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Backgrounder

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The Summer of Our (Canadian) Content:
Thinking about Canada's Response to the WTO Magazine Decision

by

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Canada has until October 30 of this year to respond to the reports of the World Trade Organization (WTO) dispute settlement panel and of the WTO's Appellate Body, issued in March and June 1997, which together struck down certain measures aimed at protecting this country's magazine industry. Canada must bring these measures into conformity with WTO rules or face stiff WTO-sanctioned retaliation by the United States.

The measures struck down consist of postal subsidies to support the circulation of Canadian magazines, and punitive tariff and tax measures to prevent the entry into Canada of "split-run" editions of foreign magazines — that is, magazines with editorial content broadly similar to their foreign original but with advertising aimed at a Canadian audience.

In my view, Canada can best promote the circulation of domestic magazines to Canadians — the stated goal of the federal government's policy — by continuing to promote a more favorable playing field for those magazines, while allowing the Canadian public and advertisers greater access to split-run editions of foreign magazines. There is no "magic bullet" capable of keeping split-run magazines out of the country even while remaining compatible with Canada's WTO obligations that would not also likely be damaging to Canada.

Measures the WTO Decision Struck Down

Postal Subsidies

The WTO found that Canada's "funded" rate postal scheme does not conform to the General Agreement on Tariffs and Trade (GATT), which allows "the payment of subsidies exclusively to domestic producers" — essentially because Canada does not pay the subsidy directly to the publishers but to Canada Post, which sets different, discriminatory, rates for domestic and foreign magazines.

Tariff Code 9958

Canada imposes a prohibitive customs duty on the entry of split-run editions of most types of magazines; indeed, it has not challenged the WTO's findings that the tariff runs contrary to Canada's WTO obligations not to impose quantitative restrictions on imports.

The Excise Tax on Split-Run Editions

Tariff Code 9958 had begun to be circumvented anyway when US publisher Time-Warner beamed the content of the Canadian edition of an issue of *Sports Illustrated* by satellite to a Canadian printing plant, which led Canada to impose a punitive 80 percent excise tax on the value of advertising in split-run magazines, intended to make their publishing unprofitable. The WTO also struck down this measure.

The WTO Appellate Body's decision here hinged on whether the tax measure concerned a *good* (which is covered by the GATT) or a *service* (advertising services in Canada are not covered by WTO agreements), and on whether it constituted discrimination between a domestic product and a foreign "like product."

On the first issue, the Appellate Body rejected Canada's view that the tax was a measure concerning advertising by, among other things, pointing out that the tax was called a "tax on split-run periodicals." In any event, the WTO said, magazines were goods, of which advertising was too important a component for Canada to suggest that punitively taxing its use in certain types of goods would not constitute unfair discrimination against those goods.

On the second issue, the WTO did not follow Canada's suggestion to compare *Maclean's* and *Time Canada*, for example, and pronounce them different products on the basis of their editorial content. Instead, the Appellate Body remarked that the Canadian magazine industry itself had admitted that US magazines were "a close substitute" for Canadian ones. Furthermore, the WTO said, if advertising as well as editorial content entered the comparison, then the domestic magazine and the split-run edition, both laden with Canadian advertising, served much the same purpose — that is, they could be considered "like products," which, under GATT rules, cannot be treated differently.

Impact of the WTO Decision

The industry contends that split-run magazines would win one-third of Canadian magazines' advertising revenues. Because Canadian magazines are produced for a relatively small domestic audience, while Canadian advertising revenues are "gravy" for the foreign publisher, the implication is that advertising revenues must continue to be redirected toward Canadian magazines to prevent them from falling into a "death spiral" of lower revenues leading to lower quality, then to lower circulation and to even greater revenue losses.

Experts estimate that, even though the entry of split-run editions would likely increase the size of the magazine advertising market overall, Canadian magazines most heavily dependent on advertising, including many of the largest consumer magazines, would suffer losses. Smaller "niche" magazines, far less dependent on advertising revenues, may, however, easily survive the challenge.

As to the *reasons* Canada should support its magazine industry, the impact of the WTO decision is less clear. While one can make a qualitative argument for support in terms of the "public good" benefits of Canadians' being well-informed about each other or in terms of cultural policy broadly speaking, the correlation between the availability of Canadian magazines and the strength of Canadian culture remains a matter of conjecture.

Avoiding Bad Responses

While efforts to bolster Canadian magazines may be justified, this is not to suggest that a certain market share for domestic magazines must be maintained at all costs. Indeed, such an attempt can best be understood as an industrial, rather than as a cultural, policy initiative.

Yet some of the proposed responses to the WTO decision seem aimed not at ensuring a healthy presence for Canadian magazines in a competitive market but at protecting them at all costs from fluctuations in market share. It has been suggested, for example, that advertising aimed at Canadians be prohibited altogether in magazines that fail to reach a certain Canadian-content threshold. Another suggestion is to tax advertisers (rather than magazine publishers) for advertising in split-run magazines, the rationale being that this would be more clearly a measure affecting services and, hence, not subject to GATT rules.

Yet any response aimed at ensuring that split runs remain excluded from the Canadian market would be dangerous and potentially counterproductive. The Appellate Body clearly interpreted advertising as an inherent physical component of magazines. This renders any punitive taxation of advertising in some imported magazines but not in domestic ones dangerously open to further WTO charges of discrimination against a particular imported good. Such a response would likely also result in severe retaliation against certain export-oriented cultural industries. And Canada would lose credibility on other trade issues because its position on "cultural exemptions" would be seen as a naked attempt to maintain an industry's market share.

The advertising angle must also be considered here. Advertising, after all, can proclaim Canadian-ness to Canadians just as effectively as do many products of the more narrowly defined cultural industries. Apart from the issue of freedom of expression involved in banning or prohibitively taxing advertising in split runs, could Canada enforce such a ban on US advertisers? If not, these firms could sell "Canadian" advertising to US publishers for their Canadian split-run editions, which could then be beamed across the border to the detriment of the Canadian advertising industry. And assuming that Canadian consumers will want to buy some magazines with US content regardless of the policy (they currently have unfettered access to non-split-run editions of foreign magazines), continuing to ban split-run editions from the market altogether would expose Canadian consumers even more to US advertising, possibly hastening, rather than preventing, cultural assimilation.

Better Responses Are Available

Instead of looking for the magic bullet that would keep split-run editions out, Ottawa has at its disposal an arsenal of weapons that could be used to promote the competitiveness of Canadian magazines, with minimal adverse consequences in other areas.

Revamp the Postal Subsidy

One possible response to the WTO decision would be to restructure, and even enrich, the postal subsidy so that it becomes more transparently a subsidy made directly to a "domestic producer," while at the same time addressing the question of publishers' independence from government influence.

For example, Ottawa could buy "rights" from Canada Post for lower postage fees, rights for which magazine publishers could then bid. The difference between the cost to the federal treasury and the revenues from the auction would be the subsidy, in effect distributed directly to publishers without in any way influencing editorial content. Furthermore, publishers would bid only for the rights to the extent that they expect to reach readers, thereby ensuring that the subsidy fit the policy goal of encouraging Canadians' access to Canadian cultural products.

Enrich Tax Deductibility for Advertisers in Canadian Magazines

One important measure of support for the Canadian magazine industry escaped scrutiny at the WTO: section 19 of Canada's *Income Tax Act*, which disallows the deductibility of advertising expenses in foreign-owned magazines. The reason the United States did not lodge a complaint against it was probably that tax measures are not usually subject to challenges under existing trade agreements unless they have the effect of expelling a foreign product or investor. In other words, the tax measure, in itself, does not prevent the entry of split-run magazines.

Accordingly, not only could Canada allow the measure to stand; it could even enrich it by allowing the actual advertising expense to be grossed up by a certain amount for income tax purposes. For cultural policy, this type of subsidy would have the advantage of ensuring that government money was spent where it would be most effective in terms of facilitating Canadians' access to Canadian cultural products. And since advertisers would, in fact, have the final say on where the money was spent, the issue of keeping publishers at arm's-length from government would not arise.

Provide Direct Subsidies to Producers

Although the GATT permits direct government subsidies, one could argue that such subsidies could constrain magazines' editorial independence (Another argument against direct subsidies, that the industry would thereby be at the mercy of the electorate, can be rejected on the grounds that taxpayers should indeed have the last word on how their money is allocated.) Nevertheless, it would be possible to subsidize the industry directly on a "per reader" basis, as determined by independent surveys, while retaining favorable features in terms of both cultural policy objectives and publishers' independence from interference. Suggestions that a subsidy to "Canadian" magazine producers could be implicitly financed by a tax on magazines as a whole should, however, be rejected — such a tax would actually tend to discourage reading generally.

Open the Industry to Foreign Investment

On the surface, it may seem paradoxical to propose bolstering the position of *Canadian* magazines by opening up the industry to *foreign* investment. But ownership restrictions in a number of industries, including "cultural" industries, are not necessarily an effective way to deliver domestic content to the domestic market. Indeed, Canadian firms themselves often expand in global cultural markets by making products that appeal to wider markets, not just Canada's. Should Canada protect and subsidize such producers? Certainly, arguments that subsidies are needed because of the smallness of the domestic market lose their saliency in such cases.

Conversely, some foreign firms face barriers to entry into Canada or to their activities here because they are not owned by Canadians, despite their having stellar records of investing in and developing domestic talent where they are allowed to operate. Specifically for magazine and newspapers, a key barrier to foreign investment is the nondeductibility of advertising expenses in foreign-owned magazines. What incentives do protected domestic firms have to develop successful Canadian magazines when their owners are limited to reselling them to an inevitably small pool of potential Canadian purchasers? The result of investment restrictions in the cultural sector may, in fact, be unnecessarily low levels of cultural industry activity and capitalization.

Perhaps the only reason to maintain such restrictions is that they are a fairly clear-cut way of determining what is a "Canadian" magazine (although Canadian-content rules are also superimposed on ownership rules to determine eligibility for subsidies and whether advertisers can deduct their expenses). Is it possible to define "Canadian magazines," for the purpose of subsidization, in ways other than through the ownership of the publisher?

What Is a Canadian Magazine?

Although GATT rules permit governments to subsidize "domestic producers," meaning the production of magazines in *Canada*, or perhaps by *Canadians*, can Canada subsidize the production and dissemination of *Canadian-content* magazines?

The WTO Appellate Body's decision seems to suggest that it views *Time Canada* and *Maclean's* as substitutable magazines, even though one devotes substantial space to Canadian affairs and the other far less. One wonders if the reasoning here reflects the personal biases of members of the Appellate Body, who do not state that all magazines are alike (a defensible position) but, rather, that a Canadian-content magazine is substitutable for a US one, while a magazine dedicated to, say, chess is not substitutable for one on sport, even though both arguably concern substitutable leisure activities.

Nevertheless, the decision does challenge Canada to find a better way to distinguish between Canadian and US magazines than by simply looking at the source of the editorial content. Canadian support measures could, for example, focus on whether or not a magazine meets some objective test of demonstrated appeal to a specifically Canadian readership. If, say, 90 percent of a magazine's circulation is in Canada and if its content (*including* advertising) is not by and large replicated by another sold outside Canada, then the magazine could be defined as domestic for the purpose of subsidies or other forms of support (even if it were published outside Canada or by a non-Canadian, thereby avoiding all forms of discrimination against imported products).

Competition Policy Approaches

In addition to needing subsidies to offset the economies of scale US publications enjoy, does Canada's magazine industry also face unfair competition from US magazines? While space does not permit me to examine this question here, Canada's Competition Bureau certainly could make such a formal analysis. A number of issues are of concern: Is advertising being "dumped" with predatory intent on the Canadian market, through US magazines offering lower rates to advertisers in Canada than they do for similar-sized markets at home? Are Canadian magazines being denied fair access to the distribution system? Can a magazine call itself "Canadian" when its editorial content is not? In other words, is inaccurate information conveyed about the Canadian-ness of a cultural product when information about product origin is an important piece of information in a properly functioning market? After all, rules exist to protect the label of origin of products in cases where origin is an important piece of information about such products.

However, unless Canadian magazine publishers are prepared to invoke such competition policy approaches — that is, to claim that the competition they face is actually unfair, predatory, or that the consumer is misinformed about the content of competitors' products, the real question is: To what extent should one increase the supply and availability of magazines specifically for Canadians, many of which would simply not be viable even in a fair market?

Conclusion

Any policy based on maintaining the market share of Canadian magazines by keeping split-run magazines out of Canada altogether will likely risk triggering retaliatory measures by US publishers that would hurt other Canadian industries. There is no acceptable magic bullet to restore support that the industry would lose if more split-run magazines were let in. But transparent measures involving an increased reliance on direct subsidies and on enriched tax benefits for advertisers could help to level the playing field for Canadian magazines. The problem of maintaining an arm's-length relationship between publishers and a government that hands out subsidies to them can be addressed by mechanisms to ensure that subsidies flow where there is relatively strong reader or advertiser interest.

And despite the WTO Appellate Body's reasoning on this issue, Canada should explore further ways to define a Canadian industry's eligibility for support based on its appeal to the Canadian market, rather than on the nationality of the publisher or the physical origin of the magazine. Finally, Canada should review barriers to fair competition, if any, that the industry faces.

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