

## **Turning the Single Digital Market into a House of Cards? The European Local Content Quota on Netflix <sup>1</sup>**

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On May 25, 2016, the Commission proposed to amend two dozen articles of the Audiovisual Media Services Directive (hereafter the “Directive”). In this heteroclite train of changes, one amendment has attracted particular attention. If adopted, Paragraph 1 of the new Article 13 would state that “*Member States shall ensure that providers of on-demand audiovisual media services under their jurisdiction secure at least a 20 percent share of European works in their catalogue and ensure prominence of these works.*” The press has immediately interpreted this amendment on local content as aimed specifically at the major on-demand audiovisual services (hereafter OAMS) provider, Netflix (EurActiv May 18, 2016). It may be so. However, there are many OAMS providers—large and small—based in Europe, a feature of utmost importance when assessing the proposal as shown below.

The Commission claims that it is an ardent believer in undertaking an impact assessment before tabling its proposals. If correct, the Commission should have subjected Article 13-1 to three tests. Is there a need to regulate? If yes, is a local content quota a good instrument—does it work? Finally, would such a quota contribute to the alleged Commission’s ultimate objective: to create a Digital Single Market by eliminating barriers among EU Member States?

Seeking answers to these questions would greatly benefit from a perspective that goes beyond a Euro-centric attitude that too often distorts judgments. Looking around the world, the Europeans are not the only ones facing change in the media industry because it is largely driven by global technological innovations. It is thus useful to examine the experience of a country far away from European passions and fears. In this respect, Korea emerges as an excellent reference point for three main reasons. First, it is a country with a longer experience of the internet and online services than Europe, an experience that has greatly contributed toward building successful cultural industries in Korea. Second, the country has a size and

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population roughly comparable to the larger EU Member States. Third, Korea is very proud of its culture and is very careful about the health of its cultural industries—two features which are in harmony with Europe’s cultural vision.

### **Test 1. Is there a need to regulate?**

The first question that any respectable impact assessment must address is: is there a need to regulate (Australian Productivity Commission 2012)? In other words, are the OAMS providers already meeting this local content quota or not? Unfortunately, the Commission provides no information on this point which is critical—whether the answer to the question is yes or no.

If the answer is positive, there is then no need to regulate—all the more because, as shown below, such a decision is likely to have numerous harmful consequences on the firms that the Commission claims it wants to help and on how “single” the Single Digital Market will be.

If the answer is negative, is there a good reason to believe that the OAMS providers will not reach such an objective within a specific period of time anyway (say, a few number of years)? The answer to this second question is more complex because there are both large and small OAMS providers.

The large OAMS providers like Netflix, Amazon, and a few relatively “smaller” TV-networks related firms (such as CanalPlay, Maxdome or Sky’s Now TV) see themselves as bridges between countries and continents. They import audiovisual works from the rest of the world that they think their European customers will enjoy. However, their fundamental economic interest requires them to do the same the other way around, that is, to produce high quality European works and export them to the world. There are already a few well-known cases, such as the recent Netflix-commissioned French TV series *Marseille* or the upcoming British TV series *Black Mirror* (among many other rebroadcasted BBC programs). In short, the large OAMS providers will do their best to work with talented European producers, directors, and actors. The quota may simply force these large firms to speed up their current business plan. However, as shown below, this may well generate damaging consequences.

The quota will be much harder on the “smaller” OAMS providers who happen to be mostly European or from other parts of the world. The latter will probably have to consider leaving the European markets altogether if their contents rely too much on their country of origin—so much for the European motto of “cultural diversity”.

Paradoxically, the quota will also hurt the smaller “European” OAMS providers (like most of those related to smaller European TV-networks)—that is, those that the Commission claims it is very keen to nurture because they could be the fertile ground from which one day will emerge the future competitors to the current Netflix-type giants.<sup>2</sup> There are three main reasons for such an unintended—though quite predictable with the help of economic analysis—consequence of the Commission’s proposal.

First, as mentioned above, the larger OAMS providers may have to accelerate their recruitment of all the major talent in Europe so that they can meet the quota on time. In this case, the financially more limited smaller European providers will be under increased pressure to do the riskiest job in a sector—entertainment business—well known for being one of the most challenging in any economy: to discover promising talent without much hope of retaining them in the future from the big players. In short, they may be relegated to the second league forever since the quota will freeze the current market structure, rather than making it more fluid. Second, this situation will be made worse if, as one should expect, the “European” quota will be “interpreted” differently by each Member State and probably enforced differently as well (more on this in test 3). Last, but not least, the European amendment will not go unnoticed in the rest of the world. It took only three days for a similar proposal to be put forward in Australia. Again, the large OAMS providers will be better equipped to adapt to these barriers outside of Europe than the smaller European ones which will then lose key opportunities to expand in the fast growing non-EU markets.

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<sup>2</sup> The Commission’s proposal alludes to a distinction between large and small OAMS providers in Paragraph 3 of the new Article 13 which deserves to be integrally quoted since it is such a gem of bureaucratic fuzziness: “*Member States shall waive the requirements laid down in paragraphs 1 [and 2] for providers with a low turnover or low audience or if there are small and micro enterprises. Member States may also waive such requirements in cases where they would be impracticable or unjustified by reason of the nature or theme of the on-demand audiovisual media services.*” “Shall” clashes with the vague (to say the least) definition of “small and micro.” Surprisingly, to be inefficient is an acceptable reason for being exempted from the local content quota—since a low turnover or low audience can easily be the outcome of inefficiency. “*Impracticable, unjustified, nature, theme*” are words ready to be captured by all kinds of vested interests. The “House of Cards” dimension of the Commission’s proposal reaches its climax.

The ways in which Korea responded to similar pressures serves as a good example to Europe on which direction to go, as best illustrated by Korea's successful pop music industry. First, "K-pop" firms have systematically and carefully recruited non-Korean performers, choreographers, and song-writers—the complete opposite of a local content quota—in order to develop their international appeal and to achieve a global outreach. Second, they have also embraced innovative business models in order to adapt to new technologies (Parc 2015a), instead of resisting change and sticking to past practices. Finally, over the last two years there have been many voices among Korean entertainers welcoming the entry of large OAMS service providers like Netflix in Korea. This is precisely because many Korean entertainers see these firms as potential powerful instruments exporting Korean cultural creations—a recognition of the huge contribution YouTube had in making K-pop well known around the world. Indeed, Netflix has already commissioned a Korean feature film entitled *Okja* involving the Korean director Bong Joon Ho who is known for his hit film *Snowpiercer*.

## **Test 2. Do local content quotas work in cultural industries?**

Assuming that there is a need to regulate—a point far to be proven at this stage—the second question is: do local content quotas work in cultural industries? The available evidence strongly suggests that they do not. As France is arguably the EU Member State that enforces the most stringent quotas in audiovisual matters, there is no better country to look at for evidence in this regard in music and cinema.

First, France implements a mandatory 40 percent quota on French language songs broadcasted on its radio stations. Its enforcement gives rise to endless conflicts on how to tighten the quota which always appears unsatisfactory to those with vested interests. That said, a quick check on the number of views on YouTube shows that performers singing in French attract a maximum of 10 million views per year for the top stars (except the Belgian singer Stromae). This should be compared to the 120-180 million views per year for Korean pop stars (Messerlin 2015). Does that mean that French singers are not talented? Not at all. The French performers who have decided to use English—at the cost of being excluded from prime time radio at home because of the quota rule—attract up to 100-230 million views per year. Ironically, unlike those who actually sing in French, these performers are those known around the world as conveying the "French touch." In fact, the very poor performance of

those singing in French is largely the result of the radio quota which induces them to limit their horizon to an increasingly smaller and introverted domestic market.

Second, France enforces a 40 percent quota for French films to be broadcasted on its TV channels. The share of French films broadcasted by these TV channels was 50 percent in 2000, 44 percent in 2006, and 41 percent in 2014 (Centre national du cinéma et de l'image animée, *Bilans annuels*). This trend shows clearly that this TV quota did not work as a booster for the popularity of French movies. However, it could be argued that, at the least, the quota kept the share above (barely) the 40 percent threshold since 2006. Is this really the case? Not at all. The 2006-2014 shares are increasingly large overestimates because they are calculated on a limited set of French TV channels. They do not reflect the fact that since the mid-2000s, French telecom suppliers offer access to more than 100 TV channels broadcasted from many countries, with free access to roughly 20 to 40 channels for each subscriber. In short, today it is possible for a TV viewer in France to completely avoid watching French movies if they so choose. In short, the quota has been made irrelevant by rapid advances in technology.

One could argue that as the quota is irrelevant it does not cause any harm. This conclusion ignores a crucial process—"creeping regulations." In the long run, the quota has been terribly harmful to French TV networks because, since the 1990s, it has opened a Pandora box of an ever increasing set of tight and rigid legal obligations between the film industry and the TV networks. Good examples of this are the arcane sequencing of film releases, making it very hard to recoup possible losses in theaters by regaining revenues from other sources (DVDs or Video on Demand) and the mandatory funding of French films by the TV networks. Indeed, Paragraph 2 of Article 13 of the Directive proposal is a copy-paste of the French regulations which have shown their toxicity.

A sure indicator of this toxicity and deteriorating situation is the annual subsidies of 5 billion euros a year—the equivalent of the annual value-added of the whole French TV sector—that the French government must grant to the TV networks in order to keep them alive (Messerlin 2014). A further illustration of this deterioration is Canal+. In the 1980s, its business model was thriving—essentially because it enjoyed the monopoly of not being subjected to the broadcast quota. Since then, the Canal+ "exception" has been slowly eroded by both

technological innovations and regulatory changes. Today, Canal+ France is said to lose 400 million of euros a year, is under intense care and its future looks uncertain.

A look at Korea confirms these observations. Whenever the Korean government has used quotas, at best it has had no notable impact—as in the case of screen quotas for movies. At worst it has led to disastrous consequences as in the case of import quotas which resulted in a dramatic decline in the quality of Korean films, a few years after its “Golden Age” (Parc 2015b). In short, Europe and Korea are far away, but the consequences are the same when they use the same bad instruments.

### **Test 3. Does the quota seek to create a Single Digital Market?**

The Commission’s ultimate ambition is to create a Single Digital Market in the EU—or so we were led to believe when reading the Commission’s press release (6 May 2015). However, the local content quota has little—to say the least—chance to achieve such an objective.

First, the Commission’s proposal does not take into account the reality of European politics at a time of rising populism across Europe. The Commission should know better than to get bogged down in technical questions that can easily morph into political fights nowadays. Indeed, the three lines in the current wording of Article 13-1 (see the introduction) unleash a tsunami of technical questions. What is meant by “at least”? What does it mean to “ensure” “prominence” of these works? How can “European content” be defined? Is it the scripts, the language of the scripts, the actors, the language of the production, the technical support, the dubbing, etc.?

As a result, the Directive proposal opens the door to possibly widely different interpretations of the “European” local content in each Member State. Indeed, it did not take more than a couple of days after the release of the Commission’s proposal to hear complaints in Paris arguing that the 20 percent quota is too small a figure. This kind of reaction was so predictable that it is astounding that the Commission’s proposal did not anticipate it. Expect to regularly hear the usual complaint from European vested interests: why “I” am excluded from (or included in) the scope of the Directive when “he” or “she” is included (or

excluded)? With its proposal, the Commission has turned the Single Digital Market into a gigantic “European House of Cards.”

Last but not least, the potential for fragmentation of the European Digital Market by this amendment may grow deeper in the EU Member States. A recent case in France offers a glimpse on what can happen. France grants subsidies to movie producers only if they fulfill local content rules: shooting in France, selecting French actors, hiring French technical staff, filming in the French language, and so on. However, earlier this year, it was reported in the press that the French movie producer Luc Besson will receive subsidies despite the fact that these conditions will not be met—except for one (shooting in France). In short, if a French movie producer could escape a three-decade old local content rule, what will happen when rules of a similar nature are imposed on the OAMS providers in the near future? This raises questions on the consistency and predictability of the EU’s rules.

#### A deep lack of confidence in Europe’s culture

Two main conclusions can be drawn from this brief impact assessment. From a purely economic point of view, it is astounding that the Commission believes that one can regulate the delicate cultural industries with such a crude instrument as a local content quota (a policy tool that even developing countries have largely abandoned). The list of negative effects is long: freezing the current market structures, closing off foreign markets, keeping intact the tight net of regulations that makes the current life of many EU TV channels so difficult and that endangers the future of the European film industry, etc. The problem is made worse by the fact that the negative consequences of the new Article 13 will emerge progressively—inducing policymakers to impose ever stricter regulations in a hard to stop creeping regulation process. And the higher the quota, the costlier the impact will be.

There is an alternative. Rather than impose the constraints faced currently by the EU’s TV networks on the largest OAMS providers (which happen to be big enough to surmount them with much more ease than the smallest OAMS providers), it would be to free, in a progressive and orderly way, European TV networks from the current regulations that have caused so much harm over the last twenty years by designing a new regulatory framework that is more flexible and adapted to the new technology-driven environment.

Economics matters, but culture is crucial. The Commission's proposal and the Parliament's support reveal a fundamental problem in this respect. European policymakers seem to believe that there are no Europeans talented enough to attract the interest of the major OAMS providers without regulations. They look at European culture as an endangered species in a hostile world that needs to be tightly protected. They want to perpetuate the existing suffocating small markets whereas creativity and culture means enduring risks and hardships. By doing so, they take on the side of the dinosaurian vested interests that have lobbied them hard—not those of promising young European talents who are too busy with their future creations than to organize themselves as lobbyists.

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