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Competition Policy Review Panel
Research Paper Summary

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Title: Canadian Foreign Direct Investment Policy and the Cultural Industries

Subjects Addressed:

- Foreign direct investment restrictions in the cultural sector
- Foreign direct investment restrictions in the broadcasting sector
- Investment Canada Act (ICA)
- Canadian content policies

Cultural industry policy:

Cultural industry policies include subsidies, taxes, government production and service provision, as well as the foreign investment controls and regulatory measures specific to individual cultural activities and industries. Explicit foreign direct investment constraints are complemented by *de facto* foreign investment restrictions created by our definition of Canadian content and the terms of access to subsidy programs designed to promote production of Canadian film and audiovisual content.

Besides the ownership constraints, cultural industry policy includes licensing and regulating broadcasters, specialty channels and broadcasting distribution undertakings (BDUs); allowing foreign broadcasters and cable channels tiered access to Canadian BDUs; subsidies for Canadian books, magazines, film and television programs; adjudicating and taxing ownership transfers of broadcasting licences; mail subsidies for magazine publishers; and restricting access of foreign magazines to the Canadian advertising market.

The goal of cultural *industry* policy is to provide and deliver more Canadian content; however, the link to Canadian *culture* is tenuous as the number of Canadians who prefer to read, watch and listen to what is officially designated as their cultural products is relatively low.

Investment Canada Act (ICA):

Under the ICA, foreign investments in the cultural industries (production, distribution and retail of books, magazines, newspapers, film, videos, music and sheet music) over \$ 5 million must pass a net benefit test administered by Heritage Canada. The guidelines for the process tend to discourage foreign investments. In book publishing, investments other than joint ventures with Canadian-controlled businesses are unlikely to receive approval. In a sale of a Canadian publisher, Canadian buyers must be given a “full and fair” chance to purchase.

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The review applies even to a transfer of a foreign-owned business in Canada to another foreign owner and increases the cost of such a sale. Canadian subsidiaries of multi-national book publishers accounted for 59% of sales in Canada in 2004. There are also many ICA reviews of small requests by foreign subsidiaries in Canada for permission to sell literature or videos that complement the services that they provide.

Book publishing:

Under Canadian Copyright Law, foreign owned book publishers have the right to price discriminate between the Canadian market and their home market. An American publisher that is also represented in Canada can charge more for a book published by a subsidiary in Canada than the going price in the United States and legally prevent the cheaper copies from entering Canada. Alternatively, a publisher in the United States without a subsidiary in Canada may obtain more net revenue by assigning the right to publish the book in Canada to a Canadian publisher.

Magazines:

In the magazine sector, the regulatory regime had to change when technology allowed for the electronic transmission of US-made content to Canadian printers, allowing for split-run magazines. The new regime introduced mail subsidies and other subsidies for Canadian magazines and allowed a 50% tax deductibility of advertisements by Canadian companies in magazines with under 80% Canadian editorial content and 100% tax deductibility for ads in magazines with over 80% Canadian editorial content. Foreign publishers may now publish up to 18% of their advertising aimed at the Canadian market in editions sold in Canada. Contrary to expectations, split runs are currently not a significant factor in the Canadian market; sales of foreign magazines with the same content and advertising as in the United States continue to dominate over-the-counter magazine sales.

Broadcasting:

Under the Broadcasting Act, direct foreign investment in a Canadian broadcasting company is limited to 20% of the voting shares. In addition, foreign firms may own up to 1/3 of the shares of a Canadian holding company that owns the other 80% of the voting shares. As a result, only non-voting shares of the company are actively traded, because if voting shares are listed, the controlling group must tightly monitor trades to ensure that foreigners' purchases do not make the company non-Canadian.

Foreign channels on Canadian cable and satellite BDUs are not licensed, but authorized by the CRTC for inclusion on "approved lists," from which the BDUs choose the channels they offer. Broadcasters do not require a physical medium to cross the border and do not have to establish broadcasting facilities in Canada to reach Canadian audiences.

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The CRTC's simultaneous substitution rule allows BDUs to substitute a Canadian station for a foreign one when both stations are airing the same program at the same time. Viewers then see the Canadian ads instead of American ads while watching the same episode of the same program. This reduces the amount of choice available since two broadcasters are showing the same program at the same time. Removing foreign ownership restrictions would be preferable to the simultaneous substitution rule; even with an American broadcaster acquiring the Canadian broadcaster, they would air different programs.

Removing foreign investment constraints may reduce costs of broadcasting; integration under common ownership is sometimes the most efficient way of coordinating the elements of the value chain. It would also allow Canada to more constructively negotiate international accords within NAFTA and the WTO about trade and investment in the cultural industries. Anticipated sales and presales in foreign markets are relatively more important for financing productions in the context of a small domestic market. Actual or proposed foreign direct investment in distribution or a representative office abroad by leading Canadian production or integrated media companies like Alliance and Atlantis Communications Ltd., Barna-Alper Productions, and DHX Media facilitates sales from their own libraries and those of other smaller Canadian companies. They have established or are considering establishing operations in the United Kingdom, Spain, and the United States. Among broadcasters, Canwest Global holds a majority ownership of a television network in Australia. The privilege of access is not reciprocal. British, Spanish and American companies cannot establish film and television distribution facilities in Canada except for proprietary films nor can an Australian control a broadcast licence in Canada.

It is sometimes argued that foreign ownership restrictions try to 'keep Hollywood at bay.' However, the main Hollywood subsidiaries in Canada existed before foreign investment was restricted in 1987 and were 'grandfathered.' This has allowed them to continue operating and has insulated them from competition from any new internationally oriented firms in their Canadian operations. Similarly, incumbent foreign book publishers are protected from new competitors from abroad.

Definitions of Canadian content:

Canadian content measures typically depend on the nationality of its creators and makers. In some cases, the nationality of the content also depends on the amount of money spent in Canada producing the content. The Canadian nationality tests in almost every case have nothing to do with the content itself.

A film or television program is Canadian depending on the points generated by its creative team and some additional requirements. If Canadians hold all key positions, the production scores 10 points. To qualify as Canadian content for broadcasting or tax credit support, a film or television program must score at

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least 6 points, have a Canadian producer, have either the director or the screenwriter be Canadian, and have one of the two leading actors be Canadian. In addition, 75% of production and of post-production expenses must be paid to Canadians, and it has to be made by a Canadian production company.

To qualify as Canadian content for the purpose of radio broadcasting regulation a musical selection must satisfy two criteria from among the following: music composed by a Canadian, lyrics written by a Canadian, lyrics sung or music performed by a Canadian, and recorded in Canada or performed in Canada and broadcast live. To receive subsidies, the music also has to be recorded by a Canadian recording company. Foreign owned record companies produce a large proportion of the Canadian content selections that are played on Canadian radio and benefit from the talent nurtured by the subsidies in the early stages of a career.

For a book to qualify as Canadian (and for Canadian support programs) its author and publisher have to be Canadian.

The view that Canadian content is what Canadians choose from an open menu and not what is officially branded as Canadian is an alternative to the current approach in cultural policy. Many Canadians are acting as if that were their preference by their increasing and broad use of the Internet.

Impact of the Internet:

The cultural effects of the Internet include a blurring of the boundary between the producer and the audience of information and entertainment (e.g. blogs, YouTube). The onus is much more on the consumer to develop filters for judging the quality of Internet sourced information, entertainment content and services.

The Internet also provides alternatives to existing distribution channels for recorded music, books, journals, newspaper and magazine content, movies, radio and television programs and other audiovisual content. Canadian radio station signals are available throughout the world on the Internet, increasing their international reach, but the reciprocal availability of foreign signals in Canada makes competition for domestic stations more intense.

There is a rapidly expanding set of Internet sites offering television and films on demand using streaming or P2PTV technology, e.g. Joost and Hulu.com (developed by NBC and Fox). CinemaNow, in which Vancouver-based Lionsgate has an ownership interest. These sites can and do restrict viewership to comply with copyrights. Internet-based programming has begun to attract significant advertising revenue.

Amazon.ca has recently entered the Canadian market for books, CDs, and DVDs. Its operations are not reviewable under the ICA because it owns nothing in Canada. Its main competitors are Chapters.Indigo.ca and Abebooks, an

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innovative system of linking small and medium bookstores to compete with chains and online services.

The CRTC decided in 1999 that it has the authority to regulate the Internet under the Broadcasting Act but it decided not to do so. Dunbar and Leblanc¹ advocate that Canada not regulate the Internet but instead support Canadian participation in new media ventures through copyright, fiscal measures and new programs.

Conclusions:

Canadians obviously like a varied menu from which to choose. The inclusion of foreign television channels on cable and satellite packages accommodates what Canadians want to watch and the reality of a good but relatively small production industry with a limited capability to supply it. More accommodation of these realities in the ICA should be given serious consideration.

¹ Review of the Regulatory Framework for Broadcasting Services in Canada: Final Report, August 31, 2007