Technology and International Trade: Wille the Real Transformer Please Stand Up?

Todd Weiler
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The primary driver of change in Canada’s cultural sector has not been some kind of contrived, neoliberal plot imposed upon an unsuspecting public with the promise of “jobs, jobs, jobs.” Rather, it has been technology. The role for liberalised trade and investment treaties comes only in the form of a conditioning force, limiting the panoply of choices available to governmental officials who want to respond to the changes being wrought by technological advances.

This paper begins with some brief definitions, moving next to an elaboration of its thesis, and finally explaining the application of this thesis to some selected case studies.

“Transformation” is defined as “a marked change, as in appearance or character, usually for the better.” Legal transformation is the phenomenon of change or displacement in the established legal order, often in response to external stimuli that challenge the underlying policy assumptions upon which that order was built. Policy is the discourse which takes place among governing elites concerning the nature or utility of societal changes. Oftentimes, the policy discourse includes a discussion or alternative means to address the perceived changes in the ideal social order. These policy choices are implemented in order to “fix” the perceived problem by changing behaviour to suit the objectives and goals chosen beforehand by these elites.

The legal regime exists in order to condition or modify behaviour, individually or collectively. The legal regime changes only through the purposive policy choices of governing elites. It cannot be transformed through osmosis. By contrast, societal change often occurs through a process akin to osmosis, although it can also be brought about by external forces, including the imposition of, or change in, a legal regime; or through some other form of external stimuli, such as technological change.

Legal disputes are an excellent vantage point from which to witness transformation (both in society and in the governing legal regime). Legal disputes represent the most challenging of contests between individuals or between individuals and regulators (the less challenging are most often settled or otherwise resolved). The legal resolution of these disputes may bring about a change in the legal order or they may arise as a result of a change in the legal order. In either case, they are likely reflective of a past or impending change in society. In other words, there is a reason for the dispute — something has effectively changed the status quo ante between the parties, permitting (or forcing) them to seek a legal resolution to their dispute. Thus, the study of legal disputes permits one to make observations concerning the nature and extent of legal transformation.

Treaty regimes such as the North American Free Trade Agreement (NAFTA) act as an external conditioning force on the way governments regulate. Contrary to the beliefs of some ardent anti-globalization protestors, treaty regimes do not represent a “surrender of sovereignty”; rather, they represent the exercise of sovereignty, whereby democratic governments determine that it would be in the best interest of their citizens to choose to refrain from acting in ways that are deleterious to the well-being of a greater number of people. In other words, through trade and investment treaties, governments have agreed to save each other from the prisoner’s dilemma of discriminatory and arbitrary regulatory conduct, which — while appealing to a local constituency — has led to such social and economic catastrophes as the Great Depression and numerous wars.

To the extent that international obligations constrain (or sometimes compel) regulatory behaviour which would not have occurred but for their existence, they can be said to have a transformative effect on domestic legal regimes. More often than not, however, governments take reservations in treaties to safeguard their most sensitive political interests — thus leaving the remainder of their local regulatory regimes to the disciplines of a new, external regime. And for the most part, none of those regimes violate the basic tenets of international economic law, such as national treatment (i.e., promising to treat the foreigner as well as the local); most-favoured-nation (MFN) treatment (i.e., promising

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to treat the foreigner as well as other foreigners); fair and equitable treatment\(^6\) (i.e., promising transparency and due process in governmental decision-making); and the promise to pay prompt and appropriate compensation for the taking of property.\(^7\)

With the NAFTA, Canada sought, and obtained, special treatment for its regulation of cultural industries. It did not obtain a complete reservation for the sector for two reasons. First, officials recognised the value of external constraints and the economic well-being they bring. Second, the price for complete impunity for the regulation of an indeterminate group of industries would have been too high, requiring Canada to liberalize in many other sensitive political areas for the expense of a handful of Canadian-owned cultural industry members. Accordingly, the NAFTA Parties agreed to grant to Canada the same “cultural industry exemption” that it had obtained in the Canada–U.S. Free Trade Agreement.

As NAFTA Annex 2106 states:

Notwithstanding any other provision of this Agreement, as between Canada and the United States, any measure adopted or maintained with respect to cultural industries, except as specifically provided in Article 302 (Market Access — Tariff Elimination), and any measure of equivalent commercial effect taken in response, shall be governed under this Agreement exclusively in accordance with the provisions of the Canada–United States Free Trade Agreement. The rights and obligations between Canada and any other Party with respect to such measures shall be identical to those applying between Canada and the United States.

Article 2005 of the Canada–U.S. Free Trade Agreement (CUSFTA), in turn, provides:

1) Cultural industries are exempt from the provisions of this Agreement, except as specifically provided in Article 401 (Tariff Elimination), paragraph 4 of Article 1607 (divestiture of an indirect acquisition) and Articles 2006 and 2007 of this Chapter.

2) Notwithstanding any other provision of this Agreement, a Party may take measures of equivalent commercial effect in response to actions which would have been inconsistent with this Agreement but for paragraph 1.

Accordingly, apart from specific provisions contained within CUSFTA Article 2206 concerning retransmission rights in the cable (and now also satellite) television businesses, some people in Canada believed that it had taken what appears to have been a very broad reservation for its regulation of cultural industries — providing it with carte blanche to exclude foreigners from making cultural investments, providing cultural services, or producing cultural goods. In order to understand how broad the reservation first appeared to be, one need only look to the NAFTA Article 2107 definition of “cultural industries”:

**cultural industries** means persons engaged in any of the following activities:

(a) the publication, distribution, or sale of books, magazines, periodicals or newspapers in print or machine readable form but not including the sole activity of printing or typesetting any of the foregoing;

(b) the production, distribution, sale or exhibition of film or video recordings;

(c) the production, distribution, sale or exhibition of audio or video music recordings;

(d) the publication, distribution or sale of music in print or machine readable form; or

(e) radiocommunications in which the transmissions are intended for direct reception by the general public, and all radio, television and cable broadcasting undertakings and all satellite programming and broadcast network services.

A more careful review at the second paragraph of CUSFTA Article 2005 reveals, however, that cultural industries were really not exempted from the NAFTA at all. Rather than being a cultural reservation or exemption, NAFTA Article 2106 and Annex 2106 represent a cultural retaliation clause. Canada is free to regulate cultural industries as it sees fit, but if such regulation harms U.S. or Mexican trade or investment interests, retaliation is permitted under the NAFTA. While some government officials appear to have believed such retaliation would only be imposed after the establishment and conclusion of a NAFTA Chapter 20 dispute settlement panel, the truth is that the provision contemplates retaliation as a first response. If Canada does not believe the retaliation was warranted on the basis that it was not taken in response to the regulation of a cultural industry, or if Canada believes the quantum of the retaliatory measure exceeds what would be the “equivalent commercial effect” of its cultural measure, Canada will be forced to take the matter to a Chapter 20 panel.

Of course, one could note that since CUSFTA Article 2005 and NAFTA Article 2106 were both drafted before the advent of the World Wide Web, there appears to be a yawning gap in the definition of “cultural industries.” The gap would appear to include such applications as video streaming and television “broadcasts” over IP. In such cases, the regulation of these activities could be reviewed under any applicable NAFTA services, investment or intellectual property provision. The result of a finding of non-compliance, as a practical matter, would be the potential for economic retaliation, although it is at least arguable that the demonstration of a breach of an international law obligation is more likely than not to result in a change in government policy in order to conform to the obligation.

The other significant reason that it matters whether the cultural retaliation clause applies to the regulation of an alleged cultural industry is the existence of Part B of NAFTA Chapter 11. This portion of the NAFTA permits an investor from another NAFTA Party to seek damages before an international arbitral tribunal for non-compliance with a number of basic trade norms. Awards rendered by these tribunals are enforceable against the NAFTA Parties using the mechanisms in place in each country for the enforcement of any commercial arbitral award. Accordingly, whereas regulation covered under
the cultural exemption would arguably not be subject to a claim for compensation, everything else would be fair game.

In addition to the NAFTA, there are also the World Trade Organization (WTO) Agreements, which contain similar kinds of obligations to the NAFTA, but which may go further than either the NAFTA or its CUSFTA predecessor would otherwise prohibit. For example, the WTO General Agreement on Trade in Services (GATS) contains an MFN treatment obligation that covers all trade in services, subject to specified exemptions. Accordingly, if the Canadian Government adopts a policy that could be construed as favouring other nationals in a new way that was not “grandfathered” through a reservation, claims could be launched by other governments against Canada for a breach of the GATS MFN obligation (Article II).

Given the nature of the NAFTA cultural retaliation clause, the numerous cultural reservations taken by Canada in most international treaties, and the basic character of Canada’s WTO and NAFTA obligations, it is nonetheless fair to say that Canada’s legal regime governing cultural industries — as it stood on the day the NAFTA and WTO Agreements came into force — has (and will be) unaffected by the existence of the NAFTA and the WTO.

That is not the end of the story, however, for there have been more than a handful of disputes involving Canada’s regulation of cultural industries over the past ten years which have resulted in changes to the existing legal regime. The two cases which will be examined in this paper are: (1) the “split run” magazine dispute; and (2) the Amazon.ca dispute. Both cases provide an excellent example of how the primary driver of legal transformation in the cultural sector has been technology, rather than the conditioning of international trade regimes.

Technological advances lead to changes in human behaviour, including business models. As the owners of video tape rental stores are learning, the advent and consumer acceptance of video-on-demand has forced them to modify or abandon their existing business models. The same is true of “record stores” (referring to a format of recording music that has essentially gone the way of the dinosaur). Record stores and record companies are struggling to come to terms with file-swapping services that threaten their business model by diversifying product offerings and markedly changing sales and distribution models. They have also resorted to legal disputes against file-sharing services and consumers.

As stated above, sometimes technology-driven changes disrupt the status quo ante upon which the existing legal regime is based. When this phenomenon occurs, one can expect to see recourse to legal disputes by those whose interests have been, are being, and/or will be affected by technological change. No better example exists today than the one-two step of music industry members launching digital-music-on-demand services (with encryption technologies) and dramatically dropping the price of music sold on compact disks, while launching waves of law suits against file-sharing companies and those who use them in a manner that arguably violates the artists’ copyright in their recordings (as protected in the licenses that implicitly govern the use of any recording sold to a consumer, regardless of format).

When the legal regime is forced to change, the time of the international trade regime is nigh. In short, international economic rules come into play when domestic legal regimes change, conditioning the policy choices available to respond to these new tensions. They require the new measures to be imposed in a transparent and procedurally fair manner (e.g., NAFTA Article 1105 or Article X of the General Agreement on Tariffs and Trade — the “GATT”’. They require the new measures to not result in better treatment to one foreigner, or one domestic economic operator, than other foreigners (e.g., NAFTA Articles 1102 and 1103 or GATS Article 11). They require that the result of the measure cannot be the effective confiscation of a foreigner’s investment in Canada (NAFTA Article 1110). Aside from these rules, governments can respond to technological change in any way they see fit. As it often turns out, however, the Government of Canada has not demonstrated a particularly good record of compliance with international obligations.

Split-Run Magazines

Split-run magazine publishing is a common publication method in the United States. In a nutshell, the magazine publisher produces magazines for each regional market, with a majority of the content shared and one-tenth to one-quarter directed to different markets. Split run publishing allows Sports Illustrated, for example, to publish a national magazine that appeals to Dodger and Lakers fans in Southern California, as well as Yankee and Rangers fans in metropolitan New York. The problem for the Canadian government was that Sports Illustrated could also publish an edition for Canada for very little added costs, potentially skimming off revenues from Canadian magazine publishers who could not take advantage of such economies of scale because Americans would not be interested in their magazines. Accordingly, they would be forced to compete with (what was assumed) a be limited pool of advertising dollars with an internationally branded “American” magazine whose production costs were limited to the hiring of one or two Canadian reporters and the contracting-out of actual publication and distribution. To some, this practice represents a form of “cultural dumping” (analogizing to trade laws that prohibit the “dumping” of goods in a foreign market at a price lower than their production in the home market).
The Canadian Government has had a long-standing policy against the publication of American split-run magazines for the English-Canadian market. While Canada was forced to repeal its laws banning foreign production of newspapers in Article 2007 of the CUSFTA, it did not bargain away its split-run policy when negotiating the NAFTA, and for a few years, the U.S. did not retaliate (most likely because no U.S. firm complained enough about basically being barred from the Canadian market). Three U.S.-owned periodicals (most notably Time Canada) had been permitted to operate in Canada because they were already in business by the time Canada began to effectively enforce its anti-U.S.-split-run policy. It is important to note that none of Canada’s measures prevented U.S.-origin magazines without a Canadian-split-run edition from entering the market. Accordingly as much as 80% of English Canadian newsstands were occupied by U.S.-origin magazines. Canada’s policy was aimed at protecting the remaining 20%, and the domestic advertising revenues that flowed from it (U.S.-origin magazines would obviously contain mostly U.S.-origin advertising, thus not affecting the Canadian publisher’s share of local revenues).

Canada enforced its split-run policy through three measures: a prohibitive 80% excise tax on the import of split-run magazines; a subsidy granted to Canadian publishers to reduce postage costs; and an income tax deduction for advertising in Canadian magazines. In particular, the 80% excise tax was calculated to prevent Sports Illustrated from entering the Canadian market in 1993. By 1997, the United States was acting on the problem — and it chose the WTO General Agreement on Tariffs and Trade to challenge these measures. It succeeded in having the first two measures found in violation of Canada’s obligation to provide national treatment to magazine publishers under GATT Article III:4, and Canada was forced to respond.

At the same time, however, the Canadian Government faced an additional problem: the excise tax could be completely circumvented by electronically transferring the contents of a magazine to a sub-contracted Canadian publishing facility — because no magazines would be imported! Faced with the obligation to adopt new measures that were GATT-consistent, and knowledgeable of how advances in technology rendered border measures useless, Canadian officials drafted Bill C-55, a measure that simply prohibited Canadians from advertising in U.S. split-run magazines.15

The idea behind Bill C-55 was that since it was strictly targeted at advertising services — something that Canada had never promised in the NAFTA or any WTO Agreement to honour the national treatment standard — the measure would protect Canadian publishers as effectively as had the border measures and postal subsidy (which could be easily reworked to comply with WTO obligations without changing the end-result of subsidized postage). Bill C-55 was completely flawed for three reasons. First, it would most likely have been found to be an unnecessary abridgement to the constitutionally protected right of free speech. Second, it would likely have simply driven advertisers to direct their money to Internet-based magazines (which were not covered by the measure); and third, the U.S. was not obliged to go back to the WTO in order to challenge Canada’s transparent attempt to circumvent its GATT obligations (which would undoubtedly have been found to affect trade in goods — i.e., magazines — and thus would have violated GATT Article III:4 anyway).

Rather than waste any more time in Geneva pursuing WTO remedies, the U.S. merely drafted a list of goods to which it would soon apply punishing duties. The retaliation would be specifically targeted at goods produced in the home town of the Cabinet Minister responsible for Bill C-55, Sheila Copps. Whereas some Canadian officials naively thought that NAFTA Article 2105 would only be invoked by the United States to receive permission from a trade panel to retaliate (which would have taken even longer than another trip to the WTO), the truth was that the NAFTA required no such thing. It merely stated that measures of equivalent commercial effect could be imposed in cases where a Canadian measure was justified under the cultural industries exemption. Accordingly, it would be up to Canada to prove: (1) that the retaliation was unjustified because Bill C-55 was not really a cultural measure; or that (2) the amount of the retaliation was simply too high. In the mean time, Madame Copps would have had to run for re-election in a city potentially devastated as a direct result of her own actions.

The solution negotiated with the United States permitted any U.S. firm to publish split-runs in Canada, subject to an agreement to provide a minimum level of Canadian content which most would arguably have ended up delivering anyway. In the years that have passed since the settlement, the magazine publishing landscape has not dramatically changed in terms of the production of hard copies, although the content-provider industry has changed dramatically with the advent of more and more sophisticated IP-based delivery methods.

Amazon.com

Safely reserved from both the NAFTA and the GATS, has been the long-standing Canadian cultural policy that those who publish, distribute, or sell books in Canada must be Canadian individuals or firms owned and controlled by Canadians. This policy is based on the presumption that a foreign (read: U.S.) book publisher or retailer would not be interested in selling books by Canadian authors to Canadians. This policy has been touted as protecting the ability of Canadian authors to
get their work published in what would otherwise be what some have called the “MacWorld.” For all of the many Canadian authors who have been nominated for, or awarded, the world’s most prestigious awards (such as the Booker), or who have appeared on the ultimate “best seller list” (maintained by the New York Times) it must seem somewhat galling that Canadian policy-makers have long believed that the millions of people around the world who read their work would not have done so if Canadians did not run the publishing houses and retail stores from which their books are sought.

Nonetheless, it must be stressed that under the NAFTA and WTO, Canada was under no obligation to alter this policy. Those who would fault international treaties for the fact that Canadians can today purchase their books by going to www.amazon.ca would be sadly mistaken. The reason why www.amazon.ca exists is because the proprietors of www.amazon.com realized that a large number of Canadians demonstrated an interest in purchasing books from them, most likely because of their business model — which provides more people with more — and generally less-expensive — access to the books they want to read than any individual book store (including those run by chains, which naturally will tend to stock only the most popular titles, leaving those in search of more obscure publications to wait for their “special order” to arrive.

The Amazon.ca business model is simple. Orders are placed on the .ca site, which is maintained on web servers in the United States. The orders are handled in the same way that they would be handled if they had been made through the .com address. Fulfillment of the orders has been contracted-out to a Canadian-owned logistical company, with warehouses in Canada, and to Canada Post, a crown corporation with a statutory monopoly to deliver mail, which is owned by the Government of Canada itself. (That Canada Post has abused its monopoly position to compete unfairly in the business of expedited parcel delivery is the subject of an unrelated NAFTA Chapter 11 arbitration launched by UPS.) The relevant question for Amazon.ca is the legal regime that governs the publication, distribution and sale of books in Canada.

It is apparent that Amazon.ca has found a perfect way of structuring its business model so as to avoid any contravention of Canada’s investment regime (which basically prohibits non-Canadian ownership unless the Minister concludes that it is in the best interests of Canada to permit it). Amazon.ca does not publish books anywhere. It does not distribute them in Canada; that work was contracted out to two Canadian-owned businesses. It does not sell the books in Canada because — as far as the Government of Canada is concerned — it does not have any investment in Canada — at all. It has no subsidiary in Canada. It has no employees in Canada. It has no Internet infrastructure in Canada. Whereas American courts have sometimes interpreted U.S. constitutional law in such a way as to assert personal jurisdiction over Internet-based retailers directing their business model towards customers in the territorial jurisdiction in question, Canada has no similar constitutional jurisprudence upon which to draw.

Canadian book publishers, distributors and retailers have basically enjoyed decades of protection from the forces of competition that were unleashed by the NAFTA and WTO Agreements, and which overhauled so many of Canada’s once-archaic and inefficient industries. All of a sudden, technological change has permitted their erstwhile competitors to enter the market, and Canada cannot simply impose new measures upon them to halt the process. Otherwise, we would witness a repeat of the split-run magazine story, as Canada has committed to make no new changes to its cultural regimes in the NAFTA and WTO Agreements. The reservations it negotiated with other trading partners effectively “grandfathered” these measures — but only in the form in which they appeared as of the date these treaties came into force (both in the mid-1990’s).

Partially because Canada’s legislation had not contemplated the kind of B2B e-commerce that permitted Sports Illustrated to avoid the existing regime, and because Canada’s legislation had not contemplated the kind of B2C e-commerce pioneered by companies such as Amazon, these regimes were left open to the transforming effects of technological change. Fresh from its failed experiment with modifying its split-run measures to maintain its split-run policy, the Canadian Government did not attempt to block Amazon.ca. Any attempt to do so would have been open to challenge under the services and investment chapters of the NAFTA (particularly the former, but possibly the latter, given the much broader definition of “investment” found in Article 1139 than could be found in Canada’s investment review measures).

A legal dispute has nonetheless arisen, however, which permits us to consider just how technological change has effectively led to legal transformation. The heretofore protected giant of Canadian book retailing, Indigo Books, along with an association of booksellers normally at odds with it, have banded together in an attempt to force the Department of Canadian heritage to do what it arguably cannot do under international trade rules: keep Amazon.ca out of Canada. Such a result, albeit unlikely (given the high standard of deference shown to the discretion of government officials in Canadian administrative law), would undoubtedly enforce the spirit and goals of the existing regime. Accordingly, whether these protected companies score an unexpected upset and compel Canada to violate its international treaty commitments, or whether they lose, technology has had a transformative effect on the old legal regime — it has rendered the regime utterly ineffective.
Conclusion

With this short paper, I have attempted to demonstrate how legal transformation can be effected by forces other than international trade and investment regimes. The legal regime underpinning Canada’s protectionist cultural policies provides compelling proof that there are other “culprits” for the critics of liberalised trade to consider. In truth, however, it is far from clear that the changes in Canadian cultural policy wrought by technological change are actually a bad thing. As a topic for further research, one might well consider how technological change has become a force for liberalisation and deregulation equal, if not superior, to the external legal force of international treaties, with all of their exceptions and reservations for each nation’s sacred cow (or cattle herd, as the case may be). After all, as the WTO working groups looking into the impact of e-commerce on trade rules have noted, technological change can even have transformative effects on international treaty obligations. In other words, I propose that somebody write a book entitled: “Technology: the Primary Agent of Legal Transformation”. I will be sure to purchase a copy — online, of course.

Notes:

1 This paper arises out of a conference held in Windsor, Ontario in June 2003, which focused on the North American Free Trade Agreement (NAFTA) and its role in legal transformation and harmonisation in North America. The general theme of the day seemed to be a lamentation that the NAFTA has illegitimately wrought societal change that was either unintended by its drafters or (worse still) intended to harmonise and integrate society in a way in which it was both unaware and unwilling to accept. The goal of this paper is modest. It explains why those who seek to blame the NAFTA for unwelcome changes to Canadian industry and the Canadian way of life should not look to an old standard, Canada’s thriving cultural industry, for examples. There have been, and will be, dramatic changes in Canada’s cultural industries and their relationship with government; but these changes were not brought about by the NAFTA — at least not only by it.


5 Ibid.


15 I worked at the Department of Canadian Heritage during this time and participated in the drafting of Bill C-55.