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## 12 Regulating culture: has it ‘Gone with the Wind’?

*Patrick Messerlin*

Institut d’Etudes Politiques de Paris

### 12.1 Introduction

Audiovisual services cover a wide range of services, ranging from art to information. They include:

- motion picture and video tape production and distribution services;
- motion picture projection services;
- radio and television services;
- radio and television transmission services;
- sound recording; and
- other audiovisual services.<sup>1</sup>

This classification covers ‘content’, not the physical infrastructure required for transmitting the content (generally included in telecommunications). Most of these services are closely associated with political power, both on a daily basis (radio or television interviews and news) and in their ability to create collective symbols. This explains why audiovisual services generated such controversy during the Uruguay Round, and why negotiators are so cautious about introducing them into the agenda for the new round of World Trade Organization (WTO) talks.

The key issue raised by audiovisual services is their ‘nature’. Are audiovisual services ‘industrial’ activities, like all other services, or are their links with culture deep enough to protect them behind a cultural ‘exception’ or ‘specificity’?

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<sup>1</sup> Both the UN *Provisional Central Product Classification* and the GATS *Services Sectoral Classification List* place audiovisual services in the *Communication services* group, along with its four other sub-groups — *postal, courier, telecom, and other services*.

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Economists are well versed in the best disciplines to impose on industries, and there is no reason to exempt ‘industrial audiovisuals’ from these disciplines. Some of these disciplines are trade-related, such as opening the domestic market to foreign competition (cross-border and establishment) in a non-discriminatory way, including affording national treatment. Other disciplines to be imposed on industries involve domestic regulatory reforms, including:

- the creation of appropriate markets for intellectual property rights;
- the regulation (or otherwise) of interactions between various services (for instance, should there be constraints on time ‘windows’ for showing films on screen, on television, on videocassette, etc, or should audiovisual producers be free to decide?);
- enabling network access (airwaves, cable or digital television); and
- enforcing competition laws.

By contrast, handling ‘cultural’ goods or services is a more difficult task. First, it requires the scope of cultural goods to be defined. This is not a simple process, as it may face strong prejudices and is often subject to powerful vested interests able to capture ‘culture’ for their own profit. Second, if existing disciplines on the use of certain instruments, such as subsidies, are relaxed for ‘cultural’ goods or services, this may require more subtle ways of reconciling the freedom to create and the freedom to trade. In particular, it would place a premium on more efficient domestic regulation, that is, regulation that supported culture successfully, while requiring less direct public intervention.

The main message of the paper is that ongoing economic and social changes are increasingly separating the industrial and cultural segments of audiovisual services. This increasing separation offers the opportunity to combine a better policy for industrial audiovisuals (based on progressive liberalisation) with better ‘regulation’ of cultural audiovisuals (institutions and instruments for supporting culture at its source, rather than through the platforms by which culture is disseminated).

Section 12.2 examines the relationship between the industrial and cultural aspects of books and paintings — two main platforms for the dissemination of culture that have been subject to open trade and a free market policy for the last half-millennium. Section 12.3 describes the protection of audiovisual services in the European Community (EC). Section 12.4 summarises its consequences. The most important one is that protection has been (and still is) *much more* harmful to the cultural than to the industrial segment of the audiovisual sector. Section 12.5 analyses the limitations of the current WTO legal framework (GATT and GATS) for addressing these issues. Hence, it suggests the need for a Reference Paper on audiovisual services to interpret WTO disciplines in a way that encompasses the

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most important aspects. Section 12.6 concludes by making a few remarks on the current environment for future WTO negotiations in audiovisual services, on the content of the proposed Reference Paper and possible domestic regulatory reforms.<sup>2</sup>

## **12.2 The nature of audiovisual services: To be cultural, or not to be?**

Economists often ignore the nature of the relationship between audiovisual services and culture, as they feel uneasy dealing with the issue. Such neglect is a recipe for policy failure. In past and current debates in the WTO and other international forums, vested interests have sought to tie audiovisual services to culture as tightly as possible, in order to retain the status quo. The last decade shows that this has been a successful tactic.

In the coming decade, culture-minded people might join economists in looking at the issue, given the consequences of the existing protectionist EC policies (see section 12.4). This is best illustrated in France, one of the EC Member states having most tightly linked audiovisual services to culture. Since the summer of 1999, mounting discomfort has seen the French press pinpointing flaws in French film policy in an unusually aggressive tone, and highlighting the ‘privileges’ (rents) drawn from this policy by a few vested interests — privileges felt all the more unwarranted because the policy shows obvious signs of failure (Messerlin and Cocq 2000). French politicians have yet to reflect this discomfort. This is not surprising. The stakes are so high — political careers in a media-intensive society depend on audiovisual services — that politicians are unlikely to enter the debate before the outcome is clear.

### *Culture, books and paintings*

During the last half-millennium, books and paintings have been major platforms by which culture has been disseminated. They offer interesting lessons for audiovisuals about the relationship between the industrial and cultural segments.<sup>3</sup>

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<sup>2</sup> As these topics are tightly related to the political life of a country, this paper focuses on France — the author’s home country. However, many of the observations about France could easily be extended to other countries that follow protectionist policies in the name of culture.

<sup>3</sup> Architecture and large sculptures are left aside because they are almost non-tradable. There are, however, some notable exceptions — a few museums have reconstituted Pergamon and other places, and art ‘razzias’ (raids) by war victors have occurred since the beginning of human history. If books are tightly related to language, paintings are not. Audiovisual services lie somewhere in between.

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From the fifteenth century until the 1920s, the fact that books (and the press) were the dominant platforms for the dissemination of culture did not prevent a very liberal trading regime. Imports and exports of books were free from quotas (at least, in democratic regimes), and subject only to the few exceptions valid for all other goods under GATT Article XX, which deals with public morals and order. Imports of books were subject to non-discriminatory and relatively moderate tariffs. Imported books enjoyed national treatment. That is, they were subject to the same tax regime as domestically produced books and to the same pricing regime (many countries still impose a minimum retail-pricing regime, despite its pro-collusive effects on domestic publishers). Lastly, publishers have rarely been subsidised since printing became an industrial activity. Only very few books — collectors' items — have been systematically subject to trade constraints (quotas or bans), but not before the late nineteenth century in Europe.

During this liberal regime, the European industrial book sectors prospered and European cultures flourished as never before. Publishers based in large countries thrived, as did those working mostly for export (because their national language did not allow a vast readership, publishers such as the Dutch shifted successfully from Latin to French and then to English). No European country lost its capacity to produce industrial and cultural books, and many without such a capacity five centuries ago developed it.

The same liberal trade regime also applied to paintings. Except for a few masterpieces, constraints on trade in paintings were almost non-existent until the late nineteenth century. In fact, the largest collectors only began to have systematic lists of their art works during the nineteenth century (those interested in art history, such as Vasari, were exceptions). In European countries, severe trade constraints on masterpieces were imposed after the 1870s, as European private and public collectors were less inclined to spend as much as the more enthusiastic new collectors from outside Europe (from the United States since the late 1800s and from Asia since the late 1900s). And, in its first (1968) *Italian Art Treasures* ruling, the European Court of Justice has reminded us that, despite their uniqueness, works of art qualify as 'goods' within the meaning of the Treaty of Rome because they are products having a monetary value, and as such, may be the object of commercial transactions.

These two brief surveys suggest two lessons.

First, they do not support the *general* argument that the industrial segment of an activity should be protected in order to ensure a lively cultural segment. Support, if any, for this argument needs to rely on some *specific* economic features of the audiovisual sector. From this perspective, painting deserves special mention. It has not benefited from an industrial evolution comparable to that for books with

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printing. Painting technology has evolved in terms of colours and materials.<sup>4</sup> But this evolution has not been based on industrial changes such as cost-cutting mass production, and it has not affected large paintings. As a result, large paintings have attracted more subsidies (eg public orders from the Church, princes and democratic governments) and have become disconnected from market rules. Nevertheless, there are two additional lessons from the history of painting that are useful in designing the best domestic regulatory frameworks to support culture in audiovisual services. The first is the importance of economically sound relationships between painters on one hand and patrons, sponsors or galleries on the other. The second is the perverse impact of the managed trade in masterpieces, with fantastic rents associated with speculation in masterpieces subject to the restrictions.<sup>5</sup>

Another broad lesson from both the book and painting sectors is that they have been divided into two clear-cut segments:

- a large segment of fully industrial activities operating under free market and trade disciplines and able to finance the cultural segment — *almost entirely* in the case of books; and
- a tiny segment of pieces not generated by market forces, as best illustrated by large paintings under public orders.

Contrary to what can be observed in audiovisual services today, there has not been an intermediate segment in the book and painting sectors — a sector with *de facto* commercial intent, but benefiting from public support in the name of culture.

### *Culture: 'à la recherche d'une définition perdue'*

In sharp contrast with the book and painting sectors, it has been assumed that audiovisual services in most countries over the last 50 years have been so intertwined with culture that the *entire* sector has needed protection from free market and trade disciplines in order to keep cultural audiovisuals alive. Compared with the assumptions operating in the book and painting sectors, such a change of perspective is so dramatic that it can only be explained by a converging set of mutually reinforcing reasons — cultural, economic and political. This then raises

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<sup>4</sup> It is beyond the scope of this paper to describe the efforts of the fifteenth century Flemish school to launch linen-based painting, 20 or 30 times less expensive than its wood-based equivalent, in order to enlarge the market of potential buyers of paintings (Harbison 1995).

<sup>5</sup> For instance, art dealers stock paintings for which they expect (sooner or later) some demand from national museums in order to trade them with paintings demanded by foreign purchasers but subjected to export bans — the whole trade being of course the source of huge profits for the successful dealers.

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the question whether these reasons are stable, or whether some components are undergoing profound change, opening the door to key reforms in commercial and domestic policies.

Tight links between audiovisual services and culture rely on a particular definition of culture. Canada best illustrates the tightness of this link, because of its special history, although similar arguments apply in almost all countries. On the one hand, culture becomes the messenger of domestic identity:

In Canadian books, magazines, songs, films, radio and television programs, we are able to see and understand ourselves. We develop a more cohesive society and a sense of pride in who we are as a people and a nation. (SAGIT 1999, p. 1)

Culture has lost its sense of ‘universalism’ (manifesting the reputation of a prince or an idea to the rest of the world). None of the five principles guiding Canada’s cultural policies evoke the role of Canadian culture in the rest of the world. The third principle only mentions a place for Canadian cultural products in the *Canadian* market (SAGIT 1999, p. 5). Such an inward-looking perspective certainly has some value — as the contingent valuation survey made in the case of Australia (Papandrea 1997) may suggest (though the survey also suggests that there is plenty of room for improvement). But such an inward-looking perspective also enables routinely uncreative sitcoms, made in a few hours with domestic directors, actors and studios, to be eligible for ‘culture’. On the other hand, because the Canadian focus on identity creates the risk of uniformity, cultural diversity constitutes one of the five principles guiding Canada’s cultural policies (SAGIT 1999, p. 5). Domestic identity and cultural diversity are inconsistent in many respects. But they work in the same direction in one case — both encourage protectionist policies that minimise competition from the outside and limit competition to ‘insiders’, such as the high barriers at the borders and massive domestic subsidies seen in the European Community.

Why the dramatic change in perspective? There is little doubt that the main driving force was the powerful European ‘nationalistic’ ideal of the nineteenth century, which progressively imposed an association between a ‘culture’ and a ‘country’ or its people — an association between groups, instead of interactions between individuals (artists and fiercely competing patrons or collectors, with successful artists playing sometimes the role of patrons or collectors).

### *Ongoing changes*

This explanation raises two questions.

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- How has this nineteenth century nationalistic view been able to survive for the last fifty years, despite the apparent relative antipathy to nationalistic notions over this period?
  - And why has this view so deeply permeated audiovisual services, and been so largely ignored in the book and painting sectors?

These two questions have a common answer. The nationalistic view would have had difficulties surviving the last fifty years if it had not been supported by certain economic and political features of the audiovisual industry. What makes the coming decade so exciting is that these economic features are vanishing — opening the door to fundamental changes.

The *economic* feature supporting the nationalistic approach in audiovisual services until the mid-1990s came from technical constraints and related market structures. Building a radio or television broadcasting network required massive initial investment that generated elements of ‘natural’ monopoly. The vertical integration of such networks and programming activities in often publicly-owned monopolies extended the natural monopoly elements to the whole audiovisual sector and, as television increasingly became the major outlet for movies and music, to the movie and music segments as well. Until the 1980s, movie studios and theatres also required large investments, amplifying the natural monopoly elements in the movie sector.

It is important to underline that these risks of natural monopoly and the possible existence of scale economies in audiovisuals do not occur before the distribution stage. Movies (bad or superb) are unique: shooting a higher number of movies does not decrease substantially their average cost of production. Scale economies occur at the distribution level when copies of a film are made in order to distribute the movie simultaneously in a large number of theatres. As a result, arguing the existence of scale economies for supporting public intervention in audiovisuals is incorrect.

- First, the argument should be limited to the distribution sector (more precisely, to movie copying), and not used for justifying subsidies at the production (shooting) stage. Moreover, the validity of the scale economies argument virtually disappears in the case of movies to be shown in TV networks, since scale economies are small in this case.
- Second, many modern industries show scale economies (and film distribution is definitely an industrial activity) without being subsidised. They cope with this feature by building appropriate industrial structures or mechanisms. Before asking for public support, one should thus look at whether existing regulations

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do not inhibit the emergence of such structures (what follows suggests that it has been the case in Europe).

Similarly, scope economies are routinely invoked for public intervention in audiovisuals. As for scale economies, their mere existence is not enough to justify public intervention. It is a feature which can be handled by firms large enough to spread risks over a diversified portfolio of audiovisual works. Public intervention, by limiting the domestic market size, hence the emergence of large firms, reduces the ability to realise scope economies (ironically, public subsidies have increased the number of films without providing more scope economies).

The *political* feature underlying the inward-looking focus of culture and audiovisual services has been the ever-closer relationship between politicians and the audiovisual sector in increasingly media-intensive societies. Audiovisual directors and actors are increasingly seen as experts in ‘communicating’ with the wider society. Their influence becomes crucial at election times — then they are fixed assets in the political process and this position enables them to extract large rents from media-dependent political candidates. The fact that the audiovisual services industry is small (compared to the economy) makes it a perfect example of how vested interests work (Olson 1965). A small but powerful group rallies together to make a large financial gain by spreading the costs over the rest of society (implying small costs per person).

This argument may be seen as leaving aside other economic reasons for public intervention in audiovisual services. While it is beyond the scope of this paper to review all these reasons in depth, some observations are appropriate.

First, as noted, many of the arguments invoked as reasons for public intervention are actually consequences of, not cases for, public involvement. For instance, public intervention is said to be necessary because the audiovisual sector is prone to monopoly. This was correct in Europe, but it was because of public mismanagement that imposed artificial links between the physical audiovisual networks and content-related activities. Unbundling network access from programming activities would have allowed competition between content producers — indeed, this is progressively being done.

Second, some reasons for public involvement in audiovisual services are based on general arguments, but general arguments are not enough. For instance, it is argued that the audiovisual sector collectively produces social benefits (positive externalities) such as national identity, that it contributes to education, and that a free market would lead to under-production of audiovisual services. But why are audiovisual services more subsidised in the name of culture than are sports, presumably also a strong source of national identity? How can it be said that the



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market will produce a sub-optimal number of films when many subsidised films are never shown, or are only shown for a few days? And even when general arguments seem appropriate (for instance, audiovisual services may cover a set of declining cost activities), there may be better policies for addressing the issue than public intervention (such as two-part tariffs). Once all these questions are raised and answered, the case for public intervention in the audiovisual sector as a whole does not appear very robust. Indeed, these arguments are also weak when applied to public support of culture (Heilbrun and Gray 1993), a point reinforced by the examples of books and paintings and re-examined the case of cultural audiovisual services (section 12.6).

The economic driving force behind the survival of the nationalistic model has been steadily eroding since the early 1980s. Technological change made radio broadcasting much cheaper in the late 1970s — widening the gap between program ‘organisers’ and program ‘producers’ by raising the issue of how to fill the growing radio broadcasting capacity with the more slowly increasing program supply. This erosion has just started, and will continue in the coming years. It is beyond the scope of this paper to describe in detail the extraordinary opportunities opened by new technologies and their capacities to expand massively consumers' choices (for a thorough analysis of the major opportunities, see PC 2000). One can simply mention that new digital television broadcasting technologies will allow a huge increase in the number of channels, multi-channelling by broadcasters, and a flourishing of ‘narrowcasting’ (cheaper and better technologies permitting a vast increase in ‘program differentiation’ capacities). In turn, this technological and economic evolution will profoundly shape the strategies of audiovisual firms, which will have increasingly strong incentives to become global in order to have more differentiated programs to consolidate. By the same token, large audiovisual firms may increasingly play the role of ‘patrons’ — not only of the culture of their country of origin, but also of the culture of their countries of destination — if this move enhances their reputation. A time could come where US firms do not hesitate to become patrons of young French moviemakers, and vice versa.

### **12.3 The protection of audiovisual services in the EC: ‘Mad tax’**

In sharp contrast to books and paintings, audiovisuals in the European Community (EC) are subject to huge and arcane protection and to widely and tightly managed domestic markets. The EC Common Audiovisual Policies (CAPs) are the joint province of the Community (the Council of Ministers and the Commission) and the Member states. In other words, both levels of decision-making are required for defining regulatory reform and commercial policy in audiovisual services. As a

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result, although the CAPs are based on similar instruments (hence justifying the ‘common’ qualification), they vary between Member states in their detail and style of enforcement (hence justifying the plural). The differences among Member states are not as significant as they first appear, and are subject to a slow ‘communitarisation’ process.

The CAPs instruments are close to those of the EC Common Agricultural Policy, suggesting that the consequences in audiovisuals will be similar to those in agriculture (as indeed is shown in section 12.4 below). However, there are two major differences between the Common Agricultural Policy and the CAPs. EC audiovisual services are dominated by a few large firms that are more aware than large and small farmers of the net costs of not becoming global. Second, these large EC audiovisual firms have markets of prime interest for them outside the European Community, namely in countries speaking the same language. These two differences are crucial enough to deserve a few remarks at the end of the section.

### *Tariffs and taxes*

EC tariffs on films (for theatres) or cassettes (for individual consumers) range from exemptions to 6.5 per cent. There are no import quotas or bans, other than those for reasons of public order.

In sharp contrast, domestic taxes are substantial. In France, a tax of roughly 11 per cent is imposed on the price of theatre seats, independent of the nationality of the movie shown. As this tax finances subsidies granted to French films, it has a discriminatory impact, although to an extent that is relatively difficult to assess (see section 12.4 below). Special annual taxes specifically used to fund public television channels are imposed on television receivers in a handful of EC Member states. Lastly, there are taxes on blank cassette sales, on the grounds that such cassettes may be used to circumvent the many quantitative restrictions listed below, in particular the broadcast quotas. Such video taxes exist in various forms in almost all EC Member states.

Taxes imposed by sub-state entities play an important role in some Member states. In certain EC Member states (Germany, Belgium and Spain), the audiovisual policies are under the joint province of the Member state and its own sub-national entities. This generates three de facto levels of decision making in the European Community (the Community, the Member states, and the sub-national entities of certain EC Member states), requiring a complex legal framework, such as the 1991 German Broadcasting Treaty between the German Länder (States). The layer of sub-national entities involved can be very low. For instance, Belgian municipalities

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have imposed taxes on television dishes, in order to limit the growth of satellite television channels competing with domestic channels.

### *Quantitative restrictions*

Greece has quotas on first runs of movies in Athens and Thessaloniki. However, laws or decrees allowing such restrictions to be imposed also exist in France, Portugal and Spain ('protected' by GATT Article IV, see section 12.4).

The Television Without Frontiers (TWF) EC Directive (adopted in 1989 and revised in 1997) imposes 'broadcast quotas' based on film 'nationality'. A 'majority' of the total annual number of movies broadcast by every EC television channel should be of European origin. In France, this provision is interpreted as reserving a quota of 40 per cent to French movies, and a quota of 20 per cent to films originating from other EC Member states — leaving a maximum share of 40 per cent to non-European (de facto US) movies. In most of the other Member states, the proportion reserved to EC works is 51 per cent.

These quotas are rigidly enforced by certain Member states. In France, a lot of Conseil Supérieur de l'Audiovisuel (CSA) resources are devoted to counting every second of French, European and US works broadcast in France, to check whether the two reserved quotas (for French and EC audiovisual works) are being fulfilled. These provisions are implemented more subtly in other Member states (such as Britain and Germany), which use an incidental clause of the TWF Directive (quotas should be imposed 'where practicable') in order to introduce some degree of freedom to the constraint. However, this flexibility may be more apparent than real. The 'where practicable' clause has allowed the almost exclusive broadcasting of US films by the British channel BskyB. But relatively few US audiovisual works are broadcast by the British Broadcasting Corporation (BBC) and other British channels, so that in the end, the shares of US works broadcast in Britain and France are almost identical (and close to 40 per cent).

Broadcast quotas are combined with other quantitative restrictions in two Member states. France enforces the following four types of quotas, whereas Italy implements only type (iii) and (iv) quotas:

- (i) 'global' quotas limit the total number of films to be broadcast;
- (ii) time-specific quotas prohibit the broadcasting of films at certain hours and on certain days on 'air-television' channels [free-to-air television channels in Australia];

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- (iii) arcane rules impose quota-equivalent constraints on the time 'windows' used for programming films in theatres, television channels and videos (these rules have been loosened recently for unsuccessful films); and
  - (iv) quotas on investments requiring every television channel to invest a share of its resources in film production by 'pre-purchasing' and/or 'co-producing' films: 3 per cent of the net turnover in the case of air-television channels, 20 per cent in the Canal Plus case (out of which 9 per cent is for French films).

The first three types of quotas systematically distort domestic competition — quotas (i) and (ii) protect movie theatres from television channels, whereas quota (iii) protects theatres and television channels from VCR and cassettes. Type (iv)-quotas are a consequence of restrictions on competition imposed on television channels (ie the pay-channel monopoly granted to Canal Plus). All these anticompetitive effects are amplified by the fact that the whole quota regime is defined on a firm-by-firm basis. Canal Plus can broadcast 364 movies, whereas the four major air-television channels can only broadcast from 170 to 192 movies per year, depending on the channel. Moreover, Canal Plus can broadcast as many films as it wants during 'prime time' hours, whereas other air-television channels can broadcast only 104 movies during these hours.

From an economic perspective, the key question is whether these quotas are binding. The answer is undoubtedly yes for the EC-wide broadcast quotas on US films, and the corollary is that such quotas are likely to be all the more harmful because they are introduced in a very imperfectly competitive environment. These quotas are strongly binding, since US films have a much higher than 50 per cent market share in all EC Member state cinemas (where EC viewers can make free choices) — from 63 per cent to more than 90 per cent (depends on the Member state). In fact, the binding effect of the quota may be perceived as more severe in Britain and Germany than in France, as the theatre-based market shares of US films are larger in these two Member states than in France.<sup>6</sup>

It is doubtful whether the other quotas are binding, with the exception of the investment quotas that have a powerful impact (see below). The French quota on the total number of films that can be broadcast annually is probably harmless, because the quota has been substantially increased over time. Now, the number of films broadcast in France is not so different from the number in EC Member states that do not enforce such a restriction. The same could be said for type (ii)-quotas. The type (iii) 'window' quotas are most costly for unsuccessful films (since they

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<sup>6</sup> However, the different market share in France may reflect the more extensive use of other protectionist tools (including subsidies).

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prevent producers from reducing their losses by selling cassettes as quickly as possible) — although unsuccessful (but not successful) films are now exempted from such quotas.<sup>7</sup>

### *Subsidies*

European subsidy regimes are very complicated in their funding sources and end uses. Table 12.1 focuses on the many sources of funding: grants from Member states and sub-state authorities, taxes on television advertising and on television receivers, and a wide range of other sources — from video taxes to National Lottery revenues (as in Britain).

Table 12.2 focuses on the different uses of these subsidies.<sup>8</sup> In a nutshell, film subsidies can be divided into aids to production (column 3), which can be automatic (column 4) or selective (column 5), and other aids (column 2), a large part of which go to movie theatres. Aids to production can be given in the form of grants or ‘advances’ (hence raising the issue of the *effective* level of reimbursement, which is close to 100 per cent in Britain, but close to 15 per cent in France (CNC 1997)). It should be emphasised that aids to theatres are de facto highly discriminatory. They are officially justified on the basis that a large number of theatres are necessary for showing a wide range of new films, hence for generating the desired cultural diversity. However, this rationale does not fit reality — 20 per cent of French film production never reaches theatres, and most of the remaining new French movies are only shown for a few days. A much more plausible rationale for the survival of these large subsidies to movie theatres is that 50 per cent of the French theatre seats are owned by the French major studios (Gaumont, Pathé and UGC) which, being movie-makers, can shift these subsidies to production or to other uses.

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<sup>7</sup> In some Member states, such as France, quotas have been imposed on music since the mid-1990s, roughly on the same basis as broadcast quotas. The first years of implementation witnessed an increase of the share of ‘French’ music — a fact interpreted by quota supporters as evidence of quota efficiency. However, this success could be because the high level of competition prevailing before the quota implementation screened the best French musicians so that the quota just amplified the success of this existing stock of musicians. If so, the progressive erosion of competition under the quota regime will reduce the quality of French musicians, and progressively undermine the apparent quota efficiency. Indeed, this was the scenario observed in the film case. Last but not least, the so-called French music is simply the French translation of reggae, rap, etc, for the benefit of large music companies able to sell more expensive French and imported music.

<sup>8</sup> A 318 page guide lists 17 broad types of subsidies applying only to feature films (excluding regional aids) (Fougea, Kalck and Rogard 1993).

Table 12.2 contains crude estimates of the subsidisation rates applying in 1995. Subsidies to production can be split between subsidies to film production (column 6) and subsidies to audiovisual works (the difference between columns 3 and 6, not shown). A first set of estimates of the subsidisation rate (column 7) is obtained by dividing the subsidies granted to film production by the revenues from theatre tickets to domestic films in each Member state. Subsidisation rates are large — the EC average is almost 40 per cent. Very high subsidisation rates for the small EC Member states flow from the fact that such countries do not grant large subsidies (in absolute terms), but they produce a few films screening to small audiences. However, the main estimates severely under-state the rates of subsidisation because they do not take into account subsidies not directly related to production that are, nevertheless, an integral part of the whole process. For example, as discussed above, France also subsidises theatres. In order to include this aspect, table 12.2 provides alternative estimates of the subsidisation rates based on the sum of the subsidies granted to film production and distribution. The average subsidisation rate for the EC film industry rises to more than 50 per cent, with huge increases in France and Germany, and little change in Britain.

**Table 12.1 Funding sources of subsidies to EC audiovisual services**  
Million ECU, 1995

| <i>EC member</i>     | <i>Grants</i> |                  | <i>Taxes and quasi-taxes</i> |                  |                   | <i>Other sources</i> | <i>Total subsidies</i> |
|----------------------|---------------|------------------|------------------------------|------------------|-------------------|----------------------|------------------------|
|                      | <i>State</i>  | <i>Sub-state</i> | <i>non-TV</i>                | <i>Public TV</i> | <i>Private TV</i> |                      |                        |
| Austria              | 11.9          | 2.2              |                              | 3.7              |                   | 4.1                  | 21.9                   |
| Belgium              |               | 23.8             |                              |                  |                   |                      | 23.8                   |
| Britain <sup>a</sup> | —             | —                | —                            | —                | —                 | —                    | 31.0                   |
| Denmark              | 26.1          |                  |                              |                  |                   |                      | 26.1                   |
| Finland              | 8.7           |                  | 2.7                          |                  |                   |                      | 11.5                   |
| France               | 56.3          | 5.9              | 88.1                         | 77.4             | 140.0             | 3.9                  | 371.6                  |
| Germany              | 8.2           | 61.3             | 31.0                         | 39.4             | 7.4               |                      | 147.2                  |
| Greece               | 3.8           |                  | 0.5                          |                  |                   | 0.8                  | 5.2                    |
| Ireland              | 3.8           |                  |                              |                  |                   |                      | 3.8                    |
| Italy                | 88.2          |                  | 7.3                          |                  |                   |                      | 95.5                   |
| Luxembourg           | 1.5           |                  |                              |                  |                   |                      | 1.5                    |
| Netherlands          | 9.9           |                  |                              | 23.7             |                   | 1.0                  | 34.6                   |
| Portugal             | 1.2           |                  |                              | 10.4             |                   |                      | 11.6                   |
| Spain                | 20.4          | 6.9              |                              |                  |                   |                      | 27.3                   |
| Sweden               | 13.9          |                  | 9.6                          | 1.6              | 0.6               |                      | 25.7                   |
| <b>EC-15</b>         | <b>253.8</b>  | <b>100.2</b>     | <b>139.1</b>                 | <b>156.2</b>     | <b>148.0</b>      | <b>9.8</b>           | <b>838.1</b>           |
| Per cent             | 30.3          | 12.0             | 16.6                         | 18.6             | 17.7              | 1.2                  | 100.0                  |

— Breakdown not available. <sup>a</sup> Including funds from the National Lottery.

Source: Estimates based on European Audiovisual Observatory (1998, 1999).

**Table 12.2 Use of subsidies and subsidisation rates in EC audiovisual services**

1995

| EC member    | (1)              | (2)              | (3)  | (4)            | (5)          | (6)              | (7)                        | (8)               |
|--------------|------------------|------------------|--|----------------|--------------|------------------|----------------------------|-------------------|
|              | <i>Subsidies</i> |                  | <i>Subsidies to production<sup>b</sup></i> |                |              | <i>Sub prod.</i> | <i>Subsidisation rates</i> |                   |
|              | <i>Total</i>     | <i>Non prod.</i> | <i>Total</i>                               | <i>Select.</i> | <i>Auto.</i> |                  | <i>estimate 1</i>          | <i>estimate 2</i> |
|              | ECU m            | % <sup>a</sup>   | ECU m                                      | %              | %            | ECU m            | % <sup>c</sup>             | % <sup>d</sup>    |
| Austria      | 21.9             | --               | --   | --             | --           | --               | --                         | --                |
| Belgium      | 23.8             | 44.0             | 13.3                                       | 71.7           | 28.4         | 11.1             | 1 078.3                    | 1 078.3           |
| Britain      | 31.0             | 9.3              | 28.1                                       | 100.0          | 0.0          | 9.2              | 8.8                        | 8.8               |
| Denmark      | 26.1             | 32.5             | 17.6                                       | 83.4           | 16.6         | 17.6             | 142.5                      | 147.7             |
| Finland      | 11.5             | 34.4             | 7.5  | 100.0          | 0.0          | 5.9              | 282.1                      | 299.9             |
| France       | 371.6            | 49.9             | 186.3                                      | 29.5           | 70.5         | 61.1             | 22.8                       | 47.5              |
| Germany      | 147.2            | 50.1             | 73.5                                       | 90.1           | 9.9          | 36.5             | 28.1                       | 42.6              |
| Greece       | 5.2              | 8.9              | 4.7  | 100.0          | 0.0          | 4.7              | 239.3                      | 239.3             |
| Ireland      | 3.8              | 0.0              | 3.8  | 100.0          | 0.0          | 3.6              | 390.0                      | 390.0             |
| Italy        | 95.5             | 4.3              | 91.3                                       | 92.0           | 8.0          | 91.3             | 70.6                       | 71.3              |
| Luxembourg   | 1.5              | 31.8             | 1.0  | 100.0          | 0.0          | 0.4              | 1 818.2                    | 1 818.2           |
| Netherlands  | 34.6             | 16.3             | 29.0                                       | 100.0          | 0.0          | 6.0              | 167.1                      | 174.6             |
| Portugal     | 11.6             | 50.5             | 5.7  | 68.4           | 31.6         | 5.5              | 652.7                      | 695.3             |
| Spain        | 27.3             | 21.2             | 21.5                                       | 51.8           | 48.2         | 17.7             | 38.2                       | 42.3              |
| Sweden       | 25.7             | 40.8             | 15.2                                       | 75.0           | 25.0         | 15.2             | 77.8                       | 81.6              |
| <b>EC-15</b> | <b>838.1</b>     | <b>37.9</b>      | <b>498.6</b>                               | <b>66.2</b>    | <b>33.8</b>  | <b>285.8</b>     | <b>39.7</b>                | <b>52.2</b>       |

ECU m: million European currency units. Non prod: non-production. Sub prod: subsidised production (films only). Select: selective. Auto: automatic. <sup>a</sup> Per cent of subsidies not directly allocated to production of films or television works. <sup>b</sup> Films and television works. <sup>c</sup> Subsidies granted to film production divided by the revenues from theatre tickets to domestic films in each Member state. <sup>d</sup> Sum of the subsidies granted to film production and distribution divided by the revenues from theatre tickets to domestic films in each Member state.

Source: Estimates based on European Audiovisual Observatory (1998, 1999).

Tables 12.1 and 12.2 do not give an idea of the evolution over time of the subsidisation process in EC audiovisual services. The following discussion focuses on France, because it is the Member state with the best data on subsidies and theatre ticket sales (these data are not strictly comparable with those of table 12.2, hence the discrepancies between table 12.2 results and the following results). In France, the estimated rate of subsidisation increased from 16 per cent in 1975 to 70 per cent in 1998 (71 per cent in 1995, instead of 47.5 per cent in table 12.2), if it is assumed that film revenues are almost exclusively drawn from theatre tickets. However, since the early 1990s, films have earned additional revenue from their release on television channels and from video revenues. This additional revenue was estimated at 25 per cent of the total revenues earned in the early 1990s (Farchy 1992). Taking into account these additional sources of revenue, the subsidisation rate has increased from 16 per cent in 1975 to 55 per cent in 1998 (52 per cent in 1995). But these

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estimates are still based on a narrow definition of subsidies (as shown in table 12.2), because they ignore the indirect subsidies flowing from investment quotas. In particular, Canal Plus, with an average spending of ECU 130 million per year (FFR 800 million) in the late 1990s, contributes two-third of all funds flowing from investment quotas.<sup>9</sup> Adding these indirect subsidies to direct state aid gives a subsidisation rate for French films close to 100 per cent in the late 1990s (as an explicit counterpart of its monopoly on pay television).<sup>10</sup> Such a skyrocketing subsidisation rate raises the question of the economic impact of the CAPs.<sup>11</sup>

## 12.4 Economic impact: ‘The castle of Count Dracula’<sup>12</sup>

This discussion of the EC CAPs raises two key questions.

- Have these huge transfers from taxpayers and viewers to audiovisual ‘producers’ been successful?
- Have they been particularly successful for the cultural segment of the audiovisual sector?

The answer is that not only have these efforts failed globally, but that their failure has been bigger for cultural audiovisual services. This has led an increasing number of culture-minded Europeans to look for regulatory reform.

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<sup>9</sup> The monopoly rent that Canal Plus can extract from its French television viewers can be estimated at ECU 300 million per year (FFR 2 billion) in the 1990s. This means that almost half of Canal Plus monopoly rents are a tax on French television viewers in order to subsidise French film producers. Since 1997, Canal Plus has had a competitor, TPS, which is a joint venture of all major French air-television channels (public channels and their archrival private channel, TF1), France Telecom and Lyonnaise des Eaux (the utility company, archrival of Vivendi). However, Canal Plus dominates pay television with 5.7 million subscribers compared to 0.6 million subscribers for TPS. Despite this, the rent erosion process has probably started.

<sup>10</sup> This result may be perceived as an over-estimate because it ignores the successful movies. But this result also ignores a last source of subsidies — those paid to factors of production of films. Until two years ago, unemployment benefits for actors and other film workers were extraordinarily generous (even by French standards), with a budget of ECU 330 million per year, and were unfair (benefits were proportional to wages and fees). Subsidies for television satellites (TDF) have also been ignored.

<sup>11</sup> A similar escalation has almost certainly occurred in all the other EC Members.

<sup>12</sup> This section draws on Messerlin and Cocq (2000).



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*CAPs have been harmful to industrial audiovisuals*

How to measure success? The number of films produced is not a good indicator, as it simply mirrors the fact that more public money is made available to filmmakers and spent by them. As, and when, EC Member states have progressively increased their subsidies (including under EC subsidy programs, such as 'Media'), their film industries have grown. Subsidies have encouraged the other large EC Member states to produce roughly the same number of films as France, the first to heavily subsidise its film industry.

A better indicator of success is the share of 'national' films in theatre ticket sales (the number of theatre tickets for 'national' films divided by the total number of theatre tickets) or, alternatively, the share of US films ('industrial' films receive a heavy weighting in both indicators). Until the mid-1990s, the domestic film share was much higher in France than in other EC Member states — leaving the impression that the French film policy was successful, compared to the less restrictive market policies of the other Member states. However, the late 1990s saw an unrelenting convergence of the domestic film share in France towards the shares in all other large EC Member states. This occurred despite arbitrary French decisions on rules of origin, such as the classification of the *Fifth Element*, a perfect Hollywood clone made by a French director, as a French film, which boosted the 1997 French film market share in France from 29 to 34 per cent.

Another interesting indicator is the share of non-domestic European films in each EC Member state (for instance, the share of non-French EC films viewed in France). This indicator gives a sense of the impact of the set of CAPs on EC audiovisuals as a whole. Not only is this share small, but it has generally been declining during the 1990s. This suggests that the CAPs may constitute a *barrier* to an integrated EC film market, contrary to their stated objective. This observation is not so surprising. National subsidies mechanically boost film production, and 'freeze' national investments in each Member state, while ignoring possible comparative advantages. But these subsidies are unable to create a demand for 'European' films. As a result, Member state subsidies have merely crowded out films from other EC Member states. Ironically, the French film industry has suffered the largest crowding out effect. And also ironically, the only EC film industry with growing EC market shares is the British film industry, which for years underwent severe cuts in subsidies (forcing it not to mimic US films, but to search for a British touch), and recently has seen noticeable investments from the US film industry.

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*CAPs have been even more harmful to cultural audiovisuals*

There are two different — both admittedly crude — indicators that focus on cultural audiovisuals. Interestingly, each indicator corresponds to a different definition of culture.

The first indicator is based on television audience (hence, it seems closer to industrial than to cultural audiovisuals) (Cocq 2000). Despite heavy subsidisation, and hence a high level of production, there are not enough French films to feed the reserved quota for French films on television during prime time. Between 1994 and 1998, there were, on average, only 10 French films per year having more than 1 million viewers in theatres, compared to an average of 24 US films per year. Thus, few French films have been successful enough to be considered as candidates for prime time television. As a result, television channels have increasingly resorted to massive re-runs of old French films (the re-run rate has increased from less than 60 per cent in the 1980s to 70 per cent in the 1990s) or to made-for-television fiction works. This has relegated recent French films to feeding the non-peak hours of the day in order to meet the annual 40 per cent quota of French films. Ironically (but in many ways consistently), French films produced before the 1980s (hence with a substantially lower rate of subsidisation), show, even nowadays, a better capacity to attract viewers during prime time television, despite the handicap of many re-runs, than the heavily subsidised films produced during the 1980s and 1990s. Moreover, such a difference in the capacity to attract television viewers is not observed for recent US films.

The second indicator assumes that people who can recognise the talents of the French ‘culture’ — the ‘élite’ — roam the film Festivals. If this assumption is correct, the French ‘share of awards’ at the three major European film Festivals (Berlin, Cannes and Venice) seems a crude, but acceptable, indicator of the quality of French films. The French share of awards at these three festivals has decreased dramatically, from roughly 16 per cent (1981–1985) to 11 per cent (1986–1993) and 6 per cent (1994–1998). If Cannes is excluded, the corresponding shares are 21, 10 and 9 per cent, respectively.

All these data are consistent with basic lessons from the economics of trade policy. The huge increase in subsidies (in particular after the 1989 Plan) has fuelled production of high-cost French entertainment films ‘à la Hollywood’. Such French films provide large private profits if successful, but sizable public losses absorbed by the French Treasury if the films are a failure. More crucially from a ‘culture’ perspective, by specially protecting French ‘clone films’ from the comparative advantage of Hollywood, this policy has accelerated the ‘Americanisation’ of French industrial film production, by inducing French producers and directors to

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turn away from cultural films and to focus on the secure and profitable niche of the market — films à la Hollywood. Moreover, the committees distributing the subsidies for cultural movies have also encouraged more homogeneous production instead of more diversification. The outcome seems the worst possible — an accelerated ‘Americanisation’ of French industrial film output and a sterilisation of French cultural film production.

### *Eroding support*

The CAPs are increasingly showing symptoms of fatigue. Support for the CAPs has eroded significantly in recent years, from both the large audiovisual firms and the public. This discomfort was recently expressed in press reports on wasteful subsidies and interviews with television CEOs calling for reform (Messerlin and Cocq 2000).

However, reform may be difficult to initiate. The existing CAPs are so complex that many participants want the status quo, simply because they are unable to assess whether they will gain individually from reform, even though there may be a net gain overall. Table 12.3 illustrates these conflicting forces for the major participants: theatre-owners, film producers (US, EC, French successful and French unsuccessful), television channels and French consumers. Of course, an analysis in terms of effective rates of assistance (ERAs) would be of prime importance here (Plunkett, Wilson and Argy 1992).

## **12.5 The limitations of the GATS for audiovisual services**

For audiovisual services, rules of origin, quantitative restrictions, subsidies and domestic regulations are the four major obstacles to trade relevant in a GATS context. This section focuses on two questions.

- To what extent could these trade barriers raise specific difficulties in handling the audiovisual sector in the coming WTO Round?
- To what extent do they hurt cultural audiovisuals substantially more than industrial audiovisuals?

The second question is particularly important because it indicates whether (and where) clarifying the definition of industrial and cultural audiovisual sectors will be beneficial to the point that it is likely to be supported by a coalition — in particular, by those concerned with culture.

Table 12.3 **French audiovisual policy: ‘Au nom de la culture’**

|                            | <i>Costs</i>                       | <i>Benefits</i>                                  | <i>Rents from protection</i> |
|----------------------------|------------------------------------|--|------------------------------|
| <b>Theatres</b>            | seat tax                           | subsidies <sup>c</sup><br>broadcast quotas on TV |                              |
| <b>Film-makers</b>         |                                    |  |                              |
| Hollywood                  | seat tax<br>broadcast quotas on TV | seat tax <sup>d</sup>                            | yes, except the best         |
| EC                         | seat tax<br>broadcast quotas on TV | subsidies  | no (unlikely to bind)        |
| French I <sup>a</sup>      | seat tax                           | subsidies  |                              |
| French II <sup>b</sup>     |                                    | subsidies  |                              |
| <b>Television channels</b> |                                    |  |                              |
| Air channels               | investment quotas,<br>taxes        |  |                              |
| Canal Plus                 | investment quotas,<br>taxes        |  | yes, from monopoly           |
| <b>Viewers</b>             | taxes, quotas, rents               |  |                              |

<sup>a</sup> Successful French filmmakers <sup>b</sup> Unsuccessful French filmmakers <sup>c</sup> If not shifted to production. <sup>d</sup> Equipment and comfort.

Source: See text.

Before looking at these four major obstacles to trade, two preliminary remarks are necessary.

First, a vast majority of WTO signatories — among them, the EC — have not made any ‘specific’ commitment on audiovisual services within the GATS, which are therefore excluded from GATS disciplines of market access, national treatment, and additional commitments (Articles XVI to XVIII). This does not eliminate the fact that EC audiovisual services have to comply with the GATS ‘general obligations and disciplines’ (that is, GATT Articles II to XV). In particular, the Members have to comply with Article II (most favoured nation treatment, though the EC has made use of the MFN exemption provided for by Annex to GATS Article II in order to cover bilateral agreements on ‘cultural’ exchanges), Article V (economic integration — listing the conditions necessary to escape from most favoured nation (MFN) disciplines in the case of ‘preferential’ trade relations) and Article XV (on subsidies). WTO panels are possible on all the matters covered by these Articles.

Second, the history of the Uruguay Round negotiations provides a sense of the provisions considered crucial by the audiovisual vested interests in the mid-1990s. France (backed by Spain and Belgium) was in favour of a ‘cultural exception’. Such an approach would have required adding an Article XIVter to GATS Article XIV (general exceptions) and Article XIVbis (security exceptions), excluding from the

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scope of the GATS all categories of audiovisual services under all present and future forms of technologies. The European Commission (backed by Britain and Germany, among others) was in favour of a more limited ‘cultural specificity’ aimed at restricting the scope of three GATS provisions:

- the Annex to Article II on most favoured nation treatment (by adding a clause allowing discriminatory co-production agreements in the audiovisual sector to last more than ten years);
- Article XV on subsidies (by adding a ‘flexibility’ clause); and
- Article XIX (by excluding, in case of ‘cultural values’, the audiovisual sector from the principle of progressive liberalisation — a principle which, if it gives more time for certain WTO Members, keeps the final goal of always increasing their general level of commitments).

Both efforts failed. The key reason was, probably, the fear among European governments and businessmen that excluding audiovisuals would incur too high a price in terms of forever excluding other sectors in which the European Community had some comparative advantage.

These aborted attempts deserve two more remarks. First, they show how difficult it is to introduce an exemption of a ‘general’ nature (such as the French proposal) into the GATS framework. Despite its many weaknesses, the GATS has an intrinsic strength flowing from the global WTO framework. The weak point of the French proposal was that implementing a cultural exception would have risked WTO panels continually checking whether the exception really involved audiovisuals or not. That is, the French proposal risked leaving the definition of the scope of the exception to non-EC Member states. Second, the only instrument-specific exemption tabled by the European Commission was on subsidies. The fact that the EC proposals did not include Article XVI (quantitative restrictions) reveals the difficulties of building a coalition on this instrument, and sections 12.3 and 12.4 suggest that this conclusion will probably be increasingly robust in the future.

### *Rules of origin*

There is no definition of, and no procedure on how to define rules of origin in the GATS text. While this problem applies to all services, it raises particular difficulties in the case of audiovisuals — often resulting in inconsistencies and farcical paradoxes.

Turning first to the inconsistencies, it is widely agreed that questioning the country of origin makes little sense when one talks about culture. Wondering whether Monteverdi is Cremonan, Mantouan or Venetian is clearly a silly question, and

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stating that he is Italian adds anachronism to nonsense. If the history of world cultures sends a clear message, it is that artists and art works travel as much as possible in order to combine influences. Thus, it seems inconsistent to defend culture by imposing rules of origin so alien to it, but so beneficial to industrial vested interests (as trade economists know so well from the GATT and WTO history). Interestingly, there has been no attempt to apply rules of origin to ‘scientific culture’ — there is an instrument (patents) at the disposal of scientists in every country which makes the ‘origin’ issue irrelevant. Similarly, book authors, architects, etc are protected by copyrights rather than rules of origin.

Such inconsistencies are more than conceptual — they have the capacity to undermine the operation of the international trade regime. For instance, the United Nations Educational, Scientific and Cultural Organization (UNESCO) is busy expanding the concept of ‘world heritage’ in an effort that extracts culture from narrow political borders. Proposing to deal with audiovisual issues within UNESCO, without establishing beforehand a distinction between industrial and cultural audiovisuals, would shift the above inconsistencies from the international trade architecture to inside UNESCO.

Leaving aside this basic problem, rules of origin in audiovisuals are likely to be solved in the WTO forum by adopting rules about local content, following the trend in goods trade. Rules of origin have increasingly been used the last two decades because of the expanding number of regional trade agreements, but experience shows that their use is unsatisfactory. It further distorts production patterns between countries, makes trade facilitation procedures more costly and generates corruption in public administration.

These flaws of a rules of origin regime will be even bigger in the case of audiovisuals, and they will be particularly costly for the cultural segment of the audiovisual sector. This is because there is no way to define a culture by its inputs. For instance, stating that, say, a French director gives a French ‘passport’ to movies raises two problems. First, a film made by a French director can be a perfect clone of an ‘American’ film — the last 20 years of the French film policy has left plenty of examples, and anyone looking at French television is welcome to test this assessment. Second, a film made by a foreign director permeated with French culture would not be considered French, even though it may be the best trophy of French culture.

There are more technical problems. In sharp contrast with goods (for which local content can be captured in one global indicator, such as a change in tariff lines or a percentage of value added), there is no possible synthetic indicator in audiovisuals, as best illustrated by movies. Plenty of criteria could be used for defining the local content of a movie (the director, the actors, the initial story on which the movie is

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based, the language used for the script or the location of shooting, etc), and, of course, there is no way of aggregating them in a meaningful way. The current French regime includes no less than 12 criteria, ranging from the language to the director, actors, scenery, equipment and other technical steps. This makes it a farcical illustration of the ‘inventaire à la Prévert’, if only because the same weight is granted to the actors as to the equipment. And yes, we are talking about culture!

The first way to solve the aggregation problem would be to require the fulfilment of *all* the listed criteria. This approach would be costly for industrial audiovisuals, but one could count on clever businessmen adjusting to this ‘one size for all’ policy. This is best illustrated by the movie *Le Affinità elettive*, based on Goethe’s work, directed by two Italians, shot in Tuscany and declared to be 100 per cent French on the grounds that 78 per cent of the dialogue was in French (three of the major actors were French).<sup>13</sup> Culture-minded audiovisual providers are less likely to have such a flexibility — making the system more harmful for culture than for business. Of course, the more criteria on the list, the more likely it is to hurt the cultural segment of the audiovisual sector.

In order to overcome these difficulties, there is little doubt that (pushed by vested interests in audiovisuals) the WTO will go one step further on such a Kafkaesque path, and decide that different weights should be given to the various criteria listed, and that nationality should be granted on a threshold basis. For instance, language could be worth 20 points, domestic star actors 10 points, etc, and the movie would be ‘domestic’ if it got more than 80 points (out of a total of 100 points). Such a solution would create more problems than it solved. For instance, what about regional languages? (In France, regional languages are accepted, allowing German, Italian and Spanish on board.) Why should star actors receive only 10 points (out of 100) when the success of a movie relies largely on them? Or would this small share be convenient enough to allow ‘French’ movies to rely on the reputation of foreign actors? Of course, from a culture-minded perspective, all these problems — and their solutions — produce Frankensteins, and disadvantage culture-minded moviemakers compared to industrially-minded directors.<sup>14</sup>

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<sup>13</sup> Opportunities for cheating are as large as in the Common Agricultural Policy. For instance, it would be possible to shoot in English, and to post-synchronise in order to get the ‘preferred’ language. French authorities have threatened to test for this by showing films to deaf people (able to recognise the language by looking at the actors’ lips). You said ‘culture?’

<sup>14</sup> And they increase the likelihood that a film can get several nationalities (independently from cases of joint production).

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### Quantitative restrictions

There are two different types of quantitative instruments relevant to audiovisual services:

- those imposed on services *per se*, either directly (the number of films) or indirectly (the time available for broadcasting foreign programs); and
- those imposed on factors of production, in particular limits on ‘foreign’ casting in ‘domestic’ films and the capital ownership of foreign investors.

This second source of quotas is particularly important in audiovisual services, which are characterised by extensive periods of working abroad. Relaxing or tightening constraints on such an input is likely to have a huge impact on the output, since a few actors are a recipe for success, or at least, for damage containment — a key advantage in the highly unpredictable world of audiovisual works.

Concerning quotas on services *per se*, audiovisual services are the only ones subjected to a GATT provision (Article IV) explicitly *authorising* quotas. Article IV allows WTO Members to impose screen quotas, defined as a percentage of the total screen time actually utilised. This provision echoes several agreements between the United States and European countries (Britain and France, among others).<sup>15</sup> It is unlikely to be harmful in the near future, mostly because technical progress tends to shift audiences away from movie theatres, and because the US Majors have invested in movie theatres outside the United States (and many theatres would be unprofitable without Hollywood films). Moreover, the wording of GATT Article IV is precise enough to make it difficult to extend its use to other audiovisual works, although the GATT Working Party of the early 1960s unsuccessfully sought to extend Article IV to television programs.<sup>16</sup>

As a result, GATS Article XVI on market access is likely to play a much more important role. It prohibits quotas, be they based on the number of service suppliers,

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<sup>15</sup> The so-called *Blum-Byrnes Agreement*, signed in 1946 by the United States and France, was negotiated at the request of the United States Government. Before World War II, there was an annual quota on dubbed films in France (150 US films out of a total of 188 films). In late 1944, the post-Vichy French ‘*gouvernement provisoire*’ imposed a ban on all foreign films, arguing from the reduction of the number of movie theatres and from the elimination of the ‘double program’ regime (which allowed a spectator to see two movies with one ticket: its elimination was equivalent to a price increase).

<sup>16</sup> Despite the absence of a formal agreement on extending GATT Article IV to television programs, the mere existence of Article IV represents a danger. For instance, there are regularly new pressures to re-impose screen quotas in France. However, as long as the US Majors retain their comparative advantage, the danger is small.



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on transaction values or on asset values ‘unless otherwise specified in the country’s schedule’.

Lastly, concerning disciplines on factor-based quotas, the GATS has very little about the movement of labour and ownership, and it has nothing about investment, except about limitations on the participation of foreign capital (these are irrelevant for the EC, which has made no market access commitment). The lack of provisions on the movement of labour is likely to be more costly in the cultural segment of audiovisuals than in the industrial segment. The reverse applies for constraints on capital. As the movement of labour is more constrained than capital flows, the absence of disciplines in the GATS may be more harmful to cultural than to industrial audiovisuals.

In any case, the widespread ten-year exemption for audiovisuals makes it impossible to test the strength of Article XVI disciplines. As a result, the coming decade will witness crucial debates on the two following questions.

- In countries implementing protectionist audiovisual policies, to what extent will an emerging understanding that quotas have been inefficient (see below) induce these countries to take commitments under GATS Article XVI?
- Even more importantly, will there be a growing recognition that quotas have been a particularly harmful instrument for protecting cultural audiovisuals?

### *Subsidies and domestic regulations*

These two issues should be examined together, as both deal with the same fundamental objective of designing and implementing the best possible domestic regulatory framework for audiovisuals in general, and for cultural audiovisuals in particular. It should be noted that regardless of international problems, subsidies raise domestic questions because they are transfers between nationals. As these transfers are costly to design and implement, they raise the question of whether lower subsidies would lead to a better cultural outcome through better design of domestic regulations. Because they are interconnected, subsidies and domestic regulations should constitute the core of a Reference Paper that is probably necessary for integrating audiovisual services into the WTO (see section 12.6).

GATS Article VI on domestic regulation is very general. Its limitations are not as severe as they may seem at first glance. GATS Article VI contains all the ‘seeds’ needed for drafting a Reference Paper because it goes further than the usual stance on transparency, which, although useful, is far from sufficient. In particular, GATS Article VI contains the two key elements needed for successful regulatory reform. It insists on the ‘lightness’ of the regulations (‘not more burdensome than necessary’),

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which echoes cost minimisation for a given objective. And it ranks highly the two major qualities of suitable dispute settlement procedures (speed with ‘prompt review’, and action with ‘appropriate remedies’).

By contrast, GATS Article XV (subsidies) is an almost empty shell in terms of the disciplines it imposes on subsidies. The current draft is of little help in addressing the ease with which subsidies can be introduced on behalf of culture, and for industrial purposes. The only interesting aspect of GATS Article XV is that it does not consider countervailing procedures (which have been disastrous in the case of trade in goods) as necessarily ‘appropriate’. This possibly opens the door to better anti-subsidy disciplines, all the more essential in the case of audiovisuals. Because of the ambiguity of GATS Article XV, WTO rules on subsidies to be inserted in any Reference Paper will be difficult to draft. It will be even more difficult because subsidies are the instrument for which it is easiest to build a coalition between the industrial and cultural segments of audiovisual services.

## **12.6 Liberalisation and regulatory reform: ‘Independence day’?**

The coming decade begins with better prospects for integrating audiovisuals into the WTO than existed under the Uruguay Round. Profound changes have occurred in the European Community and United States, generating a much less antagonistic world than six or seven years ago. However, the GATS framework could not become fully operational without the adoption of a Reference Paper laying down certain obligations specific to the audiovisual sector. In particular, the paper should make clear the distinction between industrial and cultural audiovisuals, in order to exempt cultural audiovisuals from certain WTO disciplines. This section describes key changes that would be propitious for the coming negotiations, then raises a few essential issues that the Reference Paper should address and concludes by insisting that liberalisation would only be fully beneficial if domestic regulatory reforms were also adopted.

### *A rapidly changing world*

In contrast with the general acceptance of CAPs in the European Community until the mid-1990s (Messerlin 1997), an increasing number of people are realising that they are inappropriate for ‘promoting culture’, instead often harming culture (see section 12.4). Moreover, most large EC audiovisual firms are changing their mind. The technical evolution in audiovisuals (cable, satellites, and telecommunications) has seen the integration of some audiovisual companies into parent companies with

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many other business lines. As a result, reciprocity is now a concept working *inside* EC firms. If Vivendi (the parent company of Canal Plus) or Suez Lyonnaise des Eaux (the parent company of M6, the only successful French air-television channel) want open access to US utility markets or to US radio waves, they have to be ready to accept liberalisation of EC audiovisual markets. This evolution has been accelerated by the realisation that ‘large’ EC firms are small relative to their American (North and South) and Asian counterparts. This ‘smallness’ is largely a consequence of the market segmentation generated by the CAPs and it constitutes a heavy handicap — less because it limits scale economies than because it limits risk spreading, making the long-term survival of these firms doubtful in an audiovisual industry characterised by huge and unpredictable risks.

In the United States, Hollywood still enjoys a unique capacity to produce movies that can be seen all over the world with equal success. It is a major European misconception that Hollywood produces ‘American’ movies — instead, it produces ‘worldwide’ movies. But US Majors are facing rising costs at home, forcing them to invest outside the United States and, hence, to become closer partners of audiovisual firms in the host countries. At the other end of the audiovisual spectrum, ‘narrowcasting’ has opened niches in which non-US firms have been quite successful (often by learning from and cooperating with US firms). Entry into US markets becomes a realistic target for these firms — a modest start to two-way trade in audiovisual content. Lastly, internet-based technologies reduce audiovisual entry costs, an evolution that will favour non-US firms (which tend to have a comparative advantage in ‘non-mass’ markets) more than US firms (which tend to have a comparative advantage in ‘mass’ films and have invested in theatres accordingly).

A last important change is the erosion of the EC coalition supporting highly protectionist CAPs (all other things being equal), largely because EC Member states face very different situations in terms of the prevalence of their language, hence market size and structure. Three Member states (Britain, Spain and Portugal) have large markets with the same language outside the European Community. This makes it easier for viewers from these Member states to perceive benefits from foreign competition, especially since powerful non-EC audiovisual firms operate in their non-EC markets. Three EC Member states (France, Germany and Italy) have relatively large markets with the same language in Europe, but limited markets outside the European Community. While Germany and Italy are accustomed to this situation (they have always had limited territories outside Europe), France is not. As a result, a strong coalition of these three countries is unlikely (as shown during the Uruguay negotiations). A strong coalition is even less likely given that the key French audiovisual firms are fast trying to internationalise their activities, and have been included in parent companies with worldwide perspectives (best illustrated by

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the position of Canal Plus after the proposed merger of Vivendi and Seagram). Lastly, the other Member states are accustomed to two or more languages, making them relatively open (maybe with the exception of Belgium).

### *The need for a Reference Paper*

The GATS limitations (section 12.5) and the resulting weakness of the existing legal framework make complete liberalisation difficult without the support of a Reference Paper, especially if the problem of culture is to be addressed (as it should). The following discussion presents a few key issues to be addressed from a European Community perspective.

GATS Article XVI (market access) offers enough generality and precision to cope with all the problems raised by a progressive relaxation of typical quotas. In particular, GATS Article XVI offers a robust basis for negotiating the elimination of broadcast quotas (additional type (i) to (iii)-quotas do not really matter, see section 12.3). If EC governments are strong enough (and confident enough in European creativity), quotas reserved for domestic audiovisual works could be eliminated in a few years. If EC governments are faint-hearted and invoke the GATS concept of ‘progressive’ liberalisation, the minimum achievement in the coming Round would be a bound reduction in quotas to the level of the share of domestic films in theatres. This would reduce the reserved quota in France from 60 per cent to roughly 30 per cent, and from 51 per cent to 20 per cent or less in other EC Member states.

However, GATS Article XVI has some difficulties in handling the reduction and elimination of investment quotas. GATS Article XVI is written in general enough terms to allow such a reduction or elimination. It could even allow a reduction on a firm-by-firm basis. For instance, constraints on Canal Plus could be reduced more rapidly than the investment obligations imposed on the other firms. But this evolution raises a question that GATS Article XVI cannot address. Canal Plus’s specific investment obligations flow from its monopoly power, and that power should be eroded at the same pace as its obligations. In other words, the full use of GATS Article XV on subsidies may require the use of Article VI on domestic regulations (in addition to market access). This is where a Reference Paper becomes necessary.

In particular, a Reference Paper should offer specific ways for handling progressive liberalisation of the audiovisual subsidy schemes, under the constraint that cultural audiovisuals — and only these — should not be limited by certain WTO disciplines (eg subsidies), though they should be subject to other WTO disciplines (eg the no quota commitment). This goal requires that the Reference Paper provide, not a

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definition of culture (an impossible task), but proxies for culture that would be accepted worldwide and could be used for bargaining. The following discussion provides some tentative illustrations.

- A first proxy could be the number of films made by a director. The first film of a director, say, could be largely subsidised, with the subsidies being reduced for the second film, and eliminated for the third and subsequent films. Such a proxy aims at addressing several goals:
  - it fits the frequent request for cultural diversity;
  - it seems consistent with the fact that a director able to create two films successfully (with declining subsidies) is likely to find the funds necessary for additional films;
  - it is unlikely to involve massive subsidies (for instance, the subsidies granted to ‘first’ films in France represent only 5 per cent of total annual French subsidies); and
  - it allows some progressivity to initiate the process.

Of course, such a proxy can be circumvented (if only by the use of figureheads). As a result, some additional constraints could be imposed, such as a cap on the subsidy. By definition, a subsidy on a first film should be small since the budget of such films is small. For instance, the average subsidy for first films in France is roughly US\$ 300 000.

- Such a proxy could seem inadequate to certain WTO Members, because it relies on the assumption that ‘cultural’ movies by confirmed directors could not be costly (indeed, film history suggests that it is the case). An additional approach would be to negotiate an ‘amber’ box — a maximum amount of annual subsidies, or a maximum number of films to be subsidised — in addition to the first movie(s) exemption. However, it is clear that such an amber box could easily generate the same protectionist drifts as those shown by the blue box in agriculture.

All these disciplines aim to eliminate the amount of subsidies granted to industrial audiovisuals and to make sure that subsidies granted to cultural audiovisuals will not be diverted to industrial audiovisuals. However, such liberalisation will only be fully beneficial to culture if accompanied by appropriate domestic regulatory reform.

### *Domestic regulatory reforms*

Eliminating industrial subsidies and allowing cultural subsidies is possible because these two segments of the audiovisual sector are quite distinct (Cocq 2000). This

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point is well illustrated by a recent and bitter dispute between French film directors and critics that revealed three categories of directors: those making successful industrial films; those making unsuccessful industrial films; and those making cultural films (Cocq 2000). Pressure for additional protection came from the second group, but it was striking that they got no support from the first and third groups of directors.

However, if a Reference Paper is a necessary condition for improving support for culture, it is certainly not a sufficient condition. Domestic regulatory reforms are also required.

Democratic regimes can hardly nurture culture if they do not recognise and correctly handle the key aspect of culture — that it has to be a ‘bet’. There is almost no way of knowing in advance which bets will go into the treasuries of human kind, which ones will be important preparatory works, and which ones will be deadends or wastes. Risk is thus the key factor. Hence, the absolute necessity of ‘real’ patrons, that is, individuals or small groups of people who risk their money and/or their reputation. Venetian doges, French kings, Chinese emperors and American billionaires have all taken *individual* risks by asking certain architects, painters and writers to work for them. They have spent their money on, and linked their fame to, a painting, a musical composition or a literary piece. In fact, there were complex and competing pyramids of risks, with aristocrats and commoners ‘testing’ new styles under fierce competition. This is, perhaps, best illustrated by Louis XIV using the same team to build Versailles as his Finance Minister (who ended his life in jail) did to conceive and build his castle of Vaux-le-Vicomte (often called the ‘blueprint’ of Versailles).

Democratic governments cannot exercise this ‘patron’ function in a direct way. When they try to do so, they create bureaucratic committees that tend to overspend, preferably on friends and in a reciprocal way, and/or tend to spread the money in a politically correct way (leaving France today more ‘bourgeoisie’ and ‘conventionnelle’ in many artistic respects than it was under Louis-Philippe in the 1840s). This inability of democratic governments is a well-known problem (indeed, hotly debated during the French Revolution (Monnier 1995)). Thus, there is a need to look at the best institutions that could, in a democratic regime, nurture culture. The key challenge is how to design such ‘patron-institutions’ in order to make them as interested in cultural creativity as possible (and as different as possible from the existing bureaucratic committees). Without meeting such a challenge (which goes beyond this paper), liberalisation would simply be neutral for culture. In fact, liberalisation may be beneficial for culture only to the extent that it improves the way artists are funded.

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There are many candidate institutions that could improve funding for artists. The following discussion briefly mentions two aspects relevant to audiovisuals in an international context. First, culture sheds some unusual light on intellectual property rights. If it is important that such rights exist and are enforced, the current tendency to expand these rights is worrisome. Longer copyrights (from 50 years to 70 years in the European Community) or stronger enforcement (as with the recent WTO panel on music rights, or the payment of royalties to the architect of the French Très Grande Bibliothèque in return for taking its photograph) could generate ‘excessive’ costs that could endanger the emergence of future culture. This brief observation may suggest that any Reference Paper could also look at the Uruguay Agreement on Trade-related Aspects of Intellectual Property (TRIPs) in the context of culture, possibly by integrating work done in the context of the Treaties regulating art works, and should be careful to balance the TRIPS agreement with appropriate competition policies.

Second, subsidies allowed by any Reference Paper should be better used. Some useful conclusions might be drawn from comparisons between the various EC schemes for granting subsidies — from the completely centralised and Byzantine French system to the more decentralised, but no more successful, German regime, to the relatively more successful (so far) British ‘franchise’ framework. The British approach is the only one that tries to maintain competition in ‘patrons’ production’ — capturing the core aspect of what is a patron. Improving this aspect may be as important for culture as focusing on reforming funding sources (shifting from a public to private funding<sup>17</sup>) or reforming distribution structures (public television channels or specific narrowcasting channels could show ‘cultural’ audiovisual works to a wider audience than theatres, without the risk of being crowded out by ‘industrial’ movies). The fact that ‘cultural’ audiovisual works would benefit much more from e-commerce than ‘industrial’ works in terms of audience and reputation should be taken into account by the European Community when looking at the e-commerce issues. It should induce the European Community to be more open on e-commerce issues than the United States.

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<sup>17</sup> Although, it could be argued that setting up competition among patrons to spend public money may lose an important motive to do well, namely to lose money.

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