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European Public Film Support within the WTO Framework

The promotion of cultural diversity and a competitive European film and programming industry continues to be the subject of much debate this year. As part of the public consultation concerning the review of the "Television without Frontiers" Directive, various measures designed to support TV programme production are under scrutiny. In the closely related field of film support, the European Commission has set itself the goal of preparing a new programme by the end of this year. This programme will replace, *inter alia*, the MEDIA Plus Programme, which expires in 2006. A consultation procedure is also under way on this subject.

However, Europeans are also currently faced with a contradictory suggestion: various states have called for audiovisual services to be made subject to WTO regulations, partly in order that potentially anti-competitive effects of the various support programmes might be recognised and reduced. The European Union has already taken a stance through statements made by the Commission and Parliament in relation to preparations for the fifth Ministerial Conference of the World Trade Organisation (WTO), being held in Cancún, Mexico in September. It appears determined not to enter into any commitments in the audiovisual sector.

To accompany the debate on film support in Europe, this edition of *IRIS plus* describes systematically the areas where public film support and the WTO regulatory framework intertwine. The article concentrates on the compatibility of European film support policy with the GATT and GATS rules.

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European Public Film Support within the WTO Framework

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I. WTO and Culture

The US-EU trade relations on cultural matters have been influenced by the bitter feuds regarding audiovisual services at the end of the Uruguay Round. The debate finished in a stalemate on audiovisual industries within the framework of the GATS, often referred to as "an agreement to disagree", and a *de facto* exclusion of the audiovisual sector from the GATS regime. The new round of talks, launched in Doha, has overcome this impasse, giving fresh impetus to trade negotiations. Within its framework, the need to reconcile free trade with other public policy objectives has been explicitly recognised. As no sector is excluded *a priori* from the negotiations, the treatment of cultural goods and services is likely to become once again the stumbling block. The United States is among very few states that expressed the will to include audiovisual industries in the negotiations and made an official request for the liberalisation of audiovisual services.[2] At the same time, it is more and more commonly acknowledged that it becomes increasingly difficult to envisage the development of trade rules without due regard for cultural diversity, in particular in view of the *Universal Declaration on Cultural Diversity*, adopted by the UNESCO.[3]

The position of the European Union concerning the WTO negotiations clearly respects the cultural imperatives of public audiovisual policies. According to its mandate, the EU seeks to ensure during the new negotiations round, as in the Uruguay Round, that the Union and its Member States maintain the possibility to preserve and develop the capacity to define and implement their cultural and audiovisual policies for the purpose of preserving their cultural diversity.[4]

The political salience of the audiovisual question in the framework of the GATS should not give the impression that cultural issues become relevant only within the services context. On the contrary, culture-and-trade issues occur in a range of other contexts of international trade law,[5] including the trade in goods (GATT), the protection of intellectual property (TRIPS), the protection of investment (MAI) and the regulation of subsidies (SCM Agreement). Domestic cultural policies may gain relevance under the other, non-GATS, headings.

Feature film as both a very influential and the most vulnerable of the media is a primary preoccupation of European (both national and EU) cultural policies. The financial support it receives yearly from the public sphere around Europe reaches more than EUR 1 billion allocated by the national and regional funding bodies and more than EUR 80 million granted by the pan-European funds (MEDIA and *Eurimages*).[6] It takes the form of direct subsidies and other public aid measures, granted mainly to film production but also to cinematographic services (film distribution and exhibition). The focus of this paper will be on these various public support instruments to the European film industry, which will be examined for their compatibility with the WTO core regimes: GATT (including SCM Agreement) and GATS.

Before embarking upon a comprehensive analysis of film support policies in the international context, it has to be stressed that cultural concerns represent, indeed, a potential source of legal conflict with international trade law. The alleged hostility towards cultural considerations within the world trade order is definitely not ungrounded, but more light should be thrown upon it.

The WTO law certainly impinges upon cultural policies, which has been demonstrated in the Canadian Periodicals case,[7] widely criticised for being insensitive to cultural values. It concerned a dispute between the United States and Canada over measures introduced by the latter in order to protect the national magazine industry as a medium of Canadian ideas and a tool for the promotion of Canadian culture. The US objected to the measures as being restrictive and protectionist and initiated a WTO dispute settlement procedure, which led to an unfavourable ruling for Canada. In this way, the case raised the vital issue of the significance of culture under the WTO system, and its limits.

The impact of globalisation and trade liberalisation on domestic cultural policy objectives and their interaction does not mean, however, that non-trade public policy objectives are automatically overridden by free trade rules. Although there is nothing in the world trade order to suggest a specific regime for cultural goods or services,[8] it can be argued that the WTO system, following a tradition stemming from its predecessor, the GATT, acknowledges differentiated solutions for sensitive cultural sectors like the audiovisual industry.[9] The WTO is not oriented towards unconditional primacy of commercial interests, but rather endeavours to regulate both economic and non-economic activities within the territory of its Members, in order to guarantee the achievement of trade liberalisation, aimed at increased welfare, and other public objectives simultaneously.[10] This arguable tolerance, however, is rather fragmentary and has to be reconstructed through a thorough analysis of different elements of the WTO system.

Accordingly, this paper will systematically analyse the compatibility of the public film policies in Europe with the WTO law. In order to place film support measures within the WTO legal framework, it has to be recalled that the WTO regime is based on a distinction between goods and services. Therefore, the criteria that determine whether GATT or GATS apply to the cinematographic sector have to be examined. This will be done in Section II. The normative framework on subsidies to goods consists of general rules of the GATT and specific regulations, contained in the Agreement on Subsidies and Countervailing Measures (SCM), which are discussed in Section III. The subsidies to services have not yet been regulated in a special agreement; however, the relevance of the GATS agreement for film aid mechanisms will be explored in the context of GATS general clauses and the planned draft of rules on subsidies to services (Section IV).

The real challenge, as it will become apparent, might consist in finding ways – within and/or outside the WTO Agreements – that would give states the flexibility and legal certainty to take all necessary policy measures for the preservation and promotion of cultural diversity, while bearing in mind technological and market developments.

II. Legal classification of the medium "film" within the WTO system

The legal classification of film support measures within the WTO very much depends on the interpretation of the legal nature of the medium of film within the world trade framework. In international economic law, cinematographic works are traditionally treated as goods.[11] This approach dates from 1947 when a special clause referring specifically to cinematographic films was introduced in Article IV of the GATT. However, rental activities as well as the public communication of a film (its projection) are considered, presumably also under the influence of European law, as

services.[12] The matter becomes more complicated when television programmes, including television films, are taken into account. As emphasised in the well-established literature, the members of GATS have a clear understanding that trade in television content must be dealt with exclusively under this agreement, thus excluding the application of GATT.[13] Accordingly, television programmes would be subject to GATS, whereas cinema films, together with books, works of art and music recordings, are subject to GATT.[14]

Some authors consider this distinction between television programming and other cultural products to be arbitrary,[15] since the real value of all these works lies in their literary or artistic content, irrespective of the medium on which they are stored. It is indeed questionable whether a differentiation between comparable performances can be sustained, particularly in view of the technological development that provides an increasing number of sophisticated vehicles and outlets for cultural content. Digital movies are basically computer files and can be written onto DVDs, sent through broadband cable, or transmitted via satellite. Their projection does not even require a physical carrier as used to be the situation in the analogue days with spool of films, cassettes and the like. Assuming that all films are going to be digitally projected in the not too distant future, it would become difficult to continue subjecting film trade to the rules governing trade in goods, since no tradable "good" would cross a state border.

Yet, a similar distinction between films recorded on physical carriers (treated as goods) and films projected or transmitted on television (considered to be provision of services) exists and functions in European law without major problems.[16] The WTO Appellate Body's decision in the Canadian Periodicals case sheds some light on the differentiation between GATT and GATS frameworks. According to the Body's comparative analysis between goods and services, future enquiries may focus on the substantive effects of the measure and the location of its burden. In order to establish to which extent the goods and services components are separable, it would be necessary to reflect on the extent of integration of levels of manufacture, sale or consumption and analyse the market patterns in order to find out which component is quantitatively purchased, qualitatively consumed and regarded as the end product by consumers. The decisive factor for the distinction between a good and a service will then be to see which one can be considered as an "attribute" to the other.[17] Nevertheless, this interpretation aid does not eliminate the increasingly complex and interconnected nature of production processes and the limitlessness of consumption patterns, which makes overlaps and resulting conflicts, particularly visible in the audiovisual field, imminent.[18] This is confirmed by the fact that the Appellate Body did not fully distinguish between the GATT and GATS, ruling instead that obligations under both Agreements can "coexist" and that they do not override each other, although it would seem obvious that they do.[19] The technological convergence of the industries, taking advantage of differing modes of supply and media, will give rise to further questions as to the scope and tradability of cultural goods and services, films included.

In any case, within the existing WTO framework, films are to be treated principally as goods, while bearing in mind, however, their services' aspect. The instruments relevant for the film sector include the GATT rules, referring specifically, in Article III and IV, to cinematographic films, goods' subsidies regulation, namely the Subsidies and Countervailing Measures (SCM) Agreement, and the general GATS rules to the extent that film is coupled with services. Moreover, the development of subsidy regulation within the GATS framework, which gains increasing relevance in the context of cinematographic services (e.g. distribution and exhibition subsidies), necessitates deeper reflection on the nature of films and the support measures for the film industry.

III. Film support and the GATT

1. Prohibition of quantitative restrictions on film imports

a) Screen quotas

The GATT contains a clear exception rule for the film sector with regard to national treatment. Article III:10 GATT 1947 authorises Member States to establish or maintain internal quantitative regulations relating to exposed cinematographic films, provided they meet the requirements of Article IV GATT 1947, which provides in turn for the possibility of the so-called screen quotas. Article IV permits the contracting parties to require exhibition of a certain proportion of cinematographic films of national origin during a specific screen time period. Screen quotas, although they constitute an obvious discrimination in favour of domestic works, are therefore allowed under the GATT. Hence, on the one hand, Article IV provides important evidence that the WTO framework acknowledges a certain "specificity" of culture. It can be considered as granting a political mandate to reconsider the issue of the media within the WTO and a basis for subsequent transatlantic negotiations in the field of audiovisual services.[20] On the other hand, Article IV acquires relevance in a negative sense because it limits the kind of exceptions from free trade of films: the only quantitatively restrictive instrument that the GATT tolerates is the screen quota.[21] Because Article XI GATT 1947, which stipulates exemptions from the general obligation to eliminate quantitative restrictions, makes no specific reference to audiovisual products, it can be concluded that all other quantitative restrictions are prohibited. The national film support instruments seem therefore to be permitted, albeit not in the form of quantitative restrictions on imports.[22]

b) Safeguard clause and general exemptions

Article XIX:1 GATT 1947 contains a safeguard clause that allows quantitative restrictions in the case of a threat of serious injury to domestic producers. A serious injury could result from "unforeseen developments" in the course of market liberalisation. However, the clause has hardly any application to the film industry because it presupposes a surge of imports.[23] It appears extremely difficult to demonstrate that the flood of cultural goods in the form of films onto the European market has arisen as a result of an increase in quantities of imports, absolute or relative, to domestic production. As it was demonstrated by the Canadian Periodicals dispute,[24] in the case of cultural goods, where the creative content cannot be separated easily from its material carrier, it may be virtually impossible to find evidence that the injury occurred because of the intellectual content of goods (films included) flowing onto the market and was not due to other economic factors. Taking into consideration the realities of the European film market, dominated by American productions, it is difficult to conceive any practical implications of this "infant-industry" exception for the sector, particularly in view of the fact that the exceptional restrictions have to be limited in time.

The general exceptions envisaged in Article XX GATT 1947 are not of much help either. Paragraph f) of this Article provides for the possibility to impose measures in order to protect national treasures of artistic, historic or archaeological value, which could in principle find application to the cinema sector. However, given the restrictive interpretation practice of WTO exception rules, the practical use of this exemption for the purpose of film support is unlikely.

By contrast, the possibility to restrict importation according to paragraphs a) and d) of Article XX GATT 1947 respectively can become relevant in the film context. This would be the case when restrictions are necessary to protect public morals, (e.g. films with pornographic or violent content or advertising of prohibited pro-

ducts), as well as when they are aimed at protecting intellectual property.

To sum up, the GATT exception rules seem to recognise a certain specificity for films; their practical implications for film support policies are, however, of a rather minor importance.

2. General GATT rules on non-discrimination

a) National treatment

National and EU film support systems inevitably imply privileging certain (domestic) films and therefore discrimination against foreign works. Non-discriminatory film support (at least towards non-EU goods, in particular American productions) would not only undermine the cultural aims of European film policies, but would make their realisation practically impossible.[25]

At the same time, the fundamental GATT principle of national treatment, contained in Article III GATT 1947, prohibits all discriminatory measures directed towards imported products, cinematographic works in the form of recorded film copies included. Insofar as the film support measures take the form of preferential tax reliefs for domestic film production or of any additional requirements for importing cinematographic goods, they seem to be incompatible with the GATT rules.[26] In particular, tax remittances and various fiscal measures that can be construed as subsidies, including taxes levied on box-office revenues, receipts of broadcasters or film carriers, deserve closer attention in this context. Such means of subsidising the film industry can be regarded as challengeable under the GATT on the basis of the decision in the Canadian Periodicals case.[27] *In casu,* the US successfully challenged under the WTO dispute settlement system the Canadian measures to protect its magazine industry, including the levy of the excise tax, the tariff code, commercial postal rates and the postal subsidy that Canada paid to local producers. According to the argument put forward in the case, any form of subsidy not granted directly in the form of payments to domestic producers can be found to be incompatible with Article III:8(b). In the context of film subsidies, it can therefore well have wide-reaching implications for the indirect forms of financial help granted to cinematographic producers, as confirmed by the recent dispute between the US and Turkey over the taxation of foreign film revenues by Turkey.[28] *In casu*, the US challenged the Turkish policy of controlled access by foreign films to the domestic market combined with a tax measure to ensure restricted entry. The US considered this practice to be a violation of the national treatment obligations arising from Article III GATT 1947 and requested the establishment of a panel to examine the matter. As a result of the subsequent consultations, Turkey agreed to equalise its tax on box-office receipts from the showing of domestic and imported films "as soon as reasonably possible".[29]

As far as direct film support through subsidies is concerned, Article III:8(b) GATT 1947 provides for an exception from the national treatment imperative. Accordingly, subsidies granted exclusively to domestic producers and subsidies effected through governmental purchases of domestic products are permitted. The assessment of such admissible subsidies poses some interpretation problems; in fact, the GATT subsidy regulation is confronted with a legal dilemma: while subsidies do distort international competition, they are often understood as internal policy instruments with which GATT does not interfere.[30] The ambiguity of application of subsidy rules has been partially remedied by Articles VI and XVI GATT 1947 insofar as they limit the actual prohibition to subsidies on exports. All other forms of subsidies are dealt with in a rather unclear way: Article XVI:1 GATT 1947 provides only that the GATT contracting parties shall notify the other parties of a subsidy, when its effect is to increase exports or to reduce imports of the product in question. Only in the case of a serious prejudice to the interests of another contracting party may the subsidisation be limited.

Whether the direct film subsidies are exempt from the GATT regime under the provision examined is not entirely clear. Although they can be interpreted as domestic subsidies, the potential to challenge them under certain circumstances cannot be completely ignored.

In sum, there seems to be an inherent contradiction between domestic film policies and the principle of national treatment. It could only be mitigated if the cinematographic landscape were exhaustibly regulated with co-operation agreements, which would ensure the reciprocity and mutual privileges to the parties.[31] This, however, does not seem to be realistic. The ongoing tension has been well illustrated by the above-mentioned US-Turkish dispute, which demonstrated the fragility of film policy measures taking the form of indirect support within the international trade order. Having said that, it remains true that the existence of direct subsidies to the film industry has not been challenged so far under the national treatment principle. The underlying reasons for this situation, despite the at least theoretically possible incompatibility of such subsidies with GATT, are manifold. First of all, as mentioned above, direct subsidisation could be viewed as a measure of domestic state policy, in which sphere the GATT, arguably, does not intervene.[32] Secondly, Article IV GATT 1947 that relates explicitly to cinematographic films acknowledges a certain "cultural specificity" of films within the GATT framework and can be considered as mandating the parties to reconsider the position of culture within the multilateral trading order.[33] The national cultural policies seem, at least in their aspect concerning films, to remain outside the reach of GATT due to the political will of some (notably EU and Canada) of the parties. The Turkish case has shown, however, that whereas it remains true that film support is a delicate issue, such an implicit "omission" is not absolute, in any case not for fiscal measures, but potentially not even for direct aids. Furthermore, given the US firm position on liberalisation of audiovisual sector,[34] such an uncertain legal situation under the GATT can become a source of future disputes.

The ambiguity of the analysed GATT rules plays its part in their application to the film sector, since the differentiation between permissible internal subsidies and prohibited - in principle - export subsidies is very difficult to maintain in practical terms.[35] The demarcation between allowed and prohibited subsidies has been a subject of lively discussions within the GATT and has resulted in an abundance of documents attempting to cope with this problem.[36] The Uruguay Round produced a special agreement dealing in more detail with the admissibility of subsidies. This instrument, entitled the Agreement on Subsidies and Countervailing Measures (SCM), is relevant also for the classification of cultural subsidies. It is discussed below in paragraph 3.

b) Most-favoured nation (MFN) principle

Article I of the GATT 1947 provides for the fundamental principle of most-favoured nation (MFN) treatment. It means that countries cannot normally discriminate between their trading partners: if they grant one trading partner a special favour, the same treatment has to be ensured for other WTO members, so that they all remain "most-favoured".

The exceptions to this elementary rule in the trade of goods are possible only in specifically justified cases, including, according to Article XXIV GATT 1947, the formation of a customs union or of a free-trade area under certain conditions. Thus, regional preferences within film support policies such as import regulations or national treatment (e.g. within the framework of the EU or EFTA) can be justified by customs union or free trade agreements. Cultural co-operation agreements, either bilateral or in the form of

inter-governmental organisations, such as the *Eurimages* co-production fund,[37] are more difficult to qualify: a third country could invoke the principles of non-discrimination in market access and national treatment, since these principles are accorded only to the parties to such agreements. Again, the only derogation that could possibly exist would be in relation to direct film subsidies, understood as being domestic subsidies,[38] which would be deemed exempt both from national treatment and most-favoured nation treatment principles.[39]

3. Agreement on Subsidies and Countervailing Measures

International trade law contains specific rules concerning state aid, namely the Agreement on Subsidies and Countervailing Measures (SCM). This agreement constitutes a central element of international "competition" law of the WTO and aims at the creation and protection of a "level playing field" for international competition. Subsidies, or more broadly state aid, can have serious distortive effects not only on intra-state and intra-community trade (in the case of economic integration areas), but equally on international competition, as they privilege, through selective criteria, some economic actors and penalise the others. National and EU aid to film production is covered by the SCM Agreement because, as mentioned, cinematographic works are principally considered "goods" within the WTO framework and therefore fall within the scope of the GATT.[40]

The SCM Agreement differentiates, according to the so-called "traffic light" approach, between three main categories of subventions, which entail different legal consequences: (i) prohibited ("red") subsidies, (ii) non-actionable ("green") subsidies and (iii) actionable ("orange") subsidies. The following paragraphs examine the relevance of these categories within the context of film.

(i) Prohibited ("red") subsidies

All subsidies upon export performance are prohibited by Article 3.1 a) of the SCM Agreement, which corresponds to Article XVI GATT 1947. Moreover, the WTO subsidy rules prohibit, according to Article 3.1 b) of the SCM Agreement, subsidies that privilege the use of domestic over imported goods. The scope and dimension of this prohibition are illustrated by an exhaustive list annexed to the Agreement. Article 3.1 b) does not restrict support to domestic production, but it prohibits discrimination of imported goods, which accommodates the principle of national treatment in the WTO subsidy framework. Subsidies to the film industry are not included in the mentioned list, which implies that they do not fall within the category of prohibited subsidies.

(ii) Permissible ("green") subsidies

"Green" subsidies are enumerated in Part IV (Article 8) of the SCM Agreement. They entail, on the one hand, subsidies that do not promote specific sectors or undertakings (specificity is defined in Article 2 of the Agreement), and, on the other hand, subsidies providing assistance to research projects and respective regional and environmental aids. Such aid schemes merely have to be notified in advance in order to enable other Members to evaluate their consistency with the subsidy rules, as provided by Article 8.3 of the SCM Agreement. Within the whole range of film support measures, research aid, especially for the purpose of the development of new technologies and production methods[41] can therefore be considered to constitute "green subsidy" and be exempted from the general prohibition. Such aid would be allowed, provided that its assistance does not exceed 75% of the costs of industrial research or 50% of the costs of pre-competitive development activity, and provided it is limited exclusively to personnel, equipment and investment costs, consultancy expenditure and additional costs incurred directly as a result of the research activity.[42] An example of such allowable subsidies could be the EU initiative to promote digital cinema projects.[43]

(iii) Conditionally permissible ("orange") subsidies

All remaining support mechanisms, not covered by the other two categories, come within the scope of "orange" subsidies and fall within the general definition of Article 2. According to Part III of the SCM Agreement, they are permissible insofar as they do not adversely affect the interests of the GATT Members, in particular by injuring the domestic industry, nullification or impairment of benefits resulting for Members from the GATT, or any other serious prejudice to their interests. Serious prejudice cases are exemplified in Article 6 SCM Agreement. They include, for example, the total *ad valorem* subsidisation of a product exceeding 5 %, subsidies to cover operating losses sustained by an industry, or direct cancellation of debt. Such subsidies are "actionable", *i.e.*, questionable and eventually even challengeable to the extent that the affected Member may request consultations with the subsidising Member in order to take appropriate steps to remove the adverse effects or to withdraw the subsidy. If the latter refuses to co-operate, it may be subject to the dispute settlement procedure.

The majority of traditional film support instruments, which focus on the production phase of filmmaking, seem to fall within the scope of the category of "actionable" subsidies. Whether or not the affected WTO Member is able to challenge the subsidy schemes according to Article 7 of the SCM Agreement would very much depend on the dimension of the aid and its implications for foreign film production. In view of the extremely strong position of US film production on the European market, the US government might find it difficult to demonstrate the existence of adverse effects on its film industry.[44] Still, the US dominance on the European film market cannot exclude *a priori* the assertion of adverse effects on American show business interests.[45] Moreover, it has been noted that the definitions of "adverse effects" and "serious prejudice" to the interest of the Members are relatively broad.[46] Even if the US were indeed not in a position to make use of these broad definitions, at least film producers from other countries would have a relatively strong argument if they felt affected by European subsidisation. Furthermore, although the political sensitivity of the sector works as a constraint on the parties to invoke free trade arguments in the film context, some forms of financial assistance to producers of cultural goods (films included) may fall under this category of the SCM Agreement, particularly given the wide definition of subsidy in Article 1.1 SCM.

All in all, uncertainties remain as to the extent to which national and European film subsidy schemes meet the requirements for allowable subsidies and actions under the Agreement, and may not be dismissed completely.[47] The actual impact of the subsidy on the third party remains an important criterion for questioning the measure.[48]

The delimitation of general GATT rules from the SCM Agreement in their respective application to film support measures represents an intricate issue. In most cases, the decisive factor would be the character of the support: whereas discriminatory practices in the form of fiscal measures[49] are covered by the GATT rules, specific subsidies (including also 'transnational' film support measures like the EU's MEDIA plus programme)[50] would probably be subject to the SCM Agreement.

IV. Film support and the GATS

1. General GATS principles on non-discrimination (national treatment and MFN)

Unlike the GATT, the GATS does not contain any general obligation relating to national treatment. According to Articles XVII

and XVI GATS, such treatment, like market access, has to be granted explicitly through the so-called specific commitments. Only to the extent that each Member decides to accord such privileges to specific services sectors within the negotiations framework do these sectors come within the scope of the GATS.

The relevance of cultural issues within the GATS framework is beyond doubt. This has been already demonstrated by the Canadian periodicals case[51] and confirmed more recently by the dispute between the EU and Canada over film distribution.[52] It concerned Canadian measures affecting film distribution services insofar as they treated US distributors more favourably than those of other WTO Members. *In casu*, US distributors were allowed to distribute films in Canada while European distributors, as newcomers, were not granted that right. Because Canada had not taken a MFN exemption for measures affecting film distribution services, it was clearly bound by the MFN obligation in Article II:1 GATS. The consultations have been suspended because the complaining European company, ironically, had been taken over by a Canadian one. Nonetheless, the case remains a clear example of the significance that the GATS rules have within the context of film.

In the EU framework, however, such a case would be unlikely, because, as a result of the transatlantic dispute during the Uruguay Round, neither the EU nor its Member States made any commitments within the GATS relating to the audiovisual sector. The fact that the EU (and its Member States) abstained from according national treatment and market access to non-EU service providers led to a *de facto* exclusion of the sector from the GATS framework. According to Article XVII GATS, the EU is not bound by the principle of national treatment in the field of audiovisual services. The EU also lodged, according to Article V GATS, numerous exemptions to the most-favoured nation clause, covering audiovisual agreements between EU Member States and third countries. It is debatable whether reservations of such an extensive nature, especially those that have been introduced for an indefinite time period, are compatible with Article II.2 GATS and its Annex on Article II Exemptions, which provide that such exemptions should not exceed a period of 10 years.[53]

No matter how such a general exclusion of the audiovisual sector from the scope of GATS may be evaluated, at the present stage, favouring and financial support of the EU film services or the persons involved therein remains compatible with international trade law.[54]

For the future, however, deeper reflection is needed since the prevailing GATS objective is a progressive liberalisation of trade in services (see Part IV of GATS). The general "exemption" of the audiovisual sector from the GATS might become increasingly difficult to uphold in a long-term perspective in view of American export interests, and it is coming under increasing pressure in the forum of transatlantic trade negotiations.[55] This does not mean, however, that the cultural objectives cannot be recognised within the GATS framework. General exceptions from the national treatment, modelled on the GATT provisions could be envisaged, whereby the recognition of the specific nature of culture within the international trade context has been pleaded for. Different models have been put forward in this context, ranging from 'cultural exception' to 'cultural specificity' and a separate instrument for cultural diversity.[56] All three options imply different impacts and legal consequences.

The 'cultural exception' poses problems in view of the fact that exceptions to key trade principles and disciplines, such as those found in Article XX GATT, must be narrowly defined. They could be solved by introducing the concept of an exception for 'culture' into the general exception provisions of Article XIV GATS. In order to be exempted, the measure would then have to comply with the double test that it should neither "be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail" nor act as a "disguised restriction on trade". Since this appreciation belongs to the WTO dispute settlement bodies, it would introduce a degree of legal uncertainty on the use of the "cultural exception" to trade in goods or services.[57] Given the rather vigorous practice of WTO panels when construing the exact meaning of a general exception clause and applying the tests of Articles XX GATT and XIV GATS,[58] it would not necessarily guarantee that cultural interests are taken account of. The 'cultural specificity'[59] notion was suggested by the European Commission as a negotiating objective of the Uruguay Round, with the idea of transforming the market access openings allowed by EU Member States into a schedule of specific commitments. It proposed that Article XIX GATS be modified, in order to enable parties to resist the progressive liberalisation objective for the sector, and that similar provision be included in Article XV GATS (obliging WTO Members to negotiate further on subsidies) and in the Article II Annex (MFN exemptions). This approach, although legally feasible, failed. The third idea to introduce a specific legally binding international instrument, raising cultural diversity to the rank of another international order with which the WTO must reckon, would prove a complex legal task, given the present difficulty of dealing with the twin regimes of trade and environment.[60]

At the present stage, developments in the field are difficult to predict, given the rather firm EU position neither to make commitments nor to list exemptions for audiovisual services.[61] Such an "off the table exemption" position can turn out to be a "double-edged sword" solution, since cultural specificity is already *de facto* recognised within the international trade framework and it might be desirable to introduce concrete means to further underpin international trade rules with cultural diversity. It appears that the interest of many governments to retain freedom of action in the audiovisual sector and their fear that the WTO might not be the organisation to address issues of cultural diversity must be reconciled with the needs for a more legitimate and explicit recognition of the specific nature of cultural industries (films being the paradigm example) at the international level.

2. Regulatory need for subsidies to services

The GATS contains no specific binding rules on the regulation of subsidies. There is only the commitment, laid down in Article XV GATS, to enter negotiations on the matter, reflecting the Members' recognition that subsidies may have distortive effects on trade in services. Pending the outcome of such negotiations, Members who consider that they are adversely affected by a subsidy of another Member may merely request consultation, whereby such request should be accorded "sympathetic consideration".

State aid to services has been at issue so far only in a few sectors within the GATS framework, and until now only developing countries have raised (quite general) concerns regarding subsidies to transport, basic telecommunications, construction, health, education and the audiovisual/cultural services. Thus far, the Working Party on GATS Rules has found that the direct subsidising of exports of services is not prevalent; it noted, however, that subsidies to support the arts in general are common.[62]

Hence, the cultural dimension of subsidisation represents one of the core issues in the discussions. As far as the film sector is concerned, the rules on subsidies to services would certainly apply to measures to support cinematographic services like distribution or exhibition aid.[63] The film sector is also indirectly concerned because cinematographic films shown on television are considered (together with all television productions) services and fall within the scope of GATS. Moreover, the demarcation problems mentioned above often lead to confusion in the treatment of feature films as goods or services. The relevance of subsidies to cinema services within the GATS context is confirmed by the US position on the matter: the US negotiations proposal on audiovisual services clearly includes wide categories of theatrical motion pictures into the services' negotiations agenda.[64]

As a result, a profound need to clarify the legal handling of film subsidies arises in the GATS framework, in particular, insofar as such instruments can infringe the principle of most-favoured nation treatment.[65] For the moment, the international framework on subsidies to services is still subject to negotiation. However, there are some horizontal rules in preparation within the GATS negotiations framework, in particular a multilateral discipline on subsidies. State aid aspects of cultural policies gain (at least potential) relevance within the Working Group on GATS Rules' mandate to draw up such horizontal subsidy rules. As public funding of cinematographic services is one of the main instruments of audiovisual policy, a conflict with such a future discipline is almost inevitable. Consequently, the developments in the field are rather unwelcome by the EU because of their potential to affect its freedom of action in the audiovisual sector.[66] Until now, yet, there are only three countries that expressed officially their negotiating position on audiovisual services: the US, Switzerland and Brazil.[67] While Brazil and Switzerland expressed in quite general terms the need to discuss the issue, the US suggested the necessity to develop a more concrete understanding on subsidies, which would recognise "the use of carefully circumscribed subsidies for specifically defined purposes",[68] which remains, however, a rather vague offer.

Some specialists in the sector suggest that the rules for admissible "cultural" state aid could be issued in the form of a reference paper, modelled after the Basic Telecommunications Reference Paper.[69] Particular attention in this context should also be given to the above-mentioned Canadian proposal for an international instrument on cultural diversity[70] and the ensuing discussion on its desirability and feasibility around Europe.[71]

As long as there is a lack of rules on subsidies to services, the principle of "mutual trust" could serve as a limitation for the introduction of measures that might prejudice the concessions accorded in the course of the liberalisation process, subsidies included.[72] This principle would be relevant to subsidies for film rental and exhibition services and would also cover general cultural support measures like the protection of cinematographic archives and the promotion of cinema education and events. Applied to these subsidies, the principle would oblige Members to refrain from the introduction of measures negatively affecting accorded trade liberalisation concessions. Yet, apart from the practical difficulty of using this argument (states are quite unlikely to intervene in other Members' film policies on the basis of a vaguely defined trust principle), the blurred classification of cinematographic activities within the WTO framework, which reflects general problems over the differentiation between the GATS and GATT, additionally exacerbates this type of reasoning.

In the context of the potential set of GATS subsidy rules, the question arises as to the scope of the possible exceptions for the audiovisual sector. Elaboration of such rules could, it is suggested, be based on the existing framework for goods' subsidies, including GATT rules and the SCM Agreement. According to the latter, the threshold of an actionable subsidy is attained as soon as the support measure has adverse effects on the competitor.[73] Since even a 5 % ceiling can indicate such a negative impact, it could be argued that also measures adopted in small markets with high "cultural discount"[74] in order to protect their linguistic or cultural specificity, would be questionable in such a hypothetical framework. Should the future GATS subsidy rules emulate the SCM Agreement, the necessity to construct a specific framework for cultural subsidies within the WTO legal frames would seem therefore plausible.

It remains open whether such a solution would take the form of a general agreement on subsidies to services, including precise exceptions for the audiovisual sector or of a sectoral agreement concerning exclusively subsidies to audiovisual services. The option of a separate international instrument for cultural diversity, as suggested by Canada, which would introduce specific rules to govern protection and promotion of culture globally in all aspects (subsidies included),[75] should be also kept in mind in this context.

It is argued that the explicit regulation of cultural subsidies, whatever form it takes, would have to introduce several criteria to assess the compatibility of subsidies to audiovisual (including cinematographic) services with the WTO law.[76]

First of all, the aiding Member State would have to prove the actual intensity of the support's impact on international trade. In this context, it is pointed out that the intensity of competition distortion depends not only on the dimension of the support but also on its actual ultimate goal. For instance, the financial support directed at the promotion of films in the international market would have immediate distortive effects on world trade, whereas the subsidisation of cinematographic works originating from small linguistic and cultural territories would not interfere with international competition and would not have any direct distortive effect. However, it could still have an indirect distortive effect on competition since it would automatically reduce the number of recipients of other cinematographic services. A thorough examination of such distortive effects on the "level playing field" for competitors in international trade would have to be undertaken in every case.

Furthermore, such rules would have to take into consideration the actual intention and aim of the support. Accordingly, measures which envisage production of works *à la Hollywood,* without specifically related national cultural content, would be deprived of the cultural objective to protect cultural identity and presumably would have to be treated less tolerably than support aimed at compensating the "cultural discount" of small linguistic and cultural areas.[77]

In summary, it can be argued that the interrelation between "cultural discount" or "cultural specificity" and actual film support should be decisive for the assessment of admissible public funding to the film industry. The promotion of films with high "cultural discount", in spite of a negative impact on the international "level playing field" could be, in all probability, justified in terms of cultural policy considerations, which would permit its exclusion from the anticipated subsidy prohibition in the GATS framework. An analogous exclusion exists and operates already within the EU internal market in the form of Article 87.3 d) EC Treaty. However, as the practice of exemptions from state aid prohibition under the EC Treaty has demonstrated, cultural considerations represent very vague and, to some extent, arbitrary criteria. Therefore, it would be essential to precisely define conditions for exemptions from the prospective GATS subsidy rules.[78] For instance, making the film support dimension conditional on its commercial success on international markets is deemed unacceptable since it would presuppose export subsidisation, which is generally prohibited by the GATT. As the productions characterised by a high "cultural discount" prove successful predominantly within their specific linguistic and cultural areas, the support could be linked to the film's economic performance on the national or regional market. In order to set limits to the industrial policy considerations, coming to the fore in this context, it would be useful to confine the allowable (and inevitably biased) subventions to creative productions.

One cannot resist the impression that the calls for comprehensive and precise compatibility criteria in the GATS subsidy framework resemble similar concerns invoked within the EU context, which resulted in the elaboration by the European Commission of the guidelines for state aid to the cinema sector.[79] Whatever their eventual form and legal status would be, it might well be expected that future hypothetical rules on subsidies to cultural or, more specifically, audiovisual services will evoke as many – if not many more – emotions and concerns as the Commission's framework for state aid to the film industry.

1) Ph.D. Researcher, *European University Institute*, Florence.
2) Cf. Communication from the United States of 18 December 2000, S/CSS/W/21. Other states willing to negotiate commitments in the sector are Brazil and Switzerland, cf. Communication from Brazil of 9 July 2001, S/CSS/W/99, and Communication from Switzerland of 4 May 2001, S/CSS/W/74, all available at: http://www.wto.org/english/tratop_e/serv_e/s_propnewnegs_e.htm
3) Adopted in Paris on 2 November 2001, available at: http://www.unesco.org/culture/pluralism/diversity/html_eng/index_en.shtml. This declaration is a landmark in gaining recognition for cultural aspects in the international discussion on globalisation and trade. A regional precursor to this universal instrument was the *Declaration on Cultural Diversity*, adopted by the Council of Europe on 7 December 2000, available at: http://cm.coe.int/ta/decl/2000/2000dec2.htm
4) See http://europa.eu.int/comm/trade/services/index_en.htm
5) See B. de Witte, "Trade of Culture: International Legal Regimes and EU Constitutional Values", in: G. de Burca, J. Scott (eds.), *The EU and the WTO*, Oxford, 2001.
6) 2002 Yearbook, Film and Home Video, "Public Funding of the Film and Audiovisual Sector in Europe", European Audiovisual Observatory, Strasbourg, p.97.
7) *Canada – Certain Measures concerning Periodicals*, complaint by the United States, WT/DS31/AB/R.
8) Regional economic integration areas such as the EU or the NAFTA acknowledge explicitly the specificity of culture: Article 151 EC Treaty spells out the Member States' responsibility to safeguard and promote culture and, more specifically, Article 87.3 d) EC Treaty provides for an exception from state aid rules for aid to promote culture and cultural heritage; Article (and Annex) 2106 of the NAFTA agreement provides for a special treatment of "cultural industries", as defined therein.
9) Cf. T. Cottier, 'Die völkerrechtlichen Rahmenbedingungen der Filmförderung in der neuen Welthandelsorganisation WTO-GATT", *Zeitschrift für Urheber- und Medienrecht Sonderheft* (1994), 749.
10) The non-economic concerns overtly recognised by the WTO include full employment, sustainable development, environmental protection and consideration of the needs of developing countries, see the preamble to the Marrakesh Agreement establishing the WTO, available at: http://www.wto.org/english/docs_e/legal_e/04-wto_e.htm
11) Cottier, supra, n. 9, at 750, with reference on the historical development to P. Baechlin, *Der Film als Ware*, Basel, 1947.
12) In the GATS classification list of communication services (section 2.D), they are explicitly referred to in subparagraphs a) motion picture and videotape production and distribution services and b) motion picture projection services.
13) Cf. M. Koenig, "Was bringt eine neue GATS-Runde für die audiovisuelle Medien?", *Zeitschrift für Urheber- und Medienrecht* (2002), 271, at 272, together with the literature quoted therein.
14) Such a distinction is made by M. Hahn, "Eine kulturelle Bereichsausnahme im Recht der WTO", *56 Zeitschrift für ausländisches öffentliches Recht und Völkerrecht (*1996), 326.
15) De Witte, supra, n. 5, at 16, referring to J. D. Donaldson, "Television without Frontiers: the Continuing Tension between Liberal Free Trade and European Cultural Integrity", *20 Fordham International Law Journal* (1996), 121.
16) Case 155/73 *Public Prosecutor v. G. Sacchi*, [1974] ECR, 426 and Case 62/79 *Coditel v. Cine Vog Films (Coditel I)*, [1980] ECR, 899.
17) Supra, n. 7, at 12, where the Appellate Body has ruled: "A periodical is a good comprised of two components: editorial content and advertisement content. Both components can be viewed as having service attributes, but they combine to form a physical product – the periodical."
18) Cf. Ch. R. Ezetah, "Decisions of the Appellate Body of the WTO. Canadian Periodicals: Canada - Certain measures concerning periodicals", Harvard Law School, http://www.ejil.org/journal/Vol9/No1/sr1d.html.
19) So M. E. Footer, C. B. Graber, 'Trade Liberalization and Cultural Policy', *Journal of International Economic Law* (2000) 115, at 133, referring also to W. Zdouc, 'WTO Dispute Settlement Practice Relating to the GATS', 2(2) *Journal of International Economic Law* (1999), 295, at 313.
20) Cf. R. J. Neuwirth, "The Cultural Industries and the Legacy of Article IV GATT: Rethinking the Relation of Culture and Trade in Light of the New WTO Round", Conference on *Cultural Traffic: Policy, Culture, and the New Technologies in the EU and Canada*, Carleton University, Ottawa, 22-23 November 2002, and Cottier, supra, n. 9, at 751.
21) Although some authors prophesied the end of the era of screen quotas (e.g. Cottier, supra, n. 9, at 750), they are still used as an instrument of government film policy, cf. the recent Spanish law of 9 July 2001, *Ley de fomento y promoción de la cinematografía y el sector audiovisual.*
22) Cottier, supra, n. 9, at 751.
23) Ibid.
24) Supra, n. 7. Cf. Footer, Graber, supra, n. 19, at 141.
25) In this context see the controversy about the possibility for American companies to obtain EU film distribution funding, EFDO v. UIP litigation before the European Court of Justice, case C-164/98 P, *DIR International Film Srl and Others v. Commission*, ECR [2000] I-00447.
26) So Cottier, supra, n. 9, at 752.
27) So I. Bernier, "Cultural Goods and Services in International Trade Law" in D. Browne (ed.) *The Culture/Trade Quandary: Canada's Policy Options*, Ottawa: Centre for Trade Policy and Law, 1998, p. 108, at 117.
28) *Turkey – Taxation of Foreign Film Revenues*, complaint by the United States, WT/DS43.
29) Notification of mutually agreed solution of 14 July 1997, WT/DS43/3.
30) Cf. S. Seelmann-Eggebert, *Internationaler Rundfunkhandel im Recht der WTO und der Europäischen Gemeinschaft*, Baden-Baden, 1997, at 61.
31) So Cottier, supra, n. 9, at 755.
32) Seelmann-Eggebert, supra, n. 30, at 61.
33) See supra, n. 20.
34) Supra, n. 2. In view of its export interests (the audiovisual sector represents one of its most important export industries), the US is expected to push hard for the liberalisation of the audiovisual services in the WTO negotiations, which is reflected in its general stance on the audiovisual issue.
35) Seelmann-Eggebert, supra, n. 30, at 62.
36) E.g. the Agreement on interpretation and application of Articles VI, XVI and XXIII of the GATT, 12 April 1979 and the Understanding on the Interpretation of Article XVII of the GATT 1994.
37) *Eurimages* is the Council of Europe's fund for the co-production, distribution and exhibition of European cinematographic works, set up in 1989 as a Partial Agreement and currently has 27 Member States.
38) Cf. supra, section III.2 a).
39) So Cottier, supra, n. 9, p. 754. However, as he notes, Article I:1 refers only to Article III:2 and III:4 and not to Article III:8 b); it is therefore not entirely clear whether subsidies are exempt from the MFN rule. See further, in the context of the pan-European film support measures, K. Sandberg, *Unzulässiger Protektionismus in der europäischen Medienpolitik?*, Frankfurt am Main, 1998, at 203.
40) See supra, section II.
41) So Cottier, supra, n. 9, at 754.
42) Cf. Article 8.2 of the SCM Agreement.
43) *Support from the European Commission for initiatives on innovative radio and multilingual television channels and for pilot projects in the areas of electronic cinema and production networks*, OJ 1999 C 171/20.
44) So Cottier, supra, n. 9, at 754 and de Witte, supra, n. 5, at 20.
45) Hahn, supra, n. 14, at 338.
46) Seelmann-Eggebert, supra, n. 30, at 62.
47) So Footer, Graber, supra, n. 19, at 139.
48) Cottier, supra, n. 9, at 754.
49) Such as the Turkish taxation of foreign film revenues, see supra, n. 28.
50) Hahn, supra, n. 14, at 335.
51) Supra, n. 7. Although the US challenge was mounted under the GATT rules, Canada contended that the GATS was also relevant. The Appellate Body did not distinguish between the GATT and GATS, ruling instead that obligations under both Agreements can "coexist and that one does not override the other".
52) *Canada – Measures Affecting Film Distribution Services,* complaint by the European Communities, WT/DS117/1.
53) Seelmann-Eggebert, supra, n. 30, at 94.
54) Cottier, supra, n. 9, at 756.
55) Supra, n. 34.
56) Cf. in particular the Canadian proposal for an "International Agreement on Cultural Diversity", SAGIT, September 2002, http://www.dfait-maeci.gc.ca/tna-nac/SAGIT_eg.pdf, and FERA's (Federation of European Film Directors) strategy for the European cultural industries in the context of globalisation: "A New International Instrument for Cultural Diversity", available at: http://www.fera-matin.org
57) Footer, Graber, supra, n. 19, at 121.
58) In this respect see in particular the Appellate Body's ruling in the *United States - Import Prohibition of Certain Shrimp and Shrimp Products* , WT/DS58/AB/R.
59) Cf. M. Footer, "The Future for a Cultural Exception in the World Trade Organisation", Paper for the International Trade Law Committee, International Law Association Meeting, Geneva, 22-23 June 1995 (unpublished), at 5.
60) Cf. Footer, Graber, supra, n. 19, at 143.
61) V. Reding, position on cultural policy and WTO taken during the *58th Mostra internationale d'arte cinematographica*, Venice, 7 September 2001; in the same vein her speech given to the European Parliament on 10 March 2003, "La diversité culturelle", http://europa.eu.int/rapid/start. However, in her recent talk Commissioner Reding has called EU Member States for a debate on international instrument for cultural diversity, *2èmes Rencontres Internationales des Organisations Professionnelles de la Culture*, Paris, 2 February 2003. Cf. also the EU official negotiations stand, supra, n. 4.
62) J. Arkell, "The liberalisation of international trade in services: issues of competence and legitimacy for the GATS and the impact of its rules on institutions", RESER 10th Annual International Conference, *Beyond the Economic? Institutional and Cultural Dimensions of Services,* Bergen, 5-6 October 2000, at 19.
63) For example, the EU's MEDIA plus provides for special support measures for film distributors and exhibitors, OJ 2001 L 13/34.
64) See the Summary List of Audiovisual and Audiovisual Related Service Activities (annex A), Communication from the United States, supra, n. 2. It includes: production of films, pre- and post-production services, duplication of prints, distribution (licensing) of films, delivery of motion pictures to theatres via specialized truck delivery services, via satellite or via digital networks and exhibition of films/operation of cinemas.
65) So Seelmann-Eggebert, supra, n. 30, at 107.
66) Supra, n. 61.
67) Supra, n. 2.
68) Communication from the United States, supra, n. 2, at 3.
69) So P. Messerlin, speech on "The WTO after the Doha ministerial meeting", RSCAS, Florence, February 2002.
The Reference Paper (http://www.wto.org/english/tratop_serv_e/telecom_e/tel23_e.htm) has been used during the post-Uruguay Round negotiations on basic telecom services as a tool in deciding which regulatory disciplines to undertake as additional commitments. The Reference Paper, although lacking an effective legally binding nature, proved to be a breakthrough in telecom negotiations.
70) Supra, n. 56.
71) See the proceedings from the recent *2èmes Rencontres Internationales des Organisations Professionnelles de la Culture*, Paris, February 2003.
72) Cf. Cottier, supra, n. 9, at 754, who draws parallels with the practice of the so-called *non-violation complaints* within the framework of Article XXIII GATT 1947.
73) In more detail see supra, section III.3.
74) The notion of "cultural discount" is used by Seelmann-Eggebert, supra, n. 30, at 108, when referring to minoritarian linguistic and cultural territories that have to invest relatively more in efforts to protect their cultural specificity. The concept has its genesis in the realm of "conventional" economics, where it signifies the factor of cultural difference that must be added when determining the economic value of entertainment transactions; cf. C. Hoskins, S. McFadyen, A. Finn, *Global Television and Film: An Introduction to the Economics of the Business,* Oxford 1997.
75) The annex to the conceived instrument (supra, n. 56), provides a list of measures allowed to be taken to meet its objectives, and includes explicitly in point 1: "measures to support the creation, production, distribution, exhibition, performance and sale of cultural content of national origin through subsidies, fiscal measures or other incentives to the creators of the content or to the cultural undertakings that provide them".
76) See e.g. Seelmann-Eggebert, supra, n. 30, at 108.
77) Ibid. For economic arguments supporting such a view cf. P. Messerlin, E. Cocq, *Preparing Negotiations in Services: EC Audiovisuals in the Millennium Round*, American Enterprise Institute and Groupe d´Economie Mondiale, Washington and Paris 2000.
78) Cf. Seelmann-Eggebert, supra, n. 30, at 110.
79) *Communication on certain legal aspects relating to cinematographic and other audiovisual* works, 26 September 2001, COM (2001) 534 final.