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Jennifer J. Fong

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THE CULTURAL INDUSTRIES EXEMPTION FROM NAFTA: ANOTHER CANADIAN PERSPECTIVE

*Jennifer J. Fong**

When Ron Atkey asked me a short time ago to please stand in and present a paper on the cultural industries exemption at this conference, I first said, I am pleased to do it, and then I secondly said, I think it is going to be a very short presentation. I could simply get up before this group and say that the cultural industries exemption was extracted during the eleventh hour of the FTA negotiations, that it represents such an uneasy truce between Canada and the United States, and that it really has never been formally invoked. As a result, many people could say that it has been a bit of a non-starter in terms of clarifying the trade relationships in culture between the two countries. That could be the end of my story and my cue to sit down again, but the truth is, the cultural industries exemption is much more than those three bare facts.

While it might be true that the exemption is perhaps more notable for the fact that it has kept a very low profile in terms of formal usage and invocation, I think the opposite can be said about the numerous and interesting trade disputes that actually have arisen between Canada and the United States in the last few years. Indeed, I think there is probably no better recent example of the intensity of these disputes and the amount of time that it takes up on the Canada/U.S. trade agenda than by looking at the United States Trade Representative's recent *1997 Foreign Trade Barriers* publication. In the section dealing with Canada and various irritants that have been noted by the USTR, it is very interesting to note that about one-half of the irritants deal with cultural industries.

So, while the cultural industries exemption has never been heavily invoked and has not been a lead player, in terms of the dialogue on culture in the last few years, I think it is fair to say that it has played a very important role, if only to prompt the parties to ask, "what if?"

For instance, in the Country Music Television dispute that arose a

* Jennifer Fong is an associate at the New York office of the law firm of Osler, Hoskins & Harcourt.

few years ago, I think the exemption loomed quite large as the parties asked themselves, what if we cannot find a commercial solution for this problem? What if we have to raise it to a real trade dispute? I think another example is also interesting - the *Sports Illustrated Canada* case, where the USTR no doubt asked itself, what if we decide to make a challenge under NAFTA as opposed to the GATT? So you see, while the exemption has not been called into direct focus, it has been a very interesting, enigmatic supporting player, if only to add context and intrigue to these cultural disputes from the background.

Looking at the Canadian perspective on culture and the exemption, which is my assignment today, I think the interesting question that must be asked is what is culture; what is all this fuss about? For a lot of Canadians this question can simply be restated, "how are Canadians different from Americans?" This is an interesting question for me, someone who hails from Halifax, Nova Scotia and has found New York City to be her present home. I can certainly present one Canadian's view of the answer to that question.

Having been a person who grew up in Canada, I was fascinated with absolutely everything that represented things American. I recall watching all those American television shows, yet at the same time realizing my own experiences as a Canadian were not exactly being reflected. A really interesting conflict developed as a result of that. I think another way to put that conflict into perspective in terms of answering the identity question of "what is culture?" can be found in a recent very interesting book written by two very talented Canadian journalists. The book is called *Mondo Canuck*. I have a copy of it here, and the two journalists are Greig Dymond and Geoff Pevere.

They really capture this quandary that I was trying to describe earlier by saying the following:

When you're Canadian, you grow up strayed by the relentless barrage of American media, yet every time you reach for change you realize you still share a queen with a distant tiny island that was once your colonial master. To be a Canadian is to live in the space between certainties; to dwell in the gap that separates conviction from speculation. To be a Canadian, in other words, is to exist in a state of constant becoming.¹

That is an interesting way to put it. It certainly rung true to me, and perhaps with the other Canadians in the audience.

In addition to that idea, the authors of this book present another

¹ GEOFF PEVERE & GREIG DYMOND, *MONDO CANUCK: A CANADIAN POP CULTURE ODYSSEY*, Prentice Hall Canada, 1996.

interesting idea, which suggests that we might entertain the idea of a radical change in what we think culture is, in terms of Canadian culture specifically. They suggest that we might expand the notion of culture to include things such as popular culture, which usually do not get considered along with higher art forms. They ask an interesting question, which is this:

What if for a moment we were to drop that conventional Canadian middleground disinclination towards popular culture? To suggest that Canada is every bit as distinct in its approach to schlock as it is to art, and that the former may indeed reveal vastly more of our national distinction than the latter; that it's possible to see as much of ourselves, if not more, in Mike Myers as it is in Margaret Atwood; that the Tragically Hip have as much to tell us, if not more, about the experience of living in post-Mulroney Canada as Peter Gzowski.

In looking at popular culture, there may be a number of you who might like to debate with me the significance of Pamela Anderson Lee, who appears so often on *Baywatch*, and her value to us as a cultural export from Canada. But nonetheless, I think as we continue to grapple with this idea of our own distinctiveness, there really is a lot of good news to be said about how we have taken that distinctiveness and nurtured it through our own cultural industries. Many of you already know that Canadian singers, such as Alanis Morissette, have done very well internationally. Her album, *Jagged Little Pill*, has sold thirty million copies worldwide. Celine Dion has also done similarly well, with twenty-one million copies of her album, *Falling Into You*, sold worldwide. I think these are remarkable records by anyone's standards.

Looking at it slightly differently, many of you might know that companies such as Alliance and Nelvana, which are Canadian publicly traded companies in the film business, now have full access to Canadian capital markets for the purpose of expansion and are among eight such publicly traded companies that are in existence, whereas about a decade ago there were none. Even our own Canadian National Statistics Bureau (StatsCan) tell us there is some good news out there. And that Canada's exports of cultural goods and services are growing at unprecedented rates, increasing eighty three percent between 1990 and 1995.

This is the good news, and there is really a lot more in the way of examples I could provide. But my point is simply this: In terms of our cultural identity and its successful nurturing, and even in terms of this Canadian "state of becoming," (to go back to that earlier definition), there is much to suggest that we have become something quite significant. That is not to say that the story is over and the analysis should end. Rather, it prompts two more questions. The first is, if we have been successful, *how* have we become successful? How have we

achieved all of this? Secondly, how can we ensure that these cultural successes will continue well into the future as we go forth and evolve in the global trade environment?

To answer that first question about how we have gotten to this point at all, I think it is important to turn the discussion to the existing Canadian instruments that have been in place for some years to protect Canadian culture. Canada's approach in creating and crafting these measures has always been to be careful and to craft measures that are intended to be consistent with its obligation under NAFTA and other international agreements, rather than relying on any cultural industries exemption to excuse any actions that might otherwise be viewed as discriminatory.

Protective measures take many forms, including ownership and investment restrictions, regulatory and licensing requirements, Canadian content rules, tax incentives, and subsidies. I would say, up until recently with the magazine decision, this approach has been quite successful. Ron Atkey's paper discusses these instruments at length.

I think for the purposes of these oral remarks, I will just note two of them. These examples are recent applications of Canada's cultural protection instruments which highlight some of the significant lessons that we might learn to assist us from a trade perspective. A good place to start is the film industry, and Canada's 1988 film investment policy which acts to really restrict foreign investment in the Canadian film distribution business in a number of ways. This policy prohibits foreign takeovers of Canadian-owned film businesses. It does permit foreign investors, though, to establish new film distribution businesses, so long as they are for proprietary products only. By proprietary products, I refer to film products for which the non-Canadian investor has either worldwide distribution rights or for which it has paid more than fifty percent of the production costs up until the final negative. Lastly, the 1988 film distribution investment policy will permit direct or indirect acquisitions of foreign-owned film distribution businesses in Canada so long as the non-Canadian investor undertakes to reinvest a portion of its Canadian earnings.

With this policy in place for almost ten years, we have seen the status quo maintained with the major Hollywood studios in existence in Canada prior to 1988 being effectively grandfathered from its provisions. The result has been that the major Hollywood studios have been permitted to continue to build their businesses in Canada, but the lion's share of new growth and film distribution has been reserved for Canadian businesses.

The restrictive nature, though, of these policies came into sharp focus last year with an application by another distribution firm. This

time it was Polygram, which is based in the United Kingdom and in the Netherlands. Polygram had sought to establish a distribution business in Canada to distribute non-proprietary films contrary to the policy. It argued quite vigorously, both in public and private, that should be put on a level playing field with its Hollywood competitors. And as an inducement to the Canadian government to make an exception to the policy in their case, Polygram offered to reinvest a significant portion of its Canadian earnings to promote Canadian film production and development. Notwithstanding that offer, Polygram has so far been rebuffed in its attempts to have its application approved. As a result, it must content itself with having a much reduced form of distribution business in Canada, restricting it only to its own proprietary film products.

The question that arises is, what does this mean for the United States? First of all, the USTR is actually quite content in this area to let sleeping dogs lie, because the Hollywood studios are effectively grandfathered. There is some disquiet among U.S. interests, though, because they look at this as perhaps another validation of precedent for discriminatory practices taken by Canada. That is an unsettling precedent because it could be invoked by Canada in the future in other cultural sectors and against U.S. interests.

What does Polygram mean for Canada? I think there are a number of points that could be made, but one I would like to make is that it is interesting to look at what it says about the film investment policy and its application today, a number of years later. From a Canadian perspective, the continued use of investment restrictions raises questions about whether or not such an inward-looking investment policy is still appropriate. Given the fact that the Hollywood studios have effectively been grandfathered, I think it is worth asking whether or not Canada could have benefitted more by accepting Polygram's offer for increased global opportunities, rather than the benefits that it is going to receive by simply having shut Polygram out of its market.

Leaving this investment instrument and the Polygram example behind, this brings us to the *Sports Illustrated Canada* case, which is perhaps the most striking example of how the NAFTA cultural industries exemption fits into the broader scheme of the world trading. Indeed, some might argue that the recent WTO decision is so significant, especially the USTR's decision not to go under the NAFTA, but to use the GATT '94, that it is a real sign to the rest of the world and to Canada about where we can expect to see cultural industry disputes managed in the future.

For those who are not familiar with all the facts, I will not get into all the details, except to say that the issue arose as a result of Time

Canada launching a split-run edition of *Sports Illustrated* in Canada. Various actions were taken after that and, as a result, the USTR challenged four of Canada's main magazine protections before the WTO. The most important issue for the WTO panel involved Canada's attempts to use its Excise Tax Act to achieve a cultural objective to favor Canadian-owned magazines. To counter the introduction of the *Sports Illustrated* split-run edition in 1993, the Canadian government subsequently introduced an eighty-percent excise tax on the value of all the advertising appearing in that split-run magazine. Since the tax on its face appeared to be country-neutral, the Canadian government maintained that it was in compliance with NAFTA and the other international trade obligations, even though the measure was clearly aimed at one particular business interest, that is, *Sports Illustrated Canada*.

In response to the challenge launched by the United States under the GATT, Canada's main argument before the WTO, and indeed it continues to be the main argument in the case under appeal, is that the excise tax was imposed on the advertising services in the magazine rather than the magazines themselves as goods. Canada then argued that it was really the General Agreement on Trade in Services (GATS) that should apply, and not GATT '94, which addresses trade in goods. Going further, Canada argued that Canada has not made a specific commitment regarding advertising services under GATS, which would effectively amount to being tantamount to an exception.

In its most significant finding, the WTO considered this distinction between advertising services and the magazines themselves as goods, and rejected the argument. They found that the spirit of world free trade and express wording of the various international agreements supports a much more liberal view of how the various agreements should be read together. Specifically, the panel found that GATT '94 and GATS can coexist without either taking priority over the other. Moreover, they found that even under the GATT '94 there were significant precedents that do exist which would permit a consideration of trade and services under the GATT. As a result of not finding favor in Canada's argument, the panel then went on to find that the eighty-percent excise tax constituted excess taxation applied to the foreign split-run magazine and breached Canada's obligation under the GATT.

In my view, the eighty-percent excise tax in question here represents an overextension of Canadian policy which purported to pursue a national treatment objective in principle, but not really in practice. The Canadian government was pushed into this initiative by an overly aggressive Canadian magazine lobby whose representatives actually conceived of and drafted the measure, intending to take direct aim to skewer

Sports Illustrated Canada. Remember, *Sports Illustrated Canada* was legally launched in Canada after receiving approval from two government departments, Investment Canada in 1990, and Revenue Canada in 1993.

The proponents of the excise tax took a very extreme view and rejected any idea of compromise by grandfathering *Sports Illustrated Canada* under the eighty-percent excise tax measure. In taking such an extreme view, the result caused Canada to catapult its entire panoply of tariff and postal measures onto the world stage before the WTO with the uncertain prospect of what the final legal result would be. Having seen what we think that legal result will ultimately be, (pending the appeal, of course), the result is really far more damaging to the long-standing protective legislative regime for Canadian magazines and other cultural industries than might have ever been the case, had reason prevailed when the Canadian magazine lobbyists first advocated the Draconian solution without clearly and fairly identifying the problem in the first place.

Since my assignment is to look at the Canadian perspective, I thought it might be worth spending a couple minutes looking at what the Canadian view is of the U.S. perspective on all of this. This could stir things up a little bit, but that would be a good thing. I think in trying to understand how the two countries have looked at culture and their respective objectives, it will likely improve upon the system that we presently have in place.

It is not surprising that Canada has never really feared the retaliatory measures that could come from the equivalent commercial effect provision under the NAFTA, simply because, with the exception of *Sports Illustrated*, Canada has been very careful and successful in crafting its cultural initiatives so as not to be inconsistent but for the exemption.

In terms of looking at the Canadian view of how the United States sees the issue of Canada's own identity and culture, I think many Canadians probably are somewhat irked by a view that a force so dominant as the United States is often so unaware of the impact of its cultural exports. One U.S. academic writer actually summed it up quite well when he said back in 1990:

Many Americans are relatively unaware of the extent of the success of their entertainment business in selling television programs abroad. Why do Americans pay so little attention to the outside world? Because all the world is fascinated with the Manhattan skyline and the San Francisco Bay, with blue jeans and screened entertainment. When all roads led to Rome, the Romans were less worldly than world dominant. When Britannia ruled the waves, the British did not study the world as much as sail around it.

That being said, I think the view that Americans are not that interested in what Canada is trying to do with its cultural measures is fortified by an observation that the United States seems to be particularly ready to deal with discriminatory trade practices in the entertainment area through the use of Section 301 of the Trade Act. I will not be so bold as to enter into a discussion on Section 301 when my fellow panelist is so much more able to do so, but I will try to offer a couple of points to you that give an idea of what the Canadian perspective on Section 301 has been.

In Canada we have learned to grapple with the distinctions and are trying to understand the differences between a Super 301, a Special 301, and a Regular 301. In our view, or at least the Canadian view, it might be said that the Super 301 tends to be more like a shotgun aimed at countries cited by the United States as engaging in broad and consistent patterns of unfair practices.

A Special 301 might be likened more to a big stick backed up by a high powered rifle, pursuant to which the USTR is directed to identify countries which deny adequate and effective intellectual property rights.

A Regular 301 is like a Special 301, but perhaps with a more reasonable timeframe of twelve to eighteen months, over which to make determinations. In this sense, the Regular 301 may not be viewed as unilateral and as coercive as its Special and Super counterparts, since it appears that the Regular 301, by virtue of its longer timeframe, appears to accommodate the WTO dispute mechanism. It implicitly acknowledges a rules-based multilateral approach inherent in the WTO process, which on a reciprocal basis can be of immense benefit to Canada and the other WTO members. I think for Canada this recognition of a rules-based regime as coming out of all of this is perhaps not a bad thing in the larger scheme of things.

What are the lessons from some of these disputes in our experience over the years with the NAFTA cultural industries exemption? I think the exemption has been an enigma to many, and has really led to a shifting away from what is really a rather crude mechanism based on a tit-for-tat approach (which really has the capacity to escalate matters, as opposed to ameliorating them), to something that is a little bit different.

In the wake of a magazine challenge, I think we really are moving more towards the rules-based approach of the WTO in interpreting GATT '94, the GATS, and the Multilateral Agreement on Investment (MAI). Granted, both the GATS and the MAI have cultural industries exemption corollaries but it remains to be seen how they will work in the broader scheme of all of our international obligations. As I noted

with the *Sports Illustrated* case, the panel there found that it was possible to look at GATT '94 and GATS together and to see that neither takes priority over the other and that there are precedents under GATT to look at services.

The question I posed earlier was, how can Canada ensure that the successes we have achieved can continue? And again, I think that there really is a bright side of the story for Canada in all this. Granted, in the short run, there probably will be fewer magazine protections as the country grapples with the fallout of *Sports Illustrated*, the WTO, and magazine decisions; but an important benefit that has also come is the fact that a very important and lively public debate has been precipitated after the magazine decision. This, in my view, is a very healthy sign that Canada is aware of the global changes that are taking place and already have taken place, and for the need to adjust to a more rules-based international environment for culture.

An interesting idea has been posed by a fellow panelist, Daniel Schwanen, who contemplates a delinking of foreign ownership from the delivery of Canadian cultural products. The idea suggests that there is no automatic connection between cultural content embodied in a product and the ownership of the enterprise delivering or marketing that product. It is a very interesting premise, and I think one need only look at the example of Seagram's acquisition of controlling interest in MCA/Universal. Here we have a Hollywood studio effectively under Canadian control without any commensurate increase in Canadian cultural output. While the relaxation of foreign investment restrictions is certainly considered heresy to a number of people in Ottawa, it does offer an interesting solution and certainly one that merits long discussion.

Mr. Schwanen notes in his paper that the policy implications are fairly clear. He writes,

[S]ubsidies towards products aimed at a Canadian audience and the awarding of shelf space for such products should be open to foreign owners who make an original contribution to the Canadian market. And in the vast majority of cases this will involve making use of Canadian talent and carrying Canadian perspectives.

In summary, the bilateral relationship between Canada and the United States in the area of culture is really being subsumed over time by the multilateral framework that has been provided by the GATT and the Organization for Economic Cooperation and Development (OECD) in terms of negotiations and dispute settlement rules. This, in my view, again, is not necessarily a bad thing. In fact, I think it really represents this process of "becoming," that we spoke of earlier, in the context of

what it means to be a Canadian.

Having lived for eight years in this space between certainties forced on us by the Cultural Industries Exemption, I think Canada and the United States have learned a number of things and perhaps are getting ready to move towards a new and hopefully more defined relationship in the area of culture.