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# Trading in Film: The Role of Government Regulation

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## Abstract

This study tries to understand historical trends in Korea's film trade, especially with the United States. For Korea, where U.S. market shares have generally increased, but recently the trend has reversed, the relatively slower diffusion of movie support media(theatrical ticket sales, home video, pay-per-view, pay television, basic cable television and satellite television) in Korea in contrast to the United States presumably contributed to American movies' dominance in the Korean market until the 1990s. One of the reasons of the slower diffusion of movie support media in Korea may be attributed to misdirected protectionist protection and other media policies. The recent increase of local movies' market share in Korea may be explained by the deregulation of domestic film industry and movie support media.

## I . Introduction

Many studies have tried to explain patterns of international trade in theatrical feature films, especially the tendency for American products to dominate that trade. Among a variety of different academic perspectives that these studies have taken, some economic studies have relied upon a home market economic model. Basically, the home market model contends that countries having relatively large and wealthy domestic markets for movies, notably the United States, tend to produce larger numbers of movies with higher production values, thus tending to dominate the box-office market both in foreign

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countries and at home.

Several empirical studies have applied this basic model to international film or television trade, mostly involving European countries and the United States. However, no study has systematically explained the pattern of international film trade in Korea using the home market or any other model. This study tests the home market economic model in Korea and attempts to understand historical trends in film trade in this country.

In summary, the relatively slower diffusion of movie support media-theater ticket sales, pay-per-view, pay television, home video, basic cable and satellite television-in Korea in contrast to the United States presumably contributed to American movies' dominance in the Korea film market until the mid 1990s.

If this is the case, then why have movie theater markets, home video, pay TV, cable television, and satellite television developed more rapidly in the United States than in Korea from the 1970s? This is an important question for understanding the origins of American dominance in these two countries.

One of the reasons for the slower diffusion of movie support media in Korea may be attributed to misdirected government protection and other media policies. The overall American lead in consumer spending on these media can perhaps be attributed to more freedom from government regulation. In other words, it is possible that government regulation and other media policies in the United States led to an environment more amenable to the development of new media.

In Korea, certainly, the government protectionism interfered with the development of healthy film production and distribution. The government's heavy regulations on cable television, such as the ban on a certain percentage of foreign movies, foreign investment, and multiple system operators, are probably related to the slow diffusion of cable television and pay television in Korea. High video piracy may also be an influence in the small revenue stream from video rentals and sales in Korea. The fact is that American film producers have benefited from the government's effective piracy enforcement. However, video piracy rates in Korea were high in the early days of video distribution because of less effective government policies on copyright.

It is interesting to note that the domestic movies' market share<sup>1)</sup> in Korea

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1) Korean movies' market share is defined by the proportion of total box-office receipts

has increased significantly since the mid 1990s. Such a huge increase may be attributed to the deregulation of domestic film industry and movie support media.

I begin in Section II below with a literature review, followed in Section III with the historical pattern of film trade in the Korean film market. Then, descriptive data and graphical interpretations are followed in Sections IV and V. Then, in Section VI, I interpret the results from a policy perspective. In Section VII, I examine the reasons of the increase in local movies' market share in Korea after the mid 1990s, followed by concluding comments in Section VIII.

## II. Theory

### 1. General Economic Literature on International Trade

The question of why a country specializes in the production of certain goods and then emerges as a strong exporter of those goods, whereas another country is primarily an importer of goods, has been one of the most important questions in explaining international trade.

A "new economic geography" model, which supports the increasing returns theory, attempts to explain international trade patterns. A theoretical basis of this "new economic geography" model is the home market effect. This effect has long been observed in many products and services traded on the world market. Linder(1961), for instance, argued that those countries that have a large domestic market for certain products will have an advantage in exporting those products. According to him, the home market effect helps firms to become more easily aware of business opportunities at home, and thus provides an incentive to solve problems in the home market. In addition, the home market effect makes it possible to adapt and improve a new product easily because it reduces costs significantly if undertaken for buyers in the home market. Krugman(1980) examined the causes of trade between economies with similar factor endowments, and the role of a large domestic market in encouraging exports. He also gave a formal justification for the idea that countries export

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in Korea which are accounted for by domestic movies.

what they have home markets for. That is, each country will be a net exporter in differentiated product industries under imperfect(monopolistic) competition, where it has a relatively larger demand. If two countries have the same composition of demand, the larger country will be a net exporter of the products, which has economies of scale.

In sum, the home market effect has given a theoretical basis in the form of a “new economic geography” model. The major characteristic of this “new economic geography” model is the interaction of increasing returns with transport costs across countries. This model also predicts that countries with a large domestic market will have net exports in scale-intensive industries (Helpman & Krugman, 1985; Krugman, 1980; Krugman & Venables 1990). This is the case because, given the existence of scale economies, producers will concentrate their production in one location since it will be more profitable for producers in industries with increasing returns to locate their production in countries with large domestic markets. By locating their production in one country, producers are able to take advantage of economies of scale and to avoid trade costs in selling to more profitable markets. Thus, large countries will be net exporters in scale intensive industries.

Torstensson’s(1997) empirical study showed that countries that have a large domestic market will be net exporters in scale-intensive industries: this fact would support the new economic geography model. Lundback and Torstensson (1998) examined inter-country differences in demand as a determinant of net trade. They argued that a demand bias and national preferences for a good lead to a net export. After conducting an empirical test on 17 OECD countries, they found that there was a tendency for demand bias in favor of a good that would affect net exports positively. In addition, they found that countries with a large domestic market would tend to be a net exporter in industries characterized by scale economies: this finding also would support the new economic geography model. With a panel of U.S. and Canadian manufacturing industries, Head and Ries(2001) confirmed home market effects, maintaining that an increase in a country’s share of demand was related to the increase in its share of output.

I have examined the general economic literature that is concerned with international trade. The next section explains how international trade in media

products has been studied within the framework of the general economic analysis summarized above.

## 2. Economic Model of International Trade in Media Products

The assumptions of the economic geography model are consistent with the nature of trade in movie products. As was noted earlier, the most important element in the economic geography model is the interaction of increasing returns with transport costs across countries. Movies are differentiated products, characterized by economies of scale because of high first copy cost and low marginal costs of distribution (Owen, 1975; Rosse, Dertouzos, & Wildman, 1978). However, one of the major assumptions of the economic geography model – transport costs – does not apply to movie products because movies have negligible transport costs. Given such low transport costs, producers have no incentive to concentrate their production in one country. Thus, the economic geography model cannot explain international trade in movies satisfactorily.

In order to consider the relative magnitude of trade flow in film and television, a few specific economic models have been employed (Hoskins & Mirus, 1988; Waterman, 1988; Wildman & Siwek, 1988). These models do not assume transport cost, which was a major assumption of the economic geography models. However, they have three common assumptions that lead to a home market effect.

First, there are economies of scale in the distribution of movies or television programs. That is, the incremental cost of distributing a film to consumers is relatively low because a film has a high first copy cost but low marginal cost of distribution (Owen, 1975; Rosse et al., 1978). Second, viewers are attracted to films and programming that are produced with larger production budgets. Third, cultural variables such as language (Straubhaar, 1991) are advantages for film and television producers. All else being equal (e.g., the quality of the programs produced), “cultural proximity” is a crucial factor in audiences’ programming choices (Pool, 1977; Tracey, 1985; Straubhaar, 1991; Wildman & Siwek, 1988, 1993). That is, viewers prefer films and television programs that are produced in their native language, or which reflect their own cultures, to films and programs that are produced in other languages and reflect foreign cultures.

The implication of these models is that movie producers in relatively large and wealthy countries will usually tend to have large market shares of theater box-office revenues, both in their domestic market and, to a lesser extent, in foreign markets. Because of a public good characteristic of television programs and movies, production cost is invariant to the number of viewers, and the huge economies of scale exist. If we assume that the costs of production are the same for all producers and the size of cultural discount is equal for all countries, U. S. dominance of international film trade can be explained by the fact that the United States has the largest domestic market. However, if the level of cultural discount is relatively small for U. S export of films, the extent of U. S dominance will be increased. Hoskins and Mirus(1988) state that U. S broadcasting programs have a low level of cultural discount because they are more likely to be entertaining, common-denominator, and tried-and tested programming that appeal to viewers in most foreign markets. Furthermore, since U. S. movie producers have the world's wealthiest language market, they are able to amortize the high first copy costs in both the domestic and the world's largest language market(Collins, 1994).

However, the recent advent of new regional markets shows the growing importance of geographic proximity and language. For example, the most popular programs in regional markets are domestic and regional, so that U. S. cultural products are becoming less important. For instance, Rogers and Antola(1985) examined Latin American markets and found that countries in that region imported primarily from other Latin American countries, especially Brazil and Mexico, while imported U. S. series were used as filler for less popular time slots.

In summary, motion pictures are characterized by low marginal costs in distribution but high first copy costs. Thus, due to the economies of scale in distributing movies worldwide, producers in countries with large domestic movie spending have an incentive to make relatively high budget films because they have large potential markets. Since the United States is one of the largest single markets in the world for theatrical movies, U. S. movie producers have an incentive to create high budget films that can attract many viewers in the rest of the world. This is why American movies are so dominant in other countries.

Several empirical studies have supported the economic model in the area

of international television trade. Waterman(1988) compared the economic infrastructures that support broadcast television in the United States to those in five of the major trading partners of the United States (France, Germany, Italy, UK, and Japan) in terms of GDP, population, and amount and type of support (advertising or subscription fees). In addition, he examined the movie infrastructures of all six countries, in terms of box office revenues and the total number of annual theater admissions. In both cases, Waterman found that the United States had an overwhelming advantage in terms of population and economic resources, which made U. S. dominance in the world television and film industries more likely. Waterman and Rogers' (1994) empirical study on 34 national broadcast television networks in nine Far East Asian countries showed that the percentage of domestically produced TV program hours in the Far East Asian countries was positively related to those countries' gross domestic products(GDP) and/or the proportions of those countries' gross domestic products(GDP) to the broadcast media. Chmielewski falkenheim's(1998) empirical study on 47 national broadcast television networks in South America also supported the economic model, which maintains that wealthier countries and countries with higher economic investment in their television systems produced a higher proportion of domestic programming. This positive relationship between the proportion of domestic programs and economic investment in television is more pronounced in the case of fiction, which indicates that market size and private investment are major determinants of the proportion of domestically produced programming in a country. Dupagne and Waterman (1998) examined the economic determinants of the import of U. S. television fiction into 17 Western European countries. Using a sample of all fiction programming that aired on 61 television stations in these 17 countries, they found that the GDP of these countries was negatively related to the percentage of U. S. fiction aired on these stations. This indicates that, other things being equal, the greater the GDP in the countries studied, the lower the amount of U. S. fiction imports in those countries. Dupagne and Waterman also found that an estimate of total broadcast revenue in the countries in question – that is, all revenues from advertising, sponsorship, license fees, public subsidies, and other sources – was a significant negative predictor of U. S. fiction programs. They also found that a country with a larger domestic television infrastructure would import a lower proportion of its programming from the United States

than a country with lower domestic broadcast television infrastructure.

Several empirical studies have also confirmed the soundness of the economic model in the area of international film trade. Jayakar and Waterman's(2000) empirical study, which used the cross-sectional data from box-office market shares and movie spending by 23 countries, showed that in countries that have relatively high consumer spending on movies, domestically produced movies account for relatively large shares of theater box office revenue. In this model, consumer movie spending is defined as the sum of annual box-office, video, and pay-TV revenues in each country. The study also found that U. S. movies accounted for relatively small market shares of box office in foreign countries with high consumer movie spending. This indicates that the development of primary movie support, that is, revenue from the box-office, pay-TV, and videocassette rentals and sales, was a strong determinant of the relative market shares of domestic and U. S. movie producers. These results are consistent with predictions of an economic model of international trade in media products. Waterman and Jayakar(2000) tested the economic model using time series data on total primary movie spending—theater tickets, pay television subscriptions, and videocassette rentals and sales—in the United States and the four largest European countries to correspond with the 1950~1997 market share data for Italy and the United States. In the regression analysis, they used the box-office market share of Italian films in the domestic market as a dependent variable, while they used the Italian share of the primary movie spending in the United States and the four largest European countries as an independent variable. The result confirms the economic model. The coefficient of the spending variable was significantly positive, indicating that as the Italian share of total spending increases, so does the Italian box-office market share. The relationship between the box-office share of American movies in Italy and the ratio of Italian to U. S. primary movie spending was also tested. This result also confirmed the economic model. That is to say, there was a significant negative relationship between these two variables, indicating that higher media spending in the United States in comparison with spending in Italy is related to an increase in U. S. film market shares in Italy. Using graphical analysis, Waterman and Jayakar also show that the United States has grown its domestic media for exhibiting films, especially pay television and videocassettes, more than Italy has. This faster development for such media has provided

American producers with economic support that has resulted in a relatively greater increase in film production investment than Italian producers have been able to sustain. One of the problems has been that the Italian film industry has relied heavily on broadcast television, which is a relatively inefficient medium in the support of theatrical film investment. Oh's (2001) analysis of 1988~94 box-office data from 21 countries finds a significant relationship between the box-office market share of domestic films and gross domestic product (GDP), total box-office revenues, and some measures of "cultural distance" from the United States. Using a 1955~2000 database on media industry development in the United States and Japan, Lee's work (2002) supported the home market economic model. Using consumer spending and related historical data on the four media for primary movie exhibition—theaters, premium pay television, PPV, and prerecorded videocassettes—in France, Germany, Italy, the UK, Japan, and the United States, going back to the 1950s, to correspond with the box-office market share data, Waterman and Lee (2001, 2002) found a significantly positive relationship over time between measures of domestic consumer spending on movies and domestic box-office market shares in these countries, and a negative relationship between domestic movie spending and American movie market shares.

### III. The Pattern of Film Trade in Korea

As Figure 1 shows, the prosperity of Korean films increased or held steady until about the late 1960s, but then steadily declined into the 1990s. The available data show that domestic movies accounted for about 50% of the Korean market in 1968 (*Korean Cinema Yearbook, 2001*). In the same year, the number of locally produced films was over 200. However, the Korean market share declined steadily after the early 1970s, and from 1987 on, when the direct distribution of films was introduced and import quotas were abolished, the Korean share decreased to less than 20% until the mid 1990s. Although the data for American movies in Korea are not available before the mid 1980s, American movies' share was around 60% throughout the 1990s. Since the late 1990s, however, Korean cinema has enjoyed a new renaissance, recording a market share of more than 40% in 2001. On the other hand, in the 1990s, the number of domestic movies in Korea declined, fluctuating between 40 and

60. In summary, the long-term trends show a decline in fortunes of locally produced movies in Korea until the mid 1990s. Interestingly, however, there is an indication that local movies' popularity began to increase sharply after the mid 1990s in Korea.

#### IV. Contemporary comparisons

Table 1 shows comparative GDP, consumer movie spending, and other film industry data for Korea and the United States in 1997. The United States has an advantage in GDP as well as in total multi-channel movie spending, including theater ticket sales, premium pay television subscriptions, PPV, prerecorded videocassette rentals and sales, and basic cable and satellite television subscriptions. The GDP of the United States is about 17 times larger than that of Korea, but total consumer spending on these movie media of the United States is about 26 times greater. In per capita terms, total spending on movies in the United States is about 4 times greater than that in Korea. In terms of GDP, the United States is also larger than Korea. The average investment per film in the United States is 14 times larger than that in Korea. This is consistent with the home market economic model, which says that higher film production costs, caused by higher spending on movies in the United States, led to American movies' general dominance in Korea.

#### V. Graphical Interpretation

How can the long run changes of box-office shares in Korea be related to the diffusion and development of movie support media in the U.S. and Korea?

##### 1. Cable Television, Satellite Television and Pay television

The period of declining box-office share in Korea after the 1980s corresponds to a rapid diffusion of cable television, satellite television, and pay television in the United States. As Figures 2 shows, total multi-channel television services were not introduced in Korea until 1995, but they were introduced in the 1960s in the United States and became popular very fast. As Figure 3 shows, although premium pay television was introduced in Korea in 1995, this service was

introduced in the 1980s in the United States. This means that film producers were supported by the more rapid development of multi-channel television and premium pay television in the United States than in Korea. However, domestic film producers in Korea could not be supported by these media until the mid 1990s because they were not available until then.

## 2. Home Video

Although the diffusion of VCRs in Korea came later than in the United States, the use of VCRs has grown rapidly since the late 1980s(Figure 4). However, per capita consumer spending for video rentals and sales in Korea has been much lower than in the United States since the late 1980s(Figure 5). This means that film producers in the United States were supported by video rentals and sales on a greater scale than were film producers in Korea.

In summary, the relatively slower diffusion of such media in Korea in contrast to the United States presumably contributed to American movies' dominance in the Korean film market until the mid 1990s. If this is the case, then why have movie theater markets, home video, pay TV, cable television, and satellite television developed more rapidly in the United States than in Korea from the 1970s? This is an important question for understanding the patterns of film trade in Korea.

One of the reasons for the slower diffusion of movie support media in Korea may be attributed to misdirected government protection and other media policies. The overall American lead in consumer spending on these media can perhaps be attributed to more freedom from government regulation. In other words, it is possible that government regulation and other media policies in the United States led to an environment more amenable to the development of new media.

## VI. Government policies and media diffusion

### 1. Theatrical Film Industry

Korea's film industry has been protected under the name of both infant industry (in need of economic support), and cultural entity (in need of cultural protection). In order to make sure that the industry survived both financially

and culturally, the Korean government supported it with the import quota until the late 1980s. However, such protective policies were not effective for the development of the Korean film industry in the long run. Rather, they may have led to an ineffective film distribution structure, thus weakening the competitive ability of the industry. Even today, however, the screen quota system and other protective policies for local film production exist.

*a. The Import Quota System*

The Korean film industry was protected under the import quota system until the mid 1980s. Under the import quota system, local film producers had to produce at least four domestic films prior to importing one foreign movie. However, local film producers were more interested in the importation of foreign films than in the production of domestic films. According to Lee (1995), most local film producers created their movies within a month. This indicates that domestic film production was only an excuse for obtaining foreign films. Thus, even though domestic films did not appeal to audiences, local film producers could survive with their foreign films, which provided them with stable profits. Consequently, under the import quota system, local film producers had no incentive to produce high budget films. In other words, government protectionism tended to deter the development of an autonomous film industry in Korea.

The decrease of box-office admissions until the early 1990s for Korean films is possibly related to the import quota system.<sup>2)</sup> Since that system artificially limited the number of foreign movies, Korean people had no effective choice but to watch a certain percentage of domestic movies. The result was that this protectionist policy may have discouraged people from watching Korean movies because many of them were low quality "quota-quickies". Although the import quota system artificially kept the Korean market above at a certain level, we should note that even under the import quota system, the Korean

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2) The number of average theater visits per year was 4.6 in the 1960s, when film was regarded as the most popular medium. However, the number was around 1.7 in the late 1970s because broadcast television and other entertainment were available. The figure kept decreasing until the mid 1990s possibly because the low quality of domestic films discouraged people from watching movies. However, the figure has increased consistently since the mid 1990s.

movies' market share was decreasing until the late 1980s. This indicates that domestic movies under the import quota system did not appeal to audiences. In other words, the import quota system, which was responsible for the reduction in quality of local productions, might also be related to the decrease in box-office admissions until the mid 1980s in Korea. However, since the mid-1980s, when the import quota was abolished, the demand for movies began to increase because people had a variety of movies available to choose from. With this increase in box-office admissions, the domestic movies' share also increased. Although the domestic share decreased temporarily after the mid-1980s, it has experienced a resurgence since the mid 1990s. In one sense, then, more foreign competition may have helped local films to develop in the long term.

*b. Film Distribution*

It appears that the import quota system was also responsible for a problematic film distribution structure. Under the system, Korean films with low production values could not compete with American films with high production values. Thus, the film business was considered risky. As a result, no company or bank was interested in investing in the Korean film business (Park, 2000). Accordingly, local film producers had difficulty in finding financial resources for film production, and because of their financial weakness, local film producers could not organize their own distribution networks.

The result was that local film producers borrowed funds from regional distributors or videocassette distributors in exchange for either film rentals or video distribution privileges. Local film producers sold their films for a flat fee to regional distributors, who in turn leased the pictures to a particular geographical area. Such a rudimentary distribution system presented no opportunity for the film producer to share in any additional profits that might appear at the distribution level. The persistence of this system suggests that Korean film producers were not able to capitalize on the successful showing of their films in an effective way.

In summary, faced with serious financial problems, local film producers were required to tolerate disadvantageous contracts with regional film or videocassette distributors, generating an inefficient film and videocassette distribution system. Put differently, Korean film producers were forced to market

their films inadequately without having either national distribution networks or strong bargaining power relative to regional or videocassette distributors. Such a system may have reinforced slow capitalization from the production end of the local film industry.

*c. The Screen Quota System*

The negative effects of the import quota system on the Korean movie industry call into a question the effectiveness of the Korean government's protective policies. We see further effects of those policies in the screen quota system. The screen quota system requires for that Korean films be screened at least 146 days a year. This system has been under debate in Korea for several years, and the U. S. government is using its influence to abolish such quantitative restrictions on American films. The Ministry of Culture and Tourism thus proposed to cut quotas starting in 2002.

Those who are against the abolishment of the screen quota argue that films should be excluded from the free trade principle because protecting the Korean film industry will ensure Korea's cultural identity. However, the question remains. Did local film production under the import quota system reflect the cultural values of Korea? Whether or not a film is Korean had relatively little to do with its cultural characteristics. Under the import quota system, a Korean film was defined as one made by a Korean company. There was no specific definition of cultural identity and it was impossible to define how a film should include the cultural values of Korea.

The import quota system created a film production system that was totally different from the system the regulators had projected, and it yielded a large number of low-quality domestic films that could not be considered Korean in any cultural sense. They were similar to American second-feature melodramas. As I discussed above, these "quota-quickies" did not appeal to audiences, and they were just a way to promote the import of financially successful American films. After the abolishment of the system, the number of local films decreased, but the domestic movies' market share increased. This occurred because the number of low quality films decreased after the abolishment of the import quota system. Unfortunately, even after the abolishment of the import quota system, many quota-quickies are still being produced. In terms of box-office admissions, the top 10 Korean films in 1999 accounted for 82%

of the total admissions from Korean films.<sup>3)</sup> This suggests that most box-office admissions are accounted for by the top 10 films. In other words, a lot of “quotaquickies” are still produced under the screen quota system.

Kang, director of the Korean blockbuster movie, *Swiri*, argued that if there had been no screen quota, it would have been impossible to make such big budget films as *Swiri* (“Korea filmmakers”, 1999). According to him, without the screen quota system, nobody would invest in big budget film production in Korea (Hwang, 1999). However, the argument that the film financing in Korea depends on the existence of the screen quota system ignores the economics of film financing. Bankers and investors examine the potential success of individual films very carefully, and then decide to invest in Korean films that are worth financing. If investors have difficulty in finding Korean films that are potentially successful, they will not invest in Korean films. Under the import quota system, neither banks nor investors were interested in film production because they could not find films that they thought would succeed. The point is that bankers and investors invest in films not because of the existence of the import quota system or the screen quota system, but because of the potential for success, which is by the quality of a film. Of course, the screen quota system may contribute positively to the domestic film industry for the short term in the sense that various kinds of independent film productions were supported, for without that system, independent film producers or new film companies would have difficulty entering into the film business. In the long term, however, the screen quota system may actually hurt the development of the local film industry because film producers have less incentive to produce high quality films.

The fact is that domestic film producers have competed with Hollywood films since the abolishment of the import quota system, and the significant increase in production costs after the system was eliminated reflects a substantial increase in the quality of film production in Korea. Is the significant

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3) The author calculated these numbers based on the *Korean Cinema Yearbook (2000)*. In 1999, 36 Korean movies were released. The total number of box-office admissions for these Korean movies was 8,019,027 in Seoul. The number of box-office admissions for the top 10 Korean films was 6,809,031. Thus, the top 10 Korean films released in 1999 accounted for 82%  $((6,809,031/8,019,027)*100 = 82\%)$  of the total box-office admissions from Korean films.

increase in the film production cost a result of the existence of the screen quota? If so, did film production costs also increase under the import quota? The answer to both questions is no. Under the import quota system, the average film production cost was only \$ .14 million in 1984 and \$ .21 million in 1990 (Kang, 1991). However, the average film production cost increased to \$ 1.7 million in 2000 (Current State, 2001). This significant increase in film production cost may be explained by the competition brought about by the abolishment of the import quota. Thus, the argument that the screen quota system results in high production cost for Korean films is not justified.

Some might argue that producers in Korea cannot afford the kind of expensive production costs that are common in the United States because Korean producers expect to sell their films in much smaller markets than the U. S. producers do. Thus, the screen quota may be justified to help Korean film producers compete with Hollywood film producers in a fair manner. It is true that the United States has a great advantage in its market size over Korea, and that is why American producers make films not only for their domestic market but also for the international market. However, the fact that Korea has a much smaller market than the United States does not force Korean film producers to make films just for the domestic market, for they do not necessarily think only in terms of the domestic market when they make movies. The fact that most local film production under the import quota was low-quality melodrama indicates that local film producers had no incentive to think about international markets. However, faced with fierce competition from Hollywood, Korean producers have created several high budget films that have appealed to international audiences. For example, according to the Korean Film Commission (KOFIC), total film export revenue reached \$6.98 million in 2000, an increase of over 100 percent from last year's \$3.04 million("A year of", 2000). "Swiri," the number one hit movie in Korea in 1999, was also number one at the box office in Hong Kong at the end of 1999, and drew over 1 million viewers in Japan. This suggests that competition may have forced local film producers to produce high quality films that were appealing to both domestic and foreign audiences.

At any rate, the Korean government can no longer protect the domestic film market from foreign competition because international trade obligations put severe pressure on countries to open their markets. Thus, Korean film

producers must learn to develop and market their films in this open environment, so they need to focus on improving Korean films rather than preserving the screen quota. The example of the Korean record industry, which has competed with foreign music without any protective measures, shows that although the local recording market was dominated by foreign music in the 1970s, Korean albums increased their market share in the 1980s, taking more than 70 percent of the market in the late 1990s(Hwang, 1999). No doubt the music industry is different from the movie industry in several ways. It costs much less to produce a high quality album than to produce the same kind of movie, and it is important to spend a great deal of money employing famous musicians and using high technology to produce an album of high quality. However, in the case of the music industry, high production budgets may not be a major factor in attracting audiences. In the case of film production, it is difficult for other countries' movie studios to imitate Hollywood because of American movies' high production costs, whereas it is easy to produce American style music. If American rap music becomes popular, Korean singers can imitate American rap songs. However, the film business is similar to the music business in the sense that they are both cultural products. Although American music dominated Korean music markets in the 1970s, free market competition may have provided Korean musicians with an incentive to create high quality music that appealed to local audiences.

As we have already observed, the import quota policy for the film industry in Korea has not worked because of the failure to understand the unique economic factors affecting that industry. As Wildman(1995) argued, restrictions on the commercialization of domestic media may limit international demands for their products and create internal demand for foreign products in the long run. However, since the abolishment of the import quota, Korean movies' market share has increased to 40% over the last three years. Local movies' export revenues also have increased significantly. This implies that the abolishment of the import quota system could have an important long-term effect on the increase of the quality of local films. The failure of the import quota system provides us with a valuable lesson for domestic media policy in Korea, and part of that lesson may be that the screen quota system is not a useful instrument for strengthening the competitiveness of Korean films in the long run.

*d. Other Protectionist Policies*

Throughout the 1960s, 1970s and 1980s, films in Korea were censored as regards their treatment of social, political, and cultural issues. Since the entry into the production stage of a film was determined by the government, the government could control the content of that film. Thus, Korean cinema did not possess creative freedom under the military dictatorship for many years.

Before the mid 1980s, local film production was in government hands. This control of films had been introduced by the Park military regime in the 1960s, and by controlling Korean film production, the military government could keep films from practicing cultural criticism(Park, 2000). The result was that most film companies produced films that endorsed national policy or traditional culture. In summary, the harsh censorship and the high barriers to entry in the film business may have discouraged certain forms of local production and thus had a negative effect on national film industries.

The Korean government also taxes movie theater admissions to subsidize local productions. For example, the Korean Film Commission's 2001 budget for the promotion of Korean films was about US \$ 65.7 million, which was collected from a tax on tickets and government aid(Korean Film Commission, 2001). The Korean Film Commission supports Korean film production by investing through the Invest Union, providing loans to each project and investing in individual projects. Although it is unclear how significantly these regulations affected the local film industry in Korea, such regulations were absent in the United States.

## 2. Government Regulation for the Movie Support Media

A slower diffusion of cable television, pay television, and satellite television in both Japan and Korea than in the United States may be related to inadequate government policies and the resistance of the established media.

*a. Cable Television, Satellite Television, and Pay Television in Korea*

In the early stage of cable television services in Korea, the government was concerned about the potential monopolies of the cable television business, and it strictly separated the common ownership of cable television components, such as system operator, network operator, and program provider. Such structural restrictions, along with piracy problems, led to a slow start for cable

television, with audiences turning away from cable television services. Furthermore, the penetration of cable television was slowed by the government's restriction on foreign programs, which should be no more than 30%, and foreign investment, which was not allowed. However, the Cable Television Act in 1999 allowed cross-ownership, foreign investment, multiple system operators, and multiple program providers. This new Cable Act, which is trying to achieve economies of scale in cable television services, may provide a good opportunity for the growth of the Korean cable television industry.

*b. Video Piracy*

Differences in the effectiveness of government enforcement of piracy laws have been more favorable to the commercial development of the American video market than in Japan and Korea.

In the 1980s, video piracy in Korea was in the 80% range, but it was under 30% in the early 1990s(Weiner, 1994). The Motion Picture Association of America(MPAA) reported that the proportion of video tapes that were pirated was put at about 10% in America(Video piracy, 1987). Apparently, the lack of enforcement of piracy laws in Korea may be related to the reduced distributor revenues from movies on video.

I have argued that the decrease of domestic movies' market share until the early 1990s in Korea might be partly related to the slower diffusion of the movie support media, and that one of the reasons for the slower diffusion of movie support media in Korea might be attributed to misdirected government protection and other media policies. However, it is interesting to note that the domestic movies' market share has increased significantly since the mid 1990s. How can we explain this pattern?

## **VII. The Increase of Domestic Box-office Market Share in the 1990s**

There are several factors that may explain this increase. First, the conglomerates' engagement in film production and an influx of capital from various sources into the Korean film industry may have contributed to the extraordinary performance of Korean films in the late 1990s. Before the 1990s, major film investment sources were regional film distributors and videocassette

distributors. However, in the 1990s, several conglomerates started to participate in film production and succeeded in significantly increasing box-office revenue in the Korean film industry. For example, *Swiri*, the number one box-office film in Korea in 1999, was produced by Samsung Entertainment Group, a subsidiary of Samsung Corporation. Korea's three large corporations – Samsung, Hyundai and Daewoo – produced nearly 20 films each year between 1994 and 1996, which is about one third of annual film production in Korea (Park, 2000). These large corporations' participation in the film production business may have contributed to the increase in local film production budgets and quality.

As a result of the success of Korean films, investment companies also began to provide film producers with capital in the 1990s. Major investment capital comes in two forms: specialized investment capital and venture capital ("Current State", 2001). The first refers to investment capital that emphasizes investing in film production under the terms of distribution-rights-takeover, while venture capital participates in film production through the Investment Union. Investment companies were able to recover their money quickly because the period of turnover for capital investment was short in the film business. As the amount of investment capital increased, many consortia were created to invest in film production. As a result, the risk of investment in film production was shared by several members of a consortium. Moreover, with the increase of capital from various sources, domestic production costs increased significantly. Such a huge increase may have contributed to the extraordinary financial performance of Korean films in the late 1990s. In summary, the significant increase of investment capital in film production was related to the increasing success of Korean films in the late 1990s. However, local film producers could not find these sources of capital before the 1990s.

With the increase in film funds, the appearance of major local film distributors also contributed to the increase of local films' market share in the late 1990s. CJ Entertainment and Cinema Service are two major local film distributors in Korea and the financial structure of these two companies is similar to that of Hollywood studios. They finance their own films, or they buy the distribution rights to independent films, providing all the pre-sales necessary to finance those films.

There are several reasons that the Hollywood studio system is financially stronger than project-based film production (London Economics, 1995). For one,

Hollywood's studio system has low transaction costs, obtains information required by investors and lenders, has a reduced chance of bankruptcy, and so on. On the other hand, European films are usually financed by banks, one at a time. As for Korea, in the past, film finance was similar to that in Europe. Although it is difficult to measure the effect of the different financial structures between the United States and European countries, Hollywood's dominance over the world may be partly related to the Hollywood studios' financial structure. However, it is also arguable that Hollywood's studio system is superior to European countries' project-based financing (London Economics, 1995), for according to this study, European bankers often want to find credible European films to finance. As a result, the relative lack of funding for European films may be related to the low prospect of the success of European films. In other words, European bankers are willing to invest in Hollywood films because they are likely to succeed. Thus, London Economics (1995) pointed to a "classic chicken and egg problem":

"The first point is that European film is not going to be successful without finance and distribution but, at the same time, finance and distribution are not the original source of the problem. The American dominance of these areas reflects the American success at making films. The difficulty for European film makers is that it is hard to start making successful films without finance and distribution. We face a classic chicken and egg problem: there is little point in organizing massive finance or distribution if we carry on making the films we do: but there is no point in trying to make large mass market films unless we organize better distribution and finance." (London Economics, 1995, pp.91~92).

Whatever the cause and effect may be, with the increase of Korean movies' success in the 1990s, the local film industry began to be financed in many different ways. The introduction of major local distributors also helped local films increase their market share in the late 1990s. As Table 2 shows, CJ Entertainment and Cinema Service, which are the top two local film distribution companies, accounted for 20.5% and 15.5%, respectively, of Korea's film distribution market in 2000 (Current State, 2001).

The Korean government's policy on the film industry may have stimulated investors to participate in film production. In order to promote the film industry, the government aided investment companies through the creation of new

policies, such as project financing, tax benefits, etc.

Another reason for the increase of domestic movies' share in Korea may be the relative increase of consumer movie spending in the 1990s. Considering that both the Korean box-office share and the ratio of Korean to U.S. theatrical movie spending have increased since the mid 1990s, the relative increase of consumer movie spending in Korea may be positively related to the increase of domestic box-office market share. If this is the case, then why did the domestic market share decrease from the 1980s to mid 1990s even though the ratio of movie spending in Korea to that in the United States continued to increase during this period? And why did the domestic share start to increase abruptly after the mid 1990s?

This inconsistency might be explained by the cultural discount factor. As previously discussed, the second assumption of the home market economic model is that all else being equal, viewers prefer films that are produced in their native language, or that reflect their own cultures, to films that are produced in other languages or that reflect foreign cultures. However, under the import quota system, the quality of Korean films was not comparable to that of American films. In such a situation, cultural proximity might not be a major factor in audiences' film choices. Thus, the domestic movies' share and consumer movie spending may not be positively related from the 1980s to mid 1990s. However, the abolishment of the import quota system may have significantly contributed to the increase in local films' quality, and with this increase, local audiences may have spent more money on domestic films than on foreign ones because the former reflect their own culture. In other words, the cultural proximity for local films may have been more significant in the late 1990s than it was in the 1980s.

Besides, the increase in the number of screens due to the introduction of multiplexes and wide release marketing strategy based on the direct distribution of films may be regarded as major factors to expand domestic film market in Korea.

## VIII. Conclusion

This study has attempted to test the home market economic model in Korea. Although contemporary comparisons as well as graphical interpretation sup-

ported the home market economic model, there may be other factors related to the market share of Korean films, including the Korean government's protective policies.

Historical data on movie spending indicates that one of the factors in the competitiveness of American movies (or weakness of Korean movies) in Korea is the more rapid development of movie support media in the United States than in Korea. The United States has developed its movie infrastructures – prerecorded videocassettes, pay-television, multi-channel video services, including cable television, and satellite television services – at a more rapid rate than has Korea. Moreover, the competitiveness of American films has been magnified by rapidly expanding markets for American movies worldwide, which provide even larger economic resources for film production. The Korean government's heavy regulatory policies may be the part of the reason for the slower growth of movie media development in Korea.

Although his study has shown a broad relationship between media development and box-office market share, the patterns of film trade in Korea cannot be explained completely by this economic analysis. Certainly, there are other factors contributing to these patterns in Korea. Nevertheless, there is the economic reality that over the long term a country's domestic film infrastructure is crucial in maintaining a viable film industry.

The importance of the domestic support base has policy implications for the film industries in Korea. The role of this base in determining film trade flow and the effect of domestic media policies on the growth of national film infrastructure should be considered in the formation of domestic film policy. Quotas or other restrictions on film imports, while they may achieve political or cultural objectives, limit the potential development of the support base for domestic movies. If Korea maintains or tightens the current screen quota system, the result may be to hamper the growth of its domestic film industry over the long term.

However, trade liberalization policy in the film industry should be complemented by domestic media policy reforms favorable to growth. This study has shown that the Korean governments restricted the development of pay television and multi-channel cable television with their heavy regulations and limiting commercial resource bases for film producers, whereas the American government gave great freedom to the commercial activities of its media firms.

The result is that American film producers' huge economic resources have made it possible to create internationally successful American blockbuster films with high production values.

Since the 1990s, the gap between American spending on movie support media and that of Korea has diminished moderately. As for Korea, the increasing domestic movies' market shares since the mid 1990s have been closely related to the increasing economic resources of Korean film producers. In the late 1990s, the advent of local film distributors with national distribution networks and a stable financial situation led to a renaissance in the Korean film industry. Local films' market share was more than 40% in 2001, which is one of the highest local movies' box-office shares among the Far East Asian countries. Moreover, this commercial success of Korean films helped Korean films' export revenues significantly.<sup>4)</sup> This means that the expanded resources available to produce films were increased because of expanded markets domestically and internationally. The introduction and deregulation of the cable television industry in Korea the late 1990s will provide another source of revenue for domestic film distributors.

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4) The recent success of Korean films abroad should be noted. Until the mid 1990s, Korean movies' annual export revenue was less than US \$1 million. However, it has increased significantly since the late 1990s. In 2000, the total export revenue from Korean films was US \$ 7 million(*Korean Cinema Yearbook*, 2001).

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<Table 1> Comparative GDP and Film Industry Data: Korea and the U. S.1997

	Korea			USA		
	Total	as a % of GDP	per capita	Total	as a % of GDP	per capita
	U.S. \$m	%	U.S. \$	U.S. \$m	%	U.S. \$
GDP	476485			8300800		
Population(millions)	45.99			267.9		
Consumer movie spending						
Theatrical Box office	251	0.052677351	5.457708197	6366	0.076691403	23.76259798
Pay-TV	11	0.002308569	0.239182431	6394	0.07702872	23.86711459
PPV	0	0	0	583	0.007023419	2.176185144
Videocassette rentals and sales	888	0.186364493	19.30854534	15385	0.185343581	57.42814483
Cable television and Satellite spending	531	0.11144093	11.54598826	22839	0.275142155	85.25195969
Primary movie spending	1150	0.241350413	25.00543596	28728	0.346087124	107.2340426
Total multi-channel movie spending	1681	0.352791343	36.55142422	51567	0.621229279	192.4860022
Broadcasting television revenues						
Advertising	1627	0.341458368	35.37725593	36893	0.444451137	137.7118328
License fees	419	0.087935498	9.110676234	2249	0.027093774	8.394923479
Total broadcasting	2046	0.429393866	44.48793216	39142	0.471544911	146.1067563
Investment per film(US\$m)	1.05			14.53		

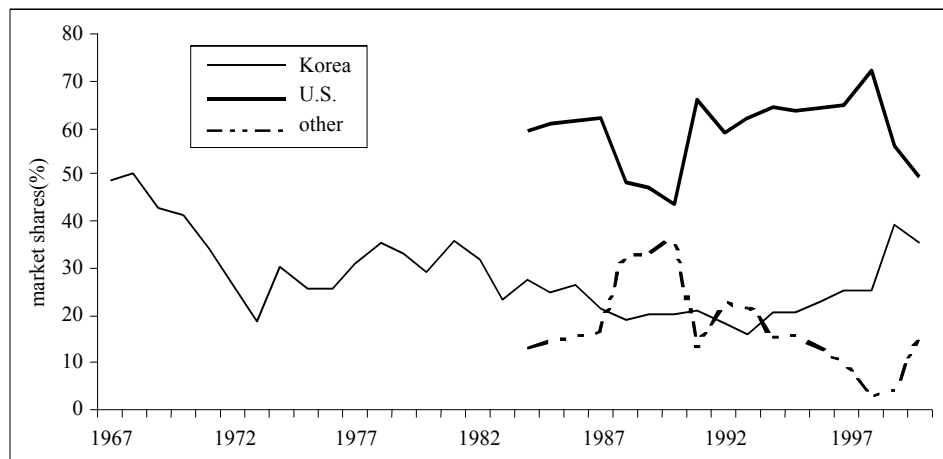
Sources: GDP data and population data from International Financial Statistical Yearbook (2000), CD-Rom; Box-office data from Korea Cinema Yearbook (various issues) and International motion picture almanac (2000); Pay TV data from Catchone (mail questionnaire) and Veronis, Suhler & Associates (1999); Video data from Culture and Tourism Department in Korea (mail questionnaire) and Paul Kagan Associates (1999); Cable and Satellite data from Korean Telecommunication Promotion Commission and Veronis, Suhler & Associates; Broadcasting data from KOBACO advertising yearbook (various issues), Korean Broadcasting System and Veronis, Suhler & Associates; Investment data from Screen Digest (1998).

<Table 2> Market Shares of Theatrical Film Distributors in Korea, 2000

Distributor	Country	Theater Admissions	Market Share
CJ Entertainment	Korea	5,546,602	20.5%
CinemaService	Korea	4,192,424	15.5%
Buena Vista	United States	3,097,356	11.4%
Columbia	United States	3,039,356	11.2%
UIP	United States	1,870,958	6.9%
Warner Brothers	United States	1,476,700	5.5%
20 <sup>th</sup> Century Fox	United States	1,325,327	4.9%
Shindo Films	Korea	854,764	3.2%
Tube	Korea	758,868	2.8%
Entertainment			
Hanmac Film	Korea	456,300	1.7%
Pass 21	Korea	117,799	0.4%
Film Bank	Korea	33,796	0.1%
Others		4,292,746	15.9%
Total		27,063,612	10%

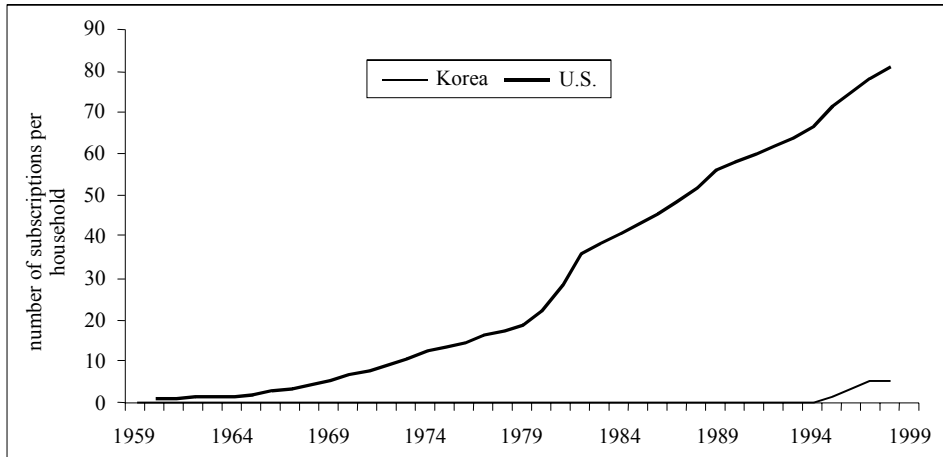
Source: *Korean Film Observatory*(2001, Spring), p.3.

[Figure 1] Box-office Market Shares in Korea, by National Origin of Films 1967~2000



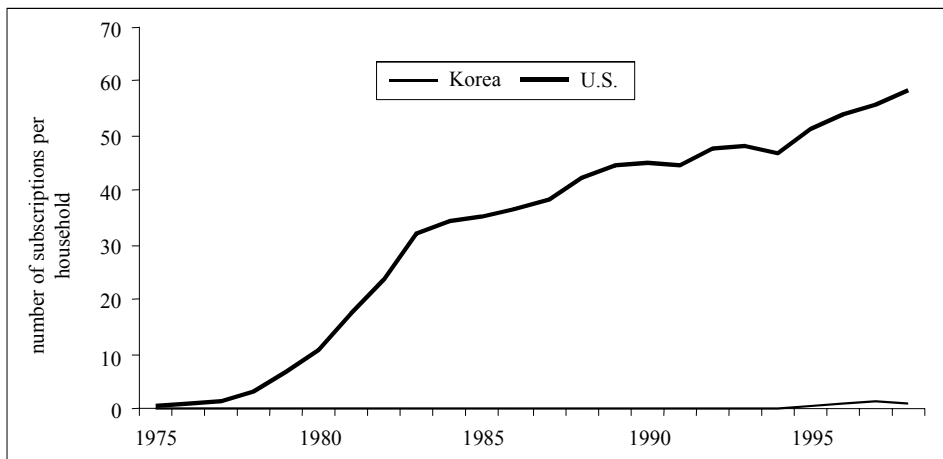
Sources: *Korean Cinema Yearbook*

(Figure 2) Number of Total Multi-channel Video Subscriptions Per Household in Korea and the United States 1959~1999



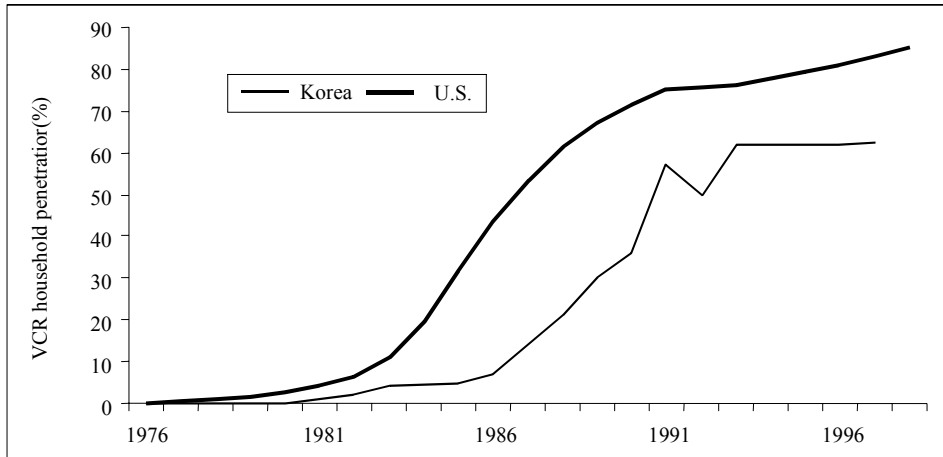
Sources: Korean Cable TV Association, Catchone, and Paul Kagan Associates

(Figure 3) Number of Pay TV Subscriptions Per Household in Korea and the United States 1975~1999



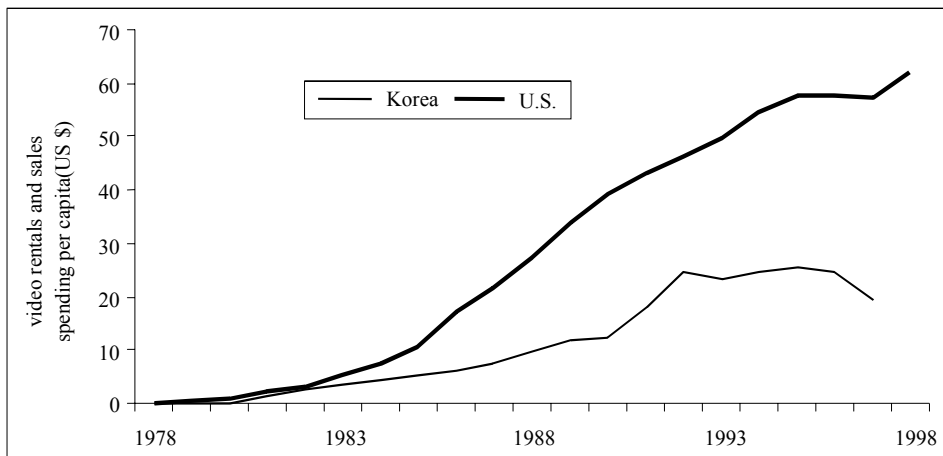
Sources: Catchone and Paul Kagan Associates

(Figure 4) Number of VCR Subscriptions Per Total Household in Korea and the United States 1976~1998



Sources: *Screen Digest*, Culture and Tourism Department in Korea, and Paul Kagan Associates

(Figure 5) Per Capita Videocassettes Spending(Rentals and Sales) in Korea and the United States 1978~1999



Sources: *Screen Digest*, Culture and Tourism Department in Korea, and Paul Kagan Associates