Theater of Conflict:

Commerce, Culture, and Competition in the Global Entertainment Industry

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Chapter 4

Rules

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Summary:

Disputes over a cultural exemption from general trade rules nearly wrecked the Uruguay Round at the last minute and were a major source of contention in the North American Free Trade Agreement. This chapter reviews the development and effects of rules for trade in filmed entertainment in the GATT, the GATS, the Canada-United States FTA, the NAFTA, and other free trade agreements.

14,217 words plus references

Rules governing national conduct cover almost all of international trade in goods and services. Yet it has been long argued that trade rules are inappropriate in the cultural sphere– either that cultural products require a special framework of understandings, or that national control over cultural policy demands that countries accept no international commitments at all. Rarely, however, has this view prevailed in the governance of the trading system. In most trade agreements, cultural products are subject to the general principles of international trade rules.

While cultural exemptions from general trade rules remain infrequent, there is no comprehensive formal code to govern trade in cultural products. Multilateral trade rules, which afford states considerable latitude to regulate the cultural sector, do not cover all entertainment media or all trading countries. The incomplete multilateral regime coexists with patchwork rules in regional trading arrangements. Cultural products have been a persistent source of disagreement in international trade negotiations, and the development of trade rules has proceeded on an incremental basis. As a result, the establishment of a global regime for trade in cultural products has proven difficult.

Three overriding factors illuminate how the interplay of economic and cultural considerations has produced international trade rules that constrain, limitedly, national regulation of trade in cultural products. First, technological changes in the production and delivery of filmed entertainment bring nations into closer cultural contact– especially western nations, which have played the central role in international trade negotiations. At critical points in time, technological innovation has created new media or more efficient methods of distributing audiovisual content, and in every case these new technologies have made filmed entertainment more tradable. Increased exposure to the cultural output of other societies in turn raises anxieties in countries that are large importers of cultural products. Moreover, filmed entertainment entering from abroad becomes more difficult for the state to control with each advance in the means of delivery. Thus, technological change arouses concerns about national sovereignty because greater cultural contact has

enhanced domestic demands for regulation while also weakening state capacity to control content.

Second, the unevenly distributed gains from trade in cultural products consistently and predictably divide nations in international trade negotiations. While trade in filmed entertainment has favored the United States since the 1920s, fuelling disagreements with importers of its cultural products– Canada and the EC, in particular– trade imbalances have increased during periods of technological diffusion. Urgency to establish new trade rules or adapt existing ones for the latest technologies therefore has peaked at precisely the time that conflicts of national interest are most pronounced. The cultural symbolism of filmed entertainment accentuates resistance to new trade rules that constrain regulatory discretion in cultural industries: according to cultural protectionists, not a mere industry but national identity and a way of life are at stake. When differences widen between net importers and net exporters, pressure intensifies for flexibility in trade rules for cultural products, if not outright exemption on cultural grounds.

Third, pressure from domestic stakeholders tends to polarize national positions, making common ground in international negotiations more difficult to locate. In the United States, the high stakes of producing for a global market have made the MPA a vigorous lobby on international trade rules and a close advisor to the US government. Though the MPA often has failed to persuade US trade officials to assign its interest in banning foreign trade restrictions top priority, the United States has consistently pushed for disciplines on the regulation of trade in filmed entertainment or, failing that, rules permitting the use of market power to impose costs on countries that preserve or extend cultural protection. In net importing countries, particularly in the EC, domestic groups seeking to defend protection of filmed entertainment– either for cultural or economic reasons– recently have become more widely mobilized. With less domestic political flexibility, resistance to accepting additional trade obligations for cultural products has increased in the countries most heavily exposed to US filmed entertainment.

This chapter examines the development and effects of the trade regime for filmed entertainment and analyzes the evolution of pressures for a cultural exemption from trade rules. The chapter begins with an overview of the global trade regime and its institutional features. The analysis then examines two key pillars of the global trade regime for filmed entertainment, the GATT and the GATS.[1] The GATT has no cultural exemption, but it contains a limited exception for trade in motion-picture films: countries have the right to protect national film industries, but only through inside the border measures; they may not restrict imports of motion-picture films at the border. How to apply this principle to other technologies– television being the first– was never settled, however, leaving the question to be taken up in the Uruguay Round negotiations on trade in services. The ensuing GATS treaty also did not exempt cultural products, but neither did it establish a comprehensive regime for trade in audiovisual services. With resistance to accepting additional obligations still strong, the GATS 2000 negotiations in the Doha Round have produced minimal progress, at best, toward fuller coverage of cultural products. With the proper content and scope of trade rules for filmed entertainment unresolved at the multilateral level, several free trade agreements have incorporated provisions for cultural products. The result has been a patchwork of overlapping rules, some of them poorly defined and untested, in multilateral and regional trade agreements.

The significance of these trends is that in the multilateral trade regime, coverage is more complete and disciplines are stronger for trade in goods than for trade in services. As a result, the earliest technology, motion-picture films, is subject to precise disciplines (as are newer media traded as goods such as videotapes and videodisks). But satellite, cable, and the Internet have made it possible to detach the service (filmed entertainment) from its physical package (a film, tape, or disk). With this technological shift, content is more difficult to control and regulations harder to enforce, yet some countries have been

[1] The book does not examine the third pillar, the TRIPS agreement in the WTO.

less willing to accept restraints on cultural protection. For the latest technologies, trade rules therefore are less defined and coverage narrows. Electronic commerce and digital multimedia are the current battleground. Despite popular arguments that technological convergence renders content regulation obsolete, net importers of filmed entertainment are not likely to perform an about-face and surrender national rights to regulate culture.

The Trade Regime

Regimes are "sets of implicit or explicit principles, norms, rules and decision-making procedures around which actors' expectations converge in a given area of international relations" (Krasner 1983, 2). In international trade, a regime enables states to make their commitments credible to others so that mutually beneficial cooperation can be sustained. Contracts between nations are costly to negotiate, monitor, and enforce. If states can break their promises easily, then the expected payoffs of a cooperative agreement when others are likely to cheat will be low compared to the costs of implementing its terms. The creation of an international institution to provide information, monitor compliance, adjudicate disputes, and mobilize collective action against cheaters reduces the incentives for states to opportunistically deviate from their obligations and alleviates uncertainty about the behavior of others. Thus, a trade regime does more than remove barriers to trade; it institutes rules and procedures to make the exchange of goods and services across borders more predictable and provides a forum for settling disputes between countries (Barton, et al. 2006, chap. 2).

The central features of the global trade regime, or any system of trade rules, are threefold: the regime encompasses the substantive obligations of countries, the allowable exceptions to those obligations, and the means of enforcement. The original multilateral trade regime, the GATT, established in 1948, included a series of commitments to MFN, tariff liberalization, and rules for the use of certain non-tariff barriers; general exceptions for public health, national security, and the like, and particular exceptions to allow states

to counteract unfair trade practices and alleviate unforeseen market disruption; and a system for settling disputes proceeding in stages from consultation to an administrative ruling to authorization to suspend trade concessions (Staiger 1995, 1498-1504). The WTO, formed in 1995, incorporates the GATT treaty; additional obligations, particularly for services (GATS) and intellectual property (TRIPS), each with various exceptions; and new dispute settlement procedures to make panel decisions binding, provide for appeals, and facilitate collective responses against members that breach their obligations.

The core principles of the GATT are laid out in its first three articles. First, states must practice non-discrimination by applying MFN to the trade of participating countries. Second, states must adhere to schedules of concessions, or negotiated commitments to liberalize or bind existing trade restrictions to a specified level. Third, states must grant national treatment to foreign products, which means that domestic laws and regulations cannot burden imports with taxes, quotas, or other limitations not imposed on comparable domestic products. National treatment prevents the nullification of trade concessions and impairments of market access through internal measures with equivalent effect to border restrictions.

At the same time, the GATT included numerous loopholes and exceptions to its basic principles. For example, the GATT legitimated non-tariff barriers that few states used at the time by devising rules for antidumping duties, countervailing measures, and safeguards. These exceptions to the scheduled commitments, by allowing policymakers the flexibility to suspend certain obligations to avert an erosion of domestic support for the regime, can be rationally optimal as long as escape is not cost-free (Goldstein and Martin 2000). In addition, loopholes in the GATT enabled "laggard" sectors, notably agriculture and textiles, to evade most of its disciplines until the Uruguay Round (Barton, et al. 2006, 98-108). In these cases, the political motive to assist private groups harmed by trade explains the demand for contingency-based exceptions to GATT obligations.

General exceptions, on the other hand, involve the provision of public rather than

private goods– specifically, the state's exercise of "police powers" or "health and welfare powers" in the pursuit of non-economic objectives. These exceptions apply to areas in which sovereign governments are unwilling to accept constraints to act consistent with the regime's rules. The exceptions listed in the GATT are broad, and countries need not notify the GATT of these measures, receive prior approval, or provide compensation. However, general exceptions (other than for national security) must satisfy "soft" MFN and national treatment requirements: states may depart from GATT obligations only to the extent necessary to accomplish their declared objectives. Thus, general exceptions are not wholly outside the GATT; they remain subject to dispute settlement to determine whether conditions for permitting the exception apply (Jackson 1997, 232-235).

There is no general exception in the GATT for cultural policies. Acheson and Maule (1999, 59) characterize the GATT as "the first major trade agreement to make explicit reference to culture," but in fact no mention of "culture" appears in the treaty's thirty-eight articles. While the GATT did not include a cultural exception, it did make allowances for protecting national film industries, without specifying the purposes for which countries might employ protectionist measures. Article IV, "Special Provisions relating to Cinematograph Films," set apart one form of protection, screen quotas, as a permissible deviation from national treatment. In devising special rules for films, the GATT plainly avoided excluding them from multilateral trade rules. Far from a broad exemption, the exception for screen quotas established that all other measures applied to films must conform to the general disciplines in force for traded goods.

GATT and Films

There are four significant elements to the special provisions for films in the GATT. First, because the GATT did not exempt films from the ban on quantitative restrictions in Article XI, films could not be subjected to import quotas. Instead, Article III, paragraph 10 exempted "internal quantitative regulations relating to exposed cinematograph films"

from the national treatment requirement, provided such internal measures satisfied the terms of Article IV.[2] GATT therefore sanctioned non-tariff barriers against films, but only non-tariff barriers inside the domestic market rather than at the border: countries could neither ban nor quantitatively limit film imports.

Second, Article IV permitted deviation from national treatment only for screen quotas, which would reserve a minimum share of total exhibition time for "films of national origin." Article IV further stipulated that screen quotas "shall be computed on the basis of screen time per theater per year" to ensure transparency. Though nothing in Article IV prevented governments from requiring exhibitors to screen domestic films only (100 percent quotas, in essence), specifically authorizing screen quotas foreclosed other departures from national treatment that would have equivalent effect as import quotas, such as excessive taxation.

Third, countries could differentiate between films of foreign and national origin, but not among foreign films. Implicitly, no favoritism could be shown to films traded inside empires, or to foreign-origin films recorded in a shared language. Thus, screen quotas were subject to an MFN requirement. Preferences already in effect could be retained, but not expanded.

Fourth, screen quotas, like other traded goods, were "subject to negotiation for their limitation, liberalization or elimination." Like the commitment in Article XXVIII *bis* to renegotiate tariff schedules at regular intervals, progressive liberalization applied to screen quotas. In future trade negotiations, countries imposing screen quotas could face continuing pressure to expand foreign access to their domestic film markets.

Overall, the provisions for films in GATT Article IV were a major achievement for US negotiators. A memorandum to President Harry Truman noted that "inclusion of this Article, which operates almost entirely to the benefit of an American industry, is a

[2] The text of Article III and Article IV appears in GATT 1986.

source of great satisfaction to the United States Delegation."[3] The US negotiating team to the Havana Conference listed the preservation of the film provisions in the Havana Charter fifth in its inventory of accomplishments.[4]

The approval US officials expressed for trade rules that sanctioned screen quotas may seem puzzling on its face. After all, why didn't the United States insist on total free trade in films or, failing that, provisions patterned after the GATT formula of low tariffs uniformly applied?

Negotiating GATT Article IV

GATT Article IV was valuable to US negotiators not only because Britain had resisted including films at all before agreeing merely to discuss the matter in the Geneva session of negotiations. At Geneva, Norway and Czechoslovakia joined Britain in asserting that cultural features separated films from other goods and required special consideration (Bernier 2004, 224). Because of this sentiment to exclude films, "negotiations had to be conducted carefully in order to avoid raising the cultural issue," the US specialist on film issues, Don Bliss, recounted to his superiors. Czechoslovakia, France, the Netherlands, and Britain submitted formal reservations on the special article for films, but the US team "offered no arguments against these, lest a prolongation of debate invite a burst of oratory from delegations influenced by cultural considerations." At the conclusion of the Geneva conference the film provisions were preserved in Article 19 of the draft ITO charter. Bliss concluded: "Although we did not obtain everything we wanted from the film negotiations, and had to concede on a number of points, everything we have obtained is

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[3] "The General Agreement on Tariffs and Trade and Related Documents," Annex D of Memorandum by the Chairman of the Committee on Trade Agreements (Brown) to President Truman, 17 October 1947, U.S. Department of State 1947, 1021.

[4] "Extract from Official Report of the Chairman of the United States Delegation to the Habana Conference to the Secretary of State," no date, U.S. Department of State 1976, 896.

almost clear gain to the United States."[5]

The MPA, however, certainly favored free trade over screen quotas. In briefs and testimony to the Committee for Reciprocity Information before the Geneva conference, the MPA pressed the case for eliminating trade restrictions and banning discrimination. Films required special treatment, the MPA argued, not for their cultural implications, but because principles such as MFN and national treatment did not prevent discrimination in cases where competing imports and/or national production were negligible. To combat protectionism abroad, the MPA offered sixteen draft clauses for US negotiators to submit in Geneva (Jarvie 1992, 405-407).

Past scholarship (e.g. Guback 1969) accentuates the reputed symbiosis between the MPA and the US State Department in the making of foreign economic policy after World War II. Often cited as evidence of this collaboration is a 1944 State Department telegram to foreign consulates, which stressed "the importance that the government attaches to the unrestricted distribution of American motion pictures abroad" and instructed foreign officers "to cooperate fully in the protection of the American motion picture industry abroad."[6] This document reviewed the web of taxes, quotas, preferences, and remittance restrictions imposed on US producers of motion pictures before World War II and it prophesied a continuation and expansion of such measures after the war. Yet three years later, US negotiators at Geneva did not advance the MPA agenda.

The State Department's willingness to endorse protection for films in the GATT reflected two peculiar features of the postwar economic environment, the first specific to the film industry and the second more universal. In the film industry, US producers had built up a tremendous backlog of films during and after the war as currency restrictions blocked trade while damage and destruction depressed cinema attendance. In some cases

[5] Bliss was a commercial attaché at the US Embassy in London assigned to film issues. His 27 August 1947 memo is quoted in Jarvie 1992, 411-412.

[6] This telegram, "American Motion Pictures in the Postwar World," is reprinted in Jarvie 1992, 379-381.

US films had been imported into foreign countries but not released for cinemas to exhibit; more frequently, US distributors held back exports to avoid flooding overseas markets all at once. With this surfeit of US films, foreign film producers faced difficulty obtaining screen time to reestablish themselves in their home markets.

Beyond the idiosyncratic circumstances of the film industry was the problem of postwar rebuilding. Mirroring a larger debate, some in the State Department favored an open European market to restore the US film industry's dominance, but for most the top priorities were economic reconstruction coupled with political stability. With European countries too short of dollars to lift financial controls, a torrent of imported films would drain scarce reserves. This meant that US films would not be permitted to overrun local film industries, hinder economic recovery, or spark political resistance (Trumpbour 2002, chap. 3; Jarvie 1992, 204-205).

As a result, close contact between the State Department and the MPA did not translate into unity of purpose: US officials determined that there should be a method for governments to legitimately protect national film industries, even if temporarily. Bliss, the State Department's film specialist posted in London, worked out the details during the Geneva negotiations. Britain, like other European countries, was committed to assisting national film producers, and insofar as the United States accepted the right of countries to protect domestic industry (subject to certain disciplines), it should advance screen quotas as the only viable means to protect national film producers. But in conceding to screen quotas, Bliss argued, the United States should demand that the basic principles for tariffs apply, that is, countries should bind screen quotas in their scheduled commitments and accept obligations to negotiate the future liberalization or elimination of screen quotas. "In other words," Bliss advised, "discriminations should be outlawed, preferences should be eliminated, and revisions of screen-quotas should be open to negotiation in precisely the same manner as tariffs" (quoted in Jarvie 1992, 408).

The question remains, why screen quotas instead of modest, non-discriminatory

tariffs? An important factor is that the unusual commercial properties of films described in chapter 2 rendered tariffs an ineffective means of protection. For national authorities to assess a tariff, the exporter must declare the product's customs value. In the case of a film, the customs value is uncertain at entry into customs since it has not been screened to domestic audiences; the film's value in terms of box office revenues is known only after it has been imported into the national market. For customs purposes, therefore, tariffs and declared values had to be based on a film's tangible characteristics: its weight and its length. Often governments levied fixed duties per linear foot of film. But while a modest footage tariff might be sufficient to curb low-quality foreign films with limited box office prospects, only a prohibitive tax could stop imported blockbusters from taking substantial screen time. The inability to adjust footage tariffs to a film's unknown earnings potential militated in favor of high duties which, despite their apparent excessiveness, nevertheless failed to protect domestic industries because they restricted imports only at the bottom of the range– the most popular films paid the lowest effective duties.

Britain's film tariff of August 1947, imposed just weeks after the drafting of the special provisions for films at Geneva, exemplifies the shortcomings of footage tariffs and the intricacy involved in schemes to assess customs duties on earnings rather than length. On 6 August, the British government announced an *ad valorem* duty of 300 percent on first copies of imported films.[7] In effect, the duty amounted to 75 percent of net earnings on film exhibition in Britain, because a film's value for customs purposes was set at one-quarter of "anticipated proceeds," with three times the value payable as duty. The tariff order required distributors of foreign films to forecast gross earnings, less income taxes and labor costs for distribution and exhibition, and pay the Treasury three-quarters of this amount, "pending arrangements fixing final values," before the film could be released to theaters.[8] Operationally, the duty was a second tax on the profits of

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[7] Later copies continued to pay the footage tariff of 5 pence (then roughly 10 cents) per foot.

[8] "British to Tax 75% of U.S. Film Profits," *New York Times,* 8 August 1947, 5.

foreign films in the British market.

Despite the tariff's inventiveness, its purpose was not to promote domestic film production but rather to stem dollar outflows. Profit repatriation by US film distributors amounted to 3.6 percent of Britain's projected dollar deficit for 1947,[9] and the Treasury had considered tightening dollar conservation measures against US films at least since 1944. In March 1947, three months before the Geneva conference's opening, Treasury officials proposed an import licensing program to manage the backlog of US films, but the Board of Trade demurred that this would contravene the national treatment principle in the draft ITO charter (Jarvie 1992, 217-227). However, that summer's sterling crisis forced the Treasury to act: the restoration of current account convertibility on 15 July, as stipulated in the 1945 Anglo-American Financial Agreement, caused capital outflows to hemorrhage. Bliss, the commercial attaché in London, advised the US ambassador that the film duty looked like "a hastily-conceived measure, introduced in an atmosphere of financial panic," exactly the sort of bilateralism that the United States was working to discipline at Geneva. In the larger scheme, Bliss noted, the measure validated the US stance "that import duties represent an unsuitable device for the protection of national film industries," and while the British tariff was not intended to promote national film production, "it nevertheless constitutes a bad example which other nations may take up for protective reasons." To dissuade other countries from emulating the measure, the United States should "maintain consistently that the device of import duties should not be applied to film imports," since the draft charter included an alternative means to protect domestic industry in the special film provisions.[10]

Thus, the British duty stiffened the State Department's resolve to discourage film

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[9] US companies netted $68 million on films distributed in Britain in 1946. British officials projected a dollar deficit of $1.9 billion with the United States and Canada in 1947, according to "The Secretary of State to the Embassy in the United Kingdom," 18 January 1947, U.S. Department of State 1947, 2.

[10] This memo, "Film Financial Problems," 22 September 1947, is reprinted in Jarvie 1992, 238-241.

tariffs. In accepting the legitimacy of quantitative restrictions for films at Geneva, the United States already had shown favoritism not only for quotas over tariffs, but for screen quotas over import quotas. European countries widely used import quotas against foreign films dating to the 1920s, as chapter 5 explains. Germany's licensing system permitted one film import for every domestic production, while France issued seven import licenses and Italy ten for each film produced domestically. These quota restrictions operated at the border, allowing imports in fixed proportions to domestic production. But import quotas could not guarantee adequate screen time for domestic films: distributors would have an incentive to enter foreign films with the best box office prospects until quotas were filled and, if foreign releases were much more popular than domestic films, theater owners could choose to screen them disproportionately. Britain's 1927 Cinematograph Films Act, however, took a multipart approach: a 7.5 percent quota on "renters" (film distributors) along with a 5 percent quota on "exhibitors" (theater owners), with both quotas steadily rising to 20 percent by 1936. In 1938, the quota for renters was changed to 15 percent and the quota for exhibitors to 12.5 percent, with the former set to reach 30 percent and the latter 25 percent by 1947 (Greenwald 1952, 42-43). The distribution quota regulated imports at the border, while the exhibition quota operated behind it.

Britain's objective in the film discussions at Geneva was to negotiate enough leeway for its film policy to conform to the draft charter while avoiding an outright exemption that countries could use as a precedent to extend to other goods or wide-ranging exceptions that other countries might abuse in restricting British film exports. This stance opened the door to a quid pro quo in which the United States accepted the legitimacy of film quotas in return for Britain's agreement that quotas apply only to screen time and not distribution (Jarvie 1992, 251-252). For US negotiators, banning import quotas would guarantee market access, while screen quotas at least would require European films to compete in their home markets with US features showing in the same theater or nearby. As an added benefit, screen quotas, with disciplines on their design,

could be made transparent and simple.

This compromise on screen quotas formed the basis of the special provisions for films that became GATT Article IV. Before these principles could be enshrined in the GATT, however, the British government demanded assurances that removing the quota for distributors would not diminish investment or stop US studios from producing films in Britain. Only US film producers could issue such a promise. Though screen quotas were, as an MPA representative later put it, "the least undesirable method of affording protection to domestic film industries" (Guback 1969, 21), the MPA had to be persuaded to make concessions for treaty language that overtly permitted the use of a trade barrier the group sought to ban. In a letter to MPA President Eric Johnston, William Clayton, who headed the US delegation in Geneva, emphasized that the draft charter included no disciplines to restrain protectionist measures on US films until the Geneva session, but now "by omitting reference to any permissible device other than domestic screen quotas the Charter outlaws all other existing or potential measures which discriminate against American films" (Jarvie 1992, 410). Eighteen days later, the second in command, Clair Wilcox, informed Johnston that Britain would insist on returning to the pre-Geneva text, without the film provisions, if the United States did not accept its reservation. "That would be a disaster, since it would leave all countries free to discriminate against films," Wilcox wrote (Jarvie 1992, 412). In a gentleman's agreement, the MPA pledged to continue financing film production in Britain; in return, Britain accepted GATT rules banning its quota on distributors (Jarvie 1992, 412-413).[11]

The impression that the film provisions were the product of clandestine dealings between the United States and Britain is reinforced by the memo quoted earlier, in which Bliss narrated the negotiations:

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[11] For the MPA, no doubt, it mattered greatly that the British market was "virtually as important as all of the other countries of the world and considerably more important than all of the other seventeen countries with which trade negotiations are to be undertaken." Jarvie 1992, 407.

> Too much publicity should not be given to the specific advantages obtained by the United States in this negotiation, and none at all should be given to the limitations which the Charter places on other countries with respect to film regulations. The Report of the Second Session will be studied carefully by all the Governments meeting in Havana in November. Many of them will observe that Article 19 requires them to modify existing practices and stops them from future action along lines which they may favor. We shall not be completely safe until Article 19 has been finally and definitively adopted at Havana (Jarvie 1992, 412).

Yet the United States managed to transfer the special article for films from the draft ITO charter into the GATT at the conclusion of the Geneva session in October 1947 and then successfully defend these provisions at Havana.

GATT Article IV formed the core of the multilateral regime for trade in cultural goods, specifically films. Since 1960, however, screen quotas have not been an essential instrument of film industry protection, much less cultural policy, with one exception– the case of South Korea, which is analyzed in chapter 5. But while screen quotas declined in importance, Graber (2004, 199-200) notes, "Article IV of the GATT is of methodological interest because it can be interpreted as proof of an old tradition in world trade law of treating cultural issues in a specific way." The specific way in which the GATT treated cultural issues is easily and often misinterpreted, however. The GATT did not exempt motion-picture films from its disciplines and its national treatment exception for screen quotas was precise and narrow. The MFN requirement, the obligation to grant national treatment (except for screen quotas), the ban on import quotas, and the commitment to progressive liberalization all applied to trade in films under the GATT.

A number of factors contributed to the decline of screen quotas in importance, as

chapter 5 explains: the recovery of European film industries, the depletion of the postwar backlog of US films, and declining film output in the United States after the *Paramount* antitrust decision in 1948. Probably the most important cause, however, was competition from an alternative medium for audiovisual entertainment– television. With the growing household penetration of television sets, the new market for television programs tested the breadth and scope of GATT Article IV and offered an early preview of later disputes over trade in cultural goods.

GATT and Television

The Soviet Union's launch of the Sputnik I satellite in 1957 presaged a revolution in the delivery of filmed entertainment. Five years later the Telstar satellite orbiting over North America transmitted the first transatlantic television signal. The growing potential for satellite communications raised new opportunities and new challenges for broadcasters, producers of television programs, and governments. In anticipation of technological developments, political debate over trade rules for television entered the GATT in 1961, six months before Telstar's launch into space. The pivotal question in this debate was: did television fall under the provisions of GATT Article IV? Or was television program distribution a service, not a good, and hence outside the jurisdiction of the GATT?

These questions were heavily contested in the GATT. In broaching the subject, the United States asserted that the exceptions for motion-picture films in Article IV did not apply to television programs, thus restrictions on imported television programs violated the national treatment requirement in Article III. Rather than insisting on full national treatment for television programs, however, the United States proposed the establishment of new obligations on contracting parties that would balance national desires to ensure sufficient local programming with the principles of transparency and fairness in international trade policy. The US position provoked dissent, particularly from France, in the GATT working party formed to study the matter. The failure to reach

consensus left the relevance of the GATT to trade in television programs unresolved.

Three important considerations underpinned the debate over the applicability of the GATT to television. First, the advent of satellite made television programs more easily tradable. Television programs were tradable before satellite, of course, as copies transferred to videotape could be physically delivered to television stations for broadcast over the air, just as motion-picture films were traded by transporting reproductions of the original chemical print to theaters for exhibition. But satellite allowed the retransmission of television signals over long distances without the incremental cost of distributing videotape copies to broadcasters, and this extended the potential scope of the market for television programs substantially. For producers positioned to benefit from this new technology, delivering a television program for broadcast to consumers in other countries generated additional license fees and cost no more than servicing domestic audiences.

Second, while satellite technology increased opportunities for trade, it did not increase the size of the market for television programs. To be sure, households in rich countries were purchasing television sets and people were watching more television, but the large infrastructural investment required for television broadcasting and the shortage of frequencies in the electromagnetic spectrum restricted the size of the overall market. Governments regulated entry by issuing broadcast licenses to allocate spectrum space, and over-the-air signals allowed room for three or four channels (Hoskins, McFadyen, and Finn 1997, 19). More trade therefore meant greater competition among producers of television programs for relatively fixed demand. This made producers in net importing countries– essentially, everywhere except the United States– a natural constituency for trade protection. In Europe, where countries outlawed private networks until the 1970s, state control of broadcasting enhanced the temptation to satisfy protectionist interests.

Third, satellite transmits television signals over a wide terrestrial range, with no regard for national borders. Television stations could access programs from a provider located in another country and rebroadcast them to domestic audiences. Even states that

did not allow private broadcasting faced the challenge of regulating the transmission of television signals that bypassed customs. Exerting control over content naturally became more of a concern, whether it was protecting viewers from indecent material or ensuring a satisfactory supply of national-origin programs.

For the United States, whose producers benefited from the wider market for their television programs but faced protectionist measures abroad, the purpose of bringing the matter to the GATT was to discipline the use of trade restrictions. The core of the US government's case was that television programs were, like motion-picture films, goods subject to GATT rules, but Article IV precisely specified films for exhibition in theaters, so its provisions could not apply to videotapes of programs for broadcast on television. At the same time, the United States acknowledged television's similarity to films, noting "its importance as a cultural and informational medium," and it accepted the right of governments to maintain standards in broadcasting. It proposed amending the GATT "so that exhibition time may be reserved for material of national origin while at the same time fair access may be assured the imported product" (GATT 1961, 1; GATT 1961, 2).

The United States sought special provisions for television programs akin but not identical to those in Article IV on the grounds that market forces restrained protectionist pressures in motion-picture films more than in television broadcasting. In motion-picture films, consumers enjoyed a wide range of choices of locations and times of day, ensuring competition among theaters to screen films that would maximize audience size, hence revenues, irrespective of national origin. This gave cinema owners an incentive to push the state to permit ample screen time for imported films because, without popular foreign features, theaters in net importing countries would be unprofitable. "For this reason," a US brief concluded, "it was safe to draw up Article IV on the assumption that popular and commercial pressures would prevent a government from limiting too drastically the use of imported films." In television, by comparison, markets placed less of a brake on protectionism. For one, television gave consumers fewer choices: restricted competition

among relatively few television stations limited viewers to a small number of programs at any given time. Moreover, quotas were not a major threat to broadcasters because profits depended less on a program's popularity than on the cost of the license fee negotiated for the right to air it. Since broadcasters lacked the same incentive to defend the prerogative to televise foreign programs, it was up to the GATT "to establish criteria to limit the size of domestic screen quotas for television programs" (GATT 1961, 1-2; GATT 1961, 3).

The US government's proposed amendment to the GATT contained three main provisions. First, as in the special provisions for films, countries regulating content on television would have to use quotas expressed as a share of total viewing time. Second, countries would have to grant imported programs "a reasonable proportion of viewing time… with due regard for favorable viewing hours," and quotas could not discriminate among foreign sources of supply. Third, broadcasting quotas would remain "subject to negotiation for their limitation, liberalization, or elimination" (GATT 1962, 2). The key provision was the second, which stipulated "reasonable" time for foreign programs and standards for viewing hours– obligations that did not apply to motion-picture films. The objective, laid out in a subsequent US recommendation, was to establish "that restrictions on international trade in television programs should be limited to a minimum and that in the selection of television programs broadcasting organizations should be allowed the greatest possible freedom of choice as between domestic and imported material" (GATT 1964, 1).

Members of the GATT working party raised several objections to this proposal. In one view, because the development of television technology was not foreseen when the GATT was negotiated, the provisions for films should apply to broadcasting– particularly since the US proposal stipulated "reasonable time" and "favorable hours," new obligations that were not easily defined in practice. A stronger argument was that television programs are a service, not a good, or that there is no basis to differentiate programs delivered as services (broadcasts via satellite) from those delivered in physical

form (recorded on videotape). In an annex to the report, the French delegation argued that television technology was advancing too rapidly to anticipate the effects of any new rules, so the matter was best left outside the GATT (GATT 1962).

The absence of consensus in the working party meant that amending the GATT to address trade in television programs was impossible, and at most Article IV applied for television programs traded as physical materials but not those transmitted by satellite or, later, cable, microwave, and the Internet. Though the status of the GATT for trade in television programs was left unresolved, the issue receded from view. "For whatever reasons," Acheson and Maule (1999, 6) note, "no cultural industry complaints were adjudicated under the old GATT." The entire history of GATT dispute settlement mentions Article IV just once in 101 panel reports, in a passing reference to the MFN obligation (GATT 1982).

Twenty-five years later, in the midst of the Uruguay Round negotiations, the United States reopened the debate over trade rules for television programs. In a request for consultation days after the EC Council of Ministers approved the *Television without Frontiers* directive, the United States contended that the directive's content rules for broadcasting, which are analyzed in chapter 5, nullified and impaired its benefits under the GATT (GATT 1989). A separate request for consultations protested a French statute reserving 60 percent of prime time programming to shows of European origin (GATT 1990). The European Commission countered that GATT rules did not cover television broadcasting (GATT 1989). With trade in services on the table in the Uruguay Round, the matter was absorbed into the ongoing negotiations and never progressed to dispute settlement (GATT 1990).

The Uruguay Round

Audiovisual services were the last sticking point in the Uruguay Round and in the final days of negotiation in December 1993 the issue threatened to derail the whole agreement.

In the end, an agreement to disagree on audiovisual services allowed the negotiations to conclude, preserving the intricate structure of the Uruguay Round's Final Act. In this arrangement, audiovisual services were not excluded from the GATS, but countries could either limit or decline to enter commitments to market access and national treatment, and they could maintain measures that deviated from MFN as long as these were specified in advance. By omitting audiovisual services from their GATS schedules countries could, at their discretion, protect domestic producers for cultural or other reasons. Though the GATS included timetables for negotiations on three other unresolved sectors– financial services, maritime transport, and telecommunications– it made no provision for talks on audiovisual services. But its incomplete coverage of audiovisual services ensured that the issue would remain an ongoing subject of discussion in the WTO.

Technological innovations increased trade in audiovisual services, adding urgency to the GATS negotiations and raising the stakes for its participants. In the early 1980s, videocassette recorders achieved mass market success, creating a new demand for video purchases and rentals. By the mid-1980s, cable television systems were being launched in the United States and Europe. The larger channel capacity of cable systems required broadcasters to produce or buy programming to fill significantly increased airtime, again enhancing the demand for filmed entertainment. When British Sky Broadcasting started the first direct broadcast satellite service in 1989, broadcasters began to deliver content directly to household television sets from space. With digital compression and the expansion of fiber optic lines, platforms for delivering audiovisual content (subscription channels, pay-per-view, and video-on-demand) were multiplying concurrent with the expansion of transmission methods (satellite and cable along with terrestrial signals). These developments benefited US producers above all, as chapter 2 detailed: US movies dominated the videocassette rental market and US exports of television shows flourished, particularly to newly-established television stations and satellite services in Europe.

Because these new technologies for delivering audiovisual services created a vast

potential market for US producers, the US government could be expected to press firmly for liberalization in the Uruguay Round. As in past negotiations, US officials maintained that audiovisuals were no different than any other service and should be subject to the same trade rules: concepts such as "cultural identity" were too elastic to serve as the basis for a broad exemption. Three specific problems occupied the USTR negotiating team. The first was to freeze EC broadcasting quotas by securing a pledge to keep pay-per-view, video-on-demand, and other new technologies quota-free. Second, the USTR wanted to roll back existing EC quotas. Third, the USTR sought national treatment in audiovisual subsidies so that US producers would be eligible for funds raised through taxes on box office receipts and blank videotape cassette sales in the EC.

The French government, on the other hand, sought to avoid any commitments for audiovisual services and, with Spain and Italy in support, pushed for a cultural exemption from the GATS. The focus of this effort was to add audiovisual services to the "General Exceptions" clause in GATS rules.[12] However, the European Commission, with British and German backing, instead advanced a "cultural specificity" formula that would keep audiovisual services within the GATS framework so that most of the general principles applied while freeing the sector from specific obligations regarding MFN, market access, and national treatment. This involved a multipart approach to incorporate a permanent exemption from MFN in an annex to Article II; a "flexibility" provision in Article XV to allow subsidies, content rules, and screen quotas; and a "cultural values" clause in Article XIX to exclude audiovisual services from the commitment to progressive liberalization (Paemen and Bensch 1995, 233-234; Messerlin 2000, 306-307).

Despite these differences, audiovisual services did not become a focus of debate until late in the GATS negotiations. Early discussions concentrated on financial services,

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[12] GATS Article XIV recognized exceptions for measures "to protect public morals or to maintain public order… [and] human, animal, or plant life or health," and "to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement." WTO 1994.

maritime transport, and telecommunications, and negotiations for all three sectors would extend past the Uruguay Round's conclusion. According to Hugo Paemen, the Deputy Director General for External Relations and head of the EC negotiating team, the United States announced its intention to limit national treatment and market access for financial services and maritime transport as a bargaining chip against the EC's desire to keep audiovisual services out of the GATS.[13] Only after several countries made commitments for maritime transport did the United States shift attention to audiovisual services. At that point, the EC offered to freeze broadcast quotas (Paemen and Bensch 1995, 233-234), effectively a pledge that the revised *Television without Frontiers* directive in 1997 would not tighten existing quotas (though the EC would remain free to extend the quotas to new technologies).

Both parties hardened their stance on audiovisual services as the December 15 deadline for concluding the Uruguay Round neared. A week before the deadline, Leon Brittan, the Director for External Relations for the EC, withdrew the standstill offer on broadcast quotas (Paemen and Bensch 1995, 245-246). In the final days of negotiations, USTR Mickey Kantor proposed that the EC remove programming quotas in prime time, apply quotas to only half of cable stations as new channels became available, and refrain from extending quotas to new technologies.[14] When the EC rejected these proposals, Kantor offered to accept EC broadcast quotas in return for limits on aircraft subsidies, if the EC would eliminate taxes on box office tickets and blank videocassettes or allow US producers to share in the proceeds. According to Dryden (1995, 389), "Kantor pushed Brittan on the entertainment programming issue all the way until the dawn of December 14." But EC negotiators would agree to nothing more than a standstill on broadcasting

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[13] Paemen criticizes USTR officials for "their failure to comprehend the European position" and notes that the EC "did not wish to exclude audiovisual services from the agreement. It simply wanted the unique nature of such culture-related matters to be given proper recognition." Paemen and Bensch 1995, 164.

[14] "With Time Waning, Europeans Reject US Movie Compromise," *New York Times,* 14 December 1993, A1.

quotas in return for a similar pledge from the United States on maritime transport. On the last day of negotiations, Brittan renewed the standstill offer on existing quotas (Paemen and Bensch 1995, 246-247). Dryden (1995, 389) writes, "Kantor finally called Clinton in Washington and laid out the EC's final offer. The president thought about it a while and then called back to say no, it wasn't enough."

Clearly the EC's last best offer on audiovisual services was too far short of the Clinton administration's minimum objectives. From the start, MPA President Jack Valenti had staked out the position that the United States "should sign a GATT accord only if TV Quotas are phased out over a number of years with a specific guarantee of that implementation." If the final agreement failed to achieve this aim, Congress "must not approve any GATT concord which leaves in place and undisturbed those unacceptable European Community TV Quotas" (U.S. Senate 1991, 150-151). To keep the pressure on, Valenti lined up 34 senators to sign a letter stating that the services agreement would be "seriously flawed" if it allowed the EC to retain its broadcast quotas. The MPA felt it had the "total support" of Bush's USTR.[15] Surely its influence was at least as great with Clinton, who relied on Hollywood's financial contributions in the 1992 campaign. Both Dryden (1995, 389) and Véron (1999, 3) state that Clinton made promises regarding the GATT negotiations to entertainment executives at a Democratic Party fundraiser in Los Angeles in the Uruguay Round's final days. But much as Kantor tried to convince EC negotiators that failure to budge on audiovisual services would be a deal breaker, Brittan, GATT Director-General Peter Sutherland, and other European officials clearly stated that they did not believe the United States would scuttle the entire Uruguay Round agreement over "film tickets and cassettes," as one official put it.[16]

By agreeing to disagree, the United States had not accepted the legitimacy of

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[15] "An Uncommon Market for US Entertainment," *Los Angeles Times,* 5 December 1990, F2.

[16] "With Time Waning, Europeans Reject US Movie Compromise," *New York Times,* 14 December 1993, A1.

broadcasting quotas and could challenge them in dispute settlement because without a cultural exemption, the general obligations of the GATS covered audiovisual services. As President Clinton's notification to Congress stated, "until we reach a satisfactory agreement, we think we can best advance the interests of our entertainment industry by reserving all our legal rights to respond to policies that discriminate in these areas."[17] However, there would be no legal basis for challenging broadcast quotas under GATS because the EC and other countries as well could enter MFN reservations for specific audiovisual policies and exclude the sector from their lists of market access and national treatment commitments. French Communications Minister Alain Carignon explained: "We got what we wanted from the start, which is basically the cultural exception."[18]

In credibly committing to block a GATT agreement that included audiovisual services, France, backed by Spain and the EC culture ministers, proved to be a more powerful veto player than the MPA and its Congressional allies. Carignon, along with Foreign Minister Alain Juppé and Culture Minister Jacques Toubon, repeatedly pressed Brittan to keep audiovisual services off the table.[19] All twelve EC ministers of culture declared their support for the cultural exemption. When the USTR proposed a deal on cinema taxes and subsidy programs, actors and directors throughout the EC mobilized pressure on the European Parliament to make sure EC negotiators did not concede the issue.[20] Late in the negotiations the Council of Ministers, whose assent was required to ratify the final agreement, left Brittan little room for flexibility on audiovisual services. Paeman attributes Brittan's late withdrawal of the standstill offer to "a highly political negotiating mandate," which prevented "even a temporary abandonment of the restrictive regulations governing the provision of audiovisual services via future technologies."

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[17] Letter to Congressional Leaders on the General Agreement on Tariffs and Trade, 15 December 1993, *Weekly Compilation of Presidential Documents,* vol. 29, no. 50, 2602.

[18] "US Opts to Bide Time on Audiovisual Battle," *Financial Times,* 15 December 1993, 6.

[19] "Brussels Tries to Calm French Audiovisual Concerns," *Financial Times,* 5 October 1993, 8.

[20] "French Film Industry Circles the Wagons," *New York Times,* 18 September 1993, 11.

While briefing the ministers on the day before the Uruguay Round deadline, "Brittan discovered that his mandate on audiovisual matters had toughened" (Paemen and Bensch 1995, 245-246). With EC negotiators facing such tight institutional constraints on their authority, an agreement to disagree appears to have been the only viable compromise.

Audiovisual Services in the GATS

The text of the GATS reflects the difficulty of crafting a single set of rules to cover all service sectors and countries. To resolve this dilemma, the GATS established a set of broad disciplines while also allowing countries the flexibility to qualify or even avoid certain commitments. Incorporating flexibility enabled countries, at their discretion, to keep trade measures in any service sector outside the scope of GATS disciplines. In practical effect, the result for audiovisual services resembled the "cultural specificity" treatment that the EC sought– but without any explicit recognition of a national right to regulate trade for cultural purposes.

The first part of the GATS is the framework agreement, which establishes the treaty's general obligations. Its key principles are MFN (Article II), transparency in the regulation of trade in services (Article III), commitments to market access (Article XVI) and national treatment (Article XVII), and the negotiation of progressive liberalization (Article XIX). The second part, the annexes to the framework agreement, covers MFN exemptions and rules for certain sectors. The third part includes the schedules of MFN exemptions and market access and national treatment commitments for GATS parties. Countries may opt out of MFN commitments for specific trade measures, and they must opt in to market access and national treatment commitments. This means that the MFN obligation covers all services except those listed in a country's schedule of exemptions; market access and national treatment obligations, conversely, apply only to the sectors listed in a country's schedule of commitments. The schedules distinguish four modes of

supply, based on how services are delivered into national markets.[21] Countries therefore may limit their scheduled commitments by mode of supply for each sector.

The option to take MFN exemptions and qualify or decline market access and national treatment commitments allowed countries that sought to maintain protection for audiovisual services to place broadcasting quotas and content rules outside the disciplines of the GATS. Article XVI prohibits quotas on the number of suppliers, the value of transactions, or the quantity of output, while Article XVII stipulates that foreign service suppliers must be treated no less favorably than domestic suppliers of the same service. These disciplines provide a basis to challenge broadcasting quotas– but only countries that listed audiovisual services in their scheduled commitments are bound by market access and national treatment obligations.[22] Countries that made no commitments for audiovisual services, or only qualified commitments, have no obligation to eliminate broadcasting quotas or content rules, and may tighten existing measures (Bernier 2004, 226-227). In addition, MFN exemptions under Article II enable the EC and other regional trading arrangements to maintain preferences by counting the services of partner countries as national under broadcasting quotas and content rules (though these preferences may be permissible under the economic integration provisions in Article V).

Countries determined to maintain domestic subsidy programs also could opt out of GATS disciplines on the allocation of subsidies. If a country's schedule listed audiovisual services without limitations, it would have to offer subsidies to domestic and foreign producers alike. But countries could preserve subsidies exclusively for domestic producers– such as the French and German film funds, which are financed by a tax on

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[21] These are cross-border supply (the supplier and the buyer remain in separate countries); consumption abroad (the buyer travels to the supplier's country to consume the service); commercial presence (the supplier establishes a business enterprise in the buyer's country to deliver the service); and presence of natural persons (the supplier travels to the buyer's country to deliver the service).

[22] For example, New Zealand backed away from establishing content rules in 2001 after the USTR cited a proposed directive as a violation of GATS obligations.

cinema admissions– by omitting audiovisual services from their schedules, or by limiting national treatment commitments.[23] Similarly, exemptions from MFN permit countries to discriminate among foreign suppliers in the provision of subsidies, as in the case of the EC Media and Eurimages programs (Bernier 2004, 231-232).

GATS rules for types and amounts of subsidies also are permissive. Article XV notes that subsidies can distort services trade, and it allows countries "adversely affected" by another member's subsidies to request consultations. But countries cited for trade-distorting subsidies must merely discuss the matter with "sympathetic consideration." Article XV leaves consideration of the types and effects of different subsidy programs and the "appropriateness of countervailing procedures" for future negotiations, though it specifies no schedule for the initiation or completion of these discussions (WTO 1994, 296). In the absence of disciplines on subsidies, a country could lodge an Article XXIII "non-violation" complaint against a subsidy that, while not inconsistent with the GATS, nevertheless nullifies or impairs a benefit anticipated under its terms. However, no remedy is available if the responding country undertook no commitments in the sector, or limited its commitments to preserve the subsidy (WTO 1996, 12).

An appraisal of the scheduled commitments and MFN exemptions under GATS illustrates the extent to which WTO members remain free to favor domestic producers of audiovisual services with content rules and subsidies. Just nineteen countries included audiovisual services in their scheduled commitments, of which only the United States and the Central African Republic made market access and national treatment commitments in all six categories of audiovisual services. Thirty-three countries listed MFN exemptions for audiovisual services, mostly for co-production treaties or preferences in subsidy programs (WTO 1998, 7-8). The United States made "very liberal commitments" for

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[23] For example, the United States limited its national treatment commitment by specifying that only US citizens and permanent resident aliens qualified for National Endowment for the Arts grants; New Zealand listed an exemption for the New Zealand Film Commission.

audiovisual services, limiting national treatment for NEA grants and market access to maintain citizenship requirements in broadcast licensing and media cross-ownership restrictions in local markets (WTO 1996, 171-172). However, the EC and Canada made no commitments for audiovisual services, and these countries listed numerous MFN exemptions (U.S. International Trade Commission 1995, chap. 5, 17-22). The EC and Canada also specified their MFN exemptions as indefinite in duration, even though the Annex on Article II Exemptions stipulates that exemptions are temporary (no more than ten years) and subject to review after five years to verify that the conditions necessitating the exemption still apply.

In view of the limited number of national commitments in audiovisual services, the built-in negotiating agenda in Article XIX guaranteed that the disagreements of the Uruguay Round would be revisited. Originally scheduled for January 2000, the GATS 2000 negotiations were finally launched with the opening of the Doha Round, and countries were given until the end of March 2003 to make offers and issue requests of others (Graber 2004, 165-166). Though the principle of progressive liberalization did not obligate countries that left audiovisual services out of their schedules to yield to demands that they increase their commitments in this sector– to the contrary, the EC, Canada, and others that opted out of market access and national treatment requirements could apply new and more restrictive trade measures without breaching the GATS– it did obligate them to again face pressure from the United States to open up.

GATS 2000

The GATS 2000 negotiations have taken place in an environment of dramatic change in technology with the convergence of telecommunications and broadcasting through digital means of delivering audiovisual content. Whereas audiovisual sector disagreements in the Uruguay Round focused on film production and distribution and terrestrial and cable television, the GATS 2000 discussions encompass direct-to-home satellite broadcasting,

broadband multimedia networks, e-commerce, and other new technologies that were only dreamed of at the time of the Uruguay Round.

Despite these innovations in technology, the bargaining stances of the principal countries hardly changed. An October 1999 Council of Ministers directive instructed the European Commission to "ensure, as in the Uruguay Round, that the Community and its Member States maintain the possibility to preserve and develop their capacity to define and implement their cultural and audiovisual policies for the purpose of preserving their cultural diversity."[24] Accordingly, the EC included no new commitments for audiovisual services in its 2003 offers and solicited none from others in its 2005 requests. Canada similarly pledged not to make "any commitment that restricts our ability to achieve our cultural policy objectives until a new international instrument, designed specifically to safeguard the right of countries to promote and preserve their cultural diversity, can be established" (WTO 2001, 2). At the other axis, the United States, Japan, China, Taiwan, and Mexico have criticized "efforts by some key participants in the negotiations to create an a priori exclusion" for audiovisual services (WTO 2005, 1). In the middle, countries such as Brazil and Switzerland have embraced the inclusion of audiovisual services in progressive liberalization while also recognizing the need for a formal mechanism to allow governments to safeguard cultural diversity, either through an enabling clause (WTO 2001, 2-3) or some other instrument (WTO 2001). As Graber (2004, 169) notes, "there is still a very wide gap separating the countries with strong export interests from those wanting to protect their domestic industries for cultural and/or economic reasons."

The contentious problem of subsidies for audiovisual services is one unsettled issue from the Uruguay Round. Before the start of the GATS 2000 negotiations, the WTO Secretariat observed that "[s]ubstantial subsidies are granted in a number of WTO

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[24] "The General Agreement on Trade in Services (GATS) and the Doha Development Agenda: A Brief Introduction on the GATS," European Commission, http://ec.europa.eu/comm/avpolicy/ext/multilateral/gats/index_en.htm.

members" (WTO 1998, 6), and a survey of forty-four Trade Policy Reviews found audiovisual subsidies in more countries, seventeen, than any other service sector.[25] Both Switzerland and the United States have advocated stronger disciplines on subsidies for audiovisual services. The US position would permit "carefully circumscribed subsidies for specifically defined purposes" while proscribing subsidies with trade-distorting spillover effects. In this view, GATS rules "need not necessarily restrict government subsidies for domestic film production and distribution, as long as subsidies are not derived from discriminatory practices" (WTO 1998, 3). This would target subsidies raised through box office taxes, which exist in France, Germany, and Sweden.

To date little progress has been made on subsidies, as the other unfinished issues in the GATS, emergency safeguards and government procurement, have received more attention. Reflecting the contentiousness of the subsidy issue, the GATS specified dates for initiating negotiations on emergency safeguards and government procurement, and also a deadline for completion for emergency safeguards, but it included no schedule for initiating or completing negotiations on subsidies. The Working Party on GATS Rules circulated a checklist of issues in 2000 and developed a work program on subsidies only in July 2001, giving members until March 2003 to submit proposals. But the paucity of official documents on the issue suggests that negotiations have not progressed very far since the initial communications (Bellis 2004, 304-306).

GATS versus GATT

Parallel agreements for trade in goods and trade in services, along with uncertainty over the classification of filmed entertainment products, raise the issue: which rules apply, particularly when countries disagree on obligations under the WTO? As chapter 2 noted, the original filmed entertainment products, motion-picture films, were services embodied

[25] These included tax incentives and direct grants in the fifteen EC member states and direct grants in Canada and Norway. WTO 1998, 2.

in a physical good– a chemical print (a good) stored the images and sound for exhibition to audiences (a service). With the advent of television, programs retained the service bundled in a good quality (when recorded to videotape), but they could be delivered as pure services as well (when transmitted to broadcasters via satellite). Technological innovation in home video produces these same features: at first, consumers bought videotapes or disks; now there is the option of selecting the same services through cable set-top boxes or downloading them from the Internet. For most audiovisual services consumers may choose the vehicle for delivery, physical good or intangible service.

In the WTO, filmed entertainment falls under the stricter GATT rules for MFN, national treatment, and market access when traded as goods; when traded as services, the softer disciplines of the GATS, which allow countries to take MFN exemptions and limit market access and national treatment commitments, apply. In the special provisions for films in Article IV, the GATT specified how countries should regulate the supply of a service (screen quotas for film exhibition) on the grounds that the means of delivery was a good (a chemical print). Since the debate over GATT rules for television programs in the early 1960s, however, countries have disputed whether and in what circumstances filmed entertainment should be treated as a good or as a service.[26] The practical effect is that the older technology, motion-picture films, clearly falls under the GATT, because of Article IV and the technical difficulty of unbundling the service from the good, while the GATS by default covers newer technologies (television programs and home video, where the service is delivered either as a service or as a good) due to the unresolved debates of the last forty years.

Thus, trade disciplines are tougher for older technologies than for newer ones. In the 1997 WTO case *Turkey– Taxation of Foreign Film Revenues,* for example, the United

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[26] In the EC, the ECJ ruled in the 1974 *Sacchi* case that the broadcasting of television signals constitutes a service under the Treaty of Rome, while trade in objects designed to deliver content via television (such as films, videotapes, and sound recordings) falls under rules for the movement of goods.

States protested Turkish cinema taxes as a violation of national treatment on the grounds that the tax discriminated against foreign films. In a mutually agreed solution, Turkey pledged to equalize the tax on domestic and foreign films.[27] If the differential tax instead had been applied to a newer media, Turkey's omission of film distribution from its GATS schedule likely would have shielded the measure from legal challenge.

In a case with the potential to serve as a precedent for the good versus service distinction, *Canada– Measures Affecting Film Distribution Services,* the EC declined to request the formation of a panel. The dispute centered on provisions in the 1988 Investment Canada Act that restricted foreign companies to distributing only films for which they held proprietary rights. Because a grandfather clause exempted US studios already established in Canada from these restrictions, the Dutch-owned Polygram received less favorable treatment after it established a Canadian subsidiary for film distribution in 1997. In a filing with the WTO, the EC charged that these provisions breached Canada's MFN and transparency obligations in the GATS because, while Canada had taken an MFN exemption for film and television co-production, it had not limited film distribution.[28] However, the case was tabled when the Canadian-owned Seagram acquired Polygram in 1998 (Acheson and Maule 1999, 313-317).

The development of trade rules for services also raises the possibility that a country could face a challenge under the GATT for a measure maintained through a reservation legitimate in the GATS. For example, the WTO Appellate Body in *Canada– Certain Measures Concerning Periodicals* concluded that the GATS and the GATT were not mutually exclusive; rather, "obligations under GATT 1994 and GATS can co-exist and… one does not override the other." In *European Communities– Regime for the*

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[27] "Dispute DS43: Turkey– Taxation of Foreign Film Revenues," WTO, http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds43_e.htm.

[28] France opposed pursuing the case out of support for Canadian cultural initiatives, and because French companies generally used Canadian distributors for their films.

Importation, Sale and Distribution of Bananas, the Appellate Body reaffirmed its finding in *Canada– Periodicals* and went a step further, explicitly recognizing the potential for the two treaties to separately impose obligations on the same trade measure: while GATT covers measures affecting "trade in goods as goods" and GATS covers measures affecting "the supply of services as services," a third class, "measures that involve a service relating to a particular good or a service supplied in conjunction with a particular good," falls under both GATT and GATS. In these situations, the Appellate Body concluded, the relevant obligations "can only be determined on a case-by-case basis."[29]

Now that the digital revolution has placed electronic commerce on the table in the GATS 2000 negotiations, the distinction between goods and services has gained urgency. The European Commission takes the position that entertainment delivered digitally is a service– a stance that would preserve MFN exemptions and limitations on market access and national treatment for these products. The United States rejects the "all services" classification and argues that some of these products should fall under GATT rules for goods, which would make it more difficult for countries to extend cultural policies to digital products (Drake and Nicolaïdis 2000, 408-409).

What appears to be an esoteric dispute over taxonomy in fact carries significant ramifications: a broad class of products could lose privileges granted under trade rules simply because of the emergence of a new technology for delivering them to consumers. As part of its campaign to "keep digital networks free of cultural protectionism," the MPA has pushed for an understanding to prevent digital products from being reclassified as services.[30] Thus, the persistence of the unresolved debate over the treatment of filmed entertainment, starting with television in 1961, leaves considerable room for countries to

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[29] "WTO Analytical Index: General Agreement on Trade in Services," WTO, http://www.wto.org/English/res_e/booksp_e/analytic_index_e/gats_01_e.htm.

[30] "Impediments to Digital Trade," Committee on Energy and Commerce, US House of Representatives, http://energycommerce.house.gov/107/hearings/05222001Hearing231/Richardson343.htm.

extend to new technologies cultural policies that trade rules prohibited for motion-picture films under the GATT.

The NAFTA Cultural Exemption

While the global trade regime has never recognized a cultural exception from trade rules, Canada has consistently insisted on cultural exemptions in its bilateral trade agreements starting with the FTA in 1988. The MacDonald Commission, which recommended the negotiation of free trade with the United States, nonetheless advised that Canada seek "explicit treaty provisions that would authorize public funding of… cultural industries and permit affirmative discrimination for Canadian producers" (Royal Commission on the Economic Union 1985, 310). In the midst of the negotiations, Prime Minister Brian Mulroney criticized USTR Clayton Yeutter of "stunning ignorance" for suggesting that cultural industries should be part of the agreement.[31]

In the FTA, Canada resisted US pressure to include cultural industries. Article 2005 states that "[c]ultural industries are exempt from the provisions of this Agreement, except as specifically provided" elsewhere in the FTA,[32] reserving for Canada the right to broadly regulate trade and FDI in the cultural industries.[33] The next paragraph, which is analyzed later in this section, reads: "Notwithstanding any other provision of this Agreement, a Party may take measures of equivalent commercial effect in response to actions that would have been inconsistent with this Agreement but for paragraph 1."[34]

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[31] "Mulroney Hits at Yeutter on Trade Talks," *Financial Times,* 6 February 1987, 4.

[32] Article 401 eliminates tariffs on certain cultural products; Article 1607 establishes rules for Canadian divestiture orders in the cultural industries; Article 2006 addresses copyright laws in the retransmission of television signals; and Article 2007 requires changes in Canada's income tax laws relating to deductions for advertising in periodicals.

[33] In Article 2012, the cultural industries encompass five sets of activities: books, magazines, periodicals, and newspapers; film and video recordings; audio and video music recordings; music publishing; and radio and television broadcasting, including cable and satellite.

[34] Canada-US Free Trade Agreement (1989), Chapter Twenty: Other Provisions,

The MPA fought the cultural exemption in the FTA, to no avail. After the negotiations concluded, Secretary of State James Baker reportedly phoned Valenti to say, "I'm sorry, Jack. We had to throw you overboard."[35] Of particular concern to the MPA was that the cultural exemption could serve as a model for the EC in the Uruguay Round. The launch of trilateral NAFTA negotiations provided an opportunity to roll back the FTA cultural exemption. In Congressional testimony, Valenti maintained that if Canada insisted on transferring the "cultural exclusion" to the NAFTA, the United States "must walk away from that table, or sign an agreement with Mexico only" (U.S. Senate 1991, 69). As in the Uruguay Round, the MPA mobilized Congressional pressure on US trade negotiators: in a letter to USTR Hills, five representatives urged the USTR "to use the new negotiations as an opportunity to reverse the damaging precedent ensconced in the Canadian FTA," because the EC had "already cited Canada's cultural exemption as a precedent" for its broadcast quotas (Robert 2000, 87). Before the NAFTA negotiations were underway, Hills and her deputy Julius Katz indicated that they intended to revisit the exemption for cultural industries.

Canadian trade negotiators faced equally keen pressure to defend the cultural exemption in the NAFTA negotiations. The Cultural Industries Sectoral Advisory Group on International Trade and the Canadian Culture-Communications Industries Committee, both of which had pushed for the cultural exemption in the FTA, lobbied to preserve it in the NAFTA. At an April 1991 conference on the NAFTA talks, Canadian Minister for International Trade Michael Wilson made it clear that Canada would not yield on the cultural exemption, stating that he would not "let the United States get through the back door what it failed to get through the front door" (Cameron and Tomlin 2000, 77).

The cultural exemption had to be revisited, however, because NAFTA rules were

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http://wehner.tamu.edu/mgmt.www/NAFTA/fta/20.htm.

[35] "An Uncommon Market for US Entertainment," *Los Angeles Times,* 5 December 1990, F2.

written to cover everything that was not explicitly exempted from the treaty, while the FTA applied only to areas explicitly included. Canada's strategy was to avoid bargaining meticulous reservations chapter-by-chapter, but the negative list formula made the status quo more difficult to defend. The cultural issue was contested through the final hours of negotiations in the summer 1992, when Canada's insistence on preserving FDI screening caused the USTR to push more firmly on cultural trade (Cameron and Tomlin 2000, 97, 142-143, 159-160). But the Bush administration's impatience to initial a draft treaty in time for the Republican National Convention in August weakened its leverage. As one high-level official noted, "Canada could just keep saying no, no, no and the US would have to concede in order to get a deal." Another explained: "How long do you hold out? We knew we were going to catch hell for the Canadian cultural exemption, and we got roasted. But Canada was simply not going to yield on it" (Cameron and Tomlin 2000, 173).

After briefing President Bush, Hills agreed to drop the cultural issue; the USTR determined that carrying forward the FTA provisions would be less meaningful for the Uruguay Round than the creation of new language exempting cultural goods.[36] Annex 2106 of the NAFTA incorporated the cultural exemption by reference to the FTA:

> Notwithstanding any other provision of this Agreement… any measure adopted or maintained with respect to cultural industries… and any measure of equivalent commercial effect taken in response, shall be governed under this Agreement exclusively in accordance with the provisions of the Canada-United States Free Trade Agreement.[37]

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[36] Hills secured Canada's conciliation on the last issue, textile rules of origin, telling Wilson, "I just burned Jack Valenti. You don't expect me to give up on textiles too, do you?" Cameron and Tomlin 2000, 174.

[37] The North American Free Trade Agreement, Chapter Twenty-One: Exceptions, Foreign Affairs and International Trade Canada, http://www.dfait-maeci.gc.ca/nafta-alena/chap21-en.asp.

The cultural exemption was limited to Canada and the United States only, however. Mexico, which saw a potential market in the United States for Spanish-language programming, did not seek a cultural exemption in the NAFTA, though it did claim specific reservations in Annex 1 to maintain its film screen quota at 30 percent and to restrict foreign ownership of cable television services to 49 percent.

The MPA lobbied once more to reopen the issue in an attempt to eliminate the cultural exemption before the NAFTA was signed in the fall 1992. Valenti warned Congress of a "fatal flaw," the "unacceptable" extension of the FTA cultural exemption, which left Canada "free to impose any manner of barrier, quota, levy or exclusion on US 'cultural' industries." Under questioning, Valenti emphasized the NAFTA precedent for the Uruguay Round and its relevance for the EC, where MPA companies earned half of their revenues (U.S. House of Representatives 1992, 179-181, 217-219).

Though US trade negotiators, recognizing Canada's commitment to preserving the FTA cultural exemption, did not push the issue too hard, the United States did retain the capacity to make cultural measures costly. USTR Hills testified that the NAFTA "cultural derogation" meant that "if we suffer any economic harm as a result of their exercising any rights pursuant to that cultural derogation, we reserve the right to retaliate" (U.S. House of Representatives 1992, 23). In this view, the "notwithstanding" clause in the second paragraph of FTA Article 2005 allowed the United States to retaliate against an equivalent amount of trade for any Canadian measure reserved under the cultural exemption– in the cultural industries, both countries were free to act as they wished and retaliate in kind. To dissuade Canada from resorting to the cultural exemption to justify new policy measures, Congress added a provision to the NAFTA legislation directing the USTR to report annually on "any new Canadian act, policy, or practice affecting cultural

industries that is actionable under article 2106."[38]

Canadian officials take a different view of the cultural exemption, asserting that Canada may implement measures inconsistent with the NAFTA and not risk retaliation provided that it does not breach any provisions of the FTA. In this view, Annex 2106 carved cultural industries out of the NAFTA, and Canada is subject only to its obligations in the GATT-WTO where the NAFTA goes beyond the FTA. This would mean that the US right of retaliation applies only in areas previously covered in the FTA (Acheson and Maule 1999, 77-78).

In the face of this ambiguity, neither the United States nor Canada has tested the NAFTA cultural exemption in dispute settlement. In the case of Canada's de-listing of the US cable channel Country Music Television (CMT) when a competing Canadian channel, New Country Network (NCN), became available in 1994, the two countries pursued high-level consultations and encouraged private actors to resolve the dispute. CMT filed a Section 301 petition with the support of several other cable media stations, leading the USTR to threaten retaliation, but a partnership arrangement between CMT and NCN settled the issue within a few months. In a second case involving the magazine *Sports Illustrated,* the United States chose the WTO rather than the NAFTA to challenge Canadian laws for advertising in split-run magazines (Acheson and Maule 1999, 200-201, 206-213).

Canada continued the exemption for cultural industries in free trade agreements with Israel, Chile, and Costa Rica. The United States, however, has sought to use free trade agreement to fill gaps in multilateral trade rules for filmed entertainment. This strategy has two main components. First, the USTR, with the backing of the MPA,[39] has

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[38] NAFTA Public Law 103-182, Section 513, "Actions Affecting United States Cultural Industries," US Customs and Border Protection, http://www.cbp.gov/nafta/nafta097.htm.

[39] The MPA is represented on the Industry Trade Advisory Committee on Services and Finance Industries (ITAC 10), formerly the Industry Sector Advisory Committee on Services (ISAC 13). Advisory committee reports on recent free trade agreements are available at Bilateral Trade Agreements, USTR,

not acceded to cultural exemptions like that for Canada in the FTA and the NAFTA, but it has accepted specific reservations permitting countries to employ measures inconsistent with the general provisions of an agreement for pressing cultural concerns. By tolerating these reservations, the USTR has been able to obtain commitments beyond those in the GATS. The key to the strategy is the negative list method, which ensures comprehensive coverage: unlike the GATS, where countries had to opt in to market access and national treatment commitments, all rights and obligations under US free trade agreements apply unless a national reservation excludes a specific service. Focusing negotiations on the exceptions for existing or new non-conforming measures allows the USTR to make deals to narrow the scope of national reservations and press for specific, targeted policies with minimal trade-distorting effects. Second, inclusion of a chapter on electronic commerce, which broadly defines electronic commerce to include any digitally-delivered product regardless of whether it is regarded as a service or a good under domestic law, ensures that new digital technologies do not emerge into a void in negotiated trade rules.

Overall, five of the free trade agreements (with Chile, Australia, Costa Rica, the Dominican Republic, and Peru) include some form of reservation for broadcast quotas or local content rules. The broadest reservations appear in the free trade agreement with Australia– not surprising, since Australia is the only developed and the only English-speaking country to reach a free trade agreement with the United States in the last decade. Australian cultural industries pushed for an exemption and, when that failed, lobbied against the treaty's ratification. Still, Australia retained quotas for broadcast television and investment quotas requiring certain cable and satellite channels to spend a minimum share of their program budget on new Australian dramas. Australia's list of exceptions also was the most forward-looking in all of the free trade agreements, as it reserved the right to increase investment quotas and to extend the requirements to other program

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http://www.ustr.gov/Trade_Agreements/Bilateral/Section_Index.html.

genres.[40] The MPA, however, merely expressed displeasure and stated the "hope that Australian policymakers will never conclude that introducing restrictions of this type are necessary to meet their cultural or industrial policy goals."[41]

The US-Australia agreement points to a downside in using free trade agreements to stimulate liberalization: the strategy accentuates the patchwork feature of international trade rules. Each free trade agreement has its own list of reservations for existing (Annex I) and new (Annex II) non-conforming measures. Thus, audiovisual services are subject to different rules in the thirteen countries with which the United States has reached a free trade agreement since 2003.

Conclusion

Disagreements over a cultural exception from trade rules nearly wrecked the Uruguay Round and caused discord in the NAFTA and the FTA. To understand the sources and effects of these disputes, it is necessary to examine their underpinnings, particularly in the GATT.

Pressures for a cultural exemption from trade rules date to France's attempt to secure an exception for film quotas in the League of Nations Convention on the Abolition of Import and Export Prohibitions and Restrictions in 1928. In the global trade regime, European countries, led by France, and also Canada and Australia, at various times and with varying success have sought either an outright exemption or special recognition of a national right to impose measures in cultural industries that breach the general obligations of trade rules. This defense of the authority to regulate cultural industries has limited the scope of the trade regime and weakened national obligations to grant market access and

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[40] Services/Investment Non-Conforming Measures, Annex I and Annex II, Final Text of the U.S.-Australia Free Trade Agreement, USTR, http://www.ustr.gov/Trade_Agreements/Bilateral/Australia_FTA/Final_Text/Section_Index.html.

[41] "MPAA Statement on the US-Australia Free Trade Agreement," 9 February 2004, MPAA, http://www.mpaa.org/legislation/index.htm.

observe non-discrimination in filmed entertainment.

Since the 1920s, the United States has maintained that the concept of "cultural identity" is too elastic to serve as the basis for a broad exemption, and it has persistently pressed for international trade rules to discipline cultural protectionism. In this view, filmed entertainment is like any other product, even if in substance it expresses social and cultural attributes of a country and its citizens. In the GATT, the United States conceded on screen quotas to reserve exhibition time for films of national origin, but insisted that market access restrictions and any other departures from national treatment be banned. On the applicability of the GATT to television, the United States acknowledged the right of governments to maintain standards for such a politically and socially significant medium of communication, but it objected to "arbitrary distinctions based simply on the sources of television programs" (GATT 1961, 2). In the Uruguay Round, the United States sought to extend the principles of the GATT for trade in goods to services. Because this effort succeeded minimally for audiovisual services, the United States has used bilateral trade agreements to supplement its attempts to limit cultural protection of new media, particularly digital products, in the GATS 2000 negotiations.

"After listening to the political discourse," Acheson and Maule (1999, 2) write, "not even Pangloss would be optimistic that a mutually acceptable agreement on this topic can be reached by WTO members." This chapter suggests three reasons why the difficulty resolving cultural construed trade issues has produced patchwork rules for filmed entertainment.

First, technological change has made filmed entertainment more difficult for states to regulate, creating concerns about the preservation of national sovereignty in an information age. Notably, national resistance to incorporating cultural industries in trade rules has hardened with the shift in delivery methods for filmed entertainment from trade in physical goods to atmospheric and electronic transmissions of information.

Second, the unevenly distributed gains from trade in filmed entertainment have

fueled persistent disagreements between the United States and net importers of cultural products, particularly the EC and Canada. As chapter 2 illustrates, US dominance of the world market has remained uncontested for almost a century, and trade imbalances have grown during periods of technological diffusion: television in the 1960s; cable and satellite in the 1980s; and digital multimedia in the last decade.

Third, the growing involvement of private stakeholders has exerted a polarizing influence in trade negotiations. The GATT-ITO conferences of 1947-48 were highly insulated from domestic interests by today's standards, and the GATT treaty required no national ratification. While US trade officials consulted with the MPA, they accepted a legitimate national need to reserve screen time for domestic producers; the British, for their part, sought to balance the conflicting interests of exhibitors and producers. In this environment, common ground was easier to locate, and the MPA could be persuaded to seal a compromise. In both the Uruguay Round and the NAFTA, however, the MPA staked out the position that exceptions for filmed entertainment should be deal breakers. On the other side, European actors and directors mobilized during the Uruguay Round to press for the cultural exclusion, and Canadian producers in the cultural industries SAGIT have taken a similar stance that cultural issues are off limits in trade negotiations.

The eventual effect of the gaps in the global trade regime for filmed entertainment is that countries have retained considerable leeway to impose quotas and content rules. How governments have actually exercised this right to regulate culture is the subject of chapter 5.

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