



Communications
Canada

EXCISE TAX
IMPACT OF REMOVAL

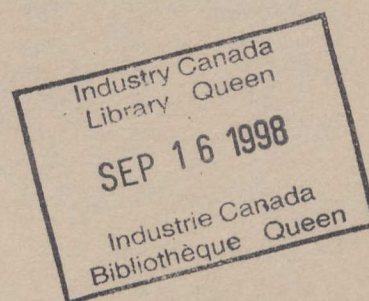
Background Study Etude de fond

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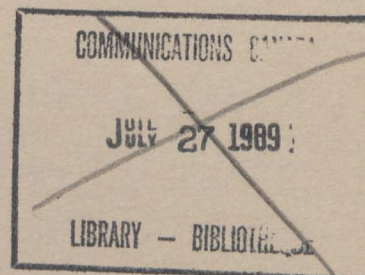
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EXCISE TAX
IMPACT OF REMOVAL



NOVEMBER 1986

COMMUNICATIONS CANADA
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This is one of two Background Studies that form part of the evaluation of Federal Excise Tax.

This Study was conducted by Woods Gordon for the Program Evaluation Division of Communications Canada.

The views expressed herein are the views of the author and do not necessarily represent the views or policies of Communications Canada.

La présente est une des deux études de fond portant sur l'évaluation de la taxe d'accise fédérale.

L'étude a été entreprise par Woods Gordon pour le compte de la Division de l'évaluation des programmes de Communications Canada.

Les points de vue exprimés ici sont ceux de l'auteur et de reflètent pas nécessairement ceux de Communications Canada.

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EXECUTIVE OVERVIEW

INTRODUCTION

Books and periodicals are currently exempt from federal sales tax (FST). Exemption serves to promote easy access to information and avoids difficult administrative problems for Revenue Canada and tax payers.

The potential revenue from removing FST exemptions from all types of publications is some \$225 million. In an effort to increase federal revenue proposals have been made to abolish the exemption. While the Department of Communications has indicated that it would wish to assist publishers adversely affected by FST it is not evident that there are readily available mechanisms to do this in a way that would be acceptable to the industry without risking foreign retaliation. It also seems likely that assistance would be an expensive proposition.

The Department of Communication commissioned Woods Gordon to determine what general impacts abolition would have on the book and periodical industries. The study was expected to be largely qualitative in nature.

Publishers are extremely sensitive about this issue especially as it seems there is no easy way of assisting those hurt by imposing FST.

The study findings are based on a review of published materials on the taxation of printed matter, the periodicals industry, departmental records on the book industry, and meetings with industry associations and book and periodical publishers. The focus is mainly on commercial publishers who aim to make profits since for most non-commercial publishers the imposition of FST will simply increase their need for subsidy.

Impact on Book Publishers

Book publishing in Canada is conducted by 180 firms of which 20% are foreign owned. Over half the market of \$1.2 billion is served by imports. Canadian firms are small, only 27 have annual sales in excess of \$1 million and 70 sell less than \$200,000 per year. Only 12 Canadian firms made a profit before grants.

If FST is applied to printed matter, Provincial Sales Tax (PST) is also likely to be imposed. Applying FST and PST to a book which currently retails for \$20 would increase its price to \$22.54, some 13%.

Publishers could do little to reduce their costs if FST were imposed other than to print more books outside Canada. Retailers are expected to retain their profit margin thus consumers will be faced with a 13% retail price increase. Consumers of trade books are expected to be resistant to higher prices and to react by reducing the volume of purchases. Text book publishers reported resistance to higher prices by education authorities.

(ii)

To test the ability of publishers to bear the tax increase representative data was analyzed for some 60 firms. All would make a loss after taking account of grants if FST is imposed and publishers have to bear the entire burden. If publishers had to bear half the FST then small firms would make a loss while medium and large firms would lose 30-40% of their profits.

Weak balance sheets indicate many publishers are over burdened with debt and have limited ability to absorb even short term losses.

Canadian Book publishers also face a number of other forces which may affect their viability including: postal rate increases, increased foreign competition, the 15% tariff on imported books and possible concessions to foreign publishers in the free trade negotiations. None of these individually appear as significant as the imposition of FST but collectively they could cause real difficulty.

The net impact on book publishers of FST might be:

- closure of 10-20 firms (mainly small Canadian trade publishers)
- increased subsidies required by the remaining Canadian publishers
- fewer new Canadian textbooks each year
- price increases to book buyers of about 13%
- major protests by the industry about the impacts of FST

Import on Periodical Publishers

There are some 5,000 periodicals published in Canada, by about 3,600 publishers, with an annual circulation close to 1 billion. There are many different types of periodicals but for the purposes of this study the prime distinction is between commercial and non-commercial publications. The former includes all publications produced with the intent of making a profit. It may be further subdivided into consumer publications (1,200 in all including mass market, special interest, and TV/radio guides) and Business (2,000 publications trade, professional, technical agricultural and business newsletters). Most consumer magazines obtain significant revenues from both advertising and subscriptions, many business magazines rely mainly on advertising revenues. The non-commercial periodicals, which include scholarly, educational, literary, artistic, cultural and religious magazines, are generally subsidized, carry relatively little advertising and have small subscription revenues.

As in the case of books, the imposition of FST periodicals would probably mean that Provincial Sales Tax would also be applied. Most non-commercial periodicals have little alternative but to look to their sponsoring organization or the government to pay for cost increases caused by the imposition of federal sales tax. Their ability to obtain the required extra subsidy varies so greatly from case to case that it is impossible to determine how many might have to close. However, given the other cost increases facing this segment through postal rate increases it is likely that many publications particularly in the artistic/literary/cultural segment would be in difficulty.

(iii)

On the commercial side, a number of business publications have forced a long term decline in advertising lineage and for some profits are below their owner's hurdle rates. Some part of the additional cost requested by FST could be passed on to publishers. For many magazines the cost of FST could represent 25-50% of the last 5 years profits. About 50 business publications might close as a result of the imposition of FST.

The consumer press's ability to pass a FST to its advertisers is likely to be less than that of the business press since it faces greater competition from other media and foreign publishers. Subscriptions are also not expected to be able to provide much additional revenues. A number of consumer magazines are currently in a loss position and up to 10% of the current population (60) might close. Other publishers may choose to cut costs by restricting circulation to those readers who are most valued by advertisers and who are least expensive to service, i.e., mainly those in urban areas.

All periodical publishers force the negative impacts of postal rate increases, and potential problems from reduced liquor and tobacco advertising. These forces, coupled with fears about free trade negotiations causing the loss of C58 and Section C advantages, mean that periodical publishers would fight the imposition of FST with all the considerable means of their disposal.

RÉSUMÉ ADMINISTRATIF

INTRODUCTION

Les livres et les périodiques sont présentement exemptés de la taxe fédérale de vente (TVF). Cette exemption facilite l'accès à l'information et évite à Revenu Canada et aux contribuables des problèmes administratifs difficiles.

Les recettes potentielles qui découlent de l'exemption de la TVF pour toutes les publications représentent une somme de 225 millions de dollars. Afin d'essayer d'augmenter les revenus du gouvernement fédéral, des propositions ont été faites pour abolir cette exemption. Même si le ministère des Communications a fait savoir qu'il souhaiterait aider les éditeurs qui souffriraient de l'application de la TVF, il n'est pas sûr qu'il existe des mécanismes immédiatement disponibles pour le faire d'une façon qui soit acceptable pour l'industrie et qui n'expose pas à des représailles de la part de l'étranger. Il semble également probable qu'une aide serait coûteuse.

Le ministère des Communications a demandé à Monsieur Woods Gordon d'évaluer les effets généraux de la suppression de l'exemption sur les secteurs du livre et des périodiques. Cette étude devait être essentiellement qualitative.

Les éditeurs sont très sensibles à cette question. En effet, il semble bien qu'il n'existe pas de moyen facile d'aider ceux d'entre eux qui seraient affectés par l'imposition d'une TVF.

Les résultats de l'étude reposent sur un examen des documents publiés sur la taxation des matières imprimées, par l'industrie des périodiques, sur des documents émanant du ministère sur l'industrie du livre et des réunions avec des associations de l'industrie et des éditeurs de livres et de périodiques. L'accent porte principalement sur les éditeurs commerciaux qui visent à réaliser des profits étant donné que pour la plupart des éditeurs

non commerciaux, l'imposition d'une TVF ne fera qu'augmenter leurs besoins en subventions.

Effet sur les éditeurs de livres

Au Canada, il existe 180 maisons d'édition de livres dont 20 % sont propriétés étrangères. Plus de la moitié du marché du livre, qui est de 1,2 milliard, est composé d'importations. Les maisons canadiennes sont petites. Il n'y en a que 27 à avoir un chiffre d'affaires qui dépasse le million de dollars et 70 d'entre elles font un chiffre d'affaires inférieur à 200 000 dollars par an. Seules 12 maisons canadiennes ont réalisé un bénéfice avant subvention.

Si la TVF s'applique aux matières imprimées, une taxe provinciale de vente (TPS) sera probablement aussi imposée. C'est ainsi que l'application de la TVF et de la TPS sur un livre qui vaut actuellement 20 \$ ferait passer son prix à 22,54 \$, soit une augmentation de 13 %.

Si une TVF était imposée, les éditeurs devraient pour réduire leurs frais faire imprimer davantage de livres à l'extérieur du Canada. Comme les détaillants se doivent de conserver leur marge de profits, les consommateurs devraient faire face à une augmentation de 13 % du prix de détail. On prévoit que les acheteurs de livres grand public réagiraient à une augmentation des prix en diminuant leurs achats de livres. Les éditeurs de livres scolaires ont fait état d'une certaine résistance des autorités scolaires aux augmentations de prix.

Afin d'évaluer la capacité des éditeurs à supporter les augmentations de taxe, nous avons procédé à l'analyse de données représentatives provenant de 60 entreprises. Une fois pris en compte les subventions, toutes ces entreprises subiraient une perte si une TVF était imposée et si les éditeurs devaient en supporter tout le fardeau. Si les éditeurs devaient supporter la moitié de la TVF, les petites entreprises subiraient des pertes tandis que les entreprises moyennes et grandes perdraient de 30 à 40 % de leurs bénéfices.

Les états de comptes montrent que de nombreux éditeurs croulent sous les dettes et ne sont même pas en mesure de subir des pertes à court terme.

Les éditeurs canadiens de livres font également face à un certain nombre d'autres forces qui peuvent avoir un effet sur leur viabilité. Mentionnons les augmentations des tarifs postaux, l'augmentation de la concurrence étrangère, un droit de douane de 15 % sur les livres importés et des concessions éventuelles faites aux éditeurs étrangers dans le cadre des négociations sur le libre-échange. Individuellement, aucune de ces mesures n'est aussi importante que l'imposition d'une TVF. Toutefois, mises ensemble elles pourraient provoquer des difficultés sérieuses.

La TVF pourrait avoir comme effet sur les éditeurs de livres:

- la fermeture de 10 à 20 entreprises (essentiellement de petits éditeurs canadiens de livres grand public)
- une augmentation des subventions dont auraient besoin les éditeurs canadiens restants
- une diminution chaque année, des livres scolaires canadiens
- des augmentations de prix d'environ 13 % pour les acheteurs de livres
- des protestations importantes de la part de l'industrie provoquées par les effets de la TVF

Importations et éditeurs de périodiques

Il existe environ 5 000 périodiques publiés au Canada par 3 600 éditeurs. Le tirage annuel de ces publications s'élève à près d'un milliard. Il existe de nombreuses sortes de périodiques. Aux fins de cette étude, la principale distinction que nous ferons sera de distinguer les publications commerciales des publications non commerciales. Les premières comprennent toutes les publications publiées avec l'intention de réaliser un profit. Ces publications peuvent être ensuite réparties entre celles qui s'adressent au consommateur (1 200 en tout pour le marché de masse, les intérêts particuliers, et les guides de télévision et de radio) et les

publications spécialisées (2 000 publications de type bulletin de nouvelles ou professionnel, technique, agricole et commercial). La plupart des magazines qui s'adressent aux consommateurs trouvent une part importante de leurs recettes dans la publicité et les abonnements. Un grand nombre de magazines du monde des affaires comptent essentiellement sur les recettes provenant de la publicité. Les périodiques à caractère non commercial qui comprennent les magazines éducatifs, scolaires, littéraires, artistiques, culturels et religieux sont en général subventionnés et ils ne disposent que de relativement peu de recettes provenant de la publicité. En outre, ils ne reçoivent que de faibles recettes des abonnements.

Ainsi, comme c'est le cas pour les livres, l'imposition d'une TVF sur les périodiques entraînerait très probablement l'application d'une taxe de vente provinciale. La plupart des périodiques non commerciaux n'ont guère d'autre choix que de s'adresser à l'organisme qui les parraine ou au gouvernement pour défrayer le coût des augmentations que provoquerait l'imposition d'une taxe de vente fédérale. Leur capacité à obtenir des subventions supplémentaires varie tellement d'un cas à l'autre qu'il est impossible d'évaluer le nombre de périodiques qui devraient cesser de paraître. Toutefois, compte tenu des autres augmentations de coûts auxquels fait face ce segment à cause de l'augmentation des tarifs postaux, il est probable que de nombreuses publications, et tout particulièrement les publications artistiques, littéraires et culturelles, seraient en difficulté.

Du côté des publications à caractère commercial, un certain nombre de publications s'adressant au monde des affaires ont subi un long déclin au niveau des recettes de publicité et dans certains cas les profits sont inférieurs au coût de livraison. Une partie des frais supplémentaires provoqués par la TVF pourrait être absorbée par les éditeurs. Pour de nombreux magazines le coût de la TVF peut représenter de 25 à 50 % des profits des cinq dernières années. Environ une cinquantaine de publications commerciales pourraient en conséquence fermer à cause de l'imposition de la TVF.

La presse qui s'adresse aux consommateurs pourrait moins facilement faire supporter à ses annonceurs la TVF que ne pourrait le faire la presse qui s'adresse au monde des affaires. En effet, la première fait face à une concurrence beaucoup plus importante de la part d'autres médias et d'autres éditeurs étrangers. On ne prévoit pas que les abonnements puissent fournir beaucoup de recettes supplémentaires. Un certain nombre de magazines de consommateurs perdent actuellement de l'argent et jusqu'à 10 % du nombre de ces magazines (60) pourraient fermer. D'autres éditeurs pourraient décider de diminuer leurs frais en veillant à ce que la diffusion ne se fasse qu'auprès des lecteurs les plus intéressants pour les annonceurs et les moins coûteux à servir, c'est-à-dire essentiellement ceux qui habitent dans les zones urbaines.

Tous les éditeurs de périodiques subissent les effets négatifs des augmentations des tarifs postaux et des problèmes éventuels provoqués par la diminution des recettes publicitaires provenant de la publicité pour les alcools et les tabacs. Tous ces éléments auxquels s'ajoutent les craintes découlant de négociations qui se déroulent dans le cadre du libre-échange et qui pourraient provoquer la perte des avantages fournis par la loi C58 et l'article C font que les éditeurs de périodiques se battent contre l'imposition de la TVF avec tous les moyens importants dont ils disposent.

1. STUDY OBJECTIVES AND LIMITATIONS

1.1 BACKGROUND

The Excise Tax Act "ETA" imposes federal sales tax ("FST") on the sale price of goods manufactured or produced in Canada and on the duty paid value of goods imported into Canada. The present rate of tax is 12%. All goods manufactured, produced or imported are subject to tax unless specifically exempted. Certain categories of printed matter are exempt. Some exemption are unconditional i.e., regardless of the status of the purchaser or the use to which goods are put. Unconditionally exempt items include bibles, religious publications, sheet music, certain types of national directories, directories, printed books containing no advertising, magazines and newspapers (although the last two have to meet certain qualifying conditions). Conditionally exempt printed matter includes books purchased or imported by public libraries, and printed matter for use by educational institutions. Other printed matter, such as forms, books containing advertising, guide books, year books and time tables are subject to FST.

All provinces, except Alberta, levy retail sales tax ("PST") on some types of printed matter but exempt others. Generally speaking, the provincial exemptions parallel the ETA exemptions.

The rationale for exempting certain classes of printed matter from FST is that the exempt categories are important sources of information, access to which should not be impeded by higher costs. Printed matter which is not exempt, such as stationery or forms, is either not perceived as information or as culturally important.

Another important reason for exempting printed matter is that application of FST in this area causes major administrative problems for

Revenue Canada and compliance problems for taxpayers. If exemptions were to be removed, these problems would be compounded. The principal problems relate to identification of the appropriate taxpayer, difficulty of enforcement of the tax on imported items mailed into Canada, and defining the scope and value of "printing".

Despite these problems and the obvious opposition from the industry to the removal of the exemptions, there have been several proposals to that effect, including one from the Neilson Task Force. The potential revenue from removal of the exemptions is estimated at some \$200 million to \$250 million of which about 60% would be borne by domestic products. 40% would likely come from newspapers (nearly all domestic), 35% from periodicals (split evenly between domestic product and imports) and 25% from books (split evenly between domestic product and imports).

1.2 OBJECTIVES

The Department of Communications wished to determine whether or not the removal of the exemption would cause harm to the publishing industry and, if so, in what way. Accordingly, it commissioned Woods Gordon to examine the impact of removing the exemption on the industry. The prime concern was to determine which parts of the system (suppliers, publishers, distributors, retailers and consumers) would bear the tax and what would be the effect on those who were hurt. It was understood that precise answers could not be expected but it was expected that the direction and approximate size of the impact could be provided. The main effort was to be on the book and periodicals industries.

1.3 LIMITATIONS

Discussion of federal excise tax exemptions was recognized to be a delicate matter and Woods Gordon was directed to approach the industry with discretion. Industry cooperation was necessary both to obtain useful information and to avoid development of a major lobbying effort against implementation of the tax before the facts were known.

During the course of the work it became evident that these concerns were amply justified. Every association and publisher contacted indicated that it would fight abolition with every means at its disposal. Opposition by newspapers was likely to be particularly fierce. One of the reasons for the opposition is that the publishing industry has little confidence that the tax can be implemented in a way which would affect foreign publishers as well as Canadian. Particular concern exists over those products which are mailed from abroad into Canada directly to individual consumers. Other reasons for concern include fear of the consequences of free trade talks* and postal rate increases. Finally, few publishers believe there are real possibilities of introducing measures which could offset any unfavourable effects of the tax. They believe that foreign publishers would fight hard against relief being granted to Canadian publishers. In any event they anticipate relief measures would be strictly temporary and easily removable.

* The industry believes that the U.S. will use the free trade talks to attempt to remove a number of measures (like Bill C-58) that are important to Canadian publishers.

It was recognized that hard data, for example, on the sensitivity of demand to price increases, would be difficult to obtain, and that considerable judgement would have to be applied.

It was originally intended that this study should cover newspaper publishers as well as book and periodical publishers. In fact it would be extremely difficult to differentiate between newspapers and periodicals should the tax exemption be abolished. However, a concurrent study of the excise tax showed that its yield would be significantly less than originally expected. It also quickly became apparent that there was no easy way of compensating those who were hurt by the imposition of a tax. Finally, following discussion with the Canadian Daily Newspapers Association, it was agreed that there was little to be gained from pursuing this part of the study.

It must be appreciated that much of the financial information obtained by Woods Gordon was only provided on condition that it was kept confidential and not used in a way that might reveal the identity of the provider. The Access to Information Act has made many respondents more sensitive in this regard.

2. METHODOLOGY AND APPROACH

2.1 METHODOLOGY

We reviewed a range of published materials on the taxation of printed matter and the periodicals* industry. The former included several studies on the application of VAT to printed matter in the U.K.** We also examined the records of the Book Publishing Development Program for some 130 firms and compiled sales, profit and balance sheet data for most of these firms for 1984 and 1985. Those included represented both official languages, large, medium, small and very small firms, trade, educational and scholarly publications. We then met with major book and periodical publishing associations. They not only gave us their views on the tax but also suggested which members of the industry it would be critical to interview. Two associations, book and business periodicals, also arranged for us to meet with groups of their members to discuss the FST situation. We then interviewed a number of publications in concert with Fox, Jones and Associates who were carrying out an associated study. A list of those we met with in the course of the study is given in Appendix A.

Those interviewed were selected to represent on the book side.

- Canadian and Foreign ownership
- Large medium and small organizations
- Trade, educational and academic publishing

* CARD and Woods Gordon's 1984 Report "A Study of the Canadian Periodical Publishing Industry".

** "Don't tax Reading" - The Case against VAT on knowledge".
National Book Committee 1985.
"The case against VAT on Learned Journals", Morris, Vickers and Hamilton
- National Book committee.
"Economic Analysis of impact of VAT on Books, National Book Committee
November 1984.

For periodicals the publications were all Canadian owned but represented:

- a mix of small, medium and large publishers and publications;
- business, consumer and association presses.

Other characteristics could have been sampled but our reviews of Departmental records and other reports, indicated that most other characteristics of both book and periodical publishers such as small size, scholarly or cultural subject matters were closely associated with lack of profitability. Other materials, including the U.K. studies referred to earlier, showed little chance of passing on costs increases caused by the tax. Thus for these types of unprofitable publications, the issue became not so much the direct impact of the tax, which was simply to increase the loss which had to be subsidized, but more to determine from where those additional subsidies would come. This was to be the subject of a companion study by Fox Jones and Associates. From the perspective of calculating the impact of the tax, it therefore became apparent that the key impacts about which there might be uncertainty, would be on the currently profitable publications and publishers and it was decided to focus effort on these.

2.2 APPROACH

We tried to answer three questions in regard to each publisher we contacted. First, how much of the tax would the publisher bear, and how much could be passed back to suppliers or on to distributors, readers or advertisers. Second, what was the financial capacity of the organization to bear whatever portion of the tax appeared likely to fall upon it. Third, if the tax could not be borne what action would the publisher likely take.

Having answered these questions for each publisher interviewed, we generalized our results to the industry as a whole. This generalization was a subjective assessment of impact based upon our knowledge of the industry, comments by those interviewed and (in the case of books) examination of BPDP records.

We have treated book publishers and periodical publishers separately because the economics of the two are quite different and because there is little common ownership.

The key differences between the book and periodical industries, so far as excise tax impacts are concerned, are:

- the unprofitability of most book publishers (before grants) whereas more periodical publishers are profitable;
- the existence of only one significant source of revenue for books whereas some periodicals have two (advertising and subscriptions); and
- scale of operation - the major periodical publishers are considerably larger than the largest book publisher.

3. IMPACT ON BOOK PUBLISHING

3.1 INTRODUCTION

Canadian book publishers account for just under half of the Canadian domestic book market, valued at about \$1.2 billion at wholesale level in 1983. Imports accounted for just one half this, although some 30% of imports consists of items (like trade manuals) which are not normally regarded as books but which are classified as such by Canada Customs. A high proportion of imports are direct purchases by libraries, retailers and the general public from U.S. and U.K. wholesalers and retailers. Canada Customs does not record low value shipments and accordingly imports are understated. Nearly half the Canadian publishers' sales were of imported product. Trade books accounted for about 40% of Canadian publishers' sales, and educational and other the remainder. Foreign publishers control about 50% of the trade book market and 70% of text book market.

There are about 180 book publishers in Canada of whom about 20% are foreign owned. Virtually all of the foreign owned have sales over \$1 million whereas only 27 of the Canadian firms fall into this category. Some 70 Canadian firms have sales of less than \$200,000 per year. However, 90% of Canadian firms' sales are made by large publishers. Canada's largest publisher, Harlequin, which is very profitable, operates in a manner quite different from most other Canadian book publishers and is not included in this analysis.*

* A considerable portion of Harlequin's sales are direct from the publisher to the readers and are essentially by subscription, like a book club.

SAMPLE OF CANADIAN BOOK PUBLISHERS - SALES AND PROFITABILITY
(# of Companies)

	COMPANIES MAKING		COMPANIES MAKING PROFIT BEFORE AND AFTER GRANTS			Total Number of Companies
	Loss After Grant & Subsidy	Loss Before Grant Profit After Grant	Profit Less 1% of Sales	Profit 1-3% of Sales	Profit More Than 3% of Sales	
Quebec						
Sales						
Less Than \$200,000	3	3	5	1	-	6
\$200,001-\$500,000	2	15	3	3	-	23
\$500,001-\$2,000,000	6	11	1	2	-	23
\$2,000,000 +	<u>1</u>	<u>2</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6</u>
Total Number of Canada	12	31	9	6	0	58
Rest of Canada						
Sales						
Less Than \$200,000	6	8	2	-	-	16
\$200,001-\$500,000	13	17	1	2	-	33
\$500,001-\$2,000,000	4	8	-	3	1	16
\$2,000,001 +	<u>1</u>	<u>2</u>	<u>-</u>	<u>2</u>	<u>1</u>	<u>13</u>
Total Number of Companies	24	42	3	7	2	78
All Publishers						
Sales						
Less Than \$200,000	9	11	2	-	-	22
\$200,000-\$500,000	15	32	6	3	-	56
\$500,000-\$2,000,000	10	19	3	6	1	39
\$2,000,000 +	<u>2</u>	<u>11</u>	<u>1</u>	<u>4</u>	<u>1</u>	<u>19</u>
Total Number of Companies	36	73	12	13	2	126

About two thirds of the Canadian publishers and 90% of the foreign publishers are English language. There tends to be a higher proportion of large French firms (50%) than English ones.

The average Canadian firm makes a loss on its book publishing operations and relies on grants for about 10% of its revenues and all its profit. The table opposite shows an analysis of 136 Canadian firms sales and profits, derived from BPDP records. There is an association between size and profit - only 11 firms out of 78 with sales of less than \$500,000 made a profit before grants whereas 6 of 19 with sales of more than \$2 million were profitable before grants.

3.2 THE AMOUNT OF THE TAX

It was assumed that Federal Sales Tax would be levied at the printing level and would include a book publisher's printing costs, and 20% of other direct costs. It was further assumed that Provincial Sales Tax would be applied where Federal Sales Tax was applied since this is the common practice for other non-exempt printed goods.

Based on these assumptions, the expected retail price increase in a \$20 book, assuming all could be passed on to purchasers, would be of the order of \$2.50 or 12.7%, as is on the following page.

Present

Publisher's Costs Eligible for Tax (\$4.33 printing and 20% of other direct)*	\$ 4.95
Other Costs Overhead and Profit	6.05
Publisher's Selling Price to Retailer	11.00
Retailer's Margin	<u>9.00</u>
Retail Selling Price	<u>\$20.00</u>

Assuming 12% F.S.T. AND 7% P.S.T.

Publisher's Costs Eligible for Tax	\$ 4.95
Federal Excise Tax 12%	.59
Other Costs and Profit	<u>6.05</u>
Publisher's Selling Price to Retailer	11.59
Retailer's Margin	<u>9.48</u>
Retail Selling Price Pre Provincial Sales Tax	<u>\$21.07</u>
Retail Selling Price Post Provincial Sales Tax	<u>\$22.54</u>
Increase due to taxes	<u>\$ 2.54</u> or 12.7%

The analysis also demonstrates that most of the price increase is due to the imposition of Provincial Sales Tax rather than Federal Sales Tax (\$1.47 against \$0.59). However, blame for the increase is likely to fall on the Federal Government.

* Since FST would likely be improved at the printer level, in principle only printing costs should be taxed. In practice other costs would likely be included - we have assumed these would amount to 20% of other direct costs. However, if there were not taxed the net effect would be to reduce the price increase to \$2.34 from \$2.54, a relatively insignificant difference.

The analysis to this point assumes that publishers and distributors would simply pass the tax on to the consumer. The following sections discuss the reality of this assumption, other courses of action open to book publishers, the reaction of the consumer and the net impact on book publishers.

3.3 WHO WOULD BEAR THE TAX

The industry's immediate reaction to this question is that any tax increase would result in a corresponding price increase as shown in Section 3.2 above. Few publishers anticipate that they could reduce their costs significantly by squeezing their suppliers. More books might be printed abroad where costs are generally lower but any significant movement in this direction would require a relaxation of the "printed in Canada" requirement of many government assistance programs. A few publishers also indicated they would squeeze price reductions out of their suppliers of illustrations and free-lance editors but these are already low paid and offer little scope for reduction.

There was no expectation that retailers would reduce their usual margin if a tax were to be added. They would most likely treat the tax as a normal increase in cost of goods and retain their percentage margin.

The consumer's reaction to price increase is expected to be slightly different between trade and educational books, although the differences are less than we expected. On the trade side there is a strong belief in the industry that books are currently priced as high as the market will bear and that further increases will result in a drop in the unit volume of sales. Some support for this view comes from the U.K. studies of VAT cited

earlier. These quote U.S., Eire and U.K. studies of price elasticity for books which show that if incomes remain constant a rise in the price of books will produce a proportionate decrease in volume.

A more recent Canadian study* concludes both that cost is a significant factor in book purchases and that the demand for books is price elastic. The study suggests a 10% increase in price would result in 25% of respondents deciding not to re-purchase.

Some publishers felt a rise in price might cause a shift to paper-back books of the expense of hardcover. The Coopers & Lybrand study, referred to earlier, gives some support by this view because it reports less price sensitivity in books costing less than \$5 than in those above this price. A move to paperbacks would affect Canadian publishers more than foreign ones because foreign published books have a larger share of the paperback market than the hardcover one. However, the same study also reports demand for foreign books would be harder hit by price increases than for Canadian books. This goes against some publishers' feelings that best-sellers (mainly foreign) were less price sensitive than other works.

* "Consumer Sensitivity to increases in Book Prices" Coopers & Lybrand Consulting Group, August 1986

- There are some questions about the data inputs and methodology in some of these studies.* Better data, examined over a large time period might indicate less price sensitivity but it is clear that it would be difficult for trade book publishers to pass on price increases to the market.

Educational publishers, generally more profitable than trade, might be expected to have greater freedom to raise prices but those interviewed disagreed with this assumption. They claimed that education authorities budgets were being squeezed and they were already meeting price resistance. Further increases caused by federal sales tax would likely result in fewer new series being commissioned and the stretching of life of existing books. A text-book publisher observed that he expected university students to react to price increases by buying more second hand books. In U.S. educational institutions the second-hand book market is larger and better organized than in Canada and given a large price differential between new and secondhand books, a comparable market could occur here. There is little data on the second-hand market in Canada which suggests it is still fragmented.

Another reaction of purchasers of both trade and text books to higher prices may be to lease more books. Some U.S. suppliers are currently leasing best-sellers to Canadian libraries. This permits libraries to purchase fewer copies of books which have a relatively short life cycle. A successful leasing business requires the existence of a substantial

* A better test of price sensitivity might be to monitor sales of imported books subjected to tariff in 1986.

second-hand market to purchase the leased books. We know of no Canadian companies who lease books so any further move in this direction may have adverse effects on Canadian publishers.*

3.4 PUBLISHERS ABILITY TO ABSORB TAX INCREASES

3.4.1 Trade Publishers

If readers, suppliers and booksellers cannot be expected to absorb a tax increase, what will be the effect on publishers? Taking a sample of some 60 English Language trade publishers financial statements, we calculated representative income statements for four size ranges. We then calculated the impact of the tax on each part of the publishing system making the following assumptions:

- total dollar retail sales would be unchanged pre and post tax;
- provincial sales tax was levied at 7%;
- publishers gross sales would be 55% of retailers sales before provincial sales tax;
- grants varied with publishers revenues (before FST);
- FST was levied at 12% on the sum of printing and 20% of other direct costs;
- printing and other direct costs varied directly with publishers' net sales; and
- overhead cost were fixed.

* Libraries report an inability to lease Canadian bestsellers, particularly in the non-fiction category. It would be worthwhile investigating whether a Canadian leasing business focussing on Canadian products could be viable.

IMPACT OF FST ON REPRESENTATIVE TRADE PUBLISHERS
(\$000)

	<u>LARGE</u>		<u>MEDIUM</u>		<u>SMALL</u>		<u>VERY SMALL</u>	
	<u>Current</u>	<u>After</u>	<u>Current</u>	<u>After</u>	<u>Current</u>	<u>After</u>	<u>Current</u>	<u>After</u>
	<u>Position</u>	<u>FST</u>	<u>Position</u>	<u>FST</u>	<u>Position</u>	<u>FST</u>	<u>Position</u>	<u>FST</u>
<u>Revenues</u>								
Retail Sales	36,364	36,364	9,091	9,091	1,818	1,818	455	455
(less) P.S.T. @ 7%	-	2,379	-	594	-	119	-	30
Retailers Revenue	36,364	33,985	8,497	3,496	1,818	1,699	455	425
Publishers Gross Sales @ 55% Retail	20,000	18,692	5,000	4,673	1,000	934	250	234
(less) F.S.T. Gross	-	856	-	206	-	36	-	13
Publishers Net Sales	20,000	17,836	5,000	4,467	1,000	898	250	221
Grants	600	535	400	357	150	135	75	66
Total Revenues	20,600	18,371	5,400	4,824	1,150	1,033	325	287
<u>Costs</u>								
Printing (plus 20% direct)	8,000	7,138	1,920	1,715	330	296	123	109
Other Direct	4,000	3,567	680	608	120	108	40	35
Overhead (Fixed)	8,000	8,000	2,550	2,550	650	650	162	162
Total Costs	20,000	18,705	5,150	4,873	1,100	1,054	325	306
Profit	<u>600</u>	<u>(334)</u>	<u>250</u>	<u>(49)</u>	<u>50</u>	<u>(21)</u>	<u>0</u>	<u>(19)</u>

Source: Calculated from BPDP record.

The table opposite shows the results of these calculations. They demonstrate that for every size range of firm, a loss occurs after FST is imposed. The assumptions made are quite stringent and, given time, some publishers might be able to adapt e.g., by trimming overhead but it is evident that the imposition of the tax would present a major threat to many English Language trade publishers. It is also true that not all grants are dependent on revenues, although many are.

To test the sensitivity of the assumptions, we made a similar calculation but assumed that publishers would have to bear only half the FST burden. In this case, small publishers would go from a breakeven position (after grants) to a small loss, while medium and large publishers would lose between 30 and 40% of their profits.

Examination of a smaller sample of regional (including Quebec publishers) records show broadly similar cost structures (since these appear to be more influenced by size of firm than location) and consequently similar threats are faced by most trade publishers, regardless of location or language.

The review of financial statements also showed that many publishers apparently had limited ability to sustain losses because of weak balance sheets. Of the 136 companies reviewed earlier 32% had debt to equity ratios in excess of 5 to 1. Quebec publishers tended to have stronger balance sheets than their counterparts in the rest of Canada, since 40% had debt to equity ratios of less than 1-1 whereas only 30% of the rest of the country's publishers were in that position. Academic publishing houses also tend to have strong balance sheets but this reflects the less than arms length relationship that exists between some of them and the educational institution to which they are attached.

Our interviews and case studies confirmed the view given from financial records. Most experienced observers felt the trade sector would be very hard hit by imposition of FST. The consensus was that in the absence of offsetting financial assistance (roughly equal to the tax paid), between 10 and 20 trade publishers would close down within two years of the tax being first imposed. While this estimate is very approximate, it is an easy task to find at least 20 firms in the BPDP records whose financial resources already appear stretched to the limit.

Other Canadian trade firms, while not going out of business would be affected enough by reduced profits and cash flow that they would probably have to cut back on their publishing program and reduce their scale of operations. There is no real way of quantifying this effect.

Foreign trade suppliers were felt less vulnerable because they made higher profits and generally have a stronger market position which would enable them to obtain whatever price increases were available. Some foreign firms might withdraw from Canada or reduce publication of Canadian works. Some trend towards more shipments of books by mail from abroad might be expected since it seems unlikely that tax could be supplied to individual shipments.

3.4.2 The Academic Press

Most academic publishers in Canada are relatively small, having sales of less than \$500,000 per year. A review of financial records of eight such publishers showed only one which made profits before grants and five which made losses after including grants. However, these publishers' objectives are not necessarily to make profit, although most are facing

pressure to become more self supporting. Some are still subsidized directly or indirectly by their parent institution. We were unable to find any evidence that higher prices would be easier to obtain for the books published by academic presses than for trade presses, although one publisher expressed the view that there was a certain price insensitivity in part of the market. The argument here is that there is a group of buyers who "must" buy books on certain subjects. However, we suspect this is still a small proportion of buyers.

It is also unlikely that cost-cutting would be any easier or more rewarding for academic presses than for others. Thus the net effect upon academic publishers is likely to be similar to the trade, with significant cuts in profits on increases in losses. We would not expect any academic publishers to close down. It is more likely that they will reduce their publishing program and/or seek more funds from their parent.

3.4.3 Educational Publishers

Educational publishers are traditionally perceived the most profitable of book publishers. They also bear the highest risks because of the development costs for new works. The educational publishers records available through the BPDP show too wide a range to develop any "representative results". However, it is clear that educational publishers are generally the most profitable and have the greatest financial strength.

Educational publishers guarantee prices to some buyers (e.g., the Book Bureau) for a year ahead and consequently would need good warning of the introduction of FST. One educational publisher expected to pass a price

increase on the school boards but said the school board would likely offset this cost by delaying the introduction of new or revised texts, thereby leaving its next expenditure unchanged.

Educational publishers do have scope to reduce costs by similarly delaying their own text book development programs.

The available financial data and industry opinion suggest few, if any, educational publishers will be driven out of business by imposition of FST. Some loss in competitiveness vis-a-vis foreign books is, however, quite possible and further delay in the introduction of Canadian material. These effects are, already being observed as educational institutions reduce their book budgets.

3.5 OTHER FORCES AFFECTING BOOK PUBLISHERS

Several other forces are anticipated to affect Canadian book publishers. None of these individually appear as significant as the imposition of FST. but collectively they could cause the industry real problems. The most important issues are:

- increased mailing costs as the postal subsidy is withdrawn
- more competition from foreign book publishers
- changes in the Book Publishing Development Program
- possible concessions to foreign book publishers in the free trade negotiations
- the 15% tariff on imported books.

3.5.1 Increased Mailing Costs

If book publishers were to pay the "average full allocated cost of mailing books as calculated by Canada Post Corporation, the cost of mailing a book would rise by close to 400% from 73 cents to \$2.85. This is not only

a huge percentage increase but also a very large absolute increase, which in itself would be almost equal to the imposition of FST on a book. It is extremely unlikely that the subsidy would be withdrawn in less than five years and quite possibly some compensatory payment would be made but still postal bills are likely to rise substantially.

For most Canadian publishers postal costs are not a significant portion of total costs; in fact with the exception of Harlequin, the largest ten book publishing users of the postal subsidy are all foreign owned. Little data are available on the extent to which Canadian publishers are dependent on the mail since book mail users are not obliged to register with Canada Post Corporation. There are, however, believed to be a few, such as Harrowsmith, which are quite dependent.

Industry participants suggested the main impact might be on rural booksellers and on a few urban booksellers heavily dependent on mail order business. There are, however, alternatives to use of the mail which, even though more expensive than current postal rates, are used by some in the industry because of supposedly greater reliability.

3.5.2 Foreign Competition

Strong foreign competition has been a fact of life for Canadian publishers since most began. There are new aspects to this competition that may make the future more difficult than the past. One of these, book leasing has already been mentioned, another potentially stronger factor is electronic ordering. Some U.S. wholesalers are beginning to offer a service which provides libraries with catalogue ready books, coupled with computerized acquisition packages, which significantly reduce the elapsed time from

ordering to books being on the shelf. The books available through these services tend to be foreign rather than Canadian, or may be foreign books which are published in Canada but which the wholesalers obtain direct from the original publisher located abroad.

3.5.3 Book Publishing Development Program (BPDP) Changes

In fiscal 1986 the BPDP was replaced by a new Book Publishing Industry Development Program (BPIDP). The new program differs from the old in that it is project oriented whereas the old program largely operated as a general subsidy. For the industry as a whole the new program offers encouragement and specific help to become viable. A few publishers, accustomed to the old program, are likely to find it difficult to adjust to the new conditions.

3.5.4 Free Trade Negotiations

Many publishers fear that protection afforded the Canadian cultural industries will be sacrificed in the interest of obtaining concessions for other industries. The likelihood of such an event occurring is impossible to estimate but it is clear that U.S. publishers would like freer access to the Canadian market. The main concerns sought include removal of preferences given to Canadian suppliers in educational markets and the ending of restrictions on foreign investment, and possible ending of government grants.

The end of preferences in the educational market would be a very severe blow to Canadian textbook publishers, as would the ending of government grants to trade publishers.

3.5.5 The 15% Tariff on Imported Books

To the extent that sales of foreign books are impeded by price increases Canadian publishers will be hurt. Many trade publishers depend on imported books to make profits to subsidize their Canadian publishing. As noted earlier, demand for books appears to be quite sensitive to price increases.

3.6 SUMMARY OF INDUSTRY REACTION

If no compensation is offered to Canadian firms in the event of abolition of the Federal Excise Tax exemptions, it would be not unreasonable to expect:

- closure of 10-20 firms, mainly small Canadian trade publishers
- increased subsidies for remains Canadian publishers
- fewer new textbooks available to students
- price increases to book buyers of about 13%.

Faced with these undesirable impacts and the other threats to viability (noted in section 3.5), the Canadian industry will undoubtedly lobby fiercely to retain its current exemption from Federal Excise Tax. The industry is strongly attracted to the exemption, not least because it perceives it to be more difficult to abolish, and less visible, than any other program which it can conceive. If it were to accept alternative compensation it would expect this to be in the form of grants matching tax paid. The practical difficulties of such a solution are obvious and, as some publishers pointed out, foreign publishers would certainly object.

In short, the abolition of the exemptions from Federal Excise Tax would appear likely to bring little but problems to the book industry and the Federal Government.

4. IMPACT OF PERIODICAL PUBLISHERS

4.1 INTRODUCTION

The Canadian Periodical Industry is large and complex. The very definition of a periodical is uncertain and in some definitions ranges from daily newspapers to annuals. For the purposes of this study we have restricted the definition to what is commonly known as 'magazines'. These are usually printed, issued regularly with a frequency of more than once per year but not more than once per week. They have a substantial (30%+) editorial content, may contain advertising and are stitched, stapled or glued.

Based on this definition there are at least 5,000 different periodicals published in Canada with an annual circulation close to 1 billion. These are published by some 3,600 publishers, most of whom produce only one periodical.

There are many possible categorizations of the industry including:

Consumer

- About 1,200 periodicals in all. 6,000 of these fall into the general category including mass market (Macleans) - and special interest (Harrowsmith). Most of these magazines are suscription based but also carry advertising. Most are designed to make a profit.
- 500 magazines are published by associations in the interests of informing members and associations e.g., the Consumer Association. Some contain advertising. Few are subscription based. Some are profit motivated. Most are a "service" of the association.
- 50 magazines constitute TV/Radio Guides. Most contain advertising. Few are subscription based. These are profit motivated.

Business

- Over 2,000 in all
- nearly 2,000 of these are trade professional or technical publications. Most contain advertising, Few have significant subscription revenues. Most are profit motivated.

- Over 150 are agricultural publications. They usually contain advertising. Most are subscription based. Some are profit motivated.
- 100 business newsletters contain little advertising. All are profit motivated.

Scholarly/Educational

- Over 500 such periodicals publish scholarly articles on behalf of government and educational establishments. They carry little advertising and are usually heavily subsidized. Most are not profit oriented.

Artistic/Literary/Cultural

- Over 600 periodicals focus on expressing the literary/artistic viewpoint. They may carry some advertising and may be subscription based but usually rely heavily on subsidies. Most are not profit oriented.

Religious

- 600 publications express the religious perspective. They sometimes carry advertising and require subscriptions but most are subsidized by a religious organization. Most are not profit oriented.

For the purpose of this study it is convenient to reclassify the above groups into two, commercial and non-commercial. The former group aims to make profit, the latter does not. In the commercial group would be general consumer, TV/Radio Guides, agricultural publications, business newsletters and many trade, professional and technical periodicals. The rest are non-commercial. In some categories the division between profit and not for profit publications is hazy but generally the distinction is clear. Only 20% of publishers are incorporated organizations and only about 20% of publishers are profit oriented.

Some 28% of periodicals are aimed at the French market, but only 20% of annual circulation is French market, showing these periodicals generally have lower circulation than average.

Canadian magazines dominate subscription sales with some 60% of the market but have only about 20-25% of the newsstand market for an overall 40% share. However, these data are based primarily on commercial publications shares of market. Taking non-commercial into account the Canadian share would be much higher, likely over 60%. This is probably the largest Canadian share of any cultural industry, except newspapers and radio.

The periodicals industry is supported by a number of programs.

The most important of these include:

- o Concessionary postal rates. These are costed at some \$130 million by Canada Post. These rates are mainly used by Canadian consumer, business and association magazines and a select group of foreign publications (Time, Newsweek, Watchtower etc.)
- o Schedule 'C' Customs Tariff Act (1964) which bans foreign publications which contain more than 5% of advertising directed at Canadian readers.
- o Amendments to the Income Tax Act (1966-76) (C.58) which disallows a tax deduction for expenses incurred through advertising in foreign owned magazines.
- o Various Grant Programs operated by Canada council, SSGRC etc.
- o Limited Provincial Subsidy Programs.
- o Some parts of the industry (e.g. controlled continued circulation magazines, such as Homemakers) only benefit from schedule C and C.58 and not postal subsidies.

4.2 COMMERCIAL PUBLICATIONS

4.2.1 The Business Press

Overview

The Business Press is dominated by Maclean Hunter and Southam Publications but there are also a number of other participants ranging from small groups to single magazine publishers. Some of these single magazine

publishers are produced by trade and professional associations and constitute only a small part of the association's activities. The Business Press faces significant foreign competition in some areas but on the whole has a large share of market.

Generally speaking the Business Press derives less than 10% of its revenues from non-advertising sources. Few business periodicals have significant subscription revenues since most are controlled circulation products. Many are, however, eligible for Second Class, Code 4, concessionary postal rates, since they are addressed.

The major participants in the industry were hard hit in the recession, losing around 30% of advertising lineage* between 1980 and 1983. There has been some recovery since then, but not to prior levels. This may be part of a longer term trend since one major publisher's average lineage per publication dropped 28% between 1973 and 1986. There have been some publishers serving high growth markets who have had large increases in lineage. These appear to be exceptional cases.

Advertising revenues have grown faster than lineage but not sufficient to compensate for lineage decreases.

Publishers have attempted to cut costs to maintain profitability. However the cases we examined showed this has met with limited success. Profits dropped substantially in the recession and are still below some publishers' targets. A very large proportion of the publications of multi-publication publishers we examined were unprofitable. In fact, some

* i.e. the physical amount of advertising measured in column inches

publications have been unprofitable for many years. The reasons for continuing these losing ventures include:

- their contribution to overheads (in the case of multi-publication firms)
- associated profitable activities (such as trade shows)
- hope of improvement
- sentiment
- management inertia

Few trade association publications are profitable. They are usually published as a service to members.

Ability to Pass on Cost Increases

Should the Federal Sales Tax Exemption be lifted, the average business magazine would experience an increase in costs about equal to between 25 and 50 per cent of the last five years average annual profits.

Such a decline would be difficult to face in light of the unsatisfactory profit position of much of the industry. However, the very fact that profits are low suggests that most easy means of increasing profits have been exhausted. One major publisher's average profit margin on business publications over the past five years have been less than 4% after tax.

On the revenue side the only significant possible way of raising revenue is to increase advertising rates.* Industry opinion, supported by the trend in advertising lineage quoted earlier, suggests that there is a relatively fixed amount available for advertising in business journals. Should some participants succeed in increasing rates then others would lose. There would likely be exceptions to this rule, e.g. in high growth areas, but

* As noted above most business magazines are provided free to selected readers. For the purposes of calculating, FST and PST, an imputed price has been derived, based on a publications costs.

for loss-making publications there would be little hope. Competitive media, and more particularly U.S. business publications which might not be subject to the tax, also restricts the Canadian industry's ability to raise rates.

A recent review of this matter by EKOS Research Associates Inc.*, suggested increases in real advertising revenues of about 1.5% per year were possible over the next 5 years. This is based on the view that there are few competitive substitutes for these periodicals.

Whether one accepts the industry view or that of EKOS's informants it is evident that ability to raise revenues is limited.

During the recession, some publications cut costs, for example by reducing paper quality and editorial content. Some of these measures were not well regarded by advertisers and revenues suffered. The industry's feeling is that further reductions could be counter productive and some publishers are currently reversing previous decisions.

* Alternatives for a Phasing Out of the Postal Subsidy Program: November 1986.

REPRESENTATIVE EXAMPLES OF BUSINESS PRESS

		<u>\$000</u>		
		JOURNAL	JOURNAL	JOURNAL
		<u>A</u>	<u>B</u>	<u>C</u>
Revenue:	Advertising	987	701	830
	Subscription	38	45	31
	Other	<u>-</u>	<u>16</u>	<u>7</u>
	TOTAL	<u>1,025</u>	<u>762</u>	<u>868</u>
Expenses:	Mechanical	326	172	252
	Post	61	8	26
	Shipping	13		
	Advertising Sales	272	194	215
	Promotion	37	31	44
	Editorial	170	171	111
	Circulation etc.	53	43	56
	Group Overhead	<u>95</u>	<u>70</u>	<u>75</u>
	TOTAL	<u>1,027</u>	<u>689</u>	<u>779</u>
	(LOSS)/PROFIT	(2)	<u>73</u>	<u>89</u>

The Table opposite provides three examples of representative business press operations for multi-publication publishers. One, "JOURNAL A", is unprofitable but makes a contribution to group overhead which makes it worthwhile to continue. The others return about 10% on sales as well as making a contribution to overhead.

We calculated what would happen to these three publications assuming the following:

Both FST and PST are applied.
No cost cutting is possible.
6 3/4% rate increases can be obtained (the average EKOS estimated available over a 5 year period).
Volume does not drop.

Based on this the net profit picture would be as follows:

	Journal A	Journal B	Journal C
Revenue Old	<u>1,025</u>	<u>762</u>	<u>868</u>
New	<u>1,122</u>	<u>800</u>	<u>911</u>
less PST*	<u>72</u>	<u>48</u>	<u>55</u>
Net New Revenue	<u>1,050</u>	<u>752</u>	<u>856</u>
Expenses Old**	932	619	704
FST	39	21	18
Overhead	<u>95</u>	<u>70</u>	<u>76</u>
	<u>1,066</u>	<u>710</u>	<u>798</u>
(Loss)/Profit	<u>(16)</u>	<u>42</u>	<u>58</u>

* Calculated on Assumed Revenues to Original Cost

** Excluding Group Overhead Contributors

The net effect is to increase the loss of the current loss maker and to cut the profit of the other two by about 40%. It should be noted here that the revenue increases of 6 3/4% are those expected over a five year period. A 1 1/2% revenue increase in the first year would turn both profit making journals into virtually a break-even situation.

Net Effects

In our opinion the abolition of the Federal Sales Tax Exemption would lead to the closure of a number of business periodicals because there is little opportunity to cut costs (which will more likely increase), because tax increases will outweigh revenue increases and because for some business press publishers profits are already sub-normal. In part the tax would accelerate a trend which is already evident but some net new closures would also happen. We are unable to estimate just how many publications might close but the number could well be in excess of 50.

One major publisher above provided a list of 12 publications which he believed could be early casualties. This particular publisher anticipated a tax would cost his firm about \$1.7 million of which only \$0.4 million might be recovered through advertising and subscription rate increases. The same publisher also indicated that plans to start up new magazines would also be adversely affected. Multi-publication publishers indicated that should closures occur they would try to protect their full time staff at the expense of free lance contributors. They also expected to reduce editorial content in those magazines which were kept going. In the case of trade association periodicals the position is unclear. Two associations did evidence concern over further losses but one seemed more sanguine.

4.2.2 The Consumer Press

The Consumer Press, has one major multi-publication Canadian publisher in Maclean Hunter, a number of smaller publishers and a significant foreign presence (57% of titles and 25% of circulation in 1981 according to Statistics Canada [87.511])

Consumer publications have three sources of revenue, advertising, subscription and news-stand sales.* Advertising accounts for between half and two thirds of total revenues and subscriptions for 20 to 30% of total revenues. Net revenues are often mainly derived from advertising since the expense of obtaining and maintaining subscriptions is often almost as high as the associated revenues.

Canadian consumer publications have shown strong revenue growth for some years but in 1985/6 suffered some setbacks in both advertising lineage and total revenues. It is believed that these declines were largely due to reductions in advertising by the important tobacco and alcoholic beverage categories. Both these industries are experiencing sales and profitability declines.

Our interviews again revealed that some multi-publication publishers had a high proportion of unprofitable publications and their overall return on sales is below company targets. In a number of instances these were special interest publications whose markets had not yet developed as expected but in other cases the reason for continuing publication of loss-making ventures appeared to be a feeling of responsibility to the reader/nation. The same feeling of duty/responsibility is also true of some other marginally profitable publications which are the sole product of some smaller publishers. Another reason for continuing with losing ventures is that management may be reluctant to kill publications which were once profitable, because of a hope that the losing situation can be remedied. In other cases, while not profitable in itself, a magazine may cover its direct

* Newsstand sales have been subjected to sales tax in some provinces, subscription sales are normally exempt.

costs and make some contribution to an organization's overhead. Closing down a loss making publication may not improve an organization's profits if doing so reduces the contribution towards fixed cost.

Ability to Pass a Cost Increase

The Consumer Press, like the Business Press, depends mainly on the Post Office to distribute its products. Should postal rates increase more than the cost of living, then most publishers would have difficulty in passing on cost increases reflecting both postal rate and taxes.

Prior to 1985's experience of shrinking lineage and revenues, it would have been reasonable to expect that some portion of the cost increase attributable to imposition of a sales tax would be recoverable from advertising rate increases. However, 1985's results suggest only minimal cost recoveries would be possible for the industry as a whole at this time, although some publishers would do better than this, for example, successful fast growing magazines, like Flare. The EKOS study referred to earlier suggested the consumer press would have less potential for rate increases than the business press (i.e., a 5% increase against 7.5% over 5 years). This was attributed to greater competition from other media, weaker reader loyalty, etc.

Most publishers interviewed did not expect to be able to make significant subscription rate increase if a tax were applied. Two publications, Saturday Night and Ontario Outdoors, were able to provide convincing evidence of inability to make rate increases since they had to roll back price increases. For other publications the picture is less clear

because there are so many special offers and incentives made available to subscribers that it has proved very difficult to identify how sensitive subscribers are to rate increases.

A number of recent studies have investigated consumers' reactions to increased rates to subscribers. The evidence is somewhat conflicting. Earlier studies by R. Cosper of St. Mary's University and Econosult suggest inelastic demand whereas a more recent one by Coopers and Lybrand suggest demand is elastic. The industry certainly believe the latter is true. In this connection the ready availability of foreign substitutes which can be priced on a marginal cost basis if necessary must be remembered. Foreign publishers need not increase prices if FST is imposed because their costs are already well below subscription prices. Moreover, it is not clear that foreign magazines mailed from abroad could be forced to pay FST.

Discussions with publishers suggested little scope for cost reduction in terms of printing, paper or mechanical costs. Any significant change here or in the quality or size of editorial would likely be offset by a reduction in advertising revenues.

There is one significant exception to this generalization. Some publications have substantial readerships, outside of major markets, which are not of great value to advertisers. If it costs more to obtain and service these subscribers than the price of a subscription the publication might be better off, in financial terms, not to have them. Thus one possible reaction to a federal sales tax would be to cease promotions to obtain subscribers outside the major metropolitan areas. One major publisher indicated that it would be possible to cut 10% from the subscriber base without affecting

revenues, and thereby obtain lower mechanical and distribution costs. We believe most publishers feel they have a responsibility to service the whole country and would not adopt this policy, but the possibility remains.

Net Effects

In our view the consumer press would undergo some contraction if the federal sales tax exemption were to be abolished. At risk would be a number of special interest loss-making magazines published by multi-publication periodicals, and smaller break-even and loss-making single periodical publishers. The latter includes some of the most prestigious and influential Canadian periodicals. Most of the special interest magazines at risk have competitors which are healthy and hence the public would not be totally deprived of publications which address their interests.

In a few instances periodicals would attempt to shrink their operations rather than go out of business. In these cases there might be some reduction in editorial staff and expenditures on illustrations, photographs, freelancers, printing and paper, although this would be the exception rather than the rule, probably constituting less than 10% of the total.

Some examples may give substance to these assertions. 40% of one major publisher's consumer magazines make losses and none of these make any contribution to overhead. The effect of FST and PST on this particular publisher's operations would be to increase the number of loss makers to 50%, assuming an advertising revenue increase of 5% over 5 years, no loss in sales, and no cut in costs. Losses of existing loss makers would increase by about 20% and profits of profit makers would be similarly diminished.

Another smaller publisher, with four consumer magazines has one major profit maker and three loss makers. In this case due to the nature of the magazines only two could expect revenue increases from advertising rate increases. The net effect of imposition of F.S.T. and P.S.T. would be to cut profit of the profit maker in half and increase the combined losses of the three magazines by nearly 50%. Two of this publisher's magazines would likely be closed under this scenario.

A third single magazine publisher, currently makes a considerable loss which is subsidized by other operations. This publisher is highly dependent on subscription revenues and is confident no increase could be sought there. Only limited advertising increases are anticipated and costs could not be trimmed without risking advertising and circulation decreases. The net effect of increasing F.S.T. and P.S.T. on this publication would be to increase the loss by 66%. The publisher commented that his owner would not contemplate said an increase.

As can be seen from these examples, individual circumstances vary considerably in this sector and it is difficult to assess the total consumer press response. A very rough judgemental estimate is that 10% might close, largely those of smaller publishers with no other source of revenues and those which are already making losses.

4.3 NON-COMMERCIAL PERIODICALS

This group includes scholarly, literary, cultural and association periodicals which generally have in common only their small size and lack of profits. Many are produced with part-time staff and receive the

benefits of low cost printing and other facilities. Many are in effect subsidized by parent organizations, such as universities or associations.

The principal revenue sources for these publications are grants and subscriptions. Most cannot and, perhaps, would not wish to attract substantial amounts of advertising. Most are already under pressure to reduce the amount of subsidy they receive and have cut costs and increased subscription rates and numbers as much as is feasible. Others might be able to raise subscription and advertising rates. EKOS (Op. Cit.) suggests religious publications and scientific journals attract "extremely loyal advertisers for whom price is of little consideration". However, EKOS also notes that for most of these publications advertising provides only a small portion of revenues.

Clearly many of this group of periodicals would generally have to obtain larger subsidies or close down. Several publishers indicated that they produced some marginal publications which would not be subsidized further. The degree of subsidy noted ranged from \$300,000 per year to a few hundred dollars.

This miscellaneous collection of periodicals is the sector which is most vulnerable to the imposition of new costs and one which contains many of Canada's most important periodicals, from a scholarly, cultural and professional perspective.

Given that this sector is facing higher costs from postal rate increases and is already under pressure to reduce subsidies from the institutions and associations which support them, we believe the imposition of FST could result in a large number of publications closing down. However, to estimate even approximately how many might close would require an almost

individual examination of each periodical's circumstances since they are so varied. To illustrate this point we examined three non-commercial periodicals, all of which were incurring significant losses. One was confident that he could improve his magazine's cost performance and revenues over the next few years to more than compensate for FST imposition. The other two both felt they would have to absorb the whole FST increase and would therefore require higher subsidy. One of these two believed his sponsor would provide this extra subsidy the other did not.

4.4 OTHER FORCES AFFECTING PERIODICAL PUBLISHERS

Periodical publishers, like book publishers, are threatened by other forces which affect their viability. The most important of these include:

- reduction in postal subsidies
- impact of free trade talks on "Section C" and C58 benefits
- possible reductions in tobacco and liquor advertising.

4.4.1 Postal Subsidies

As noted earlier, concessionary postal rates provided to periodicals amount to some \$130 million as calculated by Canada Post Corporation. There is every indication that rates will be increased as fast (or faster) than the market will bear. At present most periodicals spend only a small fraction of their expenditures on mail as shown in the table overleaf:

% of Total Expenditures Currently On 2nd Class Mail

	<u>Estimated % of Total at Current Rates</u>	<u>Estimated % of Total at Full Cost Rates</u>
Commercial Publications		
Business	3 - 5%	7 - 10%
Consumer	1 - 2%	5 - 10%
Agricultural	5 - 7%	20%
Non Commercial		
Religious	5 - 7%	20 - 30%
Scholarly	1%	N/A
Other	1%	N/A

Source: Estimate based on Woods Gordon studies and EKOS (Op. Cit.)

Should the rates be increased to CPC's full cost then postal expenses would become very significant in some categories. However, it is unlikely that most publishers would ever be faced with increases to the full cost level. Substitutes for the mail would certainly be available in major urban areas at rates well below CPC's full cost. Publishers might turn to other forms of distribution to areas where no substitutes were available. Nevertheless most publications could look forward to at least a doubling of current postal expenditures.

4.4.2 Impact of Free Trade Talks

The industry is very concerned about the possibility of concessions being granted, as a result of free trade talks, which would reduce or eliminate benefits from "Section C" or "C58". U.S. Government officials are known to be monitoring Canadian developments in this area and there are powerful U.S. media who would welcome more open access to the Canadian market. "C58" is regarded as particularly important to the periodicals industry by many publishers. However, there is little evidence as to what its removal might do to Canadian publications' advertising revenue.

4.4.3 Limits on Tobacco and Liquor Advertising

Restrictions on tobacco and liquor advertising in other media has made them heavy users of advertising in periodicals. This is particularly the case in consumer periodicals. Together they are often the largest single category of advertiser in these magazines. Tobacco advertising is expected by some observers to decline as health concerns grow, and tobacco taxes rise. It would not be surprising to see a ban on tobacco advertising in all forms within 10 years. Similar factors are at work in the liquor area although the pressure here is much less.

The net effect of these three threats is extremely adverse to much of the industry's financial interests. Their view of the prospect of FST being imposed upon them is correspondingly jaundiced.

4.5 SUMMARY OF INDUSTRY IMPACT

The impact of imposing FST on the periodicals industry is less clear cut than in the book industry but would be negative for all types of publication.

In the commercial sector, the business press would probably be the least affected but even so a loss of some 50 publications, about 1% of all periodicals and 5% of the total business publication, could be expected. On the consumer side the situation would be more difficult because of the greater difficulty of gaining significant increases in revenues. The situation of consumer periodical publishers is very varied and only a very rough estimate of closures can be provided. Some 60 might close - about 10% of the sector.

For non-commercial publications the imposition of FST and PST would largely result in corresponding requirements for subsidy. There would likely be substantial fall-out in this sector although the variety of circumstances of sponsoring organizations is such that arriving at even a judgemental estimate is impossible.

Aside from closure there would be some downgrading of some periodicals quality. This is however, a route which most publishers believe would be counter productive and foreign to their nature and would not likely be a widespread event.

Finally, the negative impacts expressed above would be much worse if the industry is also subjected to increased postal rates (without a compensating program), removal of Section C and C58 advantages and reduction in tobacco and liquor advertising.

Recognizing what FST means, the industry will fight it, or a substitute for it such as a Business Transfer Tax with all the considerable forces at its disposal. From the Department of Communication's perspective at least it seems there is little to be gained and much to lose from subjecting one of Canada's most Canadian cultural industries to these impacts.

