A paradoxical free trade agreement

Eli Noam JUNE 14 2007

On April 1, the US and South Korea signed a free trade agreement (FTA), the most important such pact for both countries in a long time. At stake is a bilateral trade of $70bn, the alleviation of a US deficit of over $13bn, and a potential model for more open markets in other Asian countries.

In America, opposition is strong from Detroit, labour unions, and cattle ranchers. As often, free trade is good for everyone in concept but bad for well-connected industries in the specifics. Add the volatile mix of an election year (in both countries), a lame duck administration facing a hostile Congress, a ballooning trade deficit, a growing fear of white-collar outsourcing, and legislative deadlines, and Congressional approval seems iffy.

For that reason, the administration cut a deal with Democratic leaders in which the Korean agreement was bundled with the more popular FTAs with Peru, Panama, and Columbia, and augmented with labour and environmental requirements. These conditions - fairly easy for an advanced Korea to meet - give Democrats a way to vote against the unions' opposition.

To create influential American winners, the FTA has, in particular, opened some of the Korean media markets to American companies. This has greatly alarmed the Korean culture and entertainment creators who have flourished in recent years and become an Asian powerhouse, in part under a protectionist umbrella. For example, until recently foreign films could be shown in Korean movie theatres only on half of all nights. American cable channels can (even after the FTA) be carried on only 10 per cent of a cable operator's channels, and are prohibited from being dubbed into Korean, thus greatly reducing their appeal.

Media industries consist of three basic segments: content, distribution networks and media devices. Each segment is affected differently. For distribution networks the FTA opens Korean markets somewhat. US firms can now fully own second-tier Korean phone companies. But will it make a difference?

Around the world, big telecom and cable television infrastructure firms everywhere have tried and mostly failed to enter other developed countries outside of new wireless ventures. Most telecom infrastructure services cannot be exported from a distance. They require a major managerial and financial presence and commitment, acquisition of high-cost labour arrangements, the assumption of social and development obligations, and the possession of domestic political capital. Korean domestic infrastructure networks industries are world leaders themselves and do not require foreign control capital or expertise. They will remain mostly domestically owned. The FTA will not change that.

In contrast, media devices are highly global, and follow the classic trade economics of industrial products. They are performance oriented, cost sensitive, and not very culture-specific. For many of these reasons the US market is already dominated by foreign firms. The FTA may give a small tariff advantage to Korean firms competing against Chinese or Taiwanese firms, but US consumer electronics manufacturers - who barely exist anymore - will not find much solace in that, or prospects of industrial success in Korea. Korean electronics exports to America in 2005 were 15 times the size of imports. Given the enormous price deflation in electronics – part of 'Moore's Law - the tariff is a trivial part.

And what about the content industries? Here, the US has been a strong global exporter. This is based on a variety of factors but rarely on price. A Hollywood film or TV series are not cheaper in Korea than French ones. Hollywood is actually the high cost producer. Foreign content on Korean TV channels has indeed grown but that's because the number of channels has greatly increased, not due to ownership. Would the full rather than part-ownership of a channel by a US firm make any difference to their Korean market penetration? Given the audience attractions to Hollywood content it would be carried by audience-maximising Korean cable channels regardless of their foreign ownership percentage. Only a quota would work to keep them down. Yet quotas for film theatres and broadcast channels are irrelevant in a world of internet TV and home video. And the theatre quotas have become a problem for a country that itself is emerging as a successful exporter of popular entertainment and culture, and have been loosened already before the FTA.

And now, broadband internet media are emerging, with Korea as the world's leader.

There will be much more content and diversity than before, but at the same time there will be an even greater pressure for “blockbuster” content that stands out. The broadband internet enables global and direct program distribution at a relatively low cost. The protection of distance is giving way, and similarly, the protections of market access through regulation and licensing.

And what about the protections of copyrights against piracy that American media would gain in Korea? Here, too, the FTA will not make much difference. Korea has increasingly its own strong interest in protecting copyrights and patents, and anyway, as a practical matter, not even the American government has had much success in stopping piracy.

Adding up: American media firms will not gain very much from the FTA with Korea (and Korean firms and culture will not lose much) that is (a) significant in practical terms, or (b) not happening anyway as part of broader trends. Whatever problems these trends create for Korean media can likely to be dealt with through direct support programs. This modest impact is not because the FTA is flawed. But media products and services are much less governed by FTA-style agreements which are economic tools for the industrial and agricultural economy, much less for the information economy. Adam Smith does not work well for international media issues.

The paradox of the FTA is that American media and information industries will help overcome the opposition to the FTA only if they expect to gain concretely rather than only symbolically. But if Korean media and cultural critics, understandably concerned and passionate about their business prospects and national culture, expect the same, then the FTA will encounter difficulties in Korea which is also engulfed in a major presidential election. To overcome this paradox may require more help from the Hogwarts School for Witches and Wizards than from the Chicago School of Economics.

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