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# Canada's Culture/Trade Quandary and the Magazine Case

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by Dennis Browne

*Canada has long been a strong supporter of open markets and the international trade agreements necessary to secure them. But recently conflicts have developed between policies put in place to foster Canadian culture and international trade agreements Canada has signed. This article argues that culture is a "special" commodity. It also examines the framework for international trade and at one specific recent case involving the World Trade Organization's decision on split-run magazines.*

In general discussions of Canadian culture and the need to foster and protect it, almost everyone finds it best to avoid definition. I remember the *L.A. Times*, headline: "Canadian Culture? Whatever It Is, They Want to Preserve It."

Definitions do exist in trade agreements. The North American Free Trade Agreement (NAFTA), for example, provides an exemption for individuals or enterprises engaged in cultural product creation, distribution, broadcasting, etc., but this does not fully address the underlying issue of the need for cultural expression in a modern society.

When pressed for a definition of Canadian culture I suggest that culture is "the value-laden expression of ideas". In other words Canadians must have opportunities to hear themselves speak in their own voices.

We must recognize that Canadians and Americans are not the same. We are remarkably similar, but we do have some pretty fundamental underlying differences. They are often subtle, they are not easily identified or catalogued without appearing to make derogatory comparisons, but they are there.

Social scientists have conducted studies which demonstrate that a sense of shared values is an essential un-

derpinning to the continued functioning of a democratic society. Intuitively it makes sense. Democracies function on the basis of consent by their citizens. The citizens may agree to disagree on various details, but they have to share a common set of fundamental values. Otherwise they would not risk elections every few years that may result in political power passing from one group to another.

From this we can extrapolate that if we are going to preserve these shared values, we must have opportunities to hear, read and see common expressions of value. If Canada is to continue as a nation state, we must share or exchange value-laden expressions of ideas that reflect Canadian values – whatever they might be.

In our society the media are the mirrors. Films and television give back images which confirm things for us. We hear our language, we see our neighbourhoods, we watch stories about people like ourselves. The question is whether our children have access to a mirror which reflects something of themselves. Does what they see identify who they are?

Frequent exposure to value-laden expressions of ideas is necessary to ensure the political socialization of children into their respective societies. It is very important. If children grow up without identifying themselves as members of their society, by the time they reach early adulthood, they will have real problems fitting in and we will end up with a sort of dysfunctional family – nationwide.

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As the population has become more mobile, as families grow a bit looser, as community structures such as neighbourhood churches and neighbourhood playgrounds become less central to our personal development, the importance of commercial cultural expression increases almost exponentially.

*Shared understandings achieved through cultural expression are essential to a well functioning democracy. Such expressions are now most frequently found in commercial packages. Hence the link between culture and trade is inextricable.*

The cultural expressions I have been talking about tend, more often than not, to be embedded in cultural products, most of which are the subject of commercial transactions: books, magazines, newspapers, films, videos, television programs, recorded music, various live performances, and so on. These products circulate or are distributed in our society and we as individuals generally must choose from what is available.

Thus if we are to have opportunities to hear ourselves speak in our own voices, circumstances must exist that will both foster the development of the talents of those among us who have the abilities to create cultural expression, and ensure that some "shelf-space" will be available for their expressions in our incredibly crowded cultural milieu.

#### **Culture and the Framework for International Trade**

The framework for international trade regulation is a collection of multilateral or regional intergovernmental agreements that seek to place limits on the capacity of member governments to interfere in the market place to achieve domestic objectives.

A common objective of international trade agreements is to open markets – to increase competition. All modern agreements are based on certain principles and exceptions. The principles open markets and increase competition. The exceptions tend to close markets or decrease competition.

For Canada, the most important agreements are the World Trade Organization (WTO) agreements and the North America Free Trade Agreement. The WTO agreements consist of an updated and expanded General Agreement on Trade and Tariffs (GATT - which deals with trade in goods), the General Agreement on Trade in Services (GATS - which deals with trade in services) and

TRIPS (which deals with trade-related aspects of intellectual property rights).

It is important to remember that these agreements are all inter-related. There are four basic GATT principles: Most Favoured Nation (MFN), national treatment, prohibition of quotas and transparency. There are a number of exceptions to these principles and the most important are:

- the exception to national treatment that allows domestic production subsidies; and
- general exceptions allowing derogations from MFN, national treatment and the prohibition of quotas which allow imports to be restricted if such restrictions are necessary to protect public morals; to secure compliance with domestic regulations; and for the protection of essential security interests.

But these exceptions are not themselves without limitations. For example, restrictions put in place under them must be necessary to achieve the objective – protecting public morals, etc. This suggests the application of some test or standard – an obligation to demonstrate, when challenged, that the action is necessary to achieve the legitimate goal.

Also, there is a general principle, that exceptions must generally be applied in the manner that is the least possible trade restrictive. If the legitimate objective can be achieved through another measure that is less trade-restrictive than a measure in place or under consideration, then there is an obligation to take the less restrictive path.

The General Agreement on Trade and Tariffs contains two culture-specific provisions: Trade restrictions may be imposed for the protection of national treasures of artistic, historic or archaeological value; and annual screen-time quotas may be established for the screening of domestically produced movies in theatres.

The General Agreement on Trade in Services applies the basic GATT principles: MFN, national treatment, transparency and market access. Market access is different for services than it is for goods as in services trade there are no physical objects crossing a border where they might be subject to tariffs and quotas. Services trade is not controlled by tariffs, it is controlled by an enormous number of laws and regulations at federal, provincial and municipal levels. Think, for example, of business permits, professional qualifications, and so on. But the underlying principle is the same.

Setting international standards for the regulation of trade in services is a new venture. As the first multilateral agreement of its kind, it tends to have more framework than substance, at least for the time being.

But the framework has familiar features. For example, it includes an unconditional MFN obligation. All WTO members must treat the services and service providers from all other members equally. There is, however, a major exception. When the GATS first enters into force for a WTO member, the member may list specific MFN exemptions on a one-time basis reflecting pre-existing circumstances. Such exemptions are to be renewed after five years and should not exist beyond ten years.

The transparency principle is more straightforward. Members must publish their laws and regulations and administer them in a reasonable, objective and impartial manner, with means for prompt review of administrative decisions such as the right to appeal.

The national treatment and market access principles are a bit more difficult to understand. Basically, each member lists, in its GATS schedule, those service sectors in which it is prepared to permit foreign services to be supplied in its market and, if market access is granted, whether it is prepared to treat foreign services and service providers on an equal footing with domestic services and service providers. Thus Canada can, for example, deny market access to foreign medical practitioners by licensing only doctors who have qualified in Canada.

Similarly, a member may grant market access but deny national treatment, for example, Canada may permit foreign bankers to establish subsidiaries (or branches) in Canada, but restrict the scope of activities they can undertake.

The GATS does not contain culture-specific provisions but the exceptions available to each member permits considerable scope to avoid service trade disciplines in the cultural area. For example, Canada took advantage of the one-time MFN exception to permit it to discriminate against the USA (and others) in favour of countries with which it has film co-production agreements. Thus a film produced in France under a co-production agreement could qualify as a Canadian film for subsidies and television national content requirements whereas an American film shot in Canada cannot.

Canada also exempted most cultural services from national treatments or market access commitments either by simply leaving them out of the relevant GATS schedules or by stating an exception in the schedule. An instance of the latter is Canada's GATS schedule which includes the right of foreign service providers to enter into "retail distribution" in Canada, *except for the distribution of cultural products such as books, musical scores, etc.* Thus we see Walmart, Home Depot, McDonalds and other foreign retailers spreading across Canada, but so far there is little evidence of foreign book stores.

## The Split-Run Magazine Case

To understand the magazine case, we must know a bit about the magazine industry. The most important point is that the industry has two income streams and two cost streams. The income streams are: (i) earnings from subscriptions and news stand sales; and (ii) earnings from the sale of advertising included in the magazine. The cost streams are: (i) the cost of the magazine's editorial content – photos and articles; and (ii) the costs of printing and distributing the magazine.

In the *Sports Illustrated* case it appears the revenues generated from news stand sales and subscriptions are more than adequate to cover the production and distribution costs of this magazine. Prior to the case, Time Warner was selling about 140,000 copies of each edition in Canada. The business had been going on for many years. I do not think the company was losing money. The other big cost – editorial content – was fully paid for by advertising sold to American advertisers.

***Thus the content of the magazines being sold in Canada was essentially a free good.***

This case was brought to the WTO by the United States to challenge Canadian measures that effectively denied American magazines access to Canadian advertisers. Thus the case was not about market access – or even about ordinary profits. It was about super profits. When the editorial content is already paid for and the selling price fully covers the production and distribution costs, practically every dollar paid for Canadian advertising in *Sports Illustrated* will be pure profit for the publisher. With their existing high levels of circulation in Canada they already had the cake – they went for the icing.

The WTO decision is not going to lead to sales of more copies of *Sports Illustrated* in Canada. It is just going to make the business of selling the same number of copies much more profitable.

But what will be Time Warner's icing is the Canadian magazine publishers' cake. The total amount of money routinely spent by Canadian advertisers in the print media is not increasing. Every Canadian dollar spent for advertising in American magazines will reduce the revenue pool available to Canadian magazine publishers.

There should be no doubt about American magazines being able to attract Canadian advertising. With their editorial costs already paid, they can readily discount the price for advertising by as much as 80% and still make

money. Canadian publishers will not be able to compete with this type of cut-throat competition.

Without their advertising revenues, Canadian magazines will not be able to pay for good quality editorial content. If that is the result, the magazines will appeal less and less to consumers and Canada could lose one of its forums – a very important forum – for cultural expression.

To protect the advertising income stream for Canadian magazine publishers, Canada had put in place a combination of measures, four of which were challenged in the WTO case. These were:

- an import ban on split-run magazines
- an excise tax on split-run magazines printed in Canada
- differential postage rates for Canadian and foreign magazines
- a postal subsidy

The import ban on split-run magazines is clearly a breach of the GATT principle calling for the elimination of quotas. An import ban is the ultimate “quota” since imports are zero.

Canada sought to justify the ban under the exception permitting quotas “necessary to secure compliance with domestic regulations” – in this case an income tax regulation that disallows business deductions for advertising placed in split-run editions. The WTO panel found that an import ban was not “necessary” to enforce the provisions of the *Income Tax Act* and, in any event, that a total ban was not the least trade disruptive way to go.

Canada Post’s differential postage rates were found to treat imported magazines less favourably than domestic magazines, which, on its face, appears to be a denial of national treatment.

Canada sought to defend the practice by claiming it was not a government measure, but the measure of a crown corporation acting independently of government. WTO rules apply to member governments, not to private actors in member countries. But the panel found that Canada Post does not operate independently of government direction and treated the differential postage rates as a government measure in contravention of Canada’s national treatment obligations.

The WTO panel found the postal subsidy paid by the government to Canada Post to be a permissible domestic production subsidy, but the appeals panel disallowed it by determining that for any such subsidy to qualify as a domestic production subsidy, it should be paid directly to the publishers rather than through Canada Post.

The most important issue in this case was the excise tax on split-run magazines as that measure could have effectively protected Canadian advertising revenues even in the absence of the other measures. The panel found it to be a breach of National Treatment as it is a tax applying differentially to split-run magazines and ordinary magazines.

Canada advanced two main arguments. First, the tax is on advertising services, not on magazines per se and thus, as it is a measure dealing with services, not goods, the panel should apply the GATS, not the GATT. As Canada did not list advertising services in its GATS schedule, it has no national treatment obligations with respect to these services. Consequently, there is no breach of the rules.

Unfortunately for Canada, WTO panels, like nature, appear to abhor a vacuum. In the absence of GATS obligations, they decided that, as the advertising was embedded in a physical good – the magazine – ordinary GATT rules would apply, including national treatment obligations.

Canada then argued, under the GATT, that they were not in breach of national treatment obligations because the obligation applies to the treatment of “like” goods or to goods that are interchangeable so far as the ultimate consumer is concerned. This argument was based on the notion that the essential quality of a magazine is its content rather than its physical form. In other words, what it actually expresses or the point of view from which the expression is made is what distinguishes one cultural product – in this case one magazine – from another.

***In the eyes of the WTO, magazines are not different than any other industrial good. Magazines should be treated the same as widgets. This is the crux of the matter for Canada.***

Canada argued that, in the case of magazines, editorial content expressing a Canadian point of view is fundamentally different from editorial content expressing an American point of view. Thus, for Canadian consumers, an American magazine is not an equivalent or directly substitutable product.

The panel was not convinced. In their deliberations they considered the examples of split-runs published in Canada by *Time* and *Newsweek* and concluded that a news magazine is a news magazine irrespective of its source. If a consumer goes to a shop to buy a news maga-

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zine, they will accept whatever is available without necessarily differentiating between *Maclean's*, *Newsweek* or *Time*. Product differentiation between magazines will depend as much on their format, quality of paper and other physical characteristics as it will on the nationality of the writers and publishers.

If we believe Canadians must have the opportunity to hear themselves speak in their own voices, we must get recognition that the "voices" of *Newsweek*, *Time*, *The Economist*, *The Far Eastern Review*, differ from the "voice" of *Maclean's*. We must get recognition that a Canadian description and interpretation of world news differs in a culturally meaningful way from an American or British or Singaporean interpretation of the same events.

This principle must be expanded to all cultural products – all products of value-laden expressions. Otherwise the trade rules will simply not fit Canada's need to have vibrant cultural industries that can make a real contribution to maintaining our distinctive national identity.

If international trade rules deny us the capacity to foster Canadian creators and ensure their products have access to at least some "shelf space" in Canada, those rules will not serve Canada well and public confidence in the framework of rules that govern our trading relations with the United States and the rest of the world may well diminish.

## Conclusion

Canada has a broad mix of measures in place to foster Canadian cultural expression and to provide some "shelf space" in Canada for Canadian cultural products. The mix of measures developed over time in response to the perceived needs of the various cultural product sectors. There is no one set of measures that would fit all sectors.

The mix is not perfect. Some of the measures may well be misguided. Some almost certainly need to be dropped or updated in the face of rapid technological change and the general forces of globalization.

**Canadian policy-makers need to re-examine all measures to assess their effectiveness and suitability in today's and tomorrow's world.**

The current mix of measures, however imperfect it may be, is not exclusionary. The intent is to give Canadians a choice which includes Canadian cultural products – not in any way to actually exclude foreign cultural products. In fact, Canada is probably the most open mar-

ket in the world to foreign cultural products. The breadth of choice available in Canada undoubtedly enriches us all. But if the strict application of trade rules has the effect of crowding out Canadian expressions of cultural values from the Canadian marketplace, each of us will be impoverished.

The challenge to Canada is to gain international recognition that cultural products differ from other industrial products – from widgets – and then get a domestic and international framework that permits both Canadian and foreign cultural expression to flourish in Canada and around the world.



## Postscript: Reaction to the Decision

On July 29, Heritage Minister Sheila Copps and Trade Minister Sergio Marchi announced Canada's response to the WTO decision on split-runs. The intent of the response is to do two things: bring Canada's regulations fully into compliance with WTO requirements; and maintain that status quo to the fullest possible extent.

As requested by the WTO, Canada will remove the import prohibition on split-runs, eliminate the excise tax, harmonize the commercial postal rate for domestic and foreign publications, and restructure the postal subsidy so that it is paid to magazine publishers rather than to the post office. These steps will bring Canada fully into compliance with the WTO ruling. But if this were Canada's total response, it would leave Canadian magazine publishers fully exposed to unfair competition from American publishers for advertising dollars. Thus there is an additional step.

In addition to the above four steps, Canada will also introduce a new measure to regulate advertising services in the magazine publishing industry, a measure to prohibit foreign publishers from selling magazine advertising directed at the Canadian market. Foreign publishers contravening the measure will be subject to fines ranging from \$50,000 to \$250,000.

As was undoubtedly anticipated, the Americans reacted quickly to condemn the announced measure. Consultation were immediately requested and they took place in Ottawa during the first week of August. The content of such consultations is not public, but one can be sure the Americans threatened further WTO action.

As noted in the article, the initial WTO ruling on the excise tax went against Canada because the panel applied the rules relating to trade in goods rather than those relating to trade in services. The proposed measure is carefully designed so that it is clear it addresses the sale of

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advertising services rather than the sale of magazines. Consequently, the panel should be obliged to apply services trade rules and, as Canada undertook no GATS obligations concerning international trade in advertising services, the measure is likely to withstand a WTO challenge.

Nonetheless, this particular choice of measure is, in my view, unfortunate as it will reinforce American arguments against cultural exceptions and thus may undermine Canada's efforts to build international consensus that cultural goods should be treated differently than other goods.

The American allegation has generally been that while Canada speaks in principled terms about the need to foster domestic cultural expression, these so-called principles are little more than an excuse to protect established commercial interests. The July 29 announcement will strengthen this allegation because, while it speaks of the need to "ensure that Canadian stories continue to be available to Canadian audiences ... Stories that reflect our

values, history and perspectives – the stories that are central to our culture and identity as Canadians", the measure is based solely on magazine ownership. It has no direct connection to magazine content.

It is unfortunate that Canadian Heritage and DFAIT officials were not able to craft a measure based on Canadian content rather than Canadian ownership. Then the measures would be tied directly to the cultural content we are determined to foster and make available to Canadians. The assumption behind the proposed measure is that foreign owned magazines will not carry Canadian stories and Canadian magazines will. If this assumption is correct, a content-based measure would have the same effect as the proposed measure, but it could not be attacked as disguised protectionism on Canada's part. If the assumption is not correct, it should not form the basis of Canadian policy. In any event, while the measure will achieve the desired result in this case, it is more likely to hurt than help Canada's longer term goals in seeking to deal with the culture/trade nexus.