

# NON CONVENTIONAL SOURCES ON FINANCING MOVIES: THE CASE OF ITALY

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## *Summary*

The theme of financing movies by the Government is discussed in relation to cognitive dissonance and rent seeking with the distinction between inefficient and efficient rent seeking. After an exam of the European Union principles to protect the cultural identity of its region, the paper analyzes the state aid to the movies in Italy by the Fund for the Performing Arts (FUS) from 1985 to 2010 showing its inefficiency as for its European objectives. More efficient results were obtained by two methods more oriented to the market: tax credits to investment in movies produced in Italy and local Governments aid to the production of movies valorizing local cultural and environmental values as tourist attractors. Product placement is also analyzed to show that the adoption of its techniques could improve substantially the local policies of "cine-tourism,, by reducing wasteful rent seeking.

**Keywords:** Efficient rent seeking, movies as cultural good , movies industry, cine tourism,

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## SECTION I

### *Cognitive dissonance as source of rent seeking, and public aid to movies in the European Union*

#### *1.1. Cognitive dissonance. Inefficient and Efficient rent seeking.*

Tullock (1971) employs the paradigm of cognitive dissonance to explain why people vote for income redistribution in favor of the poor instead of aiding them privately through charity. Aid to the poor satisfies the altruistic sentiment of solidarity arising from information on the needs of the poor. But enters in conflict with self interest, which prevents or "excessively "limits the direct altruistic private charity. To resolve

the dissonance between the sentiment and duty of altruism that people perceives to aid the poor and the scarce day to day personal altruism, people vote for redistribution in favor of the poor. Because also those who are uncharitable are obliged to share the cost, the solution of public aid, as for the charitable people, is less expensive than the private action.<sup>1</sup>

The European principle of public aid to European cultural goods sold on the market, that do not make enough revenue, because of the competition of non European products may be explained in terms of cognitive dissonance with arguments stronger than that found by Tullock as for the charity to the poor. Indeed one may observe an inconsistency between the scarce demand of these cultural goods by the citizens on the market who prefer the foreign goods and the belief of the citizens as voters that use taxpayer money to finance the market existence of the domestic products.

Tullock, in his first paper on rent seeking, devoted to the welfare implication of tariffs, monopolies and theft (Tullock 1967) introduced the dichotomy of efficient and inefficient rent seeking, to focus on the contrast between a competitive and an inherently monopolistic process of acquisition of public rents. He made reference to monopolistic privileges created by trade protection, public utilities subject to government regulation, other public concessions. under limited of supply. The position which the rent seekers aim to obtain gives them a monopoly or quasi-monopoly rent. However to acquire that rent, the rent seekers undergo a cost, consisting in the expenses to obtain the .privileged position. The costs may be limited if the process of acquisition of the rents is uncompetitive. In this case, the rent seekers may be able to capture the e consumer surplus of the monopolistic position. But if the process of acquisition of the monopoly rents is competitive, the winner of the privileged position, at the margin, may have incurred costs equivalent to the expected rent . The paradoxical result is that of a negative sum game: the consumers loose a share of their

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<sup>1</sup> The theory of creative dissonance has been introduce in social psychology by L. Festinger's (1962 and 1985 ),A Theory of Cognitive dissonance, Stanford, Stanford University Press .Cognitive dissonance theory suggests that we have an inner drive to hold all our attitudes and beliefs in harmony and avoid disharmony (or dissonance).. According to Festinger, we hold many cognitions about the world and ourselves; when they clash( as when we realized that smoking habits that we have and like to have may cause cancer) a discrepancy is evoked, resulting in a state of tension known as cognitive dissonance. As the experience of dissonance is unpleasant, we are motivated to reduce or eliminate it, and achieve consonance (i.e. agreement).The outcome may be to vote for a (“good”) public choice to remedy to the private (“bad “) choice in which we persist. ..In economics cognitive dissonance has been introduced by Gordon Tullock in his 1971 paper on the Charity on uncharitable above referred where he argues that creates an artificial expansion of the public sector , because those who vote for public charity to restore the consonance are charging on tax payers that do not feel any dissonance, part of the burden of the aid to the poor that they feel necessary but do not want to satisfy privately .The cognitive consonance theory has been formalized in political economy by G. A Akerlof, in the paper with W.T. Dickens, (1982), *The Economic Consequences of Cognitive Dissonance*, American Economic Review . vol. 72, with an opposite result. Wrong private irrational choices as those of the workers of not adopting costly safety equipments are corrected by rational public choices as those of making the safety equipment compulsory . G. L. Brady, J.R. Clark and W.L. Davies (1995), *The Political Economy of Dissonance*, Public Choice, vo. 82 have connected cognitive dissonance with rent seeking .

consumers surplus to the monopolist who gets a monopoly rent and uses it merely to cover the costs of the investment done . (Tullock 1982). However one may say that the rent seeking process is efficient because there is no appropriation of surplus by the winners in the competition for the public benefit (Tullock 1980).

Tullock implicitly assumes both that the considered public interventions never provide a benefits to the community and that the competition game among then rent seekers is distorted by wasteful means. But the public intervention may, per se, provide benefits to the community: for instance there are cases in which the public regulation prevents the monopolistic exploitation of the market deriving to a public utility from a “natural monopoly”. The following competitive market process that prizes the best, may allow the winners to provide a rent to the consumers while the competition.

And, actually, the dichotomy of inefficient and efficient rent seeking, may be extended to the case in which the government is not offering to the would be rent seekers a privileged market position but a public aid for the private supply of public goods ,in competition with the publicly provide public goods .This may be the case in protection of environment, education, arts and culture, development of less developed regions (Forte, Magazzino, Mantovani 2011), promotion of cooperatives to foster growth (Forte & Mantovani 2009).

Obviously there are great risks in developing the public aid to private activities, under the label of private supply of public goods, because this entices a ”rent seeking” process. But the alternative is a production of public goods by the government in a monopolistic position. And here too rent seeking may take place, being a phenomenon inherent to the existence of the public economy.

Gordon Brady (2005) refers to an “iron triangle “ between interest groups, politicians, and bureaucrats that , actually, becomes a quadrangle, trough the connection with media am other public opinion makers (as intellectual elites connected with the pressure groups) . Still rent seeking then may be defined as efficient if the benefit exceeds the cost at the margin, according to the accepted criteria. It should be noticed that a rent seeking game “ efficient “ in this economic sense may allow sizable producers rents even if the process of selection of the beneficiaries of the rents prizes the best offers .

Obviously then there is the problem of divergence about public wants between different voters-taxpayers and between rational public choices and true public choice in an highly imperfect scenario .

All these issues shall emerge both in examining the public aid to movies industry in Europe and in the other continents and in focusing on the various instruments adopted in the last thirty years, with particular reference to Italy.

### 1.2 *European Aid to cultural good*

According to the principles of the European Treaty, an exception is allowed to the cultural goods, as for the general veto to public aid to economic activities. Indeed, on the basis of Article 107, §.2 of the present text of the European Treaty, may be considered compatible with the common market “ d) aid to promote culture and heritage conservation where such aid does not affect trading competition in the Union contrary to the common interest.” In the same article -under c) - aid may be allowed to promote tourism and other economic activities in less developed areas of the EU countries if does not affect trading competition in the Union contrary to common interest.

Public aid to movies as cultural products has been allowed by the European Union since many decades on the basis of the above seen “cultural exception “ to the prohibition of state aids to economic activities of article 107, § 2.,.

The thesis that movies are, as such, cultural products (see Ridler, M. B [1986], Mass-Coltell A. [1999], Caves, R. [2000], Chisholm, D. [2003],[ De Vany, A. (2006)], is unconvincing. However the stated aim of the cultural exception is not the promotion of cultural goods in the normal sense of the word, but that of defending the “cultural identity” of Europe: An end that, in its vagueness, allows much inefficient rent seeking. To start with, as Mass-Coltell (1999) observes, there are two possible interpretations of this principle: the protection of production of national culture and the protection of cultural products taking place in the country even if do not express the national or local culture. It seems that only in the first type of protection may be justifiable for the end of preserving the national or local cultural identity. It may be objected that is difficult to distinguish them in practice: for instance even in national cultural products that imitate the foreigners there may be a component of domestic culture. However, it remains true that by the principle of considering cultural good any movie produced in the country merely because may contribute to preserve the national or local identity implies to aid also mere entertainment movies. And to the tax payer this may not appear an end that justifies a public aid, even if is admitted by the European Treaty.

But for the lobbies favoring the protection of the movies industry, the permission by the European rules, was enough, to foster a French public aid to it, managing the “cognitive dissonance” stimulated by the threats from America’s mass entertainment, “fast culture”. The need of this aid was reinforced with the additional connotations of defense from “excessive cultural capitalism” (Lyombe 2010). France thus, since long time, has protected her movies industry by subsidies and quotas against the US competition, as part of an identity battle (Rigaud, 1995). Public aid to movies spread from France almost every were in Europe, officially on the basis of principle of the cultural diversity<sup>2</sup>, but practically to avoid to defend the domestic movies industry from both the US and French competition.

Five main ways of giving public aid to movies at the central government level, as well as at regional and local level did develop: 1) government grants; 2) government credits; 3) equity finance, 4) tax benefits, 4) facilities and aid in kind.

In 1993, the European Union, under this French pressure, has introduced in the international free trade negotiations of the Uruguay Round the clause of protection of national diversity.

The European Commission in 2001 intervened to limit the excessive growth of state aid to movies industry, setting restrictive criteria, which, actually, were not so much restrictive. Indeed the EU Commission<sup>3</sup> states that

I) The control that the content of the aided production is cultural according to verifiable national criteria must be done by each member state, according to the subsidiarity principle.

II) The producer must be free to spend at least 20% of the film budget in other Member States without suffering any reduction in the aid provided for under the scheme.

III) Aid intensity must in principle be limited to 50% of the production budget with a view to stimulating normal commercial initiatives inherent in a market economy and avoiding a bidding contest between Member States. Difficult and low budget films are excluded from this limit. Under the subsidiarity principle, it is up to each Member State to establish a definition of difficult and low budget film according to national parameters.

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<sup>2</sup> see European Audiovisual Observatory (1998), Iris Plus (2001), Deleau (2008), Talavera Milla (2010 a), Talevera Milla (2010 b), Talavera Milla (2012 a), Talavera Milla (2012 b)..

<sup>3</sup> See “Communication of 26 September 2001 on certain legal aspects relating to cinematographic and other audiovisual works

IV) Aid supplements for specific filmmaking activities (e.g. post-production) are not allowed in order to ensure that the aid has a neutral incentive effect and consequently that the protection/attraction of those specific activities in/to the Member State granting the aid is avoided.

In 2005 the countries member of Unesco have subscribed a Convention on Protection and Promotion of Cultural Diversity .

According to a study of the European Audiovisual Observatory on the evolution of public funding from 2007 to 2011<sup>4</sup>, in this period the amount of public funding made available for film and audio visual production in the European Union and the countries outside grew by 45% from about 800 billion euro to about 1,2 billion. The fund allocated in the EU, in 2011, were 95% of the total , those of non European countries only 5% . Of the total allocated in the EU countries, 77% was allocated by the five main countries, France, UK, Germany, Spain, and Italy with France counting for about one 40% of the total, Germany for about 16% and the three remaining country with another 7% each. A classical example of the relevance of the cognitive dissonance principle for the public sector interventions. Indeed , there subsidies to the European movies industry, deriving from laws approved by the national parliaments of the European countries, where motivated by the need to contain the diffusion of the mass media American mass culture in Europe, which, obviously, derived from the fact that the majority of the Europeans that had welcome these laws, increasingly preferred these American movies.

On the one hand, as consumers the majority of the Europeans paid to see American movies, on the other hand subsidized with tax payers money of them and of the minority, the national movies, to settle the dissonance between the preference for their cultural identity and that for the American new attractive culture.

## SECTION 2

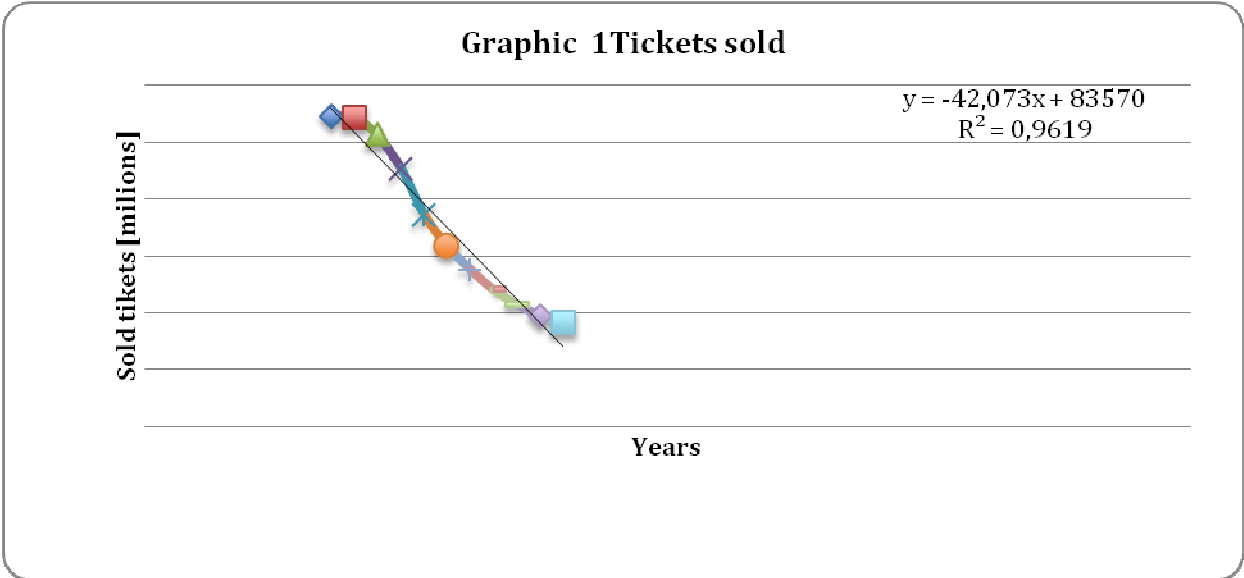
### *The bad performance of State subsidies to the Italian Movies*

#### *2.1 The crisis of Italian movies in '80*

In Italy, the policy of aid to movies became important in the mid '80 because of the crisis of the Italian movies. As one can see from Graphic 1 in the '73-'83 period there had been steep decrease of ticket sold in the Italian cinemas

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<sup>4</sup> EUROPEAN AUDIO VISUAL OBSERVATORY (2002) ,Yearbook 2002.Film, Television and Multimedia in Europe, Strasbourg, France

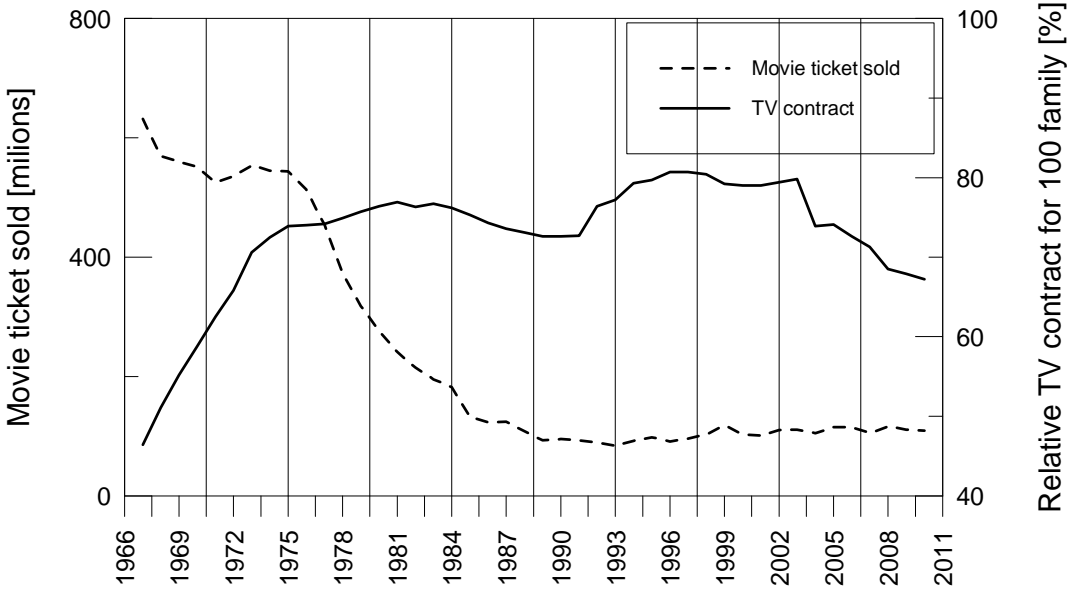


Source: ISTAT

This phenomenon may be explained by the competition of the new mass culture of which the diffusion of TV was the most representative expression (Table 2 Appendix).

Indeed as one can see from Graphic 2

**Graphic 2 Tickets sold and TV contracts**



there is an inverse relation between the diffusion of TV ,as measured by the number of TV owners, as assessed by the number of TV contracts subscribed with the State Television <sup>5</sup> and the reduction of attendance to the Italian cinemas as measured by the number of tickets sold in them. To

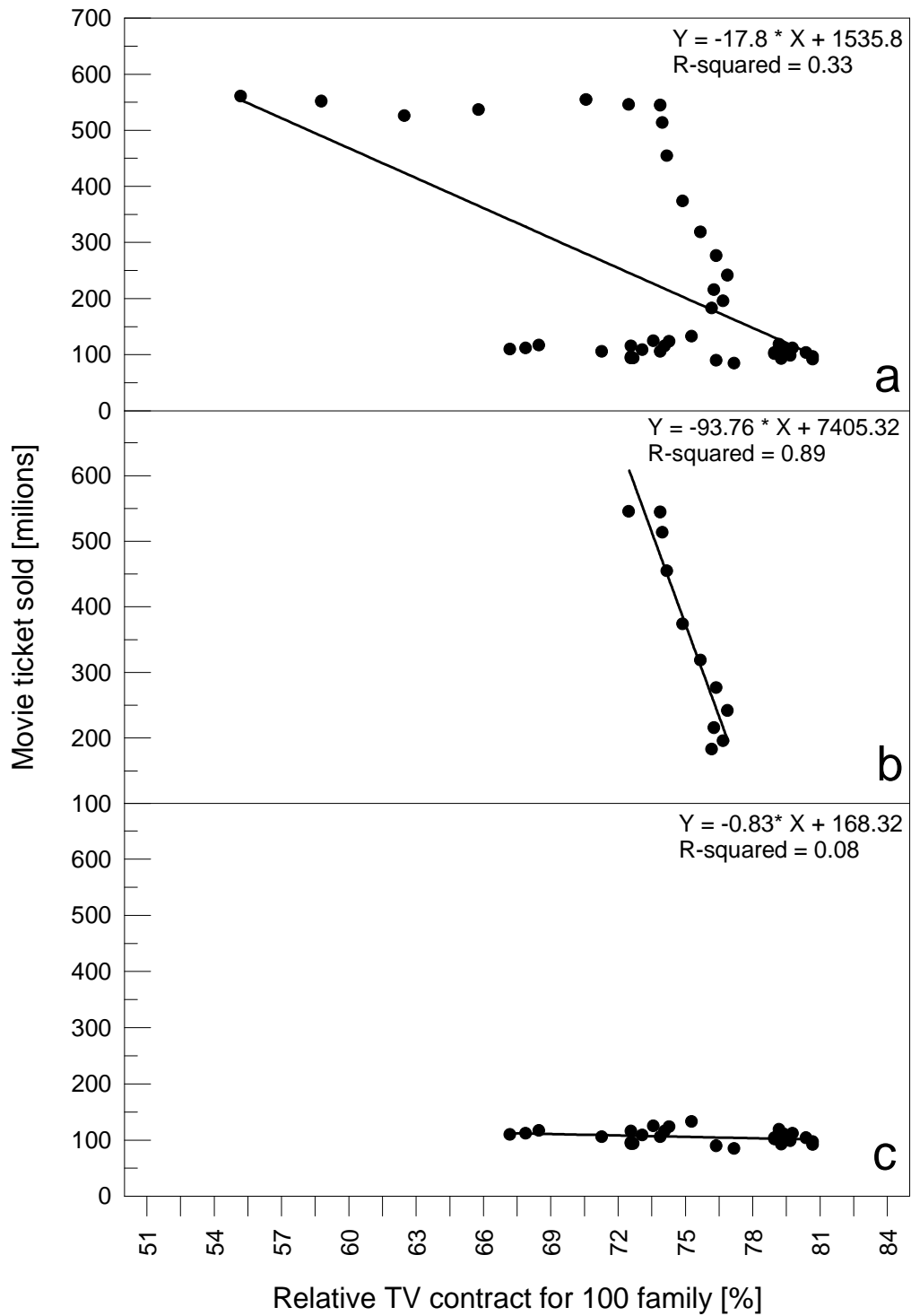
As Graphic 3b shows there is a very strong correlation ( $R^2 0,89$ ), for the period 73-83 between the increase of %of families with TV and the reduction of ticket sold (on the y

<sup>5</sup> According to the Italian Law any family that owns one or more TV functioning apperals is obliged to subscribe the contract with the State Television. The number of contracts reflects the diffusion of the TV apperals only imperfectly because there is a sizable percentage of evaders to the tax. However there are no reason to believe that this percentage is substantially diminished through tim

axis). For each percentage point of increase TV owners families we have a decrease of the ticket sold of 0,89.



**Graphic 3 Regression between TV contracts and movies' tickets sold**



To measure the market situation of the Italian movies before and after the policy of public aid initiated systematically in 1986, we, by the data set of SIAE, have re-constructed the market share of Italian movies in terms of revenue of Italian on the total revenues of the movies projected in the Italian Cinemas and the market share of the Italian movies in terms of number of new Italian movies of the total new movies in the Italian Cinemas from 1966 to 2000 (see Tables 1 and 2 in Appendix).<sup>6</sup> Until 1977 the market share of the Italian movies in terms of revenues had been constantly above 50%, with a peak of 64% in 1971. In 1978 it went, for the first time, to a 43%. And, subsequently, the downward trend persisted with a limited recovery in the first decade of the new century (Table 1 Appendix). In the sixties and until mid-seventy, the market share for the new Italian movies in the Italian cinemas in terms of number had been mostly above 50%. Until '86 then this market share dropped to a level around 25% and then fluctuated without a substantial recovery except in the last period. (Table 2 in the Appendix).

While the number of Italian movies produced until the mid-seventy remained in a range of 281-216 films per year, at the end of the decade the number of new movies decreased below 200 with a downward trend. The employment level in this industry shrank and the political pressure to protect it in the '80s increased.

## *2.2 A special state fund FUS (Fondo Unico per lo Spettacolo Unique Performing Arts Fund)*

Actually, the entire sector of performing arts had dramatically lost ground in the '70s due to the new mass culture trend. The alarm of the cultural elites at the mid-'80s was a precious ally to the movies industry in its pressure on the Government to get public aid. Thus, with <sup>7</sup> a special state fund FUS (Fondo Unico per lo Spettacolo= Unique Performing Arts Fund) was created in April 1985, under the Ministry of Culture, with an endowment determined every year by the budgetary law, to aid the Italian performing arts, with a special section for the movies.

2.2 FUS, according to the original Law of 1985, destined 25% of its funds to the movies subsector. From the '90s the Fund constantly diminished in real terms and as % of GDP. Initially the amount given to the movies industry was 150 billion lire, equivalent of €75 mln. A huge amount considering that the aggregate revenue of the Italian movies in 1985 was 153 billion lire. In 1990 the fixed percentages for the various sectors were

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<sup>6</sup> Utilizing the official statistics of the authority that controls the copy rights SIAE and those of the Association of Italian Cinematographic Industries (ANICA)

<sup>7</sup> Law n.163 of April 30 1985 promoted by the Minister of the cultural goods and activities

abolished . The movies ,from then on, obtained an yearly percentage oscillating around 18% . The funds are mostly destined to finance the new feature films on the basis of the project presented to the ministerial committee of experts.

A section is reserved to debutants new and producers. A minor share is reserved to short films, films festivals, prizes for the best movies. The share of new movies that obtain the funds of FUS on the total new movies produced per year is very large: often above 50% of the total (see Table 2 in the Appendix).

The financial aid to the production of new movies, originally, was mostly given by loans at very low interest rate. But the sum received had to be reimbursed only if there were returns net of production and only partially. Furthermore often the company producing the movie was dissolved after the production and no sanction was given for the violation of the obligations of reimbursement. Thus only a small share of the loans was recovered. Subsequently a variety of grants was added to the loans. The criteria for the assignment of the aid underwent continuous changes in the attempt of improving its effectiveness, but also to reflect changes of policies, under the influence of different pressure groups: those of the intellectual elite, mostly connected with the left, and those of the market oriented movies producers. Broadly speaking, initially the parameters relevant beside the cultural quality of the movies, where the coherence and articulation of the subject, the reputation of the director and artists and their technological and organization characters. In 1997 the Committees for the assignment of the funds was reformed A major change was done in 2004 with the introduction of a contribution on the movies' revenues, to boost the production of market oriented quality-movies , by Law January 22/01/2004 n. 28 d "Reform of rules for the matter of the cinematographic activities " promoted by the minister of Cultural Goods heritage and Activities Giuliano Urbani under the first Center right Berlusconi Government.

The revenue-market share of the Italian movies on the aggregate revenue in the Italian cinemas (see Table 1 in the Appendix) that was 39,00% in 1983 , 33,12 % in 1984, and 30,06% in 1985 first year of the FUS , from 1986 to 2010 oscillated in the range of 20,65 % - 27,84% , with two exceptions slightly above in 1987 and in 1997 and two slightly below in 1993 and 2000.

Practically the market share of the Italian movies, in the entire period after FUS to now , remained blocked at a level slightly lower than that of the first year of the FUS, with a limited recovery on the last decade of the considered period . Meanwhile FUS funds for movies had declined from 0,026% of GDP to 0,005 of GDP in 2010 . (Table 3 in the

Appendix) ) Other public finance aids to movies had entered in action from the end of the '90 on .

The trend of the share of the Italian movies in terms of number of new movies presented in the Italian cinemas, after the FUS, is similar to that of the revenue market share until the end of the '90, but better in the last decade (Table 2, Appendix). The number of new Italian movies as share on the number new movies presented in Italian Cinemas that was between 33,5% and 31,8% in the three years before 1985, went down to an average level of 25,8% in the first 5 years of the FUS. Declined with ups and down to less than 25% until 1996.

Then increased above 25% in spite of the decline of the FUS aid and with maximum level of 40,96% in 2008 after the new Law that provides tax incentives to the investment in movies produced in Italy. The share of the market in terms of revenue of the Italian movies were smaller than those of the foreign movies, but still they were had a recovery, likely because of the new ways of financing other than the FUS.

### 2.3 Regressions

To assess whether the financing of FUS has been effective in arresting the decline of importance of the Italian movies- the main official objective of it, on the basis of the European doctrine- we shall consider the correlation between the diffusion of TV (represented by the share of TV subscription on 1000 inhabitants) as proxy of the development of the new mass culture and 1) the number of movies produced , 2) the share of the number of Italian movies on new movies presented in the Cinemas in any successive year here considered and 3) the revenue market share of Italian movies on the revenue of all movies in the Italian cinemas in all the years of presence in the Italian cinemas . We shall test the effects of FUS, by inserting a dummy in 1985, the year when FUS was introduced, to check whether there has been a change in the results of the regressions. This methodology is currently done to assess the effect of public subsidies to R&D :See for instance H. Koski and M. Pajarinen, (2012)<sup>8</sup> and Guerzoni and E Raiteria,(2013)<sup>9</sup>.

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<sup>8</sup> KOSKY H and M. PAJARINE, (2012), *Do Business Subsidies Facilitate Employment Growth?*, DRUID Working Paper No. 12-02. For Finland use dummies to assess the different effects of different subsidies to RD on firms behavior,

<sup>9</sup> GUERZONI RAITERIA,(2013),” Innovative public procurement and R&D subsidies: hidden treatment and new empirical evidence on the technology policy mix”,Department of Economics “Cognetti de Martiis”, University of Turin, use the dummy subsidy to RD to assess the impact of these subsidies on behavior of firms as for RD,

**TABLE 1**

**Effects of TV diffusion on the Production of Italian Movies , on the Market Shares of the Italian Movies in Terms of Number of New Movies and in Terms of Revenue before and after FUS**

**1)REG. NEW\_ ITALIAN\_ MOVIES TV\_ SUBSCRIPTIONS \_ON 1000INHAB FUS\_ COST DUMMY**

Number of obs = 44

Prob > F = 0.0000

R-squared = 0.7684

	Coef.	P> t
TV_subscript. ~b	<b>-1.057964</b>	<b>0.000</b>
FUS_costan~o	<b>-.1148592</b>	<b>0.231</b>
dummy_FUS_~e	12.01271	0.709
_cons	424.666	0.000

Here we can notice that the number of new Italian movie is explained (dependent variable) by the number of TV contract with a negative sign, meaning that when TV contracts increase we have a decrease of new Italian movies. FUS is not significant. R-squared is sufficiently high (0.77).

**2)REG SHARE NEW ITALIAN MOVIES ON NEW MOVIES TV\_ SUBSCRIPTIONS \_ON1000INHAB FUS\_ COST DUMMY**

Number of obs = 44

Prob > F = 0.0000

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R-squared = 0.7342

Share_Ital	Coef.	P> t
TV_Subscript.	<b>-.168364</b>	<b>0.000</b>
FUS_costan	<b>-.056036</b>	<b>0.001</b>
dummy_FUS		0.006
_cons		

The share of new Italian movies is explained by the number of TV contracts and FUS with a negative sign, meaning that when TV contracts and FUS increase we have a decrease of the share of Italian movies. R-squared is sufficiently high (0.73).

### 3)REG REVENUE MARKET SHARE IT. MOVIES TV\_SUBSCRIPTIONS \_ON1000INHAB FUS\_COST DUMMY

Number of obs = 44

Prob > F = 0.0000

R-squared = 0.8419

Revenue Market_Share	Coef.	P> t
TV_Subscript.	<b>-.1381568</b>	<b>0.001</b>
FUS_costan	<b>-.0242221</b>	<b>0.243</b>
dummy_fus	-11.15706	0.114
_cons	81.08395	0.000

Market share revenue of new Italian movies is explained by the number of TV contracts with a negative sign, meaning that when TV contracts increase the revenue of Italian movies market share decrease. R-squared is high (0.84).

The regressions show that while there are significant correlations between the increase of TV subscription and the reduction of the number of new Italian movies and their market share in terms of movies produced on new movies as well with the market share in terms of revenue of the Italian movies on all movies, FUS had either no correlation (with the number of movies and the revenue market share of the Italian movies) or a

negative correlation ( with the share of Italian movies in terms of number of movies produced) . The objective of this fiscal measure of defending the Italian movies production as cultural expression of the “Italian identity “ clearly failed.

#### 2.4 Failure of FUS for Cultural contents

FUS has been a failure also from the point of view of supporting the movies as for their intrinsic cultural content as for the objectives of preserving in the public the European-Italian cultural values <sup>10</sup> . Here we present a research on the FUS funds for cultural movies, for the period 1994-2005, that shows a disproportionately high percentage of the movies financed did not enter in the circuit of the cinemas or disappeared after a very short period. So that this share of state aid to the movies, of supposedly high cultural value, done at expense of the general taxpayers, failed as a policy to provide merit goods to the Italian public and therefore was unable to reach the objective of improving the quality of the mass culture .

**TABLE 2 Movies financed by FUS for their particular cultural value which failed to be presented in the cinemas or had a return > 10 euro \***

	I	II	III
Year	Number of Movies	Movies Without Return > euro	Index Of Failure (II/I)
1994	18	4	22,22%
1995	34	7	20,58%
1996	38	9	23,68%
1997	42	13	30,55%
1998	44	9	20,45%
1999	38	10	26,31%
2000	24	5	20,83%
2001	39	8	20,51%
2002	51	15	29,41%
2003	45	15	33,33%
2004	37	25	67,56%

<sup>10</sup> A large share of the movies financed by the subsection of FUS assigned to the movies of particular cultural value has got low rates by the critic like movies of Tinto Brass director . And several of these were mere entertainment movies. The research on these aspects cannot be presented here.

2005	35	23	65,71%
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\*Inclusive of decimals

SOURCE : Our elaboration on data given in L. AREZZO and G. MECUCCI (2007) , *Cinema.Profondo Rosso*, Milano, Libero-Free

The index of failure, measuring the percentage of movies that did not enter in the cinemas or that had a revenue smaller than 10.euro, for the period between 1994 to 2005 , ranges between 20,51% and 67,56%. The average is 29,29%. One may observe that either the cognitive dissonance was so great that to see the movies of “intrinsic cultural value “finance with public aid there were very few of those who were in favor of this use of the taxpayers’ money or that these movies were of low cultural quality.

### SECTION 3

#### ***New ways of financing the Italian movies with taxpayers money more market oriented***

##### *3.1 Financial Law 2008-2010 tax incentives for movies production and distribution*

With the financial law for 2008 new fiscal incentives have been introduced by The Law December 24 /2007 n. 244 (Financial Law 2008-2010), Article 1 ,§325-343 for movies production and distribution on the investment both of investors internal to the movies business and external. The benefits, different for the two kind of investors, were originally given as a credits on the tax due (tax credit Law 244 of December 24 /2007 , Article 1 , §. 325-337 ) and as reductions of the taxable basis (tax shelter Law 244 of December 24 /2007 , Article 1. § 338-39. See G. M. Committeri and M.La Torre (2008), *Agevolazioni fiscali per il cinema*, Roma ANICA,) For the tax credits the benefit is more generous for the investors external to the movies industry i.e. is 40% of the tax due as against 15% for the investors internal to the movies business. In the tax shelter the benefit was more generous for the investors internal to the movies business, which could get a full exemption of their profits if reinvested in movies production or distribution while external investors had a maximum exemption of 30% of the profits reinvested in the movies business. But this generous incentive for the firms internal to the movies industry had no relevant effect because these firms normally prefer to distribute their profits , rather than reinvest in it.

The tax credit for external investors cannot exceed 1 million for each year , for the internal investors the limit is 3,5 million, but with the limit of 15% of the cost of each



movie financed . 80% of this amount must be spent on the Italian territory. The sum of the tax benefits cannot exceed the percentage of 49% of the cost. Indeed the EU rules do not allow aids exceeding 50% of the costs. The limit is exceptionally increased to 80% for the “difficult movies” and for the movies with a small investment under the European principle “the minimis” of each movie financed .And the external investors cannot get a share of its revenue greater than 70% . The tax credit has been dropped in 2011 because scarcely utilized. The tax shelter has survived.

The shift from the state aid to movies on their projects to the tax credits and tax shelter for the expenses of production or/and distribution implies that the investors are enticed to make movies with a return at least equal to the costs, net of the tax benefit and possibly with a return. The limit of the share of cost financed by the tax benefit, entices the investors to a fruitful investment. On the other hand the linkage of the fiscal benefit to the costs of production and distribution may incentive the increase of cost of production that result in gains for the investors and their clientele: as salaries, bonuses, fees, royalties. Tax incentives would be more efficient, if, at least partially, were given to the profits as such not to the investments.

On the other hand the lack of any previous exam by any state Commission of the project to be financed implies that also the movies without any relevant cultural value get a state aid. But obviously there is no objection to this outcome if one believes that the Italian movies must be aided to promote the national identity.

### *3.2 Regional aid by “Film commissions “*

Since the '90 a new kind of public financing of movies emerged in Italy –as well as in many other countries at the regional and local level by the so called “Film Commissions “According to a survey of ANICA, at the end of 2010 there were 150 Regional and local funds in 35 states, with Germany leader in terms of resources and France and Scandinavian Countries in terms of number of Funds in proportion to the inhabitants.<sup>11</sup>. There is also an European Association denominated Cineregio, with the task of promotion and information about these initiatives within the European Union and outside-Originally these Film Commissions, in Italy, were conceived as agencies for the supply of services of various kind to the movies producers to incentive the location of films in their territory as a mean of advertising their artistic and historic heritage, their

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<sup>11</sup> See ANICA (2010), “Evoluzione dei Fondi Regionali per il Cinema e l’Audiovisivo: Vincoli ed Opportunità”,

environmental and cultural values. The aim was to promote tourism and the local products.

Then the Film Commission reinforced their promotional efforts adding to the services in kind, also money incentives by Film Funds which provide loans, cash, venture capital for the co-production. According to the mentioned survey of ANICA At the end of 2010, in Italy there were 25 “Funds” in 14 Regions (out of 20). 60% of the Funds are directly managed by the Film Commission.

In principle also non Italian films may be object of this promotion, because the decisive factor is the connection with the territory. Often, the film Commissions perform also other policies as promotion of local film production (mostly documentaries) ,local Films Festivals and other entertainments.

In 2011 in all the Italian Regions there was a Film Commission and many other Film Commission operated at a lower level. They are particularly important, from the financial point of view in the Regions that benefit of the European interventions for the less developed regions (so called Objective 1).

### *3.3 Product Placement*

What the Film Commissions do, really, is a sort of product placement. One currently distinguishes two couples of types of product placement

- 1) Screen Placement (Visual): whereby the brand or product is represented visually
- 2) Script Placement (Verbal): whereby the brand or product is mentioned by the players of the movie. Both of them might become:

- a) Plot Placement Integrating the brand or product in the plot;
- b) Name Placement: the brand or product enters in the name of the movie, as in the movie” Breakfast at Tiffany’s” “The Devil dresses Prada” or- with an easier combination- “Christmas in Cortina “.

The various kind of product placement imply a quite interesting combination between this form of advertising via movies and the regional Film Commission promotional policies.

Until 2004 in Italy product placement in movies had been practiced extensively in a semi clandestine way. With laws of 2004 <sup>12</sup>, this form of advertising imbedded in the movie has been made legal and regulated in detail. The new legislation allows to

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<sup>12</sup> Decreto Legislativo 22 gennaio 2004, n. 28 (“ Urbani Law ”) Riforma della disciplina in materia di attività cinematografiche, art. 9. and with the by Law July /30/ 2004 on the technical modalities of the planned placement of brands and products in the scenes of a cinematographic work “product placement” ,

place in the movies the framing of brands and products coherent with the context of the script, provided that a proper information is given on the participation of the companies producing these brands and products to the costs of production of the movie. The presence of the brands and products must be open, true, correct according to the criteria adopted for the advertising and must be integrated in the development of the action without interrupting the context of the story.

The information about it has to be placed in the titles at the end of the movie. It is forbidden the placement of brands and products dangerous to the health and safety. All these principles are applicable to the advertising made by the Film Commissions in the movies produced on their territory in exchange for their aid in kind and in money because this is product placement.

On the other hand they could follow the criteria the product placement elaborated in the market for the assignment of their aids to the movies produced in their territory .

As for product placement, in a few years, a market has developed, in Italy by the intermediation of specialized advertising firms (see ANICA (2008), *Product Placement*), among the companies of production and distribution of movies and the companies interested to advertise their brands and products. In 2010 the financing of movies via the product placement (excluding that of the Film Commissions) has reached a 10% of the aggregate resources a percentage similar to that of FUS<sup>13</sup>.

The agencies working in product placement, as paramount indicator for the choice of the projects of movies to finance adopt the previous success in terms of revenue of the directors and companies producing the new movie. But the expected revenue even if paramount, is not the only relevant parameter. It is also important the “quality factor“ from the point of view of the artistic or cultural value of the movie, because it ads credibility and prestige to the advertising. The correspondence of the type of movie and the type of brands and products to be advertised is important: brands and products for children shall be better placed in movies for children. Films about adventures in vacations places may be ideal for the promotion of tourism. The effectiveness of placement also depends from the intensity if the message and its integration in the plot. The market experience and competition has given origin to tables of value indicators which combine the intensity of the exposition with the degree of integration (Del Brocco, 2007) These criteria could be adopted by the Film Commissions to make more

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<sup>13</sup> .as documented in Fondazione ente dello spettacolo (2011), *Il mercato del cinema in Italia*, 2010 , (respectively, pages. 45 and 86.)

objective and more effective their cine-tourism policies and reduce the rent seeking inherent to this policy.

### *Concluding remarks*

The previous exam shows that cognitive dissonance, influenced by pressure groups, has had a very relevant role in the public aid to movies in Italy, under the protection of the European “cultural exception” “In the EU, are considered as an important component of the European culture as expression of the national and regional diverse identities and therefore are protected and promoted under the cultural exception clause. Italian movies enjoyed a prolonged period of success since the postwar years until the mid-seventy, when the competition of the new mass culture- of which TV was the most important vehicle -began to reduce the attendance to the cinemas. And the “Americanized” foreign movies prevailed. The cultural transformation had a negative influence also on other performing arts. Thus under the pressure of intellectuals circles and of the interests of the performing art enterprises and their workers, in the eighties a new policy of public aid was inaugurated by the Italian governments, to sustain the Italian performing arts. An hoc Fund (FUS) administered by a “Committee of experts”, under the Ministry of culture, was inaugurated. In this Fund a specific section was created to subsidize the Italian movies with a sub section for the movies of particular cultural interest. FUS for movies originally provided with important financial resources (a share of 0,020 the Italian GDP), as the regressions have shown, has not been successful in terms of new movies produced and as share of market revenue by the Italian movies industry. The share of the Italian movies declined in the Italian cinemas, in spite of the protection to the Italian movies industry likely because the American mass culture is quite popular in Italy, but also because of the scarce efficiency of the instrument adopted to sustain the Italian performing arts, particularly in the cinematographic sector. FUS increasingly lost popularity and its funds for movies diminished constantly so that was a share of 0,005 of GDP at the end of the period. New more efficient sources of public aid, different from the state subsidies to the movies production were found, to stimulate the movies entrepreneurial activities. At the national level they were the tax credits and tax shelter on investments, at the Regional and local level they were the benefits in kind and money, connected to the promotion of local tourism and of typical product. These were reinforced -since 2004- by the legalized practice of product placement. The market share of the new Italian movies on

the number of new movies has recovered and also revenue market share of the Italian movies has recovered, even if less. Clearly these new form of public aid were more efficient .

Walter Santagata maintains that there is a sort of New Risorgimento of the Italian movies, imputable to sociological, cultural and organizational factors ( Santagata W. 2009), They may be true. However one may argue, with Armen Alchian (Alchian A. 1950 and 2006 ),”that the environment conditions the survival characters of the entrepreneurs. And while in the hot house of FUS, the Italian movies enterprises were not capable of blooming, since the hot house become less and less important, they have started to bloom, by alternative sources of financing public and private more germane to the market economy system.

On the other hand ,strong component of cognitive dissonance do remains in the public policy for thus sector, because Italians still –as is demonstrated the comparison between the market share of the Italian movies in term of numbers and in terms of revenue - are mostly attracted by the movies of the so called “Americanized mass culture “ Which is likely the culture of the new global age.

On the other hand rent seeking while reduced at the national level, has flourished at the local and regional level in the competition among the increase number and activities of the local and Regional Film Commissions. Likely, however, this is efficient rent seeking because of the inherently competitive setting.

## APPENDIX

TABLE 1  
*Market Share of the New Italian Movies in Revenue Terms.*  
*Revenue of Italian New Movies: Revenue of All New Movies*  
 In Billions of Lire until 2000. In Euro afterwards

Year	I	II	III
	Revenue All Movies	Revenue Italian Movies	% (II/I)
1966	165	88,9	53,87
1967	164	85,0	51,82
1968	170	91,6	53,88
1969	179	105,1	58,71
1970	181	108,6	58,66
1971	206	131,7	63,93
1972	237	149,5	62,86
1973	265	161,2	60,75
1974	321	190,5	59,19
1975	360	213,8	59,38

1976	375	213,5	56,93
1977	342	178,9	52,31
1978	346	149,9	43,32
1979	362	135,1	37,32
1980	401	173,9	43,36
1981	449	196,8	43,83
1982	504	231,5	45,93
1983	505	197,1	39,00
1984	471	156,5	33,12
1985	500	153,6	30,06
1986	584	179,2	20,65
1987	546	189,2	33,15
1988	516	143,4	27,71
1989	571	121,7	21,19
1990	607	126,5	20,75
1991	657	173,9	26,46
1992	663	160,2	24,13
1993	758	129,9	17,02
1994	823	193,7	23,57
1995	797	167,3	20,99
1996	875	216,6	24,68
1997	961	310,5	31,09
1998	1141	281,0	24,62
1999	1031	271,8	26,36
2000	529	102,4	19,28
2001	589	122,7	20,83
2002	629	147,4	23,37
2003	508	140,3	27,55
2004	656	140,2	21,24
2005	599	151,0	25,20
2006	678	151,9	22,40
2007	670	195,1	27,01
2008	636	171,8	22,59
2009	664	145,5	21,91
2010	772	215,0	27,84

SOURCE: SIAE, Annuari dello Spettacolo and ANICA

Years	New Italian Movies(I)	Italian Movies Finance d by FUS(II)	% Of Italian Movies Finance d by FUS III (II/I)	New Movies In Italian Cinema s IV	Share Of New Italian Movies On New Movies In Italian Cinema s V ( I/IV)

1966	232			466	49,8
1967	247			508	48,6
1968	246			589	41,8
1969	249			518	48,1
1970	231			494	46,8
1971	216			472	45,8
1972	280			530	52,8
1973	252			565	44,6
1974	231			539	42,9
1975	220			542	40,6
1976	237			560	42,3
1977	165			478	34,5
1978	143			438	32,6
1979	146			432	33,8
1980	160			541	29,6
1981	143			545	26,2
1982	128			382	33,5
1983	128			398	32,2
1984	108			339	31,9
<b>1985</b>	<b>80</b>	<b>80</b>	<b>100,0</b>	<b>356</b>	<b>22,5</b>
1986	109	109	100,0	416	26,2
1987	142	138	97,2	497	28,6
1988	150	109	72,7	524	28,6
1989	112	84	75,0	482	23,2
1990	113	100	88,5	495	22,8
1991	136	132	97,1	430	31,6
1992	126	85	67,5	437	28,8
1993	104	106	101,9	397	26,2
1994	110	38	34,5	373	29,5
1995	77	80	103,9	343	22,4
1996	90	64	71,1	390	23,1
<b>1997</b>	<b>87</b>	<b>59</b>	<b>67,8</b>	<b>382</b>	<b>22,8</b>
1998	97	60	61,9	396	24,5
1999	106	66	62,3	378	28,0
2000	103	57	55,3	367	28,1
2001	103	45	43,7	369	27,9
2002	130	64	49,2	368	35,3
2003	117	69	59,0	419	27,9
<b>2004</b>	<b>134</b>	<b>43</b>	<b>32,8</b>	<b>369</b>	<b>36,3</b>
2005	98	61	62,2	392	25,0
2006	116	47	40,5	385	30,1
2007	121	68	56,2	370	32,7
2008	154	62	40,3	376	41,0
2009	131	73	55,7	355	36,9
2010	141	78	55,3	380	37,1

Source: SIAE *Annuari statistici dello spettacolo*, and ANICA on Cinetel data. Years of new legislation on FUS evidenced in black

Source :ANICA

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Table 3  
 FUS in Nominal and Real Terms and as  
 % of Italian GDP  
 Millions of Euro

Year	I	II	III
	Euro Current	Euro 1985	%GDP
1985	357	357	0,083
1986	415	391	0,087
1987	444	400	0,085
1988	464	399	0,080
1989	429	345	0,068
1990	459	349	0,066
1991	436	311	0,057
1992	477	323	0,059
1993	461	299	0,056
1994	461	288	0,052
1995	439	260	0,046
1996	472	269	0,047
1997	462	259	0,044
1998	478	263	0,044
1999	494	268	0,044
2000	499	264	0,042
2001	530	273	0,042
2002	500	251	0,039
2003	518	254	0,039
2004	499	240	0,036
2005	465	220	0,032
2006	427	198	0,029
2007	441	201	0,029
2008	471	208	0,030
2009	397	174	0,026

Source :ANICA

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