HAVING YOUR CAKE AND EATING IT TOO: ARE THERE LIMITS ON CULTURAL PROTECTIONISM?

by

John A. Ragosta, John R. Magnus and Kimberly L. Shaw[1/]

published in

The Canadian Law Newsletter, Volume XXX, Summer 1996
(A Publication of the Committee on Canadian Law
Section of International Law and Practice

American Bar Association)

Several major U.S. trading partners, most notably Canada and France, have made it a trade policy priority to protect local firms operating in the "cultural" industries -- unfortunately at the expense of U.S. providers of, primarily, audio-visual goods and services. This paper will briefly discuss cultural protectionism as a trade policy goal and assess the legal framework that applies to cultural protection measures between Canada and the United States. Secondly, the paper will review some of the recent Canada-U.S. disputes involving cultural industries.

A Question of Balance

In one sense, cultural trade protectionists have a valid point. The main criticism one hears is that protecting domestic suppliers -- whether of information, entertainment, or any other commodity -- is inefficient, non-wealth-maximizing. Yet, trade policy is not, and never has been, exclusively concerned with overall efficiency. Indeed, it is hard to imagine another area of the law would where anyone would be so bold as to suggest that economic values are the only ones that matter.[2/]

As with trade policy generally, cultural trade measures present a question of balance. A reasonable balance may well include safeguarding the national culture and supporting the activities of those creative individuals who advance it. Yet, that is not to say that countries with cultural trade measures in effect today have struck a fair balance. On the contrary, in many instances the

---

1/ The authors are attorneys and a legal assistant in the Washington office of Dewey Ballantine. While the authors have represented, *inter alia*, Country Music Television in its recent dispute with Canada, the views are the authors' own and not those of Dewey Ballantine or its clients. Mr. Ragosta addressed these issues at an April 1995 program sponsored by the Trade Committee of the American Bar Association's Section of International Law and Practice.

2/ Nobel Laureate Robert Lucas, Jr. has aptly described the limitations of economics in setting normative goals and policies: "As an advice-giving profession, we are way over our heads." Quoted in *Washington Post*, Oct. 11, 1995. Careful economists like Lucas properly refer to maximizing "utility" -- the total financial and non-financial benefit after all costs -- which may differ from maximizing wealth.

legitimate governmental interest in protecting culture is used as a pretext for crassly protectionist measures with primarily economic, rather than cultural, motives and effects.

Other legitimate trade policy goals that must coexist with safeguarding culture include, *inter alia*:

- **Consumer/business choice**: Particularly in the information and entertainment sectors, consumers should have the most extensive choice of materials possible. This is not only a matter of personal liberty and self expression but -- given the fast-growing global information highway -- competitiveness.

- **Projecting culture**: Broadly, governments have two options in seeking to promote the national culture: (1) protecting local suppliers through import barriers and subsidies; or (2) making maximum efforts to project the national culture abroad. The former, which focuses on domestic restrictions, can impair a country's ability to project its culture abroad -- especially where met with a reciprocal trade approach.

- **Sustaining the consensus for trade liberalization**: Some governments see cultural protectionism as necessary to sustain domestic support for multilateral or regional liberalization. On the other hand, exempting this whole sector from trade accords leaves large segments of the participating economies with no stake in liberalization and, thus, vulnerable to anti-trade messages.

- **Wealth maximization**: As discussed above, this is a very important goal at both the national and global levels.

Governments must constantly monitor the balance among these goals -- but they do not always do so in a fair or rational way. In theory, there are reasons to doubt whether a government would impose protection other than where truly necessary for preservation of core cultural interests. In practice, as discussed below, they do so all the time. Hence the need for a system that regulates excessive invocation of "culture" to cloak economic barriers.

To promote a proper balance among policy goals, agreements should encourage governments contemplating protective measures to: 1) take care that the action contemplated is, in fact, necessary to encourage significant cultural interests; and 2) avoid to the extent possible being captured by parochial, rather than national cultural, interests. Does such a system exist? The system originally devised by Canada and the United States in 1988 comes close, but its efficacy remains in doubt.

How do the CFTA and NAFTA Address These Issues?

The negotiated language on culture is convoluted. Article 2005 of the Canada-U.S. Free Trade Agreement (CFTA) states:

1) Cultural industries are exempt from the provisions of this Agreement, except as specifically provided in Article 401 (Tariff Elimination), paragraph 4 of Article 1607 (divestiture of an indirect acquisition) and Articles 2006 and 2007 of this chapter.

2) Notwithstanding any other provision of this Agreement, a Party may take measures of equivalent commercial effect in response to actions that would have been inconsistent with this Agreement but for paragraph 1.

The effect of these provisions is fairly clear (even if the motivation for them is somewhat difficult to understand). The same cannot be said of the provision drafted by negotiators whose creation -- the NAFTA -- superseded the CFTA in 1993. NAFTA Annex 2106 states:

Notwithstanding any other provision of this Agreement, as between Canada and the United States, any measure adopted or maintained with respect to cultural industries . . . , and any measure of equivalent commercial effect taken in response, shall be governed under this Agreement exclusively in accordance with the provisions of the Canada - Unites States Free Trade Agreement.

The U.S. and Canadian interpretations of this NAFTA provision differ sharply. South of the border, where cultural industries are vital to the national economy,[3/] the NAFTA is read as if it simply repeats the CFTA provision: a party is permitted to take otherwise-NAFTA-inconsistent actions involving cultural industries, but the other party has an automatic right of retaliation if its industries are harmed by this protection. Thus, the self-regulating system discussed above: a party will only invoke the exception when the cultural interests are worth protecting even in the face of commensurate retaliation.

Both the U.S. Trade Representative (USTR) and the Congress took this view in the debates leading up to the acceptance of the NAFTA. USTR Carla Hills explained to Congress:

The Canadians have taken a cultural derogation <u>just as they took a cultural derogation in the Canadian free trade agreement</u>. . . . We for our government have said, if we suffer <u>any economic harm</u> as a result of their exercising any rights pursuant to that cultural derogation, we reserve the right to retaliate.[4/]

3/ <u>See</u> Jonas M. Grant, *"Jurassic" Trade Dispute: the Exclusion of the Audiovisual Sector from the GATT*, 70 Ind. L.J. 1333, 1334 (1995) (footnote omitted):

> *Trade in services is becoming increasingly important to the United States' economic well-being, and one of the healthiest service sector industries in the U.S. is the entertainment industry. U.S. entertainment exports generate an annual trade surplus of $8 billion -- exceeded only by the aerospace industry. In an era of U.S. trade deficits, Hollywood is a self-described trade "prize."*

4/ *North American Free Trade Agreement: Hearings Before the Senate Finance Committee* (testimony of U.S. Trade Representative Carla Hills) (Sept. 8, 1992) (emphases added).

The Senate Finance Committee echoed this interpretation:

> *Article 2106 of the NAFTA, which carries forward Article 2005 of the CFTA, makes clear that should Canada take measures to discriminate against or restrict market access to U.S. "cultural industries" (including motion picture, television, sound recordings and print publications), the United States retains the right to respond aggressively with measures of "equivalent commercial effect."*[5/]

In the NAFTA Statement of Administrative Action, the Administration stated that it

> *is committed to using all appropriate tools at its disposal to discourage Canada and other countries from taking measures that discriminate against, or restrict market access for, the U.S. film, broadcasting, recording and publishing industries. The Administration will consult with the Canadian Government regarding any proposed Canadian measures or policies that might lead to the exercise of, or reliance on, the "cultural industries" exemption. Should Canada choose to institute such measures, the Administration, in consultation with the relevant industries, is prepared to exercise fully the right to respond granted in the Agreement.*
>
> *At such time as the Administration takes remedial action in response to a Canadian measure, it will endeavor to fashion a response in such a manner as to discourage the creation of a similar non-tariff barrier in other countries.*[6/]

Private sector trade policy advisory committees, commenting on the new agreement, reinforced the view articulated by Congress and the Administration. The Industry Functional Advisory Committee on Intellectual Property Rights (IFAC-3) urged Congress

> *to let Canada know that it would find the actual implementation of such an exclusion to be unacceptable and subject to immediate trade sanctions. In this regard, IFAC-3 notes that, under the NAFTA Agreement, the U.S. remains free to take retaliatory action should the exclusion be implemented. Indeed, IFAC-3 urges the Administration and the U.S. Congress to ensure that this "compensatory measures" provision becomes a truly credible deterrent to any implementation of the exclusion by Canada.*[7/]

5/ S. Rep. No. 189, 103d Cong., 1st Sess. 58 (1993).

6/ NAFTA Statement of Administrative Action 221-22 (emphasis added).

7/ Industry Functional Advisory Committee (IFAC-3), *Report on the North American Free Trade Agreement* 14-15 (1993) (emphasis added). See also Industry Sectoral Advisory Committee on Services (ISAC-13), *Report on the North American Free Trade Agreement* 11, 30-32 (1993).

The Canadian Government views the matter differently. There is no major disagreement about the elements of the CFTA system: obligations, subject to derogation, subject in turn to an automatic right of retaliation. Canada urges, however, that the NAFTA has *literally*, rather than functionally, transplanted the CFTA system for cultural industries. In other words, only CFTA obligations are subject to the derogation-and-right-of-retaliation scheme. In this view, there are *no* NAFTA obligations affecting cultural industries and thus, for example, no obligations relating to intellectual property (not covered by the CFTA) and very few relating to services (very limited CFTA coverage). Were this interpretation correct, Canada would be free to take protectionist measures in the intellectual property and services areas without facing NAFTA-based U.S. retaliation.

Having Your Cake and Eating It Too: Canada's Interpretation

The impact of the Canadian interpretation can only be fully appreciated if one considers the breadth of "cultural industries." The definition in NAFTA Article 2107 includes

> *persons engaged in any of the following activities:*
>
> *(a) the publication, distribution or sale of books, magazines, periodicals, or newspapers . . . but not including the sole activity of printing or typesetting any of the foregoing;*
>
> *(b) the production, distribution, sale or exhibition of film or video recordings;*
>
> *(c) the production, distribution, sale or exhibition of audio or video music recordings;*
>
> *(d) the publication, distribution or sale of music in print or machine readable form; or*
>
> *(e) radiocommunication in which transmissions are intended for direct reception by the general public and all radio, television and cable broadcasting undertakings and all satellite programming and broadcast network services.*

Read in combination with the "any measure . . . with respect to" language of NAFTA Annex 2106, this definition could be interpreted to cover, for example, not simply publishers, authors and bookstores, but the ink and paper used to print books and the trucks used to ship them. (It has apparently already been interpreted, as discussed below, to include book retailing.) The result of Canada's reading is an exception to NAFTA disciplines that is quite broad and -- more important -- *infinitely* deep.[8/] This interpretation, and the system it would create if adopted,

---

8/ Canada's interpretation raises troubling questions regarding the General Agreement on Tariffs and Trade (GATT) and General Agreement on Trade in Services (GATS) provisions on regional integration, which require elimination of "substantially all" barriers to trade within a customs union or free trade area. See GATT Art. XXIV:8(a)(i), and GATS Art. V:1(b). Given the rapidly increasing reach of "cultural"

(continued...)

are untenable. Setting aside the "incentive" problems discussed above, who would decide what is and is not a legitimate cultural measure? Presumably dispute settlement panels in the extreme, but is that their function and expertise?

It is just such problems that the U.S. interpretation avoids. In practice, Canada will define in the first instance what is a legitimate cultural endeavor, but will only pursue that goal when its core cultural interests truly do outweigh economic and other interests.

The wisdom of such a system can be seen in terms of possible future trade negotiations as well. For instance, if the United States were to urge in future negotiation that gas-guzzling cars and "light" beer were significant parts of U.S. culture that needed protection, many observers might think that to be somewhat foolish.[9/] Yet, what authority -- other than the U.S. Government itself -- could be empowered to define what is and is not part of U.S. culture? The United States must make decisions in the first instance, but there must be a disincentive to over-reach. Such a system is the best method of limiting what can be defined as "cultural industries" and "measure[s] adopted or maintained with respect to cultural industries."

Less Damaging Means to Protect/Promote Culture

It is also worth briefly considering other, less harmful, means of protecting and promoting national culture. Subsidizing domestic cultural activity does far less trade damage than import restrictions, if for no other reason than that cultural industries do have some elasticity of demand. That is, subsidized Canadian cultural goods and services will not necessarily replace demand for other products -- they may create new demand. Properly implemented, subsidies may promote domestic cultural activity without unduly impinging on foreign and consumer interests. Yet, this method is far from perfect, especially when subsidies are funded in a manner that weighs disproportionately on foreigners. For instance, proposed tape levies which discriminate against foreign goods and services -- taxing foreign products to subsidize domestic -- should face the same "disincentive" as other cultural actions that violate international norms.

An even better alternative to creating domestic barriers is to place an emphasis on projecting the national culture abroad. This is how a national culture becomes more globally accepted and, in the long-run, independent of government support. As Canada's former Foreign Affairs Minister Ouellette recently stated:

> *A country that isolates itself and fails to project its identity and values beyond its borders is doomed to anonymity and loss of influence . . . . [I]nternationalization is essential to success and competitiveness.*

8/(...continued)
industries, exempting them from the NAFTA arguably would place the NAFTA in violation of the GATT and GATS rules. Of course, the more broadly the NAFTA exception is construed, the greater this problem becomes.

9/ See ISAC-13 Report, n. 8 supra ("the very concept of what is 'cultural' is impossible to define. Is American 'culture' reflected more by U.S. films than by U.S. fast food or clothing?").

Cases: How the Problem Has Evidenced Itself

The history of Canada-U.S. disputes in this sector underscores the importance of disincentives to protection. Not expecting swift and commensurate retaliation has yielded a tendency to broaden the definition of cultural interests in order to benefit economically, not culturally.

Country Music Television: Of the several disputes over market access for non-Canadian television programmers, the most publicized so far has been that of Country Music Television. In 1994, after CMT had been on the air in Canada for a decade creating a market niche for a 24-hour country music video service, the Canadian Radio-television and Telecommunications Commission (CRTC) decided to block Canadian distribution of CMT's programming to make way for a Canadian-owned "clone" service. Following a petition by CMT, the U.S. Trade Representative (USTR) initiated a Section 301 investigation and, in March 1996, determined that the Canadian access policies leading to CMT's eviction are "unreasonable," are "discriminatory," and "burden or restrict" U.S. commerce.

Ultimately, the U.S. Government's intercession and threatened retaliation led to a commercial settlement between CMT and New Country Network (CMT's Canadian-owned replacement). The agreement, which essentially merges CMT and New Country for purposes of the Canadian programming feed, was acceptable to all parties at least in part because the surviving company has sufficient Canadian ownership to be considered "Canadian" and, thus, is eligible for favorable regulatory treatment including a "must-carry" commitment imposed on cable distributors. While the agreement does not undo the harm originally done when CMT was evicted, it was accepted as a commercially sound arrangement.

The CMT case illustrates Canada's excessively broad interpretation of the NAFTA cultural industries exception. While seeking to increase the percentage of Canadian videos played on CMT arguably might have promoted Canadian culture, forcing domestic ownership of the service -- which is really just a distributor -- promotes domestic profit, not culture. At stake was simply what company would receive the advertising and subscription revenues, not which nation's videos (and by extension, which nation's "culture") were getting television exposure.

In any event, ongoing regulatory developments may lead to further tension over Canada's cable access rules. For example, the CRTC is considering new license applications that could result in the removal or limitation of other U.S.-based services.

Direct-to-home satellite tv distribution: The Canadian Government has struggled in the last year with "direct-to-home" (DTH) satellite distribution and the question of who will be allowed to provide DTH service to Canadians. Two applicants applied for licenses from the CRTC -- one with a U.S. affiliation (Power DirecTV), the other a wholly Canadian-owned company (Express-Vu). The CRTC preliminarily licensed only the Canadian company but was later overruled by Cabinet. In December 1995, the CRTC agreed to license both companies, but with conditions that Power DirecTV reportedly viewed as so onerous as to make the entire

venture no longer worthwhile. At present, long-suffering Canadian viewers are without DTH service other than what they can get in the "grey market" using fictitious U.S. addresses.

Split-run magazines: A relatively new and significant dispute between the United States and Canada concerns the magazine *Sports Illustrated*. For several years, Time Warner has printed and distributed a split-run edition of *Sports Illustrated* in Canada -- *i.e.*, an edition tailored to Canadian audiences, with resold advertising. Unhappy over the competition for advertising revenues, Canadian publishers asked their government for new measures blocking the sale of split-run editions in Canada. A task force established by the government issued a report in March 1994 urging an 80 per cent excise tax on advertising to hinder the publication of such editions. This tax was adopted in early 1996. Alongside the excise tax, the Canadian Government disallows income tax deductions to advertisers in split-run magazines, and imposes higher postage rates for foreign-owned magazines than for those which are Canadian-owned.

On March 11, 1996, USTR launched a WTO action protesting this discrimination.[10/] With Canada having exercised its right to delay the process temporarily, the WTO Dispute Settlement Body is now forming a panel that will hear from the two governments over the next several months.

Canada's magazine tax appears to be another example of protectionism with primarily economic, rather than cultural, significance. Again, one must wonder whether protecting Canada's cultural heritage truly requires action against *Sports Illustrated*.[11/] In addition, the tax hits split-runs of Canada-based magazines that would otherwise find a market in the United States.

Book distribution: A fourth dispute grows out of Investment Canada's recent decision to block Borders Group Inc.'s proposed Canadian bookselling operations based on concerns over the threat those operations may have posed for Canadian retailers. (Barnes & Noble apparently has been similarly rebuffed, while Tower Records was simply told to sell fewer non-Canadian books.) Canadian Government policy permits non-Canadians to engage in book retailing only as minority investors in joint ventures controlled by Canadians. Although Borders had indicated that it would expand through a Canadian-led joint venture, the Canadian Government rejected the proposal on the grounds that the U.S. parent company ultimately would have the purchasing power -- creating the risk that Canadian books and authors might be overlooked in favor of their U.S. counterparts.

10/ In pursuing this approach, the U.S. Government is taking advantage of the fact that magazines are "goods" covered by GATT rules including national treatment. The same is generally true in the case of books or newspapers. For music, films, and television programming, the applicability of GATT disciplines is more complicated and depends in part on the medium used for distribution.

11/ Indeed, culturally (as opposed to economically), the restrictions may be counter-productive. As with CMT, *Sports Illustrated* is a global vehicle that may tend to emphasize or de-emphasize Canadian content based on whether it has a Canadian audience. Taking away the Canadian audience could keep Canadian athletes out of the magazine and limit their exposure beyond Canada's borders.

The restrictions are, at best, based on speculation and are, at least, heavy-handed. It is hard to detect the "cultural" significance of keeping an effective retailer out of Canada.

Feature films and blank tapes: The list of active bilateral cultural disputes concludes with feature film distribution and blank tape levies. In December 1995, the Canadian Government ruled that all DTH licensees must purchase feature films solely from Canadian distributors. The U.S. Government has objected on the grounds that this requirement will give Canadian companies monopoly distribution rights and will restrict competition. It also interferes with the (efficient) industry policy of negotiating, in many cases, global or continental distribution rights for particular films. There are no similar, purely nationality-based, restrictions on the ability to distribute films in the U.S. market. Finally, the Canadian Government's recently introduced copyright legislation would establish a public performance right for record producers and performers, and would impose a levy on sales of blank audio tapes. Revenues would be used to compensate performers and producers for home-taping of their works in Canada. Reportedly, only Canadian performers and producers -- not their U.S. counterparts -- will be compensated.

Conclusion

Protecting national and local cultures is a laudable goal -- like many others. Yet, an unbounded ability to discriminate against cultural imports is subject to abuse for reasons having nothing to do with culture. And the danger goes beyond North America. The Canada-U.S. situation has been seen as a precedent in other contexts -- from WTO accession discussions to the current negotiations over a Multilateral Agreement on Investment.

The CFTA created a workable system permitting Canada to safeguard core cultural interests without generating excessive economic (or uneconomic) protectionism. That system was based upon: 1) market liberalization, 2) with a right of derogation to protect legitimate cultural interests, but 3) subject to retaliation for the economic harm done. This sound system was carried forward into the NAFTA -- at least it is what Congress and the Administration intended to carry forward. It is a reasonable and workable approach to a very difficult problem. One can only hope that it will be adhered to in future dealings between the two countries -- and more broadly if the genie of "cultural specificity" proves impossible for negotiators to put back into the bottle after the NAFTA and Uruguay Round.