PAUL AUDLEY & ASSOCIATES LTD.
RESEARCH AND CONSULTING SERVICES

BOOK INDUSTRY POLICY:
A REVIEW OF BACKGROUND INFORMATION AND POLICY OPTIONS

FINAL REPORT

prepared for
The Department of Communications
Government of Canada

August, 1990

SUITE 202, 542 MOUNT PLEASANT ROAD, TORONTO, ONTARIO M4S 2M7

PAUL AUDLEY & ASSOCIATES LTD.
RESEARCH AND CONSULTING SERVICES
Suite 202, 542 Mount Pleasant Road, Toronto, Ontario M4S 2M7
(416) 485-3550

BOOK INDUSTRY POLICY:
A REVIEW OF BACKGROUND INFORMATION AND POLICY OPTIONS

prepared for
The Department of Communications
Government of Canada

June, 1990

BOOK INDUSTRY POLICY:
A REVIEW OF BACKGROUND INFORMATION AND POLICY OPTIONS

TABLE OF CONTENTS

TABLE OF CONTENTS (continued)

... continued

TABLE OF CONTENTS (continued)

... continued

TABLE OF CONTENTS (continued)

<u>LIST OF TABLES</u>

1.0 INTRODUCTION

This study has three interrelated objectives. First, the study draws together up-to-date information concerning the book industry which is necessary as a basis for assessing existing and alternative federal policy initiatives. Second, the study examines the effectiveness of existing policy initiatives, both federal and provincial, with particular emphasis on the 1985 guidelines concerning foreign investment in the industry. Finally, alternative policy options are identified and evaluated.

2.0 BACKGROUND

2.1 The Canadian Market for Books

The Canadian market for books is substantial and growing. Total book sales in Canada at the wholesale level in 1987-88 were $1.5 billion. Of this total just over one-third of sales, representing $517 million in revenue, were accounted for by foreign-based suppliers, with Canadian-based publishers accounting for sales of $1.0 billion. (Table 1)

TABLE 1

Canadian Market for Books, 1987-88

	Supplied by Canadian-based Publisher/Agents *	Supplied Directly From Foreign Sources ≈	Total Canadian Market
$ millions	1,012.7	517.1	1,529.8
% of total	66%	34%	100%

* Source: Statistics Canada.
≈ Source: Department of Communication's estimate.

While comparable estimates of the total Canadian book market are not at present available for previous years, the revenues of Canadian-based publisher/agents grew between 1984-85 and 1987-88 at a rate substantially in excess of both inflation and Gross Domestic Product.

In fact the revenues of Canadian-based publisher/agents increased as follows:

TABLE 2

Growth in Book Publisher/Agent Revenue Compared to GDP

Year	Revenues of Canadian Publisher/Agents		Gross Domestic Product	
	$millions	% change	$millions	% change
1984-85	716.4	--	444,735	--
1985-86	772.0	+7.8%	447,988	+7.5%
1986-87	862.5	+11.7	504,631	+5.6%
1987-88	1,012.7	+17.4%	550,334	+9.1%
% Change 1984-85 to 1987-88		+41.4%		+23.7%

SOURCE: Statistics Canada

Revenues of Canadian publisher/agents increased by 41.4% in current dollars between 1984-85 and 1987-88, by comparison with a GDP increase of 23.7 per cent. In constant dollars, industry revenues grew by 24.7 per cent -- almost twice the increase in GDP over the same period.

Of total sales of $1.5 billion in 1987-88, French-language books accounted for revenues of $273 million, or 17.9 per cent of the total; English-language books for $1,257 million, or 82.1 per cent of sales. The fact that French-language book sales are not proportionate to the approximately 25 per cent of Canadians who report French as their mother tongue reflects in part the use of English-language books by francophone Canadians. In post-secondary, French-language education, the science texts used, for example, are often in English, as are many books on computer technology and programs.

2.2 Dominant Position of Imported Books

In 1987-88 imported books accounted for substantially in excess of two-thirds of total book sales in Canada (69%). In this respect the position of the Canadian book industry differs markedly from that of the mature industries which exist in the United States and Britain. As Table 3 indicates, books published by U.K. and U.S. publishers account in each case for over 90 per cent of all domestic sales, with imports of relatively limited importance.

TABLE 3

Comparison of Pattern of Sales of Imported and Domestically Published Books in Canada, Britain and the United States (at first point of sale)

	United States 1986		United Kingdom 1986		Canada 1987-88	
	$ million, U.S.	%	£ million, U.K.	%	$ million, Canadian	%
Domestic Production	10,455	94%	853	93%	475.5	31%
Imports	701	6%	65	7%	1,054.3	69%
Total Domestic Market	11,156	100%	918	100%	1,529.8	100%

SOURCES:
U.S.: The Bowker Annual of Library and Book Trade Information, 33rd ed., (N.Y.: R.R. Bowker Co., 1988), pages 413 & 418.
U.K.: Peat Marwick Consulting Group and Bill Roberts, "English-Language Book Publishing and Distribution in Canada," October 16, 1989, page B.2.
Canada: Statistics Canada; estimate of direct imports by the DOC.

The dominant position of imported books in the Canadian market creates a high level of vulnerability for Canadian publishers. First, if the imported books were to be sold directly into the Canadian market, rather than coming into Canada primarily through Canadian-based exclusive agents, as at present, the revenue base of the Canadian industry would be reduced to such an extent that Canadian publishers would be marginalized in their home market, and would either largely disappear or require very high levels of continuing financial assistance. Secondly, the potential for maintaining a strong, integrated domestic infrastructure for the distribution of books would be irreparably damaged; with East-West flows of books being replaced by a South to North pattern of distribution. In such a situation, effective national marketing and distribution of books by Canadian writers would be extremely difficult.

emphasis

The dependence on imported books provides the suppliers of those books with the potential to shape and reshape the structure of the industry in Canada. Most of Canada's imports, about 80 per cent in 1987-88, come from the United States. At present, almost all major American, British and French book publishing companies either have an exclusive agent in Canada, or a subsidiary or branch operation. For example, of the 20 largest companies involved in book publishing in the United States, 19 have either an affiliated business here, or an exclusive agent, (or in some cases have both affiliated firms and agents in Canada).[1] The one U.S. publisher in that list who does not have an affiliate or agent here -- the 19th largest in the list -- is represented by a Canadian-based sales agent, who makes partial use of Canadian warehouse facilities in servicing the market.

An additional challenge that results from the dominant position of imported books is the fact that consumer price expectations are established ~~primarily~~ by imported books. Since books imported from the U.S., Britain or France are produced for much larger markets, their unit costs are typically substantially lower than the prices of books produced for the Canadian market. As a result, there is a general pressure on publishers of Canadian books to underprice those books in response to market expectations.

Faced with a similar challenge to that which now confronts Canada, the United States was unwilling to leave to the free market the development of its own writers and publishing industry. Throughout the 19th century, as urbanization advanced rapidly and literacy ~~expanded,~~ the United States refused to grant copyright protection to any books published in Britain. American publishers were free to pirate any titles ~~published~~ outside the United States and frequently American publishers paid no royalties to foreign authors on their pirated editions. However, beginning in 1891, American copyright law extended protection to foreign authors -- but only if their works were completely remanufactured in the United States.

Testifying in 1965 before the Judiciary Subcommittee of the United States House of Representatives, Robert W. Frase, then Vice President of the American Book Publishers Council commented on the reasons for the restrictive U.S. Copyright Act and the significance of this policy:

> First, there was our tradition of not granting property rights to foreigners . . . Second, and more important, the American publishing industry was developed in its formative years on the basis of piracy of British works.[2]

---

[1] According to the December 15, 1989 issue of the U.S. trade publication, Publishers Weekly.

[2] Royal Commission on Book Publishing, Background Papers, (Toronto: The Queen's Printer and Publisher, Province of Ontario, 1972), page 144.

The result was that the powerful British publishing industry was unable to export into the United States, and, as a result, unable to take advantage of its ability to ship low-cost overrun copies of its own publications into the United States and establish and maintain a powerful position in that market. In short, the United States was absolutely unprepared to accept the dictates of the international marketplace.

This crucially important policy initiative was taken with the support of American authors, publishers, book manufacturers, printing trade unions, and representatives of book users such as the National Education Association and the American Library Association. Few substantial changes were made until the 1950's, when the requirement of remanufacturing in the United States was eliminated for books published in countries which adhere to the Universal Copyright Convention -- with the exception of books written by U.S. citizens or individuals domiciled in the United States. However, as Robert Frase went on to note in the testimony quoted above:

> We had by then become the world's leading producer of all types of creative work -- literature, plays and music -- with exports far exceeding our imports.[3] It was obviously in our interest to protect our copyrights abroad . . .

American policy, then, did not change until American interests had changed.

U.S. import controls in publishing were, of course, not an aberration in American history. From the beginning the United States was preoccupied, if not obsessed, with the essential role of communication links in determining its success as a nation. In a recent book, the American scholar, James Carey identified the challenge as follows:

> How was this continental nation to be held together, to function effectively, to avoid declension into factions, or tyranny or chaos? How were we, to use a phrase of that day, "to cement the union"? . . . the answer was sought in the word and the wheel, in transportation and transmission, in the power of printing and civil engineering to bind a vast distance and a large population into cultural unity . . . This required placing enormous emphasis upon literacy, the press and education.[4]

The import prohibitions used by the United States to develop its own communication links through publishing, while highly beneficial to the United States, had a damaging effect on Canada. Because there were never reciprocal provisions in Canadian law, U.S. publications flooded into Canada, while Canadian publishers were unable to export into the United States.

---

3 Ibid., page 145.

4 James W. Carey, Communication as Culture: Essays on Media and Society, (Boston: Unwin Hyman, 1989), page 5.

Remarkable as it may seem in retrospect, almost all books published in Canada before August 10, 1962 were in the public domain in the United States, which meant that they could be printed by any American publisher without permission, while U.S. publications enjoyed full protection in Canada. The 1972 Report of the Royal Commission on Book Publishing concluded that these American copyright provisions "impose totally unjustifiable disabilities on the book manufacturing and publishing industries of . . . this country" and emphasized that "we are . . . much more concerned with the cultural than the economic implications of the situation."

2.3 Canadian Trade Data for Books

As noted above, Canada's imports of books continue to come primarily from the United States. Recent data from the U.S. Department of Commerce suggest that between 1986 and 1989 exports of books to Canada rose from $206 million U.S. to $394 million U.S., a 91 per cent increase (see Table 4). In Canadian currency the increase was from $287 million to $467 million, or a 63 per cent increase (the lower percentage increase in Canadian currency reflects the rising Canadian dollar over this period).

TABLE 4

U.S. Department of Commerce Data:
U.S. Exports to and Imports from Canada
1986 - 1989

	U.S. EXPORTS TO CANADA			U.S. IMPORTS FROM CANADA		
	$U.S. ($millions)	$Can. ($millions)	Annual % change	$U.S. ($millions)	$Can. ($millions)	Annual % change
1986	206.4	286.8	--	104.0	144.5	--
1987	289.0	383.2	+33.6%	97.0	128.6	-11.0%
1988	358.7	441.5	+15.2%	66.3	81.6	-36.5%
1989	394.2	466.8	+5.7%	61.9	73.3	-10.2%
% change 1986-89	+91.0%	+62.8%		-40.5%	-49.3%	

SOURCE: U.S. Department of Commerce.

NOTE: "Exports" exclude shipments under $500 U.S., "imports" exclude shipments under $250 U.S.

Statistics Canada data (Table 5) indicate both a less dramatic trend toward increased importation of books from the U.S., but substantially higher absolute levels. According to Statistics Canada imports from the United States increased by 33.3 per cent between 1986 and 1989, rising from $505 million to $673 million.

TABLE 5

Statistics Canada Data:
U.S. Exports to and Imports from Canada
1986 - 1989

	U.S. EXPORTS TO CANADA (Cdn. imports from the U.S.)		U.S. IMPORTS FROM CANADA (Cdn. exports to the U.S.)	
	$Canadian ($millions)	Annual % change	$Canadian ($millions)	Annual % change
1986	504.7	--	104.8	--
1987	473.9	- 6.1%	95.9	- 8.5%
1988	606.1	+27.9%	111.4	+16.2%
1989	673.0	+11.0%	69.0	-38.1%
% change 1986-89	+33.3%		-34.2%	

SOURCE: Statistics Canada "Exports, Merchandise Trade," 1986, 1987, 1988, and "Exports by Commodity," December 1989; "Imports, Merchandise Trade," 1986, 1987, 1988, and "Imports by Commodity," December 1989.

Statistics Canada data indicate that Canada's total imports of books from all countries rose from $602 million in 1984 to $841 million in 1989. In constant dollars the increase reported was 13 per cent. However, the Statistics Canada data indicate that the dollar value of imports actually declined in real terms between 1984 and 1987, possibly in response to exchange rate trends which made U.S. books significantly more expensive in Canada during that period. Imports rose sharply again from 1987 to 1989, increasing by 28 per cent in constant dollars. These import increases over the past three years parallel a decline in the cost of U.S. imports, with $1.39 Canadian in 1986 being required to purchase $1.00 value of U.S. imports, by comparison with $1.33 in 1987, $1.23 in 1988 and $1.18 in 1989.

In examining Tables 4, 5, and 6 it must be kept in mind that the data they contain reflect the physical flow of books across national borders--regardless of whether the importers and exporters are publishers or printers. If, for example, a printer based in Canada prints books for an American publisher, the shipment of those books to the U.S. publisher will show up in Canada's export sales data. The opposite situation is also possible, with Canadian publishers having their printing done in the United States or some other country and the resulting transaction showing up in Canada's imports of books.

However, as these tables indicate, the overall pattern is that imports greatly exceed exports, and that in recent years imports are increasing, while exports are decreasing. In 1989 Canada's imports exceeded exports by about three-quarters of a billion dollars ($749.4 million).

The total export revenues reported in Table 6 are accounted for primarily by Canadian printers manufacturing books for foreign publishers, rather than by exports by Canadian publishers. As indicated in Table 13, below, Canadian publishers earned $25.5 million from export sales in 1987-88.

2.4 Trends in Industry Ownership and Control

In all of the cultural industries, there has been a concern to establish and maintain control by Canadians over decision-making. In the case of the book industry specifically, this concern with sovereignty resulted through the 1970's and 1980's in the establishing of both provincial and federal government policies intended to achieve this objective. The specific policy initiatives taken are examined later in this report.

Statistics Canada data indicate that between 1984-85 and 1987-88 the net sales in Canada of Canadian-controlled publisher/agents increased by 49.1 per cent, while the revenues of foreign-controlled firms increased by 19.6 per cent (see Table 7). As a result, Canadian-controlled publishers accounted for 30.6 per cent of net book sales in Canada in 1987-88 ($468.4 million out of a total Canadian market of $1,529.8 million). Foreign-controlled publishers accounted for an additional 35.6 per cent of net sales in Canada, generating 544.4 million. As indicated earlier, the remaining $517.1 million, representing 33.8 per cent of sales in Canada, was accounted for by purchases made directly from foreign-based suppliers.

For reasons addressed later in this report, the trend toward an expanded share of the domestic market being accounted for by Canadian-controlled companies is a fragile one.

TABLE 6

Canadian Imports and Exports - Books and Pamphlets
($000's)
1984 to 1989

YEAR	1984	1985	1986	1987	1988	1989	% change 1984 - 89
Imports*- Current $	602,178	624,705	633,890	602,528	760,331	840,903	+39.6%
Constant $ (1984)	602,178	600,640	585,534	533,207	646,651	681,076	+13.1%
% change	--	-0.3%	-2.5%	-8.9%	+21.3%	+5.3%	
Exports▲- Current $	98,511	107,157	122,350	111,790	134,897	91,553	- 7.1%
Constant $ (1984)	98,511	103,029	113,017	98,928	114,728	74,152	-24.7%
% change	--	+4.6%	+9.7%	-12.5%	+16.0%	-35.4%	

SOURCE *: Statistics Canada, "Imports, Merchandise Trade", Cat. 65-203 Annual, 1986, 1987, 1988, and "Imports by Commodity", December 1989, Cat. 65-007.

Data include commodity classification (1984, 1985, 1986, 1987) 893-04 (religious books and pamphlets), 893-25 (books published by foreign governments, U.N. and NATO), 893-29 (dictionaries, encyclopedia, atlases), 894-41 (books and pamphlets not elsewhere specified, all languages except English), 893-45 (novels and works of fiction not elsewhere specified), 893-49 (books and pamphlets not elsewhere specified) and 894-90 (children's books); and classifications (1988, 1989) 4901.91 (dictionaries and encyclopedia), 4901.99 (books, brochures, leaflets and similar printed matter, not elsewhere specified), and 4903.00 (children's picture, drawing or colouring books).

SOURCE ▲: Statistics Canada, "Exports, Merchandise Trade", Cat. 65-202 Annual, 1986, 1987, 1988 and "Exports by Commodity", December, 1989, Cat. 65-004.

Data include commodity classification (1984, 1985, 1986, 1987) 893-99 (books and pamphlets); and commodity classification (1988, 1989) 4901.91 (dictionaries and encyclopedias), 4901.99 (books, brochures, leaflets and similar printed matter), and 4903.00 (children's picture, drawing or colouring books).

TABLE 7

Net Sales in Canada of Publishers/Agents by Country of Controlling Interest *
1984-85 to 1987-88
($000's)

	1984-85	1985-86	1986-87	1987-88	% ▲, '84-85 to '87-88
Canadian-Controlled	314,208	347,557	401,380	468,390	+49.1%
Foreign-Controlled	455,338	471,268	514,394	544,420	+19.6%
Total	769,546	818,825	915,774	1,012,809	+31.6%

SOURCE: Statistics Canada

* In the Statistics Canada survey respondents are asked to indicate "the country in which the ultimate controlling interest" of the organization is held. As a result, all data based on the Statistics Canada survey reflect the publishers' own categorization of the country of controlling interest.

As Table 8 indicates, the relative involvement of foreign and Canadian-controlled publishers differs for the English and French-language components of the book publishing industry. Among French-language publishers 81.9 per cent of revenues from the industry's sales of books in Canada were accounted for by Canadian-controlled firms in 1987-88, up slightly from 79.9 per cent three years earlier. By comparison, in English-language publishing, just 37.7 per cent of the industry's domestic revenues were accounted for by Canadian-controlled firms in 1987-88, but this represented an increase from 32.2 per cent in 1984-85.

The data in Table 8 are based on classifying individual publisher/agents as either French or English-language publishers based on the language of the titles which account for the majority of their sales. However, a number of major publishing firms are active in publishing both English and French-language books, including McGraw-Hill Ryerson/McGraw-Hill Editeurs, Holt Rinehart and Winston/Les Editions HRW, and Reader's Digest Association. In fact, as Table 9 indicates, just under one fifth of all sales of French-language books are accounted for by firms classified as part of the English-language publishing industry.

TABLE 8

**Net Domestic Sales By Language of Publisher/Agent *
and Country of Controlling Interest**

	Canadian-Controlled		Foreign-Controlled		Total	
	$000's	% of total	$000's	% of total	$000's	% of total
French						
1984-85	110,989	79.9%	27,956	20.1%	138,945	100.0%
1985-86	126,152	79.7%	32,054	20.3%	158,206	100.0%
1986-87	138,691	84.1%	26,279	15.9%	164,970	100.0%
1987-88	160,281	81.9%	35,514	18.1%	195,795	100.0%
English						
1984-85	203,219	32.2%	427,382	67.8%	630,602	100.0%
1985-86	221,405	33.5%	439,214	66.5%	660,618	100.0%
1986-87	262,689	35.0%	488,115	65.0%	750,804	100.0%
1987-88	308,109	37.7%	508,906	62.3%	817,015	100.0%
Total						
1984-85	314,208	40.8%	455,338	59.2%	769,547	100.0%
1985-86	347,557	42.4%	471,268	57.6%	818,824	100.0%
1986-87	401,380	43.8%	514,394	56.2%	915,774	100.0%
1987-88	468,390	46.2%	544,420	53.8%	1,012,809	100.0%

* Publisher/agents are classified as French or English according to the language of the titles which account for the largest share of their sales.

A more accurate picture of the extent of involvement of foreign-controlled publishers in the publishing of French-language books is, therefore, provided in Table 9. Foreign-controlled firms had revenues of $67.9 million from the sale of French-language books, representing 29.3 per cent of such sales; while Canadian-controlled firms had revenues of $164.0 million, 70.7 per cent of the total.

TABLE 9

Net Sales by Language of Books Sold and by Language and Country of Control of Publisher/Agent 1987 - 1988

	Canadian-Controlled		Foreign-Controlled		Total	
FRENCH-LANGUAGE BOOKS	$million	% of total	$million	% of total	$million	% of total
English-language Publishers/Agents*	9,603 ▲	4.1%	34,633	14.9%	44,236	19.1%
French-language Publishers/Agents	154,421	66.6%	33,304	14.4%	187,725	80.9%
Total	164,024	70.7%	67,937	29.3%	231,961	100.0%
ENGLISH-LANGUAGE BOOKS						
English-language Publishers/Agents*	298,508	38.2%	474,274	60.7%	772,781	99.0%
French-language Publishers/Agents	5,859 •	0.8%	2,209	0.3%	8,068	1.0%
Total	304,365	39.0%	476,483	61.0%	780,849	100.0%

SOURCE: Statistics Canada

* Publishers/Agents are classified by language according to the language of the titles which account for the largest percentage of their revenues.

▲ Figure for English-language agents, French-language books, has been included by Statistics Canada with English-language books to protect confidentiality.

• Figure for French-language agents, English-language books, has been included by Statistics Canada with French-language books to protect confidentiality.

2.5 Sources of Revenue of Canadian-based Publisher/Agents

As indicated above, the dominance of imported books in the Canadian market leads to significant vulnerability in the Canadian book industry. Of total revenues of just over $1,012.8 million in 1987-88, Canadian-based publisher/agents earned $537.3 million from the sale of imported books (Table 10), representing over half of their total revenues.

Without the revenues the Canadian-based industry earns from selling imported books, the industry would be fundamentally weakened. This is true for both the French and English-language components of the publisher/agent industry, with French-language firms earning 46.2 per cent of their revenues from the sale of imported books, by comparison with 54.7 per cent for English firms.

TABLE 10

Net Sales in Canada of Own and Exclusive Agency Titles
By Language of Publisher/Agent and Country of Control, 1987-88

	Canadian-Controlled		Foreign-Controlled		Total	
	$000's	% of total	$000's	% of total	$000's	% of total
French-language Publishers						
Own Titles	81,498	50.8%	23,853	67.2%	105,351	53.8%
Exclusive Agency	78,782	49.2%	11,660	32.8%	90,442	46.2%
Total	160,280	100.0%	35,513	100.0%	195,793	100.0%
English-language Publishers						
Own Titles	197,468	64.1%	172,713	33.9%	370,181	45.3%
Exclusive Agency	110,642	35.9%	336,194	66.1%	446,836	54.7%
Total	308,110	100.0%	508,907	100.0%	817,017	100.0%
TOTAL						
Own Titles	278,966	59.6%	196,566	36.1%	475,532	47.0%
Exclusive Agency	189,424	40.4%	347,854	63.9%	537,278	53.0%
Total	468,390	100.0%	544,420	100.0%	1,012,810	100.0%

SOURCE: Statistics Canada.

This is important

In the French-language component of the industry most of the revenue earned from the sale of imported books on an exclusive agency basis flows to Canadian-controlled companies ($78.8 million, or 87.1 per cent of the total). By contrast, in the English-language component of the industry, three-quarters of the revenue earned from the sale of imported books flows to foreign-controlled companies ($336.2 million out of a total of $446.8 million).

In the case of the French-language publisher/agents the flow of imported books primarily through Canadian-controlled companies is in large measure a reflection of policies pursued by the Government of Quebec, as well as the Government of Canada. In the English-language component of the industry, while only a minority of all imports (24.8 per cent) flow through Canadian-controlled businesses, the $110.6 million in revenue earned from exclusive agency sales represents an important source of revenue for such firms, accounting for 35.9 per cent of revenue. Over the past fifteen years efforts have been made to protect or enhance the import revenues of Canadian-controlled firms. This policy issue is examined later in this report.

It is largely as a result of the flow of imported titles through foreign-controlled firms that foreign-controlled firms accounted for the majority of the revenues earned by English-language publisher/agents -- $508.9 million out of a total of $817.0 million. Nevertheless, while foreign-controlled publishers accounted for 75.2 per cent of the revenues earned by English-language publisher/agents from the sale of imported books, they accounted for less than half of all sales of Canadian-published, or what the tables refer to as the publishers' own books, earning $172.7 million, by comparison with $197.5 million for Canadian-controlled publisher/agents.

The competitive position of Canadian-controlled English-language firms is affected fundamentally by the fact that they earn almost two-thirds of their revenue (64.1 per cent) from the sale of their own titles; while the foreign-controlled firms rely on Canadian published titles for just a third of their revenue (33.9 per cent). Both the risks and the cost involved in originating books in Canada are higher than for agency business.

The extent of involvement of Canadian and foreign-controlled publishers varies substantially by commercial category (see <u>Table 11</u>). Foreign-controlled firms dominate the English-language textbook market, accounting for revenues of just under $200 million, by comparison with $60 million for Canadian-controlled publisher/agents. The publishing of Canadian textbooks accounts for most of the revenues earned by foreign-controlled publishers from the sale of Canadian-published titles, generating $98.4 million, or 57 per cent of their total revenues of $172.7 million from the sale of Canadian-published titles. Their next largest source of revenue from Canadian titles is reference books, which generated revenues of $37.2 million, or a further 22 per cent of the total. Just $25.5 million was earned from the sale of Canadian published trade titles.

Both overall and in every sub-category except ElHi textbooks, foreign-controlled publishers earned most of their revenues from the sale of imported books which they marketed on an exclusive basis in Canada. In the trade book category foreign-controlled firms earned 82 per cent of their revenues from the sale of imported books.

By comparison, Canadian-controlled publishers earned the largest portion of their revenue from Canadian-published titles from the publishing of trade or general interest books, which accounted for revenues of $64.9 million, or about a third (32.9 per cent) of their sales of Canadian-published books. Substantial additional revenues from the sale of Canadian-published books were also earned from professional and technical books ($58.7 million, or 29.7 per cent); textbooks ($38.7 million, or 19.6 per cent); and reference books ($32.6 million, or 16.5 per cent).

Most of the import or exclusive agency revenues of Canadian-controlled firms are accounted for by trade books, which generated revenues of $66.3 million, or 60 per cent of their total revenues from agency sales. A further $21.9 million in agency revenues -- 20 per cent of the total -- was generated by the sale of imported textbooks. The loss of these agency revenues would threaten the ability of Canadian-controlled publishers to continue to compete effectively in the trade and textbook markets.

TABLE 11

Net Domestic Sales By Commercial Category of Book
For English-Language Canadian and Foreign-Controlled Publishers/Agents, 1987-88

	Canadian-Controlled Publishers				Foreign-Controlled Publishers			
	($000's)			%	($000's)			%
	Own	Agency	Total	% of total	Own	Agency	Total	% of total
Textbooks								
ElHi	29,848	8,295 *	38,143	24.9%	74,096	39,025 *	113,121	74.0%
Post Secondary	8,855	13,651	22,506	20.8%	24,336	61,231	85,568	79.2%
Total	38,702	21,946	60,648	23.4%	98,432	100,256	198,688	76.6%
Tradebooks								
Mass Market Paperbacks	25,039	14,996	40,035	48.5%	6,617	35,973	42,590	51.5%
Trade Paperbacks	23,534	24,121	47,655	47.9%	9,688	42,090	51,778	52.1%
Trade Hardcovers	16,331	27,148	45,479	47.2%	9,215	39,415	48,630	52.8%
Total	64,904	66,265	131,169	47.9%	25,520	117,380	142,900	52.1%
Scholarly	2,489	2,372	4,861	84.2%	0	910	910	15.8%
Reference	32,631	9,474 *	42,105	22.8%	37,243	59,736 *	96,978	52.4%
Professional & Technical	58,741	3,834 *	62,575	68.6%	11,518	14,385 *	25,903	28.4%
TOTAL	197,468	110,642	308,110	37.7%	172,713	336,194	508,907	62.3%

SOURCE: Statistics Canada.

NOTE: * Breakdown of sales of exclusive agents by country of controlling interest has been withheld by Statistics Canada in some categories in order to protect confidentiality. Total sales of exclusive agents, for those categories in which country of controlling interest has been withheld, are as follows: ElHi $1,644; Reference $45,925; Professional & Technical $2,689.

Table 12 provides a breakdown by commercial category of both sales of Canadian-authored books and of total sales for both Canadian and foreign-controlled publishers, whose sales are primarily of English-language books. On an overall basis, as Table 12 indicates:

- Canadian-controlled publishers earn 53 per cent of their revenues from the sale of Canadian-authored books, $162.8 million of a total of $308.1 million.

- Foreign-controlled publishers earned 29 per cent of their revenues from the sale of Canadian-authored books.

By commercial category of book the involvement of Canadian and foreign-controlled publishers varies significantly. For example:

- While Canadian-authored texts account for 72.8 per cent of ElHi sales for Canadian-controlled firms, the corresponding figure for foreign-controlled firms is 59.9 per cent.

- While Canadian-authored books account for 46.7 per cent of sales of trade or general interest paperbacks for Canadian-controlled publishers, they account for 14.7 per cent for foreign-controlled firms.

- While Canadian-authored hardcover trade books account for 34.2 per cent of the revenues of Canadian-controlled publishers, they account for 14.5 per cent of hardcover trade books sales for foreign-controlled firms.

- While the combined sales of Canadian-authored trade books by Canadian-controlled publishers were $41.0 million, representing 31.3 per cent of their total revenues, the corresponding figures for foreign-controlled publisher/agents were $16.8 million, or 11.8 per cent.

TABLE 12

Domestic Sales of Canadian-Authored Books By Commercial Category and Country of Controlling Interest For English-language Publishers/Agents, 1987-88

	Canadian-Controlled Publishers				Foreign-Controlled Publishers			
	Cdn-Authored Books		Total Revenues *		Cdn-Authored Books		Total Revenues *	
	($000's)	% of sales	($000's)	% of total	($000's)	% of sales	($000's)	% of total
Textbooks								
ElHi	27,752	72.8%	38,143	100.0%	67,733	59.9%	113,121	100.0%
Post Secondary	6,237	27.7%	22,506	100.0%	19,635	22.9%	85,568	100.0%
Total	33,989	56.0%	60,648	100.0%	87,368	44.0%	198,688	100.0%
Tradebooks								
Mass Market Paperbacks	3,883	9.7%	40,035	100.0%	2,148	5.0%	42,590	100.0%
Trade Paperbacks	22,232	46.7%	47,655	100.0%	7,599	14.7%	51,778	100.0%
Trade Hardcovers	14,887	34.2%	43,479	100.0%	7,054	14.5%	48,630	100.0%
Total	41,002	31.3%	131,169	100.0%	16,802	11.8%	142,900	100.0%
Scholarly	2,148	44.2%	4,861	100.0%	0	0.0%	910	100.0%
Reference	32,538	77.3%	42,105	100.0%	31,064	32.0%	96,978	100.0%
Professional & Technical	53,156	84.9%	62,575	100.0%	11,489	44.4%	25,903	100.0%
TOTAL	162,834	52.8%	308,110	100.0%	146,723	28.8%	508,907	100.0%

SOURCE: Statistics Canada.

NOTE: * Breakdown of sales of exclusive agents by country of controlling interest has been withheld by Statistics Canada in some categories in order to protect confidentiality. Total sales of exclusive agents, for those categories in which country of controlling interest has been withheld, are as follows: ElHi $1,644; Reference $45,925; Professional & Technical $2,689.

2.6 Revenue from Export Sales

As indicated above (Sub-section 2.3, page 8) Canada's exports of books are relatively limited in relation to imports and have not been increasing over the past few years (see Tables 4, 5, and 6). In 1989, the ratio of imports to exports rose to 9.2 to 1, with imports exceeding exports by $749.4 million. Most of Canada's exports were accounted for by printers, rather than publishers, with publishers reporting export earnings of $25.5 million.

Table 13 provides an indication of the extent of export revenues earned by English and French-language publishers. In both cases export revenue accounts for five per cent of total revenue from the sale of Canadian published books. As Table 9 indicates, it would not be correct to assume that these figures correspond to those for the export of books in English and books in French, since English-language firms are involved in publishing French-language books and French-language firms in publishing English-language titles.

TABLE 13

Net Domestic and Export Sales of Own Books, By Language of Publisher and Country of Control, 1987-88

	Domestic Sales		Export Sales		Total	
	$000's	% of total	$000's	% of total	$000's	% of total
French-language Publishers						
Canadian-Controlled	81,498		n/a		n/a	
Foreign-Controlled	23,853		n/a		n/a	
Total	105,351	95.2%	5,286	4.8%	110,637	100.0%
English-language Publishers						
Canadian-Controlled	197,468	94.2%	12,252	5.8%	209,720	100.0%
Foreign-Controlled	172,713	95.6%	7,920	4.4%	180,633	100.0%
Total	370,181	94.8%	20,172	5.2%	390,353	100.0%
All Publishers	475,532	94.9%	25,458	5.1%	500,990	100.0%

SOURCE: Statistics Canada, Cat. 87-210, 1987-88.

In assessing the significance of these exports of Canadian-published books it is useful to examine comparable figures for the more developed industries of countries such as the United States and the United Kingdom (figures for France were not readily available).

TABLE 14

Domestic and Export Revenues of Titles Published in the United States, the United Kingdom and Canada

	United States (1) 1988		United Kingdom(2) 1988 *		Canada (3) 1987-88	
	$million U.S.	%	£ million U.K.	%	$million Canadian	%
Domestic Sales	13,222	93%	937.5	72%	475.5	95%
Export Sales	925	7%	358.8	28%	25.5	5%
Total Sales	14,147	100%	1,296.3	100%	501.0	100%

SOURCES:
1. Book Industry Trends, Book Industry Study Group, New York.
2. U.K. Department of Trade and Industry.
3. Statistics Canada

NOTES: * Provisional

The British publishing industry has been experiencing a decline in the percentage of its total revenues derived from exports, although the percentage remains relatively high. Export sales accounted for 40.5% of the British industry's revenues in 1975, 32.0% in 1980, and 27.7% in 1988.

One important factor limiting export revenues is the fact that a very substantial number of the books published in all countries are likely to be of little or no interest outside the country. In this respect book publishing differs fundamentally from the film or recording industries, in which most of the works produced are intended to entertain and have at least the potential for substantial exposure outside the country in which they are produced.

Among the many types of works not likely to be sold substantially outside their country of origin are the following:

- Textbooks designed to respond to established educational curricula, and particularly when they reflect a history, laws, political or economic institutions and systems, social realities or other phenomena distinctive to that country;

- books for the general public which are related to national or regional personalities, economic, social or political issues affecting the country, regional, national or local history, etc;

- accounting, business, legal, or other professional books, or reference works which are directly related to the country involved or to states or provinces within the country.

It is also the case that the practice of the publishing industry internationally has been that most of those works which have the potential for sales internationally have been co-published. This is true of most of the established Canadian novelists whether they write in English or French. Their work will be published in Canada by a Canadian publisher and in the United States, Britain or France by publishers in those countries. As a recent Peat Marwick study of book distribution noted, "almost any major book by an American author will not be sold in the American edition in England and in most other countries. The British or other foreign publishers will publish the book in their own edition . . ." [5]

As a result, the international practice has been to sell territorial publishing rights rather than to rely primarily on exporting books from one country to another. This does not, however, mean that a separate print run is done for each market; in fact, it is normal practice that the publishers involved in co-publishing a title will share a print run, with the same printer producing the two or more editions involved.

The publishing list of a major publisher will usually include a mix of titles of local, regional, national and international interest. In the case of Canadian publishers the foreign-authored titles which are of international interest are typically handled as imported copies of a foreign edition distributed on an exclusive basis in Canada.

2.7 Publishing of Canadian Titles

There were 7,263 new titles published in Canada in 1987-88. This represented an increase from a total of 4,995 in 1984-85 (Table 15).

---

[5] English-language Book Publishing and Distribution in Canada, Peat Marwick Consulting Group, October 16, 1989, p. IV, 21.

TABLE 15

Number of Titles Published, Reprinted and in Print by Country of Controlling Interest, 1984-85 to 1987-88

	Canadian-Controlled		Foreign-controlled		Total
Titles Published ("New Titles")	Number	% of total	Number	% of total	
1984-85	n/a		n/a		4,995
1985-86	4,105	79.9%	1,030	20.1%	5,135
1986-87	4,017	71.4%	1,609	28.6%	5,626
1987-88	5,824	80.2%	1,439	19.8%	7,263
Titles Reprinted					
1984-85	n/a		n/a		3,637
1985-86	2,241	63.1%	1,310	36.9%	3,551
1986-87	2,722	61.0%	1,737	39.0%	4,459
1987-88	2,891	64.0%	1,624	36.0%	4,515
Titles In Print					
1984-85	n/a		n/a		36,893
1985-86	30,774	71.7%	11,971	28.0%	42,745
1986-87	33,669	74.8%	11,369	25.2%	45,038
1987-88	37,648	76.0%	11,893	24.0%	49,541

SOURCE: Statistics Canada, Cat. 87-210 (1985-86, 1986-87 and 1987-88), and Cat. 87-525 (1984).

Of this total, Canadian-controlled firms accounted for the release of 5,824 titles in 1987-88, representing 80 per cent of all new Canadian titles released.

An additional 4,515 titles were reprinted in 1987-88, of which Canadian-controlled publishers accounted for 2,891 (64 per cent) and foreign-controlled firms for 1,624 (36 per cent). The higher proportion of reprinted than new titles accounted for by foreign-controlled publishers reflects the fact that they are much more actively involved in producing textbooks than are Canadian-controlled publishers. Typically, textbooks have a longer life than general interest or "trade titles", going through a greater number of reprintings.

Of the 49,541 Canadian-published titles in print in 1987-88, 37,648, or 76 per cent were accounted for by Canadian-controlled firms, by comparison with 11,893 titles for foreign-controlled firms. The number of Canadian titles in print increased from 36,893 in 1984-85 to 49,541 in 1987-88, an increase of 34 per cent.

Table 15 contains all titles published in Canada, including original works by Canadian authors, adaptations of books published originally outside Canada (adapting of foreign textbooks is a relatively common practice in the educational market), and the release of Canadian editions of works by foreign authors.

Tables 16, 17, and 18 provide a more detailed profile of the publishing of Canadian-authored works. As Table 16.1 indicates, there were 5,296 new Canadian-authored titles published in 1987-88. This figure represents just under three-quarters (73%) of all the new titles released in Canada in 1987-88.

TABLE 16.1

Number of Canadian-Authored Titles Published
By Country of Control of Publisher and Commercial Category, 1987-88

English and French Language Publishers Titles Published	Canadian-controlled Publishers		Foreign-controlled Publishers		Total	
	Number	% of total	Number	% of total	Number	% of total
Textbooks						
ElHi	761	63.0%	446	37.0	1,207	100.0%
Post Secondary	189	54.9%	155	45.1%	344	100.0%
Total	950	61.3%	601	38.7%	1,551	100.0%
Tradebooks						
Mass Market Paperbacks	182	77.4%	53	22.6%	235	100.0%
Trade Paperbacks	1,253	92.3%	105	7.7%	1,358	100.0%
Trade Hardcovers	324	80.6%	78	19.4%	402	100.0%
Total	1,759	88.2%	236	11.8%	1,995	100.0%
Scholarly	196	100.0%	--	0.0%	196	100.0%
Reference	226	74.8%	76	25.2%	302	100.0%
Professional & Technical	1,156	92.3%	96	7.7%	1,252	100.0%
TOTAL	4,287	80.9%	1,009	19.1%	5,296	100.0%

SOURCE: Statistics Canada, Cat. 87-210, 1987-88.

TABLE 16.2

Number of Canadian-Authored Titles In Print
By Country of Control of Publisher and Commercial Category, 1987-88

English and French Language Publishers Titles In Print	Canadian-controlled Publishers		Foreign-controlled Publishers		Total	
	Number	% of total	Number	% of total	Number	% of total
Textbooks						
ElHi	7,172	57.6%	5,274	42.4%	12,446	100.0%
Post Secondary	1,655	54.7%	1,370	45.3%	3,025	100.0%
Total	8,827	57.1%	6,644	42.9%	15,471	100.0%
Tradebooks						
Mass Market Paperbacks	1,345	89.1%	164	10.9%	1,509	100.0%
Trade Paperbacks	11,970	93.5%	832	6.5%	12,802	100.0%
Trade Hardcovers	2,646	76.3%	823	23.7%	3,469	100.0%
Total	15,961	89.8%	1,819	10.2%	17,780	100.0%
Scholarly	2,406	100.0%	--	0.0%	2,406	100.0%
Reference	1,905	82.3%	411	17.7%	2,316	100.0%
Professional & Technical	2,983	83.8%	575	16.2%	3,558	100.0%
TOTAL	32,082	77.2%	9,449	22.8%	41,531	100.0%

SOURCE: Statistics Canada, Cat. 87-210, 1987-88.

Of the 5,296 Canadian-authored titles released, 4,287, or 81 per cent were published by Canadian-controlled firms; the remaining 1,009, or 19 per cent were published by foreign-controlled publishers. English-language publishers accounted for the release of 3,743 new Canadian-authored titles; (71 per cent of the total); French-language publishers for 1,553, or 29 per cent. The breakdown by the language of the publisher does not correspond to the language of the Canadian-authored books released, since English-language firms will have released a substantial number of titles in French, and French-language publishers will have produced some titles in English.

Of the 1,553 new Canadian-authored titles published in 1987-88, Canadian-controlled publishers accounted for 1,428, or 92 per cent (Table 17.1). Almost all of the titles published by foreign-controlled publishers were textbooks (124 of 125), with the vast majority (116) produced for the ElHi market.

TABLE 17.1

Number of Canadian-Authored Titles Published
By Country of Control of Publisher and Commercial Category, 1987-88

French-language Publishers	Canadian-controlled Publishers		Foreign-controlled Publishers		Total	
Titles Published	Number	% of total	Number	% of total	Number	% of total
Textbooks						
ElHi	400	77.5%	116	22.5%	516	100.0%
Post Secondary	110	93.2%	8	6.8%	118	100.0%
Total	510	80.4%	124	19.6%	634	100.0%
Tradebooks						
Mass Market Paperbacks	43	100.0%	--	0.0%	43	100.0%
Trade Paperbacks	556	99.8%	1	0.2%	557	100.0%
Trade Hardcovers	37	100.0%	--	0.0%	37	100.0%
Total	636	99.8%	1	0.2%	637	100.0%
Scholarly	62	100.0%	--	0.0%	62	100.0%
Reference	146	100.0%	--	0.0%	146	100.0%
Professional & Technical	74	100.0%	--	0.0%	74	100.0%
TOTAL	1,428	92.0%	125	8.0%	1,553	100.0%

SOURCE: Statistics Canada, cat. 87-210, 1987-88.

TABLE 17.2

Number of Canadian-Authored Titles In Print
By Country of Control of Publisher and Commercial Category, 1987-88

French-language Publishers	Canadian-controlled Publishers		Foreign-controlled Publishers		Total	
Titles In Print	Number	% of total	Number	% of total	Number	% of total
Textbooks						
ElHi	3,960	81.0%	928	19.0%	4,888	100.0%
Post Secondary	831	88.3%	110	11.7%	941	100.0%
Total	4,791	82.2%	1,038	17.8%	5,829	100.0%
Tradebooks						
Mass Market Paperbacks	598	100.0%	--	0.0%	598	100.0%
Trade Paperbacks	5,394	99.4%	34	0.6%	5,428	100.0%
Trade Hardcovers	379	100.0%	--	0.0%	379	100.0%
Total	6,371	99.5%	34	0.5%	6,405	100.0%
Scholarly	866	100.0%	--	0.0%	866	100.0%
Reference	1,324	100.0%	--	0.0%	1,324	100.0%
Professional & Technical	414	100.0%	--	0.0%	414	100.0%
TOTAL	13,766	92.8%	1,072	7.2%	14,838	100.0%

SOURCE: Statistics Canada, cat. 87-210, 1987-88.

In English-language publishing, Canadian-controlled publishers published 2,859 new Canadian-authored titles in 1987-88 (Table 18.1). This represented 76 per cent of all such titles produced, with the remaining 884 titles published by foreign-controlled publishers. Canadian-controlled publishers account for a majority of the new Canadian-authored titles released by English-language firms in every commercial category except textbook publishing.

The figures in Table 18.1 can be compared with those in Table 11, which indicate the market revenues derived by foreign and Canadian-controlled publishers for each category of book. This comparison indicates the following:

- While foreign-controlled firms accounted for 62.3 per cent of the English-language industry's sales in Canada, they published just 23.6 per cent of new Canadian-authored books.

- By comparison, with 37.7 per cent of the industry's revenues from domestic sales, Canadian-controlled publishers published over three-quarters (76.4 per cent) of the new Canadian-authored books published.

- With 24.9 per cent of industry revenues from the ElHi textbook market, Canadian-controlled firms produced 52.2 per cent of the new Canadian-authored texts.

- With 46.9 per cent of revenue from the sale of trade books in Canada, Canadian-controlled publishers produced 82.7 per cent of the new Canadian-authored trade titles -- 1,123 out of a total of 1,358.

As Table 16.2 indicates, there were 41,531 Canadian-authored titles in print in 1987-88, representing 84 per cent of the total of 49,541 Canadian titles in print. Canadian-controlled publishers accounted for 32,082 of the Canadian-authored books in print, representing 77 per cent of the total. Tables 17.2 and 18.2 provide a breakdown of these totals by language and country of controlling interest.

TABLE 18.1

Number of Canadian-Authored Titles Published
By Country of Control of Publisher and Commercial Category, 1987-88

English-language Publishers	Canadian-controlled Publishers		Foreign-controlled Publishers		Total	
Titles Published	Number	% of total	Number	% of total	Number	% of total
Textbooks						
ElHi	361	52.2%	330	47.8%	691	100.0%
Post Secondary	79	35.0%	147	65.0%	226	100.0%
Total	440	49.6%	447	50.4%	887	100.0%
Tradebooks						
Mass Market Paperbacks	139	72.4%	53	27.6%	192	100.0%
Trade Paperbacks	697	87.0%	104	13.0%	801	100.0%
Trade Hardcovers	287	78.6%	78	21.4%	365	100.0%
Total	1,123	82.7%	235	17.3%	1,358	100.0%
Scholarly	134	100.0%	--	0.0%	134	100.0%
Reference	80	51.3%	76	48.7%	156	100.0%
Professional & Technical	1,082	91.9%	96	8.1%	1,178	100.0%
TOTAL	2,859	76.4%	884	23.6%	3,743	100.0%

SOURCE: Statistics Canada, Cat. 87-210, 1987-88.

TABLE 18.2

Number of Canadian-Authored Titles In Print
By Country of Control of Publisher and Commercial Category, 1987-88

English-language Publishers	Canadian-controlled Publishers		Foreign-controlled Publishers		Total	
Titles In Print	Number	% of total	Number	% of total	Number	% of total
Textbooks						
ElHi	3,212	42.5%	4,346	57.5%	7,558	100.0%
Post Secondary	824	39.5%	1,260	60.5%	2,084	100.0%
Total	4,036	41.9%	5,606	58.1%	9,642	100.0%
Tradebooks						
Mass Market Paperbacks	747	82.0%	164	18.0%	911	100.0%
Trade Paperbacks	6,576	45.9%	798	54.1%	1,474	100.0%
Trade Hardcovers	2,267	73.4%	823	26.6%	3,090	100.0%
Total	9,590	84.3%	1,785	15.7%	11,375	100.0%
Scholarly	1,540	100.0%	--	0.0%	1,540	100.0%
Reference	581	58.6%	411	41.4%	992	100.0%
Professional & Technical	2,569	81.7%	575	18.3%	3,144	100.0%
TOTAL	18,316	68.6%	8,377	31.4%	26,693	100.0%

SOURCE: Statistics Canada, Cat. 87-210, 1987-88.

2.8 Profitability and Key Financial Ratios

Financial data for the book publishing industry in Canada vary substantially, depending on whether one examines data which include or exclude Harlequin Books. As the 1989 Annual Report of Torstar indicates, Harlequin had revenues of $344.6 million in 1987 from net sales of its books internationally, and generated net income of $43.9 million. While not all of this operating revenue and profit would be included in the Statistics Canada survey, since it reflects extensive overseas activities, all of Harlequin's North American operations are included in the data reported to Statistics Canada. It is estimated that in excess of $200 million of the revenues of large Canadian-controlled, English-language publishers are accounted for by Harlequin, reflecting its combined sales in Canada and the United States.

There are a number of reasons for examining financial data for Canadian book publishing exclusive of Harlequin. The first is that most of Harlequin's book publishing operations are actually carried on in the United States--including its printing, warehousing, order fulfillment, and marketing functions for all of North America. Harlequin has recently begun construction of a 400,000 square foot North American distribution facility in Buffalo, New York. A substantial majority of Harlequin's own publications, unlike those of other Canadian publishers, are also by non-Canadian authors. Harlequin's distribution to retail outlets in the United States is handled by Simon & Schuster, an American publishing firm owned by Paramount.

Harlequin accounts for in excess of 40 per cent of the total revenues reported by large Canadian-controlled English-language publishers (at least $200 million of total revenues of $478 million). However, Harlequin's unit costs, ratio of cost of sales to revenue, and economies of scale all reflect its continental market, its involvement as the world's major publisher of romance fiction in supplying a culturally undifferentiated mass product, and the fact that its operations are carried on primarily outside Canada. But for purposes of this study, the principal goal is to look at the industry in Canada, with an emphasis on the publishing of Canadian-authored books and the maintenance of a separate national book distribution system for Canada.

Because of the need to protect the confidentiality of Statistics Canada data for Harlequin, it is not possible to simply have Statistics Canada provide financial data which exclude Harlequin. While respecting the confidentiality provisions, it was, however, possible to develop financial ratios for a selected number of large Canadian-controlled, English-language publishers, which included the major publishers of both educational texts and trade titles.

2.8.1 Basic Operating Data, 1987-88

Table 19 provides key operating data for English-language Canadian publishers. A number of basic points are obvious from the table:

TABLE 19

Average Financial Position of English-Language Publishers, By Size and Country of Control, 1987-88

	Small (under $200,000)		Medium ($200,000 - $999,999)		Large ($1 million plus)			
	Canadian & Foreign-Controlled Publishers *				Selected Canadian-Controlled Publishers+		Foreign-Controlled Publishers	
	($000's)	% of revenues	($000's)	% of revenues	($000's)	% of revenues	($000's)	% of revenues
Average Revenues								
Own Titles	82.2	70.0%	288.0	70.5%	4,300.2	46.2%	6,421.8	40.1%
Agency/Imported Titles	4.9	4.2%	35.5	8.7%	4,594.6	49.4%	9,471.7	59.1%
Grants	28.1	23.9%	74.2	18.2%	254.5	2.7%	0.8	<0.1%
Other	2.5	2.1%	11.1	2.7%	153.6	1.7%	133.9	0.8%
Total Revenues	**117.4**	**100.0%**	**408.8**	**100.0%**	**9,305.8**	**100.0%**	**16,028.2**	**100.0%**
Average Cost of Sales								
Cost of Books	49.8	42.4%	171.0	41.8%	4,769.9	51.3%	7,148.6	44.6%
Royalties	6.4	5.5%	24.7	6.0%	577.3	6.2%	615.8	3.8%
Other	0.3	0.3%	0.9	0.2%	24.6	0.3%	5.9	<0.1%
Total Cost of Sales	**56.5**	**48.1%**	**196.6**	**48.1%**	**5,371.8**	**57.7%**	**7,770.4**	**48.5%**
Average Operating Expenses	65.7	56.0%	182.7	44.7%	3,811.0	41.0%	6,632.7	41.4%
Average Pre-Tax Profit (Loss)	(4.8)	(4.1%)	29.5	7.2%	123.0	1.3%	1,625.1	10.1%
No. of Publishers	60		61		12		28	

SOURCE: Statistics Canada.

NOTES: * In the case of small and medium-size publishers, one firm in each category is foreign-controlled.

\+ Publishers selected to include major Canadian-controlled publishers of textbooks and tradebooks. (Includes Annick Press, Fitzhenry & Whiteside, Douglas & McIntyre, Gage, General Publishing, Hurtig, Key Porter, Lester & Orpen Dennys, Irwin, Macmillan, McClelland & Stewart, Nelson, and Seal Books).

(1) Without grant assistance, small and medium-sized publishers, almost all of which are Canadian-controlled, would be experiencing heavy losses on their operations; in fact, for 1987-88 the average small firm did report a pre-tax loss of 4.1 per cent of sales.

(2) Grants account for a relatively small percentage of the income of large Canadian-controlled publishers by comparison with small or medium-sized firms; but without this grant income the large Canadian-controlled firms would have shown an average loss of 1.4 per cent of revenue, by comparison with an average profit of 10.1 per cent for large foreign-controlled firms.

(3) The average large, foreign-controlled firm has revenues of $9.5 million from the sale of imported books, more than double the average imports of $4.6 million for Canadian-controlled firms.

(4) While operating costs on average are almost identical for large Canadian and foreign-controlled firms, at 41 per cent of total revenue, the average cost of sales is 9.2 per cent higher for Canadian-controlled firms -- 57.7 per cent by comparison with 48.5 per cent, accounting for all of the difference in profitability.

In Table 19 all calculations related to revenue are expressed as a percentage of all revenue, including grants. However, if grants are excluded and the costs of sales is calculated as a percentage of earned revenue, then the cost of sales figures for small and medium-sized publishers are 63.0 per cent and 58.8 per cent respectively, while the figure for large, Canadian-controlled publishers is 59.3 per cent.

The differences between the cost of sales and profit figures for large Canadian-controlled publishers and those for foreign-controlled firms reflects the greater involvement of foreign-controlled firms in selling imported titles. However, the differences also reflect the fact that a much higher percentage of the Canadian-authored books sold by foreign-controlled firms are textbooks, where traditionally books continue to sell over a much longer period than is the case for trade books, with the resulting advantage that fixed costs can be spread over larger print-runs or multiple printings.

If one looks at the comparable information for French-language publishers (Table 20) it is clear that a number of the same basic patterns exist. Small and medium-sized firms depend significantly on grant support, and the average firm in both categories would have heavy losses without such support. For large Canadian-controlled firms, the average firm would earn a profit equal to 8.0 per cent of revenue without grants; by comparison the average foreign-controlled firm reported a profit almost twice as high -- 15.4 per cent of revenue.

TABLE 20

Average Financial Position of French-Language Publishers, By Size and Country of Control, 1987-88

	Small (under $200,000)		Medium ($200,000 - $999,999)		Large ($1 million plus)			
	Canadian-Controlled Publishers *				Canadian-Controlled Publishers		Foreign-Controlled Publishers	
	($000's)	% of revenues	($000's)	% of revenues	($000's)	% of revenues	($000's)	% of revenues
Average Revenues								
Own Titles	80.4	66.4%	420.2	74.3%	2,784.0	55.8%	4,799.0	74.0%
Agency/Imported Titles	1.5	1.2%	26.4	4.7%	1,977.6	39.6%	1,642.3	25.3%
Grants	38.0	31.4%	90.4	16.0%	146.8	2.9%	--	0.0%
Other	1.2	1.0%	28.4	5.0%	81.0	1.6%	43.4	0.7%
Total Revenues	**121.1**	**100.0%**	**565.4**	**100.0%**	**4,989.5**	**100.0%**	**6,484.7**	**100.0%**
Average Cost of Sales								
Cost of Books	50.5	41.7%	270.8	47.9%	2,650.0	53.1%	2,301.8	35.5%
Royalties	9.3	7.7%	54.3	9.6%	328.5	6.6%	537.8	8.3%
Other	--	0.0%	2.0	0.4%	16.2	0.3%	--	0.0%
Total Cost of Sales	**59.9**	**49.5%**	**327.2**	**57.9%**	**2,994.7**	**60.0%**	**2,839.6**	**43.8%**
Average Operating Expenses	58.8	48.6%	214.2	37.9%	1,458.7	29.2%	2,644.0	40.8%
Average Pre-Tax Profit (Loss)	2.4	2.0%	24.0	4.2%	536.1	10.8%	1,001.1	15.4%
No. of Firms	25		36		25		5	

SOURCE: Statistics Canada.

NOTE: * In the case of small and medium-size French-language publishers, Canadian-controlled.

The cost of sales for Canadian-controlled French-language firms is also substantially higher than for foreign-controlled firms, at 49.5 per cent for small firms, 57.9 per cent for medium, and 60.0 per cent for large. However, if one looks at the cost of sales in relation to earned revenue only, then the figures are 72.1 per cent, 68.9 per cent and 61.8 per cent -- not just substantially higher than for foreign-controlled firms, at 43.8 per cent, but somewhat higher than for English-language firms of comparable size. The comparison with foreign-controlled French language publishers probably reflects the fact that such firms are involved primarily in publishing textbooks, including translations of existing English-language texts. In the case of the differences with comparable Canadian-controlled English-language firms, the reason for the difference is probably that the average print-run of French-language books is shorter than for English-language titles, reflecting the smaller market served. As a result, unit costs of manufacture are higher and fixed costs are spread over fewer copies.

On average, however, the operating costs reported by large French-language Canadian publishers are actually lower than for foreign-controlled firms -- 29.2 per cent, by comparison with 40.8 per cent. However, this is a misleading comparison, since many Canadian-controlled firms do not handle the distribution of their books themselves, instead selling at a higher discount to a distributor (typically at 55 to 57 per cent off list price). This practice is not followed by foreign-controlled firms, which typically handle their own distribution, or by most English-language publishers.

2.8.2 Trends in Profitability

An examination of key financial ratios for the industry over the period 1984-85 to 1987-88 was also carried out. <u>Table 21</u> indicates average pre-tax profit as a percentage of total revenues inclusive of grants.

In the English-language sector of the industry the pattern has been reasonably consistent. The average small firm showed losses after grants in each of the four years. Average profits of medium-sized firms showed some improvement, rising from 2.3 per cent in 1984-85 to 7.2 per cent in 1987-88.

However, the centrally important figures are for companies classified, somewhat misleadingly, as large firms, that is, those with revenues of over $1 million. Such firms account for 95 per cent of the industry's revenues. Here the pattern over the four year period is that the profits of the average foreign-controlled firm were consistently higher than for the average Canadian-controlled firm. The lowest level of profit recorded by Canadian-controlled firms was 1.3 per cent in 1987-88; by contrast, pre-tax profits for foreign-controlled firms that year averaged 10.1 per cent.

In French-language publishing as well, the profitability of small firms is lowest, with losses reported for three of the four years. Profits for medium-sized firms were also relatively low, with the highest level reached 4.2 per cent in 1987-88. Large Canadian-controlled publishers reported average profits significantly higher than those for their English-language counterparts, but still much lower than for foreign-controlled, French-language publishers.

TABLE 21

Average Profit (Loss) Before Taxes, As a Percentage of Revenues 1984-85 to 1987-88

	English-language			
	Country of Control			
	Canadian & Foreign-Controlled*		Canadian Controlled	Foreign-Controlled
	Small	Medium	Large (selected)	Large
1984-85	(5.3)	2.3	2.3	11.2
1985-86	(1.6)	2.3	4.0	8.5
1986-87	(1.0)	3.8	4.2	9.5
1987-88	(4.1)	7.2	1.3	10.1

	French-language			
	Country of Control			
	Canadian-Controlled			Foreign-Controlled
	Small	Medium	Large	Large
1984-85	(0.1)	2.1	5.9	18.7
1985-86	(2.1)	(0.3)	5.7	17.3
1986-87	(5.8)	0.8	7.5	14.9
1987-88	2.0	4.2	10.8	15.4

SOURCE: Statistics Canada.

* Almost all of the small and medium-sized English-language firms are Canadian-controlled.

If one looks at four-year averages for large firms, the comparisons were as follows:

Large Canadian-controlled,	English	3.0%
Large Foreign-controlled,	English	9.8%
Large Canadian-controlled,	French	7.5%
Large Foreign-controlled,	French	16.6%

Clearly the pattern in both English and French-language publishing is that the financial position of foreign-controlled publishers continued to strengthen over this four year period relative to that of Canadian-controlled firms.

2.8.3 Grant Income

As Table 22 indicates, there was no major change in the extent of grant income received as a percentage of total revenue. However, it is useful to look at these percentages of grant income in order to understand the profit figures in Table 21. The only general trends suggested by the data are that for small French-language firms the percentage of revenue derived from grants increased, while for large French-language firms it declined.

2.8.4 Gross Profit Margin Ratio

Among large publishers, both English- and French-language Canadian-controlled firms had substantially lower gross profit margin ratios than their foreign-controlled counterparts in all four years (Table 23). For English-language Canadian-controlled firms the trend is slightly negative, declining from 0.48 in 1984-85 to 0.46 in 1987-88, as it was for English-language foreign-controlled firms, which declined from 0.58 in 1984-85 to 0.56 in 1987-88. Lange French-language foreign-controlled firms also declined slightly, from 0.66 in 1984-85 to 0.64 in 1987-88. Large French-language Canadian-controlled firms, on the other hand, showed an improvement over the four years, from 0.40 in 1984-85 to 0.44 in 1987-88, but their profit margin remained far lower than than that of foreign-controlled companies.

Medium-size English-language Canadian-controlled firms had a gross profit margin ratio equal to that of large English-language Canadian-controlled firms in 1987-88, 0.47, showing an improvement since 1984-85, when the ratio was 0.41. French-language medium-size Canadian-controlled firms had slightly lower gross profit margin ratios than their English-language counterparts in 1987-88, but the trend was positive over the four years, showing an improvement from 0.38 in 1984-85 to 0.41 in 1987-88.

Small English-language Canadian-controlled firms showed an increase in the gross profit margin ratio over four years, from 0.38 in 1984-85 to 0.44 in 1987-88. The ratio also improved over four years for small French-language Canadian-controlled firms, from 0.34 in 1984-85, to 0.41 in 1987-88.

TABLE 22

Grants as a Percentage of Revenues:
Canadian-Controlled Firms*, 1984-85 to 1987-88

	English-language Publishers		
	Small	Medium	Large
1984-85	28.5	17.7	1.2
1985-86	23.8	16.6	1.2
1986-87	23.7	15.4	1.1
1987-88	24.0	18.2	1.0

	French-language Publishers		
	Small	Medium	Large
1984-85	21.8	16.5	4.2
1985-86	26.6	16.4	3.9
1986-87	28.0	16.6	3.4
1987-88	31.3	16.0	2.9

SOURCE: Statistics Canada.

* Almost all of the small and medium-sized English-language firms are Canadian-controlled.

TABLE 23

Gross Profit Margin Ratio, * 1984-85 to 1987-88

	English-language Publishers			
	Canadian-controlled			Foreign-controlled
	Small	Medium	Selected Large	Large
1984-85	0.38	0.41	0.48	0.58
1985-86	0.34	0.47	0.47	0.58
1986-87	0.36	0.49	0.47	0.57
1987-88	0.44	0.47	0.46	0.56

	French-language Publishers			
	Canadian-controlled			Foreign-controlled
	Small	Medium	Large	Large
1984-85	0.34	0.38	0.40	0.66
1985-86	0.30	0.38	0.41	0.64
1986-87	0.34	0.39	0.45	0.63
1987-88	0.41	0.41	0.44	0.64

SOURCE: Statistics Canada.

* Gross Profit Margin Ratio =

$$\frac{\text{Net Book Sales - Cost of Books Sold}}{\text{Net Book Sales}}$$

2.8.5 Liquidity

Tests of liquidity, of course, measure a business's ability to meet its regular financial obligations and to handle any unanticipated costs or deterioration of revenue. Table 24 looks at liquidity for book publishers by examining the current ratio for average firms of each type -- that is, by looking at the ratio of current assets to current liabilities.

The most obvious conclusion that emerges from Table 24 is that the foreign-controlled publishing firms, in both the French and English-language components of the industry are in a far stronger position than their Canadian-controlled counterparts. The firms which are in the weakest position in terms of their liquidity are the large Canadian-controlled firms.

TABLE 24

Current Ratio, 1984-85 to 1987-88

	English-language Publishers			
	Canadian-controlled			Foreign-controlled
	Small	Medium	Selected Large	Large
1984-85	1.53	1.51	1.45	2.11
1985-86	1.50	1.65	1.10	2.07
1986-87	1.42	1.56	1.09	2.03
1987-88	1.23	1.45	1.24	1.83

	French-language Publishers			
	Canadian-controlled			Foreign-controlled
	Small	Medium	Large	Large
1984-85	2.62	1.73	1.51	1.30
1985-86	2.68	1.71	1.50	2.27
1986-87	2.45	1.82	1.34	2.15
1987-88	1.79	1.37	1.53	2.23

SOURCE: Statistics Canada.

* Current Ratio = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

Large English-language Canadian-controlled publishers showed a substantially lower current ratio (1.24) than large English-language foreign-controlled publishers (current ratio 1.83) in 1987-88. Large French-language Canadian-controlled firms were in a more liquid position than their English-language counterparts in 1987-88 (current ratio 1.53), but were in a less liquid position than large, French-language foreign-controlled firms (current ratio 2.23). For large French-language Canadian-controlled firms, the degree of liquidity in 1987-88 was approximately equivalent to the 1984-85 level.

Canadian-controlled English-language medium-size firms, with a current ratio of 1.45, were in a more liquid position in 1987-88 than their large size counterparts (current ratio 1.24), as well as their French-language counterparts (current ratio 1.37). Both French- and English-language Canadian-controlled firms in this size category showed a decline in liquidity between 1984-85 and 1987-88.

Small Canadian-controlled English-language publishers had an average current ratio of 1.23 in 1987-88, equivalent to that of large Canadian-controlled English publishers, but in a poorer position than any other category of publisher in that year. As well, small firms showed a declining trend, slipping from 1.53 in 1984-85 to 1.23 in 1987-88. Small French-language Canadian-controlled firms had a much higher current ratio in 1987-88 -- 1.79.

A more conservative measure of liquidity is provided by the quick ratio or "acid test" ratio. This ratio expresses the degree to which a company's current liabilities are covered by the most liquid current assets. In the case of book publishing, this essentially means excluding inventories from current assets, since inventories are not readily convertible into cash. Any value of less than one implies a dependency on inventories to liquidate long-term debt.

For large English-language foreign-controlled publishers, the quick ratio in each of the four years was over 1 -- fluctuating slightly and ending the period at 1.03 (see Table 25). By comparison, for large Canadian-controlled firms the quick ratio ranged from a high of 0.69 in 1984-85, to a low of 0.44 the following year. In 1987-88 the quick ratio for large Canadian-controlled publishers was 0.49.

In the French-language sector the quick ratio for foreign-controlled firms also indicates that their readily available assets cover a substantially higher proportion of current liabilities than is the case for large Canadian-controlled publishers: 0.91 in 1987-88 by comparison with 0.67.

The quick ratios for small and medium-sized firms in 1987-88 were also significantly lower than for foreign-controlled firms, in both the English-and French-language components of the Canadian book publishing industry.

TABLE 25

Quick Ratio, * 1984-85 to 1987-88

	English-language Publishers			
	Canadian-controlled			Foreign controlled
	Small	Medium	Selected Large	Large
1984-85	0.57	0.73	0.69	1.09
1985-86	0.56	0.70	0.44	1.12
1986-87	0.56	0.74	0.52	1.13
1987-88	0.46	0.71	0.49	1.03

	French-language Publishers			
	Canadian-controlled			Foreign-controlled
	Small	Medium	Large	Large
1984-85	1.05	0.70	0.68	0.66
1985-86	1.12	0.70	0.67	1.23
1986-87	0.95	0.74	0.57	0.93
1987-88	0.72	0.61	0.67	0.91

SOURCE: Statistics Canada.

* Quick Ratio = $\frac{\text{Current Assets - Inventory}}{\text{Current Liabilities}}$

2.8.6 Debt to Equity Ratios

An important measure of the financial position of any business is the extent to which it depends on debt and equity capital to finance its operations. While there is no normal ratio of debt to equity capital which is desirable for all companies in all circumstances and at all times, it is axiomatic that companies which rely primarily on equity capital are less vulnerable than those reliant mainly on debt financing. The general concerns that arise, to the extent that debt exceeds equity, is that there is an absolute annual amount which must be paid to service that debt, regardless of whether the firm is earning anything, and unless fixed-rate long-term loans are involved, increases in interest rates on such debt have the potential to precipitate financial difficulties.

As Table 26 shows clearly, Canadian-controlled firms are much more dependent on debt capital than their foreign-controlled counterparts. In the case of large foreign-controlled firms, for every dollar of debt English-language firms were using in 1987-88 they had a dollar of equity, while for French-language publishers only 75 cents of debt was being used for every dollar of equity. In marked contrast, large Canadian-controlled English-language publishing had $3.35 in debt for every dollar of equity, while for their French-language counterparts the balance was $1.63 of debt to every dollar of equity.

Small and medium-sized firms in both English and French-language publishing were also substantially more dependent on debt than equity capital.

With the profit performance documented in Table 21, Canadian-controlled firms are neither producing sufficient profits on their operations to generate an expanded equity base, nor are they likely to attract new equity investment. With the sharp rise in interest rates that has occurred in 1989 and 1990 the dependence of Canadian-controlled firms on debt financing can be expected to create greatly increased financial pressure. The Canadian-controlled sector of the industry is also in a very vulnerable position to absorb any decline in revenues which may result when the federal Goods and Services Tax comes into effect in 1991.

TABLE 26

Debt to Equity Ratios, 1984-85 to 1987-88

	English-language Publishers			
	Canadian-controlled			Foreign-controlled
	Small	Medium	Large	Large
1984-85	2.70	3.55	2.45	0.85
1985-86	3.17	2.23	4.26	0.92
1986-87	3.00	3.17	3.55	0.85
1987-88	4.56	2.33	3.35	1.00

	French-language Publishers			
	Canadian-controlled			Foreign-controlled
	Small	Medium	Large	Large
1984-85	1.04	1.70	1.86	3.00
1985-86	0.96	1.70	1.70	-3.56
1986-87	1.00	1.50	2.13	0.64
1987-88	1.56	2.33	1.63	0.75

SOURCE: Debt ratios provided by Statistics Canada. Transformation to Debt-to-Equity ratios done by Paul Audley & Associates Ltd.

3.0 CANADIAN PUBLISHING IN THE 1990'S

A number of factors will significantly affect the book publishing industry in Canada over the next decade, including changes in public policy which will have a substantial impact on the industry. These shifts in the environment include the following:

3.1 Elimination of Subsidized Postal Rates for Books

The target date of April, 1991 has been set to move from the current policy of a subsidized mailing rte for books to a more selective replacement program to assist in the cost of physical distribution of books within Canada.

This policy change represents a sharp reduction in the extent of government expenditures to support book distribution. The extent of the reduction is estimated as follows:

	$million	% change
1989-90	60	
1990-91	31	-48.3%
1991-92	25	-19.4%

Without question the cost of mailing books will have to rise sharply by April, 1991 to meet these targets. Precise information concerning the costs and use of the Book Mail Program are not available. However, a December, 1989 Profile of Users of the Book Mail Program estimated that on an annual basis users of the existing program paid postage of $32.1 million in 1988-89. This expenditure reflected 31 million individual shipments, including 66 million books. Clearly if this program is to be eliminated postal rates for books will have to at least triple.

In anticipating the impact of the proposed change in postal rates, it is essential, of course, to know who the users of the subsidized rate have been. The Woods Gordon analysis provides the following estimates:

User Category	Millions of Books Mailed
Book Clubs	21.0
Book Publishers	15.0
Other	5.2
Book Distributors	4.2
Book Retailers	1.0

The book publisher category is dominated by companies involved in direct mail publishing and encyclopedia publishing, and would include firms such as Grolier, Reader's Digest, Time-Life Books and Encyclopedia Britannica. The postal rate subsidy has been primarily of value to direct mail publishers and book clubs and to other suppliers mailing relatively small shipments (two books on average) to individuals rather than to institutions or to retail outlets. Most such companies are foreign-controlled and a very substantial majority -- probably in excess of 90 per cent -- of the books being shipped are imported titles by foreign authors, supplied directly from U.S. sources, rather than Canadian publisher/agents. A significant number of the major users of Book Mail rates are companies which do not maintain integrated distribution operations in Canada -- in some cases carrying out all of their warehousing and order fulfillment functions in the United States and simply sending bulk shipments to Canada for mailing through Canada Post.

Just under ten per cent of the use of the Book Mail Program was estimated by Woods Gordon to be accounted for by organizations whose main business was other than book publishing, retailing, or wholesale distribution, with over half of that volume accounted for by firms whose main source of revenue is magazine publishing.

Most bulk shipments of books are made using other services than that of Canada Post. Book publishers in English-language publishing are involved in a co-operative freight consolidation program to try to control their shipping costs.

Effective March 1, 1990, major rate increases were implemented by Canada Post to achieve the cost reductions required in 1990-91. The increases create a rate structure which gives lower rates to smaller users. For larger users Canada Post rates have now risen to approximately the same level which book mailers pay in the United States. <u>Chart A</u> provides an indication of the levels of Book Mail rates charged by Canada Post as of March 1, 1990; while <u>Chart B</u> provides U.S. rates indicating both what U.S. publishers pay to mail to customers in the United States, and what they would pay to mail through the U.S. Postal Service to Canadian customers. Discounts are provided to the extent that mailers pre-sort the shipments they deposit with either Canada Post or the U.S. Postal Service. Canada Post rates will have to rise substantially farther to achieve cost recovery.

The transition from a structure of low rates available to any book publisher, exclusive agent, wholesaler, or retailer (including book clubs, direct mail publishers and bookstores) to a freight subsidy targeted to Canadian-owned and controlled publishers will significantly change the environment within which the book industry functions. Despite sharp reductions in the level of funding available, a targeted replacement program has the potential to offer greater benefits to Canadian-controlled firms, including publishers, wholesalers and book clubs, and indirectly libraries and retail bookstores as well, and to enhance the distribution of Canadian-authored books. In broad terms, issues related to the design and impact of the distribution assistance program are looked at below in examining policy alternatives.

CHART A

Canadian Book Mail Rates

Annual Volume	1 - 5,000	5,001-50,000	50,001 - 250,000	250,000 +
Package Size (g)				
0 - 500	57.8¢	68.4¢	82.4¢	$1.00
501 - 750	73.5¢	87.0¢	$1.05	1.27
751 - 1000	89.2	$1.06	1.28	1.54
1001 - 1250	$1.05	1.24	1.51	1.82
1251 - 1500	1.21	1.43	1.74	2.09
1501 - 1750	1.36	1.61	1.97	2.36
2001 - 2250	1.52	1.80	2.20	2.63
2251 - 2500	1.68	1.99	2.43	2.90
2251 - 2750	1.83	2.17	2.66	3.18
2751 - 3000	1.99	2.36	2.89	3.45
3001 - 3250	2.15	2.54	3.11	3.72
3251 - 3500	2.31	2.73	3.34	3.99
3501 - 3750	2.46	2.92	3.57	4.26
4001 - 4250	2.62	3.10	3.80	4.53
4251 - 4500	2.78	3.29	4.03	4.81
4501 - 4750	2.93	3.47	4.26	5.08
4751 - 5000	3.09	3.66	4.49	5.35
5001 - 5250	3.25	3.85	4.72	5.62
5251 - 5500	3.40	4.03	4.95	5.89
5501 - 5750	3.56	4.22	5.18	6.17
5751 - 6000	3.72	4.40	5.41	6.44
6001 - 6250	3.88	4.59	5.64	6.71
6251 - 6500	4.03	4.78	5.86	6.98
6501 - 6750	4.19	4.97	6.09	7.25

SOURCE: Canada Post Corporation

CHART B

U.S. Book Rate

		Within U.S.		U.S. to Canada	
Weight not over	Equivalent * (g)	$U.S.	$Cdn.*	$U.S. +	$Cdn.
1 lb.	0 - 450	0.90	1.07	1.34	1.59
2 lbs.	451 - 900	1.25	1.48	2.30	2.72
3 lbs.	901 - 1,350	1.60	1.89	3.20	3.79
4 lbs.	1,351 - 1,800	1.95	2.31	4.10	4.86
5 lbs.	1,801 - 2,250	2.30	2.72	5.00	5.92
6 lbs.	2,251 - 2,700	2.65	3.14	5.90	6.99
7 lbs.	2,701 - 3,150	3.00	3.55	6.80	8.05
8 lbs.	3,151 - 3,600	3.20	3.79	7.70	9.12
9 lbs.	3,601 - 4,050	3.40	4.03	8.60	10.18
10 lbs.	4,051 - 4,500	3.60	4.26	9.50	11.25
11 lbs.	4,501 - 4,950	3.80	4.50	10.40	12.32
12 lbs.	4,951 - 5,400	4.00	4.74		
13 lbs.	5,401 - 5,850	4.20	4.97		
14 lbs.	5,851 - 6,300	4.40	5.21		
15 lbs.	6,301 - 6,750	4.60	5.45		
16 lbs.	6,751 - 7,200	4.80	5.68		
Using M bag surface rate for U.S. to Canada •					
15 lbs.- 16 lbs.	6,750 - 7,200			10.80	12.79

SOURCE: United States Postal Service.

* Assumptions: 1 lb. = 0.45 kg; $1.00 U.S. = $1.1842 Cdn.

\+ Surface rates

• M Bag surface rate applies to mailings from the U.S. to Canada of 15 lbs. to 66 lbs. The rate is 72¢ U.S./lb. (85¢ Cdn./lb.)

3.2 The Goods and Services Tax

Table 27 provides an order of magnitude estimate of total consumer expenditures on books in 1987-88. If one assumes that book sales between 1987-88 and 1991 will grow at the same rate as they did during the period 1984-85 to 1987-88, i.e., an average of 12.3 per cent per year, then consumer expenditures on books would be about $3.1 billion and the amount of the GST collected would be $216 million. Based on the more cautious assumption that consumer expenditures will rise by just five per cent from 1987-88 to 1991, consumer expenditures on books would be $2.4 billion and GST of $165 million would be collected. A reasonable estimate would be that GST payments will be between $175 million and $200 million in 1991.

For publishers, distributors, and retailers of books, the question is what the impact of the GST will be on consumer purchases. To the extent that the demand for books declines, the book industry will be affected. It is too early to guess whether provincial governments will choose to add a provincial tax to the GST, but to the extent that they do, the potential for a decline in demand will increase.

There can, of course, be no conclusive proof in advance of the extent to which the book industry will be able to pass on to consumers a seven per cent increase in the price of books. However, in the case of libraries and other publicly-funded institutions, it seems very unlikely they will receive any special budget increases to offset the GST. In the case of individual purchases, the studies which have been done suggest that price sensitivity may be relatively high, with book sales declining significantly in response to price increases.

A 1987 Woods Gordon study which examined the impact of the tax noted that it would "move directly to counter the various measures which governments have put in place to foster a domestic industry producing culturally important work." Woods Gordon concluded that Canadian book publishers have little ability to pass such a tax on to their suppliers or buyers and less capacity to absorb it because of low profitability and small reserves. [6]

What is beyond dispute is that the tax will not have the same impact on imported books that it will have on Canadian books. A tax on imported books will not put the publishers of those books out of business, nor will it result in any of those titles failing to be published. Agents handling these titles may sell fewer copies, but the result for these agents, mainly the subsidiaries of foreign publishers, will certainly not be seriously damaging. Since imported titles are produced as run-on copies of print runs done mainly for the larger U.S., U.K., or French markets, their unit costs and selling price are lower than for Canadian titles, and there is more scope to increase selling prices without encountering resistance.

---

[6] Woods Gordon, Impact of a Multi-stage Sales Tax on Book Publishers, Booksellers and Periodical Publishers, September, 1987, pages iii and v.

TABLE 27

Estimate of Consumer Expenditure on Books in Canada
1987 - 1988

	Total Sales $000's	% of Sales Related to Books	Sales Related to Books $000's
Retail Chains, Book & Stationery Stores	418,595 (1)	80% *	334,876 *
Department Stores, Books, Stationery & Magazines	405,338 (1)	80% *	324,270 *
Campus Bookstores	336,223 (2)	68.8%	231,321
Direct Sales, Books & Encyclopedias	262,714 (3)	100%	262,714
Mass Paperback Sales (newsstand only)	n/a	n/a	50,000 (4)
Through Wholesalers	115,424 at wholesale	estimated mark-up by wholesalers averages 20%	138,510 (5)
Publishers/Agents Sales to Institutions	249,660 (5)		249,660
Estimate of Direct Imports, not included above	n/a	n/a	345,000 (6)
ESTIMATED TOTAL BOOK CONSUMPTION	n/a	n/a	**1,936,351**

SOURCES:

1 Statistics Canada, "Retail Chain and Dept. Stores," 1988-89, Cat. 63-210.
2 Statistics Canada, "Campus Bookstores," 1988-89, Cat. 63-219. Data for campus bookstores reflect the academic year.
3 Statistics Canada, "Direct Selling in Canada," 1987, Cat. 63-218.
4 Estimate of mass market titles by the Periodical Marketers of Canada.
5 Statistics Canada, "Survey of Book Publishers and Exclusive Agents in Canada," 1987-88, Cat. 87-210.
6 The Department of Communications estimates direct imports at $517 million in 1987-88. A cautious estimate would be that two-thirds of this amount is not included in the above figures, since most direct importing is by individuals and institutions.

* Estimate

For Canadian titles the situation is very different. It has always been difficult to price Canadian books at a level that reflects adequately the costs and risks involved, because price expectations are set by imported titles. For Canadian titles, both in French and English, substantial programs of public assistance have been established to ensure that in the smaller Canadian market a range of books can be produced that is more comparable to the variety that can be published in larger markets. It is worth noting that the level of support being provided through the Canada Council's program of block assistance to publishers is not even rising to keep pace with inflation, and no increase is at present planned which might help to offset the impact of the GST. The levels of funding through the Canada Council block grant program in current dollars are as follows:

1988-89	1989-90	1990-91
$7.3 million	$7.25 million	$7.25 million

In constant dollars the decline in such assistance between 1988-89 and 1990-91 is an estimated 10.2 per cent.

As indicated earlier in this report, Canadian-controlled publishers are far more dependent on the sale of their own titles than foreign-controlled publishers, and are already in a position in which their profits are marginal or non-existent. Carrying a heavy debt load, the Canadian-controlled sector of the industry is already experiencing serious financial strain, which has been added to by uncertainty concerning future federal policies affecting the industry.

3.3 Trends in Publishing Outside Canada

The period 1985 to 1990 was one which saw an unprecedented level of mergers and acquisitions in publishing in the United States and in Europe. In an industry which had been characterized traditionally by a high level of ownership diversity, levels of concentration began to increase to close to those which exist in the film and sound recording industries. By the end of the 1980's, for example, Paramount Communications' book sales in the United States through Simon & Schuster, Prentice-Hall and its many other book operations accounted for nearly ten per cent of the total U.S. market. Huge advances on royalties were being paid in an effort to tie up the most successful authors, with the size of those advances, in at least a couple of cases, topping $30 million in the United States.

In the United States, one of the most remarkable changes was that substantial concern began to be expressed about foreign investment in the industry. With levels of foreign ownership still less than 20 per cent of the industry, the industry magazine, Publishers' Weekly, in a review of the 1980's noted that:

One of the . . . more extraordinary aspects of the decade was the expansion of foreign-based ownership of American publishing. [7]

Among the major firms expanding during the 1980's (with key firms they own in parentheses) were Bertelsmann (Bantam, Doubleday Publishing, Doubleday Book Clubs, Dell), Pearson (Penguin, Viking, New American Library, Dutton, Addison-Wesley), Hachette (Grolier), Robert Maxwell (SRA, Macmillan U.S., Scribner's, Atheneum), Harcourt Brace Jovanovich (Holt, Rinehart & Winston, W.B. Saunders), Rupert Murdoch (Collins, Harper, Scott Foresman), Paramount (Prentice-Hall, Simon & Schuster, Ginn, GLC, Globe Modern), Newhouse (Random House, Ballantine, Fawcett, Times Books, Fodor's, Schocken, Crown), Time Warner (Little Brown, Warner Books, Time-Life Books, Book of the Month).

The premise of all these transactions was that the new owners could achieve a much more consistent and much higher level of profit. The strategy for doing so was to focus resources increasingly on a relatively limited number of internationally best-selling commercial titles. As in Hollywood, commercial television, or the record industry, they felt that sequels or look-alikes, new titles from proven authors, and a concentration on promotion and publicity resources might transform book publishing into the predictably profitable business it had never been. Commenting on the results of this trend, the Publishers' Weekly article referred to above observed that:

> Printings were lavishly increased sometimes to the point of absurdity (they had to be to justify huge advances); as always too many titles were created for a market that was no longer expanding; and 1989, with its heavy returns and flat sales, seemed to be the year when some of these follies were coming back to haunt their creators. [8]

In 1989 Paramount announced a write-off of $140 million, as it adopted "more conservative accounting practices", which included increasing its reserves against unearned royalty advances. Similar write-downs related to educational publishing were also announced by Harcourt Brace Jovanovich and Houghton Mifflin, both important U.S. textbook publishers.

The outside acquisitions which characterized publishing in the 1930's in the United States are not unprecedented. In the 1960's a number of major firms -- including Xerox, Raytheon, RCA, CBS and Lytton Industries -- all bought into publishing on the premise that they could bring to bear on the industry greater managerial expertise and, in some cases, achieve significant advantages by combining their expertise in software, video production, etc. with the publishers' knowledge of their markets. All but one of these firms have now sold off their book publishing subsidiaries.

---

[7] John F. Baker, "Looking Back on the 80's", Publishers Weekly, January 5, 1990, page 20.

[8] Ibid., page 20.

Part of the current process in some cases has involved a consolidation of the operations of the acquired companies with existing business. The premise of this physical consolidation of operations is that there are cost advantages to be gained.

The current mood of skepticism about the book publishing giants was expressed most forcefully in an April 7, 1990 article in The Economist, under the title "Book Publishing: The diseconomies of scale". The article begins by observing that "from a business standpoint, making and selling books is an annoyingly quaint and fiddly industry." [9] In the case of trade books the article observes that high advances and the use by trade authors of literary agents have created a changing environment which "makes publishing look deceptively like just another entertainment business. Like films and records it has high fixed costs . . . It relies heavily on a few hits to pay for all the misses . . . And, as in Hollywood, nobody knows what will hit and what will miss." [10]

In these circumstances the premise of the conglomerates is that there are advantages in being big and that "only a diversified global publisher can grab all the various hardback and paperback profits from its best sellers around the world." [11] The Economist goes onto comment as follows:

> That is the theory. Making it work in an industry as fiddly as book publishing was always going to be difficult. In the event, by over-spending and overproducing, the new conglomerate publishers have dug themselves into a hole.
>
> Their trouble is that books are not, after all, films or records. Technology and deregulation have given companies in those industries new hardware to sell (videos and the compact disc) and new markets (VCR's and satellite television). But book publishers have only two products, the hardback and the paperback, and associated rights. [12]

As The Economist notes there are also substantial pressures on publishers' margins. While discounts to retailers a decade ago were 40 per cent, the powerful American chains now demand 50 per cent, while W.H. Smith in Britain gets 48 per cent. Marketing costs have risen from negligible levels to 5-10 per cent and authors' royalties have increased from 10 per cent to 15 per cent. The average level of returns of trade books has increased sharply, in an industry in which retailers usually purchase books on a fully returnable basis. Rising interest rates add to the pressure.

---

[9] "Book Publishing: The diseconomies of scale", The Economist, April 7, 1990, page 25.

[10] Ibid., page 25.

[11] Ibid., page 26.

[12] Ibid., page 26.

There is no easy conclusion to be reached about the way events will unfold in the United States or Britain. However, the pressure to trim costs will be substantial as the debt-burdened conglomerates struggle to digest their purchases and to establish a viable pattern for future growth. At least one publisher, Harcourt Brace Jovanovich has acknowledged that it is negotiating to divest control of some of its operations.

Because Canada's publishing industry and market are so dependent on imported books, with 80 per cent of imports coming from the United States, the mergers and takeovers which occurred in the United States had a substantial impact on the Canadian publishing industry. In cases in which the company being taken over had a subsidiary in Canada the transaction was subject to review under the Investment Canada Act. In cases where the company acquired had an exclusive agent in Canada such takeovers created the potential for loss of an important part of the revenue of Canadian-controlled firms, if the agency business could be shifted to a subsidiary firm the acquiring company already owned in Canada.

While the impact of these ownership changes had the potential to substantially erode the revenues of Canadian-controlled publishers and to lead to an unprecedented level of both ownership concentration and control by non-Canadians, the Investment Canada review process and the perception that the federal, Ontario and Quebec Governments were unlikely to accept such results have constrained that process. As a result, during an extremely volatile period, ownership concentration has proceeded far less quickly than would otherwise have been the case, and a much more substantial portion of the industry -- albeit still a minority -- has remained Canadian-controlled. The major Canadian-controlled companies have, as a result, been able to continue to publish very substantial lists of new Canadian titles each year.

It is useful to look at the current arrangements in Canada for the largest of the new conglomerates, Paramount. Paramount's holdings in book publishing include the following companies or operating divisions:

Simon & Schuster (trade)
Pocket Books (mass market)
Prentice-Hall (college, el-hi and trade)
Ginn and GLC (el-hi)
Globe/Modern Curriculum Press (el-hi)

In Canada Prentice-Hall functions as a wholly-owned subsidiary of Paramount (estimated annual revenues $50-55 million). Simon & Schuster trade continues to sell into Canada through the Canadian-controlled company, General Publishing, representing about 30 per cent of that company's $25 million in annual sales, while Pocket Books are sold through the Canadian-controlled company, PaperJacks. Finally, Ginn and GLC, with annual revenues of $9.5 - 10 million in 1989 now are operating separately in Canada, with the Government of Canada owning 51 per cent of the voting shares. In combination, the Paramount companies have total revenues of over $80 million, which if combined into one company would make Paramount, by a wide margin, the largest publisher in Canada.

In a number of cases the changes outside Canada over the past five years resulted in a loss of business for Canadian publishers as foreign companies were purchased by companies which already had a subsidiary here and they shifted the agency business to their own subsidiary. Canadian-controlled publishers would lose a very substantial volume of business if the major foreign conglomerates were permitted to consolidate their holdings in Canada. The process of erosion of agency business from some Canadian-controlled firms has been more than balanced by the shift of other firms, including Doubleday, Holt, Rinehart and Winston, and Addison Wesley to at least de jure, if not de facto Canadian ownership.

Almost all of the major Canadian-controlled companies depend on agency publishing for a substantial share of their revenue and this revenue will remain vulnerable. To the extent, however, that companies which were foreign-controlled come to be Canadian-controlled -- whether through management buy-outs or takeover by existing book publishers or other Canadian companies, the likely erosion of the agency revenues of existing Canadian-controlled firms will be offset.

4.0 REVIEW OF EXISTING STRUCTURAL INITIATIVES

Significant policy initiatives have been taken at the federal and provincial level to address concerns related to book publishing in Canada. Before looking at possible new initiatives or revisions to existing measures, it may be useful to summarize the principal policy initiatives taken in the past, to review the rationale for those measures and to look briefly at their impact.

4.1 Quebec Government Policy

In 1971, the Government of Quebec initiated a new "politique du livre", acting in response to what came to be called the "Hachette affair" in 1969-70. Responding to the strong move by the powerful French company into the Quebec book industry, the Government of Quebec introduced legislation which, with additions and relatively minor amendments has continued in its essentials to the present time. The Quebec legislation requires that all government departments or organizations, municipal and regional governments and their agencies, and including school boards, high schools, private schools and public libraries, purchase books only from retail bookstores accredited under the Act. An exception is made for basic textbooks purchased by elementary and secondary schools. Any financial assistance granted to publishers, distributors or retail booksellers may also be provided only to accredited entities. To be accredited publishers, distributors, and booksellers must be either:

- a Canadian citizen domiciled in Quebec,

- a corporation in which all the shares are the property of persons who are Canadian citizens domiciled in Quebec, as well as all directors and executive officers, or

- if its shares are listed on a Canadian stock exchange, its principal establishment is situated in Quebec, with the centre of decision making and management there (excluding any corporation which is controlled either in fact or in law by one or more persons not domiciled in Quebec or by a corporation or corporations situated outside Quebec, or

- if the corporation has no capital stock, if all its members are Canadian citizens resident in Quebec.

Apart from its impact on cultural sovereignty, that is on ensuring that Canadians resident in Quebec control decision-making in the book industry, the legislation has the important function of directing most government purchasing through bookstores, and as a result expanding the system of bookstores in Quebec. A 1986 Peat Marwick study which examined this aspect of the impact of the Quebec law concluded that:

> Quebec bookstores tend to be larger physically, have substantially larger sales volumes, and carry an average of almost twice as many titles as their counterparts in the rest of Canada . . . Under the accreditation system, Quebec bookstores also carry, on average, significantly more **Canadian-published** titles in stock than bookstores in the rest of Canada . . .[13]

In return for accreditation, Quebec book-sellers are required to meet a series of regulatory requirements which include carrying a designated quantity of Canadian books, having available basic professional reference materials and conforming to a system of maximum mark-ups of price. No other province has taken comparable action to strengthen its retail system and indirectly expand access to and sales of Canadian-authored books, although the potential benefits of such a policy were recognized in the 1973 Report of the Ontario Royal Commission on Book Publishing.

The cultural importance of retail bookstores, and of independently owned stores particularly, was recognized in the 1987 Department of Communications publication, Vital Links:

---

[13] Peat Marwick and Partners, "Program Options and Policy Implications for Supporting Manitoba Independent Booksellers, Final Report", a study for the Province of Manitoba, Manitoba Culture, Heritage and Recreation, June, 1986, page V.5.

Retail chains and the shopping-mall environment add to the effect of risk reduction strategies. Powerful instruments in the marketing of books . . . chainstores, which emphasize high-volume purchasing and quick turn-over of inventory, favour the promotion of bestsellers at the expense of breadth and depth of selection. Inventories shrink. Canadian products become marginalized, because they are comparatively under-promoted. [14]

In response to the potential narrowing of choice and the commercial homogeneity which is driven by retail chain dominance, nine of the 12 Common Market countries have some form of price maintenance for books. As a recent article in Publishers' Weekly noted, these countries "believe it to be an essential precondition for the survival of a countrywide network of well-stocked bookstores." [15]

In Britain the Restrictive Practices Court last examined Britain's Net Book Agreement, through which price maintenance is provided for, in 1962 and upheld it as being in the public interest. The 1962 Court decision was that abolition of the Net Book Agreement would lead to "fewer bookshops, narrower inventories and higher prices." [16] After studying the issue in 1989, Britain's Office of Fair Trading decided in August, 1989 that there was not sufficient reason to ask the Restrictive Practices Court to reconsider its 1962 decision. The great majority of British publishers and booksellers are strongly in favour of the Agreement.

In Canada it would only be through some variant of a net book agreement that the federal government could achieve objectives parallel to those Quebec has advanced through its own book legislation. Such an initiative would require very careful planning, since it would need to take account of the specific structure and operating practices of the industry outside Quebec. It is beyond the scope of this report to develop a possible approach which might be considered, but the benefits in developing a strong, diversified Canadian book publishing industry could certainly be substantial.

It must be noted that the Quebec legislation does not completely preclude foreign-controlled publishers and distributors from operating in Quebec. What Quebec has done is to use its buying power and granting programs to benefit directly only Canadian-controlled companies. However, textbooks are exempt and foreign-controlled publishers or distributors can sell to accredited bookstores, which in turn sell to Government institutions, or they can sell directly to individuals. As Table 9 indicates, in 1987-88 foreign-controlled publisher/agents had revenues of $68 million from the sale of French-language books, out of a total of $232 million. Where the Quebec law does not apply, its policy objective is complemented by the Investment Canada review process.

---

[14] Department of Communications, Vital Links: Canada's Cultural Industries, Minister of Supply and Services, Canada, April, 1987, page 17.

[15] "British Government Decides Not to Review Net Book Agreement," Publishers Weekly, August 18, 1989, page 11.

[16] Ibid.

4.2 Ontario Government Policy

Successive takeovers by American publishers of Gage Educational Publishing and Ryerson Press, two of the largest and oldest publishing companies under Canadian control, and the threatened sale to non-Canadians of McClelland & Stewart, the leading publisher of Canadian-authored trade books, led to the creation of a Royal Commission in Ontario to examine "the economic, cultural, social or other consequences for the people of Ontario of the substantial ownership or control of publishing firms by foreign or foreign-owned or foreign-controlled corporations or by non-Canadians".[17] Subsequently the mandate of the three member Commission (chaired by Richard Rohmer, with Dalton Camp and publisher Marsh Jeanneret as members) was expanded to require that they "inquire into the merchandising of paperback books, periodicals, and other merchandise normally carried by geographical wholesalers and sold by their retailers."[18]

In an interim report issued in June, 1981 the Royal Commission recommended "restrictions on the sale to non-residents of Canada of firms or corporations whose principal business in Ontario is the distribution or wholesaling of periodical publications,"[19] noting that "the distribution of mass market paperback books is commonly associated with operations of this sort," and that "mass market paperbacks . . . tend in their selection to be no more representative of original Canadian authorship and publishing than are the magazines and other periodicals with which they travel."[20]

In response to this recommendation the Paperback and Periodical Distributors' Act was passed in 1971. The Act, which is still in place with only minor revisions, requires that any person engaged in either selling or distributing paperbacks or periodicals, except as a retailer, be registered under the Act. All non-resident corporations, i.e., corporations "formed, incorporated, or otherwise organized elsewhere than in Canada", and all non-residents are precluded by law from selling or distributing paperback books or periodicals in Ontario.

The basic criteria for registration of distributors of paperbacks in Ontario are that:

- if a corporation, they are incorporated in Canada and Canadian residents own 75% of the issued shares and no single non-resident owns more than 10% of the issued shares.

---

17 Ontario Order-in-Council, 3991/70, December 23, 1970.

18 Ontario Order-in-Council, 3534/71, November 18, 1971.

19 Canadian Publishers & Canadian Publishing, Report of the Royal Commission on Book Publishing, Queen's Printer for Ontario, page 291.

20 Ibid., page 291.

- if an individual they are resident in Canada, or if a partnership or association all members are residents.

The intent of the law was to require control by Canadians and, in introducing the bill for first reading on June 14, 1971 the Honourable Arthur Wishart stated that:

> the purpose of the bill is to impose requirements for Canadian ownership and control of businesses engaged in wholesaling and distribution of paperbacks and periodicals.

The requirement of Canadian ownership and control was not, however, given retroactive application. Distribution businesses owned or controlled by non-residents were permitted to register and to carry on business until such time as there was a transfer of control to another person. At that time compliance with the Canadian ownership and control provisions is required.

Registration is automatic for companies which comply. The Registrar has the authority to revoke the registrations of companies which do not conform to the law or the regulations. Failure to give notice of a change in ownership and control is sufficient for revocation of a registration, since the regulations require notification in writing of such changes within five days of the event.

The Royal Commission noted in its Final Report on the Distribution of Paperbacks and Periodicals in Ontario that the concerns expressed in its interim report nine months earlier had been reinforced by its extensive public hearings and research, noting that passage of the Act had "effectively prevented the further erosion of Canadian ownership."[21]

In its final report, the Commission raised further concerns about the implications of continental book distribution structures, expressing the view that it should be discomforting to Canadians:

> that geographical wholesalers of periodicals in Ontario are completely dominated by the national distributors who supply them, and that with few exceptions these national distributors are located outside Canada.[22]

While the Act as passed in 1971 did not apply to the retail component of the industry, in its final report the Commission recommended that its application be extended to cover retail news dealers and retail booksellers, and to preclude the ownership of retail outlets by any wholesaler. The Commission concluded that "If there are cogent reasons why only Canadians should be

---

21 Ibid., page 303.

22 Ibid., page 307.

allowed to acquire regional wholesalerships in the future, there are even stronger reasons why new ownership and control of retail outlets by non-residents should no longer be permitted."[23] In presenting this recommendation the report stated that:

> The testimony heard by the Commission has amply demonstrated the degree to which foreign control of the wholesale channels of distribution of paperbacks and periodicals invites monopolistic practices that show little regard for the private or public interests of the people of this province.
>
> From the standpoint of Canadian cultural needs, a somewhat more serious situation would arise if retail outlets whose principal business is the display and sale of publications should also largely pass into foreign control. There would be little merit in ensuring that geographical wholesalers stocked Canadian periodicals and paperbacks, for example, if the retail selecting of reading materials ceased to be done by Canadian owners. The situation could also be serious for publishers of original Canadian books in other than paperback editions. If, for example, new chains of foreign-owned bookshops were to spring up in shopping centres and elsewhere in this province, it is possible and reasonable that their inventories might be largely selected, and largely acquired, outside this country.[24]

These changes were not made to the Act, to a substantial degree because at the time the final report was presented to the Ontario Government, the Federal Government was proceeding with the Foreign Investment Review Act, which for the first time provided the Government of Canada with a policy instrument which could maintain Canadian ownership and control in the book industry. The way in which federal legislation regarding foreign investment has been used is examined below.

The Ontario Royal Commission's recommendations regarding the distribution of books and periodicals in Ontario were consistent with its analysis and advice concerning the book publishing industry. In its very earliest interim report in March, 1971 the Royal Commission noted that it was "prepared to . . . recommend legislation designed to prevent, among other things, the sale to foreign interests of any Canadian book publishing company operating in Ontario . . . during the course of the Commission's deliberations and before its final report."[25] The same sense of urgency was reflected both in the Commission's August, 1971 recommendation of a program of loan guarantees and interest subsidies to Canadian-owned an controlled book publishers, and in the Ontario Government's prompt implementation of that program in November of that year.

---

23 Ibid., page 317.

24 Ibid., page 318.

25 Ibid., page 289.

In the same report the Commission recommended that the Ontario Government make an announcement that further sales of Canadian publishing firms to non-residents would be considered contrary to the public interest. The Commission at that stage left to its final report the question of whether ownership legislation was necessary, but noted that a policy statement alone might be effective since "After all, most book buying in Ontario, whether for schools or libraries, is in the end paid for chiefly by public funds."[26] The same recognition of the potential importance of provincial purchasing policies had, of course, already led to legislation in Quebec.

The Commission did in fact opt for provincial legislation in its final report, recommending the establishing of an Ontario Book Publishing Board to implement the Commission's recommendations that:

> The opening of additional Ontario-based book publishing enterprises owned or controlled by non-residents (as defined in The Paperback and Periodical Distributors' Act, 1971) should no longer be permitted without prior approval obtained from and through the Board . . .
>
> We reiterate the proposal contained in our Third Interim Report that the sale of book publishing firms or branches in Ontario should not in the future be permitted to non-residents (as defined in The Paperback and Periodical Distributors' Act, 1971), without prior approval of the Ontario Book Publishing Board. Should implementation of this recommendation encounter constitutional difficulties, careful attention ought to be given to the feasibility of exercising control over such transfers by restricting the use of provincial funds to purchase from such suppliers.[27]

Like the Royal Commission's recommended extension of the Paperback and Periodical Distributors' Act to the retail sector, the recommended public agency was not established, to a substantial degree because of the passage of the Foreign Investment Review Act soon after the Commission's Report was submitted. However, the concerns evident in the work of the Commission in the early 1970's have continued to be expressed in Ontario.

In April of 1983 the then Minister of Citizenship and Culture, the Honourable Bruce McCaffrey, established a Special Committee for the Arts under the chairmanship of Robert W. Macaulay. As part of the first comprehensive review ever undertaken of the cultural policy in Ontario, the Macaulay Committee examined Ontario's policy related to book publishing. In dealing with the industry in its Report of April, 1984, the Macaulay Committee noted that:

---

[26] Ibid., page 300.

[27] Ibid., pages 259 and 260.

> As with other cultural industries, book publishing in Canada requires government support to overcome numerous challenges: the small domestic market, the formidable competition provided by both foreign books and foreign-controlled publishers operating in Canada, short print-runs and high manufacturing costs, poor distribution systems, poor access to subsidiary markets such as mass market paperbacks and film and television and chronic undercapitalization.[28]

The Committee praised Ontario's existing policies and, with some proposed fine tuning, endorsed their continuation, with support provided only to Canadian-owned companies. However, their report recommended that Ontario go substantially further, and specifically in the area of textbook publishing.

Referring to the 1973 Report of Ontario's Royal Commission, the Macaulay Committee noted its recommendation that "the criteria for books selected for inclusion in Circular 14 (Ontario's list of textbooks approved for use in elementary and secondary schools) be expanded to include the words 'published by Canadian-owned companies.' "[29] The Macaulay Committee recommended that Ontario adopt this recommendation, implementing the change over a five to ten year period, just as Ontario had done when in the 1950's the province began to require that approved texts be by Canadian authors. The Macaulay Report also recommended a re-examination of the paperback and periodical distribution system in Ontario, referring to the amendments to the Paperback and Periodical Distributors' Act recommended by the Royal Commission a decade earlier.

Soon after the 1984 Report of the Macaulay Committee was tabled there was a change of government, with a Liberal government elected. While the new government did not act on the recommended change in Circular 14 policy, it did express strong support for the Baie Comeau policy when it was announced by the federal government in July, 1985, reflecting the largely non-partisan character of policy-making in the cultural sector.

Ontario also proceeded with a review of the Paperback and Periodical Distributors' Act, both in response to the Macaulay Committee recommendation and the discovery of the need for at least technical changes to the Act to improve its effectiveness. While no policy decisions on the Act have been announced, the review of the Act included an examination of opinions in the industry itself on issues related to the legislation.

Interviews conducted for that Ontario study in 1988 and early 1989 included the major companies involved in the industry, as identified by the industry associations. The views expressed by the respondents included the following:

---

[28] Special Committee for the Arts, Report to the Honourable Susan Fish, The Minister of Citizenship and Culture, Spring, 1984, page 13/7.

[29] Ibid., page 13/12.

- 79 per cent believed that foreign control of the industry would have increased without legislation initiatives at the provincial and federal level (FIRA/ICA) (the remainder had no opinion).

- 72 per cent expressed the view that there was a link between Canadian ownership and control and making Canadian books and magazines available to the public (seven per cent disagreed, the remainder had no opinion).

- 97 per cent of respondents believed that, in the absence of legislation, foreign ownership and control would increase.

- Commenting on whether Ontario's Paperback and Periodical Distributors' Act was still necessary to address the issue of industry ownership by Canadians, 83 per cent of industry respondents said that it was. Of the remainder, seven per cent were uncertain, with only ten per cent favouring repeal.

At the present time there is no reason to anticipate that Ontario will alter the basic approach it has taken. In the meantime, the Ontario Government has continued to support strongly the application of the federal government's "Baie Comeau" policy to all transactions in book publishing and distribution.

4.3 Federal Government Policy

4.3.1 Policy Under the Foreign Investment Review Act

While both Ontario and Quebec established special purpose legislation in order to protect cultural sovereignty and the expression of Canadian identity in book publishing, the federal government has instead used its general legislation regarding foreign investment in Canadian business to pursue these objectives. Over the period 1973 to June 30, 1985 the legislative framework was that provided by the Foreign Investment Review Act; while from June, 1985 to the present the legislative framework has been the Investment Canada Act (ICA).

The administration of both pieces of legislation has been the responsibility of agencies, initially the Foreign Investment Review Agency (FIRA) and then Investment Canada, for which the responsible minister was the minister responsible for Canadian industry. As a result, the Minister of Communications and earlier the Secretary of State were not directly responsible for the legislation through which this aspect of policies affecting the book industry have been pursued, nor was the legislation designed specifically to achieve their purposes.

Under FIRA the approach taken to handling foreign investment applications was to proceed on the basis of a case-by-case evaluation of applications, within the framework of broad statements of the policy objectives of the Government of Canada related to the book industry. The federal government's first statement of its objective was made in 1974, in response to the same concerns which in Ontario and Quebec had already resulted in legislative action. The ability of provincial governments to achieve their policy goals had clear limits, since publishers or wholesalers blocked from establishing a business in one province could set up operations in another. As a result, there was, and continues to be, a need for complementary federal action.

The federal policy articulated in 1974 by then Secretary of State Hugh Faulkner was that:

> The Canadian Government believes strongly that the major segment of the book publishing industry in Canada should be owned by Canadians. Canadian books and magazines are too important to the cultural and intellectual life of this country to be allowed to come completely under foreign control, however sympathetic and benign.[30]

This policy statement was reflected both in the passage of Bill C-58, which affected magazine publishing, and in FIRA decisions on book publishing cases. Subsequently, a more precise objective was formulated in January, 1979, setting as a goal of policy that the Canadian-controlled sector of the book publisher/agent industry should "play a dominant role in both the French- and English-language markets in Canada." At that time Canadian-controlled companies accounted for an estimated 18 per cent of sales in the English-language market in Canada, but a majority of sales in the French-language market.

Under FIRA, a significant number of important proposed acquisitions of book publishing companies were rejected. These included the following:

- proposed acquisition by Gulf & Western of Simon & Schuster's Canadian subsidiary, Pocket Books,

- proposed acquisition of Lippincott by Harper & Row,

- proposed acquisition of Irwin-Dorsey by Dow-Jones.

In the case of Gulf & Western the application was denied and the subsidiary was sold to General Publishing. Instead of possibly losing Simon & Schuster's trade publishing list to a newly acquired Gulf & Western subsidiary, General Publishing retained the important trade publishing agency business of Simon & Schuster and also acquired its mass market paperback business in Canada.

---

[30] J. Hugh Faulkner, Secretary of State, Speech to the annual meeting of the Canadian Book Publishers Council, Toronto, Janaury 24, 1974, page 3.

While the business General Publishing gained from this transaction is now divided between two separate, Stoddart family owned businesses, the annual revenues involved are about $17 million -- representing a substantial share of the total agency business which still is handled by Canadian-controlled publishers.

In the case of the Harper & Row acquisition of Lippincott, the proposed acquisition had potentially important implications for two Canadian-controlled publishers, Fitzhenry & Whiteside and McClelland & Stewart (M & S), both of which were involved in distributing books for the companies involved (Fitzhenry for Harper & Row, M & S for Lippincott's trade and school texts). Denial of the application led to a decision to close Lippincott Canada, rather than to divest control. However, the important Harper & Row agency business was left with Fitzhenry and Whiteside until years later, when Rupert Murdoch's companies established Harper & Collins Books of Canada (see below). Most Lippincott titles also continued to be warehoused in Canada and sold through Canadian agents until the establishing of Harper & Collins Books.

Both of the above transactions involved indirect takeovers. In the case of the Dow-Jones' indirect takeover of Irwin-Dorsey of Canada, which was denied in January 1979, the company was unwilling to sell controlling interest to Canadians and challenged in the courts FIRA's authority to rule on indirect takeovers. At that time Gordon Dewhurst, then Director-General of policy research and communication for Investment Canada, stated that about one-third of all the acquisitions FIRA had reviewed (500 cases), had arisen from foreign transactions which involved the acquisitions of businesses in Canada.[31] In the Trial Division decision on the Dow-Jones case, the judgement was that:

> It is only the acquisition of the business carried on in Canada which is subject to the review provided by s. 8 of the Act. It, therefore, does not seek to affect extra-territorial activities but is enforced only in relation to the Canadian business. The provisions of the Act were not applied extra-territorially . . .[32]

While Dow-Jones very publicly announced its closing of Irwin-Dorsey of Canada as a result of the FIRA decision, two years later bookstores were again ordering Irwin-Dorsey books from a Toronto warehouse.

There were, however, other FIRA cases which were settled differently. In the case of transactions involving Bantam Books and Whitman Golden, takeovers by non-Canadians were permitted, but were conditional on their involvement in new Canadian mass market paperback and children's book publishing initiatives.

---

[31] "FIRA court challenge lost: Irwin-Dorsey to shut down," Globe & Mail, November 13, 1981, page B1.

[32] Robert A. Donaldson, "Foreign Investment Review and Canadianization," Corporate Law in the 1980's, (Don Mills, Ontario: Richard De Boo Publishers, 1982, page 530.

In the case of the application to acquire Random House and GLC, transactions were approved subject to undertakings which are not publicly available.

In the case of GLC, 51 per cent of the voting shares in the company were subsequently acquired by the Government of Canada, as part of an agreement with Gulf & Western related to the acquisition under the Investment Canada Act of Prentice Hall Canada.

The undertakings FIRA sought from the Newhouse interest in their acquisition of Random House of Canada Ltd. led to Random House becoming involved in publishing Canadian-authored books for the first time since it was established in 1944. The FIRA application was approved in 1982 and, according to the 1989/90 Edition of The Book Trade in Canada, Random House, a large firm which has 250 employees, has 39 Canadian titles in print and published nine Canadian titles in 1989. By comparison, the Canadian-controlled company, McClelland & Stewart, with 90 employees, published 160 titles in 1989; General Publishing/Stoddart, with 144 employees, published 150 Canadian titles in 1989; and Lester & Orpen Dennys, with 14 employees produced 23 Canadian titles. The FIRA undertakings have, however, brought Random House into the bidding process in competition with Canadian-controlled companies for the work of established Canadian writers. With their much greater financial resources, Random House and other foreign-controlled firms have the capacity to take over the most successful Canadian authors, once they have become established, without themselves contributing to a substantial degree to the development of new Canadian writers. The bidding has, over the past few years clearly driven the level of advances to established Canadian writers so high that the advances cannot possibly be recouped. The resulting losses, which in the case of one Canadian firm represent three-quarters of a million dollars, can be handled far more readily by the foreign-controlled firms than by the Canadian-owned companies, in part because the former do not bear comparable costs in developing new Canadian writers and publishing for a wide range of interests and markets in Canada.

While not a comprehensive review of FIRA decisions, the comments above are intended to make it clear that the decisions reached on foreign investment cases have important direct and indirect affects on Canadian-controlled book publishing companies. It must be noted that under FIRA the general policy regarding the establishing of new foreign-controlled book publishing companies was to deny all such applications. This policy on new establishments meant that foreign publishers with exclusive agents in Canada did not have available the option of setting up their own subsidiary and taking their agency business away from the Canadian firm which represented them -- a process which had gone on rapidly throughout the 1960's, with a resulting progressive loss of import business by Canadian-controlled publishers. Instead, the process which threatened the revenues of domestic publishers was that the foreign publishers for which they acted as agents in Canada, would be acquired by other foreign publishers which already had a subsidiary in Canada, and agency business would be transferred to that existing subsidiary. Such transactions are not, of course, subject to review.

Commenting on FIRA decision-making in a 1982 article, Robert Donaldson noted that:

> although the government's policy has not been codified in a statute, FIRA decisions have almost uniformly reflected the government policy. . . . the Secretary of State in April 1977 and again in November 1979 confirmed the government's objective that a major segment of the publishing industry in Canada should be owned by Canadians. Apart from the natural resource and energy sector, in no other industry have cabinet decisions in FIRA cases so clearly reflected the policy objectives of the federal government. [33]

As indicated above, a significant factor in this pattern of decision-making was that the Governments of Ontario and Quebec had both passed legislation which indicated their desire for Candian control of the industry. Provincial policy was -- and remained under the ICA -- a factor to be considered in FIRA decisions.

However, there continued to be substantial criticism of the case-by-case approach to FIRA decisions. Canadian-controlled publishers were quite critical of the inconsistency with which the government's policy was being pursued, particularly since the objective that had been stated remained so far from being attained. But foreign buyers and would-be buyers of companies were equally critical of the fact that one transaction would be accepted while another was denied, without any obvious logic or relationship to the policy goal the government had stated.

4.3.2 Policy Under the Investment Canada Act: Baie Comeau

a) Weaknesses of the FIRA Case-by-Case Policy

There were two principal problems with the way foreign investment in the book industry was handled under FIRA. The first, as noted above, was that the policy resulted in inconsistent decisions on foreign acquisitions of Canadian-based companies. Some acquisitions by non-Canadians were accepted, while others were rejected, and the process was viewed as unfair and capricious by those applicants who were rejected. At the time of the 1985 hearings of the Standing Committee on Regional Development on the Investment Canada Act, James Nininger, President of the Conference Board of Canada stated that "foreign investors do not object to controls and screening per se, because they exist everywhere; they do object to unexpected changes in such controls and to any inconsistent applications of such controls." By those concerned about achieving the objectives which the government had stated, the inconsistency was seen as a sign of a lack of commitment to the goal of a book industry controlled by Canadians. In proceeding with a new policy under the Investment Canada Act one of the objectives stated by the government was to create for the first time a clear policy on the role of foreign investment, ending the confusion that existed in the international publishing community.

---

33 Ibid., page 474.

In replacing the FIRA approach to foreign investment in the book industry there was, however, a second goal. Analysis of the state of the industry after almost fifteen years of efforts to strengthen the Canadian-controlled sector of the industry made it quite clear that policies capable of success were not yet in place. The structure of the domestic publishing and distribution industry remained unacceptably weak, with the Canadian-controlled publishers in a relatively marginal position in their domestic market, and imported books in a position of overwhelming dominance, which created both cultural and economic concerns.

b) The Baie Comeau Policy

The new policy on foreign investment announced almost five years ago, and usually referred to as the Baie Comeau policy, reflected three basic premises:

(1) Foreign publishers would continue to be free to export books into Canada subject only to copyright law, reflecting Canada's international obligations to respect and protect equally foreign copyrights and Canadian.

(2) There would be no retroactivity in the application of the policy. Implicit in the use of Investment Canada to administer the government's policy was the fact that there was no forced divestiture by existing owners. Only new establishments and changes of ownership of existing businesses after the date the policy was announced were affected.

(3) The policy would be applied equally to all owners of book publishing and distribution businesses in Canada, whether foreign or Canadian-owned and regardless of the way that ownership was structured.

The specific provisions of the policy are as follows:

(1) All "notifiable" investments in book publishing and book distribution are subject to review.

(2) New businesses and direct acquisitions in book publishing and distribution (whether the target business is Canadian or foreign-controlled) are permitted only where the non-Canadian has a minority position, that is, where control rests with Canadians. However, for foreign-controlled businesses, direct acquisition could proceed if divestiture of control to Canadians occurred within a reasonable period of time (two years), at a fair market price.

(3) Indirect acquisitions, while being reviewed case-by-case, are allowed only when control will be divested to Canadians within a reasonable period of time (two years), and where effective competition will not be lessened.

This policy was affected by Bill C-65, the legislation which gave effect to the provisions of the Canada-U.S. Free Trade Agreement (FTA). The amendments to the Investment Canada Act made explicit the fact that the general changes being made to the ICA to raise the threshold for review of direct acquisitions by Americans, and to eliminate the review of indirect acquisitions by Americans, did not apply to investments to acquire control of any cultural business. Therefore, the FTA presented no obstacle in principle to the application of the Baie Comeau policy.

The FTA did, however, affect the process for implementing the Baie Comeau policy. As the guidelines above indicate, the policy made provision for conditional approval of both direct acquisitions of foreign-controlled book publishing and distribution businesses, and indirect acquisitions of any business in the industry. Approval in both cases was to be conditional on an agreement to divest control to Canadians within a two year period. Article 1607 of the FTA amended the specific provisions related to the requirement of divestiture by non-Canadians acquiring a controlling interest in a book publishing or distribution business, but it did so only with respect to indirect acquisitions by Americans. Specifically, Article 1607 (4) states that:

> In the event that Canada requires the divestiture of a business enterprise located in Canada in a cultural industry pursuant to its review of an indirect acquisition of such business enterprise by an investor of the United States of America, Canada shall offer to purchase the business enterprise from the investor of the United States . . . at fair open market value, as determined by an independent, impartial assessment.[34]

As a result of this change, divestiture in the case of directly acquired book industry businesses that were foreign-controlled would proceed as before, but in the case of indirect acquisitions the Government of Canada is now required to offer to purchase the Canadian business. While the "fair market value" provision of the Baie Comeau policy remains in effect in relation to all direct acquisitions, indirect acquisitions by Americans under the FTA may result in a purchase by the Government of Canada, at "fair open market value" if no private purchase in compliance with Baie Comeau occurs. What precisely "fair open market value" means is not evident from the FTA itself, but it presumably means the price that would be paid for the Canadian publishing or distribution business if it could be sold to the highest bidder, rather than to the highest Canadian bidder.

This raises valuation issues which are identified more precisely below, as well as creating a potential cost to the Government of Canada if it were not able to recover all of the price paid under this special FTA provision through a subsequent sale to a Canadian buyer. The issue has already arisen, of

---

34 The Canada - U.S. Free Trade Agreement, (Ottawa: External Affairs), January 2, 1988, page 238.

course, in relation to the Government of Canada's purchase of Ginn and GLC publishing from Paramount (formerly Gulf & Western), although it should be kept in mind in looking at the Ginn and GLC acquisitions that they were not acquired through the process set out in the FTA, but rather through an agreement reached in March, 1986, prior to the FTA.

c) The Baie Comeau Strategy

The fundamental strategy of the new policy was to make provision over time for an increasing percentage of the imported books handled on the basis of exclusive agency rights to flow through Canadian-controlled businesses. Exclusive agency revenues account for just over half of the industry's total revenues -- and involved the lowest risks, the least investment capital, and a substantially lower cost of sales than for Canadian-published titles. Indirectly, whoever handles this agency business also is in a privileged position to select foreign titles, particularly textbooks, suitable for adaptation for use in Canada. In English-language publishing, 75 per cent of all revenues earned from imported titles in 1987-88 flowed through foreign-controlled book publishers ($336 million of a total of $447 million).

Rather than following the American model and blocking the flow of imported books as a means to develop a domestic publishing industry, the Baie Comeau policy sought to ensure that an increasing percentage of the imports flowed through Canadian-controlled publishers. As the policy guidelines noted above indicate, this was to be achieved without any retroactive action affecting existing foreign owners. The shift of agency revenue would occur only as companies changed hands.

In explaining the reasons for the policy, when it was announced in 1985, the Minister of Communications stated that:

> It has now been fifteen years since the State began subsidizing Canadian publishing. Government support, which has increased constantly during this time, has still not altered the structural makeup of the publishing and book distribution sector. It is therefore obvious that, without structural change, the government would have to increase its support, continually, simply to maintain the status quo.

While it had been recognized for the previous fifteen years that book publishing, like newspaper and periodical publishing, is a key sector in which Canadians should exercise control, no policy capable of success in achieving that goal had previously been implemented. Although it had been clear at the time that major new initiatives were required, the only response when the federal government reviewed its policy in 1978 was the creation of a new and inadequate grant program, the Book Publishing Development Program, which left the broad structural problems of the industry unresolved. As a recent study for Investment Canada by the Peat Marwick Consulting Group noted:

When the federal government introduced the Book Publishing Development Program in 1979 it threw a lifeline to many publishers who were in desperate need of assistance. With the introduction of the new BPDP in 1986, the emphasis has shifted to funding undertakings which enhance the ability of Canadian publishers to finance themselves.

Whether any long-term beneficial changes can be effected in this way remains to be seen. Certainly it is hard to imagine significant permanent benefit for Canadian-controlled publishers who remain confined in the high-risk, low-profit, sector of the total publishing spectrum. [35]

Commenting on the position of the Canadian publishing industry the same Peat Marwick study noted that:

> Canadian publishers can hardly survive on such a small domestic market, unless foreign publishers let them distribute more foreign books, or bid for the rights to publish them, or unless they can expand into the lucrative educational market. [36]

One of these three options Peat Marwick identified -- that of acquiring the right to publish Canadian editions of foreign titles -- the report quite rightly in our judgement concludes is of marginal significance. To the extent that this can be even a part of an effective solution, Peat Marwick noted that it is linked directly to the agency issue, since "the only way it is likely to become possible for Canadian-controlled publishers to acquire rights to publish foreign authors in Canada is if they control the agencies through which those authors enter the Canadian market." [37]

A second option, that of entry into educational publishing, is affected by two factors. First, as in the case of trade publishing, agency business provides an important source of revenue: even in the el-hi market where there is the greatest insistence on Canadian texts, imported titles account for almost a third (31%) of total revenue, and with less than 20 per cent of that el-hi import business (18% in 1987-88), Canadian-controlled publishers are at a great disadvantage. However, textbook publishing also requires close contact with educational authorities in every province and involves a heavy investment in textbook development costs. As a result, educational publishing in Canada is dominated by a relatively small number of large firms.

---

35 English-Language Book Publishing and Distribution in Canada: Issues and Trends, Final Report, Peat Marwick Consulting Group in Association with Bill Roberts, October, 1989, page IV.17 - IV.18.

36 Ibid., page IV.17.

37 Ibid.

In the case of the English-language educational market, the small number of firms which dominate that market are increasingly the same ones which dominate the U.S. market. In the absence of Investment Canada action to counter their effects in Canada, mergers and acquisitions abroad -- almost all of which affect Canada indirectly -- threaten the remaining educational agency business of Canadian-controlled publishers. For example, Rupert Murdoch's acquisition of Scott-Foresman, a leading U.S. educational publisher, threatens the revenue base of one of the very few important Canadian-controlled educational publishers left, Gage Publishing, since Gage acts as Scott Foresman's exclusive agent in Canada and this business is a fundamentally important part of its revenue base. Murdoch acquisitions have already had a major effect on the Canadian-controlled sector of the industry, by taking the valuable Harper & Row agency business away from another important Canadian-controlled publisher, Fitzhenry and Whiteside. The Harper & Row business was consolidated with Wm. Collins Sons & Co., which Murdoch also acquired.

The key point here in relation to educational publishing is really that participation in that market is also linked directly to the Baie Comeau policy, since any substantial increase in the involvement of Canadian-controlled publishers will only come about as a result of control of existing foreign-controlled textbook publishing firms being acquired by Canadians.

On the key issue of the strategic goal of bringing agency imports increasingly under Canadian-control, the Peat Marwick study concluded that "there would clearly by benefits of the kind described in the Issues section of this report," which section identified those benefits as follows:

- sales volumes will be increased without the heavy developmental costs of originating books.

- the additional revenue generated provides stability and offers economies which reflect beneficially on a publisher's own published books.

- publisher-agents are better able to withstand economic disasters than publishers who have to rely wholly on "own published books." They have greater diversity of product and a greater array of proven authors with which to tempt consumers. In difficult times, publishers who must rely entirely upon publishing books which require a greater investment and carry a higher degree of risk, will be at a disadvantage.

d) Policy Implementation

As indicated above, the responsibility for implementing the Baie Comeau policy does not rest with the Minister of Communications, but rather with the Investment Canada agency and with the Minister of Industry, Science and Technology, who is responsible for making decisions under the <u>Investment Canada Act</u>. This arrangement in principle presents no difficulty, since the policy guidelines were intended to be applied to all cases, without the exercise of discretion.

In a number of ways the Investment Canada Act appears to be a better vehicle for implementing such a policy than the FIRA legislation, since it includes special provisions which provide a basis for review of all applications in the book industry and makes explicit provision for the cultural policies of both federal and provincial governments to be considered in reaching decisions. The Act makes it clear, as the Foreign Investment Review Act did not, that the cultural sector is a special case which should be dealt with on a different basis from other industries and that decisions related to this sector should be based on cultural, rather than primarily industrial, policy considerations.

When the Investment Canada Act was drafted, care was also taken to remove any doubt which may have existed that the Act applied with equal force to both indirect and direct acquisitions. Commenting on this issue when the Act was originally drafted in 1985, Timothy Kennish of Osler, Hoskins & Harcourt noted that "The ICA has clarified the fact that the legislation applies to indirect acquisitions of control, for anyone who continues to doubt that the provisions of section 3(6)(h) of FIRA had this effect."[38]

There are, however, a number of fundamental problems inherent in the use of the Investment Canada legislation as currently drafted to give effect to the Baie Comeau policy. The most fundamental problem is that, while the stated goal of the Baie Comeau policy is to achieve Canadian control over an expanded portion of the book publishing industry, the test of control which is applied under the general provisions of the ICA is one of de jure, rather than de facto control. As a result, foreign investors can meet Investment Canada's definition of Canadian control without necessarily actually surrendering control.

This does not, of course, mean that the intended application of the Baie Comeau policy has always failed to result in the transfer of control to Canadians, but simply that under the Act effective control does not have to be transferred to meet the technical test of control.

On this centrally important issue a legal opinion provided to the Association of Canadian Publishers by McCarthy & McCarthy (now McCarthy Tétrault) found that "the de facto 'control in fact' test, which is now being applied by the Department of Communications when cultural acquisitions are involved, may lack the necessary authority in the Act . . . " The following examples were cited of transactions which would clearly be inconsistent with the Baie Comeau policy, but which could be deemed acceptable under the ICA:

> A partnership or joint venture could be formed in which a Canadian or voting group of Canadians holds a 51% ownership interest in the assets thereof but agrees to let a non-Canadian partner or co-venturer exercise control and management of the entity. This entity would be considered

---

[38] J. Timothy Kennish, "Status and Acquisition of Control Rules," Seminar on Investment Canada, Department of Education, Law Society of Upper Canada, Osgoode Hall, Toronto, May 3, 1985, page C9.

to be Canadian-controlled and could purchase a Canadian or foreign-controlled publishing firm carrying on business in Canada without having to comply with the Act or the policy, subject to section 39(1)(g).

Second, a corporation could be incorporated with (i) a minimal number of voting shares to which is attached a right to receive a share of profits and to share in the assets upon dissolution and (ii) a large number of non-voting shares, similar in every respect to the voting shares except that they are non-voting. If a majority of the voting shares were issued to Canadians, the corporation would be considered to be Canadian-controlled and could purchase a publishing business carrying on business in Canada without having to comply with the Act or the Baie Comeau Policy, subject to section 39(1)(g). This classification as a Canadian entity would result despite the existence of a shareholders' agreement which specifies that the non-voting shareholders have the right to appoint one or more directors and that no significant or material changes, as exhaustively specified, in the corporation may be made without the approval of all directors.[39]

While McCarthy & McCarthy's opinion is that "these transactions could be prevented if the Minister in charge took a pro-active role in exercising Ministerial discretion by aggressively enforcing Part VII (Remedies, Offenses and Penalties) of the Act, pursuant to section 39(1)(g)"[40] they recommended that either the ICA be amended or a new act created to review foreign investment in cultural industries and that a "control in fact" test be applied to any entity which claims to be Canadian.

Changes made in the definition of control from FIRA to the ICA were part of a broad and deliberate shift in policy with respect to foreign investment in the overall economy. On this issue James Arnett, who was Special Counsel to the Government of Canada when the ICA was drafted, has noted that:

> In contrast to the FIR Act definition of non-eligible person, jurisdiction of incorporation is totally irrelevant in determining whether an entity is Canadian-controlled for purposes of the ICA. More importantly, <u>control in fact through a trust or a contract or any other method other than the ownership of a voting interest is also irrelevant</u>. (emphasis added)[41]

---

[39] Letter to the Association of Canadian Publishers from McCarthy & McCarthy, Re: Investment Canada and the Baie Comeau Policy, March 9, 1989, page 4.

[40] Ibid., pages 5 and 6.

[41] E. James Arnett, "From Fira to Investment Canada," <u>Alberta Law Review</u>, Vol. XXIV, No. 1, page 7.

With respect to the application of the Baie Comeau policy, this issue of control by contract is at least as important as the issue of the extent of Canadian equity participation. This is the case simply because the transfer of control to Canadians involves primarily decisions related to the contractual basis on which books published by companies outside Canada are to be imported and sold by Canadian publisher/agents.

There are two quite separate options as to what is being acquired in a transaction involving a publisher/agent business with substantial revenues from the sale of imported books:

1. Acquisition of Copyright

The acquisition of a Canadian publisher/agent may involve acquiring the ownership of copyright for Canada in those hardcover and/or paperback titles being imported into Canada. However, as the Peat Marwick study for Investment Canada noted, this is rarely the case.

It is normally the case that the non-Canadian firm retains the ownership of the copyright to its titles for Canada. An exception is usually made only for any titles which were originated in Canada and are primarily of interest to Canadians (Canadian school texts, reference books, historical, political or economics titles related to Canada, etc.) Otherwise, it is not the copyright that is being acquired by Canadians.

2. Acquisition of Exclusive Sales and Distribution Rights

As the Peat Marwick study noted, "The vast majority of books are still imported in finished copies and bear the U.S. or U.K. imprint. This is the activity engaged in by agencies."[42]

The principal transaction which actually occurs involves entering into a contractual agreement related to the terms and conditions on which the Canadian agent will have access to titles published by the non-Canadian publisher for sale and distribution on an exclusive basis in Canada. Key elements which dictate the value of such agreements include:

- length of agreement,
- renewal/continuation provisions,
- price at which titles will be acquired (usually a discount from publishers' list price),
- return provisions related to excess stock,
- right to acquire Canadian copyright or produce Canadian adaptations of selected titles (often the contracts provide for the right of first refusal).

[42] Op. cit., English-language Book Publishing and Distribution in Canada, page IV.3.

If what were changing hands was the ownership of copyright for Canada in titles published by a non-Canadian publisher, then the transaction would require putting a price on all existing copyrights and acquiring rights for the Canadian market to all titles under contract. In future, this approach would presumably involve buying on a title-by-title basis the right to publish separate Canadian editions. If this approach were taken the costs involved would be substantially higher, but the benefits would also be much greater than is the case in an agency arrangement where the Canadian agent simply buys at an agreed discount from the U.S. or U.K. or French publisher's price.

The reality, however, is that copyright does not normally change hands, nor do such transactions involve dealing with the rights to specific individual titles. While there may be real estate, Canadian originated copyrights or other assets to be acquired, these transactions which come under the Baie Comeau policy almost always have as their central and fundamental element a distribution contract. Because this is the case, and because the foreign supplier of books is typically in the most powerful position during negotiations, (reflecting the dominant position of imported books in the Canadian market) the non-Canadian seller can be expected in many cases to try to incorporate provisions in its equity, distribution or other agreements with the Canadian agent which go beyond simply setting out the basis on which titles will be acquired for distribution in Canada. Because this is the case, a key ingredient of any test of control in fact must be an assessment of all contractual provisions between the parties to see that they do not go beyond setting out the essential ingredients of an exclusive agency contract. Such contracts should not impose any contractual restrictions on the legitimate prerogatives of the Canadian agent to control decisions related to his own publishing activity or the expansion of his business. This does not, and cannot mean, of course, that the agent can proceed with impunity to ignore his obligation to serve the foreign publisher effectively, since such agreements almost always provide for periodic renewals which include a review of performance. Agents are kept honest by the unquestioned ability of foreign publishers to shift their business to someone they believe will do a better job.

For the foreign publishers, however, there is an inevitable preference to shift from the use of a Canadian-controlled agent to the use of a subsidiary or affiliated company, or indeed to the use of any entity over which they themselves have control. It was precisely to reverse this trend toward ever greater control by non-Canadian publishers -- exercised through their control over the distribution of their titles in Canada -- that the Baie Comeau policy was adopted. Unfortunately, the <u>Investment Canada Act</u> was not designed to be an appropriate vehicle for achieving this purpose.

A second weakness in the ICA as an administrative vehicle for implementing the policy is the fact that it does not apply to the acquisition of branch businesses. While so far this loophole does not appear to have been used substantially to evade the intent of the policy, it clearly could be, and any adjustment to the policy would need to make provision to cover unincorporated branch businesses as well as corporations, partnerships, trusts or joint ventures.

It is also important to recognize the financial implications of the ICA assumption that if 51 per cent of the voting shares are held by Canadians, then control rests with Canadians. As noted above, it is possible to set up a corporation in which a large number of non-voting shares are held by non-Canadians, with the bulk of the profits made by the firm accruing to non-Canadian shareholders. However, even if this were not the case, it is inherent in the drafting of an exclusive agency contract that a decision is made implicitly as to how much of the profit will be taken by the foreign publisher on the sale to the Canadian agent, and how much in the agency business itself.

An example is useful to illustrate the point. Suppose that at the time a foreign publisher is selling control to a Canadian, the discount being given to the Canadian business on agency titles is reduced from 65 per cent to 60 per cent, and at the same time all books acquired must be purchased on a non-returnable basis. The result will be that the foreign publisher will have captured, through a change in the distribution contract, a substantially higher percentage of the profit. It is, in fact, quite possible to reduce the discount to the agent to such a degree that no profit at all can be made at the agent's end of the transaction because the full potential for profit on the foreign publisher's exports to Canada has been taken by the foreign supplier.

The essential point is that the profits are actually divided at two levels:

1. Potential profit is divided implicitly between the foreign publisher and the Canadian-based agent as a result of the terms agreed to for the acquisition of books by the agent.

2. The profits made by the agent are then divided further among the shareholders in the Canadian business.

In the case of arrangements in which the foreign publisher owns 49 per cent of the equity in the Canadian-based agency business, the foreign publisher may, as a result, be realizing substantially more than 49 per cent of the potential to make a profit from selling that publisher's titles in Canada.

There are two central points that follow from these observations regarding exclusive agency profits. First, the 51 per cent standard is a quite modest one, since in reality it does not actually require that the foreign publisher give up 51 per cent of the potential for profit from the sale of its titles in Canada. Profit can be, and is, taken at the supplier's end, constrained only by a recognition that it would be counter productive to reduce the financial rewards to the agent to a point at which the agent had insufficient resources or insufficient potential for profit to market the imported titles effectively.

The second key point is that in attempting to estimate the value of the businesses affected by the Baie Comeau policy, it has to be recognized that the process of establishing a distribution agreement typically and quite properly, assigns part of the profit potential to the copyright owner supplying the foreign publications. It is only the value of the agency business itself that should be used in valuing the Canadian business being divested, regardless of whether the price is based on only Canadians bidding for the business or an "open market", with foreign and Canadian bidders.

The weaknesses in the ICA as a vehicle for implementing Baie Comeau have had a crucially important effect on the ability and willingness of arms-length Canadian investors to purchase Canadian book publishing and distribution companies when transactions occur which trigger the application of the policy. Unless the foreign investor is willing to give up management control of the Canadian business and to deal with that business on an arms-length basis determined by a clear and enforceable contract, no rational, independent investor would risk substantial resources. If the Canadian investors do not have control in fact over the Canadian business, then the distribution agreement is really an internal agreement between two entities controlled by the foreign publisher. In such circumstances an outside investor without effective control would be extremely vulnerable.

e) The Impact of the Policy

In these circumstances, the effectiveness of the Baie Comeau Policy has clearly been substantially reduced from what it would have been had more appropriate legislative provisions been in place to implement it. Nevertheless, it would be a mistake to ignore the significant benefits which have been achieved.

First, it has been one of the greatest fears of the Canadian book publishing industry that American retail bookstore chains would move into Canada. The implications of such a change were addressed by Ontario's Royal Commission on Book Publishing and have been referred to earlier in this study (subsection 4.2). Investment Canada's 1985 review of the acquisition of the Classics bookstore chain by W.H. Smith led to an agreement by W.H. Smith to sell 49 per cent of W.H. Smith Canada to Canadians within a five year period. Subsequently, W.H. Smith decided to go further and sold its 306 stores in Canada outright to Federal Industries Ltd. of Winnipeg, a Canadian-controlled company. At present almost all of the retail bookstores in Canada are owned and controlled by Canadians.

Over the past five years important progress has also been made in increasing Canadian control over the book clubs which operate in Canada. In order to comply with the Baie Comeau policy, the West German firm, Bertelsmann, divested at least 51 per cent of the voting shares of its Canadian businesses to a group of Canadians, which included Anna Porter. This change has had a substantial impact on the way Doubleday's book clubs are managed in Canada, with the percentage of sales accounted for by Canadian-authored titles increasing five-fold -- from about five per cent five years ago, to the current level of 25 per cent. Publishers interviewed for this study indicated that the Doubleday book clubs have become an important source of revenue for them. Previously, with little or no Canadian control over the management of these clubs or equity participation in them, they had been almost entirely distributors of imported U.S. titles.

Other transactions which resulted from the Baie Comeau policy have also at the very least resulted in substantial Canadian equity participation in firms in which there had previously been little or no such opportunities. However, in preparing this study we have not had access to information concerning the terms of those agreements and, in some cases, it is widely assumed that the Canadian investors do not have control. Media reports and industry interviews provide evidence to support the latter interpretation of some transactions.

The transaction which resulted in the acquisition of a majority of the voting shares of Doubleday Canada by Canadians also affected the important publishing business of Doubleday in Canada. Sales of Canadian-authored books published by Doubleday increased substantially as a percentage of Doubleday's total sales in Canada. In the case of Pearson PLC, the British firm was allowed in 1985 to acquire a controlling interest in Copp Clark Pitman Canada on the grounds that the transaction had been completed prior to the announcement of the Baie Comeau policy. Subsequently, however, when Pearson acquired control of Addison-Wesley the company is believed to have complied with the policy through selling a controlling interest to Canadians, and the Addison-Wesley business has not subsequently been consolidated with that of Copp Clark Pitman Ltd.

There are other cases where the level of skepticism concerning the transfer of any substantial measure of control is very high -- including the Harcourt Brace Jovanovich deal with CBS which affected Holt, Rinehart & Winston of Canada Ltd., Les Editions HRW and W.B. Saunders. Holt, Rinehart & Winston and W.B. Saunders now operate out of the same building as Harcourt Brace Jovanovich, Canada and operations appear to have been merged.

In the case of the Paramount (Gulf & Western) holdings, as noted earlier, the trade publishing business and mass market paperbacks are now with Canadian-controlled firms; the Government of Canada owns 51 per cent of the voting shares of Ginn and GLC, but does not have de facto control; while control of Prentice-Hall and Globe/Modern Curriculum Press has been acquired by Paramount.

Other important cases are unresolved so far. The most important outstanding cases involved the proposed entry into the Canadian book publishing industry of Rupert Murdoch (News International) and Robert Maxwell (Maxwell Communications). Both wish to enter Canada by acquiring existing companies, something which is not permitted under the Baie Comeau policy. The main transaction involved in the case of Murdoch's companies is the acquisition of William Collins & Sons Canada. Collins has been used as a base for expansion by Murdoch in Canada, with the business of a second major Murdoch company in the United States, Harper & Row being moved from its Canadian-controlled agent to Collins.

The Murdoch transactions directly contradict the intent of the Baie Comeau policy. First, while the explicit strategic goal of Baie Comeau, as stated by the Government of Canada, was to see that a larger share of agency import business came into Canada through Canadian-controlled companies, News International has separated its Canadian companies into two: one for purposes of publishing Canadian books, the second for purposes of handling imported books. While that deal provides for at least nominal, or de jure, Canadian control of the entity which publishes Canadian books, it results in full control by non-Canadians over the import business. In this way the Murdoch deal would, if permitted, institutionalize structurally the very dilemma which led to creation of the Baie Comeau policy, with the risky business of publishing Canadian titles in Canadian hands and the lucrative import business in foreign hands.

The Murdoch deal actually went further by stripping away from the Canadian-controlled sector of the industry the agency business for Harper & Row. As a result, if permitted to stand, the transaction would not only fail to bring additional import business under Canadian control, it would go further by stripping the Canadian-controlled sector of some of its existing agency business. Even in cases decided on the basis of the rules in effect prior to Baie Comeau, foreign buyers of Canadian based companies often at a minimum protected the existing agency business of Canadian-controlled firms. As noted above, when Gulf & Western acquired Prentice-Hall, for example, the quite substantial agency business which was at that time with Canadian-controlled firms was left there. The Murdoch transactions, therefore, not only would break both the letter and the spirit of the Baie Comeau policy, but would be inconsistent with the treatment of other foreign investors seeking to acquire businesses in Canada, even under the old FIRA regime. The result would be a perception of basic unfairness and a growing pressure from the foreign investors affected not to conform to earlier undertakings, since the legitimacy of those undertakings would be undermined. Murdoch has more recently acquired Scott Foresman and there are strong concerns that the Scott Foresman agency business will be taken away from the Canadian-controlled firm, Canada Publishing Corp. (Gage Educational Publishing).

The other important and unresolved cases involve Robert Maxwell. Maxwell has made it clear that, unlike Bertelsmann or Paramount, or Pearson or Harcourt Brace Jovanovich, he refuses to comply with either the letter or the spirit of Baie Comeau. The transactions involved are the acquisitions by Maxwell Communications Corp. of Collier Macmillan Canada Inc. and of Science Research Associates (Canada) Ltd. In this case also, if Maxwell Communications is permitted to do what other applicants have not, then to the extent other firms which made acquisitions over the past five years have complied with the policy, they will perceive that they have been treated inequitably. As a result, pressure could be expected to be applied by these firms to be given the same treatment as Maxwell, or at least the government would be expected to look the other way while they reduced Canadian involvement. The result would inevitably be a further decline in Canadian control of an industry in which foreign control is already very high, and the inevitable accompanying decline in the publishing of Canadian books.

f) The Absence of Incentives for Compliance

Since 1985 the task of implementing the Baie Comeau policy has been made more difficult by the absence of any substantial incentives for compliance (except in the case of companies operating in Quebec which wish to make sales directly to provincial or provincially-funded institutions). There are some direct grant programs operated by the provincial and federal governments to which only Canadian-controlled companies have access, but the amounts involved are relatively limited ($17.2 million in 1987-88) and such funds are usually provided only to assist in publishing non-commercial titles, including literary and scholarly works. Only $8.6 million in 1987-88 went to firms with sales of over $1 million, which account for the vast majority of industry sales. The major government expenditures affecting the book industry, which included the postal subsidy for books (valued at $60 million in 1989-90) and an exemption of books from the Federal Sales Tax which applies to most other manufactured goods (valued at an estimated $145 million in 1989-90)[43] were provided on a basis which did not differentiate at all between Canadian and non-Canadian publishers.

By contrast, in the Canadian newspaper and magazine publishing industries, substantial benefits accrue to Canadian-controlled companies. Section 19 of the Income Tax Act denies taxpayers the ability to deduct the cost of advertisements directed to Canadians unless they use Canadian-owned newspapers or magazines whose content is not substantially the same as that of foreign publications. This preferential access to Canadian advertising revenue makes Canadian newspapers and magazines much more valuable to Canadians than to non-Canadians. Postal rate policy in the case of Canadian newspapers and magazines, unlike the existing policy for Canadian book publishing, also provides lower rates to Canadian-owned than to foreign-owned publications.

If access to the major benefits provided to the book industry (about $200 million in 1989-90) had, as is the case in magazine and newspaper publishing, been provided only or primarily to Canadian-controlled publishers then the task of implementing Baie Comeau would have been far easier. Depending on the extent of such benefits and the elements of the industry affected by them, the financial benefits to non-Canadians might have been greater if they divested control to Canadians, rather than retaining control themselves -- assuming that a transfer of de facto control was required to be eligible to benefit from either tax expenditures or postal subsidy.

However, instead of establishing a targeted tax incentive or distribution assistance, the only real incentive established so far is that which is provided by the 1988 FTA provisions, which require the Government of Canada to offer to buy companies acquired indirectly by Americans at "fair open market value". While this does have the effect of encouraging new American owners wishing to buy Canadian-based book publishers and distributors to comply with the policy, it does so in a way that is cumbersome and unpredictable, requiring that the Government of Canada acquire the businesses affected. While the FTA provisions do assure non-Canadians that they will receive fair, perhaps generous, payment when they comply with the policy, the FTA only affects American investors and leaves British, French, West German or any other foreign investors with no incentive to comply.

---

[43] Rough estimate based on a 13.5 per cent tax on book imports (calendar 1989 -- $841 million) and 13.5 per cent of manufacturing expense of approximately $235 million (45% of estimated 1989-90 publisher revenues of $525 million for Canadian-published titles).

g) The Current Situation

The situation which now exists is an awkward one. The Baie Comeau policy is now being challenged directly by News International (Rupert Murdoch) and by Maxwell Communications. Over the past five years most of the major English-language publishing firms have been affected directly or indirectly by the spate of mergers and acquisitions which has occurred. In addition, one of the two major English-language retail bookstore chains and one of the two major English-language book club operators have been affected.

The importance of the transactions in publishing affected by the Baie Comeau policy over the past five years can be seen clearly in Table 28. The total revenues of the English-language companies affected were $247.1 million in 1987-88, which represented 30 per cent of the total revenues of all English-language publishers, and almost half (47%) of the sales made in Canada by the foreign-controlled sector of the industry.

TABLE 28

Revenues in 1987-88 of English-Language Publishers Affected by the Baie Comeau Policy from 1985 to the Present
($000's)

Commercial Category	Own Books		Imported/ Agency Books	TOTAL
	Domestic	Export	Domestic	
Textbooks				
El-hi	43,208	4,828	18,861	66,897
Post-secondary	12,315	570	34,589	47,475
Sub-total	55,523	5,398	53,450	114,372
Tradebooks	12,251	224	55,561	68,036
Reference	5,884	--	49,576	55,460
Professional and Technical	539	13	8,710	9,261
TOTAL	74,198	5,636	167,297	247,130

SOURCE: Statistics Canada. Companies included are: Addison-Wesley, Bantam Books, Collier Macmillan, William Collins Sons & Co., Copp Clark Pitman, Doubleday, Ginn Publishing, Globe/Modern Curriculum, Grolier, Harper & Collins Books, Harper & Collins Publishers, G.L.C., Holt, Rinehart & Winston, New American Library, Prentice-Hall, W.B. Saunders, Science Research Associates.

Of the total sales in Canada accounted for by these firms, $167.3 million was accounted for by the sale of imported or exclusive agency titles. This represented 37 per cent of the total revenue earned by English-language publishers from agency titles. This figure includes only the agency business handled directly by the subsidiaries affected. However, to the extent that the foreign publishers involved in these transactions still have part of their sales in Canada handled through Canadian-controlled firms, the total volume of agency business potentially affected would be even higher -- probably in excess of $200 million. In addition, these companies reported for 1987-88 revenues of $79.8 million from the sale of Canadian-published books, that is, their own titles. The vast majority of sales of their own titles reported (76%) were textbooks produced primarily for the elementary and high school market.

As Table 29 indicates, these companies reported sales of $63.3 million of books written by Canadians. These Canadian-authored books were primarily Canadian textbooks, with textbook sales accounting for 81 per cent of reported sales of Canadian-authored books, and just nine per cent coming from the sale of Canadian-authored trade or general interest books.

TABLE 29

Revenue from the Sale of Canadian-Authored Books
Reported by English-language Publishers
Affected by the Baie Comeau Policy from 1985 to the Present
($000's)

Commercial Category	Domestic	Export	Total
Textbooks			
El-hi	37,825	4,733	42,558
Post-secondary	7,840	569	8,409
Sub-total	45,665	5,302	50,967
Tradebooks	5,688	224	5,912
Reference	5,844	--	5,844
Professional and Technical	539	13	552
TOTAL	57,736	5,539	63,275

SOURCE: Statistics Canada.

Clearly the ownership of a remarkably high percentage of the English-language industry changed hands between 1985 and 1990. As a result, the decisions made by government on these cases have the effect of determining the structure and control of the book publishing industry in the future. Since there is, as noted above, no "carrot" to encourage compliance with the policy, the only instrument available to the government is for Investment Canada to reject the applications by foreign investors to acquire these companies. Even this is not simple, since the administrative and legal framework provided by Investment Canada and the ICA itself are far from the best instrument to ensure that control in fact is actually transferred to Canadians.

5.0 POLICY OPTIONS REGARDING BAIE COMEAU

Based on the above analysis, a number of policy options can be identified which might respond to the problems which obviously have arisen since the Baie Comeau policy was adopted. Options related to Baie Comeau are looked at separately in this section of the report. The four basic policy options examined are as follows:

OPTION 1: DISCONTINUE THE BAIE COMEAU POLICY

OPTION 2: STRENGTHEN THE LEGISLATIVE AND ADMINISTRATIVE STRUCTURE FOR IMPLEMENTING BAIE COMEAU

OPTION 3: STRENGTHEN THE LEGISLATIVE AND ADMINISTRATIVE STRUCTURE FOR IMPLEMENTING BAIE COMEAU AND ESTABLISH INCENTIVES FOR COMPLIANCE

OPTION 4: DISCONTINUE THE BAIE COMEAU POLICY AND RELY ON INCENTIVES TO ENCOURAGE CANADIANIZATION OF CONTROL OF THE INDUSTRY

However, the Baie Comeau issue, which essentially addresses the question of whether imported books will be distributed in Canada by the subsidiaries of foreign publishing firms or by Canadian-controlled agents, is interrelated with possible policy initiatives to protect the revenues Canadian publisher/agents earn from selling imported books as exclusive agents and to strengthen Canada's national book distribution structures. Issues related to the protection or enhancement of the revenues of Canadian-based publishers and distributors are addressed separately in section 6 of this report.

5.1 OPTION 1: DISCONTINUE THE BAIE COMEAU POLICY

The most likely form this option would take would be to stop applying the policy to indirect acquisitions. Since the basis of the policy was its impartial application to all takeovers and new establishments, this would effectively terminate the Baie Comeau policy. The policy would be applied in

future only to the entry of new businesses into Canada and to the direct acquisition of existing businesses. In effect, what would occur is a return to the policy which had been in effect from 1974 to July, 1985 under FIRA. Applications would be reviewed case-by-case for all indirect acquisitions. To the extent there was a difference from the FIRA policy, it would be that there would be a presumption that indirect acquisitions would be approved, the reverse of the presumption under FIRA.

5.1.1 Advantages

Problems have clearly arisen in the application of the Baie Comeau policy. As indicated above, one of the results of the weaknesses in the administrative arrangements for implementing the policy is that, despite the intention to treat all applicants in exactly the same way, this goal of equity has not been achieved.

The policy also has not, in many and perhaps most cases, achieved its intended purpose of transferring control to Canadians, although there are important exceptions. Acknowledgement of the failure of the policy to achieve its intended benefits could be regarded as a reason to abandon the policy.

The Baie Comeau policy continues as well to be the subject of strong criticism from some parties in the United States. The critical stance taken seems hypocritical when one compares the import restrictions and denial of copyright protection to foreign publications which the United States used for a century and a half to protect and develop its own publishing industry with the contrasting Canadian policy of preventing, on a non-retroactive basis, foreign acquisitions of book publishing and distribution companies (while accepting a trade imbalance of $750 million annually). In addition, the FTA appears to reflect implicit acceptance of the Baie Comeau policy by the American Government. Nevertheless, there is still pressure to abandon the policy and it is expected that the United States Administration will press to reopen this and other investment issues in future negotiations. Abandoning the policy might buy goodwill and support for Canada in the Administration and in Congress, which could be beneficial in achieving concessions on other issues.

Non-U.S. investors perceive that the Baie Comeau policy, which treated all foreign investors equally from 1985 to January, 1988, when the FTA was signed, now accords American investors preferential treatment, since it requires that the Government of Canada offer to buy from U.S. investors only at "fair open market value". By abandoning the policy, the Government of Canada could avoid pressure to deal in the same way with non-U.S. investors.

The FTA provisions are also perceived to have exposed the Government of Canada potentially to significant financial costs, since it may not be able to sell any companies it acquires at as high a price as the "fair open market value" it has undertaken to pay. The extent of such exposure will depend on the way the FTA provisions are interpreted. As noted above, it will make a major difference in determining these potential costs whether what is being acquired includes the copyrights for imported agency titles, or an exclusive agency contract. Presumably the Government of Canada will not pay for something it is not acquiring -- that is it will not pay for territorial copyright for Canada when it is buying primarily an exclusive distribution agreement. If the basis for an impartial determination of value is an assessment of what is actually being sold, then the gap between the price the Government of Canada will pay and the amount that will be bid by Canadian buyers is unlikely to be substantial. However, if the decision were made to interpret "fair open market value" as requiring that the government pay for copyrights it was not acquiring, then the gap could be quite substantial. Either way, in the absence of any significant incentives to support the Canadianization of companies affected by Baie Comeau, there is going to be some cost to government. These costs could be avoided if foreign investors were free to treat any Canadian business acquired indirectly as simply an integral part of any foreign-based book publishing company acquired, and, therefore, outside the scope or effective jurisdiction of any policies the Government of Canada may wish to pursue in relation to the publishing industry in Canada.

Finally, there is some concern that the United States might retaliate and restrict the operation of large Canadian media conglomerates in the United States. Similar concerns have been expressed in the past regarding other Canadian public policy initiatives, including Canadian content quotas in broadcasting and Bill C-58, which restricts the access U.S. broadcasters and publishers have to Canadian advertising revenue. While Baie Comeau is simply part of this broader issue of structural initiatives to protect Canada's cultural sovereignty and identity, it is clear that the commercial interests of Canada's media conglomerates could potentially be jeopardized by any such initiatives, including Baie Comeau.

The American government, of course, has a radically different situation to deal with than that which exists in the book publishing industry in Canada. In the United States, the output of the domestic industry accounts for 93 per cent of all book sales in the domestic market, by comparison with just over 30 per cent in Canada. In addition, while foreign-controlled companies account for a substantial majority of the Canadian industry's domestic sales, in the United States foreign-controlled companies account for an estimated 15 per cent of industry revenue.

The fact that the objective situations faced by the United States and Canada are fundamentally different, does not mean that the United States will agree that mirror legislation or some type of retaliation is inappropriate and should not be adopted. If this threat of retaliation is perceived to be real, then obviously any potential damage to the external investment opportunities available to the larger Canadian media conglomerates would need to be weighed against the pursuit of cultural policy objectives.

5.1.2 Disadvantages

On the negative side, a decision not to require a transfer of controlling interest to Canadians when the transfer of control of Canadian book publishing or distribution businesses occurs through an indirect acquisition raises serious policy questions. First, and most importantly, almost all of the reviewable transactions which were dealt with under both FIRA and Investment Canada involved indirect acquisitions. If all of these acquisitions had been approved, then foreign investment review policy would have lost most of its value as an instrument for achieving the government's policy objectives.

The review of new establishments is extremely important in keeping foreign retail chains and wholesalers from entering Canada. However, in book publishing, most foreign publishers already have either a subsidiary or an agent in Canada. Where companies have a Canadian-controlled agent in Canada, the restriction on setting up new foreign-controlled publisher/agent businesses can assist these publishers in retaining their import business only to the extent that the owners of these foreign publishing companies do not already have a subsidiary in Canada. However, much of this agency business involves foreign publishers who already have a subsidiary here (for example. the Simon & Schuster trade business or Scott Foresman textbooks or E.P. Dutton's trade list). The issue then is less whether a new subsidiary can be established than whether that agency business still with Canadian-controlled publishers will at some point in the future be transferred to a directly controlled subsidiary already in the market.

There are some cases in which FIRA or Investment Canada received undertakings from foreign publishers to leave part of their business in Canada with a Canadian-controlled firm. However, such undertakings affect only a minority of the agency business still with Canadian-controlled publishers. Moreover, it is not clear how long undertakings of this kind can be enforced. It also has to be recognized that foreign publishers have the capacity to squeeze the margins of independent arms-length agents by reducing their discount or making other changes so that all the profit is taken by the foreign publisher and the agent is receiving no benefit from handling the business. While as a long-range strategy such an approach would be counter-productive, since it would reduce sales in Canada, in the short term a foreign publisher might accept reduced sales as a means of getting direct control over the distribution of his books in Canada. To the extent that foreign publishers have subsidiaries in Canada, they will clearly be in a position to reduce the attractiveness to any Canadian-controlled publisher of handling that agency business in order to be allowed to take that business over themselves.

The application of the Baie Comeau policy to direct takeovers, like its application to new establishments, has limited potential as a policy instrument to develop a strong Canadian-controlled book publishing and distribution industry. First, the general pattern is that takeovers of companies now controlled by Canadians fall into the category of "direct takeovers," (though there are exceptions as noted below), while the takeover of companies now controlled by non-Canadians generally falls into the category of "indirect takeovers." However, the bulk of the Canadian-controlled sector of the English-language component of the book publishing industry is in a vulnerable position financially and is dependent on distributing imported books for 40 per cent of its existing revenue. Virtually all of this revenue from the sale of imported books is vulnerable to pressure from the now dominant foreign-controlled publishers who can be expected to try to take over more and more of this business if they are treated as exempt from the application of the Baie Comeau policy. Applying the foreign takeover restriction only to the vulnerable, Canadian-controlled sector of the industry, and not to the profitable, foreign-controlled component of the industry, cannot achieve the goals established.

The pursuit by a number of major media giants (including Bertelsmann, Murdoch, Maxwell, Pearson PLC, Paramount, and Hachette) of aggressive acquisition and consolidation strategies is reshaping the book publishing industries in the U.S. and Britain. While predicated primarily on buying expanded market share in the key U.S. and U.K. markets, these strategies have included buying control over distribution in smaller countries as well. The general direction which these firms have been taking leads toward the creation of international distribution structures in the book industry similar to those which already exist in film, with a corresponding pressure toward more homogeneous and commercially-focussed production. The book industry is, however, very different from the film industry, and it is not yet clear to what extent the assumptions of these firms are correct. For some of these firms 1989 was a year when substantial investments were written off and emphasis shifted to whether there was going to be a bottom-line return which reflected the assumptions behind the purchase of companies at extraordinarily high multiples of earnings.

What the exemption of indirect takeovers from the Baie Comeau policy would accomplish is to deliver control over the Canadian marketplace for books to these foreign, multinational companies. What Canada would lose, as a result, is control over the extent of investment in Canadian books, control over the process of selecting those Canadian-authored books which are to be published, and control over the promotion, advertising, publicity and sales resources necessary to launch a book successfully in the domestic market.

As noted above, the <u>Investment Canada Act</u> was deliberately designed to apply equally to direct and indirect takeovers, as was the Baie Comeau policy itself. Any decision to exempt indirect takeovers from Baie Comeau, while continuing to apply the policy to direct acquisition, therefore, would raise fundamental issues of fairness. It would divide companies in the Canadian book publishing and distribution industry into two categories: first, those which are directly held, usually owner-managed companies, and which could only be acquired directly; and second, those which are indirectly held, usually part of large, generally foreign-based, conglomerates, which are only likely to be acquired indirectly. Such a policy would say to one class of owner of a Canadian book publishing or distribution company -- generally a smaller company owned by Canadians -- that they could only sell their companies to other Canadians, rather than to the highest bidder. However, it would say to a second class of owner of precisely the same kind of business -- generally large and usually foreign companies -- that they could sell to anyone, maximizing their financial return.

Such a policy clearly violates the principle of "national treatment." However, since it does so by damaging the financial interest of Canadian, rather than foreign investors, this violation of national treatment will quite properly be no concern of the United States. Nevertheless, it is clear from the interviews carried out for this study that even without a decision to completely exempt indirect takeovers from the policy, the fact that the policy has been administered in a way that has not always required that real control be transferred is seen by Canadian owners of publishing companies as discriminatory, since they believe they would never be permitted to give up de facto control of their companies.

To put the point in its simplest form, the issue is whether the rights of Canadians such as Jack Stoddart of General Publishing, Avie Bennett of McClelland & Stewart, and Ron Besse of Canada Publishing Corporation to sell their companies will be restricted, while those non-Canadians who wish to sell their publishing businesses in Canada to Rupert Murdoch and Robert Maxwell, or any other non-Canadian, rather than to Canadians, will be permitted to do so.

If it were decided to simply stop applying the Baie Comeau policy to indirect takeovers there would also be substantial transitional questions. The principal issue would be whether the exclusion of indirect takeovers would be retroactive, and if so, how far. Would the exemption apply to takeovers which have already occurred, but where the new owners have not yet complied with the policy -- for example, would the News International and Maxwell Communications acquisitions be exempt? And if these transactions were exempt, would those foreign investors who have complied with the policy while it was in effect not feel that they were being treated unfairly in not also being covered by the exemption?

A number of analysts of public policy have also raised the issue of whether there is any logic to treating indirect acquisitions differently from direct acquisitions. Writing on this issue in Foreign Investment in Canada, an established reference service published by Prentice-Hall Canada Inc., Senior Editor, Peter R. Hayden, has argued that:

> There is . . . a problem with phasing out the screening of indirect acquisitions of Canadian firms by American investors . . . Whether control of a Canadian business changes hands as a result of a direct or indirect acquisition that change may still have an effect on the Canadian economy . . . Why should . . . an acquisition be reviewed if it is direct and not reviewed if it is indirect. The effect on Canada is the same regardless of the method of acquisition. [44]

[44] Foreign Investment in Canada, Monthly Report Bulletin, November 30, 1987, (Toronto: Prentice-Hall Canada Inc.), page 2,093.

While in the case of the book industry the central concern is with the cultural, rather than economic, effects of acquisition, the same essential point is obvious: the acquisition of a Canadian book publishing business by non-Canadians has precisely the same effect, whether it occurs through an indirect or a direct takeover.

In considering the option of exempting indirect takeovers, it is also important to recognize that not all indirect transactions involve companies now owned by non-Canadians. While the most common indirect acquisitions involve the purchase of a foreign parent corporation which has a Canadian subsidiary, indirect acquisitions may equally involve the purchase of a Canadian parent corporation which has a Canadian subsidiary in the book publishing and distribution sector. To take only the most obvious example, the W.H. Smith bookstore chain is a subsidiary of the Canadian-controlled company, Federal Industries Ltd. If indirect acquisitions were exempt from the Baie Comeau policy, then the acquisition of Federal Industries by non-Canadians could occur without triggering any requirement that the W.H. Smith bookstore chain remain in Canadian hands. Foreign control over the retail sector of the industry is, however, a fundamental concern of Canadian publishers.

It would, of course, be possible to make provision that indirect takeovers were covered by Baie Comeau when they involve Canadian parent corporations, but not when they involve foreign parent corporations. However, if that were the approach adopted, then the distinction would no longer involve treating indirect transactions differently from direct, but rather treating all Canadian owners of companies in the industry differently from all non-Canadian owners. This would raise even more forcefully the basic issue of whether it is fair to allow non-Canadians to sell in the open market, while requiring that Canadians sell only to other Canadians. The result of such a policy is seen very clearly by the Canadians who own companies in this industry as a reduction in the value of their companies. They accept and support the objectives of the Baie Comeau policy, but will oppose it in a form that prejudices their financial position by comparison with that of non-Canadians.

The option of simply ceasing to apply the Baie Comeau policy to indirect takeovers may also be seen to involve submitting to unreasonable and unfair pressure from the United States. American pressure seems illegitimate in the light of the policies the American Government pursued in order to develop its own publishing industry. The standard industry handbook, The Book Trade of the World, provides a succinct summary of the American approach to achieving cultural sovereignty. From the time the 13 British colonies declared their independence in 1776:

> For the next century the USA freely pirated books of English origin. In 1891 the USA extended copyright protection to British and other foreign authors, with the limitation that to enjoy such protection their works had to be printed in the USA. [45]

---

[45] Sigfred Taubert, Editor, The Book Trade of the World, Vol. II, (New York: R.R. Bowker Company), 1976, page 287.

Because the United States was unwilling to provide copyright protection to books manufactured in other countries, the United States was unable to be a member of the Berne Convention, which was the standard international copyright agreement. From 1891 to 1955 the United States was not a signatory to any international copyright agreement, and in 1955 was only willing to join the newly created Universal Copyright Convention because it permitted the United States to retain its domestic manufacturing requirement for works by citizens or residents of the United States.[46]

In the case of radio and television the United States has also understood well the concern with cultural sovereignty. Just within the past few years the United States required that the Australian, Rupert Murdoch, take out American citizenship before he was allowed to own American broadcasting outlets.

In these circumstances, it is obviously an untenable position for American publishers, the United States administration, or the United States Congress to pretend that they are unable to comprehend the concept of cultural sovereignty. It will appear an unnecessary and awkward thing for the Canadian government to submit to American pressure to eliminate the Baie Comeau policy when that policy is obviously far less interventionist and far less prejudicial to the interest of foreign publishers than the policy the United States itself pursued for almost two centuries.

The U.S. administration's convenient amnesia with respect to its own history, and its determination to prevent Canada from protecting its cultural sovereignty and identity, are evident on the public record in the Statement of Administrative Action tabled with the American legislation implementing the Canada-U.S. Free Trade Agreement on July 25, 1988. At that time, the U.S. administration stated that "Any invocation of this exception [that is, the Cultural Industries exemption from the FTA] to escape obligations of the Agreement that would otherwise apply would be regrettable." The statement went on to say that:

> The United States is exempt from FTA obligations for measures of equivalent commercial effect in response to Canadian measures under article 2005 (1) that would otherwise be inconsistent with the Agreement . . . In determining any such future action, however, the administration would be mindful of the importance of discouraging, if at all possible, the exercise of and reliance on article 2005 (1) by the Government of Canada. At such time as the President takes remedial action in response to actions that would have been inconsistent with the Agreement but for article 2005 paragraph 1, with respect to enactment by the Government of Canada of legislation, proclamation, or other action having the force and effect of law, either directly or indirectly, which impedes the production, distribution, sale or exhibition of films,

46 Ibid., pages 296-7.

television programs, video recordings, or any other measures that would be inconsistent with the Agreement but for the exemption . . . the President shall endeavour to fashion a response in such a manner as to discourage the creation of similar non tariff barriers in other countries.

In these circumstances, the reasons for a decision to exempt indirect takeovers from the Baie Comeau policy would be well understood. This would be the case particularly if, as suggested in this option, no other action were taken.

This option also, by permitting a limited number of large multinational companies to achieve a position of overwhelming dominance, parallel to that which they already have in the film and sound recording industry, would be seen as implicit acceptance of the process of globalization in the cultural industries. By contrast, the 1987 Department of Communications policy paper Vital Links draws a distinction between the process of globalization and that of internationalization. The former is a two-way process implying an exchange of information and cultural expression; the latter, a one-way process. Vital Links noted that: "Canadians are keen internationalists, a vocation implying a breadth and depth of choice. By contrast, globalization is a process leading to centralization of decision making, narrowing of choice." [47]

The Investment Canada Act also includes, as one of the factors to be considered in making decisions on proposed acquisitions by non-Canadians, the "cultural policies enunciated by the government or legislature of any province likely to be significantly affected." The Government of Quebec has pursued a policy intended to ensure that companies in the book industry are 100 per cent owned by Canadian citizens resident in Quebec. Ontario also has legislation in place intended to ensure that all companies selling or distributing paperback books or periodicals in the province are 75 per cent owned by Canadians. Ontario has also expressed its support for the Baie Comeau policy and would likely oppose its termination. As a result, a decision to exempt indirect acquisitions would appear to conflict with the policies of both Ontario and Quebec.

---

[47] Vital Links: Canadian Cultural Industries, (Ottawa: Department of Communications, Minister of Supply and Services Canada, 1987), page 11.

5.2 OPTION 2: STRENGTHEN THE LEGISLATIVE AND ADMINISTRATIVE STRUCTURE FOR IMPLEMENTING THE BAIE COMEAU POLICY

5.2.1 Legislative Changes

The essential legislative changes required as part of such a strategy include the following:

1. **That whether by amendment to the Investment Canada Act, or through separate legislation that would deal with the book industry only or with the cultural industries generally, the test of control should be changed to incorporate a test of "control in fact", including the requirement that "control by contract" not be in the hands of non-Canadians.**

   - The test of control in fact should be such as to ensure that control by contract is not exercised by non-Canadians. In particular, the legislation should permit legitimate and necessary contractual relationships with non-Canadians and particularly with foreign principals for whom the Canadian business may act as an exclusive agent, but should ensure that such agreements do not include provisions which restrict the ability of the Canadian owners to exercise full management control, including the unfettered ability to publish books, to borrow and raise equity capital, and to expand the business.

2. **The definition of a Canadian-controlled company for purposes of the administration of the Baie Comeau policy should also be changed to require at a minimum that, in addition to Canadians owning at least a majority of the voting shares, a majority of all beneficially held shares are also in the hands of Canadians. Consideration should also be given to increasing the percentage of the equity of businesses which must be in Canadian hands to two-thirds of total equity.**

   - In the newspaper, magazine, radio, television and cable television industries the standard used of define the required level of equity participation by Canadians is substantially higher. Using an effective test of 51 per cent leaves the Canadian partner in a venture involving a single non-Canadian shareholder in a vulnerable position. For example, if it is necessary to raise additional equity capital, there is a danger of loss of control. As a result, it would appear preferable to raise the minimum requirement to two-thirds. However, the percentage of Canadian equity participation required above a simple majority is much less important than the test of *de facto* control.

3. **An amendment should also be made which would ensure that the Baie Comeau policy applied to transactions involving the branches of businesses controlled by non-Canadians.**

- There is now substantial scope for the branches of American wholesaling companies to expand into Canada through establishing branch businesses in Canada. This development represents a substantial threat to the survival and development of a separate Canadian book publishing and distribution industry. At the present time the Investment Canada Act provisions make no provision for the review of branch businesses.

5.2.2 Administrative Adjustments

Two separate aspects of the administration of the Baie Comeau policy also require adjustment.

1. **The requirement of divestiture within a two-year period should in future be based on a two year period commencing on the date a transaction being reviewed under the Baie Comeau policy was completed.**

- The original policy was not clear as to the date from which the two year divestiture period was to be measured. The general practice of measuring the two year period from the date at which an applicant agrees to divest in conformity with the policy has led to unreasonable delays and extended negotiations. Since the policy itself applies equally to all applicants, there should be no legitimate need for lengthy negotiations. However, if applicants recognize that they can delay the divestiture date by prolonging the negotiating process, they are provided with an incentive to do so. As these protracted negotiations go on the acquired company may become more and more integrated into the business of the non-Canadian making the acquisition, making it more difficult to enforce the policy.

2. **If necessary, the legislation should be amended to remove any doubt of the agency's ability to require that any non-Canadians involved in establishing a new business or acquiring an existing Canadian business in book publishing and distribution provide any and all information legitimately required to ensure that they are in compliance with the Baie Comeau policy.**

- The successful administration of the ICA is predicated on non-Canadians providing notification of investments and complying with the requirements set by Investment Canada decisions, in this case requirements to comply with the Baie Comeau policy.

- Section 39 of the ICA permits the Minister responsible for the Act to require, when he believes that a non-Canadian has failed to give the required notice of an investment; or has implemented an investment on terms and conditions different from those set out in an application; or has failed to divest himself of control as required; or to meet any other requirements under the Act; that the non-Canadian cease the contravention of the Act or demonstrate that he is in fact in compliance.

- These provisions appear to provide an adequate basis for requesting information in order to ensure notification of transactions reviewable under the Baie Comeau policy, and to ensure that the provisions of the policy are met. However, there is in the publishing industry at least a perception that, regardless of the reason, there has not been sufficient disclosure of information to the agency to ensure that there was notice of all reviewable transactions and that there has been compliance.

- We are not in a position to judge the validity of these concerns or the adequacy of the provisions of the Act related to ensuring compliance. However, it is obvious that the Act must provide the necessary scope to ensure compliance and that in administering the policy a systematic effort must be made to ensure that all non-Canadians affected conform equally to the policy.

5.2.3 Possible Clarification of the Policy

As indicated earlier in this report, there has been some confusion as to what it is that is being acquired when Canadians purchase a controlling interest in any Canadian-based book publisher/agent company affected by the Baie Comeau policy. In these circumstances it may be valuable in any review of the policy to consider clarifying its application to the sale of imported titles handled by any business affected.

While the original statement of government policy does not address the issue explicitly, it does not appear to have been the intention of the Government of Canada to require the sale of copyright to Canadians for any of those imported titles sold and distributed in Canada on an exclusive basis by companies affected by the policy. Indeed, if the policy were interpreted as requiring the sale of copyrights to Canadians, then it would be inconsistent with Canada's international obligations under the Berne and Universal Copyright Conventions. Those agreements prohibit Canada from making copyright protection conditional on meeting any requirements regarding the place of manufacture of titles or the nationality of ownership in them. Any title published in a signatory country has full protection in all countries which are members of these international copyright organizations.

Because there appears to have been confusion concerning the basis for valuation of companies affected by Baie Comeau policy and the related FTA provisions it may be useful to clarify formally that the transfer of copyright is not required in order to comply. The scope of the policy extends only to the ownership of distribution rights for these titles in the Canadian market. The principal limitation implicit in the transfer of exclusive distribution rights rather than publishing rights is that any Canadian who acquires a publisher/agent company has absolutely no right to manufacture copies of the agency titles affected, but simply the exclusive right to distribute those titles in Canada based on purchasing copies from the non-Canadian publisher who does own those rights.

The precise form such an adjustment might take would be that non-Canadians acquiring existing book publishing or distribution businesses in Canada would be permitted to do so if either of the following conditions were met:

1. **They agreed, as provided for in the current policy, to divest controlling interest to Canadians within a two year period in the case of the direct or indirect acquisition of foreign-controlled businesses; or**

2. **They provided an undertaking to assign to a Canadian-controlled business or businesses the exclusive right to market and distribute the books sold by the acquired Canadian business (exclusive of any third party distribution rights which were beyond the control of the company making the acquisition).**

The second option would mean that in the case of an indirect acquisition of a Canadian business which occurred as part of a transaction involving the acquisition of the foreign parent company, the transaction could be approved if in Canada exclusive marketing and distribution rights were assigned to a Canadian-controlled business. As a practical matter, such a transaction might in fact include the purchase by the Canadian business of physical assets of the subsidiary company. However, this adjustment would make it clear that compliance with the policy is not intended to force the sale of copyright in any book properties.

5.2.4 Advantages

The advantages of the policy remain the same as were stated at the time the policy was adopted. Essentially the policy represented an effective approach to protection Canada's cultural sovereignty and identity, while avoiding either any retroactive application of the policy to non-Canadians who owned companies in the industry before the policy was announced and without compromising the copyright protection provided to books published in other countries which are signatories to the Berne or Universal Copyright Convention.

As noted earlier in this report, the October 1989 study prepared for Investment Canada by Peat Marwick under the title, English-Language Book Publishing and Distribution: Issues and Trends, confirmed the original premise of the Baie Comeau policy. Effective implementation of the policy has the potential to substantially strengthen the Canadian-controlled sector of the industry, to provide economies of scale of operation to Canadian-controlled companies and to improve the ability of the industry to continue to finance the production of a wide range of books by Canadian writers and to market those titles more effectively.

The key sector approach implicit in the Baie Comeau policy is consistent with policies already in place which affect the newspaper, magazine, radio, television, cable and telecommunications sectors. Taken together the cultural and communications sector of the economy has always been regarded as having a special role in nation-building and in maintaining flows of information and expression from East to West. Permitting the English-language book industry in Canada to become essentially a continentally-structured industry, with the vast majority of that industry simply made up of subsidiaries of U.S.-based book publishers and distributors would be inconsistent with that tradition of recognizing the special role of the culture and communications sector.

Every major study of the book industry has concluded that the publishing of a diverse range of books by Canadian writers, and including books about Canadian subjects, is linked to maintaining a strong Canadian-controlled industry. For foreign publishers their Canadian subsidiaries are fundamentally a means of marketing in Canada the titles published by the parent company. Even with an active Canadian-controlled component of the industry setting the pace by publishing Canadian books on a wide range of subjects, the foreign-controlled publishers confine their publishing of Canadian titles to Canadian textbooks and established, popular writers of trade books. All of the available evidence indicates that in the absence of a strong Canadian-controlled book publishing industry, a broad range of Canadian-authored books would not continue to be published.

American policy for almost two centuries was driven by a recognition of the essential and fundamental role of communications in building a new nation. Commenting on this obsessive concern the American scholar, James Carey made the following observation in a recently published book Communication as Culture:

> How was this continental nation to be held together, to function effectively, to avoid declension into factions, or tyranny or chaos? How were we, to use a phrase of that day, "to cement the union"? . . . the answer was sought in the word and the wheel, in transportation and transmission, in the power of printing and civil engineering to bind a vast distance and a large population into cultural unity . . . This required placing enormous emphasis upon literacy, the press and education.[48]

---

[48] James W. Carey, Communication as Culture: Essays on Media and Society, (Boston: Unwin Hyman, 1989), page 5.

Carey notes that in two of the essays in the Federalist Papers, (numbers 10 and 14) Madison argued that improvements in communications would efface distance and facilitate continental democracy. Carey goes on to note that:

> In this fragile society technology and communication created the hope of economic, political, and cultural unity. Small markets thinly spread in space could be integrated into one large market capable of efficient exploitation. Small political units thinly dispersed in space could be collected into one political organism. Small cultural enclaves thinly dispersed over a continent could be collected into one great community.[49]

It was in the context of these objectives that the United States policies described above were established. As noted already American policy in book publishing fundamentally damaged the interest of publishers in other countries, and particularly Great Britain, by removing their copyright protection if they shipped more than 1500 copies of any book into the American market.

The publishing industry in Canada, and the cultural and communications industries generally, have an equally important role to play in maintaining Canada as a distinct society. Recently, as an internal policy issue, Canadians have been asked to reaffirm their belief that Quebec should be preserved and protected as a distinct society within Canada. Issues related to the control over the functioning of the book industry and other communication media in Canada raise in the international context the question of whether there is a will to maintain Canada itself as a distinct society within the community of nations. Within this context, the Baie Comeau policy can play an important role in maintaining the distinctive traditions, values and cultural and artistic expression of Canadians.

This option also has the advantage of pursuing the objectives stated for the book publishing industry in Canada at the lowest possible direct cost to Government. While there are associated costs, they involve only the potential FTA costs. With the GST beginning to generate revenue for the Government of Canada in 1991, and with postal rate subsidy for books reduced by $35 million in 1991-92, the net financial impact on government would be extremely positive.

5.2.5 Disadvantages

Since this option incorporates no incentives for compliance with the Baie Comeau policy, it is the option that will generate the greatest opposition from the foreign companies whose ability to buy up firms in the Canadian book

---

[49] Ibid., page 8.

industry will be restricted. This does not mean that the foreign companies affected have been unanimously opposed to the policy, in fact, some firms have complied voluntarily. However, there are now very powerful foreign firms which are opposed, and any moves to reinforce the legal and administrative arrangements for implementation of the policy, particularly if taken in the absence of incentives for compliance, will be aggressively resisted.

There is also some vulnerability implicit in this course of action, to the extent that foreign companies applying to Investment Canada for approval to buy firms in Canada may threaten to close those firms, rather than to divest control to Canadians. This threat was made publicly, in the case of the acquisition of Prentice-Hall by Paramount; in effect Paramount's position at times seemed to be: either let us buy the firm, or we will close it.

Opinions as to the reality of this threat vary. Almost all of the publishers interviewed for this study believed that no publisher could successively maximize sales in the Canadian market who did not operate through a Canadian-based company -- whether a directly-controlled subsidiary or a Canadian-controlled agent.

The possibility of serving Canada from a U.S. base clearly varies, depending on the type of publishing involved. Certainly in educational publishing no company could expect to do well operating from a base outside Canada, and particularly in elementary and high school textbook publishing. In encyclopaedia publishing it would also appear quite unlikely that any publisher would try to operate from a non-Canadian base. Opinions differ as to how successfully general trade book publishers could operate from outside Canada, but the publishers themselves seem extremely skeptical that this is a real option. The one aspect of publishing operations that some, but not a majority, believed could be successfully relocated was warehousing and order fulfillment.

By contrast, it seems obvious that mass market paperback publishers and direct mail publishers are able to function reasonably successfully from a U.S. base. A number of mass market publishers already function with only a minimal presence in Canada, as do the Time-Life book clubs and its direct mail publishing division. However, by contrast, Doubleday's book clubs operate out of Canada at present, and when Bertelsmann acquired Doubleday, shares were sold to Canadians in compliance with the requirements of the <u>Investment Canada Act</u>. Readers' Digest's direct mail publishing business also functions from a Canadian base.

It is clearly a complex matter to decide to what extent threats to withdraw from Canada represent only an attempt to bully the Government of Canada into approval of foreign takeovers of companies in the book industry, rather than a real option which companies would follow through on and maintain. All that can really be said is that almost all major foreign publishers at present have either an agent or a subsidiary in Canada.

It seems certain, however, that this issue of withdrawal from Canada will continue to exist as a vaguely perceived threat whose substance it is difficult to judge. Because this is that case, and because there are broader concerns related to the potential development of a more fully integrated North American English-language book industry dominated by U.S.-based publishers and distributors we have looked separately in chapter 6 at policy options which are available to the Government of Canada which would limit any trend toward a continental industry.

In addition to arousing opposition from foreign multinationals wishing to acquire an even greater strangle-hold on the Canadian market, this option is also most likely to result in renewed opposition from the United States Government. Certainly it is consistent with the broad American initiative to pressure foreign governments into eliminating or preventing the establishment of barriers to investment or to the flow of American cultural products into foreign markets.

The current American strategy represents the second phase of a policy which began by keeping foreign cultural products out of the American market and maintaining control by Americans over the culture and communications sector. Once the United States achieved a position of having a substantial comparative advantage, its emphasis shifted to eliminating any foreign obstacles to the export of its own publications, films, television programs, and other cultural products. More recently, there has been substantial agitation within the United States over the acquisition of some major American media giants by foreign investors and it remains possible that a third phase of American policy could result. It is significant to note that, even with a quite limited level of foreign equity investment in its economy, the United States has begun to monitor foreign investment and to restrict such investment in areas deemed important to national security.

An additional disadvantage of this option is that it does nothing to reduce the potential for the Government of Canada to sustain some financial losses as a result of acquiring businesses in the sector under the FTA provisions and selling them at a lower price to Canadians. This option neither eliminates the review of indirect acquisitions by Americans, nor does it provide any incentive structure which might increase the value to Canadian owners of businesses affected by the policy -- and, as a result, increase the amount Canadian investors might pay for companies in the sector, including the probability that such transactions would occur without the government being involved.

These potential FTA costs cannot be budgeted for, since the likelihood of such transactions occurring in the future is impossible to predict. As noted earlier, the extent of such exposure will depend on the way the "fair open market value" concept is interpreted.

In the context of the initiation of the GST on books, it must be recognized that this option does not address the expected quite negative effects of the GST on the publishing of Canadian-authored books. As indicated earlier, the cost of sales for Canadian-authored books is substantially higher than for imported titles, and it is an important disadvantage of this policy option that it does not address the issue.

Finally, it must be noted that we heard criticism of this policy option from some Canadian publishers who would prefer to see a different approach taken to achieving Canadian control of book publishing and distribution. Rather than waiting until companies change hands before requiring that Canadian control be established, they would prefer to have the government pass legislation which would provide as follows:

- that before a designated date (within a two or three year period) all Canadian businesses a substantial part of whose business involves the publishing of books in Canada and/or the importation or marketing of books as an agent for a foreign publisher or publishers, or the wholesale or retail distribution of books in Canada, shall be majority owned and effectively controlled by Canadians.

The rationale for this view is that the importance of Canadian control over the national book industry is as great as in the case of broadcasting. At present, the Broadcasting Act provides for Canadian ownership and control of all companies in the industry; and it clearly is possible to argue that an industry which provides the textbooks and learning materials used in Canadian schools, as well as books for the general public dealing with every aspect of Canadian life, is of substantial significance for the future development of Canada.

Some publishers also argue that, while this alternative, unlike the Baie Comeau policy, would require divestiture by existing owners of companies in the book industry, it is inherently fairer, since as of the date the requirement would take effect, it would put all companies in the industry on the same footing. There is also a belief that foreign investors might be more willing to go along with this approach than with the Baie Comeau policy. The logic behind this view is that one of the concerns of some of the non-Canadian interests affected by Baie Comeau is that they do not have a major presence in Canada while other big multi-nationals which are their direct competitors do. If, for example, Paramount and McGraw-Hill own companies in Canada and are free to continue to own them unless their ownership changes, then News International and Maxwell Communications are more anxious to have a corporate presence in Canada sanctioned by government.

Clearly, a substantial case can be made for this alternative approach. Further, in the case of the broadcasting sector, there is precedent for an approach which is applied retroactively, requiring simultaneous divestiture by all foreign owners. Very substantial assets changed hands as a result of this 1968 initiative in broadcasting. The government's policy statement on telecommunications policy also indicates that the Government of Canada intends to require that all Class I telecommunications carriers should be 80 per cent owned by Canadians -- an approach which would require divestiture by non-Canadian investors in some of the businesses affected.

We do not anticipate that there would be any shortage of Canadian buyers if such a policy were adopted. To the extent that businesses in the Canadian book industry have been available to Canadian investors on a basis that made financial sense, there has never been a difficulty in raising the necessary funds -- whether in the case of Federal Industries acquisition of the W.H. Smith bookstore chain, which had reported revenues of $178 million annually, or the acquisition of Simon & Schuster's Canadian subsidiary by General Publishing, or Ron Besse's acquisition of Gage Educational Publishing from Scott Foresman. To the extent that shares in McGraw Hill Ryerson are available to Canadians (approximately 30 per cent is available), such shares have been acquired. What has been lacking in the case of the Canadian book industry is sellers, not buyers. Non-Canadians own most of the viable companies, and if they are free to do so, will continue to own them, and in fact to use their strong, established position and competitive advantages to expand their market share.

The fundamental issue with this alternative approach of requiring divestiture by all non-Canadians is that it would have a retroactive impact. While such an approach has both precedents and advantages, as noted above, it is substantially more interventionist than an approach which affects, as Baie Comeau does, only transfers of ownership to new non-Canadian owners.

5.3 OPTION 3: STRENGTHEN THE LEGISLATIVE AND ADMINISTRATIVE STRUCTURE FOR IMPLEMENTING BAIE COMEAU AND ESTABLISH INCENTIVES FOR COMPLIANCE

While this option might vary in its precise composition, our examination has assumed that it would have the following four components:

1. **Legislative and administrative changes would be made affecting the implementation of the Baie Comeau policy, as described in OPTION 2 above.**

2. **A fully refundable tax credit would be provided to Canadian-owned and controlled companies which are involved primarily in book publishing, with the credit based on the cost of developing new, or revised editions of existing, books written by Canadian authors. It would be a requirement that any books benefitting from this incentive be distributed by Canadian-controlled companies. A three tier system of tax credits is proposed as follows:**

   - **eligible English-language publishers based in Ontario: 40 per cent of eligible expenditures.**

   - **eligible French-language publishers based in Quebec and eligible English-language publishers based in British Columbia and Alberta: 50 per cent of eligible expenditures.**

- all other eligible publishers: 60 per cent of eligible expenditures.

3. The revised $25 million program of support for the distribution of books in Canada, which will replace the $60 million postal subsidy program, would be based on the following principles:

   a) Support would be provided to Canadian <u>suppliers</u> of books (including publisher/agents, wholesalers, and book clubs) and not to Canadian <u>purchasers</u> of book (including libraries or retail bookstores);

   b) Access to such distribution support would either be restricted to Canadian-owned and controlled companies (redefined as proposed in OPTION 2), or to Canadian-owned and controlled companies plus foreign-controlled businesses whose ownership has not changed since the Baie Comeau policy came into effect in 1985 and which undertake to comply with the policy should their ownership change in the future;

   c) All recipients of distribution assistance would be required to operate fully integrated businesses within Canada, including warehousing books in Canada and fulfilling orders from a Canadian base; and

   d) All recipients of distribution assistance would have to undertake to pay the full postage or shipping costs to either retail bookstores or libraries throughout Canada.

4. A program of financial assistance would be provided through which Canadian-owned and controlled book publishers could have access to at least $25 million in loan or equity capital, perhaps through the Federal Business Development Bank. Unlike either the proposed tax credit or distribution assistance, this program as it affects book publishing could be phased out after a five year period, assuming that the first three elements of this policy option were implemented. It would be desirable that the extent of financing available in the first year or two of the program not be restricted arbitrarily, since it must be anticipated that there may be the greatest demand for such assistance early in the five year period.

5.3.1 General Description of the Incentive Elements of OPTION 3

a) The Refundable Investment Tax Credit

At the present time the Income Tax Act provides significant incentives to Canadian manufacturing and processing companies, and in particular a tax credit based on expenditures for scientific research and development. Scientific research and development is defined to include the creation of new products, or the improvement of existing materials, devices, products or processes. Special provisions regarding the level of the credit and its refundability apply to private Canadian-controlled corporations. However, book publishers do not now benefit from such an incentive in relation to their own development expenditures.

In 1989 Canada's imports of books exceeded exports by $750 million. Imports have been growing substantially, while exports are declining. Imports account for over two-thirds of book sales in Canada, Canadian-published titles for less than a third (31%). Canadian-authored books account for an even smaller percentage of total sales, estimated at about 25 per cent.

The most significant factors differentiating Canadian- and foreign-controlled publishers are their respective cost of books sold. For large, English-language, Canadian-controlled publishers the cost of sales in 1987-88 was 57.7 per cent of revenue, by comparison with 48.5 per cent for foreign-controlled publishers; while for French-language publishers the corresponding figures were 60.0 per cent and 43.8 per cent. The difference reflects the fact that most of the books sold by foreign-controlled firms are imported, with editing, typesetting, design and other development costs already paid, and fixed costs spread over longer print runs. Canadian-controlled firms also produce four times as many new Canadian titles each year as foreign-controlled firms. The fixed costs of producing this diverse range of Canadian titles are a major factor in increasing the average cost of sales for domestic publishers.

While not precise, the information provided in Tables 30 and 31 illustrates the nature and extent of the differences in the operating cost structure of Canadian- and foreign-controlled publisher/agents. As Table 30 indicates, the percentage of employees involved in the various publishing functions varies significantly. In English-language publishing, for example:

- while 20.7 per cent of all employees in Canadian-controlled companies are involved in editorial, design and production activities, the corresponding figure for foreign-controlled companies is just 11.8 per cent -- reflecting the differences in the number of Canadian books being produced and differences in the extent of involvement in selling imported books, for which all editorial, design and production work has been done outside Canada.

TABLE 30

Number and Percentage of Full-Time Employees of Publishers and Exclusive Agents, By Language and Country of Controlling Interest, 1987-88

	Canadian-Controlled Publishers				Foreign-Controlled Publishers			
	English		French		English		French	
	#	%	#	%	#	%	#	%
Working Owners	14	0.5%	4	0.4%	0	0	0	0
Editorial	328	12.3%	90	8.5%	266	8.4%	22	12.0%
Design & Production	225	8.4%	145	13.6%	111	3.5%	8	4.3%
Marketing & Sales	566	21.2%	190	17.8%	1,225	38.5%	37	20.1%
Fulfillment	490	18.3%	317	29.8%	716	22.5%	50	27.2%
Administration	653	24.4%	275	25.8%	620	19.5%	50	27.2%
Not Specified	398	14.9%	44	4.1%	244	7.7%	17	9.2%
TOTAL	2,674	100.0%	1,065	100.0%	3,182	100.0%	184	100.0%

SOURCE: Statistics Canada.

TABLE 31

Salaries of Full-Time and Part-Time Employees and Outside Fees of Publishers and Exclusive Agents, By Language and Country of Controlling Interest, 1987-88

	Canadian-Controlled Publishers						Foreign-Controlled	
	English		French		Total *		Total	
	$	%	$	%	$	%	$	%
Editorial	11,169,590	14.4%	4,679,164	13.4%	15,848,754	14.1%	10,161,235 ▲	12.3%
Design & Production	7,058,283	9.1%	7,379,247	21.1%	14,437,530	12.8%	3,397,992	4.1%
Marketing & Sales ▪	18,652,250	24.0%	6,189,926	17.7%	24,900,311	22.1%	27,464,108	33.3%
Fulfillment	11,046,286	14.2%	6,965,460	19.9%	18,011,746	16.0%	14,778,487	17.9%
Administration	21,506,523	27.7%	8,236,386	23.6%	29,783,155	26.4%	16,904,426	20.5%
Not Specified	8,000,674	10.3%	1,480,895	4.2%	9,481,569	8.4%	9,195,702	11.2%
TOTAL ▪	77,679,792	100.0%	34,956,523	100.0%	112,636,315	100.0%	82,356,669	100.0%

SOURCE: Statistics Canada.

NOTES:
* Totals do not equal sum of English and French Columns due to language being withheld to protect confidentiality in the Marketing & Sales and Administration Categories.

▲ Figures for part-time employees are included by Statistics Canada in "not specified" category, in order to protect confidentiality.

▪ Certain figures for exclusive agents withheld by Statistics Canada to protect confidentiality.

Figures do not add due to data withheld by Statistics Canada to protect confidentiality.

- while 21.2 per cent of the employees of Canadian-controlled companies are engaged in sales and marketing activities, the corresponding figure for foreign-controlled companies is much higher, at 38.5 per cent.

Where there is very little difference is in administrative and order fulfillment activities, with 42.7 per cent of employees involved in these functions in Canadian-controlled firms and 42 per cent in foreign-controlled. Given the extent to which employees functions were not specified by respondents, the difference is not significant.

In French-language publishing, there are also significant differences:

- 22.1 per cent of all employees in Canadian-controlled companies are involved in editorial, design and production functions, by comparison with 16.3 per cent in foreign-controlled companies.

- 17.8 per cent of employees in Canadian-controlled firms are involved in marketing and sales activities, by comparison with 20.1 per cent for foreign-controlled firms.

Here too there are no significant differences in the percentage of employees involved in fulfillment and administration in Canadian- and foreign-controlled companies.

While for confidentiality reasons a breakdown of salary and fee expenditure could not be provided separately for foreign- and Canadian-controlled French-language publishers, the broad pattern of differences by type of activity is evident in combined salary and freelance fee expenditures.

- While 23.5 per cent and 34.5 per cent respectively of total salary and freelance payments by English- and French-language, Canadian-controlled publishers are related to editorial, design and production costs, the corresponding figure for foreign-controlled publishers was 16.4 per cent.

- By contrast, while just 24.0 and 17.7 per cent respectively of salary and fee expenditures by English- and French-language, Canadian-controlled publishers are for marketing and sales activities, such expenditures represent a third of the total for foreign-controlled firms.

The cost advantage of foreign books and foreign publishers has been recognized for many years, but the only action taken in response has been to provide direct subsidy: however, the subsidies are usually focussed on titles with limited potential for financial success. The 1973 Ontario Royal Commission on Book Publishing explained the problem as follows:

> The cost advantage enjoyed by the foreign publisher operating in Canada is as overwhelming as the economics of his advantage are easily explained. Fixed costs in book publishing are small in comparison with many other industries -- but then so are the markets. A new title can be put out for a fraction of what it costs to add a new product line in other enterprises, but in book publishing the proportion of fixed costs to variable cost in each unit produced is very much higher.
>
> . . . Thus a Canadian-owned publisher, issuing Canadian books . . . for the Canadian market primarily, can hardly hope to generate enough working capital to permit large-scale healthy expansion of his book publishing program in the face of foreign or foreign-owned competition which is largely based on run-on costs of editions first published abroad. [50]

While part of a policy for strengthening Canada's domestic book publishing industry must, in an import-dominated market, be to pursue policies which will protect and enhance the revenues Canadian-controlled firms earn from their exclusive agency business, it is equally important to address the basic issue of the economics of publishing books by Canadian authors to meet a wide diversity of Canadian needs in French and English and in all regions. What is proposed is to provide a fully refundable tax credit based on expenditures to develop new Canadian-authored books. The basic concept of sharing the risks inherent in developing new products is already recognized in the R & D incentives provided to manufacturers in the Income Tax Act.

Effective January 1, 1991 the book publishing industry, which has traditionally been exempt from the federal sales tax -- neither paying nor collecting tax -- will be subject to the Goods and Services Tax. The amount of tax to be collected in the first year is estimated at between $175 million and $200 million, depending on the extent to which the tax can be collected on sales made by foreign suppliers directly to individual and institutional consumers in Canada. In an examination of the likely impact of the tax, Woods Gordon noted that it would "move directly to counter the various measures which governments have put in place to foster a domestic industry producing culturally important work." Woods Gordon concluded that Canadian book publishers have little ability to pass such a tax on to their suppliers or buyers and less capacity to absorb it because of low profitability and small reserves. [51]

Since July 1985 the Government of Canada has also been pursuing, through the Baie Comeau policy, a practice of requiring that, when ownership changes occur in book publishing, control is transferred to Canadians. However, no substantial incentives are now in place which encourage and complement this

---

[50] Canadian Publishers and Canadian Publishing, Royal Commission on Book Publishing, Queen's Printer for Ontario, 1973, page 54.

[51] Woods Gordon, "Impact of a Multi-Stage Sales Tax on Book Publishers, Booksellers, and Periodical Publishers", September, 1987, pages iii and v.

policy by making companies in the industry more valuable to Canadian than to non-Canadian owners. In the other print media -- newspaper and magazine publishing -- section 19 of the Income Tax Act provides substantial benefits, based on both Canadian ownership and the origination of Canadian content editorial material.

Implementation of the incentive will require definitions of "eligible book publishers", "books", "Canadian-authored books", and "eligible development expenditures". There are substantial precedents for defining these terms in existing legislation and program guidelines, except in the case of development costs. With respect to development costs, the approach proposed reflects a review of the existing provisions of the Income Tax Act related to eligible expenditures for scientific research and development, combined with a desire to base the incentive on verifiable direct costs. It is also proposed that the Department of Communications perform the function of certifying expenditures on eligible titles, and possibly eligible publishers as well. The Department already performs this function of certification for Canadian films and videotapes for purposes of the capital cost allowance incentive in the Income Tax Act.

While more detailed and precise definitions will be required, the basic elements of the proposed definitions are as follows:

"Eligible Publisher": To benefit from the tax credit proposed publishers must meet the following criteria:

- Book publishing must be a primary activity of the business, with revenue from the sale of books published and books distributed as an exclusive agent in Canada representing the major source of revenue.

- The business must be owned and controlled by:

  (i) a Canadian citizen or an association or society of which at least three-quarters of the members are Canadian citizens;

  (ii) a partnership of which at least three-quarters of the members are Canadian citizens and who also own at least three-quarters of the total value of the partnership property;

  (iii) the Crown in right of Canada, or a province, or a Canadian municipality;

  (iv) a corporation incorporated in Canada of which the chairman or other presiding officer and at least three-quarters of the directors or similar officers are Canadian citizens. If the corporation has share capital, at least three-quarters of the voting shares and shares representing three-quarters of the paid-up capital, must be beneficially owned by Canadian citizens or by corporations which are not controlled by citizens or subjects of a foreign country.

(v) In addition, the book publishing firm must not be subject to control directly, or in any manner whatever, by a non-Canadian corporation, person or group of persons.

NOTE: This proposed test of Canadian ownership and control essentially combines the standard already used for the other print media in Canada -- Canadian newspaper and magazine publishers -- with the test of "de facto control", which was implemented as part of Tax Reform 1987.

- Eligible publishers are publishers which are involved primarily in publishing books for sale to the general public and/or for use in educational institutions in Canada, and exclude publishers involved primarily in producing books for use by professionals in the legal, accounting or other professional fields.

- Qualifying publishers must carry on integrated publishing operations within Canada, with warehousing and order fulfillment functions for the Canadian market carried out substantially from a location in Canada.

- The province of location of an eligible publisher would be determined on the basis of the location at which a majority of full-time employees normally work. For purposes of establishing whether companies are English- or French-language publishers, the decision would be based on the language of the books which account for most of publisher's revenues. In the case of two or more related businesses which are eligible for support, all related businesses will be combined in order to determine their location and language category.

"Book" means a bound, non-periodical printed publication which has a minimum of 48 pages (except in the case of children's books) that contains no paid advertising and that is published solely for educational, technical, cultural or literary purposes and is intended primarily for use in educational institutions or sale to the general public. "Book" may include books in braille and learning materials, teacher's guides, kits and workbooks supporting educational textbooks or prescribed programs of study in educational institutions.

"Canadian-authored book" includes books written, translated, or edited either by a Canadian citizen ordinarily resident in Canada, or by a landed immigrant resident in Canada, and includes books adapted by a Canadian or landed immigrant. Qualifying Canadian-authored books would include only books which were distributed by Canadian-owned and controlled publisher/agents, based on the definition of Canadian ownership and control proposed in OPTION 2.

"Eligible Development Expenditures" include:

- the full salaries of all employees involved for at least 90 per cent of the time in editing or design activities or in managing the process of developing prototypes of books and making arrangements for them to be printed; all freelance fees and other direct payments related to these functions; as well as salaries, wages and other fees paid to secretarial and other support staff involved at least 90 per cent of the time in assisting staff responsible for editing, design and "production management" (as defined above). In cases in which an eligible business is engaged in producing ineligible as well as eligible titles, the extent to which salary and fee expenditures in these categories qualify as part of "eligible development expenditures" shall be based on the percentage of the total number of pages in all new or revised titles published that year which were in eligible Canadian-authored books.

- in the case of smaller publishing companies in which the same individuals may be involved in different aspects of the publishing business, the option should be provided of choosing to claim as a part of eligible direct development expenditures an amount for eligible salaries, wages and fees based on a standard percentage of the total of other eligible direct prepublication expenditures, as specified below. While further analysis is needed before setting this percentage, the analysis we have done indicates that the figure would be close to 50 per cent.

- artwork, including photo research, graphics, print and permission costs, photography, maps, etc.

- development of a prototype and preparation for printing, including typesetting, proof correction, layout and assembly, colour separation, imposition, film and print plates; and

- field or pilot testing of learning materials.

- any advances against royalties to Canadian authors not recovered three years after publication of the title against which the royalty advance was made.

Excluded are all costs of paper, printing and binding, royalties, market research, sales promotion, and general operating and administrative overheads.

In order to estimate the impact of establishing such an incentive and the related costs to government in foregone tax revenue, two sources of information were used. First, we went to eight of the larger Canadian publishers and requested information regarding their total sales, sales of Canadian-authored books, eligible development costs, and pre-tax profit. On a consolidated basis that analysis produced the following findings:

Total book sales:	$108,038,000
Total sales: Canadian-authored books:	$42,933,000
Total development costs:	$10,121,000
Pre-tax profit:	$789,000

The pre-tax profits reported -- less than one per cent of revenue -- are typical of the Canadian-controlled sector of the industry (assuming one excludes Harlequin, which is not typical of the industry and would not qualify for the proposed incentive). The reported development costs reflect heavy investments in new areas of publishing by one of the eight firms; and as a percentage of sales of Canadian-authored books the ratio of 23.6 per cent indicated above would drop to 18.5 per cent if this firm were excluded.

For this group of companies, the impact of the refundable tax credit proposed would be as follows:

- Had such an incentive been in place, its value to these firms would have been $4.1 million, representing 3.8 per cent of their total revenues and 9.6 per cent of revenues from the sale of Canadian-authored books.

- The existence of such an incentive would have increased average pre-tax profit for these companies from $789,000 to $4.9 million, or from 0.7 to 4.5 per cent of revenue.

We also examined Statistics Canada data. While the survey does not at present divide publisher's cost of sale into plant costs (typesetting, etc.) and running costs (paper, printing and binding) it did so in the past. We examined the 1981-82 survey results, the last year this breakdown was requested, for all companies which provided a full break-down of relevant costs. The results of that analysis are as follows:

Plant costs:	$20,015,000
Editorial salaries & fees:	$9,894,000
Design & production salaries/fees:	$3,072,000
Total development expenditures:	$32,981,000
Sales of Canadian books:	$144,759,000

Development costs as a % of Cdn. book sales:	22.8%

The data examined for individual companies make it clear that there is a significant difference between educational publishing and trade publishing in the ratio of development costs to revenue from the sale of Canadian-authored books. In the case of trade books, development costs varied from 12 to 16 per cent of revenue; while for educational publishing the corresponding figure appears to vary from 20 to 27 per cent. The percentages are in relation to sales of Canadian-authored books and as a percentage of total sales of books, inclusive of imports, would be much lower, since there are no costs in these categories for imported titles.

In order to prepare an estimate of what this refundable tax credit might cost the government if it were in effect in 1991, a breakdown of sales of Canadian-authored books by province of location and language of the purchaser was examined. That analysis has been used as a basis for preparing Table 32, which offers an estimate of the impact of the incentive proposed, including the extent to which government revenue would be reduced. The total value of the proposed incentive to Canadian-controlled publishers in 1991 is estimated at $32.4 million. Of this total, $21 million, or 65 per cent, would be accounted for by English-language publishers, and $11.4 million, or 35 per cent by French-language publishers. Of the total, $3.3 million would represent the value of the incentive to Canadian-controlled publishers outside Ontario and Quebec.

Implementation of the incentive would involve a contingent benefit to companies which are foreign-controlled to which they could have access only if their ownership were transferred to Canadians. The amount involved is $21.4 million, which represents a contingent liability from the perspective of government. The additional foregone revenue would bring the total potential cost to government to $53.8 million.

To the extent that the incentive generated an expansion in the publishing of Canadian-authored books, and an expanded market share, the resulting expansion of employment would create additional tax revenues. The experience at the time an incentive was created for Canadian periodical publishing was that substantial growth did result. However, in the context of implementation of the GST, caution must be exercised in projecting resulting growth in Canadian publishing, especially in the short term.

The above calculations of the impact of the incentive and its cost to government do not take into account the fact that some Canadian-authored books will not qualify for the incentive because they are produced primarily for sale to professionals in the legal, accounting or other professional fields. The impact of the exclusion of such titles is difficult to estimate because data are not collected which would permit a careful estimate. However, a reasonable guess would be that this exclusion might reduce the cost by 10 per cent.

The administrative costs involved in implementing such an incentive are estimated at between $1 million and $1.5 million annually, with the Department of Communications handling the principal administrative functions.

TABLE 32

Estimates of Sales of Canadian-Authored Books, Non-recurring Pre-publication Expenditures Related to Canadian-Authored Books, and Value to Industry of Proposed Tax Credit, by Language and Region of Publisher, 1991

	Canadian-controlled Publishers		Foreign-controlled Publishers	
	English-language	French-language	English-language	French-languag
	$000's	$000's	$000's	$000's
Sales of Canadian-authored books (1)				
- Quebec	5,500	96,900	--	24,000
- Ontario	187,400	2,500	202,200	--
- B.C./Alberta	27,400	n/a (2)	--	--
- Other	5,300	n/a (2)	--	--
TOTAL	225,600	99,400	202,200	24,000
Estimated development costs (3)				
- Quebec	900	22,300	--	5,500
- Ontario	43,100	400	46,500	--
- B.C./Alberta	5,500	n/a	--	--
- Other	800	n/a	--	--
TOTAL	50,300	22,700	46,500	5,500
Estimated Value of Development Tax Credit Incentive (4)				
- Quebec	500	11,200	--	(2,800) (5
- Ontario	17,200	200	(18,600) (5)	--
- B.C./Alberta	2,800	--	--	--
- Other	500	--	--	--
TOTAL	21,000	11,400	(18,600)	(2,800)

NOTES:

1 Sales are distributed based on actual data for 1987-88 and an assumption that total sal of Canadian-authored books in 1991 will be $550 million.

2 Small amount included with Ontario to protect confidentiality.

3 Development costs are estimated based on the assumption that they represent 23% revenue from Canadian-authored books in Ontario and Quebec, 20% in B.C and Alberta, 16% in other provinces. The variations reflect differences in the extent of involveme in publishing textbooks, where development costs are significantly higher.

4 Based on a refundable tax credit with variable levels as follows: Ontario English - 40%; Quebec French and B.C./Alberta English - 50%; and Other - 60%

5 As foreign-controlled publishers, the firms involved would not qualify for the incentive unless they became Canadian-controlled.

b) Book Distribution Assistance

It is intended that the current $60 million postal subsidy for books will be replaced by a $25 million program of assistance towards all distribution expenditures, rather than simply postal expenditures. As described earlier in this report, the existing postal subsidy program does not discriminate between Canadian and foreign-controlled publishers, or between companies based in Canada and those in other countries who truck books across the border for mailing with Canada Post.

More general issues related to the importation and distribution of books in Canada -- and in particular possible legislative initiatives -- are looked at in Chapter 6. However, to the extent that a decision is made to do so, the replacement program for the current postal subsidy to books, while at a greatly reduced level of funding, has the potential to provide an incentive for compliance with the Baie Comeau policy, as well as to contribute to meeting other policy objectives.

while the following figures must be used with some caution, our interviews and the limited data available suggest the following:

i) That in English-language publishing the total cost of shipping (including postal costs) for books averages between two and three per cent of publishers sales (net of returns).

ii) That in French-language publishing such costs range from one to one-and-a-half of net book sales.

These figures need to be considered in relation to the breakdown of sales by customer category. While the data require more explanation than is possible within the scope of this report, Table 33 indicates to whom English- and French-language publishers are selling their books. The following key points relevant to decisions on distribution assistance emerge:

- Sales to retailers were $343.0 million in 1987-88, including $233.0 million and $110.0 million for English- and French-language publisher/agents respectively.

- Sales to wholesalers (who in turn supply mainly public, educational and other libraries) were $115.4 million ($90.4 million for English-language publisher/agents and $25.0 million for French-language publisher/agents. Direct sales by publisher/agents to libraries were $30.7 million.

- Sales to book clubs were just $25.6 million, of which $24.9 million was reported by English-language publisher/agents.

TABLE 33

Net Sales by Customer Category and Language of Publisher/Agent, 1987-88
($000's)

Customer Category	English-language		French-language	
Wholesalers	90,384	(11.2%)	25,041	(12.8%)
Retailers				
- Accredited	5,444		46,069	
- Independent	34,267		3,765	
- Campus	53,251		7,199	
- Chain	68,287		3,710	
- Department Store	8,495		4,944	
- Other	63,248		44,335	
Sub-total	232,993	(28.5%)	110,022	(56.2%)
Institutional (direct)				
- Govt/Special Libraries	18,446		563	
- Public Libraries	11,475		245	
- Elementary/High Schools	130,040		30,380	
- Post Secondary Ed.	49,091		2,471	
- Other Institutions	4,243		2,705	
Sub-total	213,295	(26.1%)	36,365	(18.6%)
Other				
- Direct to Public	168,192		16,243	
- Book Clubs	24,930		678	
- Unallocated	87,222		7,444	
Sub-total	280,344	(34.3%)	24,364	(12.4%)
TOTAL	817,016	(100.0%)	195,793	(100.0%)

The intent of our recommendation is that the distribution support program be focussed on supporting the cost of shipments to retailers and to libraries from coast to coast. At present in the English-language sector of the industry, some publisher/agents pre-pay freight charges, while others do not. Peat Marwick's recent study of English-language book publishing and distribution raised concerns about both the extent to which bookstores in Canada have increased their purchases from U.S. suppliers and the alarming decline in their profit margins. Their report noted that "freight charges between publisher and bookseller are a major factor in the erosion of bookseller profit." [52]

To the extent that retailers themselves pay freight costs, the extent of such costs varies in proportion to their distance from their suppliers in Central Canada, and their distance from large urban centres. The Peat Marwick study also noted that libraries are increasingly tempted to buy from U.S., rather than Canadian suppliers. The ability to buy on the basis of supplier-paid freight charges would provide a significant incentive to purchase from Canadian sources.

In the case of French-language publishing, distribution patterns and structures differ markedly, largely as a result of legislative measures in place in Quebec since 1971. As <u>Table 33</u> shows, roughly twice as high a proportion of French-language publishers' sales are to bookstores as is the case in the English-language sector of the industry: 56.2 per cent by comparison with 28.5 per cent. Retailers, and particularly retailers accredited by the Quebec Government, look after sales to public institutions which would be made directly by publisher/agents in the English-language sector of the industry. Care will have to be taken to ensure that in a more precise design of the distribution support program its effects and strategic impact are balanced between the English- and French-language sectors of the industry.

The tax credit incentive proposed above would on its own have two basic limitations. First, it would provide no incentive at all for foreign publishers to have the books they export to Canada distributed through a Canadian-owned and controlled exclusive agent, rather than a subsidiary. Secondly, it provides somewhat greater benefit to Canadian textbook publishing than to Canadian trade book publishing. The broad policy recommendation regarding distribution support made above is designed to address to some extent both of these factors, in addition to providing an incentive to Canadian retailers and libraries to purchase from Canadian, rather than non-Canadian sources.

The incentive would reduce the total costs of warehousing, order fulfillment and physical distribution for Canadian-owned and controlled companies, although it would only do so for companies whose practice it is to pre-pay freight and only in relation to books being sold to retailers or to libraries. An order of magnitude estimate of the cost involved is from $4 million to $6 million dollars in 1991.

---

52 Op. cit., <u>English-Language Book Publishing and Distribution in Canada</u>, page IV, 27.

A good case can be made for offering to extend such support as well to foreign-controlled publisher/agents whose ownership has not changed since the Baie Comeau policy came into effect. It is, of course, a goal of public policy not just to achieve greater Canadian control over the industry; but also to maintain a strong Canadian-based industry. The owners of the foreign-controlled companies affected have done nothing that is contrary to the Baie Comeau policy, since it has no retroactive application. If access to support for such companies were made conditional on both maintaining fully integrated publishing operations in Canada, including warehousing and order fulfillment, and on a commitment to comply with the Baie Comeau policy if their ownership changed, then it would appear consistent with the goals of public policy to provide such support. The same conditions, in fact, ought to apply to Canadian-owned and controlled companies receiving distribution assistance. The cost of this extension of support would be in the range of $2 to $3 million. Assuming that this approach were adopted, the only publishers/agents not eligible for distribution assistance would be those that were not in compliance with the Baie Comeau policy.

If it is accepted that the intent of this distribution assistance is to encourage Canadian libraries to purchase from Canadian suppliers, then it would be discriminatory to limit such support to publisher/agents and would reduce the effectiveness of such an initiative. To the extent that wholesalers are supplying Canadian libraries, they too ought to qualify for distribution assistance. This is particularly important if, as is implicit in the recommendation made above, the special library rate for book mail were to be discontinued. More research would be required, however, before reaching a firm conclusion that, with the changes recommended here, libraries themselves do not need access to a reduced rate.

In the case of wholesalers eligible for distribution assistance, such access should be restricted to companies that are owned and controlled by Canadians, that service the Canadian market from a Canadian warehouse and order fulfillment facility and that buy from Canadian publisher/agents all titles for which the latter have either copyright or exclusive sales and distribution rights for Canada (as evidenced by their listing in the CTA electronic database or its French-language counterpart).

As noted above, publisher/agents sales to all wholesalers in 1987-88 were reported to be $115.4 million. Taking account of the fact that not all of these wholesalers would qualify for assistance, the estimated cost of assisting with freight and other direct shopping costs in relation to wholesalers is estimated at $3 million to $4 million. This is a very rough estimate, since little or no direct information is available concerning Canadian wholesalers beyond the level of Canadian publishers' sales to them--and it is not even clear to what extent the wholesalers involved service libraries or bookstores, as opposed to supplying mass market retail outlets through the standard local newsstand supply routes. This estimate in relation to wholesalers should be regarded as a high estimate of the potential cost.

A number of English-language bookstores also are involved in supplying books to libraries and, in Quebec, publicly funded libraries are required to make their purchases from accredited bookstores. To the extent that this is the case, it would appear necessary to make comparable assistance available for retailers. Costs are very difficult to estimate, but except in Quebec are likely to be very low.

In order to encourage publishers, wholesalers and retailers to use the most effective method of shipment the distribution assistance provided should not cover all of the direct costs involved. In the case of the postal rate program, earlier analysis suggests that users of the book rate were typically covering 20 per cent of the actual costs involved. A comparable standard appears desirable for the replacement program.

The one additional area where distribution assistance ought to be considered is that of book clubs. Consideration should be given in designing the distribution support program to extending support to Canadian book clubs, with such support provided to clubs that are owned and controlled by Canadians, maintain integrated warehousing and fulfillment facilities and services in Canada; and meet a minimum requirement in relation to the percentage of titles offered to members which are by Canadian authors and the percentage of sales which are of Canadian-authored books. A reasonable minimum level might be 25 per cent, with escalating levels of assistance for levels in excess of the minimum.

Any such extension of support to book clubs, however, requires more careful analysis than has been possible in the course of preparing this report. The traditional practice has been that book clubs simply pass on postage costs to subscribers and if this continued to be the case, there would be no reason for any financial assistance. However, the phasing out of the concessionary book rate will push up the cost of mailing books to such an extent that, in combination with the addition of GST -- which foreign-based competitors may be able to avoid -- it has the potential to greatly damage Canadian book clubs.

It would be extremely unfortunate if the substantial gains made over the past few years in making Canadian-authored books available through book clubs were lost as a result of sharp increases in postal rates and imposition of the GST. The funds budgeted for the replacement distribution support program appear adequate to ensure that these gains are protected and that further progress is made.

Even if all of the proposals made here are accepted, the total costs involved, at least initially, are unlikely to exceed $15 million annually. There are two additional areas in which these resources might also be used productively. First, it would be beneficial to use some of this funding to assist with the cost of getting the Canadian Telebook Agency system into the hands of a wider variety of users, and perhaps upgrading the system.

At present it is also the case that alarmingly little money is being spent on advertising and publicity for Canadian-authored books. The extent of this inadequacy was evident in our interviews with publishers, but it is equally evident in the comparisons in <u>Tables 30</u> and <u>31</u> between the overall sales and marketing expenditures of Canadian-controlled publishers and those of foreign-controlled publishers.

In broad terms, we recommend that initially the program to replace the postal subsidy program should be conceived as a two-part program with separate Distribution and Marketing components. The Marketing support provided should involve a shared-cost program to assist in substantially expanding the advertising and promotion of Canadian-authored books.

We examined the cost sheets for a variety of Canadian-authored books and were alarmed by the limited scope which exists to commit significant funds to marketing new titles effectively. The limited expenditures on marketing reflect the economics of publishing for the smaller Canadian market. While sales might be increased through committing additional resources, the additional costs involved typically substantially exceed the extra revenue that could be expected.

Marketing costs fall into two categories of expenditure. First, there are internal costs, which include the salaries of staff or freelance employees involved in publicity, catalogue preparation, and marketing. Secondly, there are direct external costs, which primarily involve the cost of media and advertising.

A general rule of thumb concerning the appropriate minimum level of direct external advertising and promotion expenditure is five per cent of sales. However, our interviews indicate that at present such expenditures in relation to Canadian-authored books would average between one and two per cent, and for many such titles would be zero. Of necessity, reliance is placed on such free publicity as can be gained from media interviews, combined with some in-store materials, which can be distributed with the seasonal catalogue of new titles when sales representatives visit retail accounts.

The total sales of Canadian-authored trade titles in 1987-88 was $96.8 million, of which Canadian-controlled publishers accounted for about $80 million. A reasonable estimate would be that net sales of Canadian-authored trade books by Canadian-controlled publishers would be about $100 million.

A Marketing support program should leave publishers to cover 100 per cent of their internal costs, while contributing substantially toward direct external costs. Typically internal costs now far exceed external costs. As a broad principle it would be desirable to ensure that publishers were covering at least 50 per cent of combined internal and external costs. However, for the sake of administrative simplicity, and to avoid any potential abuse, it would be preferable to base support on verifiable direct external costs, covering perhaps 75 per cent of this component of costs.

A reasonable approach might be to permit publishers to claim 75 per cent of designated costs up to a maximum of perhaps five per cent of their sales of Canadian-authored books in the previous year.

While further research is required concerning its precise scope and funding, we believe that it would be desirable to create a focussed Marketing program based on matching direct payments by Canadian-owned and controlled publishers to advertise and promote books by Canadian writers. To have a substantial impact, the budget of such a program for an initial year should probably be at least $5 million.

We note that programs of government support to advertising and promotion already exist in other areas. In the film and video industry, for example, such assistance has been provided since 1983 and the resources allocated have been substantially increased since 1988.

The assistance proposed, because it would flow primarily into media advertising, would have a significant indirect impact on Canadian periodicals and to some extent on broadcast media. Canadian magazines at present receive relatively little revenue from book advertising, although in the United States, Britain, and France book publishers are a significant source of advertising revenue for a wide range of periodicals.

c) Development Fund to Provide Loan and Equity Assistance

The tax credit and distribution incentives described above represent, in combination with more effective implementation of the Baie Comeau policy, the key elements of a strategy for the development of a strong, Canadian-controlled publishing industry capable of publishing and marketing effectively a wide range of Canadian-authored books. However, as the statistical data in this report indicate, the current financial position of existing Canadian-controlled publishers is generally weak. While incentives and a Canadianization of control of firms that are now foreign-controlled will lead to a financially stronger domestic industry in the future, the effect of such measures is not immediate.

Assuming that the other elements of this policy option were to be accepted, it would be valuable, during a transition period of perhaps five years, to make loan and equity capital available to Canadian-owned and controlled book publishing companies. Access to such assistance would provide additional flexibility to existing Canadian owners of publishing companies, permitting them to expand through acquisition and merger in order to maintain a viable, competitive position in the industry. Since these existing owners have in many cases demonstrated a strong commitment to publishing Canadian writers, it is important that they be able to take advantage of opportunities to strengthen their businesses.

For the most part, however, it should be kept in mind that in so far as such funding is to be advanced for the purpose of financing the buy-out of companies in the industry, any such transactions normally make sound commercial sense and financing is available from private investors or lending agencies. Where the proposed fund can be valuable is in permitting existing owners of companies in the industry to finance sound expansion without giving up control of their businesses to outside investors.

This is not to suggest, however, that access to such financial assistance should be limited to existing Canadian owners of publisher/agent companies. There are examples of successful acquisitions by management and there is no reason any application for assistance through such a program should be rejected if the resulting business is clearly controlled by Canadians.

There is also no reason in principle to limit financial assistance to takeover financing. However, the difficulties facing the Canadian-controlled component of the book publishing industry are not linked fundamentally to access to financing. The limited availability of equity financing specifically, whether in the form of shareholder investment or retained earnings, is a symptom of the industry's problems and not the problem itself. The basic issues involve the economies of publishing Canadian-authored books, and access to the revenues and economies of scale generated by handling imported books. Unless equity or loan assistance is provided in the context of measures which address these basic weaknesses in the competitive position of the Canadian-controlled sector of the industry, such assistance can produce only limited results.

5.3.2 Advantages

This option best combines the protection of Canada's cultural sovereignty and the enhancement of opportunities for the expression of the identity of Canadians. While the cultural benefits are highest from this option, it is also the option which would generate the most significant economic benefits as a result of expanded publishing and sales of Canadian-authored books and a reduction in Canada's trade deficit in books, which reached $750 million in 1989.

The incentives proposed would create a situation in which non-Canadians required to divest in compliance with the Baie Comeau policy would be paid more by Canadians acquiring the Canadian businesses involved than is the case without such incentives. This would be true particularly in the case of those companies actively involved in publishing Canadian books. In effect, while non-Canadians wishing to acquire a controlling interest in a Canadian publishing business could not benefit directly from the incentives proposed, they would benefit indirectly to the extent that Canadians could pay more to acquire such companies.

The extent of this impact in the case of educational publishing can be seen readily by testing the impact of the incentives in the case of Ginn Publishing. Data concerning Ginn were made available to potential Canadian investors as a result of the 1986 commitment by Gulf & Western/Paramount to sell 51 per cent of the voting shares in the company to Canadians. These figures identified the extent of development costs. Based on the estimated data for Ginn in 1986, for example, a small loss of $74,000 on net sales of $7.6 million would have been a profit of about $0.5 million if the refundable tax credit had been in place and Ginn had qualified as a Canadian-owned and controlled company. It is this difference in profitability which would make the firm more valuable to Canadian owners.

It is the existence of a tax advantage for Canadian-controlled newspapers and magazines which now keeps such publications in Canadian hands. The Globe and Mail, La Presse, Saturday Night, or Macleans would be worth far less to non-Canadian than to Canadian-owners, since advertisers cannot deduct as a business expense the cost of advertising in foreign-controlled publications. This incentive has no effect on book publishing, because the industry derives its revenues only from book buyers.

To the extent that the proposed incentives have the effect of increasing the value of book publishing companies to Canadians, they will also substantially reduce the financial exposure of the Government of Canada to losses as a result of any acquisitions made under the provisions of the Canada-U.S. FTA. This effect will vary in its impact from company to company, depending on the nature of the specific business being acquired.

The refundable tax credit proposed would decrease the risks and the costs involved in originating new Canadian-authored books. As a result, profitability would be improved by an estimated average of nine to ten per cent of revenues from the sale of Canadian-authored books, representing an average of from four to five per cent of combined industry revenue from the sale of all books, including imported exclusive agency titles.

The credit would offset the negative impact of the GST on the publishing of Canadian-authored books and on Canadian-controlled book publishers. The GST on books will generate between $175 million and $200 million in 1991, while the tax credit would cost between $32 million and $54 million -- depending on the extent to which publishers met the Canadian control requirement proposed.

In offsetting the substantially higher costs and risks inherent in publishing Canadian books, as opposed to importing foreign titles published initially for the much larger American, French or British markets, the tax incentive would address a fundamental existing imbalance in the incentive structure. The Government has stated clearly that it is an objective of the Government that a wide range of books by Canadian writers should be published, including school texts and learning materials and books related to Canada's history and geography, and to social, political, and economic realities and issues, as well as books reflective of the artistic creativity of Canadians. It is inconsistent with this goal to leave unchanged in perpetuity a situation in which, as every study of the industry has stated, the dice are loaded against all such Canadian publishing.

In periodical publishing precisely parallel problems led in 1965 and 1976 to changes to the Income Tax Act which helped to level significantly a playing field which, until that time, had been sharply tilted against the publishing of Canadian magazines. Before these tax policy changes, foreign magazine publishers had been able to resell to Canadian advertisers editorial content developed originally and already edited, designed, and typeset for another society, creating an enormous advantage over Canadian publishers who had to cover all the costs of originating their own editorial content, and of design, artwork and composition.

A comparable initiative for book publishing would bring policies related to Canadian content in book publishing into line with the policies already in place in newspaper and magazine publishing and in radio and television. All of these industries have been dealt with in the context of a concern to protect both Canada's cultural sovereignty and its distinctive identity. An essential factor has been the role these media must play in maintaining East-West links within Canada and an exchange of information and expression among Canadians.

One of the basic realities of book publishing is that a book with a short print run incurs a higher fixed cost as a percentage of total costs than does one with a larger printing. As a result, the more limited is the population of a community or society, the greater the average percentage of fixed, or development costs, as a percentage of total publishing costs. In proposing a three tier tax credit, with a higher credit for French-language and regional publishers, the incentive is responsive to the different population levels of the linguistic and regional communities within Canadian society.

By providing an incentive as well to encourage libraries and retailers to buy from Canadian suppliers, Option 3 assists in maintaining national book distribution structures which are essential if there is to be a flow of books among the various parts of Canada.

The proposed program of marketing support to Canadian-controlled trade publishers would also assist such publishers in keeping their established high profile Canadian authors. The much greater financial resources available to non-Canadian publishers have created a situation in which large, and often unrealistic advances, are paid to attract Canadian writers away from Canadian-controlled publishers once their works become popular. The danger in the current situation is that the Canadian publishers, who produce 80 per cent of the new Canadian-authored titles, will progressively lose their capacity to do so as a result of systematically losing their established and profitable Canadian writers. The shared cost marketing support proposed would provide a strong incentive for Canadian writers to stay with their Canadian publishers.

5.3.3 Disadvantages

While the proposed incentives would create a financial incentive for foreign publishers to comply with the Baie Comeau policy, they would not eliminate such objections.

The refundable tax credit proposed assumes the use of the FTA exemption for the cultural industries, since it violates the national treatment commitment in the FTA which is applicable to most other sectors of the economy. This proposed initiative can best be considered in the overall context of American objections to existing Canadian policies such as Canadian content quotas in broadcasting and Bill C-58 as it affects radio, television, newspapers and magazines. Like the provisions of Bill C-58, the proposed tax credit would be inconsistent with the general requirements set out in the Canada-U.S. tax treaty.

The remaining incentives proposed do not raise FTA concerns, since, as subsidy programs, they are not covered by the agreement. It would also be possible to establish a separate statutory program outside the framework of the Income Tax Act which would deliver precisely the same benefits as the proposed Refundable Investment Tax Credit. This approach could be considered as an alternative to utilizing the FTA exemption.

This option does not eliminate the preferred position of U.S. investors, by comparison with that of other foreign investors, although it does reduce the extent of such preferential treatment. As incentives to comply with the Baie Comeau policy, the proposed new initiatives would affect equally all non-Canadian investors. The impact of the FTA provisions, which require the Government of Canada to offer to purchase companies from American investors only at fair open market value, would be reduced. However, any concerns related to the preferred position of U.S. investors are not specific to the book industry, but reflect the overall impact of the FTA. The agreement, of course, provided this preferred position to American investors in exchange for achieving other Canadian objectives.

There are obviously costs to government in the incentives proposed. In the case of the distribution support proposed, what is involved is not new funding; in fact, it reflects a reduction of the $60 million postal subsidy for books to $25 million for distribution and marketing. The Refundable Tax Credit, however, is a new initiative and would cost between $32 million and $54 million in 1991. The loan and equitable capital assistance proposed would also involve new expenditure, which would average $5 million annually over a five year period. However, it is intended that these amounts would be repaid.

These program costs need to be set in the context of the termination of the federal sales tax exemption which the book industry had previously enjoyed. Books which benefitted to the extent of an estimated $145 million from this exemption in 1989-90, will in 1991-92 be subject to the replacement tax initiative and will remit under the Goods and Services Tax an estimated minimum of $175 million in 1991-92. The net position of the Government of Canada in relation to the book publishing sector, assuming the proposed incentives were implemented, can be summarized as follows:

- Between 1989-90 and 1991-92 the federal government's revenues from the book industry will increase by $175 million as a result of the GST. The postal subsidy replacement program will also cost $35 million less than the postal subsidy program it will replace. The net improvement in the financial position of the Government of Canada will be at least $210 million.

- The new refundable tax credit would involve an annual cost of between $32 million and $54 million, depending on the extent to which companies incurring development costs qualify as Canadian-controlled. The loan and equity capital assistance proposed would create an average contingent liability of $5 million.

- Taking into account the cost of the new measures proposed, the net result is an estimated financial gain of between $150 million and $175 million. This calculation excludes any increases in government revenue which would result from expanded Canadian book publishing and reduced imports.

5.4 OPTION 4: DISCONTINUE THE BAIE COMEAU POLICY AND RELY ON INCENTIVES TO ENCOURAGE CANADIANIZATION OF CONTROL OF THE INDUSTRY

This option is essentially OPTION 1 combined with the incentive elements only of OPTION 3. The only adjustment which would be made in the proposed incentives would be that distribution assistance would be restricted to Canadian-owned and controlled companies. In summary, the elements of OPTION 4 would be as follows:

1. **Discontinue the policy of making approval by Investment Canada of indirect acquisitions of Canadian book publishing and distribution businesses conditional on divestiture within a two-year period.**

2. **A fully refundable tax credit would be provided to Canadian-owned and controlled companies which are involved primarily in book publishing, with the credit based on the cost of developing new, or revised editions of existing, books written by Canadian authors. It would be a requirement that any books benefitting from this incentive be distributed by Canadian-controlled companies. A three tier system of tax credits is proposed as follows:**

   - **eligible English-language publishers based in Ontario: 40 per cent of eligible expenditures.**

   - **eligible French-language publishers based in Quebec and eligible English-language publishers based in British Columbia and Alberta: 50 per cent of eligible expenditures.**

   - **all other eligible publishers: 60 per cent of eligible expenditures.**

3. **The revised $25 million program of support for the distribution of books in Canada, which will replace the $60 million postal subsidy program, would be based on the following principles:**

a) Support would be provided to Canadian <u>suppliers</u> of books (including publisher/agents, wholesalers, and book clubs) and not to Canadian <u>purchasers</u> of books (including libraries or retail bookstores);

b) Access to such distribution support would be restricted to Canadian-owned and controlled companies (redefined as proposed in OPTION 2);

c) All recipients of distribution assistance would be required to operate fully integrated businesses within Canada, including warehousing books in Canada and fulfilling orders from a Canadian base; and

d) All recipients of distribution assistance would have to undertake to pay the full postage or shipping costs to either retail bookstores or libraries throughout Canada.

4. A program of financial assistance would be provided through which Canadian-owned and controlled book publishers could have access to at least $25 million in loan or equity capital, perhaps through the Federal Business Development Bank. Unlike either the proposed tax credit or distribution assistance, this program as it affects book publishing could be phased out after a five year period, assuming that the first three elements of this policy option were implemented. It would be desirable that the extent of financing available in the first year or two of the program not be restricted arbitrarily, since it must be anticipated that there may be greatest demand for such assistance early in the five year period.

5.4.1 Advantages

Essentially this option has all of the advantages, from the perspective of non-Canadian businesses and governments, that OPTION 1 would have. Non-Canadians engaged in the creation of large multinational book publishing companies would be allowed to achieve a substantial measure of control over the distribution and marketing of books in Canada. This control over distribution and marketing in Canada, while less important to these firms than the acquisition of expanded market share through a merger and acquisition strategy in their primary market, is a significant element in the strategy being pursued. Acceptance of these strategies would be appreciated by non-Canadian businesses.

The United States would regard a decision to permit indirect takeovers of businesses in the book industry as a significant concession by Canada. Any potential costs resulting from the FTA undertaking by Canada to purchase indirectly acquired businesses at fair open market value would also be avoided.

The potential for the United States to retaliate by imposing similar restrictions on the right of Canadian businesses to acquire controlling interest in American publishing businesses might also be reduced by abandoning the review of indirect acquisitions. However, any American move to restrict foreign control over businesses in those cultural industries which are open to such investment (i.e., excluding radio and television) is more likely to be precipitated by European and Japanese acquisitions of American businesses than by public policy initiatives in Canada. Moreover, the only thing that will fully satisfy the United States is to eliminate all deviations from national treatment, including the new measures proposed here.

By comparison with OPTION 1, however, this alternative does not similarly compromise the goals of enhancing cultural sovereignty and identity. Since it creates new incentives which benefit Canadian-controlled companies, primarily in their publishing of Canadian-authored books, but also in their distribution costs and in the marketing of Canadian-authored trade titles, there would be benefits that flowed to Canadian-controlled companies. A rough estimate of these benefits in 1991 would be $43.4 million for all Canadian-controlled publishers on estimated revenues of just over $650 million (see <u>Table 34</u>). Because most of the incentives proposed affect the publishing and marketing of Canadian-authored books, the incentives affect mainly the activity of publishing Canadian writers. In relation to Canadian-authored book sales, the tax and marketing incentives represent 10.9 per cent of net sales for English-language publishers, and 13.0 per cent for French-language firms. As a percentage of total sales, the three incentives total an estimated 6.7 per cent of sales for both English-and French-language publishers.

The great advantage here, as with OPTION 3, is that the proposed incentives improve the basic economics of publishing books by Canadian writers. This is true as well in the case of foreign-controlled publishers and the data in <u>Table 34</u> suggest the extent to which a desire to qualify for the incentives might encourage divestiture by foreign-controlled publishers. In 1991, if such incentives were in place, foreign-controlled publishers could gain access to $22.6 million in assistance in relation to their publishing and marketing of Canadian-authored books, representing 10 per cent of such sales, and to $27.1 million overall, if they were to qualify as Canadian-owned and controlled businesses.

If these incentives are to be effective in strengthening domestic industry structures, then it would be essential that access to the tax credit and marketing incentives be available only if the Canadian-authored books affected are distributed by Canadian-owned and controlled publisher/agents. Otherwise, the incentives will encourage the kind of structure established by Harper Collins: two companies will be created, one either nominally or in fact a Canadian-controlled company whose purpose is to publish Canadian-authored books; the second a foreign-controlled exclusive distribution business to distribute both the Canadian-authored books published by the Canadian-controlled firm and to handle the lucrative import business for the foreign parent company. In such cases the potential for the foreign-controlled company to indirectly capture benefits intended to flow to Canadian-controlled companies through the manipulation of transfer pricing would be enormous.

TABLE 34

Estimates of Overall Financial Impact of Incentives Proposed, Exclusive of GST Impact, 1991
($000's)

	Canadian-controlled Publisher/Agents		Foreign-controlled Publisher/Agents	
	English	French	English	French
Sales of Canadian-Authored Books (1)	225,600	99,400	202,200	24,000
Value of Tax Credit	21,000	11,400	(18,600)	(2,800)
Value of Marketing Incentive	3,500	1,500	(1,200) (4)	-- (5)
Support as Percentage of Canadian-Authored Books Sales (2)	10.9%	13.0%	(9.8%)	(11.7%)
Total Sales	426,900	220,990	701,300	49,000
Value of Distribution Incentive (3)	4,000	2,000	(4,500)	-- (5)
Incentives as Percentage of Total Sales	6.7%	6.7%	3.5%	5.7%

NOTES:

1 For the basis of these estimates, see <u>Table 32</u>.

2 Assumes same ratio of Canadian-authored to total sales as in 1987-88.

3 This figure must be used cautiously, since distribution support reduces costs only for publishers.

4 Assumes additional funds would be added to Marketing Support Program if additional publishers were to qualify through divesting control to Canadians.

5 Assumes foreign-controlled, French-language publishers are not involved in the trade book market.

It is not easy to assess exactly what would happen under this option for at least two basic reasons. First, the incentives would affect different companies in different ways and to varying degrees. For some companies, the potential benefits from Canadianizing control would be substantial; in other cases they would not. Each foreign-controlled firm would have to decide whether or not to divest control, and, if so, to decide whether or not to divest control, and, if so, of what. Some might choose to hive off the part of the firm which published Canadian-authored books and sell it to a Canadian firm; others to sell their Canadian business as an integrated operation, including both the Canadian-authored publishing side and the valuable exclusive agency business. Other foreign-controlled firms might choose to retain control of their import distribution business and simply phase out any publishing of Canadian-authored books they were involved in.

The second factor that makes predicting impact difficult is the political factor. At present, for example, foreign-controlled businesses have a powerfully dominant position in the publishing of Canadian textbooks. They will be reluctant to give up that position and could choose to make a decision which is not based primarily on business considerations.

Nevertheless, as Table 34 shows, the incentives would have a very substantial effect on an estimated $226 million in business now handled by foreign-controlled companies. Commercial logic suggests that a high percentage of this business, which includes most publishing of Canadian-authored textbooks, would be transferred to Canadian-controlled publishers.

5.4.2 Disadvantages

Some of the disadvantage identified for OPTION 1 (see pages 85 to 90) exist as well for this option. The exemption of indirect takeovers would fundamentally weaken the foreign investment review process as an instrument for protecting Canada's cultural sovereignty. Such an exemption also raises questions of fairness by treating some acquisitions differently from others, and some owners, generally Canadians, less favourably than other owners, generally non-Canadians. However, the incentives proposed would probably be viewed by most Canadian owners as offsetting the less favourable treatment under Investment Canada.

Transitional questions would still be raised by the exemption of indirects: is the exemption retroactive, and if so, how far? Such an exemption would also be contrary to the policies of the Ontario and Quebec Governments.

The basic question of the logic of treating indirect acquisitions differently from direct may also be raised if this option is pursued. Indirect and direct acquisitions have precisely the same effects on control over resources and decision-making in the book industry and on Canada's publishing of Canadian-authored books.

It is also possible that it may be perceived as inconsistent or illogical to abandon the Baie Comeau policy at just the point at which an incentive structure is being put in place to encourage compliance with it. A specific concern may be that through the exemption of indirect takeovers the government is giving up on its effort to see more of the exclusive agency business channelled through Canadian-controlled companies, while at the same time pursuing much more forcefully a strategy which should shift the business of publishing Canadian-authored books into Canadian hands.

The central weakness of this option is that it provides only limited incentives for the transfer of exclusive agency business to Canadian-controlled publishers. In large measure the reason for this is the inherent difficulty of justifying public financial support to an activity which is very profitable. Imported books enter Canada with a major competitive advantage already, and any direct or indirect financial assistance to the importers of such titles has the automatic effect of widening the competitive incentive to import. It is a basic advantage of the Baie Comeau policy that it dealt with imported books by looking exclusively at the question of who will be assigned the exclusive right to distribute such titles.

With this option there is serious cause for concern that the industry will be split into two parts: a foreign-controlled sector which handles an even greater percentage than at present of the valuable import distribution business, and a substantially less viable Canadian-controlled sector which is even more reliant on revenue from the sale of Canadian-authored books. In the case of the foreign-controlled companies, their substantial withdrawal from publishing Canadian-authored books would make them more likely to regard Canada, in the English-language sector, as nothing more than an extension of the American market. This could encourage further closings of the warehousing and distribution facilities of these companies in Canada, with a resulting loss of employment and a further deterioration of a national Canadian book distribution system able to maintain East-West distribution links.

The environment created by the FTA creates an expectation that greater integration of Canadian and U.S. industry and of the Canadian and American markets will occur. This general policy environment is affecting the book industry already and will do so even more if a policy decision is taken which permits a much higher degree of non-Canadian control over the flow of American publications into Canada.

This potential loss of exclusive agency business by the Canadian-based industry is important. It is not possible that a strong Canadian-based publishing industry and an effective national book distribution system could survive which handled only Canadian-authored books.

It is also a basic weakness of this option that the value of the proposed incentives for the publishing of Canadian-authored books will be greatly reduced by the negative impact of imposition of the Goods and Services Tax. In addition, the current high level of interest rates has already put Canadian publishers in a position of financial vulnerability, since the Canadian-controlled companies are heavily dependent on debt financing. Both of these factors will significantly reduce the benefits resulting from new incentives.

Where this option is weakest is in relation to trade publishing, since imported books account for a larger percentage of trade than of educational books. There is a risk of ending up with a relatively strong domestic educational publishing industry and a weak publishing and distribution structure for Canadian books intended for sale to the general public.

The ultimate impact of this option can only be determined by testing it. However, the potential problems involved can be identified and they are substantial. While there is an incentive included which would reduce the cost of distributing books through a Canadian-controlled company, in the absence of other initiatives, this incentive alone is unlikely either to shift a significant amount of business to Canadian-controlled agents, or to prove a decisive factor in encouraging foreign publishers to have their business handled through a Canadian-based company at all.

There are other incentives which might be considered that would enhance those incorporated in this option. We explored, for example, the option of providing a lower tax rate to Canadian than to foreign-controlled publisher/agent businesses. Some publishers interviewed expressed support for this idea. This could be done, for example, by removing the $200,000 cap on the small business deduction which is now provided for Canadian-controlled companies. Such a measure would affect the integrated Canadian publishing and exclusive agency business of the companies affected. The result would be to reduce the rate of federal tax from 38 per cent to 22 per cent: as a result, the federal tax on the first $1 million of profit for Canadian-controlled publisher/agents would decline by $128,000 (16% of $800,000) and by $160,000 on each million above that.

Such an initiative would certainly further encourage the Canadianization of control of the industry. However, such an initiative would also generate objections from foreign publishers and probably from the U.S. Administration and Congress, and would be more difficult to defend than the tax incentive proposed, which has the public policy goal of reducing the risk of generating new Canadian-authored books. The Department of Finance would almost certainly object to this change to what is now conceived as a small business tax concession.

We considered as well an initiative to provide an incentive for new Canadian equity investment in publisher/agent companies. There are examples of such measures in existing provincial government programs of support for venture capital companies: an example is Ontario's Small Business Development Corporations Act. There is also the example provided by the Ontario Film Investment Program. Such programs use either the tax system, usually providing a tax credit equal to a percentage of the amount invested, or a cash rebate system. In the case of the Ontario Film Investment Program, Ontario investors receive a cash rebate of up to 25 per cent of any amount invested in an eligible Canadian film or television program produced in Ontario. Through this program Ontario committed $32 million over an initial two year period.

The Government of Canada could either through the tax system, or by providing cash rebates, perhaps through the Book Publishing Industry

Development Program, provide a system of incentives to encourage new Canadian equity investment in publisher/agent companies. Access to such incentives would be limited to investments in companies owned and controlled by Canadians, as defined in OPTION 2. Eligible investments could include investments in previously foreign-controlled businesses as long as the result of the investment was the acquisition of control by Canadians.

Such an initiative might be of some assistance in achieving a greater level of Canadian control of the industry. If it were done outside the tax system, it would raise no FTA or tax treaty concerns. A rebate of 25 per cent might stimulate substantial new investment. A substantial amount of funding would be required -- probably a minimum of $75 million over a five year period.

It is difficult to predict whether, and to what extent, such an initiative might trigger the sale to Canadians of companies with substantial import business. However, we recommend further exploration of this option if a decision is made to proceed with a package which relies on incentives and does not include effective legislative action to address the book importation issue.

In the following chapter we have explored issues specifically related to the distribution of imported books in Canada. The goal is to review legislative options and other policy alternatives which might complement or act as an alternative to initiatives explored in OPTIONS 1 to 4.

6.0 POLICY OPTIONS RELATED TO BOOK IMPORTATION

6.1 Background

In excess of two-thirds (69%) of all the books sold in Canada are imported. In this respect Canada is in a very different position from countries such as the United Kingdom and the United States, in which imported books account for less than 10 per cent of sales. In the case of the United States, the limited imports reflect a policy pursued throughout the 19th century and until the 1950's of not providing copyright protection to imported books. The U.S. import prohibition had a damaging affect on the development of Canadian book publishing, since Canada was a market open to, and inundated with, books from the United States, while Canadian publishers could not sell into the American market until the 1960's.

In 1989 Canada's imports of books were valued at $841 million, with exports at $92 million. This represented a trade deficit of just under three-quarters of a billion dollars.

Canada's book publishing industry earns the majority of its revenue (53%, or $537 million in 1987-88) from the sale of imported books. A further $517 million in revenue is estimated to have been earned on the direct sales by foreign-based suppliers to customers in Canada.

Of the imports which flow through Canadian-based publishers, usually on the basis of the assignment of exclusive distribution rights granted by foreign-based publishers, about two-thirds flow through foreign-controlled companies, and a third through Canadian-controlled firms ($348 million and $189 million respectively in 1987-88). The situation is substantially different in English-language publishing than in the French-language component of the industry. Canadian-controlled companies handle 87 per cent of exclusive agency sales in the French-langauge sector of the industry, by comparison with just 25 per cent among English-language publisher/agent companies.

However, while most imported books come into Canada through foreign-controlled companies, most publishing of Canadian books is carried out by Canadian-controlled publishers. Canadian-controlled publishers produced four out of five of all the new Canadian titles published in 1987-88 (5,824 by comparison with 1,439 for foreign-controlled publishers), including 61 per cent of Canadian-authored textbooks and 88 per cent of all trade books, i.e. books published for sale to the general public.

To the extent that the Canadian market is served directly from the United States, experience indicates that Canadian-authored books will receive very limited distribution. In sectors such as book club and direct mail publishing, or mass-market paperback distribution, Canadian-authored books account for less than five per cent of sales; by comparison, in retail bookstores which acquire books primarily from Canadian-based publishers, Canadian-authored books account for 20 to 25 per cent of sales. The recent acquisition by Canadians of a 51 per cent equity interest in the Doubleday book clubs was followed by a sharp increase (from about five per cent to 25 per cent) in the percentage of their sales accounted for by Canadian-authored books.

In these circumstances, public policies related to the book publishing industry must address patterns of book importation, since the industry is structured around the sale of imported books.

6.2 Key Strategic Issues

6.2.1 "Buying Around"

At present there is growing concern that Canadian book buyers, including retailers, wholesalers, and public and school libraries, are purchasing directly from U.S. suppliers books for which a Canadian publisher/agent has been assigned exclusive distribution rights for the Canadian market. Under Canadian law, publishers are not able to protect their exclusive distribution rights. By contrast, U.S. publishers can keep out of their market any books imported without the consent of the copyright owner.

The particular focus of this concern is the increasing purchases being made by Canadian retailers from U.S. wholesalers. However, this is also an issue raised by French-language publishers, with Québec-Loisirs reportedly not respecting the exclusive agency rights of Québec publisher/agents.

6.2.2 Possible Reductions in Use of Canadian Agents

While at present almost all major book publishers in the United States, France, and the United Kingdom have either subsidiary companies or Canadian-controlled exclusive agents here, there is concern that some firms may withdraw from the Canadian market and supply Canada directly from the United States. A few publishers, most notably Doubleday, have begun to supply the Canadian market from U.S. warehouses and order fulfillment facilities. While there are some problems involved in operating successfully on this basis (one publisher, Irwin-Dorsey, which withdrew from Canada several years ago in response to a FIRA decision, fairly quickly returned to Canada), the development of a far more concentrated industry in the United States has added to concerns that this may occur, with the result a major undermining of the revenue base of the industry in Canada.

6.2.3 Loss of Agency Business by Canadian-Controlled Publishers

A series of mergers and acquisitions outside Canada has created threats to the agency business, which accounts for 40 per cent of the revenues of Canadian-controlled publishers. This import revenue is crucial to the financial survival of Canadian-controlled publishers and to their ability both to continue to finance the production of a wide range of Canadian-authored books and to market them effectively.

Commenting on this issue in a 1989 study for Investment Canada, Peat Marwick noted that:

> Since any compulsory licensing or regulation of import distribution by the federal government seems unlikely, the best hope for Canadian-owned publishers in achieving their objectives in this regard (i.e., expanded handling of imports) would appear to be the Baie Comeau policy.[53]

Despite the opinion concerning import regulation expressed in the Peat Marwick study, there is the option of linking Investment Canada policy to legislation affecting book importation. In fact, there is considerable support in the Canadian publishing industry for an initiative to achieve this purpose.

---

[53] Op cit., English-language Book Publishing and Distribution in Canada, page IV,20.

6.3 Alternative Policy Instruments

A number of policy instruments exist which can contribute to resolving the complex and interrelated issues which result from the dominance of imported books in the Canadian market. While one of those options -- certainly the most effective one -- would be to follow the American model of requiring the republishing in Canada of books selling more than a designated number of copies, that option is precluded by Canada's international copyright commitments and is contrary to the strongly entrenched tradition of openness which has always characterized Canadian policy. Alternative policy instruments which might be used are as follows:

6.3.1 Restrictions on Foreign Control of Canadian Publishing and Distribution

The provincial governments of Ontario and Quebec, and the federal Government, through the Baie Comeau policy, have addressed the issue of Canadian ownership of book publishing and distribution. Quebec requires 100% ownership by Canadians resident in Quebec of all book suppliers selling books to provincial government departments and agencies, and of all book publishers receiving financial assistance from government. Ontario law requires that distributors/publishers selling imported paperback books be 75 per cent Canadian-owned and effectively controlled in Canada, subject to a grandfather clause for foreign ownership established prior to passage of the law in 1971.

At the national level the objectives of the Baie Comeau policy were to prevent non-Canadian book wholesalers and retailers from expanding into Canada and to direct a greater share of the revenues the publisher/agent business earns from selling imported titles through Canadian-controlled firms. Issues related to Baie Comeau have already been reviewed extensively.

6.3.2 Purchasing Policy

At present Quebec has used its purchasing power to direct purchases through retail bookstores 100 per cent owned and controlled by Canadians resident in Quebec. Quebec, Ontario and other provinces to varying degrees also require or give preference to Canadian textbooks and learning materials in establishing lists of titles which may be purchased for use in Canadian schools.

At present, however, substantial purchases are made by provincially funded school and public libraries from foreign-based suppliers, principally U.S. book wholesalers. Often these purchases involve buying around Canadian-based subsidiaries and agents of foreign publishers. There appears to be considerable scope for provincial governments to strengthen the Canadian book industry by pursuing a policy of purchasing from Canadian sources. However, it has not been a part of this study to review provincial patterns of book acquisition, or the policies related to such acquisitions and national, publicly available data relevant to this issue are not available. As a result, the potential impact of a more systematic policy of purchasing from Canadian sources cannot be estimated, nor can any potential increase in acquisition costs.

A substantial majority of sales of Canadian textbooks to provincial government are now accounted for by foreign-controlled publishers. This business has been essential to their success in establishing a dominant presence in the Canadian market. The 1984 Report of the Macaulay Committee in Ontario suggested an orderly process for changing this situation and ensuring that over time textbook publishing would come to be handled by Canadian-controlled companies.

However, these issues are clearly within provincial jurisdiction. For the federal government the only question is whether national policies or programs might be pursued within which provincial governments would either be encouraged, or possibly required, to purchase from Canadian sources.

6.3.3 Programs of Direct Financial Support

Indirectly the incentive measures proposed in Chapter 5, OPTIONS 3 and 4, would affect provincial governments. For example, if the Refundable Tax Credit led to companies involved in textbook publishing being to an increasing extent controlled by Canadians, then provincial purchases of Canadian texts would be made to a greater degree from Canadian-controlled publishers.

The proposed general guidelines for the distribution assistance program would also provide for the first time a substantial incentive for provincially-funded libraries to purchase from Canadian sources -- and from Canadian-controlled suppliers who do not buy around Canadian publisher/agents. The incentive would be that libraries could buy from such sources on a freight- or postage-paid basis. In a recent Globe and Mail column on this issue, Bronwyn Drainie noted that "For libraries far away from Toronto, freight rates can be an enormous extra burden."[54]

The subsidy to distribution proposed would have the same impact on retailers as on libraries, resulting in freight- or postage-paid shipments from eligible Canadian suppliers. Commenting on this issue, the Peat Marwick distribution study noted that:

---

54 Bronwyn Drainie, "Questions raised by maverick librarian are long overdue," The Globe and Mail, April 1, 1989, page C1.

> Most freight is paid by the retailer, thus the landed cost to the retailer is higher in B.C. than in Ontario. Retail prices, however, set by publishers, are the same from coast to coast.

The same study went on to note that:

> . . . freight cost is still a cause of major irritation to retailers located at a distance from the centres of supply. Since virtually no publisher inventory is held regionally, bookstores feel some justice in seeking the institution of an F.O.B. Canada policy on the part of their suppliers. [55]

In these circumstances, and given the existing financial vulnerability of Canadian-controlled publishers, the impact of high interest rates, the coming GST, and the impetus toward continental rather than national structures resulting from the FTA, we believe that the distribution support proposed is an essential element of a strategy to reassert in this special industry, the continuation and strengthening of national distribution ties.

The proposed basis for direct subsidies to strengthen Canadian book distribution structures put forward in Chapter 5 provides broad underlying principles and a strategic direction. Within this framework a number of factors could be taken into account in determining the precise extent to which individual applicants might qualify for support. If, for example, it was agreed that assistance through the proposed Canadian book distribution fund was to be based on actual expenditures in the previous year, then information could be gathered concerning at least the following four factors:

1. Country of controlling interest;

2. Location of the warehousing and distribution facility from which the Canadian market is supplied;

3. Percentage of revenue accounted for by the sale of Canadian-authored books;

4. Percentage of revenue accounted for (in the case of book clubs, wholesalers, and other non-exclusive distributors), by books purchased from Canadian-based publisher/agents.

On the basis of such information a flexible but administratively workable policy could be pursued which reflected the principal public policy concerns. However, the amounts involved are not large in proportion to the size of the industry, and non-financial measures also need to be considered.

---

[55] Op. cit., English-language Book Publishing and Distribution in Canada, page IV, 25.

6.3.4 Protection of Exclusive Distribution Rights

Prior to 1953 a number of Canadian publisher/agents had established a practice of giving notices in writing to Revenue Canada of their desire that certain titles, for which they had been assigned exclusive distribution rights by publishers in Great Britain, the United States, or France, should not be imported into Canada except by themselves. This protection against importation not authorized by the copyright owners was sought under Section 27 of the Copyright Act.

In response to a request for clarification of the legal basis for this practice, the then Deputy Attorney General of Canada, F.P. Varcoe, gave his opinion on March 12, 1953 that the Act, as then drafted, did not support this protection. The 1957 Report on Copyright of the Royal Commission on Patents, Copyright, Trade Marks and Industrial Designs (the Ilsley Committee) was unable to reach agreement on appropriate amendments to Section 27. At present Canada's copyright law has not been amended to provide for such protection.

As part of a strategy to strengthen the Canadian book industry, it would be possible to amend the Copyright Act in the second phase of amendments to permit Canadian publisher/agents to protect the exclusive distribution rights assigned to them by foreign copyright owners or their agents.

6.3.5 Special Purpose Legislation Establishing a Framework for All Book Importation Into Canada

In relation to the film industry, proposals have already been developed which would establish a legislative framework for film importation. Draft legislation was tabled on June 8, 1988, but not passed. At the provincial level, distributors of films are already subject to government licencing.

Legislation could be developed which established requirements for the licensing and regulation of book importers, using the same jurisdictional basis for a federal initiative as in the case of the draft film legislation. Such legislation could be complementary to, or an alternative mechanism for, protecting the rights of exclusive distributors.

Before assessing specific legislative options to strengthen Canadian publishing and distribution structures, however, it is useful to review the different legal bases on which book titles are sold, and the extent to which import protection is, or could be, available in relation to each. In identifying the three categories into which titles can be classified, it is possible to clarify both the strategic objectives which might be pursued and the nature of the actions government might consider.

6.4 Categorization of Books Sold in Canada According to Rights of Canadian Publishers and Distributors

6.4.1 Category A: Canadian-Published Books

These are books for which copyright for the Canadian market is held by a publisher in Canada. Most such titles are originated in Canada and are by Canadian authors. The Copyright Act provides protection to the Canadian industry on such titles, which accounted for about $475 million in revenues in 1987-88, or just under a third of a total of $1.5 billion in book sales in Canada. The rights protected include the basic right to manufacture copies.

In the case of foreign titles, as the recent Peat Marwick study for Investment Canada noted:

> The practice of a Canadian publisher acquiring the right to publish a foreign book, in the full sense of developing a Canadian edition, has never developed. In very recent years it is true that some publishers/agents do produce Canadian editions of popular titles or authors, from among the principals' list but these are exceptions. The vast majority of books are still imported in finished copies and bear the U.S. or U.K. imprint. [56]

As the Peat Marwick study noted, it is not likely that any great improvements will be made in the Canadian rights area, since the most attractive titles come into the Canadian market through Canadian-based subsidiaries of the foreign publisher, or through a Canadian-controlled exclusive agent.

The only way to greatly increase the sale of separate Canadian publishing rights would be to establish compulsory licensing requirements in the Copyright Act, forcing the sale of such rights. This is contrary to Canada's copyright obligations internationally, and would not have public or industry support. As a result, foreign writers and publishers will continue to be free to decide whether to assign separate publishing rights for Canada.

6.4.2 Category B: Exclusive Agency Titles

An exclusive agency agreement is a contractual agreement between a foreign publisher and a Canadian-based publisher/agent granting the latter the exclusive right to sell and distribute books in the Canadian market. Sometimes the exclusive agency rights assigned by contract exclude the book club segment of the market. As noted above, this is the basis on which the

---

[56] Ibid., page IV, 3.

Canadian publishing industry handles most foreign titles, with revenues from the sale of exclusive agency titles accounting for the majority (53%) of the Canadian industry' revenues --$537 million in 1987-88.

While the foreign publishers under these agreements formally grant exclusivity to their agent or subsidiary in the Canadian market, and will not themselves sell to Canadian purchasers, Canadian law does not now permit the parties to such agreements to protect the exclusive rights granted against violations by third parties.

Exclusive agency rights are being eroded primarily by U.S. wholesalers selling directly into Canada, both to institutional buyers and to retailers. Commenting on this problem, the Peat Marwick study referred to above noted that: "It is likely that considerable amounts of revenue are lost to publisher/agents due to this practice," that "it seems clear that 'buying around' is increasing in the retail marketplace," and that "it is now accepted by many knowledgeable observers that Canadian retailers use U.S. wholesalers extensively, and that the level of use is increasing". [57]

At present no foreign publisher or writer is obliged to grant separate distribution rights for the Canadian market. If they wish to, foreign publishers can sell directly into the Canadian market, or rely on U.S. and Canadian wholesalers to sell to Canadian buyers.

Opinions vary in the industry as to whether the Canadian market can be serviced effectively from a U.S. base. This question has been reviewed earlier in this report.

There are two separate policy issues related to exclusive agency publishing. First, should legal provision be made for the parties to an exclusive agency agreement to better protect the exclusivity granted? Secondly, should any or all writers or publishers outside Canada whose books are being sold here be required to grant separate distribution rights for the Canadian market to a Canadian-based publisher/agent?

The issue of protection of exclusive distribution rights is not one that is unique to book publishing. A recently completed policy paper notes that:

> Domestic and international owners of copyright property often secure the services of a resident Canadian distributor to market, promote, and distribute such product in Canada. A growing number of such authorized distributors are Canadian-owned and -controlled companies . . .
>
> A typical agreement will provide for the exclusive distribution of such product in a specified territory for a limited period of time. An agreement to supply the distributor with copyright product is always a component of such an agreement and the distributor, in turn, will undertake to use its best efforts 'to sell, promote, and increase its market for the sale' of such product in the specified territory. In

---

57 Ibid., page IV, 4 and 8.

order to protect the integrity of a distributor's exclusive market, distribution agreements routinely provide for restrictions on both parties against selling the product to anyone who it knows, ought to know, or has reason to believe, will sell product out of its exclusive territory into another territory, thereby defeating another's exclusive distribution rights. [58]

Section 12 (4) of the Copyright Act provides that the owner of copyright in a book "may assign the right, either wholly or partly, and either generally or subject to territorial limitations . . . and may grant any interest in the right by licence." Such assignments or grants, which must be in writing, appear to extend to distribution contracts, if the licence is exclusive. It would seem to be necessary to name the specific titles involved and may be possible to register such exclusive licences related to distribution contracts under Section 40 of the Copyright Act.

Where difficulty arises under the current law is in relation to its definition of infringing copies of protected works. Section 17 of the Act provides protection in relation to the sale, distribution, display, or importation for sale by any person of:

> any work that to his knowledge infringes copyright or would infringe copyright if it had been made in Canada.

Sections 25 (1), 27 and 28 of the Act give effect to these restrictions by providing for summary remedies and the listing of infringing copies on Schedule C to the Customs Tariff. However, as the 1953 Varcoe ruling referred to above indicated, the essential difficulty which arises is that the copies an exclusive agent is importing are not copies which would have infringed copyright if made in Canada. As a result, while 12 (4) of the Act appears to protect the rights of exclusive distributors as holders of an "interest in the right by licence," section 17 defines infringing copies in a way that has been interpreted as denying such protection.

Other countries have drafted their laws differently, with the result being the clear provision of protection under copyright law for exclusive distributors. This is the case in the United States and in Australia, for example. Section 602 of the U.S. Act provides, in part as follows:

> a) Importation into the United States, without the authority of the owner of copyright under this title, of copies or phonorecords of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies of phonorecords under section 106, actionable under section 501.

---

[58] Duncan C. Card, of Lang Michener Lawrence & Shaw, "Parallel Importation of Copyright Property: A Proposal to Amend the Copyright Act of Canada," article submitted to the Intellectual Property Journal, page 1.

Section 106 of the U.S. Act defines as one of the exclusive rights of copyright owners the right to distribute, or to authorize the distribution of, copies of the copyrighted work to the public.

Australian law also provides such protection, but in a form more compatible with the character of the Canadian Act. Section 37 of the 1968 Australian Copyright Act addresses the specific issue raised by the 1953 Varcoe ruling, providing as follows:

> The copyright . . . is infringed by a person who, without the licence of the owner of the copyright, imports an article for the purpose of . . . distributing the article . . . where, to his knowledge, the making of the article would, if the article had been made in Australia by the importer have constituted an infringement of the copyright. [59]

A comparable amendment of the Canadian Copyright Act which covered the import, sale or distribution of titles in Canada would clarify its application to exclusive distribution contracts. Such an amendment would create a situation in which U.S. wholesalers selling and distributing books into Canada without the approval of the copyright owner and anyone knowingly importing such works for sale or distribution in Canada would be in violation of the Act (subject to the exemptions in the Act) for all copyright works. The potential through such a revision to curtail buying around is quite substantial.

6.4.3 Category C: Titles Not Published Separately in Canada or Handled in Canada by Exclusive Agents

Most mainstream titles published in the United States, the United Kingdom, and France are either published or distributed by an exclusive agent in Canada, as are many more specialized titles. However, there are a very wide range of publishers outside Canada whose titles are neither published nor handled by an agent here.

It is not possible to be precise about the volume of sales of such titles in Canada. Because the extent of "buying around" is not known, the only available figure is the $517 million in estimated purchases made by Canadian book buyers directly from foreign suppliers.

In the case of the film industry, Bill C-134, introduced in June 1988, proposed to use a registered importer system to establish Canada as a separate distribution territory for films, requiring a separate granting of Canadian distribution rights. The draft bill made provision for the regulations established to exempt "any film product or class of film products . . . on the basis of the length, language, intended audience or content of the film

---

[59] Ibid., as quoted on page 10.

product or film products of that class or the intended use of the film product or film products of that class in a broadcast undertaking."

It would be possible to establish a parallel requirement in book publishing which would require that with limited, well defined exceptions, imported books enter Canada, for distribution here only through Canadian-based publisher/agents. The extent of the exemptions granted would establish the degree to which the Canadian publisher agent industry would have to expand to handle this business. For example, if the requirement applied to mass paperback publishing -- which would be reasonable -- then the operations of U.S.-based publishers in Canada would have to expand substantially. Similarly, if it applied to book clubs and direct mail publishing, Canadian-based operations would have to expand significantly.

There would have to be substantial exemptions provided, however, or the Canadian publisher/agent system would collapse of its own weight. There are, for example, 50,000 titles published annually in the United States alone, and 850,000 titles in print. About the same number of titles are published annually in France and Britain. Many foreign publishers and foreign titles could not possibly be handled profitably or efficiently by a Canadian-based publisher/agent, but the exceptions are not at all easy to define.

For importation legislation to achieve its purpose of helping to strengthen the Canadian-based distribution system, registered importers would have to be required to maintain warehousing and order fulfillment services in Canada. Otherwise, all that the act would accomplish would be to create a token corporate presence in Canada to achieve technical compliance with the law.

One of the potential results of this model of a registered importer system would be to prevent foreign publishers from avoiding compliance with Investment Canada decisions by simply withdrawing from Canada. It should be noted, however, that there is general skepticism in the book publishing industry as to how practical it is for major foreign publishers to try to do business in Canada without a full corporate presence here. However, this first possible approach to import legislation appears impractical. There are far too many foreign books in English and in French that it makes no sense for a publisher/agent to handle, and the exceptions would be so extensive they would create an administratively unworkable policy.

A second option that could be considered in designing a registered importer system would be to leave all foreign writers and publishers free to decide whether to grant separate distribution rights for Canada, but to require instead that they either sell into Canada through a registered publisher/agent <u>or</u> through a registered Canadian-based wholesaler. Registered wholesalers could be required to maintain inventory in Canada and to handle all order fulfillment from a Canadian base. Registered wholesalers would also be required to purchase from the Canadian source in all cases where publishing rights or exclusive agency rights have been assigned to a registered Canadian publisher/agent and where the titles involved were listed on the Canadian Telebook Agency's or Periodica's list of titles available from publisher/agents in Canada. The criteria for such listing would have to conform to the requirements set out in legislation.

Under this second option foreign publishers would be free to withdraw from Canada, but would know that if they did so they would have to sell into Canada through a registered Canadian wholesaler. It would still be necessary under this second option to provide for exemptions. The regulations would, for example, need to exclude books in languages other than French and English.

By permitting the registration of wholesalers, the import legislation would not force through Canadian publisher/agents business which could not be handled economically and efficiently. Wholesalers could buy on behalf of a wide variety of book purchasers, using Canadian publisher/agents where they exist.

A third option would be to register publisher/agents, wholesalers and other major non-exclusive importers, especially retail bookstore chains. Under this option importers other than publisher/agents would be free to import non-exclusive titles freely, but would be precluded from importing any titles for which publishing or exclusive distribution rights were held by a Canadian publisher/agent.

6.5 Interrelationship of Book Importation Legislation and Foreign Investment Policy

Issues related to foreign control of book publishing and distribution businesses have been examined above in chapter 5, which contains an assessment of the advantages and disadvantages of the principal policy alternatives. These issues are conceptually separate from initiatives related to either the degree of protection to be afforded to the rights of publisher/agents, or the extent to which Canada's very large imports of books ought to be channeled through Canadian-based publisher/agents and distributors. However, if a decision were made to proceed with legislation related to book importation, such legislation could also be used to administer a policy concerning foreign investment.

Import legislation could be drafted, for example, to give effect to the changes to the Baie Comeau policy identified in Section 5.2, OPTION 2 (pages 91 to 94), or to give effect to any change in the application of the policy to indirect acquisitions. An importation act could also be drafted either so that it required that as of a designated date all importers should be Canadian-controlled, or to provide for the grandfathering of existing non-Canadian ownership.

In assessing the distribution options below, questions related to foreign investment have been set aside.

6.6 Assessment of Legislative Options to Strengthen the Canadian-based Book Publishing and Distribution System

6.6.1 **OPTION 1: An Amendment to Provide Protection Under the *Copyright Act* for Exclusive Canadian Distribution Rights Granted By Copyright Owners**

As indicated above, a specific option that could be implemented would be to amend the Copyright Act, as part of the second phase of copyright reform, to define it as an infringement for any person, without the licence of the owner of the copyright, to import any work for the purpose of sale or distribution . . . where, to his knowledge, the work would have infringed copyright if made in Canada by the importer.

Legal advice will need to be sought concerning the precise formulation of an amendment to the Act. While we have consulted analyses of the existing Act by legal experts, our advice is limited to the substantive nature of the protection the Act ought to provide.

6.6.1 (i) Advantages

The proposed amendment would protect those rights now voluntarily assigned to Canadian publisher/agents by foreign copyright owners or their authorized agents. The available evidence suggests that these rights are being substantially eroded through "buying around" exclusive Canadian distributors, with the primary problem arising from U.S. wholesalers supplying such titles directly to Canadian bookstores and libraries.

6.6.1 (ii) Disadvantages

This option will require that Canadian publisher/agents take primary responsibility for protecting the exclusive distribution rights assigned to them. Some English-language publishers have expressed concern that the dominant retail chains, W.H. Smith and Coles, might retaliate against any publisher who took action to prevent either of them from buying around. However, publishers now take such action to protect those titles in which they hold copyright, and if action were taken by all or most of the industry to protect such rights the potential for retaliation would, as a result, be limited. It does not appear unreasonable to expect the industry itself to ensure that its rights are respected.

There is some concern also in the industry that U.S. wholesalers affected by such an initiative would try to persuade U.S. publishers to stop assigning exclusive rights to their affiliated Canadian businesses or Canadian agents. It has not been possible within the time and resources available for this study to assess how likely it would be that U.S. publishers would respond to such pressure from U.S. wholesalers. While it certainly seems unlikely that industry-wide changes would be made to eliminate exclusive distribution rights, additional consultation with the industry might be helpful in clarifying whether this is a serious concern. Our judgement is that the Canadian industry would support this change.

6.6.2 **OPTION 2: To Pass Legislation in the Form of a <u>Book Importation Act</u> Which Would Contain the Following Provisions:**

(1) It would create an agency or authority with the power to establish regulations which would govern the importation of books into Canada.

(2) It would provide, subject to limited exceptions, for books to be imported by two classes of importer:

(a) Registered publisher/agents; and
(b) Registered book wholesalers

(3) Registered publisher/agents would be the only entities allowed to import the titles for which they held publishing or exclusive distribution rights, subject only to the exceptions which apply to any works protected by copyright.

(4) All other titles, with limited exceptions, such as for works in languages other than French and English, could be imported only by registered Canadian wholesalers.

(5) It would provide the agency with the power to enforce any agreed policy related to foreign investment in businesses licensed as book importers, either acting separately or in a manner which complemented Investment Canada decisions.

(6) The legislation could include provisions creating an advisory body, including librarians, booksellers, publisher/agents, wholesalers, and educational institutions which would advise the agency on the drafting of regulations either related to exemptions from the act or to the regulations which must be met by both publisher/agents and wholesalers in order to continue to qualify for registration.

6.6.2 (i) Advantages

This legislative option would provide for direct action by the proposed agency to protect the exclusive rights granted to Canadian publisher/agents. Canadian publisher/agents prefer such an approach.

While such legislation would not oblige any foreign copyright owner to assign exclusive rights for Canada to any Canadian-based entity, it would eliminate both the option of foreign publishers selling directly into the Canadian market from outside and the option of using U.S. wholesalers to supply the Canadian market. The only alternative to assigning exclusive rights to a Canadian publisher/agent would be to supply the Canadian market through a Canadian wholesaler. It seems likely that this approach would provide an incentive for any foreign publishers whose books had the potential to achieve significant sales in Canada to assign exclusive distribution rights to a Canadian agent to ensure that their works received effective marketing here.

By leaving open the option of a Canadian wholesaler supplying non-exclusive titles, there is substantial scope for responding to the needs of the Canadian market. There are well-financed companies involved in Canadian book wholesaling, including Maclean Hunter, and it is reasonable to believe that they could provide effective service to Canadian buyers.

6.6.2 (ii) Disadvantages

Electronic databases now exist capable of providing comprehensive information through telecommunication throughout Canada regarding the wide range of titles available from Canadian publishers. As a result, it is possible to administer a policy such as is proposed. However, this option does require the creation of a new agency, with significant related costs. We have not yet been able to assess the extent of the costs involved.

Any narrowing of the options of purchasers can be expected to meet with concerns regarding the possible implications for cost and service. In refining this option these concerns would need to be addressed through prior consultation and/or further, more detailed, analysis.

In assessing the impact of channeling non-exclusive titles through Canadian wholesalers, the interests of retail and institutional buyers will be protected to a significant degree by the competition that already exists among Canadian wholesalers, and would be likely to increase in response to an expanded market. In the case of publishers and exclusive agents or distributors, however, there is by definition only one legitimate supplier. This does not mean there is no competition, however, but the competition that affects pricing policy is competition among competing titles, rather than among alternative suppliers of a given title. By precluding buying around exclusive distributors this option, like OPTION 1, would oblige Canadian buyers to purchase from the Canadian agent. This change, while a natural part of copyright protection, can be expected to be resisted.

6.6.3 OPTION 3: To Pass Legislation in the Form of a Book Importation Act, Which Would Contain the Following Provisions:

(1) It would create an agency or authority with the power to establish regulations which would govern the importation of books into Canada.

(2) It would provide for books to be imported by two classes of importer:

a) Registered publisher/agents; and
b) Other importers required to register under the Act, including Canadian retail chains, perhaps defined based on common ownership of six or more retail outlets, as well as Canadian wholesalers.

(3) Registered publisher/agents would be the only registered importers allowed to import the titles for which they held publishing or exclusive distribution rights, subject only to the exceptions which apply to all works protected by copyright.

(4) Other importers required to register would be required to respect the exclusive rights of Canadian publisher/agents, but could import all other titles directly from any legitimate suppliers outside Canada.

(5) It would provide the agency with the power to enforce any agreed policy related to foreign investment in businesses licensed as book importers, either acting separately or in a manner which complemented Investment Canada decisions.

(6) The legislation could include provisions creating an advisory body, including librarians, booksellers, publisher/agents, wholesalers, and educational institutions which would advise the agency on the drafting of regulations either related to exemptions from the act or to the regulations which must be met by both publisher/agents and wholesalers in order to continue to qualify for registration.

6.6.3 (i) Advantages

The main advantage of this option over OPTION 2 is that it allows retailers to purchase directly from foreign sources, as long as they respect the exclusive rights granted to Canadian publisher/agents. For this reason retailers might be less opposed to this option.

6.6.3 (ii) Disadvantages

At present, however, it is a major concern in the industry that retailers are to an increasing degree acquiring books directly from U.S. wholesalers, rather than relying on Canadian sources. This has encouraged some publishers to drop their Canadian agents. While this option would require that the retail chains buy from Canadian agents when exclusive distribution rights have been assigned, it would continue a situation in which increasing reliance can be placed on continental supply structures. There would be a corresponding risk that this alternative, by leaving a potentially large escape hatch, could have unintended results. The large Canadian retail chains and the large American wholesalers might press American publishers to eliminate the exclusivity provisions in the contracts with their Canadian affiliates or agents. OPTION 2 is not open to the risk of comparable evasion.

Administratively, this option is more complex than OPTION 2. There would be more registered importers, and control and monitoring would be more difficult.

By comparison with OPTION 1, this alternative is more costly and administratively complex, while its purpose is essentially the same: to protect the exclusive distribution rights granted to Canadian publisher/agents. Its advantage is that it would provide a means for government to enforce exclusive distribution rights, rather than relying mainly on the publisher/agents to enforce their rights, as would be the case if the Copyright Act were amended for this purpose.

7.0 CONCLUSIONS AND SUMMARY OF RECOMMENDATIONS

7.1 Conclusions

A wide variety of factors are now affecting, or will in the near future affect, the book industry in Canada, including both publishing and distribution. These factors have been identified and analyzed earlier in this report, and in summary include the following:

a) Increasing pressure toward the continentalization of book publishing and distribution structures, driven in part by expectations in the aftermath of the 1988 Free Trade Agreement that there will be a structural shift toward North American industrial integration;

b) Uncertainty in the Canadian publishing industry regarding government policy, arising from the failure to consistently and effectively implement the 1985 Baie Comeau policy;

c) Continuing financial vulnerability among the Canadian-controlled publishers who account for 80 per cent of the new Canadian-authored titles published, with this vulnerability heightened by high interest rates, the insecurity of exclusive agency revenues and the anticipated negative impact of the Goods and Services Tax which will come into effect January 1, 1991; and

d) The expected negative impact of the GST on the publishing of all Canadian-authored books and the effectiveness of all existing government programs of financial assistance to the industry.

One of the central issues addressed in this report is that of the Baie Comeau policy. In our assessment of the potential impact of this policy we have reached the same conclusions as those arrived at by Peat Marwick in their 1989 study for Investment Canada, English-language Book Publishing and Distribution in Canada: Issues and Trends. That study noted that "Canadian publishers can hardly survive on such a small domestic market, unless foreign publishers let them distribute more foreign books, or bid for the rights to publish them, or unless they can expand into the lucrative educational market." [60] The study concluded that if the Canadian-controlled firms disappear "many kinds of trade books, of the riskier kind financially, certain of which would undoubtedly be categorized as culturally important, would have a much more difficult time being published and distributed." [61]

The Peat Marwick study noted that "overshadowing all other concerns for the Canadian-owned publisher sector of the industry are the questions: How to achieve entry into educational publishing" and "How to acquire some of the distribution of foreign books in Canada, either by managing to acquire some of the lucrative agency-import business, or by acquiring the right to produce Canadian editions of foreign authors." [62]

The study concluded that "the only way it is likely to become possible for Canadian-controlled publishers to acquire rights to publish foreign authors in Canada is if they control the agencies through which those authors enter the Canadian market". [63] In the case of educational publishing, the study concluded that this was largely in the hands of the provinces, although, as our analysis indicates, a strong federal tax incentive and the Baie Comeau policy itself could achieve that objective.

On the key issue of agency imports, however, the Peat Marwick study concluded that:

---

[60] Op. cit., English-language Book Publishing and Distribution in Canada, page IV, 17.

[61] Ibid., page IV, 17.

[62] Ibid., page IV, 18.

[63] Ibid., page IV, 39.

Leaving aside entirely how this state of affairs might be brought about . . . there would clearly be benefits of the kind described in the Issues section of this report.[64]

The Issues section of the report described the benefits as follows:

- sales volumes will be increased without the heavy developmental costs of originating books.

- the additional revenue generated provides stability and offers economies which reflect beneficially on a publisher's own published books.

- publisher/agents are better able to withstand economic disasters than publishers who have to rely wholly on "own published books." They have greater diversity of product and a greater array of proven authors with which to tempt consumers. In difficult times, publishers who must rely entirely upon publishing books which require a greater investment and carry a higher degree of risk, will be at a disadvantage.[65]

In the text of this report we have made it clear that we consider these conclusions obvious and unmistakable. However, an attempt has been made to assist in understanding the impact of a wide variety of policy measures which might enhance Canadian ownership and control of the industry and the publishing of Canadian-authored books. All of the analysis contained in this report is predicated on the premise that these are basic objectives of public policy. If different objectives were to be pursued, then the analysis and recommendations would differ.

7.2 Summary of Recommendations

In order to pursue as effectively as possible the goals of cultural sovereignty and identity assumed in this study the following policy initiatives are recommended:

RECOMMENDATION 1: STRENGTHEN THE LEGISLATIVE AND ADMINISTRATIVE STRUCTURE FOR IMPLEMENTING THE BAIE COMEAU POLICY

The essential legislative changes required as part of such a strategy include the following:

---

64 Ibid., page IV, 21.

65 Ibid., page IV, 21.

a. That whether by amendment to the Investment Canada Act, or through separate legislation that would deal with the book industry only or with the cultural industries generally, the test of control should be changed to incorporate a test of "control in fact", including the requirement that "control by contract" not be in the hands of non-Canadians.

b. The definition of a Canadian-controlled company for purposes of the administration of the Baie Comeau policy should also be changed to require at a minimum that, in addition to Canadians owning at least a majority of the voting shares, a majority of all beneficially held shares are also in the hands of Canadians. Consideration should also be given to increasing the percentage of the equity of businesses which must be in Canadian hands to two-thirds of total equity.

c. An amendment should also be made which would ensure that the Baie Comeau policy applied to transactions involving the branches of businesses controlled by non-Canadians.

Two separate aspects of the administration of the Baie Comeau policy also require adjustment.

d. The requirement of divestiture within a two year period should in future be based on a two year period commencing on the date a transaction being reviewed under the Baie Comeau policy was completed.

e. If necessary, the legislation should be amended to remove any doubt of the agency's ability to require that any non-Canadians involved in establishing a new business or acquiring an existing Canadian business in book publishing and distribution provide any and all information legitimately required to ensure that they are in compliance with the Baie Comeau policy.

f. Because there appears to have been confusion concerning the basis for valuation of companies affected by the Baie Comeau policy and the related FTA provisions it may be useful to clarify formally that the transfer of copyright is not required in order to comply. The precise form such an adjustment might take would be that non-Canadians acquiring existing book publishing or distribution businesses in Canada would be permitted to do so if either of the following conditions were met:

   i) They agreed, as provided for in the current policy, to divest controlling interest to Canadians within a two year period in the case of the direct or indirect acquisition of foreign-controlled businesses; or

ii) They provided an undertaking to assign to a Canadian-controlled business or businesses the exclusive right to market and distribute the books sold by the acquired Canadian business (exclusive of any third party distribution rights which were beyond the control of the company making the acquisition).

RECOMMENDATION 2: ESTABLISH INCENTIVES FOR COMPLIANCE WITH THE BAIE COMEAU POLICY AND TO OFFSET THE IMPACT OF THE GST

While this option might vary in its precise composition, our examination has assumed that it would have the following three components:

a) A fully refundable tax credit would be provided to Canadian-owned and controlled companies which are involved primarily in book publishing, with the credit based on the cost of developing new, or revised editions of existing, books written by Canadian authors. It would be a requirement that any books benefitting from this incentive be distributed by Canadian-controlled companies. A three tier system of tax credits is proposed as follows:

- eligible English-language publishers based in Ontario: 40 per cent of eligible expenditures.

- eligible French-language publishers based in Quebec and eligible English-language publishers based in British Columbia and Alberta: 50 per cent of eligible expenditures.

- all other eligible publishers: 60 per cent of eligible expenditures.

b) The revised $25 million program of support for the distribution of books in Canada, which will replace the $60 million postal subsidy program, would be based on the following principles:

i) Support would be provided to Canadian <u>suppliers</u> of books (including publisher/agents, wholesalers, and book clubs) and not to Canadian <u>purchasers</u> of book (including libraries or retail bookstores);

ii) Access to such distribution support would either be restricted to Canadian-owned and controlled companies (redefined as proposed in OPTION 2), or to Canadian-owned and controlled companies plus foreign-controlled businesses whose ownership has not changed since the Baie Comeau policy came into effect in 1985 and which undertake to comply with the policy should their ownership change in the future;

iii) All recipients of distribution assistance would be required to operate fully integrated businesses within Canada, including warehousing books in Canada and fulfilling orders from a Canadian base; and

iv) All recipients of distribution assistance would have to undertake to pay the full postage or shipping costs to both retail bookstores and libraries throughout Canada.

c) A program of financial assistance would be provided through which Canadian-owned and controlled book publishers could have access to at least $25 million in loan or equity capital, perhaps through the Federal Business Development Bank. Unlike either the proposed tax credit or distribution assistance, this program as it affects book publishing could be phased out after a five year period, assuming that RECOMMENDATION 1 and part a) and b) of this recommendation were implemented. It would be desirable that the extent of financing available in the first year or two of the program not be restricted arbitrarily, since it must be anticipated that there may be the greatest demand for such assistance early in the five year period.

RECOMMENDATION 3: **AMEND THE <u>COPYRIGHT ACT</u> TO PROVIDE FOR PROTECTION OF THE EXCLUSIVE CANADIAN DISTRIBUTION RIGHTS GRANTED BY COPYRIGHT OWNERS.**

RECOMMENDATION 4: **FURTHER CONSULTATIONS WITH THE INDUSTRY AND MORE DETAILED RESEARCH SHOULD BE CARRIED OUT REGARDING DISTRIBUTION OPTION 2 (PAGE 145). THIS OPTION SHOULD BE DEVELOPED FURTHER AS A MEASURE WHICH COULD BE IMPLEMENTED IF THE OTHER INITIATIVES PROPOSED ABOVE ARE NOT SUCCESSFUL IN REVERSING THE EMERGING TREND TOWARD CONTINENTAL DISTRIBUTION STRUCTURES. OPTION 3 (PAGE 147) IS SUFFICIENTLY UNCERTAIN OF SUCCESS THAT IT SHOULD NOT BE PURSUED FURTHER.**

While we have not examined the impact of the GST on the effectiveness of the support programs provided to assist in the publishing of particular types of culturally important Canadian books through the Canada Council and the Social Science and Humanities Research Council, consideration should be given to the need for increased funding to these programs. It appears virtually certain that the GST will reduce the effectiveness of the Canada Council and SSHRC programs and increases in funding would, therefore, constitute an important part of an integrated policy for the book industry.