Evaluating the Effects of Protectionism on the Film Industry: A Case Study Analysis of Korea

Jimmyn Parc

1 Bumpy Start of the Korean Film Industry

With the growing popularity of South Korean (hereafter Korea) contemporary culture known as *Hallyu* or the Korean wave over the last two decades, the Korean film industry would have naturally been expected to have enjoyed uninterrupted success as well. However, the film industry has experienced many periods of difficulties. Interestingly though, these hardships have helped it to form its own competitive advantage within the global film market. The history of Korea's industry offers a fascinating history of how to develop a successful film industry.

During the period of Japanese occupation (1910–1945), strict censorship was imposed which hindered the growth of the Korean film industry. For example, Korean-speaking films were banned completely in 1942 (Kim, 2007), and all film producers were forcibly merged into a single production house to make Japanese propaganda films.

When Korea was liberated in 1945, under the US Army Military Government (1945–1948), many Hollywood films were distributed to Korean theaters while only a handful of Korean movies were produced annually. Meanwhile, the prevalence of Hollywood films in Korea meant that the domestic audience became more

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familiar with Hollywood-style films. This contributed to the growing sophistication among the Korean audience after decades of exposure to Japanese films (Shin, 2008, p. 43).

During the Korean War (1950–1953), Korea's entire industrial infrastructure was destroyed, and many Korean film directors worked for or under the US Army which later provided them with modern film technology and equipment (Paquet, 2007; Song, 2012). The transfer of advanced US filmmaking equipment and technology to Korean filmmakers and production companies allowed Korea to become one of the most dynamic movie industries in Asia (Kim, 1998, pp. 130–135). However, this so-called golden age lasted only until the 1960s. In order to promote the film industry further, the Korean government introduced several protectionist measures. Yet, despite these efforts, the Korean film industry faced unexpectedly serious stagnancy throughout the 1970s and 1980s.

In the early 1990s, the Korean film industry began to recover. Since then, it has performed strongly in the domestic market with 54% of the market share on average over the last decade and annual record peaks of between 60 and 65%. Underlining this success, many Korean films have also been recognized internationally: *Thirst* (Jury Prize at 2009 Cannes Festival), *Poetry* (Best Screenplay Award at 2010 Cannes Festival), *Night Fishing* (Golden Bear for Best Short Film at 2011 Berlin Festival), *Pietà* (*Golden Lion* at 2012 *Venice Festival*), *Inside Men* (Best Actor at 2016 *Asian Film Award*).

In short, the Korean film industry achieved its competitiveness within a relatively short period of time and has become one more additional dimension of *Hallyu* and a step toward developing a new hip identity, that of Korea as one of "Asia's cultural powerhouse" (Chua & Iwabuchi, 2008; Parc & Moon, 2013; Time, 2012).

In this respect, the successful renaissance of the Korean film industry raises the following key questions: What is the impact of various government policies on the Korean film industry? What kind of lessons can countries, especially those with declining film industries, learn from Korea's experience with its film policies? The impact of such policies and other possible factors to account for Korea's success are analyzed in this chapter.

I shall focus on providing a fact-based assessment of the results produced by the aforementioned policies and its practices in the case of the Korean film industry. In addition, this assessment has been put into perspective since it can be argued that these policies have had either immediate or lagging effects. The main conclusion of this chapter is that most of the successive Korean film policies have not been effective, rather it was business strategies that emerged as the critical factor to help boost the industry.

This chapter is composed of four sections corresponding to three periods. Section 2 focuses on the "import quota" regime which dominated Korea's film policy from the early 1960s–1986. Section 3 looks at the "screen quota" system which has been the most visible element of Korea's film policy since 1987, but has begun to lose its predominance after July 2006. Section 4 examines the subsidy policy, the most frequently discussed issue in Korea nowadays, which emerged in

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80% (1973 and 1975).[1] The reason for such a failure is that foreign films attracted a larger domestic audience than Korean films did. Merely limiting the number of foreign films did not protect or promote the Korean film industry as it did not enhance its competitiveness. In short, I wish to argue that the import quota system sought to protect the Korean film industry and it was well enforced, but it was unable to increase the number of admissions for Korean films.

2.2 Impact on the Quality of Korean Films and Audience's Perception

The import quota system also induced a largely unexpected and strongly negative effect on the Korean film industry. Far from the initial intention for the anticipated virtuous circle, the quantity-based reward system induced Korean filmmakers to produce low-quality movies and to screen and export them—nicknamed "quota quickies"—in order to have the rights to import more foreign movies. This fact, again, emphasizes why the number of admissions is the key criterion for assessing the success of any film policy.

Low quality Korean quota quickies could not be exported; foreign currency earnings were reduced, leading to less capital to produce Korean films, hence fewer imports of foreign films. This vicious circle became more visible when the Korean government devaluated significantly the Korean won several times after 1964. As a result, these low quality domestic films could not be exported. This meant that most profits had to be generated domestically through screening foreign films which created more incentives to screen and to import more blockbusters from overseas. As one might expect with such a situation, more quota quickies had to be produced; however, without much investment, it was impossible to produce many domestic films. Hence, the import quota measure rather put the whole industry into a negative situation. For example, from 1980 to 1986, the last years of the import quota regime, only 17 Korean films per year were exported, compared to almost 80 during the 1970s. This shows clearly how the whole system fell into an unintended vicious circle.

This negative impact of the import quota regime on the Korean film industry is accurately captured in Fig. 1. It shows a striking contrast between the two periods: the years under the import quota regime (marked with a thick solid line) and those after the abolition of the import quota (no line). When the import quota regime was imposed, the admission share per foreign movie was, on average, much higher than the admission share per Korean movie. For instance, one foreign film attracted, on average, 2.5 times more admissions than one Korean film in 1980 (the lowest record) and 13.2 times higher in 1975 (the highest record) (see Fig. 1).

Remarkably, when the import quota regime was abolished at the end of 1986, this anomaly vanished quickly. Even more surprising is that Fig. 1 shows a complete reverse in the ratio of admission shares between Korean and foreign

[1]Official data can be found only from 1965. The import quota system was abolished in 1986.

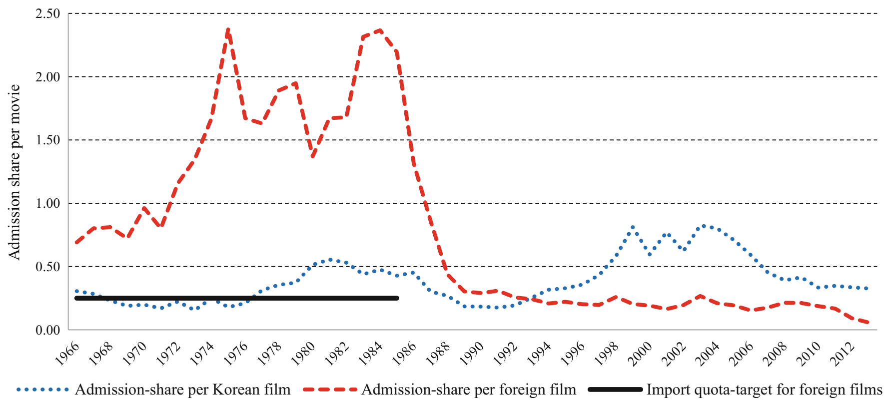

Fig. 1 The impact of import quotas in Korea (1966–1986). Notes: (1) Based on author's calculations. (2) The average admission share per (Korean and foreign) movie is the share of admission for Korean/foreign movies in total admissions divided by the number of Korean/foreign movies for given years. Data sources: Koreanfilm.org (for 1966–2002) and KFC (various issues) (for 1999–2013)

movies in the late 1990s. That is one Korean film attracted, on average, the same admissions number of 2.1 as foreign films. Some might simply argue this abnormality is due to the increased number of foreign films imported after the abolishment of the import quota, and such an outcome can then be easily expected. However, I think it is important to highlight one point which is critical toward understanding consumers' view.

In fact, the lifting of the import quota changed the perception consumers had on foreign films. During the period of the import quota system, foreign films were carefully chosen by Korean companies to meet local tastes. Since these selected films were released in Korea, the domestic audience perceived that all foreign films were of high quality. By contrast, after the abolition of the import quota, foreign companies began to distribute all kinds of films without any careful selection process in the belief that all films could be successful in Korea. The result was that Korean audiences realized that not all foreign films were good quality.

2.3 The "Industrial Policy" Made Things Worse

It is noteworthy that other industrial policies accompanied with the import quota put the Korean film industry into unexpected trouble. In order to produce quality films, the government pushed Korean film companies toward integration. This integration was done in two ways. One was between production companies in order to achieve economies of scale which can facilitate the making of quality films with a stronger financial capacity. The other was between film producers and importers in order to benefit from the reward systems of the import quota regime. Different from what might be expected with "integration," the Korean film industry evolved into an oligopolistic situation because few consolidated companies had little incentive to compete in such conditions (Jwa & Lee, 2006, pp. 99–100).

In short, these inconsistent regulatory changes could not prevent the collapse of the Korean film industry. Korean movies could only attract small audiences; thus, the revenue became very modest. Profits from screening foreign films were not reinvested in the domestic film industry. As a result, the decreasing number of Korean films forced a decrease in the number of foreign films imported. Simply, the Korean public largely deserted the theaters.

3 The Screen Quota Regime (1966-Present)

The screen quota regime imposes a mandatory number of days for screening domestic films at movie theaters. This policy approach seeks to guarantee market access for domestic films as movie theaters often prefer to show foreign films due to the potential for better returns. This screen quota system is often mentioned as a factor to help explain the surprising success of the Korean film industry. However, this assumption does not have any concrete basis when examined carefully.

The screen quota regime was introduced in 1966 with the second amendment of the Motion Picture Law in Korea. The screen quota regime became then the only key protectionist measure of Korea's film policy as the import quota regime was abolished in 1986, as required by signing of the first Korea-US Film Agreement. It imposed a mandatory 146 days to screen only Korean films from 1986 to 2006. This number was reduced to 73 days following the Korea-US Free Trade Agreement (FTA) negotiations in 2006. The 2006 screen quota cut generated huge debate on whether this decision would endanger the future of the film industry.

Here, I would like to stress that Korea underwent a very important tectonic shift with its cultural industries during this period since 1987 with globalization through "open door" approach, including in cultural matters (Gills & Gills, 1999; Hsiung, 2001). This new environment meant that Korean companies had to compete against foreign companies in order to survive, which in fact emerged as an effective way to boost cultural industries, notably the Korean film industry.

3.1 The Real Function of the Screen Quotas

Contrary to what is often believed, the screen quota regime does not protect domestic films. It merely sets the number of days to screen domestic films, thus "potential market access," or limits the number of days for foreign films. This means that it does not ensure increased admissions to domestic films. It is similar to a case in international trade where greater access to a market is granted by a trade agreement, but it does not guarantee that exports to this newly open market will grow.

In addition to its limited protectionist power, the screen quota system is confronted by systemic contradiction: (1) a restriction on the number of days for

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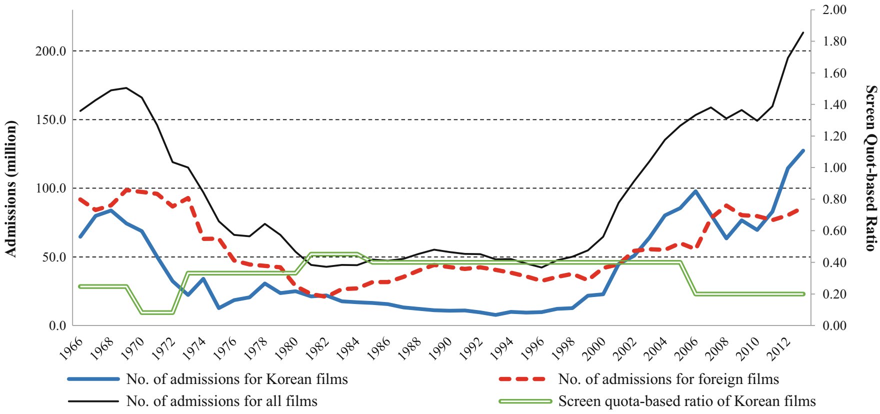

Fig. 2 The limitations of screen quotas (1980s–2013). Note: Based on author's calculations. Data sources: Koreanfilm.org (for 1966–2002) and KFC (various issues) (for 1999–2013)

Regarding the number of admissions to Korean movies, the first turning point occurred around the period 1998–2000 with a surprising rise in the admissions for Korean films in total, with a remarkable succession of huge, often unexpected, successes: *Shiri, JSA, Friend*, and others. Such films were known as "Korean blockbusters" owing to the heavy investment put into their production. The number of admissions for foreign films increased again after 2000. However, it is remarkable that this increase is much smaller than that for Korean movies, reflecting the fact that Hollywood movies began to face stronger competition from successful Korean films.

It is noteworthy to point out the fact that most of the turning points observed after the elimination of the import quota (1986) occurred while the screen quota system was maintained. This conclusion raises serious doubts about the impact of the screen quota regime on the attractiveness of Korean movies. Furthermore, what requires closer attention is the critical change before and after these last two periods, namely reforms in the business environment of the Korean film industry.

3.3 The Influential Factors for the Emergence: Pro-competitive Regulatory Reforms

The real impact of the screen quota system has depended critically on intense competition in the Korean film market. The import quota regime of the 1960s–1980s left a legacy of a very close relationship between Korean importers and producers—with a very limited role for the owners of movie theaters. After the abolition of the import quota regime, all these regulations were progressively relaxed and/or eliminated.

The internal constraints were first relaxed in 1984 with the liberation of the ties between producers and import companies. However, the decisive shift was made following the conclusion of two Korea-US Film Agreements in 1985 and 1988.

The 1985 Agreement allowed US film studios to distribute their movies directly to movie theaters in Korea (Shim, 2006). The 1988 Agreement further eliminated cumbersome Korean regulations on the method for conducting business when distributing US films. These provisions ensured that Hollywood movies, with the best chance for success, would be directly distributed by foreign studios to Korean movie theaters.

The abolition of the import quota system would have had little impact if Korean importers (or producers, depending on the period) were the only ones allowed to import films. Ultimately, keeping these provisions in a Korean film market subjected to the screen quota regime would have been enough to suffocate competition. By sharp contrast, these internal reforms allowed, unlike before, movie theaters and *chaebols* or the large Korean conglomerates to emerge as important players in the industry. By "freeing" competition forces in the Korean film market, internal regulatory reforms made the screen quota regime ineffective, although still an emotionally charged issue in public debate.

Finally, as Hollywood studios were allowed direct distribution of their films in Korea, movie theaters emerged as a new power player in the industry. As Korean production companies did not have any more mandatory importer–exporter ties, movie theaters were the only source that these companies could manage in order to minimize the effect from the direct distribution of films by Hollywood studios in the domestic market. *Chaebols* expecting high returns on their investments were more aggressive in expanding their power by acquiring individual theaters and forming "theater franchises."

3.4 The Critical Role of Business

These pro-competitive measures were clearly unleashing two major forces—one in distribution and the other in production—which had the potential to undermine greatly the screen quota's limited protectionist capacity. First, the direct distribution by foreign companies and the elimination of the "collective monopoly" on the importing of foreign films reduced the revenues that Korean film production companies earned from distributing foreign films in the domestic market. This new business environment changed the role of Korean producers and distributors because it induced them to partner with US companies in order to benefit from producing and distributing lucrative Hollywood movies.

Second, at the same time, the "disintegration" process of the old structure of the domestic film industry triggered the entry of new Korean participants. In the early 1990s, a number of *chaebols*, led by Samsung and SKC, entered the film industry through joint investments for Hollywood film projects (Russell, 2008). However, as most of these endeavors failed, the *chaebols* redirected their investment toward Korean film production.

Based upon their experiences with Hollywood studios, the *chaebols* learned how to develop a modern and vertically integrated system of production covering financing, producing, distributing, and exhibiting movies. They transformed the

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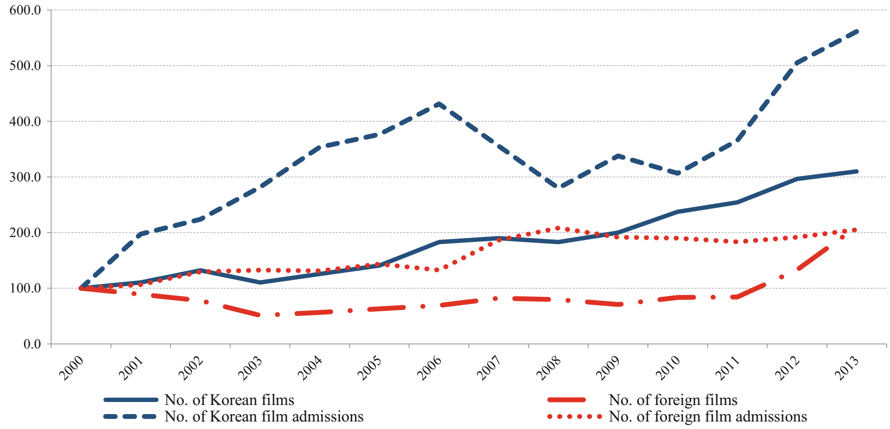

Fig. 3 The Korean film market before and after 2006. Note: Based on author's calculations. Data sources: Koreanfilm.org (for 1966–2002), KFC (various issues) (for 1999–2013)

the amazing increase in the number of foreign movies imported and screened. In short, there was no change in the supply of domestic movies and no rush of Koreans to watch foreign movies.

These two observations do not support the argument that the 2006 screen quota cut had a direct negative impact on the plunge of admissions for Korean movies, particularly from 2007 to 2009. The reasons behind the plunge is on factors related closely to the Korean film sector itself.

The first possible explanation is that there was simply a shortage of lucrative and attractive Korean blockbusters to please domestic tastes. Despite no considerable impact on the number of Korean films produced after 2006, there has been a noticeable stagnancy of investment beginning in 2003, after the considerable increase in investments from 2000 to 2003 (KFC, 2009). Furthermore, although more of bigger-budget blockbusters were planned, the amount of investment per film also shows the same trend (see Table 1). When the business environment is in the midst of radical changes, such as screen quotas and a new FTA, Korean investors in the film industry tended to reduce their investment in order to avoid any possible risk.

A second possible explanation is that the Korean film market is facing ongoing structural change, characterized by a desire for more variety in terms of themes, genres, and the film's country of origin. Between 2006 and 2013, the number of non-US films increased from 101 to 457 for almost the same number of admissions in total. This was only due to the increasing number of screens available in Korea multiplied by three (from 720 in 2000 to 2,184 in 2013). Much of this was due to the emergence of multiplexes. The supply of films could, thus, be much more diverse. This diversity reflects the wider range of foreign films, particularly as the number of foreign films increased modestly as shown in Fig. 3.

Table 1 Amount of investment in the Korean film industry (2000–2009, Unit: 100 million KRW)

Year	No. of films produced	Total investment	Investment per film
2000	59	1268.50	21.5
2001	65	1657.50	25.5
2002	78	2901.60	37.2
2003	80	3328.00	41.6
2004	82	3411.20	41.6
2005	87	3471.30	39.9
2006	110	4422.00	40.2
2007	124	4612.80	37.2
2008	113	3401.30	30.1
2009	138	3187.80	23.1

Data sources: KFC (2009)

4 State Subsidies to the Film Industry (Late 1990s-Present)

Government subsidies are a form of financial aid or support extended to an economic sector or entity to promote the sector or entity that is experiencing economic and social difficulties or are in need of funding for whatever reason. Despite the subsidy scheme adopted in 1963, Korea's film policy has relied almost exclusively on the import and screen quota system until the late 1990s, and it was only recently that the Korean government has seriously engaged in subsidy schemes. Before conducting an in-depth analysis of Korea's subsidy regime, several important preliminary points should be mentioned.

First, successive Korean governments have shown two fundamentally different approaches in cultural matters: as a strict regulator before 1993 and as an encouraging benefactor afterwards. The turning point occurred in 1993, when the film industry was reclassified from a "service" to a "manufacturing" sector. This change opened access to two new kinds of support for the film industry: (1) an increasingly affluent public budget opened up the potential for subsidies and (2) the recognition of the entertainment industry's economic value as a "commercial product" allowed filmmakers to tap bank loans for the first time as well as to benefit from tax exemptions as manufacturers (Forbes, 1994; Kim, 2000, 2007).

Second, there are two different ways of allocating/granting subsidies: directly and indirectly. For example, the French government grants most of its huge subsidies directly to filmmakers (Messerlin, 2014; Messerlin & Parc, 2014), whereas the Korean government has essentially subsidized infrastructure or distribution channels (Messerlin & Parc, 2014; Parc, 2014). This indirect subsidy helped to boost the success of the Korean film industry during its lagging years. Many scholars have identified the negative effects of direct subsidies, while indirect subsidies may enhance the competitiveness of a film industry, as in the case of Korea (Messerlin & Parc, 2014; Pager, 2011; Parc, 2014).

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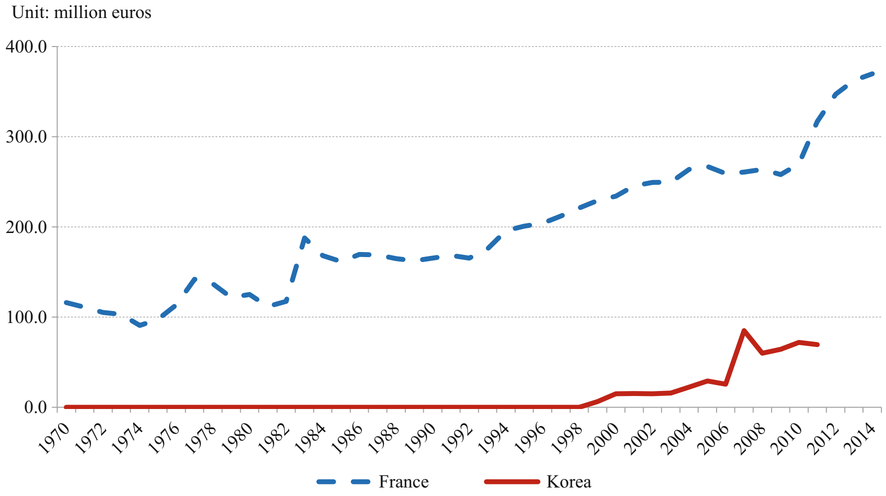

Fig. 4 The growth of subsidies in France and Korea (1970–2014). Data sources: CNC (various issues) for France; Kim (2012, 2013) and Parc (2017) for Korea

industry (see Fig. 4). In fact, it is rather unrelated or loosely related. First, as subsidies substantially increased only after the late 1990s as mentioned before, it does not account for the huge growth of the Korean film industry that occurred before the late 1990s (Kim, 2013; Messerlin & Parc, 2014, 2017). Second, in 2011, the highest estimate of the subsidies granted to the Korean film industry amounted to roughly USD106 million (roughly EUR77 million at 2011 exchange rates), which is roughly a tenth of the subsidies (EUR676 million) received by the French film industry in the same year (Messerlin, 2014).

It could be argued that Korean subsidies are relatively small because the Korean film industry is not as big when compared to European examples. However, in 2011, the size of the Korean film industry was at roughly two-thirds of the French film industry. This is a remarkable achievement when one recalls the situation of the Korean film sector in the early 1950s or even as recently as the early 1990s. In addition, the level of subsidies was very low until the late 2000s.

As a result, depending on the estimate of the subsidies used, the "subsidy rate"—subsidies as a share of value added in the Korean film industry—ranges from insignificant (2–3%) to roughly 8% in 2011—compared to 30–65% in France during the same year (Messerlin, 2014). In short, there should be some other driver that enhanced the competitiveness of the Korean film industry given the fact that the subsidies provided has been very little in either absolute or relative senses. It is also noteworthy that Korea's financial support is based on indirect subsidies, rather than direct ones as in the French case.

4.2 Another Way to Subsidize: Tax Deductions but Still Too Low

Finally, some have argued that the Korean government offers various tax exemption schemes for publishing, broadcasting, and film sectors. However, it is important to stress that these schemes are subjected to many conditions. First, only small- and medium-sized enterprises (SMEs) in these sectors are eligible. Second, these SMEs have to meet strict conditions of size: <1000 employees on average, an equity capital lower than KRW10 billion (USD9 million at 2011 exchange rates), total sales lower than KRW10 billion (USD9 million), and/or assets lower than KRW50 billion (USD45 million). Third, eligible SMEs have to comply with a crucial "independency" condition: more than 30% of securities issued should not be owned by the largest shareholder. Fourth, these SMEs should not be located in the Seoul Metropolitan area, a serious constraint for cultural content producers which often need a large market nearby (MCST, 2010a). Last but not least, once a company is qualified to be an SME, it is treated as such for only 4 years. After this period, there is a reevaluation procedure.

Once combined, all these conditions strongly suggest that there are not many SMEs which could benefit from the tax deduction system. In fact, MCST (2010a) reported that only 15.9% of SMEs benefited from this scheme. Given this figure, it seems reasonable to argue that the subsidy equivalent generated by the tax exemption regime is not significant. To sum up, the current tax deduction regime does not change substantially the subsidy rate calculated before. Indeed, many Korean organizations and scholars have advocated for an increase in the tax exemption regime for the film industry (Do, Park, & Kim, 2005; Kim, 2000; MCST, 2010b).

5 Key to Success: Business Function

The Korean film industry provides a remarkably dynamic success story. Uncovering the reasons for this is a very important task. So far, most studies have only highlighted the importance of government policies, particularly protectionist or supportive measures, such as quotas and subsidies. None of these approaches though have considered other crucial elements, for example pro-competitive reforms, business environment, and business activities over a long-term perspective.

By conducting an in-depth analysis of Korea's film policies based upon reliable data and a rigorous analysis incorporating a historical perspective, this chapter offers important implications for the film policies of other countries. First, Korea has implemented various protectionist and supporting policies, yet the success story of the Korean film industry cannot be attributed to efforts like import and screen quotas or supportive policies in the form of subsidies and tax rebates. In fact, the import quota system has been very detrimental to the industry, the screen quota regime has played no noticeable role, and subsidies, which began from the late 1990s, came too late to be credited for the precedent success initiated since the early

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