

# Preparing Negotiations in Services: EC Audiovisuals in the Millenium Round. The World Services Congress on “Services: Generating Global Growth and Opportunity”

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## **Preparing Negotiations in Services: EC Audiovisuals in the Millenium Round**

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September 1999 (Comments welcome)

### **Introduction**

Under the 1994 Uruguay Round Agreement, only 19 WTO Members have made commitments in audiovisual services in their GATS schedule. As illustrated by Table 1, these commitments are generally of limited scope and magnitude [WTO, 1998]. Among the large audiovisual producers, only the United States have taken substantial commitments at the various stages of audiovisual production, distribution, and transmission.<sup>2/</sup> Though much more limited, the commitments by Hong Kong, Japan and India (the world largest film producer) have shown the acceptance by large producers with very influential cultures to consider the issue of liberalization in audiovisual services with an open mind. The rest of the WTO members, insecure about the ability of their audiovisual industry to face competition and/or willing to minimize the exposure of their people to foreign influence, have severely limited access to their markets. This broad coalition was led by the EC, the only large audiovisual producer in this camp.

If services would follow the same pattern of negotiations than goods, WTO negotiators would try to get out of such a situation through inter-sectoral trade-offs -- with the help of the U.S. audiovisual sector lobbying the U.S. government for the opening of maritime transportation, and of EC water utilities or Canadian lumber firms lobbying for removing EC or Canadian barriers in audiovisuals. These trade-offs may be a component of WTO negotiations in services. But, they are unlikely to be a driving force because reciprocity (the concept behind inter-sectoral trade-offs) has a more limited meaning in services than in goods. Hence, the chances to include audiovisuals in the coming "Millenium" Round of negotiations have so far been received by skepticism in WTO circles.

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<sup>2/</sup>Table 1 focuses on the major items of the Central Product Classification (CPC) related to audiovisuals. Items related to inputs (such as actors) are left aside. Moreover, there has been some disagreements about the accuracy and appropriateness of the Classification. We leave these points aside (despite their importance for the negotiations *per se*).

The paper argues that on contrary, there are good reasons for optimism, and the initiative about trade and culture launched in Summer 1999 by Canada (which pertains to the second group of countries described above) is a first, though tenuous, sign of change. This optimism flows not only from the systemic evolution underlined by Siwek [1999], but also from ongoing profound *economic* changes (*partly* driven by technological changes) in importing countries, including in the large EC film markets on which the paper focuses. The European Common Audiovisual Policies or CAPs (the plural is required because the implementation of the European common audiovisual regulations is mostly left to Member states) are as highly protective as the Common Agricultural Policy (CAP). But they increasingly show the same fatigue symptoms than the CAP, and broadly for the same reasons. As a result, the coming years may witness a significant erosion of the support to the CAPs, first among large audiovisual firms, then among regulatory agencies directly in contact with markets, lastly (as usually) among EC and Member State authorities. After describing the first manifestations of this erosion, the paper investigates the ways which could *both* hasten the process *and* provide adequate instruments to answer legitimate questions about culture (which are raised in the U.S. as well as in the EC).

The paper is organized as follows. Section 1 presents ongoing and future technological changes engulfing EC audiovisual firms in a worldwide competition, and making these firms increasingly conscious that their size is not appropriate -- that they are too small for the entertainment markets *and* too big for the "culture" markets. Section 2 shows that this situation has been largely created by existing CAPs, and it describes the emerging recognition in Europe that these policies did not provide the expected positive outcomes, but that they have rather led to unexpected (for their proponents) costly results not only for film viewers, but also for many audiovisual firms. As a result, when reviewing their own strategies, EC firms will increasingly ask for EC "unilateral regulatory reforms."<sup>3/</sup> Section 3 then suggests a method for hastening such EC "unilateral" regulatory reforms and for preparing WTO discussions on audiovisuals.

### **1. Audiovisuals in the Millenium Round: "Mission impossible"?**

Because of their heavy emotional content, audiovisual services are a good illustration of the fact that the traditional negotiating instrument for liberalization (reciprocity) is weak to the point to lead to pessimism if one counts only on it. Fortunately, other forces are at work.

#### ***Reciprocity: "Apocalypse Now"***

Reciprocity will be of limited use for introducing audiovisuals in the Millenium Round for several reasons [for detail, see Hoekman and Messerlin, 1999]. It cannot be easily measured in the services context: negotiators will have little clue for assessing whether liberalizing audiovisuals will be (or not) worth roughly the same value than trade

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<sup>3/</sup>The paper defines "regulatory reforms" as Winston [1993]: de-regulation of economic conduct (pricing, exit and entry) and re-regulation of social conduct. Social conduct in audiovisuals means the introduction of better rules for promoting culture than the existing rules -- a relatively easy goal since current rules did (still do) about nothing for culture.

liberalization in maritime transport or in water utilities -- hence whether “trading” liberalization in EC audiovisuals for market access in foreign maritime transport or water utilities would be a good deal. Negotiators’ lack of information will be put under strong pressures by increasingly heterogeneous audiovisual firms: for some of them, potential trade-offs will be an internal matter (for instance, Vivendi in France is a large water utility firm and own a large audiovisual firm, Canal Plus) whereas other firms operate only in audiovisuals. Myopic negotiators and powerful but divided lobbies are likely to be a sure recipe for *status quo*.

Negotiators’ difficulties do not flow from ethereal considerations about “culture.” They emerge in the very first steps of negotiators’ usual computations about the value of concessions.<sup>4/</sup> For instance, reliable data on imports require a definition of the “rules of origin” which allows a clear distinction between imported and domestic products (services), and between products (services) imported from different countries. That is not the case in audiovisuals. Defining a “domestic” film is not a simple matter, and differences in definitions lead to huge differences in volumes or values. For instance, French authorities have three alternative definitions (“integrally” French films, “French-initiated” films and “CNC-supported” films): in the five most recent years (1994-98), the narrower definition (integrals) leads to an average production of 77 films, and the wider (CNC-supported) to an average of 147 films, a difference of almost the double.<sup>5/</sup> Criteria for classifying a film are so complicated that they often lead to arbitrary decisions: for instance, the “*Fifth Element*” has been considered as an integrally French movie because it has been largely financed by a French studio, although it has also been funded by an U.S. firm, made in London, in English, with non-French actors -- all infringements to normal conditions for getting the status of an integrally French movie. Lastly, reciprocity tends to have a much more limited impact in services than in goods. In goods, removing a tariff is often enough for changing substantially pricing behavior, entry and exit. It is not generally the case in services where border liberalization requires *domestic* regulatory reforms to provide the expected welfare benefits.

In addition to these general obstacles, two obstacles specific to audiovisuals make things even more difficult. First, there is a strong link perceived between audiovisuals and “national culture” in many GATS members, as best illustrated by the EC, Australia or Canada. Any liberalization of audiovisuals has to take into account this emotional aspect. The paradox is that the *existing* regulatory policies which are allegedly supporting domestic culture tend to harm it profoundly: as shown below, the CAPs induce strongly European film makers to mimic U.S. film makers -- leading to an accelerated “americanization” of the

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<sup>4/</sup>Calculations for reciprocity in goods consist in getting the value of concessions received and granted, both being estimated by the tariff reductions (received and granted) weighted by the trade (import) value involved.

<sup>5/</sup>If one limits to traded films, this percentage is higher because many integrally French films are not exported, whereas many of the “CNC-supported-but-not-integrally-French films” are co-produced, hence “imported” and “exported.”

European cultures, as best illustrated by the French case. The problem is that this paradox is rarely perceived and recognized in Europe -- making particularly hard for launching regulatory reforms addressing the national culture issue in a sensible and convincing way, and making particularly easy for vested interests to defend the upholding of existing protection.

Second, audiovisual producers (film directors, film-makers involved in advertising) are, by definition, “masters” in public relations. They are able to exert unusually skillful and powerful pressures on governments, as recently illustrated by the fact that a few European film-directors have provided the “coup de grâce” to the OECD-based Multilateral Agreement on Investment (MAI), at a time when it was already clear that audiovisual services were excluded from the MAI coverage [Henderson, 1999]. As the audiovisual sector is an essential instrument of the day-to-day relations between the “rulers” and the “people,” government officials need media professionals on a regular basis who, in turn, ask for protection, creating obviously *quid-pro-quo* situations which can be easily hostile to liberalization.<sup>6/</sup>

These factors imply that coalitions needed for counterbalancing audiovisual protectionist lobbies should be larger than in other services. This heavy constraint on reciprocity leads to skepticism about multilateral negotiations on audiovisuals.

***Technological and economic tremors: “The Quantum Project”<sup>7/</sup>***

However, such a skepticism ignores the extent to which technology is profoundly changing the audiovisual markets, inducing firms to make drastic revisions of their strategies, and to ask for *unilateral* regulatory reforms. As technology progress is perceived first by firms, it makes more important their rôle in the negotiating process, generating a potential divorce between the most dynamic firms and governments captured by prejudices and laggards. What follows reviews quickly these aspects.

As is well known, technical progress in telecoms is generating profound changes in audiovisuals, and it is far to be over. Digital telecoms and other innovations (including the possible use of electricity grids for telecom purposes) are likely to be as powerful in audiovisuals as in telecoms, and reduce the governments’ ability to protect domestic markets. For instance, the EC quota on foreign movies in TV programmes (40% of all broadcast movies) will become obsolete when EC TV-viewers will be able to download at a reasonable cost movies from a satellite dish through Internet (or from terrestrial digital TV in countries like the EC which allows for free cross-border diffusion between Member states). This technology makes possible for each broadcaster to fulfill the current EC obligation of supplying permanently 40% of domestic films (if only by installing audiovisual daubs produced in large quantities by CAPs), whereas European TV-viewers would only download

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<sup>6/</sup>There is a noticeable correlation between French major elections and increases in audiovisual subsidies.

<sup>7/</sup>This is the title of a \$3 million-40 minutes film made specifically for initial Internet distribution (in May 2000) by Metafilmics [International Herald Tribune, 25 August 1999, p.1].

foreign films supplied by this firm.

These coming technological changes force EC firms willing to survive as world players to re-assess the contours of the market relevant to them, and to realize that they are small in “global” markets. Table 2 illustrates this point for 1997 (the last year for which data are available): the average size among the 23 EC largest firms is half the average size among the 15 U.S. largest firms. As audiovisuals are among the riskiest economic sectors, size is also a matter of risk management: Table 2 shows that EC firms are significantly more specialized in audiovisual activities -- hence more fragile in case of downturns. These undesirable features appear correlated with CAPs: EC firms tend to be smaller and less diversified in the EC Member states which enforce the strictest restrictions. Since 1997, major mergers, acquisitions and alliances have been concluded in the U.S. and in Europe, but they don't modify substantially Table 2 results.

This correlation is not accidental. EC protectionist measures have consisted in taxing and in reinforced or creating monopolies, two sure recipes for inhibiting normal market growth: the more strictly the CAPs were enforced, the more the markets were severely segmented and restrained, the smaller the EC firms tended to be. The recent years have revealed all these contradictions: as EC audiovisual firms tend increasingly to be monopolies, they have become the target of European competition policies for “abuse of dominant power,” a paradoxical outcome of the restrictions in place. For instance, the largest French firm (Canal Plus) has been recently condemned by French competition authorities for excessive market power in film catalogue. This is because, in accordance to existing audiovisual regulations, the relevant market as defined by French competition authorities has been the French-speaking film market, that is, 40% of the French market -- in sum, a small portion of an already relatively small market by world standards. At the EC level, mergers in EC audiovisual services represent 2% of the total number of EC mergers, but the ban of such mergers by the EC Commission amounts to half of all the merger bans decided. In sum, EC firms are kept smaller than they could be because audiovisual policies are segmenting national markets.

Being relatively small, unable to grow because of artificial segmentation, and often in quasi-monopoly (rent-creating) situations, EC audiovisual firms have been interesting firms to buy. Most of them have become part of firms owning and operating other activities (rarely cultural activities): press and publishing (Bertelsmann, Canal Plus-Havas, Fininvest, Kirch), advertising (Canal Plus-Havas and Fininvest), insurance (Fininvest), telecoms (Bertelsmann) and utilities (Canal Plus-Vivendi).

This recent integration of EC audiovisual firms in a wider set of activities is essential because it may change the balance of coalitions supporting the next WTO Round. Being a profound departure from the traditional European scheme of public monopolies specialized in audiovisuals, it is likely to influence the debate about culture in two ways. First, it enlarges the vision about “cultural goods,” fudging the economically sterile (but politically powerful) debate about trade balances. For instance, the negative EC trade balance in films is a powerful argument for protection (despite its economic non-sense). A wider vision about

cultural goods will balance the negative EC trade balance in films by the positive EC trade balance in books, help to diffuse the pressures on narrow “cultural” protection. Second, EC firms looking for access to foreign markets for their non-audiovisual activities will be less hostile to the opening of EC audiovisual markets.

All these powerful forces for changes are at work. Our understanding is that they are waiting for an initial push in order to appear in broad daylight. The discussion about the fate of the 10-years cultural exception may offer this opportunity, and the August 1999 Canadian initiative on trade and culture may be a first step -- leaving the EC as the only large audiovisual producer which may try to argue that the “audiovisual/cultural” exception is for ever (despite the use of the term “indefinite” in its schedule which is quite consistent with the 10 years deadline). Of course, there is always the possibility that exceptions could be followed by waivers, and that waivers will be traded. Possible “negative” trade-offs (such as trading protection in maritime cabotage for protection in audiovisuals) may well fit negotiators’ tactics captured by vested interests. But, they may not necessarily fit the interests of the EC audiovisual firms facing technological challenges and/or owned by firms interested in WTO deals in other services.

## **2. Audiovisuals in the EC: “Titanic”**

There is a slowly increasing sense of dissatisfaction in Europe with the CAPs which have been developed during the late 1970s and early 1980s in certain Member states (most notably, in France and Germany) and then “communitarized” with the *Television Without Frontiers* (TWF) Directive adopted in 1989. Today, more voices recognize that quotas are useless, a position still taboo a few years ago.<sup>8/</sup> Although the same conclusion is not yet reached for subsidies (still almost unanimously praised in EC audiovisual industry) the CAPs are perceived as less protective as it was initially expected, and as having negative effects, *including* for film firms.

The section provides a brief survey of these effects. Though it draws many examples from the French case, it is important to stress that most of the EC Member states (including “free trade minded” countries, such as Britain) have adopted (or kept) measures in audiovisuals relatively similar to the French policy [Stetser, 1996].<sup>9/</sup> For instance, as shown by Table 3, the shares of U.S. and domestic films in British and French theaters may seem quite different in the mid-1990s. But U.S. films market shares in Britain (1997) and in France (1998) are similar, and, as a corollary, the same can be said for the market shares for domestic films (see Table 5). Table 3 also shows that the shares of U.S. fiction (TV) works are almost identical in Britain and France.<sup>10/</sup>

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<sup>8/</sup>However, the debate about the new audiovisual law in France has revealed opponents to the current pattern of distributing these subsidies between beneficiaries.

<sup>9/</sup>More details about French specifics can be found in Messerlin [1997] and Cocq [1999].

<sup>10/</sup>One could argue that nevertheless, the resulting level of protection is different because in Britain, BBC channels broadcast few American movies but BSkyB broadcasts almost

### *Quotas: "A bout de souffle"*

As is well known, the market share of U.S. films broadcast by EC TV-channels is restricted in an indirect way. The TWF Directive imposes "broadcast" quotas based on "film" nationality which are rigidly enforced only in France (and Belgium): at least 40% and 20% of the total annual number of movies broadcast by every EC TV channel should be, respectively, "national" (i.e., originated from the Member state in question) and "European" movies, leaving a maximum share of 40% to non-European (*de facto* U.S.) movies.

Broadcast quotas are far to be the only quantitative restrictions enforced in EC audiovisuals, as best illustrated by the French case. There are also "global" quotas which limit the total number of films to be broadcast and time-specific quotas which prohibit the broadcasting of films certain days and hours by air-TV channels: both quotas aim at protecting movie theaters from competition by TV-channels.<sup>11/</sup> There are quotas on investments which require every TV-channel to invest a share of its resources in film production, by "pre-purchasing" and/or "co-producing" films: 3% of the net turnover in the case of air TV-channels, 20% in the Canal Plus case (out of which 9% for French films). There are arcane rules on programming films in theaters, TV-channels and videos (though these rules have been recently loosened for unsuccessful films).

The key question is: are all these quotas binding? The answer is likely to be negative for quotas on the total number of films to be annually broadcast: these quotas have been substantially increased over time, and they are not so different from the number of broadcast films in EC Member states which do not enforce such a restriction. But, the answer is positive to the extent that the *structure* of the broadcast films by nationality is different from what it would have been without these quotas. Broadcast quotas on U.S. films are strongly binding since U.S. films have a market share ranging from 53 to 63% since 1989 (hence, much larger than 40%) in cinemas where French viewers can make free choices. The same could be said for investment quotas which contribute to increase production of French films.

What matters is that these protections have not the expected *positive* impact on French films. Despite heavy subsidization (see below), there is not *enough* French films for feeding the quota of French films during TV prime time. Between 1994 and 1998, there has been, on average, only 10 French films per year having enough success in theaters (more than 1 million viewers) to be candidates for broadcast during prime time -- compared to an average

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exclusively such films, whereas *every* French TV channel broadcasts at most 40% of American movies. As a result, a British viewer equipped with satellite TV has a less-restricted choice at any time of the day than a French viewer (he can always see an American movie). But, one could also argue that a French viewer equipped with a VCR buys twice more blank video-cassettes than its British counterpart -- probably for good reasons easy to understand.

<sup>11/</sup>Canal Plus can broadcast 364 movies, whereas air TV channels can only broadcast from 170 to 192 movies per year, depending the channel. Canal Plus is not subject to "global" quotas: it can broadcast as many films as it wants during "prime time" hours whereas other air TV channels can broadcast only 104 movies during these hours.



of 24 U.S. films. As a result, TV-channels have had to have increasingly recourse to massive reruns of old French films (the rerun rate has increased from less than 60% in the 1980s to 70% in the 1990s) and to TV fiction works -- relegating the recent (subsidized) French films for feeding the TV late or early hours of the day, and for meeting the annual 40% quota of French films.

### **Subsidies: “Men in Black”**

Table 4A shows that all EC Member states implement massive subsidy schemes. However, it deserves two remarks. Relying on 1994 figures, it shows a British exception which has been eroded since then by the British National Lottery contribution to film production for roughly ECU 20 million per year -- although the subsidy equivalent of this fund is smaller because 70% of these funds are effectively reimbursed, implying a subsidy equivalent of ECU 6-7 million. Table 4A also underestimates substantially the amount of French subsidies (and of a few other Member states: according to other sources, Italian subsidies are 25% higher than Table 4A figure). In order to limit problems related to unaccurate information (and because of the specificity of each Member state subsidy policy), the rest of the section focuses on French film subsidies (French subsidies granted to TV-fiction works are ignored).<sup>12/</sup>

Table 4B provides a complete information on *public direct* subsidies granted to French films for 1975, 1980, 1985, and for all years from 1988 to 1998.<sup>13/</sup> Subsidies have more than doubled (in constant 1995 French francs) whereas the number of films has increased by less than 15%. The resulting rate of subsidization (subsidies in percent of film revenues) is massive. Until the late 1980s, film revenues have been almost exclusively drawn from their release in theaters: on this base, the subsidy rates range from 16% (1975) to 70%

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<sup>12/</sup>The EC-French system is extraordinarily complex: the specialized “guide” of 318 pages lists 17 broad types of subsidies, only for feature films and excluding regional aids [Fougea, Kalck and Rogard, 1993]. In a nutshell, French film subsidies can be divided in two major categories: aids to production and aids to movie theaters (*aides à l'exploitation*). Among production subsidies, automatic aids (*soutien automatique*) and selective aids (*avances sur recettes*, or advances on revenues) play a central role. They are granted to film makers through the CNC agreement, hence the crucial role of this institution. Though most of the production subsidies are technically *avances*, they are *de facto* pure subsidies. For instance, reimbursements of such *avances* granted to film makers between 1985 and 1991 have reached roughly 12% of the *avances*, a result provided by two CNC studies [CNC Info, 1984, August, No.202, page 6, and CNC, 1997].

<sup>13/</sup>A specificity of French subsidies (see Table 4A) is the large share granted to movie theaters (*exploitation*), compared to aids to production. The official rationale for this feature is that theaters are necessary for showing new films, and generating the targeted cultural diversity. However, this rationale fits hardly reality: 20% of the French film production never reaches theaters, and many films are shown a few days. Another rationale for large subsidies to movie theaters is that 20% of the French movie theaters (representing 50% of the French seats) are owned by the three French major studios (Gaumont, Pathé and UGC): as little (if any) monitoring of the *exploitation* subsidies is done, there are wide opportunities for these three film producers to shift *exploitation* subsidies to production or to other uses.

(1998). Since the early 1990s, movies get additional revenues from releases in TV-channels and video revenues on which information is imperfect. Assuming these additional revenues equivalent to 25% of the total revenues earned in the early 1990s [Farchy, 1992], and extrapolating these estimates until 1998 suggest an average rate of subsidization of roughly 55% in the late-1990s.

However, Table 4B relies on a *narrow* definition of subsidies -- those granted through the official channel of CNC. Another source of funds for film production which is equivalent to public subsidies consists in investment quotas: TV-channels are mandatorily required to invest in pre-purchasing or co-producing films. In this respect, the case of Canal Plus deserves particular attention since, with an average spending of ECU 130 million per year (FFR 800 million) in the late 1990s, Canal Plus alone contributes to two-third of all funds imposed by investment quotas.<sup>14/</sup> This huge investment requirement has been explicitly conceived as a counterpart of the monopoly granted to Canal Plus for broadcasting films in Hertzian pay-TV. The monopoly rent that Canal Plus can extract from its French TV-viewers can be estimated to ECU 300 million per year (FFR 2 billion) in the 1990s. In other words, almost half of Canal Plus monopoly rents is a way of taxing French TV-viewers in order to subsidize French film producers. Including these indirect subsidies, French total subsidies to film production amount to ECU 310 million per year, and the rate of subsidization of French films is close to 100%.

The huge increase of subsidies mirrors not only higher rates of subsidization, but also the high costs associated to the production of French entertainment films “à la Hollywood.” This shift was the result of the “Plan Lang” (from Culture Minister Jack Lang) adopted in 1989 which was a mixture of political gesture (French films competing with Hollywood films) and of business craftiness (big budget films allow large private profits in case of success -- and otherwise big losses to be absorbed by the French Treasury). This shift has a crucial corollary: the main goal of French subsidies (and quotas) is to protect “entertainment” French clone films from Hollywood comparative advantages, not “cultural” films.

#### ***A system failing to deliver its promises: “2001, A Space Odyssey”***

The efforts to extend to Europe the French (and German) system of subsidies and quotas have led an unexpected outcome: it has made more apparent the flaws of the used instruments.

During the early years of the system (the 1980s), the number of films produced was seen as the sign of success of the French policy: this number remained high in France, whereas it was declining (sometimes dramatically) in other EC Member states. Of course, this number was simply mirroring the fact that more French public money was made available to film-makers and spent by them (not necessarily for the official “cultural”

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<sup>14/</sup>A last source of subsidies consists in subsidies paid to factors of production of films. Until two years ago, the unemployment benefits for actors and other film workers has been extraordinarily generous (even by French standards), with a budget of ECU 330 million per year, and extraordinarily standards) and unfair (benefits were proportional to wages and fees). There have also been subsidies for TV satellites (TDF).

purpose, as just underlined). As time went and as other EC Member states have been implementing their own version of the CAPs, their film industry begun to exhibit roughly the same number of films produced than France (between 80 to 130 films per year, for the largest Member states) leading to the progressive realization that this indicator is meaningless.

As a result, the focus of attention shifted progressively from supply to demand, that is, from the number of films produced to the number of theatrical entries (despite the fact that this indicator is heavily weighted by “entertainment” films). During the late 1980s and early 1990s, this indicator was perceived as the best sign of success of the French-style film policy. However, as underlined before, this sign is vanishing: Table 5 shows a convergence towards market shares in all EC Member states speaking worldwide spread languages, including France.<sup>15/</sup> This evolution has not yet changed the taboo of beneficial subsidies -- but it has definitively turned down the tone about the benefits to be expected.

What has still not been largely realized is an even more interesting evolution: the demand for European non-domestic films in each EC Member state (for instance, the demand of EC non-French films in France) is not only small, but generally *declining* during the 1990s -- suggesting that the CAPs constitute a *barrier* to an integrated EC film market, contrary to its flaunted objective. This evolution is not so surprising. National subsidies have mechanically amplified film production, while “fixing” national investments in each Member state. But they have not created a demand for “European” films (whatever it means) for all that. Rather, they have been crowding out films from other EC Member states in each Member state. Ironically, the French film industry has suffered the largest crowding out effect, whereas the only EC film industry with growing market shares in the EC is the British industry which has been characterized by a severe cut in subsidies for years (*forcing it not* to mimic U.S. films, but to dig in for the British touch) and noticeable investments from U.S. film industry in the recent years.

The most entrenched belief of the supporters of the CAPs is that such policies contribute to create a cinema of “quality”(whatever it means). What follows tests this statement (only for French films) with two, admittedly crude, indicators.

The first indicator assumes that people who can recognize the talents of the French “culture” roam the film Festivals. If this assumption is correct, the French “share of awards” in the three major European film Festivals (Berlin, Cannes and Venice) seems a crude, but acceptable, indicator of the evolution of the quality of French films. This share has dramatically decreased: from roughly 16% (1981-1985) to 11% (1986-1993) and 6% (1994-1998) if one includes the Cannes Festival (21%, 10%, and 9%, respectively, if one excludes Cannes).

The second indicator is based on TV audience. As shown above, French films produced before the 1980s (hence with little subsidization) show, *even nowadays*, a much better capacity to attract viewers during prime time TV hours than the heavily subsidized

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<sup>15/</sup>As mentioned in section 1, the arbitrary classification of the *Fifth Element* as a French film increases the 1997 French film market share in France by 5%.

films produced during the 1980s and 1990s, despite the handicap of many reruns. Such a difference in the capacity to attract TV viewers is not observed for recent U.S. films.

Of course, these results do not constitute a big surprise for economists who see changes in artistic quality as largely exogenous to public policies, and who are ready to expect the following negative impact of the instruments used. Broadcast quotas can induce TV firms to produce more domestic films only (or essentially) for increasing the number of foreign films to be broadcast, making quality a marginal preoccupation. Subsidies can modify the trade-off between quantity and quality, by anaesthetizing film makers risk assessment, as implicitly suggested by the much higher ratio of films to viewers in France compared to U.S. (there is roughly 1.1 film produced per one million of annual viewers in France, compared to 0.43 in the U.S.).

### ***A system loosing support: “The Bridge on the River Kwai”***

Under such circumstances, it is not astonishing that CAPs are loosing support, even in France when it started first and left for a while the impression that it was working. Loosing support is exacerbated by the fact that the policy is becoming inconsistent in two major aspects.

First, since 1997, the Canal Plus monopoly on Hertzian pay-TV is eroded by the emergence of a TV-satellite competitor (TPS) which is a joint venture of all major French air TV-channels (public channels and their arch-rival private channel, TF1), France Telecom and Lyonnaise des Eaux (the utility company, arch-rival of Vivendi). A duopoly in pay-TV is slowly emerging, though Canal Plus remains dominant with 5.7 millions of subscribers (4.6 for its Herzian activities and 1.1 for its satellite activities) compared to 0.6 millions of subscribers for TPS. But, the rent-erosion process has started.

Second, in a recent (November 1998) decision, the French TV regulator (Conseil supérieur de l’audiovisuel, CSA) has decided, in application of the TWF Directive, not to impose French legal constraints to TV-channels from other EC Member states, but to submit them only to the EC constraints which are less severe (in particular, the EC regime has no legal obligation concerning the subsidy regime). As said in the introduction, moves by large firms are echoed by regulators in direct contact with markets.

### **3. Regulatory reforms and liberalization**

Section 2 leaves little doubt about the fact that EC firms willing to become worldwide players will be interested in EC unilateral regulatory reforms, as a preparatory step for multilateral negotiations. In this respect, there is little difference between the CAPs and the CAP: Blair House has required the 1992 CAP Reform.

### **Effective rates of assistance: “Four funerals and one wedding”<sup>16/</sup>**

The existing CAP system is so complicated that one has to reveal the *net* winners and the *net* losers -- in trade parlance, the “effective rates of assistance” of the various

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<sup>16/</sup>We apologize for the deliberate hijacking of the title: the new title seems much better appropriate with the many net losers and the only net winner of the CAPs.

participants in the film industry. For instance, the French version of the EC system of quotas, subsidies, monopoly rents (created, then taxed and transferred) involves at least six different participants: theater-owners, film producers (foreign, French successful, and French unsuccessful), TV-channels and French consumers.

*Theater-owners* face the annual quota on the total number of films to be broadcast which tends to increase demand for theater seats, the 11% seat tax which tends to reduce this demand, and they receive subsidies which may increase it. As underlined above, the effect of global quotas is likely to have been small, the seat tax impact is substantial, and it is not clear to which extent theater-owners benefit really from subsidies which can be easily passed to film production to a large extent.

*Foreign-U.S. film makers* face the seat tax which reduces the demand of their films, recoup a portion of this tax to the extent that they are the main beneficiaries of the good shape of theaters in France, and they face the indirect 40% broadcast quota on U.S. films. As underlined above, the quota is severely binding: one-third of the U.S. films which would have been broadcast in the absence of quotas are not. On the other hand, U.S. films which are effectively broadcast can get rents, but with a negative twist: the “best” U.S. films are not likely to be numerous enough to be bound by the quota (hence to get rents); by contrast, rents are more likely to accrue to the “good” U.S. films for which the demand is really constrained by the existing quota. In other words, the quota system works against quality (as for the French films, as shown below).

*Foreign-EC film makers* face the same situation than U.S. film producers, with two key differences: they have access to French subsidies, and they are unlikely to benefit from possible rents associated to the quota on EC films (their demand by French TV-viewers is limited).

*Successful French film producers* share many features with EC film makers, and they get even more subsidies. It seems unlikely that successful French films receive rents from the 40% quota on *domestic films*: as said above, they are in too short supply for feeding the quota.

*Unsuccessful French movies* are *unambiguously* among the net winners: they are not hurt by the seat tax (nobody wants to see them) and they are fully subsidized. The larger their budgets are, the larger the pure transfers are: in other words, large-budget unsuccessful French clones of Hollywood films get the best of the EC-French system.

*TV-channels* are the last major participant on the supply side. Air TV-channels are likely to be net losers: they are taxed by investment quotas (and by a special tax of 5.5% on their advertising resources in case of private TVs, or on license fee resources in case of public TV-channels). These investment quotas provide some benefits under the form of more flexibility in TV programming, but they are small, compared to the costs mentioned. Canal Plus is a special case: it enjoys huge monopoly rents, but half of them disappear in investment quotas. The erosion of these rents with the emergence of TPS will deteriorate Canal Plus net winner situation -- becoming a net loser seems a matter of time.

Of course, the *viewers* of French films (and French tax-payers) are *unambiguously* net

losers: they are taxed, directly (when funding subsidies) or indirectly (when going to movie theaters and/or when subscribing to Canal Plus); French viewers looking after entertainment are hurt by restrictions on U.S. films, *whereas* French viewers interested in “cultural” films are hurt by the marginal support in terms of subsidies.

This global picture leads to an essential question: a majority of participants on the supply side are likely to be or become *net* losers -- making them more friendly to unilateral regulatory reforms of EC audiovisual markets and to multilateral negotiations going in the same direction.

### ***Liberalization as a support of domestic regulatory reforms***

What does this presentation of the effective rates of assistance -- and its corollary policy of netting out quotas, taxes and subsidies -- tell for the coming WTO round of negotiations?

The first lesson is that broadcast quotas should be eliminated. In the importing country, these quotas hurt every participant on the market (supply and demand), except the producers of domestic bad films or TV works. If they will be less and less protective because of new techniques, counting on time for getting the full impact of technological changes would simply make the industry recovery more difficult. Moreover, as quotas generate monopolies and inefficiencies (two strong forces for price hikes and/or quantity contractions), they “call for” subsidies just in order to be more endurable by the domestic industry itself in the long run.

The second lesson is that the policy frequently suggested nowadays in Europe (eliminate quotas, but keep subsidies) is insufficient. However, going further requires pragmatism, that is, to make a distinction between “industrial” and “cultural” subsidies in audiovisuals. The above description of the EC regime has amply shown that issues at stake are not cultural. The same observation can be done with the emerging dispute between Canada and the U.S. about the runaway film production from American to Canadian studios: it involves “the small business that support the film industry,” such as “caterers, rental equipment business, electricians, etc,” not the actors, the script writers, etc. [Statement of U.S. Rep. J. Weller, August 5, 1999].

As underlined by Siwek [1999], “industrial” subsidies are not acceptable. At a first glance, this proposition has little chance to fly in Europe. But again, changes are emerging. The slowly eroding monopoly rents (such as for Canal Plus) is undermining a substantial source of subsidies, hence the firms’ strategies. The evolution of market shares in European film markets force regulators to increasingly recognize that subsidies generate barriers, rather than the Single European Market. Lastly, banning industrial subsidies echoes recent Commission’s decisions about Member state subsidies granted to their domestic “studios”. The principle of banning industrial subsidies leads to the problem of their definition, and the time framework for implementing the prohibition: pragmatism should take the lead, as it has been done in agriculture, with an immediate focus on export subsidies, and a more progressive phasing out of amber box subsidies).

“Cultural” subsidies should be excluded from the WTO scope and disciplines. They

are small today (a point which should be made better known) and they are likely to remain small. Their existence raise two issues. First, at the multilateral level, they should not become a way to circumvent disciplines on “industrial” subsidies. An option would be to notify and monitor them at the multilateral level: WTO Member states should report, on an annual basis, on the magnitude of these subsidies, the sources of financing, the instruments used (direct subsidies or tax reductions) and other key conditions, etc. Notifying subsidies at the multilateral level is often a lip service: in this case, on the contrary, one could expect some competition between WTO Members eager to show their support for culture.

Second, cultural subsidies raise many domestic issues, the most important being the following one: to what extent democratic authorities (and associated bureaucracies) can play the role of a patron?<sup>17/</sup> Being a patron requires to take risks, and to pay for them. Democratic public authorities are *necessarily* reluctant to take risks: they could be accused of “*favoritism*.” And they *never* pay for their errors: the tax-payers do. In these conditions, it is hard to see how such authorities can really *promote* culture (except in the narrow sense of keeping in good shape the physical heritage of old buildings, paintings, or films). As a result, a serious treatment of culture in the film industry (as well as in other arts) requires adequate regulations for art foundations and for innovative structures for patronage (as aimed by the British system of “franchised units”) -- all institutions which could behave quite easily according to the principle of non-discrimination.

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<sup>17/</sup>Also of importance is the issue of the source of subsidies. On the one hand, a general tax system is better than a seat tax (a proxy for general tax being the British case of National Lottery which may be felt as superior to public budget by film-makers, because easier to trace). On the other hand, a seat tax is equivalent to tariffs, hence easily negotiable in successive Rounds of trade negotiations.

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**Table 1. Summary of specific commitments in audiovisual services under the Uruguay Round**

Countries	Film & Video production & distribution CPC: 96112, 3	Film projection services CPC: 96121, 2	Radio & TV services CPC: 96131, 2, 3	Radio & TV transmission services CPC: 75241, 2	Sound recording CPC:	Other CPC: 96114	Total
Large producers (by decreasing number of films produced)							
India	X						1
USA	X	X	X	X	X	X	6
Hong Kong	X				X	X	3
Japan	X	X			X		3
Smaller producers							
Central African Rep.	X	X	X	X	X	X	6
Dominican Rep.				X		X	2
El Salvador				X		X	2
Gambia	X	X	X	X			4
Israel	X						1
Kenya	X	X					2
Korea	X				X		2
Lesotho	X	X	X	X			4
Malaysia	X			X			2
Mexico	X	X					2
New Zealand	X	X	X	X		X	5
Nicaragua	X	X					2
Panama	X	X	X		X		4
Singapore	X				X		2
Thailand	X		X				2
<b>Total</b>	<b>17</b>	<b>10</b>	<b>7</b>	<b>8</b>	<b>7</b>	<b>6</b>	<b>55</b>

Source: WTO, Audiovisual services, Table 9, S/C/W/40, 1998.

**Table 2. Comparisons of leading U.S. and European audiovisual firms, 1997**

Country	Audiovisual turnover Millions USD 1996	Total turnover Millions USD 1997	Audiovisual turnover Millions USD 1997	Growth rate in audio. turnover (%) 1997/1996	Audiovisual in total turnover (%) 1997	Net results Millions USD 1997	Net results in % of turnover 1997	Audiovisual turnover per inhabitant 1997
<b>The 23 European firms among the 50 leading world firms</b>								
Austria (1 firm)	942	818	818	-13,2	100,0	26,5	3,2	101,0
Britain (7 firms)	14927	27081	17170	15,0	63,4	1504,3	8,8	293,5
France (4 firms)	6085	5896	5602	-7,9	95,0	353,1	6,3	96,4
Germany (7 firms) [a]	19177	27872	18904	-1,4	67,8	1169,8	6,2	230,8
Italy (2 firms)	5049	4855	4855	-3,8	100,0	476,8	9,8	84,9
Luxembourg (1 firm)	2683	3189	2910	8,5	91,3	-80,6	-2,8	[b]
Netherlands (1 firm) [c]	5628	5686	5686	1,0	100,0	403,3	7,1	277,4
All	54491	75397	55945	2,7	74,2	3853,2	6,9	196,6
All in 1996 (23 firms)	53356	72890	54269	1,7	74,5	3234,9	6,0	190,7
<b>The 15 U.S. firms among the 50 leading world firms</b>								
All	64557	230583	73491	13,8	31,9	14009,4	19,1	279,4
All in 1996 (13 firms)	49055	95365	63416	29,3	66,5	4653,2	7,3	241,1

Source: European Audiovisual Observatory, Statistical Yearbook 1999, p.69

Notes: [a] Net results are not available for Kirch, RTL et SAT1. [b] not significant. [c] including Belgian flemish-speaking population.

**Table 3. EC audiovisual markets: cinemas, TV channels and videos, 1996-97**

	Theaters [a]		TV-channels [b]		Videos	
	US films	EC films	US films	US fiction works	VCR penetration rate [c]	Blank cassettes [d]
	1994-97	1997	1996	1996	1997	1997
Austria	--	0,0	64,6	26,6	75,3	4,7
Belgium	71,9	0,1	34,1	31,1	68,4	4,1
Britain	80,5	4,8 [e]	75,3	19,8	83,0	3,1
Denmark	70,2	0,2	65,6	27,4	79,0	5,0
Finland	72,7	0,1	67,0	14,8	72,2	4,4
France	55,7	10,2	36,2	18,9	77,5	6,3
Germany	78,6	3,7	65,2	35,5	77,3	3,4
Greece	--	0,0	--	20,2	55,7	1,5
Ireland	--	0,0	--	27,1	72,7	2,1
Italy	59,9	2,2	61,6	23,6	59,2	2,3
Netherland	86,6	0,2	72,4	22,7	67,3	4,0
Portugal	80,8	0,1	--	19,0	52,0	1,3
Spain	72,7	1,9	69,0	28,1	72,1	1,9
Sweden	67,2	0,4	--	29,7	79,2	4,9
EC-15 [f]	72,4	1,7	61,1	24,6	73,6	3,5
USA	95,4	--	--	--	92,8	--
JAP	41,3	--	--	--	90,8	--

Source: European Audiovisual Observatory, Statistical Yearbook, 1998 and 1999.

Notes: [a] in % of total entrances. [b] in % of hours broadcasted (weighted by audience).

Data for US films are available only for 1996 (for comparison sake, data for US fiction works for the same year are presented. [c] in % of households. [d] expenditures in current Ecu per person. [e] the share goes up to 8.7% if British-US films are included. [f] EC-15 simple averages of the columns are in italics.

**Table 4A. European Public Support for Film & Video, 1994**

	Total Mion ECUs [a]	Production %	Distribution %	Exploitation %
Austria	14,9	94,2	5,8	
Belgium	8,2 *	96,3	3,7	
Britain	1,9 *	100,0	0,0	
Denmark	10,5 *	94,2	2,3	3,5
Finland	6,2	85,3	11,7	3,0
France	125,0 *	40,5	6,6	52,9
Germany	76,4	77,5	10,2	12,3
Greece	4,9	91,5	8,5	0,0
Ireland	1,7 *	100,0	0,0	0,0
Italy	74,4 *	42,1	26,3	31,6
Netherlands	9,1 *	98,6	1,4	0,0
Portugal	5,5	86,1	6,2	7,7
Spain	21,7	92,1	2,9	4,9
Sweden	16,3	94,7	3,7	1,6
EC-15	376,6	62,5	10,6	26,9
Others [a]	10,2	67,4	38,3	4,1

Source: FIAPF, Films Funds 1994, April 1996.

Note: [a] Possibly underestimated subsidies.

**Table 4B. French subsidies, 1970-1997**

Years	Amount of subsidies Mion ECUs	Subsidization rate (%)	
		[a]	[b]
1975	30,6	16,3	16,3
1980	58,3	25,4	25,4
1985	102,7	35,8	35,8
1988	110,3	54,8	54,8
1989	112,5	63,5	60,5
1990	120,3	58,1	52,8
1991	125,3	75,8	65,9
1992	128,5	63,6	53,0
1993	143,7	60,6	48,5
1994	164,3	88,2	67,8
1995	172,9	70,8	52,4
1996	180,0	65,8	47,0
1997	185,7	69,4	47,9
1998	195,3	79,7	53,1
1990-97	157,3	70,2	54,3

Source: CNC, Bilans annuels. Authors' calculations.

**Table 5. EC audiovisual policies: a barrier to an European film market**

	Market shares of films from:						Market shares of films from:					
	Domestic	U.S.	Britain	France	Germany	Italy	Domestic	U.S.	Britain	France	Germany	Italy
	<b>Britain</b>						<b>France</b>					
1989	10,0	86,2	--	0,7	0,4	0,0	34,3	55,5	4,4	--	0,8	0,8
1990	7,0	88,0	--	1,0	0,4	0,5	37,5	55,9	1,5	--	0,3	0,9
1991	5,0	89,0	--	1,3	0,7	0,2	30,6	58,0	7,2	--	0,7	0,9
1992	6,8	90,6	--	1,0	0,1	0,0	35,0	58,2	1,6	--	0,6	0,8
1993	2,5	94,2	--	0,7	0,0	0,0	35,1	57,1	2,7	--	0,3	0,2
1994	8,8	90,2	--	0,5	0,0	0,0	28,3	60,9	7,0	--	0,5	0,2
1995	10,5	85,2	--	0,5	0,0	0,2	35,2	53,9	6,5	--	1,1	0,1
1996	12,8	81,7	--	0,5	0,0	0,2	37,5	54,3	5,1	--	0,4	0,1
1997	28,1	69,3	--	0,2	0,0	0,0	34,5	52,2	8,9	--	0,2	0,2
1998p	14,2	83,7	--	0,2	0,0	0,0	27,4	63,5	4,5	--	0,2	2,1
	<b>Germany</b>						<b>Italy</b>					
1989	16,7	65,7	11,2	4,3	--	0,5	28,5	57,2	5,0	5,8	1,5	--
1990	9,7	83,9	2,9	2,1	--	0,3	21,7	63,1	1,6	3,8	1,0	--
1991	13,6	80,2	1,4	1,9	--	0,2	21,0	70,0	6,6	4,2	1,0	--
1992	9,5	82,8	2,5	2,7	--	0,2	26,8	58,6	6,1	4,5	0,2	--
1993	7,2	87,8	1,1	2,0	--	0,1	24,4	59,4	4,7	3,4	1,0	--
1994	10,1	81,6	4,8	1,5	--	0,1	17,3	70,0	6,7	3,2	1,8	--
1995	6,3	87,1	2,2	1,7	--	0,1	23,7	61,4	6,4	4,0	0,7	--
1996	15,3	75,1	7,0	1,0	--	0,1	21,1	63,2	5,9	2,5	0,1	--
1997	17,3	70,5	8,5	2,9	--	0,1	24,9	59,7	8,2	2,2	0,4	--
1998p	9,5	--	--	--	--	--	32,9	46,7	--	4,0	--	--
	<b>Portugal</b>						<b>Spain</b>					
1989	1,2	67,4	6,0	3,6	3,6	8,2	7,4	71,4	8,6	3,2	0,9	1,5
1990	2,2	63,5	7,3	11,2	2,6	5,8	10,4	72,5	4,3	2,3	1,1	2,2
1991	2,1	67,8	11,5	6,6	1,0	4,5	10,9	68,7	9,7	5,6	1,2	0,9
1992	2,0	68,4	--	--	--	--	9,3	77,1	3,9	4,0	2,6	1,2
1993	1,0	97,0	--	--	--	--	8,8	75,7	4,1	3,9	1,5	0,4
1994	1,0	95,0	--	--	--	--	7,1	72,3	8,7	3,2	2,3	0,3
1995	--	--	--	--	--	--	12,2	72,1	7,3	2,9	1,1	0,6
1996	--	--	--	--	--	--	9,3	78,3	5,8	2,7	0,4	1,6
1997	2,0	66,5	4,0	6,0	--	8,0	13,1	68,2	12,6	2,6	0,7	0,4
1998p	--	--	--	--	--	--	11,9	78,6	--	0,9	--	--

Source: European Audiovisual Observatory, Statistical Yearbook, 1999. For 1998, CNC Bilan, 1999.