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# REPORT

## **Canada - Audiovisual Policies: Impact on Trade**

**Keith Acheson**

**Christoper Maule**

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# **Canada – Audiovisual Policies: Impact on Trade**

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## Introduction

The current array of Canadian audiovisual policies is the outcome of a century of developments. Protectionist and promotional measures in the English-language market have aimed at creating a Canadian market separate from that of the United States. These policies restrict the inflow of content from the US, either directly or indirectly, control foreign ownership of firms engaged in production and distribution, encourage the production of Canadian content and assure that it is given 'shelf-space' by distributors. Nationalism is often interwoven with other goals such as developing an appropriate intellectual property rights regime and assuring that material distributed is socially acceptable.

A parallel set of concerns plays out somewhat differently in the Canadian French-language market. This set reflects the English-Canadian aspiration of becoming both an important and an independent presence in an international language market dominated by a larger player, the United States. What the United States is to English-speaking Canada in the world English-language market, France is to French-speaking Canada in the world French-language market. An asymmetric concern is the protection of a French-language market in films, broadcasting and recorded music from the competition of English-language films from the rest of Canada or abroad.

A dense policy network has evolved to support the production and distribution of audiovisual content. Three factors have contributed to the growing complexity of Canadian policy: (i) a cluster of technological advances, (ii) accompanying changes in organizational, contractual, and exchange relationships, and (iii) the political entrepreneurship of a growing policy bureaucracy. The technological evolution from film through television to the Internet and DVDs has required amending policies or developing new ones. Generally, technological change has reduced the costs of distributing content internationally and challenged protective policies. It is now harder to discriminate either among foreigners (granting most-favoured-nation [MFN] status) or between domestic and foreign firms (denying national treatment). Consumers have more ways to avoid discriminatory measures and to link with foreign suppliers. Satellite broadcasting and the transmission of content via the Internet are prominent examples. These competitive pressures have elicited new initiatives. Our focus is on current policy and its roots. In subsequent sections, we examine licensing, content policies and quotas, intellectual property policy, public ownership, foreign ownership restrictions, competition policy, subsidies and tax incentives, coproduction treaties and the available statistics on audiovisual trade. The effects of these policies can be examined in terms of their direct and indirect impact on Canadian imports and exports of audiovisual products. In a final section of the paper, we provide a conservative estimate of the protective effect of Canadian policies measured as a subsidy rate on tradable Canadian content.

## 1. Licensing

Many of the important players in the Canadian audiovisual sector require governmental licenses to operate. The rights allocated in this fashion include a right to broadcast over the air or through broadcasting distribution undertakings (BDUs) and the right to operate a BDU, such as a cable company, multipoint microwave system, or satellite broadcasting provider. Distributors of films to cinemas are licensed in the Province of Quebec.

Unlike a publisher or record producer, broadcasters have to obtain licenses to distribute content. Licensing was introduced in part as a response to the scarcity of spectrum. The alternative would have been to create a tradable property right, which was the social process that dealt with the scarcity of paper in publishing. Licensing permitted a higher degree of political control over broadcasting. A government position paper on broadcasting of July 4, 1966 put it this way: “Television channels and radio frequencies, the number of which is at present limited, are public property over which the public is entitled to exercise appropriate control, primarily by issuing broadcasting licenses subject to special and enforceable conditions.”<sup>1</sup> That obtaining a license to carry out this public trust was often rewarding to the successful applicant is usually not mentioned in official circles. A refreshing and humorous exception appeared a few years later in another official inquiry:

No other communications medium has this charge laid upon it by Act of Parliament: “to safeguard, enrich and strengthen the cultural, political, social and economic fabric of Canada.” We rely for this on the same medium that is the principal advertising mainstay of the soap industry.

We rely on it, and we expect broadcasters to shoulder the burden cheerfully. After all, the other shoulder is often employed in carrying quite heavy bags of money to the bank.<sup>2</sup>

What the government sought to influence through licensing has varied over time. In the early days of radio licensing, the government controlled the amount of recorded, as compared to live, content that was broadcast, the character of advertising and its intensity, and the airing of ‘controversial’ editorial opinions.<sup>3</sup> The interests and views of the public broadcaster, the CBC/Radio-Canada (CBC), had a significant impact on what the government considered proper goals for commercial broadcasting to serve. In 1968, an independent regulator, the Canadian Radio-Television Commission (CRTC) was created with authority over all of the elements in broadcasting. In response to technological convergence, regulation of telecommunications was added to the Commission’s broadcasting responsibilities in 1976.

Public hearings are required to be part of the CRTC’s licensing procedures for broadcasters. The regulator establishes and enforces the conditions of license that

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<sup>1</sup> Bird, R., ed. (1989) *Documents of Canadian Broadcasting*. Ottawa: Carleton University Press, 357.

<sup>2</sup> Canada, Report by the Special Senate Committee on the Mass Media, December 1970, Vol. 1, Chapter 10.

<sup>3</sup> A listing of “Milestones in Canadian Content for the Film and Television Sectors,” is published in a Canadian Heritage discussion paper, *Canadian Content in the 21<sup>st</sup> Century*, March 2002, Annex A, 17-20.



typically include--Canadian content quotas, spending targets for Canadian programming and an increasing list of other considerations, such as: violence in programming; non-stereotypical and fair portrayal of racial minorities, aboriginal peoples, and minority groups; employment equity goals; and attending to the needs of the hearing and visually impaired.<sup>4</sup> The government can issue directives on licensing to the Commission and override individual decisions on appeal. Directives have been issued infrequently.

In licensing one size does not fit all. The CRTC considers the special circumstances of a licensee and modifies the targets for Canadian content and expenditure on Canadian programming accordingly. This customizing approach creates incentives for licensees to adopt accounting and other practices that underreport their broadcasting income and to ingratiate themselves with the Commission through politically attractive promises that are mutually forgotten when the attention of the media turns elsewhere.

BDUs retransmit over-the-air broadcasters as well as deliver specialty and pay channels that are not otherwise available to viewers. There are three regulatory categories of BDUs—cable systems, DTH satellite service providers and wireless cable.<sup>5</sup> Canadian cable is the most important BDU category. It owes its high penetration rates (around 70% of TV homes passed by cable in 2001) largely to the wider range of content, much of it imported, that it makes available. Its professed commitment to carrying and paying for more Canadian content is tempered by this commercial reality.

Licensing interacts with foreign investment policy, as only Canadians are eligible to apply for Canadian broadcasting and BDU licenses. The regulator nevertheless recognizes foreign broadcasters in establishing its rules of carriage for BDUs encompassing priority rules, tiering, and linkages.<sup>6</sup> Foreign programming is delivered to Canadian customers of BDUs indirectly by Canadian broadcasters and directly by foreign broadcasting services of all types, mostly but not exclusively from the United States. Since 1979, Canadian cable companies have been allowed to carry the major US commercial networks -- originally NBC, CBS, and ABC, subsequently expanded to include the Fox network--and the American public broadcaster, PBS, on their basic service.<sup>7</sup> These stations plus the Canadian commercial networks, the Canadian public

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<sup>4</sup> CRTC, Public Notice CRTC 1999-97, Ottawa, 11 June 1999

<sup>5</sup> We use wireless cable to refer to broadband systems over-the-air technologies such as multipoint distribution system (MDS) or local multipoint communications systems (LMCS).

<sup>6</sup> These terms are part of the regulatory lexicon in Canada. They may not have their counterparts in other countries. Their purpose is to identify different regulations controlling the composition of programming carried by BDUs. Brief definitions are: basic services – services that a BDU carries on its entry package; discretionary packages – additional services that a consumer may purchase after subscribing to basic service; linkages – formulas that dictate what and how many foreign services can be added to the carriage of Canadian services on different packages; priority – the eligibility of a service for a particular package and any preferences that it might enjoy for inclusion in a particular package; and tiering – the ordering in which packages may be purchased.

<sup>7</sup> The BDUs are currently allowed to choose 3 of the 4 commercial US networks and PBS on their basic service. This longstanding policy illustrates the importance of foreign programming to the viability of cable franchises, particularly those in cities and towns that are not able to receive US broadcasting over the air.

broadcaster and the provincial educational channel, local stations, and a few specialty channels provide the core of basic service.<sup>8</sup>

A more expansive array of Canadian specialty and pay channels and foreign broadcasters and cablecasters is available on discretionary packages. Access is typically hierarchical. A subscriber must take the basic service in order to contract for the discretionary package. The CRTC requires that the inclusion of the foreign channels in a discretionary package be linked to the inclusion of Canadian specialty and pay channels according to published formulas. A cable service can only include in its packages foreign services that appear on eligibility lists determined by the CRTC in a decision-making process that is not public. A notable US broadcaster that is not on the eligibility lists is HBO.

The ongoing conversion of cable systems from analogue to digital has increased capacity substantially. In late 2000, the Commission licensed 21 (16 English and 5 French) digital specialty channels and instructed all but the smallest BDUs to distribute those that are “appropriate to their market.” It also licensed 262 digital specialty channels that are not assured carriage.

The CRTC must approve the takeover of a BDU license that is sold by the present holder. In the past, the Commission examined the situation of the licensed service and either denied or approved the transfer. When a transfer was approved the buyer would be assessed a takeover “tax.” This levy would typically be in kind and involve, for example, the setting up of a fund to provide Canadian content. The total value of the commitment depended on the circumstances of the licensee. Recently, the Commission has replaced this discretionary process with a charge calculated as a percentage of the value of the transaction. For the transfer of television broadcasting licenses--conventional, pay, pay-per-view and specialty services—the buyer promises to deliver a package of “clear and unequivocal tangible benefits” representing a financial contribution of 10% of the value of the transaction, “as accepted by the Commission”. The complex regulatory structure acts, perhaps inadvertently, as a barrier to entry. The transfer tax and foreign ownership restrictions further insulate incumbent managements.

Film distributors are not required to acquire a federal licence. Distributors operating in the province of Quebec, however, must obtain a provincial licence. General licenses for distribution of proprietary and non-proprietary films are only granted to Quebec-based Canadian distributors. Special permits are issued for the distribution of proprietary rights films by other distributors. A special agreement was negotiated in 1986 by the provincial government with the Motion Picture Export Association of America (MPEAA), now known as the Motion Picture Association (MPA),<sup>9</sup> that allowed its members to distribute English-language films in which they had proprietary rights. For the purpose of the agreement its members are judged to have proprietary rights if any of the following

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<sup>8</sup> For example, the authors live in an area served by Rogers cable. Rogers description of its basic offering is:

With The Basic Cable package you will enjoy all the major Canadian and American networks and their local affiliates. Top-rated shows, daytime dramas, evening sitcoms, news and late-night everything!

<sup>9</sup> The MPA represents the international industry and the Motion Picture Association of America (MPAA) the industry in the US.

conditions are met: the member invested more than a stipulated sum in the film (adjusted after discussion every two years), provided 50% of the total sum invested in the film or owned world rights.<sup>10</sup>

As a result of the agreement, the MPA members enjoyed more privileges in Quebec with respect to English-language films than any other foreign distributors and, ironically, than any Canadian distributors from other provinces. With respect to non-English-language films the MPA members do not have a preferred status but are subject to the general condition applicable to all non-Quebec-based Canadian distributors: “(N)o license may be issued” if the MPA member has “not invested 100% of the costs of production” unless the member produces a certificate issued by the Minister of Cultural Affairs. The Minister will issue a certificate only if he or she is satisfied “that the application is justified considering the size of the member’s investment in the film.”<sup>11</sup>

## 2. Content policies and quotas

Canada has adopted content regulations and various support programs to encourage production of national audiovisual content. Content requirements require that at least a specified percentage of some measure of national content be shown or aired by television stations and specialty channels that are carried by BDUs. The critical percentage is usually an average over a stipulated period. The impact of content controls or subsidies to national programs and films depends on the measure of the nationality that is adopted.

Canadian content regulations for television require private television broadcasters to broadcast Canadian content at least 60% of the time the station is on the air and at least 50% of the time between 6 pm and midnight (prime time).<sup>12</sup> The public broadcaster must maintain the same overall level of Canadian content and 60% during prime time. These requirements are calculated as yearly averages. The separate prime time minimum was added to the overall minimum to reduce the extent to which broadcasters would meet their commitments by showing Canadian content during periods when small audiences are expected. The regulator has also identified as priority programming targets genres that stubbornly resist Canadianization. Prime-time drama is an example.<sup>13</sup> Canadian

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<sup>10</sup> For the purposes of the agreement, investment was defined to include negative production costs, negative pick-up costs, and costs for prints, advertising, publicity, and promotion. World rights were defined as the rights to Canada, US, the European Economic Community countries, Japan, Australia and New Zealand, excluding the country of origin of the film. For distributors that are not part of the agreement between Quebec and the Hollywood majors, world rights exist only if the rights to distribute the film throughout the world are held (section 105(2) of the Cinema Act, R.S.Q., chapter C-18.1, updated to 21 November 1995).

<sup>11</sup> Revised Statutes of Quebec, Cinema Act, chapter C-18.1, Section 105.1

<sup>12</sup> We remind the reader that we use the term benchmarks because individual stations may be *required* by condition of license to air additional Canadian content or alternatively, if they are in financial difficulties, are likely to be granted relief from fully meeting the benchmarks.

<sup>13</sup> CRTC, Public Notice CRTC 1999-97, Ottawa, 11 June 1999.

broadcasters are often able to fill much of their quotas by distributing Canadian news, current affairs and sports programming and show few Canadian drama and entertainment programs. Removing the content quotas would probably leave the news, current affairs and sports programming in place and reduce the small amount of Canadian drama and entertainment programming presently shown, replacing it with foreign programming.

Whether a program appearing on a television screen is deemed Canadian content does not depend on the national aspects of its story, images or sounds but on the nationality of those who financed, managed and made it. All of the current systems partitioning content as Canadian or non-Canadian use a version of the point system and require that the producer be Canadian. For a television program, qualification depends on the total points earned by staffing key positions with Canadians. The designated positions and their point allocation are: director 2; screenwriter 2; lead performer 1; second lead performer 1; production designer 1; director of photography 1; music composer 1; and picture editor 1. For a live action program to be classified as Canadian, the CRTC requires that the producer, either the director or the screenwriter, and at least one of the two lead performers be Canadian, and the total point score of the production be at least six. In addition, 75% of spending on production services must be paid to Canadians and 75% of laboratory and post-production expenses be spent in Canada. Dubbing a foreign program shot in English, French or a native Canadian language to another language in this set receives a Canadian programming credit of 25% if the lip synchronization is done in Canada, using Canadian resources. Dubbing a foreign program that is not in English, French or a native Canadian language into any of these languages receives a 50% Canadian programming credit.

News and public affairs programs produced by a Canadian broadcaster are classified as Canadian with no requirement to calculate points. Television programs and films that have qualified for the Canadian Production Tax Credit (CPTC) are also automatically considered Canadian for meeting broadcasting quotas. A sports telecast is Canadian if a Canadian production company controls the production, at least one major on-screen position, e.g., the announcer or half-time moderator, is a Canadian, and if the event is held abroad, a Canadian team or athlete is involved. Productions meeting the terms of a coproduction treaty are granted Canadian content status (see below).

The Canadian Audio-visual Certification Office (CAVCO) introduced the points system in 1974 for qualifying films as Canadian for a tax shelter program. CAVCO continues to classify films and programs that are eligible for the Canadian Production Tax Credit, which replaced the tax shelter program in the mid 1990s. CAVCO's current point system differs in a minor way from that used by the CRTC for classifying programs shown on television but its expenditure requirements are identical.<sup>14</sup> The Canadian Television Fund (CTF), which subsidises the production of television programs (see below), also classifies

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<sup>14</sup> The excluded programs are news, current events or public affairs, weather or market reports, talk shows, games, questionnaires or contests (except if directed primarily at minors), sports, gala or awards, production that solicits funds, reality television, pornography, advertising produced for industrial, corporate or institutional purposes, primarily stock footage (except if documentary), and production for which public financial support would, in the opinion of the Minister of Canadian Heritage, be contrary to public policy.

films that qualify for support in a similar manner.<sup>15</sup> Telefilm administers the Canadian Feature Film Fund (CFFF) that provides equity investments in cinematic productions using the point system.<sup>16</sup>

The cultural rationale for content quotas and related subsidies is that Canadian production teams and money will produce programs with a Canadian sensitivity. The commercial incentive, however, is to produce the programs that are most profitable. Since the market for most productions, either mass-market or niche-market, is typically international, the content is tailored to international demands. Even with the generous subsidies now available, a Canadian production cannot typically meet its costs without foreign sales. Almost all of the high quality Canadian made-for-television movies, for example, are pre-sold to both Canadian and US broadcasters, with the latter paying a higher license fee and exercising some control over content.

Pay-per-view services, specialty channels, pay movie channels, and conventional broadcasters currently distribute movies on television. The CRTC applies and enforces Canadian content requirements on these services. There is no similar national control over what appears in Canadian cinemas. In the 1970s and 1980s, the government negotiated a variety of ad hoc agreements with the dominant cinema chains in response to political concern over the low percentage of Canadian films shown in movie houses. By early 2001, many of North America's large cinema chains had declared bankruptcy.<sup>17</sup> Consequently, there is a lull on this policy front but it would not take much of a spark to light the fire again.

In part the agitation about exhibition arises from misreading the significance of statistics reporting that Canadian movies are a low percentage, say 5%, of those shown in Canadian cinemas while movies made in the United States are a large percentage of the films shown in American cinemas. The following hypothetical situation illustrates how these statistics can be misinterpreted. Assume that English-speaking Canadian viewers are 5% of the total population of English-speaking viewers in the world; Australians are 5%; Brits are 15%; and the Americans are 75%. If all the English-language viewers had the same tastes for first run movies and production houses in each country were equally creative and efficient at making first run movies, each country would produce films in proportion to its share in the total market. Canadians would produce 5% of the movies shown in a typical cinema, Brits 15% and so on. A marquis of a typical cinema in each country would feature the same set of films over a year. In this hypothetical world, 75%

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<sup>15</sup> The CTF requires that both the director and screenwriter be Canadian, all copyrights be owned by Canadians, shooting be mainly in Canada, and the production score 10 Canadian content points.

<sup>16</sup> Eight Canadian content points are required to qualify as Canadian in the CFFF.

<sup>17</sup> One of the two dominant chains in Canada, Loews Cineplex Entertainment, declared Chapter 11 bankruptcy in the United States and obtained an order to restructure in Canada on February 15, 2001 as part of a deal engineered by an investment group led by Onex Corp. of Canada. Onex became the majority shareholder (60%) when the company emerged from Chapter 11 status and completed its Canadian restructuring on March 21, 2002 (See Loews Cineplex Entertainment Corp.'s form S-1, filed with the SEC on August 6, 2002). The other large chain, Famous Players, is a subsidiary of Viacom.

of the films shown in all countries would be from the United States, 15% from the United Kingdom, 10% would be split between Australia and Canada. Since licensing fees would reflect the population of viewers in each country, the balance of payments in movie rental payments would be zero for each country. Canadian made films, for example, would make 95% of their revenue abroad and only 5% at home. An American film would earn only 25% of its revenue abroad and 75% at home. Canada's cinemas would rent many more foreign films but the relatively low total rental fees paid for each one would be balanced by the far higher rental fees paid by foreigners on the relatively few pictures made by Canadian producers.

In this hypothetical world, a statistic of 5% for Canadian-made films in its cinemas is a source of pride and not concern. In no sense, is Canada or Australia being dominated if they attain that percentage. Of course, in the real world, many factors result in deviations from this benchmark. There may, for example, be a preference by national viewers for films from their own countries. The income of individuals in these countries is not the same. The national industries may not be equally capable because of different learning over time, lingering effects of small scale in the past and other factors. We have chosen the numbers in part to compensate for such factors. Canadian viewers, for example, represent an even lower percentage of the total market for first-run English-language films than the five percent assumed in our hypothetical world. In any case, the mitigating factors would only cause adjustments around the benchmark percentages in the example.

Although we consider the Canadian industry to have the potential of being as efficient as any in the world, the array of current policies, in our opinion, has made the Canadian production industry considerably less efficient than its potential. The most important message from this simple analysis is that a small country operating in large language markets should put much more weight on exports and imports in balance-of-payments statistics than on the percentage of national films in the movie houses to measure its performance in the industry. Such statistics are difficult to put together, but, as we will show below (see section 9), what can be discerned reveals a positive picture from the Canadian perspective.

There are some similarities between the setting of Canadian content quotas for individual broadcasters and specialty channels and the priority, tiering and linkage requirements for BDUs. The CRTC controls the mix of Canadian and foreign broadcasters of different types that can be carried in various service packages offered to customers. Canadian specialty and pay channels are given a hierarchical access status to different service packages. Some are slotted for the basic service while others typically appear on discretionary tiers. The CRTC's linkage rules require that the cable company can only carry US specialty and pay channels in a discretionary package if each one is accompanied by a specified number of Canadian services. These stipulations are quite complicated.<sup>18</sup> American broadcasters dominate the foreign services on the eligible lists,

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<sup>18</sup> In the CRTC's wording: "Canadian pay television service may be linked in a given discretionary tier with no more than five channels containing any of the non-Canadian-originated services specified in either Section A or Section B of the list of Part 2 eligible satellite services, but in no case can a licensee distribute more than five channels of non-Canadian-originated services linked with Canadian pay television services, regardless of the number of Canadian pay television services distributed by the licensee," CRTC, Public Notice CRTC 2001-90, Ottawa, 3 August 2001.

but there are an increasing number of services from other countries including, for example, TV Japan, TV Polonia, Radio-France outre-mer (RFO1), Deutsche Welle, The Filipino Channel, and BBC World.

### **3. Intellectual property**

Copyright and neighboring rights are the branches of intellectual property with the most direct impact on the cultural industries. Copyright law is national but constrained by international agreements. With the inclusion of the Trade Related Intellectual Property (TRIPS) accord in the WTO, the international scope of copyright commitments and the effectiveness of their enforcement increased significantly. The WTO countries agreed to adopt the commitments of the Paris protocol of the Berne Convention for the Protection of Literary and Artistic Works with the exception of its moral rights article (6bis). Those owning copyright in computer programs and movies (cinematographic works) were given the right to prohibit rental of their works. In the case of movies a WTO member need not grant owners this privilege unless the rental market was leading to widespread copying. With respect to neighboring rights, TRIPS grants musical performers the rights to prevent an unauthorized sound recording of a concert or other show and its distribution. This right was not granted performers with respect to an unauthorized audiovisual recording of a show. Unauthorized broadcasting of performances is forbidden.

In 1996, a WIPO treaty on Intellectual Property was negotiated. In addition to repeating some of the content of TRIPS it more explicitly addressed copyright obligations with respect to the Internet. The “agreed statements” by the negotiating parties clarify that the reproduction right applies to content in digital format and that a member can “carry forward and appropriately extend into the digital environment limitations and exceptions in their national laws which have been considered acceptable under the Berne Convention.”<sup>19</sup> Authors are granted a distribution right, an exclusive right to make a work available to the public and a communication right, which gives copyright owners control over posting their works on the Internet.<sup>20</sup> Members also commit to proscribe in law and take action against anyone circumventing a Rights Management System. As of April 15, 2002, 35 states had become parties to the treaty. Canada has not ratified its decision to join.

There has been over the past decade a significant shift in copyright law and international copyright agreements to a more protective stance. The duration and breadth of coverage

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<sup>19</sup> Agreed statements concerning the WIPO Copyright Treaty adopted by the Diplomatic Conference on Certain Copyright and Neighboring Rights Questions, December 20, 1996. Available from WIPO at <http://www.wipo.int/treaties/ip/wct/statements.html>.

<sup>20</sup> Article 8 of the treaty defines the communication right of authors as “the exclusive right of authorizing any communication to the public of their works, by wire or wireless means, including the making available to the public of their works in such a way that members of the public may access these works from a place and at a time individually chosen by them.”

has been increased. Exemptions from copyright for educational purposes and fair dealing (fair use in the United States) have generally been reduced. Protective rental rights have been created. Enforcement penalties have increased. Greater international and domestic concentration of audiovisual distribution systems has apparently accompanied the trend in copyright law. Both factors contribute to greater copyright protection.<sup>21</sup> There is, however, a strong counter force. Digital technology and the development of the Internet have made copying cheaper and unevenly reduced the effective protection given to different content.

Canada has a blank medium levy that compensates rights holders in the audio recording industry. The current Canadian rates are 29¢ per audio cassette, 21¢ per CD-Rs or CD-RWs, and 77¢ per CD-R Audio, CD-RW Audio or MiniDiscs. These fixed levies are high in percentage terms, far exceeding the 3% of the sales price set by statute in the neighboring United States. Technology is also affecting the tax base. Hard drives are becoming more important as storage devices for digital music and audiovisual files. It is difficult to conceive that they will become part of the tax base. The Canadian scheme distributes income in a two-tiered process. The Copyright Board of Canada decides the shares of the fund that will accrue to various collectives representing copyright and neighboring rights holders. Each collective decides how to divide the funds it receives among its members. The division of blank medium funds would become even more complicated with the inclusion of audiovisual producers and performers. The ability and desirability of raising additional funds from more heavily taxing recording media raise doubts about tax and administered redistributions as an alternative framework to copyright for supporting the audiovisual industry.

The impact of the Internet on producers and distributors of audiovisual content extends beyond file sharing. Traditional cable and satellite services extend the geographical reach of television programming. The breadth of their offerings has increased markedly but is still limited. The Internet has the potential to expand the reach of programming to every corner of the world and further add to the breadth of offerings. In 1999, a Canadian company, iCraveTV, began rebroadcasting North American television stations over the Internet using streaming technology. A number of US television production companies, sports leagues, the major studios, Canadian audiovisual producers, major broadcasters, and other interested parties brought suit against iCraveTV in the United States District Court for the Western District of Pennsylvania. After granting a temporary injunction, the Court issued a permanent injunction on iCraveTV. In its defence, the Canadian company submitted a statement of University of Ottawa law professor, Michael Geist, arguing that its activities were allowed under Canadian law.<sup>22</sup> The Court decided that as the plaintiffs were seeking relief for infringements of the U.S. Copyright Act, the issue of legality in

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<sup>21</sup> Arnold Plant in his classical article “The Economic Aspects of Copyright in Books” published in the first edition of *Economica* (1935) considered the oligopolistic book publishing industry to have such control that no copyright protection was warranted.

<sup>22</sup> The argument has three parts. The CRTC had stated that it would not regulate the Internet. Under copyright law, anyone can retransmit a distant signal if they pay the stipulated tariff. No tariff had been set for Internet retransmission.



Canada was irrelevant to its proceedings. An agreement was worked out among the parties closing down the service.

After iCraveTv disappeared, a new retransmitter of television programming appeared on the Canadian scene with a different approach. JumpTV claimed that it could and would filter out non-Canadian viewers from access to its website. After a sequence of events that included the Heritage Canada Minister ordering the CRTC to reconsider its exemption of the Internet from regulation and report by January 2003, and the passing of amendments to the Copyright Act, JumpTV offers only a limited service of channels.<sup>23</sup> With the incidence of broadband access to the Internet rising and improvements in streaming technology, retransmission of broadcasting services over the Internet promises to compete effectively with cable systems and satellite broadcasting services. The established services are likely to argue for protection against this competition. Governments will probably not ignore such pleas, but the resulting policies may be difficult to enforce. Consumers are likely to be the agents of circumvention and realize the benefits and the existing standalone distribution systems may be further integrated into the Internet.

Another copyright related broadcasting policy that predates the Internet is simultaneous substitution.<sup>24</sup> When a Canadian conventional channel and a foreign channel carried by a Canadian BDU simultaneously broadcast the same program, the BDU is required to replace the signal of the foreign channel with a duplicate of the Canadian channel. Simultaneous substitution occurs most frequently with programs that are separately licensed to a US station or network for broadcast in the United States and to a Canadian station or network for broadcast in Canada.

As a result of the substitution, all subscribers to the BDU who view the program see the Canadian signal with its accompanying advertising rather than the same program accompanied by the advertising sold by the American broadcaster. Since advertising revenues for a station are linked to viewership, the value of the license to show the program rises for the Canadian broadcaster and falls for the US broadcaster. As a result of this shift, the rental price for the right to air the program will rise in Canada and fall in the United States. If the adjustments in the two rental prices offset, the wealth of the owner of the program's copyright will not be affected. Nonetheless, if the broadcaster earns some economic rents from showing the program, they will be transferred from the American broadcaster to the Canadian. In 1997, the CRTC ruled that BDUs would not be required to fulfill simultaneous substitution requests by providers of Canadian specialty services.<sup>25</sup> In the same decision, the CRTC extended the scope of simultaneous substitution for conventional Canadian broadcasters by requiring substitution by the BDU if the foreign channel broadcasts the same program within the same broadcast week.

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<sup>23</sup> Eleven channels are offered: Canal Vasco Spain, The NASA channel, CNI40 Mexico, America 1 Television, RTPPortugal, PROTV International Romania, TKC 76 Korea, Telenorba Italy, London Today England, Thai TV Global Thailand, and FTV Fashion Paris. We have no idea where the server is located.

<sup>24</sup> It was initiated by the CRTC in July 1971.

<sup>25</sup> CRTC, Public Notice CRTC 1997-150 Ottawa, 22 December 1997.

Some Canadian broadcasters have argued for more extensive non-simultaneous substitution. The CRTC has offered a sympathetic ear but to date has not significantly extended the policy.

In our view, simultaneous substitution strengthens the ability of programming owners to license their products more effectively. As long as an equivalent to the policy applies domestically as well as internationally, copyright will offer more protection and economic rents may be redistributed. Similar issues arise concerning the decisions of countries to allow or police against parallel imports. In that area international agreements allow countries freedom to decide according to their druthers.

#### **4. Public ownership**

Public ownership occurs in the case of both radio and television broadcasting and film production. For television, the most prominent enterprise is the federal national broadcaster, the Canadian Broadcasting Corporation/Radio Canada or CBC that operates almost entirely in English and French. The CBC is not a pure public broadcaster as it sells and carries advertising on its television service. There are also provincial public television broadcasters such as TV Ontario (TVO) and the Knowledge Network but their budgets are smaller. TVO has revenues of \$66m, 76% provided by government, as opposed to \$1.32bn for the CBC. British Columbia and private sources fund the Knowledge Network.

For film, the federal government funds and operates the National Film Board (NFB). Provinces offer tax incentives and subsidies for locating shooting within their boundaries and fund film commissions that promote local shoots. The following sections examine the activities of the CBC, the NFB and the provincial film commissions.

The CBC operates an English and a French national television network, four national and commercial free radio networks, two English and two French. It also operates two specialty television news services, CBC Newsworld and Le Réseau de l'information (RDI) that are funded separately through subscriber and advertising revenue, as well as three specialty services, Tele des Arts, Land and Sea and The Canadian Documentary Channel operated through partnerships with the private sector. In addition, the CBC operates Galaxie, a pay-audio service with 30 channels of continuous music, and an international short-wave radio service, Radio-Canada International (RCI).

In 2000-01, the CBC's total operating budget of \$1.32 bn was financed by a federal grant of \$795m (\$512m to the two national TV networks; \$266m for the four radio networks; and \$17m for corporate management), conventional television advertising revenue of \$349m, specialty channel fee and advertising revenue of \$123m and \$65m from miscellaneous sources.

Ninety percent of programs aired on CBC English television in prime time are Canadian compared to 23% and 24% respectively for the two privately owned networks, CTV and Global. CBC French language television aired 88% Canadian programming in prime time and Canadian programs account for 92% of programs viewed in prime time. The two

private French-language networks, TVA and TQS, aired 53% and 45% respectively and had a viewing audience of 61% and 39% of Canadian programs in prime time.<sup>26</sup> Export revenues are currently a small percentage of total revenues and are in part generated from government-funded programming.

The CRTC issues and renews the broadcasting license for the CBC and has been known to chide the organization for not showing enough Canadian programming. The domestic audience share of CBC TV has declined substantially over recent years. According to the Television Bureau of Canada, the CBC English television's viewing share of 11.5% in 1991 fell to 5.8% in 2000; CBC French language share fell from 6.3% to 5.1% over the same period. Less people are watching programs, Canadian and foreign, distributed by the public broadcaster. Public broadcasting combines several types of policies, foreign ownership restrictions by definition, content requirements and government subsidies, each of which is considered separately below.

The NFB describes itself as "a public agency that produces and distributes films and other audiovisual works which reflect Canada to Canadians and the rest of the world." It has not succeeded in fulfilling the aspirations of its first director, John Grierson, who aspired to make it the "eyes of Canada." The NFB uses almost entirely Canadian inputs to produce Canadian content (documentary, feature films, animation) in its own studios or through contracts with independent producers. Its annual production does not divert a large audience from either domestic or foreign commercial productions. The federal grant to the NFB in 2000-2001 was \$61.5m, or about 5% of that to the CBC.

## 5. Restrictions on foreign ownership

Specific ownership restrictions apply to broadcasters, BDUs and satellite service providers as well as to film distribution firms, cinema chains, videostores and wholesalers of videos. Canadian Heritage (DCH) administers the *Investment Canada Act* as far as the takeover of existing foreign owned firms in the Canadian cultural industries.<sup>27</sup> The CRTC administers the policy for television and radio while DCH handles film distribution policy.

Videos and the Internet are alternative means of distribution for some audiovisual material, such as video games, and a wider array of content in the future as broadband connections to the home become more common. The Internet is also a means of

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<sup>26</sup> Nielsen Media Research, CDS – September 2000 to August 2001. The public-private comparison does not take account of differences in the types of Canadian programs shown in prime time. The CBC shows a higher percentage of news, current affairs and sports programming in prime time than the private stations. CanWest Global Communications Corp., a private network, broadcasts its evening news program outside of the prime time hours identified by the CRTC. Also, hours of broadcasting comparisons do not take into account audience size for these programs.

<sup>27</sup> Section 6 lists the type of cultural businesses covered by the Act; section 20(e) states that the investment must be compatible with cultural policy objectives enunciated by the government; and section 21 refers to the test being that the investment is of "net benefit" to Canada.

transporting and of sharing audiovisual content. No ownership restrictions apply to Internet services but the cable and telephone companies providing the distribution facilities for the Internet are subject to restrictions.<sup>28</sup>

Subsection 22(a) of the Broadcasting Act gives the CRTC the authority to restrict foreign ownership of distributors. At present, Canadian citizens or companies must own 80% of the shares of a licensed broadcaster. Non-Canadians may own up to one-third of a holding company that owns the company holding the license. In effect this means that a foreign company may own about 47% of the equity in a broadcasting company.<sup>29</sup> One effect of the holding company provision is to keep large blocs of shares off the Canadian capital markets making an already thin market thinner.

When ownership of a license changes hands, the issue of control can be questioned. Even if the broadcast entity has the requisite amount of Canadian share ownership, it may be argued that the Canadian owners do not control the entity. Control refers to influence over key managerial decisions. The CRTC states that “ ‘control’ means control in any manner that results in control in fact, whether directly through the ownership of securities or indirectly through a trust, agreement or arrangement, the ownership of a corporation or otherwise.” Administration of this policy leads to lack of transparency since influence over management decisions can be exercised in many ways. For example, an equity owner may have other relationships with the firm such as licensing technology, supplying management expertise or programming and providing brand names and trademarks.<sup>30</sup>

In an attempt to divert funds to Canadian film distributors, the government introduced a film distribution policy in 1988<sup>31</sup> with the following components: prohibition of the takeover of Canadian owned and controlled film distribution businesses; new foreign businesses will only be allowed to distribute proprietary products where the importer owns world rights or is a major investor. The existing American major film distributors (Hollywood), a number of which are foreign owned, were explicitly excluded (grandfathered) from the announced policy and continue to distribute their films. All other foreign film distribution firms are subject to the policy that has caused trade frictions and lack of transparency regarding how the policy is administered due to a series of corporate acquisitions and divestitures. No further qualification has been made since 1988.

In 1995, Canadian owned Seagram’s purchased Universal Studios. Through the European Commission, Dutch owned Polygram initiated a complaint in the WTO that Canada’s film distribution policy was inconsistent with its WTO obligations in that it discriminated

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<sup>28</sup> Discussions are currently underway to relax the ownership restrictions on telecommunications and cable companies.

<sup>29</sup> Canadian Broadcasting Regulatory Handbook, 6<sup>th</sup> Edition, pp.120-124.

<sup>30</sup> The murky determination of what constitutes ownership and control can be gleaned from how the Canadian authorities dealt with the related area of book distribution. American owned Borders Books was not allowed to have a minority position in partnership with a Canadian bookseller because it was argued that Borders would control the operation.

<sup>31</sup> Communications Canada Fact Sheet FS-88-3844E.

against Polygram due to the preference granted to the Hollywood majors for film distribution. The complaint was dropped when, in 1998, Universal, Canadian owned at the time, purchased Polygram.<sup>32</sup>

Subsequently, French owned Vivendi purchased Universal Studios from Seagram's, thereby transferring Canadian ownership of Universal's film distribution assets in Canada to a foreign owned firm that was not grandfathered under the existing policy. According to the announced policy, the acquisition should not have been permitted, but it was allowed to proceed with no public explanation.<sup>33</sup> The Polygram-Seagrams-Vivendi case illustrates the difficulty of evaluating the effect of policies where transparency is muddled by the absence of public disclosure as to whether discretion can be exercised or what the normal bounds of discretion are. In this case, the discretion used clearly negated the stated policy.

In sum, the ownership restrictions for broadcasters, BDUs, satellite service providers and film distributors limit initial foreign access to the Canadian market and do not offer national treatment in the event of sale of assets. The administration of these policies is far from transparent. No ownership restrictions apply in the case of the sales or rentals of videos and DVDs or the provision of Internet services.<sup>34</sup> If cable or telephone companies provide Internet services, then foreign ownership restrictions apply to these distribution systems but not to those providing Internet services over the systems.<sup>35</sup>

The rationale put forward for ownership restrictions is that Canadian controlled firms are more likely to use their earnings to finance the production and distribution of Canadian content. Such reasoning has no economic basis for support and is contradicted by available evidence. Television broadcasting and cable franchises have been extremely profitable. If the cross-subsidy hypothesis were correct the generous tax credits and subsidized funding to production and film distribution, discussed in the next section, would hardly have been needed. Regardless of nationality, a commercial firm will produce and/or distribute those films or programs that make money and will shun those that do not. When large cinema chains have been owned by Canadian investors, their choice of films has not changed perceptibly from those owned by foreigners, at least as far as nationality of the films shown is concerned. If broadcast ownership restrictions assured the showing of the requisite amount of Canadian programming, it would be unnecessary to impose content rules. On their own, ownership restrictions do not significantly limit imports.

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<sup>32</sup> See Acheson and Maule, 1999, *op cit*, 315-317.

<sup>33</sup> The 1988 directive was part of a statement on film policy issued at the time that was not part of any legislation. According to Canadian administrative law and practice, discretion can be exercised in the case of a policy statement that is not embodied in legislation and the decision that results from the discretion is non-reviewable. See Reid and David, *Administrative Law and Practice*, 2<sup>nd</sup> ed., Canadian Legal Text Series, pp. 312-13.

<sup>34</sup> If a Canadian owned videostore was acquired by a foreigner, it would be subject to Investment Canada review by DCH.

<sup>35</sup> Issues associated with regulation of the Internet are expected to be revisited by the CRTC in future hearings.

Another impact of ownership restrictions is to limit the possible buyers for these assets and to limit the amount of investment in the sector. By eliminating potential buyers, foreign ownership restrictions lower the market value of the assets of current owners by eliminating potential buyers. At the same time foreign ownership restrictions raise the value of those assets by reducing competition from better-managed and more aggressive competitors in the markets that they serve. These competing factors help account for the ambivalence of current owners to relaxing foreign ownership constraints.

In sum the impact of ownership restrictions on the import of foreign content in broadcasting has to be considered in conjunction with content rules. The latter are likely to be more restrictive of imports but, as we will see in a later section, coproductions provide ways of partially relaxing the restrictions imposed by content rules. The alternative means for distributing audiovisual content that are not regulated limit the impact on the quantity of imports of any tightening of controls in the regulated part of the industry. The case of film distribution is different from that of broadcasting as the stated policy exempts the major Hollywood studios. Due to the grandfathering, the film distribution ownership policy has had little impact on the import of foreign especially American films into Canada.

## **6. Subsidies and tax incentives**

The government provides financial support to the audiovisual industry through a combination of investments, loans, grants and tax incentives. While the bulk of the support comes from the federal government, some is provided by provincial agencies. In this section we deal first with television and film subsidies provided by Telefilm Canada, the principal federal agency, and note the funds made available by private cable operators as a result of the regulatory process, and second with the various federal and provincial tax incentives.

Telefilm Canada is the principal funding agency of the federal government. Television funding is provided through Telefilm's administration of the Canadian Television Fund (CTF), and film funding through the Canadian Feature Film Fund (CFFF). The CTF consists of two programs, the Equity Investment Program (EIP) of \$100m and the Licence Fee Program (LFP) of \$130m. The CFFF rose to \$80 million in 2001-02 and is estimated to increase to \$90 million in 2002-03 according to the government's estimates. The purpose of these funds is to support culturally significant productions by Canadians that "speak to Canadians about themselves, their culture, their issues, their concerns and their stories." This mandate has generated a complex administrative structure.

The federal and provincial governments also offer tax incentives for audiovisual production and distribution. The federal tax credits are reimbursed regardless of whether the firm pays any taxes in the year in which the credits are due, so that the amount approved provides a direct contribution to the production budget. There are two important federal programs, the Canadian Production Tax Credit (CPTC), aimed at promoting Canadian content, and the Film or Video Production Services Tax Credit Program (PSTC), directed at attracting foreign productions to Canada.

The CPTC is a refundable tax credit of 25% of eligible salaries and wages. A ceiling of 48 % of the cost of the production can be claimed as eligible salaries and wages. Our understanding is that this ceiling is typically met. When it is, the tax credit will be 12% of the production's total costs. In 2000/01, the total costs of production for those productions that applied for the CPTC was \$1.5bn.<sup>36</sup> The Department of Finance's estimate of tax expenditures for the CPTC for 2001 was \$105m.

The PSTC is designed to attract foreign producers to Canada and employ Canadians. The tax credit is 11% of salary and wages paid to Canadian residents or taxable Canadian corporations (for amounts paid to employees who are Canadian residents) for services provided to the production in Canada. There is no cap in this program. For the period 1996-97, the total cost of productions that were accredited for PSTC was \$6.0bn; the Canadian share of this cost was estimated at \$3.0bn. The Department of Finance's estimate of tax expenditures for the PSTC for 2001 was \$15m.<sup>37</sup>

Most provinces also have a film commission or agency that either provides funding for local productions or facilitates productions within the province. Some provinces have tax credit programs that typically require that expenditures take place within a province not just within Canada. For example, Ontario has six tax credit programs administered by the Ontario Media Development Corporation, five of which could be used by the audiovisual sector. The direct funding is typically modest.

The cumulative effect of the provincial and federal grants and tax benefits, the growing sophistication of the Canadian industry, and a 'favorable' exchange rate has attracted foreign filmmakers. Through the Department of Canadian Heritage, the federal government collects information from provincial film agencies about foreign location shooting that takes place in their borders.<sup>38</sup> In 2000, the total budgets of Canadian productions, \$1,677.8m, were less than the total budgets of foreign productions, \$1,759.8, shot in Canada.

The subsidy programs encourage the production of both traded and non-traded content. Concentrating only on the federal subsidies and tax incentives for 2000-2001, we have the CBC television share of its federal grant at \$523m,<sup>39</sup> the NFB at \$65m, Canadian Television Fund at \$230 m, the Canadian Feature Film Fund at \$80 m, the CPTC tax credit at \$105m and the production services tax credit at \$14 m for a total of \$1,017m. Adding contributions made from a diverse set of funds established by private companies

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<sup>36</sup> An industry report for calendar 2001 records a total of \$2bn.

<sup>37</sup> Budget totals for foreign location shooting collected by Canadian Heritage survey and reported in PricewaterhouseCoopers, Profile 2002, p.12 at [http://www.cftpa.ca/newsroom/pdf\\_profile/profile2002-english.pdf](http://www.cftpa.ca/newsroom/pdf_profile/profile2002-english.pdf); tax expenditures at [http://www.fin.gc.ca/taxexp/2001/taxexp01\\_3e.html#\\_Toc519392245](http://www.fin.gc.ca/taxexp/2001/taxexp01_3e.html#_Toc519392245) (both websites consulted Feb. 13, 2003).

<sup>38</sup> The data refer either to the budgets for these projects or the money spent on them in the province. It is not strictly comparable between provinces and there may be double counting. If a production is shot in more than one province, each province may claim the total budget or revenues for itself in order to inflate the importance of the province for film and television production.

<sup>39</sup> This represents the CBC allocation to television of \$513m plus a share of CBC corporate expense of \$17m equal to the share of the television allocation to the total expenditure of radio and tv.

as part of takeover packages, provincial subsidies and tax incentives we estimate that this total of \$1bn would increase by at least 10% to around \$1.1bn.<sup>40</sup>

A number of Canadian productions are made as coproductions under bilateral treaty agreements with producers in other countries where the coproduction may be eligible for subsidies and tax incentives in both countries. This may make them more competitive in each of their domestic markets against imports and jointly in foreign markets. As a result, the two partner countries benefit at the expense of all other countries.

Canada, like many other countries, exempted these treaties from MFN in the GATS. This is consistent with its general position in the NAFTA to exempt culture from the obligations of the agreement, and with its failure to make any commitments for audiovisual services in the GATS in order to seek protection for its content rules and ownership restrictions. In current GATS negotiations, Canada has stated that it will make no further audiovisual commitments until the passage of an international agreement to protect cultural diversity.<sup>41</sup> Even though the exemption route has not eliminated a number of debilitating disputes, Canada continues to pursue an attempt to surround its cultural industries with a protective blanket.

In sum, Canada provides a subsidy/tax incentive of about \$1.1bn per year to the audiovisual industry, measuring about 30% of total annual production only part of which is traded.

## 7. Coproductions

The Canadian government has encouraged international cooperation between domestic producers and those in other countries by entering into bilateral coproduction treaties with over 50 countries, although the majority of productions made under the treaties is undertaken with less than five countries. Other forms of cooperative arrangements exist outside of treaty arrangement.

Once certified, treaty co-productions gain national status both as Canadian content productions in Canada and as national content productions in the country of the foreign partner. In addition, the Canadian production company may be eligible for assistance from various public funding programs. Requests for Official Treaty Coproduction approval were 107 in 2001 for total production budgets of \$793 million from 16 countries: Canadian financial participation was \$433 million or 55%. Four countries—

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<sup>40</sup> Some of the programs, particularly the Telefilm CFFF and the EIP part of the Canadian Television fund involve partial recoupments if the production is a success so that gross and net figures are not the same. In 2000-2001, for example, Telefilm provided assistance of \$155.2m of which \$24.3m (15.7%) was financed by recoupments. There are no recoupments for LFP part of the Canadian Television Fund and the tax credit programs.

<sup>41</sup> A draft of an agreement is on the Department of Foreign Affairs and International Trade website at [http://www.dfait-maeci.gc.ca/tna-nac/sagit\\_paper-en.asp#messagefromsagitchair](http://www.dfait-maeci.gc.ca/tna-nac/sagit_paper-en.asp#messagefromsagitchair) (consulted Feb. 14, 2003).



UK, France, China and Australia--accounted for 85% of the requests and 83% of the total production budgets in 2001. In Europe, coproductions have been labeled “Europuddings” that water down recognizable national characteristics. Transforming the current web of bilateral coproduction treaties into a multilateral system would result in a more flexible and efficient regime

The reports of publicly traded Canadian film and television production companies note extensive cooperative financing arrangements undertaken especially with firms in the US, a country with which Canada does not have a coproduction treaty. These are known as coventures. They are not eligible for subsidies and the CPTC but are eligible for the PSTC. They can be granted Canadian content status by the CRTC if certain conditions are met. The CRTC requires co-ventures to meet the same minimum six points and 75% cost requirements as under CAVCO to obtain credit as Canadian content except for co-ventures with Francophonie and countries with a coproduction treaty, which require five points. Essentially this means that Canada-US co-ventures face a higher hurdle for qualification than other co-ventures.<sup>42</sup>

## 8. Competition policy

Since film became part of cultural life in Canada, sporadic competition policy initiatives affecting Canadian film distribution and exhibition have been launched. During the 1930s, charges were laid under the Combines Investigation Act and section 498 of the Criminal Code against major distributors, the dominant theatre chain, and some key figures. The charges were based on a detailed report<sup>43</sup> maintaining that vertical integration of dominant distributors and cinema chains, the classification of films into first-run and second-run, the restricted access of independent cinemas to first-run films, the length of time between first-run and second-run offerings, the imposition of a standard contract, and a number of other practices, such as block booking (supplying films in a package rather than individually) and blind bidding (selling an exhibition right based solely on description) had affected adversely independent Canadian-owned cinemas.

Antitrust actions targeting film distribution in Canada had important international dimensions then as they have today. Famous Players Canadian Corporation, a subsidiary of Paramount,<sup>44</sup> and its managing director were the most prominent of the fifteen

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<sup>42</sup> See CRTC PN 2000-42 March 17, 2001, Sec. VII.

<sup>43</sup> White, P. C. (1931). Investigation into an Alleged Combine in the Motion Picture Industry in Canada. Ottawa, Department of Labour, Canada.

<sup>44</sup> Famous Players remains one of the two dominant chains in Canada seventy odd years later. At the time of the trial, the Canadian subsidiary of Paramount acted for other important Hollywood, British and French film companies. It had the Canadian distribution rights for films from MGM, Pathé, and British International (See Morris, P. *Embattled Shadows: A History of Canadian Cinema, 1895-1939*. Montreal: McGill-Queen's University Press, 1978).

companies and three individuals charged. The Supreme Court of Ontario dismissed the charges.<sup>45</sup> The Canadian case occurred in the midst of extensive antitrust proceedings in the United States addressing similar issues.<sup>46</sup>

In the late 1970s there were a series of prosecutions of violations of competition law regarding the contractual terms between the Hollywood distributors and Canadian cinemas.<sup>47</sup>

A more comprehensive initiative was initiated towards the end of 1982. The Director of Investigation and Research asked the Restrictive Trade Practices Commission to order the Hollywood distributors (Columbia Pictures Industries, Inc., Paramount Productions Inc., Universal Films (Canada), Warner Bros. Distributing (Canada) Ltd., United Artists Corporation, and Twentieth Century-Fox Film Corporation) to provide a Canadian cinema chain, Cineplex, access to first run films and to adopt a more open process for distributing films. A year and a half later, an agreement was reached with the competition policy authorities and the defendants. The Hollywood distributors agreed to use an open bidding system on a picture by picture basis, to make less expansive clearances, provide estimates of patterns and length of runs to all bidders, not tie exhibition assignments in one area to the granting of rights in other areas, not collude to limit runs after the first, hold independent auctions for different runs, and open additional facilities for exhibitors to view films before bidding on their exhibition rights. As the agreement began to be implemented, Cineplex acquired Odeon, a large chain of theatres. The new firm, Cineplex Odeon, became Canada's largest exhibitor and not surprisingly, its enthusiasm for the new arrangements evaporated. The former practices were gradually reinstated without eliciting formal complaints from other cinemas or from the competition bureau.

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<sup>45</sup> Rex v. Famous Players, Ontario Supreme Court, March 18, 1932.

<sup>46</sup> In the United States, similar issues were addressed in anti-trust actions that extended from 1921 to 1948. In a 1927 decision, the Federal Trade Commission (FTC), ruled against block booking and for restricting vertical integration (Federal Trade Commission Decisions, Famous Players-Lasky Corporation et. al., Complaint, Aug. 30, 1921- Decision, July 9, 1927). After Paramount was found by the FTC not to have complied with its order, a round of legal actions culminated in a court order containing the main features of the FTC order. This order was stayed when the industry agreed in 1933 to conform to a code of Fair Competition for the Motion Picture Industry under the Roosevelt administration's National Industrial Recovery Act. The Fair Competition code allowed block booking, clearance, zoning, and admission price discrimination. A second sequence of antitrust cases and consent decrees, labeled the Paramount cases, began with *United States v. Paramount et al.* on July 20, 1938. The Government charged the major studios with combining and conspiring to restrain trade unreasonably and to monopolize the production, distribution, and exhibition of motion pictures. The Paramount cases ended a decade later when the Supreme Court decided against the defendants in *United States v. Paramount Pictures, Inc.*, 334 U.S. 131 (1948). For more information see Conant, M. (1960). *Antitrust in the Motion Picture Industry*. Berkeley, University of California Press and Conant, M. (1981) "The Paramount Decisions Reconsidered." *Law and Contemporary Problems* 44(Autumn): 79-107. For a more recent economic interpretation of the distribution practices at issue see De Vany, A. and R. D. Eckert (1991) "Motion Picture Antitrust: The Paramount Cases Revisited." *Research in Law and Economics* 14: 51-112.

<sup>47</sup> An example addressing a contract with a specific theatre occurred in 1977 when Columbia Pictures Industries, Inc. pleaded guilty to not allowing a theatre owner to reduce prices and was fined \$1250. An example of more general constraints imposed on contracting occurred in 1979, when United Artists was from using contractual clauses or actions preventing a cinema from providing discounts of any kind. In all cases a guilty distributor or one subject to a restraining order had to inform all cinemas.

From the mid-eighties to 2003, the competition policy front has been relatively quiet. An exception occurred in 1995, when the Director of Competition Policy testified before a Senate Committee deliberating on proposed directives (later issued) from the government to change the CRTC's satellite broadcasting policy. The Commission had required licensed satellite BDUs to deliver all of their programming from a Canadian satellite. The Director testified against including such a provision remarking that if enforced it "would cost hundreds of millions of dollars in additional costs over the average twelve year life of a satellite."<sup>48</sup>

Among the factors that have generated this quiescence is the increased reliance in film distribution policy on direct subsidies, the requirement that Canadian producers use Canadian distributors as a condition for obtaining production subsidies, and the success of a Canadian distributor, Alliance Releasing, in obtaining domestic distribution rights of foreign films (including a significant number of films financed and distributed in other areas by the Hollywood majors). Another contributing factor is the difficulty of prosecuting antitrust cases involving international activities without a greater degree of effective coordination among competition policy authorities in different countries than currently exists.

In our opinion another cause was a shift in economic opinion about the impact of the business practices that have traditionally exercised the competition policy authorities. There is a growing willingness in competition theory to weigh efficiencies that are generated by business practices against their enhancement in market power in assessing their overall social impact. The potential for exercising monopoly power also creates incentives for independent producers to seek alternative distributional channels. There has been an active exploration and development of international consortium of regional and national distributors for the cinematic release of a medium-budget feature film. Finally, any market power exercised in cinematic distribution has diminished in importance as non-cinematic venues have developed. The importance of revenues from video, DVD, ppv, movie channels and general television windows has grown rapidly, both absolutely and relatively. Cinematic release still retains a disproportionate importance as box-office success or lack thereof affects the success of these other distribution windows. Television is an important element in many of these alternative windows. Its detailed regulation has reduced the scope for competition policy actions.

We will close this section by noting that the thrust of Canadian competition policy initiatives with respect to the film industry has been to support Canadian-owned cinemas and distributors in their rivalry with foreign concerns. It has seldom been driven by a concern over the prices charged to consumers.<sup>49</sup> One of the possible rationales for this orientation is the widely held view that Canadian-owned businesses act differently in this

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<sup>48</sup>. Comments of the Director of Investigation and Research on DTH and PPV proposed directions to the CRTC and the Senate Standing Committee on Transport and Communications, Ottawa, June 7, 1995, 4. See Acheson, K. and C. Maule (1979) *Much Ado about Culture: North American Trade Disputes*. Ann Arbor, University of Michigan Press, Chapter 12 for an analysis of the satellite broadcasting case.

<sup>49</sup> For example, In the 1932 decision, the judge commented that "there was at all times very considerable rivalry and marked competition for business between them with the result, so far as the general public is concerned that no complaint whatever is made as to the prices of admission charged."

sector than their foreign rivals but there is no convincing evidence that Canadian exhibitors show more Canadian films than foreign-owned cinemas or that Canadian distributors systematically invest in the making of a Canadian film if they would earn more by investing in a production that would not qualify as Canadian. Nor has there been concern over the increasing concentration in the Canadian production sector, which there should be if it were producing a unique product. The most effective competition policy instrument for a relatively small country like Canada is introducing foreign competition.

## 9. Trade statistics

A variety of data sources paint a picture of trade in audiovisual goods and services. Each uses a different concept of foreign revenues. Each measures a different aspect of the industry. Only one provides some indication of imports. Over time the concepts used to collect data have changed but in a rough sense the numbers provide an indication of trends. The quality of cultural statistics including trade statistics has been and remains poor.

The first three reports are published by Statistics Canada:

i. Trade data for the audiovisual sector is contained in the merchandise and services trade published by Statistics Canada based on surveys. The gap between audiovisual services imports and exports decreased between 1996 and 1998; in 1997 exports exceeded imports. This shows that the Canadian industry is holding its own in international markets from a balance of payments perspective. As the earlier discussion in section 2 illustrated, the balance of payments provides an informative measure of the relative performance of a country's audiovisual production for content with an international audience.

**Table 1 Balance of Payments of cultural industries – selected categories**

Year	Exports		Imports		Balance of Payments	
	C\$ millions		C\$ millions		Surplus - C\$ millions	
	Music Video and other recordings	Selected services and IP	Music Video and other recordings	Selected services and IP	Music Video and other recordings	Selected services and IP
1996	309.6	727.0	122.3	850.8	187.3	-123.8
1997	246.3	878.3	156.3	856.4	90	21.9
1998	272.1	966.1	189.4	986.9	82.7	-20.8

Source: Statistics Canada 87-211 for 2000, pp 31-34. Consistent figures for other years are not publicly available.

### ii. Film, Video and Audiovisual Production

This report measures total annual production revenues divided between exports and non-exports. Exports (foreign sales) consist of revenues received from foreign clients for current and previous years' productions, including license fees and royalties, outright

sales and rentals, contracts, sponsors' payments and remittances from distributors after their expenses. Sales to foreign markets through Canadian distributors are not included in foreign sales. Exports increased over seven times between 1991/92 and 1999/00. As a percentage of total production revenues, exports rose from 14% to 42%.

**Table 2 Exports (Statistics Canada measure)**

<b>Year</b>	<b>Exports C\$ millions</b>	<b>% of Production Revenue</b>
<b>1991/92</b>	<b>82.8</b>	<b>14.2</b>
<b>1992/93</b>	<b>na</b>	<b>na</b>
<b>1993/94</b>	<b>na</b>	<b>na</b>
<b>1994/95</b>	<b>163.1</b>	<b>20.5</b>
<b>1995/96</b>	<b>320.7</b>	<b>37</b>
<b>1996/97</b>	<b>361.5</b>	<b>37.4</b>
<b>1997/98</b>	<b>428.9</b>	<b>38.1</b>
<b>1998/99</b>	<b>451.0</b>	<b>35.9</b>
<b>1999/00</b>	<b>592.0</b>	<b>42.4</b>

Source: Statistics Canada Daily, March 27, 1998, April 3, 2000, July 22, 2002

### iii. Film and Video Distributors and Videocassette Wholesalers

In this report, total exports equal sales of Canadian productions plus revenue from the distribution of non-Canadian films. Exports rose six times from \$31.9 million in 1991/92 to \$132.1 mil in 1997/98 to \$187.3 mil in 1999/00. Exports represented 5% of total distribution revenues in 1991/92 and 16% in 1999/00. (Source: Statistics Canada Daily, February 3, 2000 and March 25, 2002.)

### iv. PricewaterhouseCoopers (PwC) statistics in a study for Canadian Film and Television Production Association (CFTPA).

This study of approximately 500 Canadian companies is now conducted annually. Exports are measured by foreign presales and distribution advances for CAVCO and other productions. Exports rose about 140% between 1991/92 and 1998/99 and then fell 28% to 2000/01. Over the whole period there has been a rise in export revenues comparable to the trends shown in the previous two sets of figures.

**Table 3 Exports (PwC measure)**

<b>Year</b>	<b>Exports C\$ millions</b>
<b>1991/92</b>	<b>255</b>
<b>1992/93</b>	<b>240</b>
<b>1993/94</b>	<b>293</b>
<b>1994/95</b>	<b>149</b>
<b>1995/96</b>	<b>230</b>
<b>1996/97</b>	<b>454</b>
<b>1997/98</b>	<b>464</b>
<b>1998/99</b>	<b>616</b>
<b>1999/00</b>	<b>593</b>
<b>2000/01</b>	<b>442</b>

Source: PricewaterhouseCoopers, A 1999 Profile and Profile 2002.<sup>50</sup>

### **Estimating the overall impact of Canadian policies**

We have described eight policy categories—licensing, Canadian content quotas, intellectual property, public production, foreign ownership constraints, subsidies, special terms granted treaty and other coproductions, and competition policy--that affect international trade and investment in the audio-visual sector. These policies discriminate among foreign and domestic content, service providers and distributors. The differences in treatment form a web of protection for the Canadian audiovisual industries.

In this section, we estimate a single measure to represent the extent of overall protection of audiovisual activities. Our starting point is the explicit subsidies given to Canadian value added in production, broadcasting or distribution. The other seven policies interact with the direct subsidies to further increase or reduce the support of domestic producers. We “guesstimate” a multiplier for each of these factors that adjusts the base support given by the subsidies. For example, if in our judgment policy X raises protection by an additional 10% the multiplier for X would be 1.1. If the subsidy rate was 30%, the adjusted rate of protection would be 33%, i.e., an explicit subsidy rate of 33% would achieve a similar level of support as the 30% rate of subsidy plus the complementary X policy. If the multiplier were .9, the rate of protection measured as a subsidy equivalent would be reduced to 27% by the introduction of the X policy.

Hoekman<sup>51</sup> introduced a family of measures of protection for services that have been useful in comparing trade restrictions on services across countries. These indices all

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<sup>50</sup> The studies were available on the CFTPA web site <http://www.cftpa.ca/>. If no longer posted, the address of the association is available at the site.

depend on the commitments made by WTO members for each of four modes of service supply across the 155 different categories of services during the negotiation of the GATS in the Uruguay round of trade negotiations. In constructing a Hoekman index, a GATS member receives a 1 if it commits not to have any restrictions for a mode of a given service; if it commits to qualified access, it receives .5; and if it makes no commitment it receives a 0. For comparing the protective stance of countries across all sectors and modes the aggregative indices constructed from these inputs provide a useful statistic. For a single sector it often gives little information.

This is particularly true for audiovisual trade. Canada, for example, has made no commitments for the audiovisual sectors. Its score on each category would be 0 indicating a totally protective regime. However, a very large flow of audiovisual products enters the country from abroad. Canada is not bound by GATS to allow this inflow to continue but the chances of the Canadian government shutting down access completely are effectively zero. An assessment of actual policies in comparison to a measure determined by GATS commitments provides a much more accurate appraisal of Canadian audiovisual policy. More detailed assessments of protection of particular services—telecommunications, banking, education, distribution, and professional services—have typically constructed measures based on actual policies rather than GATS commitments. This approach requires judgment in measuring different elements of policy and in aggregating them.<sup>52</sup> We acknowledge this subjectivity and have been conservative in our estimates of adjusting factors.

While the amount of direct and indirect public funding for film and television is estimated to be \$1.1 bn, only a part of this relates to tradable content that affects imports and exports. Programs certified as Canadian content by CAVCO are the principal items that affect imports. For 2000-01, CAVCO productions are estimated to be \$2 bn out of total film and television productions for the year of \$5 bn, according to the study of the Canadian film and television production industry carried out by Pricewaterhouse Coopers (PwC) using data provided by official reports and industry sources. PwC estimates total public funding for CAVCO productions at 38% of the \$2bn total or \$760 m split evenly between direct and indirect funding. The PwC study does not give a detailed breakdown of the sources of direct and indirect funding other than to say that direct refers to grants and equity investments such as the Canadian Television Fund, and indirect to items such as tax credits.

The \$760 million subsidy on tradable content estimated by PwC is comparable to our \$1.1 bn figure for total subsidies of content production. Over half of the \$1.1 bn figure is government support for the federal public television broadcaster and the public film producer. Some of those funds will finance the CBC and NFB portion of programming

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<sup>51</sup> Hoekman, Bernard, "Assessing the General Agreement on Trade in Services," in W.Martin and L.A.Winters (eds) *The Uruguay Round and the Developing Economies*, World Bank Discussion Paper No. 307 Washington, D.C. 1995.

<sup>52</sup> For an excellent survey of the literature on measuring trade barriers in services see Z.Chen and L.Schembri, "Measuring the Barriers to Trade in Services:Literature and Methodologies," in Canada, Department of Foreign Affairs and International Trade, *Trade Policy Research 2002*. ISBN 0-662-31893-5, 219-288.

and films made by the private sector with the additional help of CAVCO approved funding. If we allocated 42 % of the CBC television grant and NFB budget as relating to CAVCO production our subsidy estimate would be similar to the PwC subsidy estimate. This still seems high in our opinion. To be conservative, we take note of the 38% figure from the PwC study for the calculations in this section but after considering some additional information adopt a lower benchmark percentage.

The annual reports of Canadian production firms that are publicly owned and listed on Canadian and American stock exchanges also provide information on the dependence of subsidies. By far the largest of these firms is Alliance Atlantis. For 2001, the company's annual report records government support of \$85.8 mil consisting of \$18.8 mil for equity participation, \$15.6 mil for grants and \$51.4 mil for tax credits. The support is 18% of the operating revenues for the company's entertainment group that is responsible for productions; these operating revenues would be larger than the productions costs to which the grants would be applied. Based on this firm's activity, public support at 25-35% of production costs seems a reasonable figure.

In sum while the overall value of public funding is less than 30% for all types of Canadian film and television production, the amount that relates to trade, based on the CAVCO data and PwC estimates of subsidies, is about 38 %. Using the example of one company, the percentage may be about 30%. We adopt the more conservative 30% figure as our base measure of protection on tradable content.

We now make some conservative adjustments to this base to reflect the protective impact of non-subsidy policies. Canadian content requirements that are imposed on broadcasters as a term of license, for example, add to the protection offered by the subsidy plans. Unless the Canadian content quotas are purely window-dressing, which we do not think is the case, they force purchases by Canadian broadcasters in addition to those induced by the subsidies.

The CRTC adjusts their requirements as the capacity of the Canadian industry rises both as a result of its experience and the protective policy framework. This constant adjusting of Canadian quotas to the profitability of broadcasting licenses has steadily increased the protective impact of Canadian content policy.

The application of Canadian content requirements to licensed broadcasters is mirrored by the setting of priority, linkage and tiering rules in the licensing of BDUs. These are also altered by the regulator to absorb some of the profit gains realized by low cost access to the spectrum and technological change. As capacity rises, the CRTC allows the BDUs to carry more foreign content, which raises potential profit. At the same time, it ensures that some of the gains are spent on fostering the production of Canadian content by requiring the BDUs to carry services that they presumably would not choose to carry in the absence of the regulations.

We believe that the Canadian content requirements and the rules for access to the service packages offered by BDUs significantly augment the protection offered by the direct subsidies. To be conservative, we have chosen a magnifying factor of 1.25 to capture the effect of including these stipulations as part of broadcast and BDU licensing and regulation.



Licensing and foreign ownership restrictions have had an additional but separate negative impact on Canadian welfare with respect to satellite television BDU service. The existing Canadian and American services have the capacity to serve all or large parts of each other's markets but are prevented from doing so. The American services were launched earlier than their Canadian counterparts and offer more diverse packages. As a consequence the management of the two Canadian services has spent considerable resources on legal initiatives to prevent sales to Canadians of gray market subscriptions to American services. The separation of the two markets does not make economic sense. There is considerable latitude for working out a mutually advantageous agreement for access to each other's markets while respecting the differing regulations imposed by the two countries. In making the reception of American DBS services illegal, Canadian policymakers succumbed to arguments that bear an eerie resemblance to those in Bastiat's famous petition of the candlemakers. We amend the key request of the candlemakers' petition by replacing "sun" with "US satellite services" and "fair industries" with "Canadian BDUs" in *italics*:

We ask you to be so good as to pass a law requiring the closing of all windows, dormers, skylights, inside and outside shutters, curtains, casements, bull's-eyes, deadlights, and blinds — in short, all openings, holes, chinks, and fissures through which the light of the *US satellite services* is wont to enter houses, to the detriment of the *Canadian BDUs* with which, we are proud to say, we have endowed the country, a country that cannot, without betraying ingratitude, abandon the *Canadian BDUs* today to so unequal a combat.

Restricted to a smaller market, Canadian wireless services cannot afford to match the quality offered by US wireless services in the larger United States market. The largest US satellite broadcasting service, DirecTV, had more customers than the Canadian cable and satellite BDUs combined at the end of 2001. Wireless BDUs have a market *share* in Canada that is about 5% less than that held by wireless services in the United States.<sup>53</sup> As a guide to our estimate, we assume that Canadian policy has retarded penetration of satellite delivery to the home in contrast to what would have been achieved with a North American solution. Assuming that the shares in Canada would be the same as in the United States with an integrated solution, we conclude that the Canadian policy has reduced the share of direct-to-the-home digital satellite services by 5% of the total Canadian market for BDU service. To put this in terms of an equivalent subsidy measure, we need an estimate of the subsidy to programming provided to this medium that would recapture this share of the market. We think that the subsidy necessary to realize that increase in penetration would be well above \$100 million per annum. Using the \$100 million figure and a base of CAVCO programming of \$2 billion, the subsidy as a percentage of the value of subsidized Canadian content would be 5%. The implied multiplier for this policy is 1.05.<sup>54</sup>

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<sup>53</sup> The Canadian figures for August 2001 are from Cable and satellite television 2001 Statistics Canada Daily Sep 12 2002. The American figures for July 2001 are from David Beckwith and Marc O. Smith, "Video competition has fully taken hold" National Cable and Television Association, September 12, 2002. Satellite broadcasting services are the most important component of the wireless BDUs.

<sup>54</sup> We are assuming that if the two markets were integrated Canadian wireless customers would be the same share of the total number of BDU customers as in the United States. Current policy reduces the share by 5% of the total market. What subsidy would be needed to allow the Canadian services to recapture the 5%. \$100 million is a low estimate. For measurement purposes we assume that the subsidy is paid

In the case of films, a recipient of a production subsidy must contract with a Canadian distributor for distribution within Canada. The explicit subsidies to Canadian distribution firms are included in our estimate of the direct subsidy rate but adding a requirement to deal only with Canadian distributors as a term of access to production subsidies implies a further subsidy. Each time a supported Canadian filmmaker has to choose a Canadian distributor when he or she would prefer to contract with a foreign distributor because of better price or service, an implicit subsidy is granted by the filmmaker to the national distributor. The size of the subsidy is the loss of profit or higher losses experienced by the filmmaker. We have not made an adjustment for this factor.

Copyright protection nationally and internationally is likely to be a significant focus of national and international attention in the audiovisual sector as the effects of file swapping and CD burning on the industry become clearer. On the other hand the manipulation of copyright law in a beggar-thy-neighbor way is not a significant aspect of Canadian policy. We make no adjustments on account of copyright.

Without the ownership rules, the overall policy package would lose, in our opinion, political valence within Canada. These rules prevent more efficient management and ownership teams from abroad working in the Canadian setting. They restrict foreign competitors from establishing a presence in Canada (Mode 3 supply under the GATS), which is recognized by the competition authorities as one of the more effective promoters of competition within the Canadian market. They contribute further to the uncharacteristically, and to our minds regrettably, close relationship between the government and the industry in Canada. Similar rules adopted by other countries bar Canada's efficient managers and owners from extending their reach internationally. With national treatment in Canada of foreign suppliers what qualifies as Canadian content could be produced more cheaply or with less protection. We believe that this factor is important but find it difficult to quantify. To be conservative we have not made an adjustment on its account.

Competition policy has also not had a significant impact on the imports of audiovisual content. If there were effective integration of competition policy internationally, it might be an instrument for realizing more efficient outcomes from the liberalization of trade in audiovisual content and services. This condition is unlikely to be realized in the foreseeable future. We make no adjustment in either direction for competition policy.

Putting together the different adjustment factors we have a 25% adjustment for licensing and Canadian content and a further 5% adjustment for Canada's direct broadcasting satellite policy. There are two ways of applying these magnifying effects. One is cumulative so that the adjusted rate of protection is given by the formula  $(1.25)(1.05)(.3)$ , which is equal to an adjusted rate of 39.4%. More conservatively the 25% adjustment for Canadian content quotas and licensing could be added to the 5% adjustment for Canada's

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to suppliers of production of programming if that programming is carried by the Canadian satellite services and this lowers the rental prices by the \$100 million. An extra \$100 million of subsidies would have raised the base estimate by 5%. Therefore we use a multiplier of 1.05. We also note that according to Statistics Canada the Canadian wireless operators lost 293 million or \$182 per subscriber (before interest and taxes) in 1981 (Cable and satellite television 2001, Statistics Canada Daily Sep 12 2002).

policy to what the cable industry calls the American Death Stars to generate an adjusted rate of protection of (1.3)(.3) or 39%. We submit the 39% as an overall estimate of the protective effect of Canadian policy measured as a subsidy rate on tradable Canadian content.