,938,975	−0.51
2003	47	74,568,721	1,586,569	141,187,601	−0.47
Total	431	809,741,873		1,129,673,069	−0.28

Source: Osservatorio di Cinecittà: FUS reports from 1995 to 2003 to the House of Parliament (*Relazione al Parlamento*), *Direzione Generale per il Cinema*. Ministry of Cultural Heritage
Note: Rates of return calculations are exclusive of distribution and promotion costs

'national cultural interest'. On the other side of the ledger, the subsidy amounted to twice the revenue generated by these films at the box office. Indeed, as mentioned earlier, of the 135 films in the sample, only three covered their production costs without the subsidy, while another 14 did so as a result of the subsidy.[5]

The relationship between revenues and subsidy is further examined by simple bivariate OLS regression of revenues on subsidies. The outcome is a statistically significant positive coefficient value for the dependent variable. But with an R^2 that is <0.1, on top of a highly positively skewed residual plot in which a disproportionate number of films earn revenues less than that predicted by the model, counterbalanced by a relatively small number of films that earn substantially more, no discernible relationship can be detected between box office and the subsidy. In contrast, a better fitting model is obtained by simply regressing production costs on subsidy, with a highly significant coefficient value for the dependent variable, as well as an $R^2 > 0.3$, and a better behaved distribution of the residual error. Not surprisingly, the size of the subsidy is related to the size of the production budget, although other factors clearly play a part.

6 Conclusion and Discussion: Government Failure

In the light of the results shown in Tables 3 and 4, it would appear that the State subsidy given to the Italian film industry between 1995 and 2003 was neither an efficient nor effective instrument for generating consumer well-being, supporting the view that either public resources used to support film production could have

[5]The three films were: *I Cento Passi* (2000), *Tano Da Morire* (1997), *Le Affinità Elettive* (1996).

been better utilised elsewhere, or the instrument could have been better designed and targeted. Indeed, had the films of 'national cultural interest' not been subsidised, very few of them would have been made, meaning they only take a marketable form because they are subsidised. Bagella and Becchetti (1999) claim that subsidy can be justified 'provided that we refer to those movies that can be considered a form of art' (p. 238)—see also Dimitri and Paolini in this book. Clearly, these authors propose a 'market failure' type of argument: that is, if left to itself the market will undersupply films that are of cultural merit. However, the evidence presented in Table 3 indicates that so few paying customers went to see films of 'national cultural interest'—particularly between 1999 and 2002—as to render virtually empty any argument inferring that they contributed to the general diffusion of cultural welfare. Of the five reasons supporting the subsidy advanced by Bagella and Becchetti (1999), only the fourth—that of generating positive externalities for film production—is not critically weakened by the chronic lack of consumer interest shown in the films being subsidised. However, of course, this argument has a severe moral hazard dimension to it, in that producers/directors in proposing that their film should be supported by the State will know that films of 'national cultural interest' rarely became films that are of popular interest.

The results can be readily rationalised in the context of simple public policy thinking. The evidence furnished in this Italian arts context suggests that subsidy allocation process seems better to serve the needs of the production and bureaucratic bodies involved, rather than the altruistic aims for which the subsidy awarding panels were commissioned. Over the period under study, the influence of the then Prime Minister Silvio Berlusconi, in the political, business and public media domains, was strong and pervasive. However, this should be set against the role played in Italian cinema and culture by left-wing artists (Gundle, 2000). Accordingly, many opponents to the present system argue that left-wing governments sustained the film industry because it was ideologically sympathetic to the left. Furthermore, it has also been suggested that left-leaning parties would typically highlight cuts made to film industry budgets when right-leaning governments were in office, campaigning on the diminution of "national cultural interest" that such policies entailed. Some have even gone as far as to argue, "[. . .] left-wing welfare has sunk the film industry" (Kolker, 2009; Mecucci, 2007).

Even though the subsidy allocation procedure is based on objective criteria, there is considerable scope for various lobbies to influence the award of prizes and subsidies and thus skew outcomes. This process of influencing budget allocation is similarly observed within other sectors (such as health and education) and also in other geographical contexts (Mitra, 1999; Marshall, 2012). Some commentators (e.g. Gundle & Parker, 1996) do, however, acknowledge the unavoidability of market failure arguments. In large part, this has been linked to the domination of Italian media and cultural industries maintained by Berlusconi and his commercial interests (Downey & Koenig, 2006; Quaglia & Radaelli, 2007). Such fears were exacerbated by his potential to influence these sectors even more profoundly after his entrance into the political arena in 1994 (Hasted, 2008). That a Prime Minister who had extensive personal media interests was ultimately responsible for national media policy made the conflict of interest issue particularly acute (Hanretty, 2007). Inevitably, the complex political context is likely to have impacted on policy, causing the film subsidy to be less effective than it otherwise might have been in securing broader national cultural and industrial objectives.

With respect to the Italian film industry, the legislation designed to promote a cinema of cultural integrity through subsidy resulted in an institutional apparatus that was self-serving, producing films that formed small niche markets that were largely ignored by the cinema-going public at large. For the same period, Jansen (2005) has produced a similar argument with respect to the subsidisation of films in Germany. Much of the blame for this lay in the actual design of the policy. The film business is generally considered to be highly risky in that audiences are attracted by novelty and need to discover whether or not they like a particular film. Producer risk is thus born out of consumer risk (Sedgwick & Pokorny, 1998). Popular cinema works on the basis that producers attempt to generate novel products that audiences pay to see. While audiences are not infrequently disappointed, producers commonly fail to attract sufficient audiences to cover the costs associated with finance, production and distribution. Thus, both producers and consumers incur risk. That the producers of 'films of national cultural' were not required to take much in the way of risk, meant that they had less incentive to produce films that audiences in sufficient numbers wanted to see. It would appear that the bilateral monopoly that emerged between bureaucrats and politicians oversaw a system in which the size of the audience was of secondary importance to getting the film made. Inevitably, if consumer well-being is removed from the equation, the market becomes distorted in that the cultural establishment, including filmmakers, civil servants, politicians and cultural commentators and not audiences at the box office, drives the imperative.

Historically, "cinema" and "audiences" have been conjoint concepts—without audiences there would be no cinema. However, in the case of Italian cinema, the state subsidy between 1995 and 2003 served to separate the two, leading to the production of too many films that too few filmgoers paid to see. Thus, while it might be claimed by some that subsidy was essential to the very existence of the film industry, the results presented herein suggest that the subsidy regime could not assure the future development of the industry since, even before distribution costs were factored into the profit equation, production losses exceeded the subsidy. The subsidy regime during this episode of recent Italian cultural history was ineffective and wasteful. An approach in which markets impose a measure of discipline on the support given to the film industry would surely be preferable—i.e.: product markets in which exhibitors screen films that audiences actually want to see and finance markets in which investors (including the state) are attracted to products that have a good prospect of generating positive rates of returns. Specific institutional and contextual elements characterising the Italian system have got in the way of achieving such an outcome. To some limited extent, by creating a system in which both the State and producers share the revenue stream generated by subsidised films on the basis of their respective contributions to costs, recent reforms of the subsidy regime have begun to address the issues raised in this study. In doing this, the regime now requires the case for subsidies to be much more rigorous from a film production business viewpoint, but the existential rationale for the provision of such ‘riskless’ subsidies seems to remain politically unquestioned, at least up until the time being.

As for the current situation, in January 2016, the current Minister of Culture, Dario Franceschini, presented a draft for a new cinema law (*Disegno di legge* no. 2287 “*Disciplina del cinema dell’audiovisivo e dello spettacolo*”). The aim of this new law is to give the Italian Film Industry a more functional and less wasteful regulatory framework. Under the draft proposal, a new fund “*Fondo per lo sviluppo degli investimenti nel cinema e nell’audiovisivo*” with an annual endowment of 400€ million is proposed, designed to stabilise financial resources available to the audiovisual industry. The fund takes inspiration from the French model and will be financed from taxes derived from the audiovisual industry. It will support the indigenous production in four ways: through: (1) *tax credits*, (2) *automatic subsidies*, (3) *selective subsidies* (4) and *co-funding arrangements* with selected cultural institutions—*La Biennale di Venezia; Centro Sperimentale di Cinematografia; Istituto Luce-Cinecittà*.

With reference to *automatic subsidies* (*contributi automatici*), the new draft proposes the abolition of the existing infrastructure built around promoting films of ‘national cultural interest’, the essential aspects of which can be found in Sect. 2, and replacing it with one in which indigenous production companies seeking support will be evaluated by a mixture of artistic and economic criteria, entailing an assessment of their previous domestic and international box office performance, prizes won, financial robustness, profitability and average production costs. To be managed by a new commission (*Gruppo di Esperti*), under the proposal, only 15% of the Fund will be dedicated to *selective subsidies* (*Contributi Selettivi*), with the focus on supporting artistic and cultural movies, the first or second works of directors, young talent, start-ups and small cinema halls.

Appendix

Law and regulation developments concerning public subsidies to film production in Italy

Law no. 1213, 4 November 1965	Italian State confirmed its support and commitment to the film industry—one that can be dated back to 1927
Decree no.26, 14 January 1994, amended in 2004/5	A distinction between films of ‘national cultural interest’ and ‘nationally produced’ films is established, each governed by separate administrative procedures
Law no. 153, 1 March 1994, Article 8	The categories of ‘first works’ and ‘second works’ related to films of ‘national cultural interest’ are introduced
Law no. 137, 1, 6 July 2002	New procedures to improve subsidy allocation, and control
D. Lgs. No. 28, 22 January 2004	Establishes a new set of guidelines for the regulation of the public subsidy to film industry
Ministerial Decree, 27 September 2004	Stricter prescriptions on subsidies to film production are introduced
Ministerial Decree, 13, August, 2015	Criteria published defining ‘cultural interest’, including technical criteria necessary for films to be considered eligible for public funding

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