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Preparing Negotiations in Services: EC Audiovisuals in the Doha Round

Patrick A. Messerlin and Emmanuel Cocq

Introduction

Under the 1994 Uruguay Round Agreement, only nineteen WTO members have made commitments in audiovisual services in their GATS schedule (see table 7).

As illustrated in table 7, these commitments are generally of limited scope and magnitude.[1] Among the large audiovisual producers, only the United States has taken substantial commitments at the various stages of audiovisual production, distribution, and transmission. Although more limited, the commitments by India (the world's largest film producer), Hong Kong, and Japan show the acceptance by countries with large production and influential cultures to consider the issue of liberalization in audiovisual services with an open mind. The rest of the WTO members, led by the EC, have severely limited the access to their markets because they are insecure about the ability of their audiovisual industry to compete, they want to minimize the exposure of their people to foreign influence (France), or they want to use audiovisual services as an instrument for building their national identity (Australia and Canada).

If negotiations for services followed the same pattern as those for goods, WTO negotiators would try to solve such conflicting approaches among WTO members by striking intersectoral trade-offs. For instance, the EC water utilities or Canadian lumber firms would lobby their own authorities for removing EC or Canadian barriers in audiovisuals (as concessions to be granted for getting better access to U.S. water or lumber markets), whereas the U.S. audiovisual services sector would lobby the U.S. government for the opening of maritime transportation (as concessions to be traded for getting better access to EC or Canadian audiovisual markets). However, these intersectoral trade-offs may be a component of WTO negotiations in services, but probably not to the same extent as in goods. As a result, the inclusion of

TABLE 7
SUMMARY OF SPECIFIC COMMITMENTS IN AUDIOVISUAL SERVICES UNDER THE URUGUAY ROUND

Countries	Film and video production and distribution CPC: 96112, 3	Film projection services CPC: 96121, 2	Radio and TV services CPC: 96131, 2, 3	Radio and TV transmission services CPC: 75241, 2	Sound recording CPC: n.a.	Other CPC: 96114	Total
Large producers (by decreasing number of films produced)							
India	X						1
United States	X	X	X	X	X	X	6
Hong Kong	X				X	X	3
Japan	X	X			X		3
Smaller producers							
Central African Republic	X	X	X	X	X	X	6
Dominican Republic				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
Total	17	10	7	8	7	6	55

SOURCE: World Trade Organization, *Audiovisual Services*, Table 9 S/C/W/40 (Geneva: WTO, 1998).
NOTE: CPC: Central Product Classification.

audiovisuals as one of the services to be liberalized during the Doha Round has so far been received by skepticism in WTO circles.

However, there are good reasons for optimism, as stressed in the postscript (see page 54), and recent developments in audiovisuals have confirmed this view. Optimism flows from ongoing profound economic changes, partly driven by technological changes. These changes are largely

procompetitive and require larger markets, including in the EC, which is the focus here. Meanwhile, the highly protective European Common Audiovisual Policies (CAPs) increasingly show the same fatigue as EC agricultural policy—broadly for the same reasons—and face a significant erosion of public support. All these converging forces make the option of market opening in the audiovisual services sector increasingly attractive.

Audiovisuals in the Doha Round: *Mission Impossible*?

Reciprocity—the traditional negotiating tool in trade rounds—will be of limited use for services, including audiovisuals. First, it cannot be easily measured. Negotiators have no tools to assess whether liberalizing audiovisual services will be worth roughly the same value as, for example, liberalizing maritime transport or water utilities. (In the case of goods, evaluating the concessions received and granted relies on the tariff reductions received and granted, weighted by the trade values involved.)

Second, reciprocity has a much vaguer meaning in services than in goods. Removing a tariff is often enough to change substantially pricing behavior, entry, and exit in product markets. This is not necessarily the case for services, for which liberalization requires deep domestic regulatory reforms.

Difficulties for negotiators do not start with considerations about culture. They emerge in the very first steps of evaluating the concessions offered by the various trading partners, and they are common to all services. For instance, reliable data on imports require "rules of origin," which allow a clear distinction between imported and domestic products and between products imported from different countries. Such a concept is not easily applicable to all services, including audiovisual services. For instance, defining a "domestic" film is not a simple matter, and differences in definitions can lead to huge differences when assessing the scope and evolution of the audiovisual services sector. The French Centre National de la Cinématographie (CNC) has three alternative rules of origin for defining French films: "French-initiative films," which include "100 percent French films" and "French majority co-productions"; "Foreign majority co-productions"; and "approved films." From 1997 to 2001, an average of 108 films were produced under the narrower definition (100 percent French films) and an average of 150 films were produced under the wider definition (approved films). Rules of origin are so complex that they can easily lead to arbitrary decisions, recently illustrated by *The*

Fifth Element, which was defined as an integrally French movie because it had been largely financed by a French studio. However, it was shot in London and in English, and employed many non-French actors—all infringements to normal conditions for obtaining status as an integrally French movie (in fact, there is an ongoing legal suit against this decision to grant French origin).

Moreover, negotiations in audiovisual services present specific obstacles, the most prominent being the strong link perceived between audiovisual services and "national culture" by many GATS members. However, the paradox is that the existing regulatory policies that allegedly support national culture tend to harm it profoundly. For instance, the French audiovisual policy has strongly induced French filmmakers to mimic U.S. filmmakers, leading to an accelerated "Americanization" of French culture. The fact that this paradox is increasingly perceived in Europe removes an obstacle to liberalization.

In such a delicate context, negotiators will be strongly pressured by audiovisual firms, which are very diverse. Whereas some of these companies operate almost exclusively in the audiovisual services sector of their countries (such as publicly owned audiovisual firms), others have internal potential sectoral trade-offs. For example, Bertelsmann is a large German-based press firm that owns a large audiovisual services sector in several OECD countries. The same could still be said for Vivendi, a French firm, although there are doubts about the long-term sustainability of its strategy.

Technological and Economic Changes: *The Quantum Project*[2]

Technology is profoundly changing audiovisual markets, inducing the most dynamic EC firms to make drastic revisions to their strategies—to the point of being much more open to unilateral regulatory reforms. Following is a quick survey of these changes.

As is well known, technical progress in telecoms is generating profound changes in audiovisuals, and this convergence process is far from over. The digital revolution in telecoms will reduce a government's ability to protect domestic audiovisual markets. For instance, the EC quota on non-European movies on TV (40 percent of all broadcast movies) will become obsolete when EC TV viewers are able to download movies at a reasonable cost from a satellite dish through the Internet or from terrestrial digital TV, allowing free cross-border diffusion between EC member states. New technology

will make it possible for each EC broadcaster to fulfill the current obligation of permanently supplying 40 percent of domestic films (if only by buying audiovisual flops produced in large quantities by the massive subsidies available in the CAPs), whereas European TV viewers will download only foreign films supplied by this company.

Technological change has generated economic changes. It has forced EC firms willing to survive as world players to reassess the contours of the markets relevant to them and to realize that they are too small in global markets. Table 8 shows that in 1997 the average size (in terms of audiovisual turnover) of the twenty-three largest EC firms was half the average size of the fifteen largest U.S. firms.

Size matters in the audiovisual services sector because it is one of the riskiest parts of a modern economy. A large firm can implement several strategies of risk management more easily than a smaller firm. These strategies can include launching several films (hoping that the profitable ones will compensate for the losses of the others); releasing films on video, DVD, and other formats; and marketing brands by using the same concept in, for example, a film, a TV series, a book, a magazine, clothes, and toys (to increase revenues).

Table 8 suggests that EC firms are significantly more specialized in audiovisual services and hence more fragile during the inevitable downturns. It also suggests that EC firms tend to be smaller and less diversified in the EC member states enforcing the most restrictive CAPs. This correlation mirrors a true causality. Most EC protectionist measures in audiovisual services have consisted of taxing consumers or creating monopolies—two sure recipes for inhibiting market growth. The more strictly the CAPs have been enforced, the more the markets have been severely segmented and restrained, or balkanized, and the smaller the EC firms have tended to be. Moreover, the fact that size counts much less for "cultural" films and TV shows (such works tend to require less funds, making their risks more easily bearable) implies that most EC firms are too small for entertainment and too big for culture.

However, because EC audiovisual firms tend to be monopolies in member state markets, they have become the target of the European competition authorities for "abuse of dominant power." Mergers in EC audiovisual services represent 2 percent of the total number of EC mergers, but the ban of mergers in audiovisual services by EC competition authorities amounts to half of all the merger bans decided. Similar observations can be made at the member state level. For instance, the largest French firm (Canal Plus) was fined for excessive market power in film catalogue (the

TABLE 8
COMPARISONS OF LEADING U.S. AND EC AUDIOVISUAL FIRMS, 1996–1997

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 percent of turnover 1997	Audiovisual turnover per inhabitant 1997
The 23 European firms among the 50 leading world firms								
Austria (1 firm)	942	818	818	–13.2	100.0	26.5	3.2	101.0
Britain (7 firms)	14,927	27,081	17,170	15.0	63.4	1,504.3	8.8	293.5
France (4 firms)	6,085	5,896	5,602	–7.9	95.0	353.1	6.3	96.4
Germany (7 firms)[a]	19,177	27,872	18,904	–1.4	67.8	1,169.8	6.2	230.8
Italy (2 firms)	5,049	4,855	4,855	–3.8	100.0	476.8	9.8	84.9
Luxembourg (1 firm)	2,683	3,189	2,910	8.5	91.3	–80.6	–2.8	ns[b]
Netherlands[c] (1 firm)	5,628	5,686	5,686	1.0	100.0	403.3	7.1	277.4
All	54,491	75,397	55,945	2.7	74.2	3,853.2	6.9	196.6
All in 1996 (23 firms)	53,356	72,890	54,269	1.7	74.5	3,234.9	6.0	190.7
The 15 U.S. firms among the 50 leading world firms								
All	64,557	230,583	73,491	13.8	31.9	14,009.4	19.1	279.4
All in 1996 (13 firms)	49,055	95,365	63,416	29.3	66.5	4,653.2	7.3	241.1

SOURCE: European Audiovisual Observatory, *Statistical Yearbook* 1999 (Strasbourg, France), 69.
a. Net results are not available for Kirch, RTL, and SAT1.
b. Not significant.
c. Including Belgian Flemish-speaking population.

list of films on which it can levy fees for intellectual property rights) because (in accordance with the existing audiovisual regulations) the relevant market has been defined by the French competition authorities as the French-speaking film market, that is, 40 percent of the French market—a small proportion of an already relatively small market by world

standards. In summary, EC firms have been kept smaller than they could have been because CAPs balkanize national markets.

Despite their small size and their inability to grow because of market balkanization, EC audiovisual firms have been a good buy for other firms because of their monopoly rents. Most of them have thus become integrated in companies involved in other activities, for instance, press and publishing (Bertelsmann, Canal Plus-Havas, Fininvest, and Kirch), advertising (Canal Plus-Havas and Fininvest), insurance (Fininvest), telecoms (Bertelsmann), and utilities (Canal Plus-Vivendi).

The recent integration of EC audiovisual firms in larger firms with a wider set of production activities is dramatically changing the balance of coalitions that could support the Doha Round. Being a profound departure from the traditional European scheme of public monopolies highly specialized in audiovisual services, it is likely to influence the debate about culture in two ways. First, it enlarges the vision about "cultural goods," fudging the economically wrong (but politically powerful) debate about trade balances. For instance, today, the negative EC trade balance in films is a powerful argument for protection (even though economically it does not make sense). A wider view about all cultural goods produced by firms like Bertelsmann or Vivendi will balance the negative EC trade balance in films by the positive EC trade balance in books or magazines, helping to diffuse the pressures on cultural protection. Second, EC firms looking for access to foreign markets for their nonaudiovisual activities will be less hostile to the opening of EC audiovisual markets. Most of the large European groups owning audiovisual firms are in such a situation.

Audiovisual Services in the EC: *Titanic*

This section provides a brief survey of the main instruments—quotas and subsidies—used by the CAPs and an economic analysis of their effects. Although it draws many examples from France, it reflects the overall situation in the EC for two reasons. First, almost all other EC member states (including "free trade–minded" countries, such as Britain) have adopted or maintained audiovisual measures relatively similar to the French ones.[3] Second, the complex process of generating European, "supra-national" regulations is further eroding differences among member states. For instance, in November 1998, the French TV regulator (Conseil Supérieur de l'Audiovisuel [CSA]) decided not to impose

French legal constraints on TV channels from other EC member states but to submit them to the EC regime.

Quotas: *A bout de souffle.* The Television Without Frontiers (TWF) European Directive (adopted in 1989 and amended on June 30, 1997 by the European Directive 97/36/EC) imposes "broadcast" quotas based on film nationality. It stipulates "that broadcasters reserve for European works . . . a majority proportion of their transmission time, excluding the time appointed to news, sports events, games, advertising, teletext services and teleshopping." The Directive, however, specifies that "member-states shall ensure this principle where practicable and by appropriate means."[4] These quotas are rigidly enforced in certain member states (for example, France) and more subtly implemented in the other member states—but not necessarily with less consequences, as best illustrated by the almost identical shares of U.S. fiction TV shows in Britain and France.[5]

Broadcast quotas are combined with other quantitative restrictions in certain member states. In France, for instance, "global" quotas limit the total number of films that can be broadcast per year, and time-specific quotas prohibit the broadcasting of films on most TV channels on certain days and hours. These quotas are set to protect cinemas from competition by TV channels.[6] Quotas on investments require every TV channel to invest a share of its resources in film production by "prepurchasing" or "coproducing" films, that is, 3 percent of the net turnover for French TV channels, 20 percent in the Canal Plus case (out of which 9 percent are French films). Furthermore, there are additional rules imposing constraints on how quickly a movie done for theaters can be programmed on TV channels and sold as videos. These rules (which have been loosened in recent years) have the same effect as quotas; that is, they artificially segment markets.

From an economic perspective, the key question is whether or not these quotas are binding. The answer is no for the French quotas on the total number of films that can be broadcast annually. These quotas have been substantially increased over time, and they are close to the number of broadcast films in EC member states not enforcing such a restriction. However, the answer is yes for EC-based broadcast quotas on U.S. films. For example, these quotas are strongly binding in France, where U.S. films have a market share greater than 40 percent (ranging from 53 to 63 percent during the 1990s) in cinemas where French viewers can make free choices.[7] Similarly, investment quotas that contribute to increased production of French films are binding.

TABLE 9
EUROPEAN PUBLIC SUPPORT FOR FILM AND AUDIOVISUAL WORKS, 2000

	Total million euros	Production[a] %	Distribution %	Exploitation %
Austria	16.4	90	10	
Belgium	18.4	92.4	7.6	
Britain	57.5	96.5	1	2.5
Denmark	23.3	91	8.2	0.8
Finland	12.4	90	4.4	5.6
France	368.1	82.1	5.4	12.5
Germany	149.6	90	8.4	1.6
Greece	3.8	100	0	0
Ireland	8	99	1	0
Italy	94.5	89.9	10.1	0
Netherlands	34	99.4	0.6	0
Portugal	17.2	92.2	0	7.3
Spain	80	98.6	1.1	0.3
Sweden	36.7	78	22	[b]
EC-15	921.3	88.3	6.2	5.5

SOURCE: European Audiovisual Observatory, *Statistical Yearbook* 2002, vol. 3 (Strasbourg, France), 102.
a. Includes scriptwriting and development schemes and project development.
b. Support for exhibition is included in distribution.

However, these instruments of protection have not had the expected positive impact on French films. For instance, not enough French films are produced to meet the quota of French films to be broadcast during TV prime time. From 1994 to 2001, there have been, on average, only eleven French films per year having enough success in cinemas (more than one million viewers) to be candidates for broadcast during prime time—compared with an average of twenty-four U.S. films. As a result, TV channels increasingly show reruns of old French films (the rerun rate has increased from less than 60 percent in the 1980s to 70 percent in the 1990s) to meet the annual 40 percent quota of French films and fiction TV works—relegating recent French films to late or early hours of the day.

Subsidies: *Men in Black.* Table 9 shows that all EC member states implement massive subsidy schemes. In 2000, with supports amounting to 368 million euros for films and audiovisual works (films made for TV channels in EC jargon), France outdistanced other European countries. (In what follows, euros will be used for ECUs as well as for euros.) Since 1997, the gap has somewhat narrowed. In 2000, the amount of the

TABLE 10
SUBSIDIZATION RATES OF THE FRENCH FILM INDUSTRY, 1995–2000

M€, annual average during the period	Estimate 1	Estimate 2
Public aid to cinema	187.7	318.9
Movie theater income of French films	259.6	259.6
TV income of French films	326.6	195.4
Video income of French films	69.3	69.3
Export income of French films	82	82
Average subsidies rate of French films	25.5%	52.6%

SOURCE: Centre National de la Cinématographie, *Annual Reports*, 1995–2000 (Paris); authors' calculations.

French subsidies represented 39.9 percent of total European funds, compared with 45.6 percent in 1997. Nevertheless, French public support still exceeds by far the support granted by Germany, Britain, Italy, and Spain, all countries known for their interventionist policies on this matter. Note that table 9 underestimates the differences between France and the other EC member states because the figures provided on French public support do not fully take into account the implicit support imposed by the investment quota regime (which is much more important in France than in any other European country).

Table 10 addresses this implicit subsidy issue for French films (excluding audiovisual works) for the period between 1995 and 2000.[8] It gives two estimates of the subsidization rate, which differ with their treatment of the income that film producers derive from TV purchases. Estimate 1 includes in the film industry income the full expenses on purchased and prepurchased films made by TV channels. However, part of these TV purchases are imposed by the regulatory framework, namely broadcasting and investment quotas. This component should thus be considered as implicit subsidies granted by TV channels to French film producers. Because it ignores this more appropriate interpretation, estimate 1 undervalues somewhat the subsidization rate to French films. Estimate 2 aims to correct this bias by using Cocq's estimate,[9] according to which 41 percent of broadcasters' investments are imposed by the existing regulations. Consequently, 131.2 million euros should be deducted from the income from TV channels and reported as public support.

Table 10 suggests that during the late 1990s, the subsidization rate of the French cinema exceeded 50 percent, according to the unbiased

estimate 2. However, this rate is likely to be substantially lower than the true rate because it is based on film revenues (and not on the added value, as it should be) and it does not take into account a variety of funds, in particular SOFICA's tax-based incentive scheme for private investment in film production, and—much more importantly—Canal Plus monopoly rent. With an average spending of 130 million euros per year in the late 1990s, Canal Plus alone contributed to two-thirds of all funds flowing from investment quotas.[10] This huge investment requirement has been explicitly conceived as a counterpart of the monopoly granted to Canal Plus for broadcasting films in pay TV. In the 1990s, the monopoly rents that Canal Plus could extract from its French TV viewers was estimated to be 300 million euros per year, meaning that almost half of Canal Plus monopoly rents is an indirect way of taxing French TV viewers in order to subsidize French film producers.[11] If one adds all these subsidies, the rate of subsidization of French films is close to 100 percent.

This regime deserves a last, but crucial, observation. Skyrocketing subsidies have profoundly shaped film production away from culture. The standardization of "automatic" production subsidies calculated on admissions in cinemas, introduced by the "Plan Lang" (from former Culture Minister Jack Lang) in 1989, has fueled the production of French "entertainment" films mimicking high-cost Hollywood movies. Combined with broadcast quotas, such subsidies have protected French-made Hollywood clones from their Hollywood competitors, leading to an accelerated "Americanization" of the French film output and hurting the production of cultural films—all the more because the very limited subsidies for such movies are granted by quasi-corporatist committees favoring the fashion of the time more than creativity.

Winners and Losers: *Four Funerals and a Wedding*

European CAPs are so complex that operators in audiovisual markets want to stick to the status quo simply because they cannot assess whether they will lose or gain in the case of reforms. Fear of being among the net losers of liberalization nurtures everybody's hostility to reforms, whereas the complexity of the protection is likely to have generated so many inefficiencies that everybody is already a net loser. For instance, the French version of the EC system of quotas, subsidies, and

monopoly rents (created, then taxed and transferred) involves at least six different participants: cinema owners, film producers (foreign, French successful, and French unsuccessful), broadcasters, and French consumers.

Most of these operators do not know whether the existing regime makes them net winners or losers. Cinema owners benefit from the quota on the total number of films to be broadcast and from the subsidies (both increase demand for cinema seats), whereas they bear the cost of the 11 percent seat tax, which reduces this demand. U.S. filmmakers face the seat tax and the 40 percent broadcast quota on U.S. films (both reduce the demand of their films), but they recoup a portion of the seat tax to the extent that they are the main beneficiaries of the relatively comfortable French cinemas. EC filmmakers face the same situation as U.S. film producers, with two differences: They have access to French subsidies, but they are unlikely to benefit from possible rents associated with the quota on EC films (their demand by French TV viewers is too limited). Successful French film producers share many features with EC filmmakers, and they get even more subsidies, leaving them with the impression of being major beneficiaries (but perhaps wrongly, because their situation in the absence of CAPs could be even better). Broadcasters are "taxed" by investment quotas (and by taxes or fees on their advertising resources), but they may benefit from these quotas to the extent that they provide some flexibility in programming. Canal Plus is an extreme case, with huge monopoly rents constrained by investment quotas (with the rise of its competitor TPS increasingly deteriorating Canal Plus's net situation to the point that it could become a net loser in the future).

There is only one group of sure winners and one group of sure losers. Unsuccessful French filmmakers are unambiguously net winners: They are not hurt by the seat tax (nobody wants to see their movies), and they are fully subsidized. The larger their budgets are, the more they are winners. Ironically, big-budget unsuccessful French-made clones of Hollywood films get the best of the EC-French system. By contrast, the viewers of French films and the French taxpayers are unambiguously net losers. They are taxed directly (when funding subsidies) or indirectly (when going to movie cinemas or when subscribing to Canal Plus), and French viewers who want to see U.S. films are hurt by restrictions on these films, whereas French viewers interested in cultural films are hurt by minimal public support for this category of films.

A System Slowly Losing Its Support: *Titanic, Part II*

In the late 1990s, the perception of the CAPs enforced in some member states since the early 1980s, and generalized with the 1989 TWF European Directive, dramatically changed. A profound sense of dissatisfaction has emerged in all the member states, particularly in those implementing strict CAPs, such as France. What follows documents this evolution, underlining the fact that the much-publicized statement made in December 2001 by Jean-Marie Messier, then head of Vivendi-Universal, that "the Franco-French cultural exception is over," is the end result of a long process.

The unfairness of certain rules (and the ease with which they can be manipulated by committees) has been the first source of increasing criticism, as illustrated by the disputes on rules of origin discussed previously. A few years ago, movies unduly classified as French films were denounced in carefully balanced terms by Cour des Comptes but with no public echo.[12] In 1997, the above-mentioned highly controversial case of *The Fifth Element* was widely covered by the film specialized press (which is closely following the ongoing legal battle).

In 1998, the procedure for granting French origin to movies was reformed, with the language criterion losing some of its influence. But the changes have only generated new problems, as illustrated by a few recent cases. In 2000, a Japanese-made cartoon was presented as a French movie, fueling fierce criticisms in *Le Monde*.[13] More recently, the film *Un long dimanche de fiançailles*, directed by Jean-Pierre Jeunet (the director of the very successful *Le fabuleux destin d'Amélie Poulain*), almost did not receive French origin—despite the fact that it was shot in French and in France, with French actors—because the producer of the film (Production 2003) was a 40 percent subsidiary of the U.S. firm Warner.[14] Opponents to granting French origin to the movie in question argued that providing French subsidies to subsidiaries of U.S. filmmakers signified the end of the French cultural exception. Meanwhile, the movie *Alexander the Great* by Oliver Stone (a U.S. director with a French passport) was shot in English, with U.S. and British actors, but received French origin without problem, even though it was funded by the French firm Pathé only up to 20 percent.

Dissatisfaction has then grown concerning the production performance of the CAPs. During the early years of the system (the 1980s), the high number of films produced was perceived as a sign of success of the

French audiovisual policy—it was an essential argument for "selling" the French regime to the other EC member states. Of course, the fact that French film production remained high—while film production was declining (sometimes dramatically) in other EC member states—simply mirrored the fact that more French public money was made available to filmmakers and spent by them (once again, not necessarily for a cultural purpose). As time went on and other EC member states implemented their own version of the CAPs, their film industries began to produce roughly the same number of films as France (between 80 and 130 films per year for the largest member states), leading to the realization in Europe that this indicator was largely meaningless.[15]

The disenchantment was then followed by a spreading recognition of the uselessness of broadcast quotas in Europe, as underlined by the EC Commission: "There [is] a pretty general consensus that broadcast quotas no longer suited the new environment."[16] This perception has penetrated even the member states that have been historically the most attached to this instrument. A series of interviews about audiovisual regulations before the Seattle WTO Ministerial revealed a definite change of tone in France.[17] Patrick Le Lay, head of the largest (private) TV channel, TF1, was very clear about the fact that quotas have been made "obsolete" by digitalization and the Internet, whereas Marc Tessier, head of the public channel France Télévision, and Pierre Lescure, head of Canal Plus, were in favor of "more flexibility" of the existing regime, leaving only Rémy Sautter, head of CLT-UFA, in favor of quotas (but not of subsidies).

Declining public support for the quota regime in recent years mirrors the increasing share of foreign films in cinema admissions. Until the late 1990s, the diverging evolutions of the shares of U.S. and domestic films in France and other European countries (see table 11) were perceived as the sign of success of the French film policy. In fact, however, as said above, the high market share of domestic films in France was the mere consequence of the massive French subsidies, relative to the support granted by other countries.

However, this difference has been vanishing during recent years, and market shares of films by nationality tend to converge in all EC member states (see table 12). The same can be said for the market shares for domestic films (the dubious classification of *The Fifth Element* as a French film increases the 1997 French film market share in France by 5 percentage points), and the recognition of a "commercial rout" in 1999 has been widely acknowledged in the French press.[18]

TABLE 11
EC AUDIOVISUAL MARKETS: CINEMAS, TV CHANNELS, AND VIDEOS, 1996–1997

	Theaters[a]		TV channels[b]		Videos	
	U.S. films	EC films	U.S. films	U.S. 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
Netherlands	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[f]	72.4	*1.7*	*61.1*	*24.6*	73.6	3.5
United States	95.4	—	—	—	92.8	—
Japan	41.3	—	—	—	90.8	—

SOURCE: European Audiovisual Observatory, *Statistical Yearbook* 1998, 1999 (Strasbourg, France).
a. In percentage of total entrances.
b. In percentage of hours broadcasted (weighted by audience).
Data for U.S. films are available only for 1996 (for comparison, data for U.S. fiction works for the same year are presented).
c. In percentage of households.
d. Expenditures in current euro per person.
e. The 1997 share is 8.7 percent if coproduced British-U.S. films are included as EC films.
f. EC simple averages of the columns (based on the 15 member states) are indicated by italics.

A newly emerging source of dissatisfaction in France is the role of subsidies. Until the very early 2000s, criticisms had been limited to the subsidy pattern, with certain observers finding the subsidy share granted to distribution to be excessive, with a notable exception in a weekly newspaper.[19] But sweeping criticism erupted unexpectedly with a hot debate between directors and film critics. In a paper published in one of the major French newspapers, certain directors bitterly accused film

critics of "premeditated assassinations" and of wanting "to kill off all commercial French cinema designed for a mass audience."[20] The article generated an outcry, which leads to two key observations. First, directors producing small-budget cultural films did not endorse the stated accusations (as the quote shows, the article referred to "commercial" films), whereas directors specializing in "pure" entertainment movies did not intervene in the controversy. This clear split among directors of three types of films ("pure" entertainment, cultural, and "in-between") is crucial not only because it underlines that problems are concentrated in the "in-between" segment of the French production, but because, as argued above, it provides a basis for designing a worldwide acceptable subsidy regime. Second, the debate offered an opportunity for many commentators to criticize "a protection of film makers which has reached such a level that its beneficiaries are no more able to tolerate the least criticism,"[21] at last opening the door to criticisms of the existing subsidy scheme in the French press.[22]

Interestingly, doubts on the efficiency of the French subsidy scheme have very recently begun to emerge among official circles, as best illustrated by a very recent report from the French Senate.[23]

These criticisms have not reached the EC subsidy regime (as distinct from member states' subsidies), which is still widely perceived as beneficial despite the fact that the demand for European nondomestic films in each EC member state (for instance, the demand for EC non-French films in France) is not only small but also generally declined during the 1990s. This evolution suggests that the EC subsidy regime is self-destructing because CAPs constitute a barrier to an integrated EC film market, contrary to its stated objective. This is not surprising. National subsidies have artificially bolstered film production by "gluing"—the idea that investments are stuck in each member state, instead of looking to the best places in Europe—national investments in each member state. Rather than creating a demand for so-called "European" films, these "sticky" investments in a member state have been crowding out films from other EC member states. Ironically, the French film industry has suffered the largest crowding-out effect. In sharp contrast, the only EC film industry with growing market shares in the EC is the British industry, which has been characterized by a much lower level of subsidization for years (to a large extent, forcing it not to mimic U.S. films but to offer a British touch) and noticeable investments from the U.S. film industry in recent years.

TABLE 12
EC AUDIOVISUAL POLICIES: A BARRIER TO A EUROPEAN FILM MARKET

	Market share of films from:						Origin of first-time release feature films					
	Domestic	United States	Britain	France	Germany	Italy	Domestic	United States	Britain	France	Germany	Italy
	Britain (market share of gross box office)						Britain					
1992	6.8	90.6	—	1.0	0.1	0.0	11	59.9	—	6.6	0.9	0.9
1993	2.5	94.2	—	0.7	0.0	0.0	10.2	57.2	—	6.4	0.8	0.8
1994	8.8	90.2	—	0.5	0.0	0.0	15.8	58.9	—	5.4	1.3	2.0
1995	10.5	85.2	—	0.5	0.0	0.2	16.3	60.7	—	5.0	1.0	1.7
1996	12.8	81.7	—	0.5	0.0	0.2	18.7	59.8	—	6.6	0.6	0.6
1997	28.1	69.3	—	0.2	0.0	0.0	23.5	57.1	—	5.7	0.6	1.2
1998	14.2	83.7	—	0.2	0.0	0.0	20.5	53.4	—	5.9	1.1	0.0
1999	17.8	80.5	—	0.2	0.1	0.5	23.3	52.8	—	5.3	1.4	0.8
2000	21.4	75.3	—	0.3	0.0	0.0	21.4	51.9	—	6.0	0.5	0.8
	Italy (market share of gross box office)						Italy					
1992	24.4	59.4	6.1	4.5	0.2	—	26.1	47.8	7.1	6.6	2.3	—
1993	17.3	70.0	4.7	3.4	1.0	—	27.8	52.0	4.2	5.0	1.6	—
1994	23.7	61.1	6.7	3.2	1.8	—	27.5	50.0	5.2	5.5	1.4	—
1995	21.1	63.2	6.4	4.0	0.7	—	22.0	52.5	6.2	6.7	1.2	—
1996	24.9	59.7	5.9	2.5	0.1	—	26.6	48.9	8.3	6.5	0.8	—
1997	32.9	46.7	10.8	4.0	0.4	—	22.9	47.9	9.7	6.8	1.1	—
1998	24.7	63.8	7.4	2.2	0.2	—	24.0	47.8	8.9	8.1	1.6	—
1999	24.1	53.1	13.8	2.7	0.4	—	24.8	43.1	10.9	9.2	1.0	—
2000	17.5	69.6	3.3	5.8	1.1	—	20.1	45.6	—	—	—	—
	Spain (market share of gross box office)						Spain					
1992	9.3	77.1	3.9	4.0	2.6	1.2	11.3	53.5	6.6	8.8	1.6	6
1993	8.8	75.7	4.1	3.9	1.5	0.4	18.3	51.3	6.2	7.5	4.9	3.3
1994	7.1	72.3	8.7	3.2	2.3	0.3	12.8	52.8	8.7	6.1	9.0	2.0
1995	12.2	71.9	7.3	2.9	1.1	0.6	14.1	45.8	7.9	7.7	10.6	4.1
1996	9.3	78.2	5.8	2.7	0.4	1.6	17.7	39.5	5.2	6.7	5.2	1.9
1997	13.1	68.2	12.6	2.6	0.7	0.4	16.6	44.1	9.1	6.0	13.3	2.3
1998	11.9	78.5	5.8	0.9	0.5	0.3	13.0	47.9	8.0	5.4	13.2	1.8
1999	13.8	64.4	10.8	3.2	0.6	3.5	17.1	45.1	9.8	7.3	11.7	2.1
2000	10.0	81.6	3.7	1.6	0.8	0.2	—	—	—	—	—	—

TABLE 12 *(continued)*
EC AUDIOVISUAL POLICIES: A BARRIER TO A EUROPEAN FILM MARKET

	Market share of films from:						Origin of first-time release feature films					
	Domestic	United States	Britain	France	Germany	Italy	Domestic	United States	Britain	France	Germany	Italy
	Germany (market share of gross box office)						Germany					
1992	9.5	82.8	2.5	2.7	—	0.2	21.9	45.1	7.3	8.7	—	4.2
1993	7.2	87.8	1.1	2.0	—	0.1	25.5	49.4	5.3	8.0	—	0.4
1994	10.1	81.6	4.8	1.5	—	0.1	22.8	50.2	6.8	7.2	—	1.1
1995	6.3	87.1	2.2	1.7	—	0.1	24.2	51.9	5.0	5.0	—	1.5
1996	15.3	75.1	7.0	1.0	—	0.1	22.3	52.3	4.9	6.3	—	1.0
1997	17.3	70.5	8.5	2.9	—	0.1	21.3	47.2	8.4	7.3	—	1.0
1998	8.1	85.4	5.2	0.7	—	0.3	16.9	56.9	6.4	5.4	—	2.4
1999	11.1	78.6	—	0.7	—	—	—	—	—	—	—	—
2000	9.4	81.9	—	0.9	—	—	—	—	—	—	—	—
	France (market share of gross box office)						France					
1992	35.0	58.2	1.6	—	0.6	0.8	41.6	30.2	3.0	—	1.2	2.5
1993	35.1	57.1	2.7	—	0.3	0.2	38.9	34.1	3.8	—	2.5	1.8
1994	28.3	60.9	7.0	—	0.5	0.2	35.6	35.9	3.4	—	1.2	2.2
1995	35.2	53.9	6.5	—	1.1	0.1	36.3	35.0	4.5	—	2.5	2.0
1996	37.5	54.3	5.1	—	0.4	0.1	38.9	36.3	5.2	—	1.8	1.3
1997	34.5	52.2	8.9	—	0.2	0.2	38.3	36.8	6.3	—	1.5	3.3
1998	27.6	63.2	4.5	—	0.2	2.1	38.6	35.5	8.3	—	2.0	1.1
1999	32.4	53.9	8.7	—	0.6	0.9	39.8	34.1	5.3	—	1.5	2.1
2000	28.5	62.9	4.7	—	0.6	0.4	38.2	35.7	6.8	—	1.7	1.7
2001[a]	41.5	46.4	5.7	—	0.9	0.3	40.3	32.0	6.3	—	2.2	0.8

SOURCE: European Audiovisual Observatory, *Statistical Yearbook* 2001 (Strasbourg, France).
a. Provisional figures.

Regulatory Reforms and Liberalization: *Shakespeare in Love*

The above evidence leads to the conclusion that domestic regulatory reforms are much needed. Thus, this section looks at two issues: Why have almost no reforms been launched? What could be the desirable reforms?

Explaining Inertia: *Citizen Kane*. There are several explanations of why almost no reforms have been established. First, there is the sheer importance of the media for politicians. Media professionals (for example, film directors and actors) are, by definition, masters of public relations. Their skills make them particularly apt at exerting powerful pressures on governments, as illustrated in 1998 by a few European film directors, who were able to provide the "coup de grâce" to the OECD-based Multilateral Agreement on Investment (MAI), despite the fact that it was already clear that audiovisual services were excluded from the MAI coverage.[24] Because audiovisual services are an essential tool of the day-to-day relations between the "rulers" and the "people," government officials need the expertise of media professionals on a regular basis. This gives these producers much more influence than their economic weight would suggest. (Increases in audiovisual subsidies are significantly correlated with French major elections.)

Second is the much-entrenched belief that CAPs are necessary for creating "quality" movies. There is no evidence to support such a belief, as shown by the two (admittedly crude) indicators for French films. The first indicator is based on the TV audience. As stressed previously, the lightly subsidized French films produced before the 1980s attract, even nowadays (despite the handicap of many reruns), many more viewers during prime time TV hours than the heavily subsidized films produced during the 1980s and 1990s—such a difference in attractiveness is not observed for recent U.S. films. The second indicator assumes that the only people who can recognize the virtues of French cultural films are those who attend 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 20 percent (1981–1986) to 8 percent (1987–1994 and 1995–2000), if one does not include the Cannes Festival. (Including Cannes confirms the decline during the two first periods, from 16 percent to 10 percent but shows an increase to 14 percent during the third period.) All this does not support a strong correlation between the CAPs and "quality" movies.

These results are not surprising for economists who regard changes in artistic quality as largely exogenous to public policies. They may even expect the CAPs to have a negative effect on quality for the following reasons. Broadcast quotas tend to induce TV firms to produce more domestic films only (or essentially) to increase the number of foreign films to be

broadcast, making quality a marginal preoccupation. Subsidies change the trade-off between quantity and quality by anesthetizing filmmakers' risk assessment, as indirectly revealed by the much higher ratio of films to viewers in France compared with the United States (there are roughly 1.1 films produced per million annual viewers in France, compared with 0.4 films per million in the United States).

Third, the balkanization of EC audiovisual markets by the many quotas, subsidies, and monopolies (public and private) introduced by the CAPs has left EC audiovisual firms with two main strategic options. The first is to replicate the EC system in Central Europe by establishing additional monopolies—an option relatively easy to implement but with very low returns (because of the smallness of the available markets) and with the costs of increasingly hostile environments. (Why should Estonians be happy to grant monopoly rights and rents to French or German TV firms?) The alternative option is to become global (world) firms. However, that requires such large funds that it cannot be done alone by EC audiovisual firms (which are small and underfunded). Going global makes sense only for EC audiovisual firms that are part of much larger and diversified companies; however, this option is still very risky, as best illustrated by the integration of Universal Studios or even Canal Plus in Vivendi.

Last but not least, the absence of proposals for the liberalization of audiovisual services reflects the above-mentioned fact that audiovisual services companies do not know whether the existing policies make them net winners or losers, leaving no constituency for change.

Three Proposals: *Le fabuleux destin d'Amélie Poulain.* The three reforms discussed here are a preparatory step for multilateral negotiations and could improve the situation for both the entertainment- and culturally oriented audiovisual services sectors among WTO members. The reforms focus on the EC, but because all the suggestions are consistent with the letter and, more importantly, the spirit of the WTO, they also could be considered by other countries. Reforms should aim to eliminate the waste of European resources for making entertainment and to provide a much better environment for culture—a de facto, much neglected aspect in the existing CAPs.

The first proposal is to dismantle the CAPs quota regime. Justifying this action in a narrow WTO context—the highly discriminatory content of this regime—would miss the main reason of such an action: The existing quota regime is a crucial obstacle to a European integrated film market. As

discussed previously, such quotas hurt every market participant, except the producers of bad domestic films. They create monopolies (hence inefficiencies) through price hikes or quantity restrictions, and as a result, they call for subsidies to be sustainable in the long run (at a large cost to public treasuries). The CAPs quota regime could be dismantled in three ways: merging domestic and other member state film categories into one ("European") category in the broadcast quotas, increasing the share of non-EC films in the broadcast quotas, and reducing the investment quotas (and eliminating the constraints of these quotas). The sequence of these measures should be examined carefully (ideally, the reduction of the distortions in the film markets per se should precede the reduction of the distortions in the investment domain in order to avoid the misallocation of investment resources in the most protected markets).

The second proposal is to make a distinction between subsidies for entertainment and subsidies for culture, eliminating the former and allowing the latter. Eliminating quotas but keeping subsidies for all kinds of films (a policy often suggested in Europe) would be inappropriate. The previously mentioned French debate between directors and critics shows that entertainment films can survive without state subsidies, but cultural films cannot, and the ambiguous case of "in-between" movies is not a serious obstacle to this distinction because most of these films have little cultural content. At first glance, such a proposal seems drastic and to have little chance of succeeding in Europe. However, the situation is changing. Eroding monopoly rents within member states' markets (such as for Canal Plus) will inevitably undermine a large source of subsidies. Declining market shares of European films in European markets will force operators in the film market to recognize that subsidies generate barriers rather than create a single market.

Subsidies for cultural films do not raise any problem of principle about their compatibility with the rules of the WTO. The direct and indirect effects of such subsidies on film trade are minimal because such films tend to have limited audiences and are not a substitute for entertainment films. The source of subsidies does not seem to be a serious problem in the WTO framework. Funding through the general tax system (or a proxy for general tax, such as the British National Lottery, which may be seen as superior to funding through public budget because it is more transparent) is nondiscriminatory. Funding through a seat tax can be treated as (partially) equivalent to a tariff, which is an instrument easily negotiable in multilateral trade negotiations.

Such subsidies raise two problems of implementation. First is the instrument that will allow their introduction to the WTO framework. The solution seems to be a "reference paper" defining the conditions of competition in films, that is, allowing subsidies for cultural films and prohibiting them for other types of films. The second problem is to prevent filmmakers from improperly using subsidies for films other than cultural films. Such a problem is not serious in countries acting in good faith, because the distinction between entertainment and cultural films is easy to make and because cultural films rarely require large funds. For instance, French subsidies to cultural films amount (by all possible standards) to less than 30 percent of the total amount of public subsidies. But the problem does exist in the absence of good faith behavior by some WTO members. To monitor this risk, WTO member states should be requested to notify an agreed international body of their subsidies—perhaps an embarrassing exercise because it might reveal how amazingly little countries invest in their culture (and how culture is an excuse for sheer protectionism of narrow domestic economic interests).

The third proposal deals with the serious, and fundamentally domestic, issues raised by an efficient regime of subsidies for cultural films, that is, of an efficient "patronage." Such issues are completely ignored by the existing CAPs. To what extent can democratic institutions (that is, elected representatives and government officials) and associated bureaucracies (such as the French Centre National de la Cinématographie) be effective "patrons"? Being a patron implies the willingness to take risks and be ready to pay for the possible mistakes and corresponding losses. In democracies, representatives and government officials are intrinsically reluctant to take risks because they could be accused of favoritism. In addition, they never pay for their errors—the taxpayers do. Under these conditions, it is difficult for public authorities to promote culture directly (except in the narrow sense of preserving uncontroversial historical items and landmarks).

As a result, a serious treatment of culture in the film industry (as well as in other arts) requires adequate domestic regulations for art foundations and for innovative structures for patronage (for example, the British system of "franchised units"). Each country should make an in-depth examination of its capacity to provide the appropriate regulations and institutions for the support of its culture. These are purely domestic problems, and such regulations and institutions are unlikely to raise a problem with the WTO principle of nondiscrimination. In fact, a patron of French culture could be a U.S. institution or person (as in the late 1800s and early 1900s, with

the U.S. tycoons and French Impressionists), and filmmakers producing movies nurtured by and enriching French culture could be natives of other countries.

In conclusion, none of these three proposals threatens "culture" or the WTO. To the contrary, they all offer opportunities to design better mechanisms for patronage than the defaulting ones on which the existing protectionist policies rely. The WTO is perfectly fitted for discussing the issue of culturally oriented subsidies (and other competition-related issues) in a reference paper specific to audiovisual services. There is no need to go to another international forum.

Postscript: And the Kiwis Came

The following postscript addresses four issues that emerged between the Uruguay and the Doha Rounds—during the late 1990s and early 2000s.

First, during the Uruguay Round, Hollywood was dominant in entertainment movies and fiction TV shows. Today, Hollywood retains its unique capacity to produce movies that are seen in cinemas all over the world—it is a major European preconception that Hollywood aims to produce only "American" movies. However, the situation has evolved in the fiction TV segment. The existence of a much larger number of European broadcasters has generated a strong demand for more differentiated programs based on more local content (local actors, scenery). Because skills for making fiction TV shows are easier to learn, and digitalization has made equipment less expensive, TV programs can target national audiences and still be profitable. To keep their previous positions, U.S. firms have had to make joint TV shows with non-U.S. firms.

Second, the costs of making Hollywood films in the United States have skyrocketed, inducing Hollywood filmmakers to shoot their movies outside U.S. territory. Requests for protecting audiovisual interests in the United States against "runaway productions" have emerged, as illustrated by a dispute between the United States and Canada over American movies being shot in Canada. What was at stake was (explicitly) "the small business that supports the film industry, . . . caterers, rental equipment business, electricians, etc."[25] and not, for example, the authors, directors, actors, and scriptwriters, that is, all the sources of culture.

Third, digitalization has created huge possibilities for creating images, including "virtual" images, at low cost. Countries that have not previously

been involved in audiovisual production—but have workers who have digitalization skills and untapped natural resources—have been able to attract large productions, as best illustrated by *The Lord of the Rings*, which was mostly produced in New Zealand. (Interestingly, this movie is considered to be of U.S. origin in most countries, but of New Zealand origin by the French authorities.) As a result, competition between possible places to shoot films and fiction TV shows has tremendously increased.

Fourth, the strengthening of the Internet-based economy has dramatically changed the market prospects for cultural films. The Internet is a very cheap and widespread means of disseminating cultural films, which, by nature, tend to attract geographically dispersed audiences. Forces in the EC that want to extend to Internet-related audiovisual services the barriers and restrictions imposed on audiovisual services channeled by other means of communication are suicidal from the cultural point of view. In terms of the audiovisual services sector, the EC probably has more to gain from an untaxed and free Internet than the United States does.

Interestingly, all these issues challenge the U.S. comparative advantages in movies shown in cinemas—there is no such thing as producers with permanent advantages. As a result, they favor situations that can be seen by negotiators as more "balanced" between market operators in the United States, the EC, and elsewhere; hence, if more frequent and recognized, these evolving comparative advantages could make negotiations on audiovisual services at the WTO easier.