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Memorandum

To: Film and Television Action Committee

From: Alan M. Dunn & William A. Fennell

Date: May 28, 2002

Subject: **Potential Trade Remedies To Eliminate or Offset Canadian Film and Television Subsidies**

SUMMARY

This memorandum presents our initial views concerning various international trade remedy actions that members of the U.S. industry could take in response to film and television subsidies provided by the Canadian federal and provincial governments. It is based on information and data that we have been able to obtain to date and, while it should be considered a preliminary analysis only, we believe there is strong support for one or more of the actions described below.

We believe that the subsidies provided by the Canadian federal and provincial governments for the purpose of encouraging the production of film and television projects within Canada are actionable both under the Agreement on Subsidies and Countervailing Measures (one of the sub-agreements that establishes the rights and obligations of WTO members) and under the domestic U.S. countervailing duty law. In the former case, an action would be brought under the Dispute Settlement Mechanism (DSM) of the WTO to declare the Canadian subsidies inconsistent with the WTO so that Canada would eliminate the subsidies or provide compensation to the U.S. The DSM is the body within the WTO that settles disputes between member nations based on allegations of violations of international trade commitments. In the latter case, the U.S. workers and/or management of the U.S. film and television production industry would file a petition for relief in the form of countervailing tariffs that would offset Canadian subsidies on films and television productions entering the United States on any medium (films, disks, tapes, etc.)

We further believe that members and workers of the U.S. film and television production industry are entitled to pursue relief simultaneously under both the Dispute Settlement Mechanism of the WTO and under the U.S. countervailing duty law. Thus, the U.S. industry may choose to pursue either or both of the remedies.

DISCUSSION OF THE SUBSIDIES

The Canadian federal government and its provincial governments are granting subsides for the specific purpose of encouraging the production of film and television projects within Canada. We have conducted a preliminary review of some of these subsidy programs and have concluded that the subsidies are, on their face, inconsistent with Canada's obligations under the World Trade Organization (WTO), the international body that serves as the central authority on certain matters of international trade including subsidies.

During the 1999/2000 production year the Government of Canada received applications from more than 1500 television or film productions requesting tax credits under two federal government programs, the Canadian Film or Video Production Tax Credit Program (CPTC) and the Film or Video Production Services Tax Credit Program (PSTC). The Canadian government reported that for 1999/2000 productions totaling an aggregate value of C$1,844,236,443 filed applications for tax credit reimbursement under the CPTC program alone. The CPTC is a refundable tax credit, which is available at a rate of 25% of eligible salaries and wages incurred during production. Eligible salaries and wages qualifying for the credit may not exceed 48 % of the total cost of the production, net of assistance, as certified by the Minister of Canadian Heritage. Therefore, the tax credit could potentially provide assistance of up to 12% of the total cost of production, net of assistance. Using this calculation and applying only to the CPTC program alone, it is possible that the Canadian federal government provided tax credits totaling more than C$220 million in 1999/2000 under this single program.

We emphasize that the CPTC and its sister federal program the PSTC are not the only subsidy programs which are available to productions wishing to locate in Canada. Indeed, the provincial governments of Canada grant additional tax credits totaling millions of dollars more.

REMEDIES

Where subsidies provided by foreign governments meet certain criteria and have sufficient adverse effects, U.S. workers and industries injured by the subsidies have remedies available both under U.S. domestic law and under the General Agreements on Tariff and Trade.[1] Our preliminary review of the

[1] The latest version of the General Agreements on Tariff and Trade signed in Marrakesh in 1994 is also referred to as GATT 1994 or the WTO Agreement. In fact, the

subsidies provided by the Canadian federal provincial governments indicates that these programs meet the criteria that define a subsidy and that the adverse impact on the U.S. film and television industry and its workers is sufficient to make these subsidies actionable.

First, a subsidy must involve a transfer of funds or government revenue that otherwise is due is foregone or not collected (*e.g.* fiscal incentives such as tax credits). Clearly, the tax credits that the Canadian government has been providing to film and television productions meet the criterion of a transfer of funds and the criterion of revenue that is foregone by the Canadian governments.

Second, a subsidy must confer a benefit. Here the benefit is a financial one to film and television production companies.

Third, a subsidy must be specific. Because these tax credit programs are available only to the film and television industry (rather than being available to every industry in Canada) the criterion of specificity is met.

Fourth, the subsidy must cause harm to a domestic industry in the United States. Our initial research indicates that the U.S. film and television production industry has experienced substantial declines in employment, revenues earned, number of film and television productions, utilization of capacity, and other indicia of harm. Moreover, it appears that there has been a substantial increase in the number of films and television programs, wholly or partially produced in Canada, that are being imported into the United States market for distribution through the normal film and television channels (*e.g.*, theatres, broadcast and cable television, premium pay television, and video rentals). Because the decline in U.S. production is to a large extent offset by the increase in imports of these films and television productions from Canada, and because other evidence strongly suggests that production companies are making a conscious decision to produce in Canada in order to enjoy the benefits of the subsidies, there appears to be credible evidence that the harm is caused by the subsidies.

Finally, films and television productions are goods subject to GATT 1994 Agreements on Trade in Goods and within the meaning of U.S. trade law. This issue of whether the films and television productions are goods appears to have been resolved under U.S. law in prior trade remedy actions.[2] The issue has not, to the best of our knowledge, been addressed by a WTO dispute settlement panel but the very fact that these films and television productions have several specific

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WTO Agreement is actually a series of agreements that collectively describe the rights and obligations of the WTO member countries. One of the GATT 1994 Agreements on Trade in Goods is the Agreement on Subsidies and Countervailing Measures.

[2] *See*, Department of Commerce, *Preliminary Affirmative Countervailing Duty Determination Certain Computer Aided Software Engineering Products from Singapore*, 55 Fed. Reg. 1596 (Jan. 17, 1990).

Harmonized Tariff System numbers under which the film, video tape, and video disks enter the U.S. as imported products strongly suggests that they are goods subject to all the normal rules of importation spelled out in the Agreements on Trade in Goods.

Based on the foregoing analysis, the domestic film and television production industry and its workers have several remedies available. Each is briefly described below.

Section 301(a)

The U.S. industry and workers may request a Section 301(a)[3] investigation by filing a petition with the Office of the United States Trade Representative (USTR). Section 301 is a mechanism used by the USTR to identify what it deems to be unfair trade practices faced by U.S. producers and to request reform -- backed by the threat of sanctions.

Under Section 301(A), the United States Trade Representative would determine if the rights of the United States under any trade agreement are being denied or an act policy or practice of a foreign country --

(i) violates, or is inconsistent with, the provisions of, or otherwise denies benefits to the United States under, any trade agreement, or

(ii) is unjustifiable and burdens or restricts United States commerce.

With regard to Canadian film and television tax credits, we would allege a specific violation of the United States' rights under the WTO's Agreement on Subsidies and Countervailing Duty Measures.

If USTR accepts a petition as making the necessary showing, then it proceeds immediately to a dispute settlement proceeding under the WTO Dispute Settlement Mechanism (DSM) aimed at eliminating the WTO inconsistent subsidy. This process would begin with mandatory consultations regarding the cessation of the subsidy practice but would move to a rapid and binding decision by an arbitral body (called a WTO panel) if the consultations were not successful within 2 to 3 months. The WTO panel would be established, would accept briefs and presentations by the governments of the U.S. and Canada, and would complete their deliberations and issue a decision quite quickly. Subsidy cases, such as the instant matter, are subject to an accelerated schedule so panels typically issue their decision within 4 to 7 months (rather than the normal 9 to 11 months).

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[3] *See,* 19 USC § 2411(a).

Although Canada could appeal a panel decision ruling the subsidies to be inconsistent with its obligations under the WTO, Canada generally has responded to WTO panel and appellate body decisions without undue delay. In the event that Canada does not implement a favorable finding in a timely fashion, the USTR has several options to enforce such a determination.

A) The U.S. could suspend concessions given to the offending country (by raising tariffs) in the product area in question;

B) The U.S. could impose duties or other import restrictions on any goods imported from the offending country; or

C) The U.S. can enter into binding agreements with the offending party in order to otherwise remedy the situation.

Section 301(b)

The U.S. industry and workers also may request a Section 301(b)[4] investigation by filing a similar petition with the Office of the USTR. Section 301(b) also is used by the USTR to identify and eliminate unfair trade practices faced by U.S. producers but it begins with an investigation to determine if "an act, policy, or practice of a foreign country is unreasonable or discriminatory and burdens or restricts United States commerce."[5] In addition, USTR must determine whether action to correct the foreign practice is appropriate and feasible.[6]

Under Section 301(b), the USTR has greater discretion as to how to pursue remedial actions and whether to impose sanctions, even though the remedies are the same. For this reason, if FTAC chooses to pursue a trade remedy action under Section 301, we recommend that FTAC focus on Section 301(a) rather than (b).

Countervailing Duty Action

Members and workers of the domestic film and television production industry also may file a petition with the U.S. Department of Commerce and the U.S. International Trade Commission under U.S. domestic law, requesting the initiation of an investigation that could lead to the imposition of offsetting tariffs on imports of Canadian film and television productions.

Because FTAC already has experience with this type of action, we omit the details of this process. However, our initial analysis indicates that the difficulties FTAC encountered in defining the industry for "standing" purposes in its first countervailing duty action can be overcome. These issues are not trivial, but the

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4 *See*, 19 USC § 2411(b).

5 *See*, 19 USC § 2411(b)(1)

6 *Id.*

law clearly contemplates that management and/or workers in such an industry should have recourse to U.S. countervailing duty remedies.

Furthermore, we believe that the Department could find subsidies to be substantial, as the value of the subsidies appears to run into the tens and perhaps hundreds of millions of dollars.

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Memorandum

To: Film and Television Action Committee

From: William A. Fennell

Date: February 28, 2003

Subject: **301**

The purpose of a § 301(a) action is to obtain compliance by a U.S. trading partner with the trade agreements to which the partner and the U.S. have mutually agreed. Canada's subsidies violate Article 5 of that Agreement whereby ***Canada, the U.S., and the other 143 countries that are members of the World Trade Organization (WTO) agreed not to cause adverse effects to the interests of other members through the use of a subsidy.***[*] Thus, the purpose of a § 301(a) action against on the subsidies given by Canada to film production in Canada would be to obtain compliance by Canada with the Agreement on Subsidies and Countervailing Measures that is part of the Uruguay Round Agreements.

Once the United States Trade Representative initiates a § 301(a) investigation, it will enter into negotiations with the Canadian government to remove the subsidies that harm the domestic U.S. industry. If those negotiations fail, the U.S. may request a panel proceeding under the WTO's Dispute Settlement Understanding that is part of the Uruguay Round Agreements. The WTO panel, after a process of briefing and hearings, will issue findings as to whether the subsidies cause adverse effects to the U.S. industry in violation of the Agreement on Subsidies and Countervailing Measures. (Note: In a typical WTO panel action, the complaint alleges violations based on all the ways that a measure is inconsistent with the WTO agreements. Thus, a single measure may violate, for example, the SCM Agreement as well as several other Agreements, all of which would be included in the complaint and addressed in the WTO panel's findings.)

The panel decision may be appealed by either country to the Appellate Body of the Dispute Settlement Mechanism. If appealed, the Appellate Body also will issue findings as to whether the subsidies cause adverse effects to the U.S. industry in violation of the WTO Agreements.

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[*] Emphasis added by FTAC.

Under the SCM Agreement (Article 7) the recommendation that both the panel and the Appellate Body would make would be "to remove the adverse effects" or "withdraw the subsidy."

If Canada fails to comply with an adverse WTO decision, the U.S. would need to go through the WTO DSU process to get the right to retaliate. The WTO DSU sets out those steps and the ways in which a Member country may retaliate and how to establish the degree to which they may do so.

Under the WTO, however, retaliation is the last option, behind compliance and compensation. Out of the 6 years of dispute settlement retaliation has only been implemented on two occasions -- in the EC - Bananas case and the EC - Hormones case. Even in FSC where the U.S. continues to be out of compliance (under a ruling that came out in 1999) the EC still has not imposed retaliatory measures, even though such retaliation was approved by the WTO. There are a number of other cases-- notably, the aircraft subsidy disputes between Canada and Brazil --where retaliation has been authorized, but not actually resorted to. In practice, Members treat retaliation as the last resort.

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Memorandum

To: Film and Television Action Committee

From: William A. Fennell

Date: October 25, 2002

Subject: **The Legal Basis for FTAC's 301 Petition**

U.S. law specifies that the United States Trade Representative (USTR) must consider a petition for relief under § 301 under the following circumstances:

> (a) Mandatory Action.-
>
> (1) If the United States Trade representative determines under section 304(a)(1) that-
>
> (A) the rights of the United States under any trade agreement are being denied; or
>
> (B) an act, policy, or practice of a foreign country –
>
> (i) violates, or is inconsistent with, the provisions of, or otherwise denies benefits to the United States under, any trade agreement, or
>
> (ii) is unjustifiable and burdens or restricts United States commerce;
>
> the Trade Representative shall take action authorized in subsection (c) [see below], subject to the specific direction, if any, of the President regarding any such action, and shall take all other appropriate and feasible action within the power of the President that the President may direct the Trade Representative to take under this subsection, to enforce such rights or to obtain the elimination of such act, policy, or practice.[7]

[7] 19 U.S.C. § 2411 (commonly referred to as "Section 301").

The actions that the USTR is authorized to take are:

> **(c) Scope of Authority**
>
> (1) For purposes of carrying out the provisions of subsection (a) or (b) of this section, the Trade Representative is authorized to-
>
> (A) suspend, withdraw, or prevent the application of, benefits of trade agreement concessions to carry out a trade agreement with the foreign country referred to in such subsection;
>
> (B) impose duties or other import restrictions on the goods of, and, notwithstanding any other provision of law, fees or restrictions on the services of, such foreign country for such time as the Trade representative determines appropriate;
>
> (C) . . .
>
> (D) enter into binding agreements with such foreign country that commit such foreign country to-
>
> (i) eliminate or phase out, the act, policy, or practice that is the subject of the action to be taken under subsection (a) or (b),
>
> (ii) eliminate any burden or restriction on United States commerce resulting from such act, policy, or practice, or
>
> (iii) provide the United States with compensatory trade benefits . . .[8]

"Any interested person may file a petition with the Trade representative requesting that action be taken under Section 301 and setting forth the allegations in support of the request."[9] An "interested person" includes "domestic firms and workers."[10] The petition to be filed on behalf of U.S. film and television workers will allege that the rights of the United States under the Uruguay Round Agreements are being denied

[8] *Id.*
[9] 19 U.S.C. § 2412(a).
[10] 19 U.S.C. § 2411(d)(9).

because the production subsidies provided by Canadian governments are causing serious prejudice to the interests of the United States. Article 5 of the Uruguay Round Agreement on Subsidies and Countervailing Measures (which binds both the U.S. and Canada) specifies that:

> No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:
>
> . . .
>
> (c) serious prejudice to the interests of another Member.

Once a petition is filed, and the USTR decides to initiate an investigation, the USTR must request independent consultations with a foreign government under the WTO Dispute Settlement Understanding (DSU) and seek a bilateral remedy. These consultations under the WTO may lead to a resolution such as elimination of the subsidies. If not, the U.S. can request the formation of a WTO panel to make a binding determination that the subsidies are inconsistent with the WTO and seek their elimination.

Section 301 petitions have been filed by businesses, business organizations, and the AFL-CIO. Section 301 investigations also have been self-initiated by the USTR.

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