GLOBAL-WOOD:
HOLLYWOOD’S FOREIGN MARKET CHALLENGE IN THE DIGITAL ECONOMY

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ABSTRACT

This study examines the impact of the global digital economy on cost structures in Hollywood, as an example of an information intensive, or intellectual property dependent, industry. Furthermore, it analyzes how a shift in industry cost structures due to digital technology has impacted the issue priorities of film industry trade associations and lobbyists in their efforts to set and shape the US Government’s legislative and foreign trade agendas.

The research aims to answer these questions: Given that digital technology exacerbates the ‘appropriability problem’ of information intensive industries by lowering the marginal costs of content reproduction, what will be the response of Hollywood’s trade association as it seeks to protect the market dominance of American film? Additionally, what factors have to come together in order for the industry’s business-government relations representatives to deem the issue critical enough to merit substantive action.

This thesis hypothesizes that it was the conjunction of two shifts in cost structure – the reliance on revenues from content licensing as opposed to content exhibition and a
growing dependence on overseas profits – which prompted an industry response as it became necessary to consider the intellectual property protection infrastructures of foreign nations. Only then did the issue prioritization and agenda-setting strategies of the American film industry’s trade associations widen in scope and breadth to accommodate the industry’s new challenges in the digital economy.
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Chapter 1. The Information Industries’ Dilemma: Introduction

Over the last decade, international political economists have begun to closely examine the emergence of a global digital economy and what it means for the global structure of trade, industries, and competition. Many leading scholars concur that for most of the twentieth century, the globalization of business and production has increasingly interconnected worldwide markets and national economies (Porter, 1985; Grossman and Helpman, 1991; Held et al, 1999).

However, modern digital technology has dramatically sped up the pace of that international integration, rapidly increasing the diffusion of technological innovations and changing the nature of global competition amongst national industries and multinational corporations. Perhaps even more significantly, the global digital economy has created a knowledge, or information, economy (Ryan, 1998; Tapscott 1997, Shapiro and Varian 1999). Given that much of the world’s information can now be reduced to ones and zeros, perfectly reproduced, compressed, and swiftly transmitted across distances and borders in the blink of an eye, what are the market challenges and opportunities that arise for information-intensive industries, such as motion pictures? What is the effect on global trade and competition now that the costs of reproduction and distribution have fallen while the cost of production continues to grow? In any context, the Internet would have greatly affected international diplomacy but under circumstances of globalization, when
international industries are already rapidly evolving and responding to the explosion of trade in information, the effect is amplified, accelerated, and volatile (Mazarr, 2002).

This thesis seeks to examine the effect of these global changes on the American film industry, as an example of an information/copyright industry (pharmaceuticals, music, software etc.) for whom information in the form of patents, trade secrets, and copyrights – ie. intellectual property - founds the basis of competitiveness. More specifically it is concerned with the puzzle of how global digitization and the resulting shift in industry cost structures has shifted the issue priorities of film industry trade associations and lobbyists in their efforts to set and shape the US Government’s legislative and foreign trade agenda. It is an underlying assumption of this study that in order to examine how the digitization of the global economy has impacted issue-advocacy in the information industries, explicitly Hollywood, it is necessary to look not only at the negotiation strategies of state and industry actors but at their interaction as well.

The research will aim to answer these questions: How have the strategies and tactics of the industry associations changed from those used to protect Hollywood market dominance throughout the bulk of the 20th century? Have their long-term interests changed or just their positions and if so, how? In the context of global digitization, how is the long-term global business strategy of the industry and of its individual firms reflected
in the actions of US Government agencies as they act on the industry’s behalf in legislative and trade negotiations?

This thesis hypothesizes that it was not until the emergence of the global digital economy shifted the basis of industry competition that the issue prioritization and agenda-setting strategies of the industry associations needed to respond to the impact of digital technology, widening in scope and breadth to accommodate the industry’s new global challenges and its new interconnectedness with previously unrelated sectors.

**Globalization and Digital Technology**

It is helpful here to undertake a review of the framework this thesis uses for analysis of the digital global economy. Even prior to the advent of digital technology, there has been a debate as to whether globalization has really changed the world economy. Although scholars such as MIT professor and economist Paul Krugman have argued that the modern global economy is no more integrated, beyond increased trade in goods, services, capital and labor, than it was in the 19th century (Krugman in Tapscott, 1997), this thesis assumes differently. Rather, it looks to the argument, supported by a large number of economists and international relations theorists from the international liberalist tradition (Porter, 1985; Ataman, 2003; Held et al 1999), that nation states are progressively more interdependent and that a simple increase in trade fails to adequately describe the impact of globalization. In particular, the globalization of businesses and
industries has increasingly interconnected national economies and consequently intertwined their economic futures (Held et al, 1999).

The digitization of the global economy has served to even further underscore this interdependence, blurring the boundaries between nation states and calling attention to the current limitations of national and international law. Don Tapscott, author of The Digital Economy (1997),\(^1\) one of the first works on this subject, reasons that the phenomenon of the Internet has created a new world economy, one in which the “bipolar geopolitical world has disintegrated” (Tapscott, 1997, p.64) in favor of the further globalizing forces of trade in information or ‘knowledge.’\(^2\) Furthermore, he describes an Age of Networked Intelligence, in which the exchange of information made possible by digital ‘networks of networks’ amongst businesses, governments and individuals has profoundly affected economics, politics, and social structures (Tapscott, 1997). The speed of these changes affected by high-technology development has naturally had destabilizing effects, locally and across the globe (Mazarr, 2002).

Digital technology is, essentially, a ‘disruptive innovation,’ defined as a technology that “reshape[s] existing markets…creat[ing] new growth by making it easier for people to do something that historically required deep expertise or great wealth”

\(^1\) Tapscott is also widely considered to have coined the phrase, ‘digital economy.’
\(^2\) Already, in 1997, almost 60% of all American workers were ‘knowledge workers’ and eight of ten new jobs were in information-intensive sectors of the economy. (Tapscott, 1996, p.7)
Simply by automating and greatly reducing the costs of reproduction digital technology has certainly reshaped markets. What is different about digital technology than most other disruptive innovations is that the new value proposition applies not just to one market, but to the global market. It has become necessary for all industries, and especially information-intensive industries, to undertake a paradigm shift concerning the structure of industrial competition and the reorganization of the value chain. When the basis of competition changes, the integration of the value chain likely reconfigures across all its stages (what marketing experts calls ‘value chain evolution’ or VCE) as the industry responds with a new competitive strategy (Christensen, 2004). It is helpful to posit that “integration is like energy; it doesn’t go away” (Christensen, 2004, p. 19).

Even in 1985, economic scholars noted that “technological change plays an important role in altering industry boundaries” (Porter, 1985, p. 175). Though industry boundaries are already somewhat indistinct due to the existence of competing products, which are substitutes for an industry’s own products to a greater or lesser degree, technological advances can further blur this line, creating a push to reduce costs and maintain a competitive edge via mergers and acquisitions (Porter, 1985). The rapid

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3 The term ‘disruptive technology’ first appears in Clayton Christensen’s 1997 book *The Innovator’s Dillema*. Later, in his book *The Innovator’s Solution*, the term was replaced with ‘disruptive innovation’ – a concession to Christensen’s recognition that it is in many cases strategy, not technology itself, which initiates the disruption.

4 The term ‘paradigm shift’ here refers to a radical change in thought process/basic assumptions, replacing the former way of thinking with a new one. It was first used to describe information tech and business by Don Tapscott in his 1992 book, *Paradigm Shift*. 

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diffusion of technology greatly emphasizes the pressure from substitutes, creating competitive threats that have reshaped and consolidated entire industries over a very brief period (Porter, 1985, p. 196).

In particular, economies of scale will grow increasingly important to firm competitiveness as information becomes cheaper and cheaper to reproduce, reducing certain capital barriers to industry entry although legal barriers often remain in place. By enacting positive scale effects across related product categories, larger firms can hold smaller entrant attackers at bay (Christensen, 2004; Davies, 1979). Consequently, horizontal strategy, “a coordinated set of goals and policies” (Porter, 1985, p.319) that ties together the firm’s new interrelated business units, becomes essential to the firm’s long-term survival in the new technological environment.

These ideas about the industrial impact of technological change, though two decades old, hold even more so in the age of global digital technology, where the same effects occur but exponentially faster. As digital technology facilitates vertical integration by allowing firms to circumvent existing distribution channels to gain direct access to consumers (Porter, 1985), horizontal integration and strategy become ever more critical. The speed and scope of digital technology indicate that integration and consolidation will occur swiftly across a wide range of newly overlapping industries. These trends will reflect the fact that competitive advantage no longer depends just on products and technologies but also on the speed at which innovation diffuses throughout the industry,
which has been increased by digitization and the resulting trade in information. The pace at which individual firms react to and reflect that innovation by diversifying, merging, or adapting their business model, greatly affects their chances of survival (Held et al, 1999).

Additionally, as technological innovation becomes more essential to a multinational corporation’s competitive advantage, the costs of product development may grow, pushing the industry both to concentrate itself (ie. consolidate) and to geographically disperse production to help defray expenses (Held et al, 1999; Porter, 1985). Essentially the global digital economy doesn’t just contribute to the further evolution of interconnected markets and economies; it affects business globalization as well through the necessity of globally interconnected networks of firms belonging to the same parent company.

Scholars of international political economy (Held et al, 1999) postulate that as digitization fuses the critical technologies of previously separate sectors of the economy together (telecommunications, media, informatics, computing) five main trends will emerge. These are: concentration of ownership, shift from public to private, increasingly transnational corporate structures, corporate portfolio diversification across sectors, and mergers of companies from previously unrelated sectors (Held et al, 1999, p. 437). Certainly the digitization of media, including audio and textual information, visual imagery and animations, has “seen extensive potential synergies emerge” between the telecommunications, broadcasting, computer, and media industries on a global scale
The largest side effect of these international media mergers is the significant growth of the global entertainment industry, driven by the new content produced by computing, telecomm, and media corporation alliances. The true value of this new media sector is in the sheer variety of possible entertainment products and hybrids, ranging from “software, games, situation comedies [to] art, photos etc” (Tapscott, 1997, p. 243). It is the growing consumer demand for these new forms of entertainment content that drives the direction of the rest of the market.

**The Cost of Information**

Given that this thesis explores the global digital economy’s effect on information industry cost structures, it is useful to first characterize these industries and also to examine the foundations of their cost structures. Economists define a good as an ‘experience good’ if it is necessary for consumers to experience it in order to place a value on it. Information as a good poses particular obstacles in that it is an experience good each and ‘every time it is consumed’ (Shapiro and Varian, 1999, p.5). Although information businesses have used tactics such as brand equity and previewing in order to get consumers to purchase information before they see it, having to market and sell the information good on an individual basis each time greatly adds to the expense of its production.
Nonetheless, scholars concur that information is expensive to produce even apart from its status as an experience good (Shapiro and Varian, 1999; Ryan, 1998). Across information and intellectual-property intensive industries, not all products are created equal in terms of their profit potential. Filmmakers and pharmaceutical manufacturers are similar in that it is the one blockbuster film or miracle drug that helps to offset the costs of all the others (Ryan, 1998, p.5). In order to remain competitive in these risky industries, producers pour years of time, tremendous effort, and capital into the development of numerous products that may provide little return in order to beat the odds and produce one piece of tremendously valuable content. Because competitive advantage lies in the firm’s ability to get that one ‘home run’, competition in information industry sectors is “better measured by slugging percentage than by batting average” (Ryan, 1998, p. 5). After all, it is not the product itself which provides value but what can be done with the intellectual property that goes into it, whether in the form of a successful drug formula or licensable movie characters.

When that ‘home run’ is achieved, it creates such exponential profits because of another quirk of information - that while it is expensive to produce it is very cheap to reproduce. Economically, the production of an information good “involves high fixed costs but low marginal costs” (Shapiro and Varian, 1999, p. 3). It is that first print of a movie or the first infection fighting pill that costs so much. The cost of the second copy
and the ones afterwards is insignificant; it is just the cost of the physical manufacturing of
digital video discs or plastic pill capsules.

Low marginal costs create the impulse for content and portfolio diversification for
added profit as producers seek out ways to recoup the costs of producing the intellectual
property. Successful formulas for anti-depression medications, for instance, are
reappearing in medicines for premenstrual syndrome. Popular characters from movies
often resurface in video games or as toys in McDonald’s Happy Meals.

If the costs of development are high and the costs of reproduction are low, the
costs of product theft and imitation are lower still, as there are no sunk costs. This gives
rise in information industries to what economists term the ‘appropriability problem’
(Ryan, 1998). When other manufacturers appropriate the intellectual property, they will
enjoy the fruits of low marginal costs without the risks and price of development.

Copyright and patent laws attempt to confer intellectual property protection via
limited periods of owner exclusivity. In the digital era, nevertheless, two new challenges
arise. The first is that when reproduction becomes digital, those insignificant marginal
costs shrink further; they essentially disappear, providing new incentives for
appropriation. The second is that the speed, stealth, and global reach of digital
reproduction make it harder to trace and to control. The natural outcome is that the
already front-loaded cost structure of the information-industries will become more
pronounced. The costs of production will rise as the cost of IP protection and maintaining
brand equity (to discourage imitators) are factored in, and the market value per copy of
the product will fall as competition and low marginal costs drive price down.

Although the US has a rich history of intellectual piracy that persisted until the
beginning of the 20th century and helped fuel the growth of its entertainment industry
(Goldstein, 2003), today it arguably has one of the strongest cultures of intellectual
property (IP) protection. Copyrights and patents are enforced by the government,
institutions, and the market. Information industries from film to software are heavily
supported by domestic policy-makers in their efforts to institute IP protections (Ryan,
1998). The US government currently makes the argument that IP industries have
flourished in the United States to an extent perhaps unmatched anywhere else in the
world because the whole protection infrastructure, from rules to enforcement, is in place
to encourage innovation.

Nonetheless, as the global digital economy interconnects the world, foreign IP
policy will have increasing ramifications for the front loaded cost structure of information
industries. Information-intensive firms tend to react to weak IP regimes by vertically
integrating in order to control content rather than licensing it to outside distributors
(Ryan, 1998). As the information industries come to depend more on global revenue from
countries with weak IP protections, vertical and horizontal integration will likely be
increasingly observed as an effective means to protect proprietary knowledge without
litigation and to simultaneously take advantage of low marginal reproduction costs.
In addition to vertical structures, information-intensive industries deal with appropriation problems by attempting to capture greater economies of scale as it becomes more and more essential to quickly recoup the costs of production. Thus, “the competitive process can easily lead to a concentrated industry structure with one or a few firms dominating the market” (Shapiro and Varian, 1999, p. 301). The unique cost structure of information industries is especially amenable to such a configuration, particularly because one large conglomerate can take advantage of low marginal costs much faster than several small firms. Additionally, only by taking advantage of huge economies of scale can a firm hope to compete with imitators and pirates on the basis of cost, if it so chooses that strategy.

Some scholars have pointed out that information wants to be free (Barlow, 1994; Dyson in Ryan, 1998) and a few have argued that in the future, it will be necessary for content producers to find alternative profit models. Technologist Esther Dyson argues that in the new business model, content will be free but it will be sponsored by advertisers, the way television is today. Dyson also speculates that producers will get paid for interactivity – live performances of content, customized and interactive content (Dyson in Ryan, 1998, p. 171). Information producers and content industry executives, however, tend to argue that the creation of intellectual property is just too expensive and risky an undertaking to give it away for free, particularly when it can already be distributed with negligible cost (Ryan, 1998). Consequently, although meeting the
challenge of the global digital economy does mean that producers will have to explore ways to utilize IP that are difficult to reproduce, such as customer-specific customization, they will first attempt to continue selling their content in the traditional manner because of the high profit margins they have grown accustomed to.

**Why International Diplomacy Matters to IPRs**

Nationally recognized marketing expert Clayton Christensen describes the influence of non-market factors, including industry standards, cultural norms, and domestic IP infrastructure, on innovation and IP production, but singles out government policy as the most important of these (Christensen, 2004, p. 74). With experience goods, it is not product differentiation or brand equity, scale economies or distribution networks that form the main basis for competition, although all of these are important, but proprietary knowledge. Accordingly, it is this proprietary knowledge, or intellectual property, that is necessary for governments to protect and which is essential to policy diplomacy for the information industries (Ryan, 1998).

As long as information goods remain domestic, then domestic government regulation is enough. However, the globalization of the world economy has provided myriad opportunities for information intensive industries as well as challenges. As the world becomes smaller, these industries, like others where the domestic market is saturated, have come to rely on new markets overseas. Because information goods have
become key to the global economy, foreign trade negotiations will become key to the future of information goods. Consequently we have seen the advent of ‘knowledge diplomacy,’ in which diplomats are attempting to institutionalize standards for trade in information products to motivate innovators to export their products to the global marketplace, strengthening domestic economies (Ryan, 1998).

In the United States, for instance, trade in information goods was so significant to the economy by the 1980s that policy makers took notice and began to comprehend the value of IP as opposed to large-scale manufacturing (Ryan, 1998). The United States recognized also that in the globalizing economy efforts would have to be made to “maintain American incentives to innovate despite a world of porous international boundaries” (Calan, 1998, p. 4). America was thus the first country to highlight the importance of intellectual property in international trade, which it did throughout the economic disruptions that accompanied the globalization of businesses in the 1980s (Calan, 1998), but it would not remain the only one. Developed countries have been quick to hop on the IP bandwagon and as other countries have modernized and developed an intellectual property infrastructure, they too have begun show interest in adopting more international standards for Intellectual Property Rights (IPRs).

Still, because this thesis examines emergence of a global digital economy as an independent variable, it is not enough to indicate merely that globalization has emphasized the extent to which international diplomacy matters for the economic
strength of information-intensive industry sectors. Given that it has always been necessary for governments to act on behalf of these businesses in the global economy, what makes the global digital economy different?

In the past, information goods were experience goods but they were not necessarily digital goods and some existed solely in analog form. It was necessary for governments to protect the intellectual property that went into these goods but it was not critically essential to the same degree because the appropriation problem described in the previous section\(^5\) was not as marked. Today, digital technology makes information so tradable that information-intensive industries believe that their future in the global economy will be in jeopardy without broad and far-reaching IP protections.

**Business-Government Tactics and Strategies**

This thesis is predicated on the notion that business-government relations activities are particularly important for the future of information-intensive industries and play an essential role in representing these business interests in foreign policy negotiations. Although few people knew much about Intellectual Property Rights (IPRs) when the United States Trade Representative first insisted on their inclusion in the General Agreement on Tariffs and Trade’s (GATT) Uruguay Round discussions in 1986, the institutionalization of IPRs had become a hot trade topic by 1990 (Ryan, 1998, p. 10).

\(^5\) See p.9
By 1994, when the United States successfully negotiated for the inclusion of the Trade-Related Intellectual Property Rights (TRIPS) agreement in the Uruguay Round, it was supported by Japan and much of developed Europe (Ryan, 1998). Arguably, TRIPS has been “potentially the most important legal advance for the world trading system” since the GATT’s establishment (Ryan, 1998, p. 1). It is also a notable example of how linkage-bargaining strategies have been utilized successfully in IPR negotiations (Ryan, 1998, p. 12).

With the issue of intellectual property rights in particular, because they were so unknown prior to the 1980s, the key to reaching otherwise unobtainable agreement has been to redefine the importance of such issues in the minds of negotiators. In the case of TRIPS, USTR negotiators achieved success in their efforts to frame and set the agenda by endeavoring to link these issues to issues already on the table (Ryan, 1998). Furthermore, USTR negotiators effectively utilized the structure and organization of the existing GATT regime to locate those legitimate issue areas that would yield the most productive linkages (Ryan, 1998).

Amidst the globalization of the last century, the United States, as a world superpower, has been a particularly effective agenda-setter in international trade, having

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6 The process of creating possible package deals between previously unlinked issues. Trade rounds become “two-level games in which states [bargain] with their own domestic groups even as they [bargain] with each other as to which issues to link…epitomized by the way U.S. trade diplomats, anxious to respond to…pressures by U.S. business groups, engaged in multilevel negotiations…to achieve unprecedented multilateral enforcement of universal minimum standards of intellectual property protection during the Uruguay Round in exchange for liberalization of the apparel and agricultural sectors sought by the South” (Alvarez, 2002).
had a lot of sway in deciding what issues are important enough not only to bring to the negotiating table but to remain on it and gain favorable outcomes. Nonetheless, though realist\textsuperscript{7} theories of hegemonic power provide a fair explanation as to how the US has leveraged its voting power to utilize the issue areas legitimized by the GATT/WTO regime they do little to address the influence of MNCs and industries. Power over outcomes is not always influenced by the use of hegemonic authority, or the control of elite networks.

Since the advent of TRIPS, the USTR has become the de-facto agent for the advocates of business interest needs in globally competitive information industry sectors, fighting uncompromisingly on their behalf in international diplomacy agreements (Ryan, 1998). Consequently, the USTR is the chosen channel via which industry associations aim to set the agenda of foreign trade negotiations. The industry associations of information-intensive industries - led by the pharmaceuticals sector - have been especially zealous practitioners of function-specific diplomacy built on initiatives designed to educate the USTR, and through them, negotiators across the table (Ryan, 1998). There is an understanding over the last couple of decades that international diplomacy involves “not only the states themselves, but MNCs, NGOs…international governmental organizations and transnational epistemic communities, bodies of

\textsuperscript{7} Realism in international relations assumes that nation states are the primary actors in international diplomacy and that no higher government authority regulates the interactions of states (“International Relations Theory,” Wikipedia, 2006).
professionals with expertise” (Ryan, 1998, p.3). Special interests have been remarkably successful in influencing the USTR, in part because while the benefits of trade are diffused across a large number of people, each with a minimal stake, the costs are often concentrated in an industry and push it to mobilize (Destler, 2005)

Certainly from 1988 to 1998, the fact that trade negotiations involving IPRs were conducted by “a US government representing a hegemonic power in innovation and expression-based global markets” meant that much of the work required to achieve the desirable outcome was done once industry lobbyists educated their USTR counterparts (Ryan, 1998, p. 4). However, in the global digital economy the importance of non nation-state actors is increasing and thus hegemonic stability theory is less applicable than it once was (Held et al, 1999). In the current post-TRIPS environment old power-based tactics are not as likely to work. The United States, facing competition from several different directions including the vast emerging markets of China and India, does not wield the same political influence. Following the end of the Uruguay Round, it no longer unfailingly and consistently receives the same amount of support from Japan and Europe in its efforts to globalize IP standards (Callan, 1998).

The digital economy requires new strategies - traditional intellectual property law cannot simply be “patched, retrofitted, or expanded to contain digitized expression” (John Perry Barlow in Shapiro and Varian, 1999). The globalization of the internet and the resulting information trade has resulted in geopolitical disintermediation (Tapscott, 1997)
and amidst the growing influence of non-state actors, multinational corporations are chief
in terms of leverage. In particular, the international institutional transformations initiated
by new technologies of telecommunications, media transmission, and the rapid spread of
global cultural exchange have altered the balance of power between international media
conglomerates and national governments (Held et al, 1999, p. 328). Although the world
has been slowly globalizing for centuries, the rapid deployment of digital technology in
conjunction with other “technologies of cultural transmission” seems to have done more
to shift the balance of effective cultural power away from nation states than anything else
over the last two hundred years (Held et al, 1999). In spite of the fact that nation-states
negotiate trade agreements, other interests are now a major part of the process and play a
key role in determining negotiation outcomes.

Accordingly we have seen a reaction from business interests - the growing
demand for, and growth of, an international regime to protect intellectual property rights
(Ryan, 1998). More than ever it is necessary to consider that business interests will
mobilize to protect the economic sources of industry competitiveness and to further long-
term global business strategies by advocating for changes in trade policy (Held et al,
1999). Furthermore, the political power and agenda-setting capabilities of the industry
sector will be used to highlight which market conditions will become redefined as
problems to be resolved via international diplomacy. It is notable that in the 1980s and
early 1990s, US patent and copyright business interest groups representing the copyright

and pharmaceuticals industries were unusually effective in successfully directing the
development of trade-related intellectual property rights, as compared to lobbying groups
from other industries (Ryan, 1998).

**Case Study: Hollywood**

This thesis will analyze and dissect the process of information-intensive industry association trade agenda-setting in response to global digitization through an empirical case study. It will examine, in depth, the American film industry, considering the current and historical efforts of the Motion Picture Association of America (MPAA) and the International Intellectual Property Alliance (IIPA) - the industry’s trade associations - to drive foreign trade policy on behalf of entertainment conglomerates dealing in the sales and production of American filmed entertainment – ie. Hollywood.

Jack Valenti, former MPAA chairman (1998, 2000, 2001), attempts to make the case that the strength of America’s national film industry stems from consumer preference and technological and artistic superiority. This thesis sets up its case argument, however, on the assumption - supported amongst a large number of film scholars (Segrave, 1997; Litman, 1998; Ulff-Moller, 2001; Miller et al, 2001) - that the global dominance of Hollywood since World War I can be ascribed in large part to the US government’s foreign lobbying efforts, legislative assistance, and supportive public policies on behalf of the industry.
By drawing a brief historical comparison, the author hopes to demonstrate a change in agenda and strategy between the pre-global-digitization era and the current period dating back from 2005 to the mid 1990s – which we will take as our point of entry for the emergence of the global digital economy. The author suggests that in the context of the global digital economy, film industry representatives will seek to reframe the foreign trade agenda, increasing the scope of issues on the table, expanding the reach of intellectual property legislation to more broadly cover digital rights management, content licensing, and high-tech anti-trust, and focusing more heavily on IP enforcement and universal cooperative standards-setting than in the pre-digital era.

Although such shifts will naturally reflect the changing nature of industry competition and cost structures, theories of current economic incentive do not provide a sufficient explanation. Rather, it is necessary to consider long-term global business strategies in addition to current interests; the future economic sources of industry competitiveness matter as much to incentives behind business lobbying activity as the current sources of profit (Ryan, 1998, p. 8). Although Hollywood still seeks to maintain market leadership through legislative control of its intellectual property exhibition and merchandising rights, as it did in the 1980’s, the copyright industries have developed an increasing dependence on digital content licensing profits in foreign, and particularly emerging, markets. Thus, there has been a change in industry strategy focus, although not in overall interests or goals for market domination.
Case Methodology

This thesis begins its case analysis by briefly examining the position and structure of Hollywood in the global film industry. Jack Valenti (2003), former CEO of the Motion Picture Association, calls the film industry the “crown jewel” of America’s copyright industries, which in 2003 were estimated to have produced five percent of the nation’s GDP (Valenti, 2003), ranking higher in this respect than automobiles, aircraft, or agricultural products. Furthermore, at a time when the United States carries a sizeable trade deficit, the movie industry runs a surplus trade balance with each one of its trading partners around the globe, a feat unmatched by any other American industry (Valenti, 2003). The context is then laid for the USTR’s special policies concerning the interests of globally competitive industry sectors, as they are perceived to contribute to the agency’s multilateral diplomatic goals for the United States (Ryan, 1998). Thus, groups from these industries hold particular leverage in terms of influence on the USTR’s diplomacy agenda.

This thesis will proceed with its case in the following manner. An explanation of international diplomacy concerning intellectual property ought to begin with a study of the nature of competition in information-intensive, or content-based, industries. Accordingly, Chapter Two will review the market forces that operate in the digital economy and examine how they have helped to drive the consolidation and simultaneous vertical and horizontal integration in the global entertainment industry.
Furthermore, it will examine how these forces have shaped the ownership structures of the major industry players. There is a general consensus amongst authors (Epstein, 2005; Litman, 1998; Bagdikian, 2000; Wolf, 1999) that today, just six corporations control Hollywood and - through Hollywood’s dominant market share - the global market for filmed entertainment[^8]: Sony, Disney, Time Warner, Viacom, News Corporation, and NBC Universal. Though these powerful conglomerates own and operate vast properties, including newspaper empires, publishing houses, theme parks, music production companies, radio stations, sports teams, and cable networks, it is film and television which form the “bedrock” of their media and entertainment businesses (‘King Content’, 2006).

Chapter Two will also examine how growing industry competition and conglomerate have initiated a corresponding shift in Hollywood industry cost structures as it has become more and more necessary to recoup the growing costs of information production through cheap reproduction and distribution. The chapter additionally explains the mechanics by which film studios invest large amounts of capital to get the film into the box-office, in order that once the film finishes its theatrical run, its true life may begin in cheaper profit-making incarnations and spin-offs. Essentially, the chapter

[^8]: Roughly two decades ago, Ben Bagdikian, the author of *The Media Monopoly*, pointed out in his book that the vast majority of global media was controlled by just fifty corporations. In a later edition in 1992, his prediction that the number of key corporations would eventually fall to half a dozen was met with much doubt by other scholars, though only fourteen major players remained at that time. By the year 2000, Bagdikian was proven correct.
makes the argument that content, or intellectual property, is king. The production of intellectual property fuels and creates value for corporate libraries of films, television shows, books, music, and character trademarks. The holdings of the ‘Big Six’ range from television networks to theme parks, movie studios to cable companies. They control the means of production, the means of distribution, and increasingly, the means of exhibition. These properties and resources create powerful means by which the companies can maximize that most important asset – licensable content.

Chapter Three will place the argument within a historical context by first examining the business-government relations strategies and issue prioritization of American film government-relations professionals prior to the era of the global digital economy. Specifically, the chapter will make a brief study of the historical tactics used by the USTR and by Hollywood industry groups to fight cultural protectionism in the form of foreign film tariffs and quotas, as well as to circumvent anti-trust law overseas, in order to exercise control of foreign distribution and exhibition. The bulk of the chapter, however, will be concerned with a study of Hollywood industry association efforts since the mid 1990’s to impact legislation in Congress and to set the audio-visual services agenda of the USTR. What are the issue priorities of the MPAA and IIPA? What are the strategies and tactics used to get certain issues on the table or to leverage influence in foreign markets? How is the overall strategy informed by, or reflective of, the
competitive realities of the global digital economy and the long-term global business interests of Hollywood?

Chapter Four will come to a conclusion about the hypothesis tested within the case – namely whether and how there has been a change in industry association efforts to set the foreign trade agenda in response to global digitization. The chapter will then examine the future of digital technologies within the global economy and the resulting challenges and opportunities for Hollywood and the other copyright industries. How might long-term global business strategies have to adapt to continuing change and what models may be adopted for success and industry leadership? What might be the repercussions for, and tactical changes to, industry association lobbying strategies? Essentially, this thesis assesses what about Hollywood industry association strategies has changed. In my conclusion I will attempt also to consider what, in order for the American film industry to sustain its market leadership, should change.
Chapter 2. Big Media Takes on the World

Building on the theoretical arguments in the previous chapter of this thesis, this chapter aims primarily to provide evidence that digital technology on a global scale has triggered a shift in the American film industry’s competitive basis which first led to a focus on content licensing and subsequently to a reliance on foreign markets for industry profits. It is the hypothesis of this thesis that these two shifts in profit structure are the primary factors which have led to a new emphasis on intellectual property protection in foreign markets.

However, it is useful here to first provide a contextual overview of the global film industry itself. Such an overview will seek not only to introduce the case but to define the position of the American film industry, and the major firms which comprise it, within the international film market environment.

The Film Sector in the Global Economy

The global film industry is an enormous force, producing upwards of 3000 films annually at revenues estimated by Screen Digest to have hit up to $450 billion (USD) by the end of 2005 (“European,” 2005). By far, the biggest film producing nation in the world is India, whose ‘Bollywood’
industry churns out 800-1000 films annually for 300 million Indian moviegoers and attracts an annual world audience of about 3.6 billion (Bezaitis, 2005).

However, as is no doubt obvious to global film audiences, the true dominant power behind the world of filmed entertainment is the second biggest film producing nation worldwide – the United States of America. In 2002, America’s Hollywood industry pulled in USD $51 billion in worldwide revenues (see table), dwarfing Bollywood’s $1.3 billion take. It is an incredible figure, particularly when one considers that the Hollywood world audience is just 2.6 billion people and that between 1997 and 2004, the industry produced, on average, just 625-675 films annually (MPAA, 2004).

Hollywood controls 75% of worldwide distribution and 44% of global box office revenues are generated by American moviegoers (“European,” 2005). Jack Valenti (2003), former CEO of the Motion Picture Association, calls the film industry the “crown jewel” of America’s copyright industries, which in 2003 were estimated to have produced five percent of the nation’s Gross Domestic Product (“Testimony of Jack Valenti,” 2003), ranking higher in this respect than automobiles, aircraft, or agricultural products. Furthermore, at a time when the United States bears a sizeable trade deficit, the movie industry runs a surplus trade balance with each one of its trading partners around the globe, a feat unmatched by any other American industry (“Testimony of Jack Valenti,” 2003).
**An American Empire**

There is a consensus amongst a number of film scholars (Segrave, 1997; Litman, 1998; Ulff-Moller, 2001; and Miller et al, 2001) that the global market leadership of Hollywood since World War I can be ascribed in large part to the US government’s foreign lobbying efforts, legislative assistance, and supportive public policies on behalf of the industry. The nation’s well developed domestic market played an influential role as well but it is doubtful that without the US government’s instrumental collaboration with the industry, Hollywood would have dominated on such a global scale, even supplanting the national film industries of some nations.

Legislation such as the Webb-Pomerene Act of 1918, exempted the overseas operations of US corporations from domestic antitrust law and hastened global media consolidation by allowing collusive practices, such as block booking - the practice of selling multiple films as a ‘take-it-or-leave-it’ style package. The creation of the Motion Picture Export Association in 1945 by the major studios in an effort to further break down foreign import barriers essentially “created what amounted to their private cartel” (Epstein, 2005, p.95) and cemented the dominant market advantage of American media conglomerates.

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9 In 1922, the major studios cooperated in the creation of an organization exempt from domestic antitrust law because of its classification as a trade organization - what is now called the Motion Picture Association of American (MPAA) (Epstein, 2005).

10 In order to acquire one likely hit movie [a block-buster], theatre owners were literally forced to simultaneously purchase a ‘block’ the studio’s other films – usually lesser quality in terms of stars and budget. (Ulff-Moller, 2001)
US Government policies and market pressures have also helped to drive the consolidation and simultaneous vertical and horizontal integration in the global entertainment industry. Though the landmark Hollywood Antitrust Case of 1948 (aka United States vs. Paramount Pictures Inc.) separated exhibition from distribution and production by outlawing theatre ownership by studios and put an end to practices that discriminated against theater owners (ie. Block Booking), a push was simply created for the studios to pursue horizontal integration (Epstein, 2005).

Later in the 20th century, the US government would also relax its anti-trust laws, no longer enforced the US vs. Paramount et al decision, such that the media conglomerates could fully horizontally and vertically integrate domestically as well as abroad. Thus, the film industry in the 21st century looks very different than it did for the bulk of the last century. Films no longer come from individual film studios mainly responsible for production and distribution, while exhibition is the purview of theatre chain owners. Films are produced by media behemoths, for whom the studios constitute just one of many assets.
The Big Six: Why Size Matters?

Over the last century it has been those entertainment firms best able to vertically integrate that have survived, beginning in the 1920s, primarily because they have been able to ensure strong distribution deals for the content they produce. Though horizontal integration became part of the overall industry strategy after the 1948 US vs. Paramount verdict, it still took a backseat to studio efforts to ever more fully integrate production and distribution across all the various distribution outlets.

In spite of the Hollywood Antitrust Case, entertainment industry sectors all rank high (see Table 2) in terms of the Herfindahl-Hirschman index used by the Department of Justice to measure monopolization. Roughly two decades ago, Ben Bagdikian had pointed out in his book, *The Media Monopoly*, that the vast majority of global media was controlled by just fifty corporations and in a later edition in 1992, when only fourteen major players remained, he predicted that the number of key corporations would eventually fall to half a dozen. By the year 2000, Bagdikian was proven correct.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Top Companies Market Share</th>
<th>Herfindahl-Hirschman Index</th>
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<tbody>
<tr>
<td>Wireless Telecom</td>
<td>57.2% (6 companies)</td>
<td>2,188</td>
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<tr>
<td>Car Rental</td>
<td>63.5% (6 companies)</td>
<td>1,200</td>
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<tr>
<td>Recorded Music</td>
<td>64.5% (6 companies)</td>
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<td>Automotive</td>
<td>68.3% (6 companies)</td>
<td>1,378</td>
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<tr>
<td>Cable Television</td>
<td>67.4% (6 companies)</td>
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<tr>
<td>Wireless Telecom</td>
<td>72.7% (6 companies)</td>
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<tr>
<td>Airlines</td>
<td>91.0% (6 companies)</td>
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<td>Film</td>
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<td>Pharmaceuticals</td>
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<td>Beverages</td>
<td>63.4% (6 companies)</td>
<td>546</td>
</tr>
<tr>
<td>Radio Broadcasting</td>
<td>43.1% (revenues) (10 companies)</td>
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</tr>
<tr>
<td></td>
<td>16.8% (no. of stations) (10 companies)</td>
<td>92</td>
</tr>
</tbody>
</table>

There is a general consensus amongst media scholars (Epstein, 2005; Litman, 1998; Bagdikian, 2000; Wolf, 1999) that today, just six significant corporations dominate Hollywood and the global market for American filmed entertainment: Sony, Disney, Time Warner, Viacom, News Corporation, and NBC Universal. Though Sony is technically a Japanese electronics manufacturing corporation, French conglomerate Vivendi has a twenty percent stake in NBC Universal, and News Corporation founder, Rupert Murdoch, has his roots in Australia, these companies have headquartered their entertainment empires in the United States and the authors describe their motion-picture businesses as dealing predominantly in the promotion and sales of American film content. Furthermore, all six companies are members of the Motion Picture Association of America, the American industry’s trade association.

How is it, then, that fifty global media corporations have consolidated into six over a period of twenty or so years? The rise of the internet and the subsequent ‘dot.com’ boom created a surge in capital that funded numerous mergers and acquisitions as firms from the telecommunications and computer industries sought to acquire content-producers. Consequently, the once autonomous eight major Hollywood studios (Twentieth Century-Fox, Columbia Pictures, Metro-Goldwyn-Mayer (MGM), United Artists, Warner Bros. Pictures, Paramount Pictures, RKO Pictures, and Universal Pictures) have been folded into the six conglomerates. Simply put, in the global economy, big has become the norm.
Seven of the eight studios grew via acquisition by other firms, beginning in 1985 with the Fox studio, under Twentieth Century Fox Film, which was acquired by News Corporation, an Australia-based media company whose chairman, Rupert Murdoch, had just become a United States citizen in order to purchase American media outlets (Epstein 2005, p.15). The Disney Studio, although it was never acquired, ultimately went in the same strategic direction as its peer studios, becoming part of a massive media conglomerate as parent corporation The Walt Disney Company purchased numerous media properties over a span of more than two decades.

Columbia Pictures Entertainment was purchased in 1989 by Japanese conglomerate Sony Electronics for $3.4 billion USD (Sony Pictures, 2006). Sony was primarily a hardware giant, with assets that ranged from computers to gaming systems. With the purchase of Columbia Pictures studio, and over the next fifteen years the Metro-Goldwyn-Mayer studio, United Artists and Tri-Star Productions as well (Sony Pictures, 2006) it became a top player in the film industry and thus a major controller of significant intellectual properties. In hindsight it is unsurprising that an electronics conglomerate would be one of the first firms to realize that digital technology would make intellectual property a key revenue generator.

The Warner Brothers Studio was purchased in 1989 when Time Warner Inc. was formed from the merger of Time Inc. with Warner Communications (Columbia Journalism Review, 2006). Time Warner then augmented its movie studio holdings with

The Paramount Studio was acquired by media company Viacom International in 1994 for $10 billion USD. By 1999 Viacom’s movie studio holdings also included the former RKO studio (“Who Owns What,” 2006). Finally, the Universal Pictures studio is today owned by NBC Universal (Epstein, 2005, p.81), an entertainment conglomerate owned in turn by two other conglomerates, industrial General Electric (80%) and French company Vivendi (20%) and created in 2004 when Vivendi sold its then majority share of Universal to General Electric, the parent company of NBC (The Studio Tour, 2006a).

**It’s Not Who You Are But What You Own (Horizontal Integration)**

Over the last quarter of a century, as globalization and digital technology have pushed horizontal integration to the forefront for media firms seeking to stay ahead of the curve, it is no surprise that across the board, entertainment industry sectors have tended even further towards media consolidation. Although the ‘Big Six’ have largely achieved vertical integration, acquiring the means to production, distribution, and exhibition, today, vertical integration just isn’t enough. Portfolio diversification to achieve much
touted ‘synergy’ between many related businesses is considered the key to maintaining an oligopoly with significant barriers to new entrants.

One reason is that the cheap reproduction of information creates a supply glut of information goods and the corresponding drop in the price per product creates a necessity for economies of scale to maintain profits. Digital technology further heightens industry competition by also expanding the range of possible content products. Thus companies operating in one entertainment industry sector, in this case film, come to see their products as part of a larger entertainment strategy and seek to merge with other content producers and to acquire the means by which to distribute the new content. The need to produce varied entertainment products on a mass scale poses significant capital requirements which can be met only by large firms able to achieve both economies of scale and of scope. The need for capital, in fact, poses the single largest barrier to entry in the entertainment industry, ahead of know-how, regulations, and price competition (Vogel, 2004, p.16). It is particularly notable that the last two independent studios, Dreamworks SKG and Pixar Animation Studios, with any major influence in Hollywood have recently succumbed to market pressures and folded themselves into the existing six major entertainment conglomerates.

In late December of 2005, DreamWorks sold itself to Viacom and similarly, in the last week of January, 2006, Pixar sold itself to Disney for $7.4 billion in stock. Despite the financial talents and star power of founders David Geffen, Jeffrey Katzenberg, and
Steven Spielberg, DreamWorks could not afford the annual billion-dollar capital investment needed to produce competitive films ("King Content," 2006). Pixar, although it had produced a number of hit films, has relied on Disney to co-finance and distribute the movies (Vogelstein, 2006a). Size and capital requirements have finally created market entry barriers that are not just prohibitive but are likely insurmountable for independent producers (Litman, 1998). Companies must find ways not only to distill their existing intellectual property into diverse information products but also to mass distribute these products on a global scale.

Furthermore, the acquisition of Pixar, previously owned by Apple Computers, by Disney, an entertainment media company, is indicative not only of the need for scale economies but also of the blurring of industry boundaries as a natural consequence of the digital economy. With Apple chairman Steve Jobs set to join the Disney board of directors\(^\text{11}\), Disney will have access to a leader at the "intersection of Hollywood and high-tech – the one figure in position to control the fast-moving evolution of media consumption" (Vogelstein, 2006a, p.1). Digital technology has placed the stronger emphasis on horizontal synergy to keep up with the pace of disruptive innovations that are consolidating the media, computer (software/hardware), and telecommunications industries. By purchasing Pixar, Disney aims to stay ahead of the market by capitalizing not only on the studio’s digital approach to filmmaking but also on Apple’s plans for

\(^{11}\) As a condition of Pixar’s purchase, Apple Computer CEO Steve Jobs becomes a major Disney shareholder and will join Disney’s board of directors (Vogelstein 2006).
digital content distribution (Vogelstein, 2006b) via digital broadcasting and the video I-Pod, a portable digital video player.

The Hollywood studios today are just a small part of global corporate empires seeking to take advantage of horizontal synergy and cross-marketing opportunities with vastly diverse entertainment portfolios. Whereas film production was once the raison d’etre of these companies, today the revenues generated by the film business alone represent a fraction of each conglomerate’s annual profits. In 2003, for instance, Disney earned 21 percent of its annual income from movies, followed by Sony and News Corporation with 19 percent, Time Warner at 18 percent, Viacom with seven percent and General Electric (if it had owned Universal Pictures that year) with two percent. (Epstein 2005, p.16).

Time Warner is the world’s largest media company and its entertainment holdings include, in addition to the Turner Entertainment corporation, Turner Cable, Eight television networks, 23 brands under HBO and Cinemax, 150 magazines, 24 book brands, 52 record labels, 25 online ventures, four sports teams, theme parks and retail outlets for ancillary merchandise (Williams, 2001; Time Warner, 2006). Its film interest comprises not just the Warner Bros and New Line Cinema studios but divisions devoted to distribution, home entertainment, television, music, theater, merchandising and global sales (Time Warner, 2006).
The Walt Disney Company is divided into twelve divisions: Walt Disney Pictures, Walt Disney Feature Animation, The Disney Channel (cable television), Walt Disney Theatrical (stage plays), Walt Disney Television, Walt Disney Television Animation, Walt Disney Parks and Resorts (theme parks), Disney Publishing Worldwide, Disney Store (merchandizing), Jim Henson’s Muppets (puppet production), Disney DVD & Video, and Walt Disney Records (Disney, 2006). Additionally the company owns 18 online ventures, 27 entertainment cruise ships, and several sports teams (Williams, 2001, p.1)

In addition to its studio, Paramount, Viacom’s major media and entertainment holdings include four major television networks and 200 TV stations, two music channels (MTV & VH1), United Cinemas International (a movie theatre chain), Blockbuster Video (an international retail movie rental chain), 180 US radio stations, Infinity Outdoor (advertising), and a publishing house (Viacom, 2006).

The Sony Corporation is split into eight divisions, not including its electronics and semi-conductor businesses: Sony Pictures, Sony Ericsson Mobile, Sony Broadcast Media, Sony Computer Entertainment, Sony Music (six record labels), Sony Communications Network, Sony Broadband, Sony Marketing and Sony Online Entertainment. Its film holdings include nine film and television studios, the major ones being Columbia, Tri-Star, MGM and United Artists (Sony, 2006).
NBC Universal has taken media convergence the furthest, not only acquiring film, music, and mobile phone holdings but also the telecommunications cables and wires that distribute such services. The company supplements Universal Studios with media assets that range from two movie theatre chains, several online ventures (including VivendiNet which combines internet, mobile-phone, and interactive TV), worldwide television networks, two international movie theatre chains, two major mobile phone companies, five theme parks, Universal Music Group, and sixty publishing houses (books and software titles) (NBC Universal, 2006).

In order to survive in the world of global entertainment it has become clear to all six studios that significant advantages come from holdings in other media, particularly on a global scale. Multiple distribution channels develop for the same content. Significant synergies across the different business sectors allow “ideas that develop in one subsidiary of the corporation [to] cross-fertilize and be exploited in another…the hope and dream of media conglomeration” (Litman, 1998, p.31). Valuable content is then recycled across a wide variety of media, spreading out the high costs of the initial intellectual property development.

*How Content Became King*

As the six major film studios have become folded into large conglomerates, opportunities have risen for cross-marketing and new profit opportunities through
obvious linkages. The Walt Disney Company, for example, uses the trade-marked characters from its animated films to promote its theme parks, market its magazines, drive its book business, and sell music soundtracks, in addition to creating television shows and animated series around them (“Who Controls,” 2006).

The exploitation of intellectual property across different media forms is not new. In the 1950’s, although Disney, like its peers, sought to vertically integrate production and distribution, if not exhibition, forming Buena Vista Distribution Company in 1953, it also pursued a horizontal strategy. The Walt Disney Company debuted its first weekly television series in 1954 and opened its first theme park, Disneyland, just one year later (“Who Owns What,” 2006).

In fact, Disney pioneered the use of horizontal strategy in entertainment in 1937 – a decade before the Hollywood Antitrust Case – with the opening of *Snow White and the Seven Dwarves*. It was the first film to have a soundtrack, the first film to have a merchandising tie-in, and the first film to create characters (Snow White, the dwarves, the wicked queen) that would be licensed as toys, theme-park exhibits, and a wide variety of ancillary merchandise (Epstein, 2005, p.13). Other film studios, however, were skeptical of the Disney strategy and slow to pick up on the fact that Disney had defined the future profit model of the entertainment industry: the creation of intellectual properties or content that could be reproduced in different forms or licensed to other media. Although *Snow White and the Seven Dwarves* was marketed to children, a market then believed to
be insignificant (although they are now the driving market segment of entertainment), it became the first film ever to gross $100 million (Epstein, 2005, p.13).

In the 1980s, when horizontal synergy became the new buzzword, other film studios were quick to jump on the Disney bandwagon and a flurry of mergers and acquisitions ensued as studios sought new channels to resell their content in ancillary markets. In the peak year of the merger wave, 1989, the market value of merger transactions exceeded $600 billion (Muth, 1998).

The emergence of digital technology in the 1990s, with the promise of swift and flawless reproduction, has only increased the extent to which intellectual property, and the ability to gain from the rights to license it, matters to the film industry. Prior to the emergence of the digital economy, horizontal synergy almost always meant related product merchandising. Digital technology has opened up myriad new channels for horizontal integration via the perfect reproduction of the original intellectual property in different forms. Thus, we saw another wave of mergers in the 1990s and early 21st century, this time with peak market values soaring above a trillion dollars (Muth, 1998).

Unlike the VHS tape, for instance, the Digital Video Disc (DVD) is an exact copy of film content that will not degrade with use. Additionally the value added by the inclusion of bonus features (even more ways to consume the content!) is an even further incentive to purchase. The DVD has become “the technology that radically transform[ed]
movies as a home entertainment” (Epstein, 2005, p.54). Today there is simply no limit to the possibilities for content reproduction and licensing created by digital technology.

Today, all six studios are involved in ventures which will enable the digital delivery of entertainment content to consumers through “as many channels, platforms, and devices as possible” (Time Warner, 2006). One such venture, Movielink, LLC is a joint-enterprise between five Hollywood studios owned by Sony, NBC Universal, Time Warner, Disney, and Viacom. It plans to offer US broadband customers an online movie download service featuring an extensive selection of films from the film libraries owned by all five companies (Sony, 2006).

In addition, they are still innovating new ways to sell consumers merchandise beyond the now traditional retail stores, e-commerce sites, theme parks, books, and music products, which produce billions of dollars of revenue a year at high mark-ups. The introduction of video games and other software, over the last decade, into the ancillary market for movies has been a tremendous success, with three titles derived making it to the top ten in video game software sales for 2005 and fourteen making the top 100 (Gaudiosi, 2006). Studios have come to realize that the key to ancillary merchandizing is to reach children, preteens, and teenagers with products directed at their segment.

For the market at large it is the digital promise – the possibility to consume film content in any number of preferred forms either by downloading movies onto portable video players, viewing them on the internet, or by watching them with a digital television
service - that will drive consumption. However, for both kinds of ancillary licensing (content & merchandising) one thing is the same: without good content, there is little value in the hardware products or merchandise items themselves (for example, how much more are pajamas worth when they have Mickey Mouse printed on them?). The money lies in the product’s ability to exploit the popularity of film content, just as it exploits the equity of its brand. Thus it is through ownership, the creation of a ‘copyright’ over the work, that the studios controlling attractive intellectual properties, such as Hollywood blockbusters, become true powerbrokers of the entertainment industry. If as media mogul Sumner Redstone famously stated, ‘Content is King’ (Epstein, 2005), the ‘Big Six’ rule the entertainment kingdom.

**How Films Broke the Bank and Bankrupted the Box-Office**

Clearly, theatrical exhibition is no longer the be-all and end-all of filmic success and the box-office has become just one of many sources of revenue. Conventional wisdom, however, has long held that the box-office is not just one but the primary source of revenue, and that the movie lives on in other incarnations as an added monetary bonus.

In 1980, for instance, domestic theatrical ticket sales made up over a third of total industry revenues, a vastly higher proportion than that of television, home video, or cable (Vogel, 2004). By 2000, domestic theatrical ticket sales made up only a sixth of total industry revenues. Market forces in the industry have shifted over the last two decades
and today it is a reality for all six major media corporations that the majority of their Hollywood films produce net losses in ‘current production’\textsuperscript{12}.

How is it that Hollywood theatrical releases are running at a loss when the top three global box-office performers of all time, \textit{Titanic} (1997), \textit{The Lord of the Rings: Return of the King} (2003), and \textit{Harry Potter and the Sorcerer’s Stone} (2001), grossed $1.2 billion, $752.2 million, and $651.1 million, respectively, and even film #100 (\textit{The Rock} (1997)) grossed a hefty $196.4 million? Of the top 150 highest grossing films of all time, only five were foreign (‘All-Time,’ 2006)\textsuperscript{13} and one has to go as low as film #316 to even find a film that grossed under $101 million.

Take the case of Disney’s 2000 hit movie, \textit{Gone in 60 Seconds}, which grossed $242 million at the box-office. The cost of film production was $103.3 million. It took $23.3 million to get the film into global theatres, including the cost of prints, insurance, taxes, customs, censorship, and shipping. $67.4 million went to worldwide advertising and $12.6 million to union fees. The total cost of putting the film in the theatres was $206.5 million. Furthermore, of the $242 million gross, theaters retained $139.8 million, leaving Disney with $102.2 million for a total loss of $160 million (Epstein, 2005, p.16).

In 1947, virtually all the films put out by the major studios made profits in the box-office. The average cost of film production that year was just $732,000 and the

\textsuperscript{12} Aka theatrical exhibition
\textsuperscript{13} #55 was \textit{Sen To Chihiro No Kamikakush} (2001) – Japanese, #73 was \textit{Hauru No Ugoku Shiro} (2004) – Japanese, #112 was \textit{Bean} (1997) – British, #130 was \textit{Vita e bella, La} (1997) – Italian, #141 was \textit{Monokē-hime} (1997) – Japanese.
average net receipt for theatrical exhibition was $1.6 million, making for very nice per film profits, indeed (Epstein, 2005, p.9). Today, the simple truth is that while press accounts still cite box office receipts as a major factor in a film’s success, in the last ten years, the big six have lost money on the global theatrical exhibition of the majority of their movies. Films are an expensive business and consumers have other options.

Although Hollywood produced just 739 films in 2002 in comparison to Bollywood’s 1013, as noted at the beginning of this chapter, the American film industry spent, on average, roughly 32 times as much on production costs per film and roughly 55 times as much on per film marketing expenses (“European,” 2005). In 2004 the average cost to produce and market an MPAA member film was $98 million. This figure includes $63.6 million in raw production costs and $34.4 million in print and advertising costs (MPAA, 2004). Note in the table below that on average, production costs have more than tripled over the last twenty years and marketing costs have nearly quintupled. Even when one adjusts for inflation (the inflation rate from 1984-2005 was 87.14% (inflationdata.com), costs have soared.

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<td>1.0</td>
<td>0.6</td>
<td>9.0</td>
<td>4.4</td>
<td>36.2</td>
</tr>
</tbody>
</table>

As competition continues to increase and profit margins shrink, the costs of producing feature films “have often grown faster than revenues growth, average negative and marketing costs and aggregate rentals” (Vogel, 2004, p.108). Although there are exceptions, the costs of production have risen so steeply, as competition increases and profit margins shrink, that most films will do no better than to break-even. In 1995, despite the production of more Hollywood movies than in the previous quarter century, industry analysts stated that it was “the worst time to be producing motion pictures in the history of the business” (Litman, 1998, p.121).

In recent years, reporters have touted the cheap production costs of digital filmmaking, arguing that digital technology is the secret to making competitive films for the half the price of the average Hollywood budget. Digital film is cheap and production companies would be able to cut printing and shipping costs by 80%, saving 20-30 million dollars on average (Corliss, 2006, p.68). Over the last three years production costs have leveled off, perhaps reflecting the cautiousness of producers noticing Hollywood’s three year box office slump. Why have the statistics not reflected a significant drop in costs though, although digital production is increasing every year?

For one thing, digital special effects are expensive. As the digital revolution of the new millennium brings the technology to everyone, the visual effects wizardry required
to remain competitive and innovative sends costs through the roof. Studios must earmark an increasingly large share of film budgets for visual effects services that may include digital editing, compositing, and digital sound effects, and that is just regular movies. Special effects films may include wire-frame animation, CGI (computer graphics imagery) characters, digital landscapes, and digital facial effects. Additionally, although digital films have smaller crews because more of the work is done in post-production, it is not necessarily done by fewer people. Digital special effects outfits such as Industrial Light & Magic or Pixar Animations employ hundreds of specialized employees who all need to get paid.

<table>
<thead>
<tr>
<th>Year</th>
<th>All amounts USD in millions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Print</td>
</tr>
<tr>
<td>2004</td>
<td>$3.74</td>
</tr>
<tr>
<td>2003</td>
<td>4.21</td>
</tr>
<tr>
<td>2002</td>
<td>3.31</td>
</tr>
<tr>
<td>2001</td>
<td>3.73</td>
</tr>
<tr>
<td>2000</td>
<td>3.30</td>
</tr>
<tr>
<td>1994</td>
<td>2.19</td>
</tr>
<tr>
<td>1984</td>
<td>1.29</td>
</tr>
</tbody>
</table>

Source: MPAA, 2004

Furthermore, a famous star is often perceived to be necessary to give the film an edge over the growing competition and as there are, at any given time, only a handful of bankable celebrities, they command sizeable salaries to sign on to a project. Increasingly, they also demand a share of the profits. Finally, most films are financed with other people’s money, be it outside investors or the parent corporation or a distributor. The production company itself does not generally fund the film. Thus, a bias is created for costs to rise at least as quickly as anticipated profits (Vogel, 2004, p.108). Even as new outlets are found in new media for film companies to
license content and production costs have leveled off in the last few years, marketing costs increased by 5.2% from 2004-2005 for MPAA member companies and 33% for their affiliates (MPAA, 2004). This included a rise in overall advertising expenditures.

It is important here to note, however, that films are experience goods, as described in the previous chapter, and thus consumers must experience them to place a value on them. This means that film is a singularly unusual product in that each film requires its own distribution and marketing campaign, drawing on the brand equity of known quantities, such as the actors or directors, or, if the film is a sequel, the success of its predecessor to create box-office draw.

Although films compete only with each other in the box-office, in the world of marketing they compete with all the other companies out there at a distinct disadvantage. Whereas a company like L’Oreal creates commercials and advertisements for a line of products that may number in the dozens, film studios put out hundreds of individual trailers, commercials, and advertisements, as well as film-specific promotional events, every single year.

<table>
<thead>
<tr>
<th>Percentage of money spent on ad campaigns</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Other Media</strong></td>
</tr>
<tr>
<td>Cable TV/Network TV</td>
</tr>
<tr>
<td>Network Radio</td>
</tr>
<tr>
<td>Spot Radio</td>
</tr>
<tr>
<td>Magazines</td>
</tr>
<tr>
<td>Billboards</td>
</tr>
<tr>
<td><strong>Other Non-Media</strong></td>
</tr>
<tr>
<td>Production/Creative Services</td>
</tr>
<tr>
<td>Exhibitor Services</td>
</tr>
<tr>
<td>Promotion &amp; Publicity</td>
</tr>
<tr>
<td>Market Research</td>
</tr>
</tbody>
</table>

*Source: MPAA, 2005*
Because the cost of producing each incremental unit (an extra DVD, an extra soundtrack) of film content product is so slim as compared with the sunk costs making the film, it makes logical sense to spend more on marketing and advertising not only to help sell more content but to create higher, more price-inelastic demand, such that higher profit margins can be made to help cover the sunk costs (Vogel, 2004, p.18). Overall, rising production costs, including actor’s salaries, special effects wizardry, and sophisticated sets, as well as the huge cost of creating a unique marketing campaign for each film, have created a shift in accounting that has led to the use of the box-office as a loss leader (Putnam, 1998; Vogel, 2004; Daniels et al, 1998).

_In This House There Are Many Windows_

Before the dawn of television, movie-theatres had little competition. In 1947, roughly two thirds of the American population, or 90 million people, went to the movies every week (Epstein, 2005, p.3). Theater ticket sales were America’s third-largest retail business and comprised over 95% of revenue for the six major studios (Epstein, 2005, p.7). In stark contrast to 1947, between 1999 and 2004, people spent, on average, just 13 hours a year at movie theatres (MPAA, 2004). Consequently, although the population has nearly doubled, movie theaters in 2003 sold 3.1 billion fewer tickets than they had 56 years prior to that in 1947 (Epstein, 2005, p.17). 2005 has been termed the ‘year of slump’, a reflection of three straight years of decline in theatre ticket sales.
Today, audiences have options that film goers in 1947 simply couldn’t have envisioned. In addition to the option of watching films on television, or on a DVD or VHS player, or on a laptop, there are a wide variety of home entertainment options that compete with movies, including videogames and the internet.

So, with rising costs, declining audiences, and rising competition, how do film companies keep the business afloat and recoup the massive initial investment they make in production? It all goes back to the idea that ‘content is king.’ Film companies are in the business of content distribution and licensing – theatrical exhibition is just a necessary means to an end. When films represent just one small part of the business for a company who has holdings in many related areas of media, the idea is to successfully utilize the company’s holdings to get the films into as many ancillary markets as possible.

Theatrical release is the only stage at which there is the possibility of a negative cash flow (Vogel, 2004, p.157). However, a film’s box office performance is one of the greatest single determinants of its profit potential down the distribution pipeline and thus
allows higher prices to be commanded in all the ancillary markets. Consequently, although money is lost in the box-office, theatrical release does indeed work as a ‘loss leader,’ serving as a very real ‘launching platform’ for the film to continue on in other windows.

The film product becomes not unlike a new drug in the pharmaceuticals business. Massive amounts of money are poured into the ‘production costs’ (ie. research, development, and testing). Many of the resulting drugs will be unsuccessful in trials but once a successful formula is found, making copies (more pills) is extremely inexpensive. Similarly, in film, large amounts of capital are invested to create the film and get it into the box-office, which serves as a testing vehicle for the content. Once the film finishes its theatrical run its true life begins as it then advances through the sequence of exhibition windows (see table), beginning with VHS/DVDs and pay-per-view, then pay cable, then network TV, and then syndication and foreign licensing (Litman, 1998, p.76). It is surmised that digital download will one day move to the front of the line, maybe even occurring simultaneously with theatrical exhibition.

<table>
<thead>
<tr>
<th>Estimated Ancillary Revenues for an ‘average’ MPAA member film in 2000 ($) millions</th>
<th>Typical License Fees per Film*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ancillary Sector</td>
<td></td>
</tr>
<tr>
<td>Pay Cable</td>
<td>8.5</td>
</tr>
<tr>
<td>Home Video (VHS + DVD)</td>
<td>12.0</td>
</tr>
<tr>
<td>Network TV Licenses</td>
<td>2.5</td>
</tr>
<tr>
<td>Syndication</td>
<td>1.5</td>
</tr>
<tr>
<td>Foreign TV</td>
<td>2.5</td>
</tr>
<tr>
<td>Total</td>
<td>27.0</td>
</tr>
</tbody>
</table>

* per film figures represent the approx. going rate for representative pictures. However, they are not derived by taking an exact average. Averages would be much lower if non-MPAA member films were to be included.
Success in these secondary markets is tied to a film’s box-office success. However, while only a small portion of films are box office hits (10-15% of major releases (Vogel, 2004), and an even smaller portion contain truly licensable characters, those films are a catalyst for retail sales. In 2000, movie-based characters “brought in $40 billion in worldwide global sales and accounted for over one third of sales for the entire licensing industry” (Epstein, 2005). Furthermore, these characters have lives far beyond that of the movies they came from, and can continue to produce licensing fee revenue for decades.

In the digital economy, the sequence of windows is critical even for those films without licensable characters. The need to bolster studio coffers with fee income means that every piece of content will be exploited to the furthest extent. In fact, because the six major studios produce relatively few films themselves, beginning in the 1990s they have tended to buy up content created by their own ‘independent subsidiaries,’ acquire foreign film and book rights, even video-game IP rights, and purchase low-budget films with high potential produced by small production companies.

This is akin to the pharmaceuticals process of always maintaining projects in the research and development pipeline. It is ironic that as producers put more content out on the market, repackaging old movies and old television shows for the DVD market (Corliss, 2006), they give people another reason to stay at home, away from the theatres. Still, once the film finished, theatrically, costs are relatively inexpensive. DVDs and
videocassettes are cheap. Digital broadcasting is cheaper still. The profits from the reproduction of the film’s content or intellectual property can be mind-boggling once the staggering costs of production are accounted for.

The total fees collected from the licensing of films in ancillary markets for home entertainment (network television, syndicated television, pay cable, and home video) have far surpassed box-office revenues since the mid 1980s. This is, in part, because although total spending at the box office was steady throughout the 1980s and early 1990s, total spending on television and video grew so much that the box office proportion of profits shrank considerably. In 1993 the box office share of profits was only 19 percent while in 1983 it was a much larger 39% (Litman, 1998, 100).

Beginning in 1986, home video generated more in domestic gross revenues (about $2 billion) than theatrical ($1.6 billion) sources did, thus tipping the fundamental profit structure of the business towards ancillary markets (Vogel, 2004). Yet arguably, the technology that most transformed the future of movies as a home entertainment was the
digital video disc (DVD). Invented by Sony in the late 1980s, it provided viewers with the combination of a high quality viewing experience and instant navigation – something they could not get in theaters (Epstein, 2005). Because of the DVD, the proportion of revenue that came from home video (which includes VHS & DVD) more than tripled between 1983 and 1993 (see above pie chart) and by 2003, home entertainment produced almost five times as much revenue as theatrical release (Epstein, 2005). In the United States alone, DVD penetration has increased by 41% over a five year period, while TV penetration increased by just nine percent over the same span of time (see table below.).

<table>
<thead>
<tr>
<th>Year</th>
<th>TV Households (millions)</th>
<th>DVD Households (millions)</th>
<th>Penetration (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>99.4</td>
<td>1.2</td>
<td>1.2</td>
</tr>
<tr>
<td>1999</td>
<td>100.8</td>
<td>4.6</td>
<td>4.5</td>
</tr>
<tr>
<td>2000</td>
<td>102.2</td>
<td>13</td>
<td>12.7</td>
</tr>
<tr>
<td>2001</td>
<td>105.2</td>
<td>24.8</td>
<td>23.6</td>
</tr>
<tr>
<td>2002</td>
<td>106.7</td>
<td>38.8</td>
<td>36.4</td>
</tr>
<tr>
<td>2003</td>
<td>108.4</td>
<td>46.7</td>
<td>43.1</td>
</tr>
</tbody>
</table>

Source: Epstein, 2005

<table>
<thead>
<tr>
<th>Year</th>
<th>DVD</th>
<th>VHS Sell-through</th>
<th>VHS Rental</th>
<th>% Rental</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>1</td>
<td>5.2</td>
<td>3.4</td>
<td>35</td>
</tr>
<tr>
<td>2001</td>
<td>5.7</td>
<td>4.1</td>
<td>2.6</td>
<td>31</td>
</tr>
<tr>
<td>2002</td>
<td>10.4</td>
<td>4.1</td>
<td>1.8</td>
<td>11</td>
</tr>
<tr>
<td>2003</td>
<td>14.9</td>
<td>2.7</td>
<td>1.3</td>
<td>7</td>
</tr>
</tbody>
</table>

Source: Epstein, 2005

Although the Big Six will not be leaving theatrical exhibition behind anytime soon, they are well aware that the future of film profits will only increasingly be in home entertainment. It is the belief of the studios that “going to the movies will continue to be
the most important way Americans get their filmed entertainment” (Litman, 1998, p.98) in terms of viewer impact and MPAA studies certainly show that moviegoers are significantly more likely to be DVD buyers (MPAA, 2005). However, there is a recognition that the primary job of a studio is not to be exhibitors, it is to function as a pool of copyrighted intellectual properties from which the parent company can draw.

Time Warner Entertainment, for instance, is a newly organized entity of Time Warner that groups together its movie, television, and cable interests, and boasts a library of more than 3,000 film titles (Epstein, 2005). Rupert Murdoch’s News Corporation has a plan make popular television shows and movies available for instant playback to home viewers with digital video recorders and video-on-demand services, beginning in 2006 (“Old Mogul,” 2006, p.66).

Without the box-office, there is no big launch, no easy way to capture the public’s attention and imagination. However, that is all it is today – a starting point. The true profits for the ‘Big Six’ are heavily dependent on the ability to sell and reincarnate the film content over and over at ever increasing economies of scale. Herein lies an essential argument of this chapter - that conglomeration and simultaneous vertical/horizontal integration of media led to a shift in industry profit structures which has made intellectual property the cornerstone of media revenue.

Now that the film studios are the property of global companies whose holdings extend far beyond film, the structure of the industry has been forever changed. First, we
have seen that in the digital economy, the basis of competition has been changed from content exhibition, in the form of box-office ticket sales, to content reproduction. As the effects of globalized digital technology increase over time, multiplying content production, increasing trade in information, and driving up competition, the initial change in the industry’s competitive basis has been followed by a second consequence – that there has been an increase in the extent to which foreign markets matter to film studios.

When America Isn’t Big Enough: The Globalization of Film Profits

Although digital technology has created massive revenue opportunities through the proliferation of different content vehicles for intellectual properties derived from film, the resulting content glut has saturated the domestic market. American consumers are inundated with entertainment opportunities ranging from videogames to interactive websites to downloadable television content. As a result, American film content is in need of new outlets.

Three years ago, News Corporation chairman Rupert Murdoch told financial analysts at the annual Morgan Stanley Media and Communications Conference that if ‘content is king,’ as head of Viacom Sumner Redstone once said, ‘distribution is queen’ (Epstein, 2005, p.66). Content without an outlet or an audience is of little use to film studios. After all, given the high costs of information production, information mass-reproduction is critical, and as information costs only continue to rise, new markets must
be developed if consumption is to keep apace. That day Murdoch described his plan for
distribution via a network of satellites orbiting the earth – he knew that it is not enough to
create digital forms of entertainment without creating a means to deliver it to consumers
on a global scale.

Although in 2004, US movie theatre admissions were down 2.4% from the same
period in 2003, worldwide box office profits increased by 24% over the same period
($25.24 billion), helped along by rapid growth in Europe, the Middle East, Africa, and
Asia (MPAA, 2004). In the first half of the 20th century, high import taxes and strict
restrictions on currency repatriation made it impossible to retrieve film profits from
abroad (Epstein, 2005). From 1965 until roughly 1980, however, foreign theater rentals
have been the icing on the cake for Hollywood. Because film studios were able to break-
even on their initial production expenses in the large domestic market, foreign rentals and
ancillary markets were sources of pure profit, allowing US motion picture distributors to
dominate the global industry by setting prices just high enough to cover their incremental
expenses (Litman, 1998, p.91). This strategy was so successful that America came to
dominate the global box office and was accused of film dumping. Without the strong
domestic rentals seen in the US, foreign film industries had just two options, either to cut
back on production or to charge higher prices (Litman, 1998), both of which made them
less competitive.
Today, foreign markets are not the icing on the cake but rather the cake itself. In 1997, MPAA head Jack Valenti noted in a Forbes interview that 42% of Hollywood’s total profits were from foreign revenues (Ulf-Moller, 2001, p.xiii). Since 2003, Foreign revenue from theater rentals has exceeded domestic revenue, (Epstein, 2005), a trend intensified by American film’s massive share of the European and Japanese box offices (over 80%) and in 2004, 55% of total theatrical and home video sales came from overseas (Glickman, 2005).

Still, as in the domestic market it is not so much the foreign box office which is key to profits, but its potential to create content demand in the overseas home entertainment ‘windows.’ In spite of the fact that worldwide box office admissions were up 10.5% in 2004, in stark contrast to the US drop, the proportion of revenues that comes from foreign theatrical revenues has declined much in line with the domestic share (see table below).

<table>
<thead>
<tr>
<th>Film Industry Sources of Revenue Estimated, 1980 and 2000</th>
<th>1980</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Theatrical (Domestic)</td>
<td>29.6%</td>
<td>15.2%</td>
</tr>
<tr>
<td>Theatrical (Foreign)</td>
<td>22.8%</td>
<td>14.2%</td>
</tr>
<tr>
<td>Home video</td>
<td>7%</td>
<td>38.2%</td>
</tr>
<tr>
<td>Pay cable</td>
<td>6%</td>
<td>7.8%</td>
</tr>
<tr>
<td>Network TV</td>
<td>10.8%</td>
<td>1.5%</td>
</tr>
<tr>
<td>Syndication</td>
<td>3.8%</td>
<td>3.9%</td>
</tr>
<tr>
<td>Foreign TV</td>
<td>2.5%</td>
<td>6.9%</td>
</tr>
<tr>
<td>Total</td>
<td>82.5%</td>
<td>~89%</td>
</tr>
</tbody>
</table>

Source: Vogel, 2004
The foreign market for content licensing (note the growth in Foreign TV, above) has the potential to be the industry’s savior. Seventy-nine percent of the worldwide growth from overall 2004 sales came from home video (mostly DVDs) (Glickman, 2005). Cumulative unit sales of home videos exceed one billion to date and in the bulk of developed nations (US, Japan, Britain, France, Germany, Italy, Holland, Scandinavia), and in many less developed nations as well, VCR and DVD players have penetrated two/thirds of television households and the market is growing quickly (Vogel, 2004, p.103). It comes as little surprise that, given the figures for hardware penetration, sales of pre-recorded home-video software produce upwards of $16 billion in domestic retail revenues, two/thirds of which are buyers of feature films (Vogel, 2004, p.103).

<table>
<thead>
<tr>
<th>Year</th>
<th>Theater</th>
<th>Video/DVD</th>
<th>Pay TV</th>
<th>Free TV</th>
<th>Total</th>
<th>Theater Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948</td>
<td>6.9</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>6.9</td>
<td>100</td>
</tr>
<tr>
<td>1980</td>
<td>4.4</td>
<td>0.2</td>
<td>0.38</td>
<td>3.26</td>
<td>8.2</td>
<td>33</td>
</tr>
<tr>
<td>1985</td>
<td>2.96</td>
<td>2.34</td>
<td>1.041</td>
<td>3.39</td>
<td>11.9</td>
<td>25</td>
</tr>
<tr>
<td>1990</td>
<td>4.9</td>
<td>3.87</td>
<td>1.62</td>
<td>7.41</td>
<td>19.8</td>
<td>25</td>
</tr>
<tr>
<td>1995</td>
<td>5.57</td>
<td>10.6</td>
<td>2.34</td>
<td>7.92</td>
<td>26.43</td>
<td>21</td>
</tr>
<tr>
<td>2000</td>
<td>5.87</td>
<td>11.67</td>
<td>3.12</td>
<td>10.75</td>
<td>31.4</td>
<td>19</td>
</tr>
<tr>
<td>2003</td>
<td>7.48</td>
<td>18.9</td>
<td>3.36</td>
<td>11.4</td>
<td>41.1</td>
<td>18</td>
</tr>
</tbody>
</table>

Source: (Epstein, 2005)

Despite revenue growth in the theatrical market after 1990, likely boosted by a push in the foreign box-office after a steep decline in domestic box-office, the theatrical share of profits has decreased since 1948 (see Table 1.). Thus, given the stable growth of
worldwide revenues in every film market but theatrical, it has become a top priority of
the six entertainment conglomerates to gain full and unimpeded access to the worldwide
market for filmed entertainment. The fact that most of the ancillary markets, including
video, DVD, pay television, television licensing, and film merchandise, are in areas not
covered by the Hollywood Antitrust decree or any other domestic antitrust decree, is an
added bonus, allowing the Big Six to cooperate in their quest to cover the globe.

Though the six companies distribute their filmed entertainment in over one
hundred foreign countries and territories, eight countries (Japan, Britain, Germany,
France, Spain, Mexico, Italy, and Australia) generated the bulk of foreign revenues in
2003 (Epstein, 2005, p.203). Consequently they have been the main focus of film studios
in the past. However, in the last five years the decline of the global box office coupled
with the subsequent rise of foreign content licensing has made the studios rethink their
foreign market operations. If foreign markets are now responsible for more than half of
total revenue, in both the theatrical and ancillary markets, and if the global digital
economy has caused the proliferation of content production on a worldwide scale (and it
has) then eight major markets are not enough. It is also notable that these nations (with
the exception of Britain, whose film industry is owned by Hollywood) have national film
industries of their own that are now becoming more competitive (since 1997, one Italian
and three Japanese films have snuck onto the top 100 list of all-time box-office hits (‘all-
time’, 2006).
<table>
<thead>
<tr>
<th>Country</th>
<th>Theater Rentals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>450</td>
</tr>
<tr>
<td>Germany</td>
<td>392</td>
</tr>
<tr>
<td>Britain</td>
<td>344</td>
</tr>
<tr>
<td>Spain</td>
<td>248</td>
</tr>
<tr>
<td>France</td>
<td>242</td>
</tr>
<tr>
<td>Australia</td>
<td>166</td>
</tr>
<tr>
<td>Italy</td>
<td>154</td>
</tr>
<tr>
<td>Mexico</td>
<td>124</td>
</tr>
<tr>
<td>Total, 8 countries</td>
<td>2,120</td>
</tr>
<tr>
<td>Total, All Overseas Markets (excluding Canada)</td>
<td>3,272</td>
</tr>
</tbody>
</table>

**Source:** Epstein, 2005

The Big Six have, in the last few years, begun to focus more on large emerging markets like India, and China, whose 1.3 billion people represent a fifth of the world population and whose economy (according to the Beijing government) is larger than that of Britain or France (Wallace, 2006, p.1). It is, after the US and India, the world’s largest film producing nation, with budgets that rival Hollywood’s. All six studios have projects in the works in China but because the nation, like many emerging markets is caught “in the purgatory between one-party rule [or despotism] and go-go capitalism” the six entertainment empires must increasingly consider the impact of foreign policy on their efforts to profit via content licensing in foreign markets. In China, particularly, not only has there been a government imposed limit on the number of foreign films allowed into the country (twenty annually, 16 of which were American in 2005) since China opened its film market to American features in 1994, but intellectual property rights are a foreign concept in Chinese markets (Wallace, 2005).
Without the protection of the strong infrastructure of intellectual property protection found in the domestic market, the threat of pirates wishing to reap the benefits of intellectual property reproduction without the initial sunk costs becomes a very real danger to the Hollywood’s current business model. The degree to which the American industry is able to address rampant piracy in these areas while simultaneously capturing their audiences will determine whether it can sustain its market leadership while maintaining the massive profit margins it has grown accustomed to.

_When Piracy Stops Being a Pest and Becomes A Problem_

At its heart this thesis argues that the new content-based structure for profiting from intellectual film properties that was created by digital technology was not enough by itself to prompt Hollywood’s business-government professionals to push the enforcement of intellectual property rights through foreign trade agreements to the top of the agenda. Although piracy has been a major problem since the appearance of the VHS tape and even more so since the appearance of the DVD, which produces exact copies, it was not a threat to the industry’s profit structure while the bulk of revenue was still made in the theatres. Furthermore, as long as the break-even point of film industry profits still occurred domestically, it was the strong domestic IP infrastructure which mattered while foreign markets, although important, provided bonus income. The global enforcement of IPRs was an issue, but not one considered mission-critical to the industry’s future.
It is likely that if foreign profits were predominantly contingent on theatrical revenue, as they were until the mid-1980s, piracy would not be an issue to the same extent. Theatrical exhibition is, unlike intellectual property, difficult (although not impossible) to pirate. Rather, the MPAA would likely have maintained its focus on fighting foreign box-office quotas. However, in 2003, the Big Six spent a total of $18 billion on the promotion and worldwide distribution of 185 films produced by themselves and their ‘independent’ divisions, recouping only $6.4 billion in the global box-office (Epstein, 2005, p.19). Were it not for the profits to be made by licensing their intellectual property for home-entertainment, the $11 billion deficit following the worldwide theatrical runs of all the movies would have meant the end of the industry.

As in the domestic market, it is increasingly content licensing which drives global film profits and the protection of film content in foreign markets is governed by each nation’s intellectual property policies. This thesis hypothesizes that it is the conjunction of these two industry changes, namely the importance of content and the dependence on foreign markets, which has caused the enforcement of IPRs in foreign markets to become truly critical to the American film industry’s global business strategy. Thus, it is only in recent years that international intellectual property rights enforcement has supplanted the box-office as the central issue-advocacy focus of Hollywood business-government relations professionals and film industry trade associations. So, if, as Sumner Redstone
and Rupert Murdoch say, content is king and distribution is queen, Hollywood is looking to expand the kingdom, or at least to enforce its rule.
Chapter 3. Movie Diplomacy: From Protectionism to Piracy

In 1998, speaking before a group of British film executives, MPAA head Jack Valenti argued that “the nationality of a film confers no obligation that it be seen,” that “no one can bully an audience.” Tacitly referring to the American film industry’s global domination of box office exhibition and distribution for the last fifty years, he went on to claim that there was “no quarrel between the cinema communities of US and Europe” because they were, and had been, engaged in a “visible collaboration” (Valenti, 1998b).

In fact, in speeches at home Valenti proudly hailed the American film industry as “one that every other nation views with envy” (Valenti, 2000a). Later that same year the film industry boss would state to his own industry peers that “the American movie is affectionately received by audiences of all races, cultures and creeds on all continents…This isn’t happenstance. It is the confluence of creative reach” (Valenti, 1998a).

Certainly it is far from happenstance that more than 50% of the movies exhibited in theatres worldwide are American and that in 2005, Hollywood controlled 75% or more of worldwide film distribution (“European,” 2005; Ulf-Moller, 2001, p.xv). It can be no accident that though foreign films represent just a quarter of one percent of the American market today, the Hollywood industry’s share of the European market is around 80% (Ulf-Moller, 2001, p.xv). However, to say that the dominance of the American film product since World War I is simply due to consumer preference and artistic superiority
is just as incomplete a presentation of the facts as to invoke the possibility of chance, particularly given that in times when the American film industry has boycotted a nation, people have continued to go the theatres to watch other movies (Segrave, 1997, p.12).

This thesis predicates its case argument on the assumption that it was arguably not the popularity of American films alone that secured the industry’s global market leadership but rather the very powerful partnership in the United States between big business and big government (Segrave, 1997; Litman, 1998; Ulf-Moller, 2001; Miller et al, 2001; Ryan, 1998).

Whereas the diplomacy efforts of foreign nations to support their native film industries have often “consisted primarily of introducing protectionist measures,” the US government has acted instead as a “virtual partner in trade negotiations with Hollywood’s trade association”, launching offensive measures against restrictive foreign policies and collecting crucial intelligence as well as undertaking defensive measures and providing legislative assistance on behalf of American film’s interests overseas (Ulf-Moller, 2001, p.xiv). Thus, Hollywood as an industry eventually came to contribute more to the US economy than automobiles, aviation, or chemicals (Ulf-Moller, 2001, p.xiii). It is this close alignment between US foreign policy and the long-term global business initiatives of its major export industries that is critical to a full understanding of the US government’s current actions on behalf of the American film industry and its close relationship with Hollywood’s trade association, the MPAA.
In the second chapter of this thesis it was established that due to digital technology the bulk of American film industry profits are collected 1) not in the box-office but via content licensing and 2) foreign markets account for over half of all American film revenues. It naturally follows from this change in industry profit structures that there has been a corresponding switch in the industry’s legislative agenda. Hollywood’s long-term global business strategy has always centered on its capacity to sell its intellectual property on a mass-scale to consumers in whatever form they chose to consume it and thus the MPAA must logically respond to the fact that today people predominantly choose to consume film content in the form of digital home entertainment products.

Historically, when theatrical exhibition was the crux of the film business, it was enough for Hollywood international negotiators and business-government relations representatives to focus on fighting cultural protectionism in the form of foreign film tariffs and quotas. In the digital economy, however, the dominant asset of the information industries, including film, is intellectual property. Note that a full-text search on the current website of the Motion Picture Association of America\textsuperscript{14} for the words ‘piracy’ or ‘thieves’ yields 62 relevant results whereas a search for the words ‘theatre’ or ‘box-office’ yields only nine. Although the industry has sought to eliminate cultural

\textsuperscript{14} This search was performed using the program, Scrapbook, on March 3\textsuperscript{rd}, 2006.
protectionism for the past eight decades, at some point it clearly became no longer the number one issue.

Thus, this chapter seeks primarily to prove that around the turn of this century there was a shift in the primary focus of Hollywood’s lobbying arm from cultural protectionism to foreign film piracy in response to the industry’s dual dependency on content licensing and foreign market revenues. Hollywood business-government relations representatives today still develop initiatives to further penetrate foreign film markets but more importantly to protect the industry’s intellectual property overseas.

In order to see how and why the MPAA prioritized the importance of intellectual property piracy as a foreign policy issue when it did, it is necessary to first undertake a historical overview of Hollywood’s relationship with the US government. In this way it is possible both to define the process via which the industry’s business concerns translate into government actions and to establish a contextual framework for the MPAA’s switch in issue advocacy from fighting cultural protectionism to fighting digital pirates.


In studies of international political economy over the last twenty years, there has been increasing recognition of the growing role that non-state actors, including multinational corporations, subject area experts, and non-governmental organizations, are playing in international diplomacy (Ryan, 1998). Hollywood, as an industry, is perhaps
unique in that has already long been involved in international diplomacy, not only as a publicity arm for America’s overseas campaigns, but also as an active player in trade liberalization negotiations during a period when it was unusual for commercial interests to take part.

Until World War I, American film did not lead international film exhibition and had the largest foreign market share only in Germany (31 percent) (Segrave, 1997, p.4). However, with the 1917 entry of the United States into the first World War, a partnership was undertaken between the US government and the film industry as demand for American films in wartime Europe began to rise exponentially. The US Congress created the Committee on Public Information to disseminate ‘the Gospel of Americanism’ and towards this end, President Woodrow Wilson arranged for US and Allied Nation films to be distributed throughout France, Italy, and Russia (Segrave, 1997, p.15).

In 1918, in an overall effort to promote trade export, the US Congress passed the Webb-Pomerene act, which legalized anti-competitive activity by US firms operating overseas (Ulf-Moller, 2001). The law allowed exporters to cooperate in ways made illegal by the Sherman Antitrust Act, which barred the formation of cartels in domestic trade. The American film industry has become the largest single beneficiary of the Webb-Pomerene Act (Ulf-Moller, 2001) and it remains on the books today, amended as the Export Trading Company Act of 1982, due to vigorous lobbying by former MPAA head, Jack Valenti, who successfully argued before Congress that without the act the film
industry should be crippled, as it was ‘peculiarly vulnerable’ to the punitive actions of foreign governments (Valenti in Ulf-Moller, 2001, p.49).

In the early 1920s, the US Bureau of Foreign and Domestic Commerce nearly doubled its foreign office (to 58) and quadrupled its staff in response to the desire of Herbert Hoover, who had just been appointed Secretary of Commerce, to greatly increase trade promotion (Bjork, 2000). Towards this end, Hoover pushed Commerce Department to aid the film industry in every way possible, testifying before the US Senate in 1925 that the growing popularity of American films “bore very materially on the the expansion of the sale of other goods throughout Europe and other countries” and helped promote Americanism (Bjork, 2000). In addition to increasing backing in terms of policy, the film industry also gained the support of 400 State Department consular officials located worldwide (Bjork, 2000).

The active support of the United States’ diplomatic services was extremely significant to the success of the American film export business. The major film studios, of which there were eight that dominated the domestic market (and still do, as part of the ‘Big Six’ media firms), had achieved market leadership by vertically integrating the production, distribution, and exhibition functions of the business. These eight, which were Warner Brothers, Paramount Pictures Inc.-Loew’s Inc., Twentieth Century Fox, MGM, RKO, Columbia Pictures Inc., Universal Corporation, and United Artists (Ulf-Moller, 2001, pxv) undertook the formal creation of an overseas cartel, the Motion
Picture Producers and Distributors of America (MPPDA) in 1922 in order to expand control of the foreign market (Segrave, 1997, p.21). The association engaged William Hays, the Postmaster General under President Harding, to be its president, thus initiating a tradition of hiring leaders who had worked in the presidential administration.

Early attempts to form a cartel had failed due to the market entry and exit of various independent producers as the domestic market swiftly expanded. Now the industry had the support of the State Department, which managed any difficulties of the MPPDA in dealing with foreign governments (Ulf-Moller, 2001, p.51) and whose actions on behalf of the motion picture industry were approved by Presidents Harding, Coolidge, Hoover, and Roosevelt ((Ulf-Moller, 2001, p.53).

American films grew exponentially, controlling 95 percent of the South American market in the early 1920s, for instance, as opposed to the 10 percent controlled prior to World War I (Segrave, 1997, p.17, p.55). In Britain 95-90 percent of movies shown were American whereas only one percent of films screened in the US were British (Seagrave, 1997, p.43) and throughout most of Europe and parts of other regions the story was much the same. However, Hollywood’s success did not go unnoticed. Other nations suffered losses, not only to their film export industries but also to their native film industries,
which hadn’t had a chance to recover after the war and were completely overwhelmed by American film products.¹⁵

Germany put into effect the first film import quota in 1921, then tried unsuccessfully to impose a plan wherein one US film could be imported for each German produced film (Segrave, 1997). Shortly thereafter the British and French began lobbying their governments for quota policies and import restrictions increased (Ulf-Moller, 2001, p. 45). In 1925, Austria initiated a twenty-to-one quota plan and in 1926, Poland too instituted restrictions, creating an admission tax for foreign movies. However, by then the Department of Commerce had declared the film industry to be the fourth or fifth most important in America (Segrave, 1997, p.59) and thus the US government intervened, helping Hollywood put pressure on the Polish foreign affairs minister, who withdrew the tax later that year. Poland then tried to introduce a ten-to-one ratio plan (US-to-Polish) which was quickly stifled as well (Segrave, 1997, p.47). In the case of Austria, although the quota plan was modified to a ten-to-one ratio, an MPPDA rep was sent to Vienna where he negotiated with the Minister of Commerce until Austria agreed to allow the quota to fluctuate with market demand (Segrave, 1997), essentially rendering it useless.

Other countries, fearful of being overcome by US culture (as disseminated through the powerful propaganda of American films), then jumped into the international trade

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¹⁵ As noted in chapter two, American films at this time were well supported by capital from a flourishing domestic film market and could thus be rented very cheaply to overseas exhibitors.
battle. Alarmed by the Hollywood’s 93.5 percent share of their domestic film market in 1926 and by the amount of money being repatriated to the US, the Australian government imposed a 50 percent duty increase and threatened a 25 percent tax on film rentals (Segrave, 1997, p.51). That same year Hungary introduced import duties as well and a one-to-thirty ratio plan. Hollywood responded with a boycott and MPAA head William Hays traveled to Budapest to protest, with the result that the duties were dropped (although a ratio plan was created three years later) but a flat tax per film was instituted, with the money then going to domestic film subsidies (Segrave, 1997, p.47).

Worried that import restrictions had now been levied by England, France, Austria, Hungary, Australia, Holland, and Czech, Hays requested that the State Department take action. All the embassies and consulates were asked for film market reports and a special Trade Commissioner was appointed by Commerce Secretary Hoover to be stationed in Paris where he could monitor film regulations and gather intelligence (Segrave, 1997, p.64). A Motion Picture Section was also created in the Commerce Department, specifically to gather information concerning the foreign business climate for the motion picture business, which would come from the department’s fifty foreign offices then be distributed to the industry via the trade press. Such reports became invaluable and allowed Hollywood to react immediately to restrictive foreign policies (Ulf-Moller, 2001, p.176).
Nevertheless, in late 1927, Britain introduced a quota bill requiring exhibitors to screen 7.5 percent local films. The percentage was to increase to 25 percent by 1935 and stay there indefinitely. After negotiations with the major studios the requirement dropped to 5% following the agreement that the American practice of block booking\textsuperscript{16} would be banned (Segrave, 1997, p.46). The quota remained in place until 1938. Germany, too, created import controls in 1927 and France considered imposing sanctions and imposed a one-to-four ratio, angered that its previously strong film industry produced only five percent of the movies screened in France and could not penetrate the US market, while the United States accounted for eighty percent of movies screened in France (Segrave, 1997, p.37). The MPPDA sent a representative to negotiate but also brought in the US Ambassador to France and the MPPDA foreign department chief, who warned France that in a film trade war, their industry was sure to lose (Segrave, 1997, p.38). Washington threatened to call in French debts and to impose tariffs on all French imports and Hays threatened a complete boycott of the French film market (Segrave, 1997, p.39).

The French situation is very indicative of the general tactics used for the rest of the 1920s. Import quotas proved more effective than customs duties, which hardly made a difference (Ulf-Moller, 2001, p.57). Even so, they are effective only by comparison. France has utilized the quota policy for seventy years, even advocating that the main element of EU audiovisual policy be television quotas, with the result that Hollywood

\textsuperscript{16} This practice, already frowned upon in the US, required exhibitors to rent films as a group package.
retains its 80-90 percent European market share and foreign films control a fraction of a percent of the US domestic market (Ulf-Moller, 2001, p.157).

In the 1930s the US Government's New Deal foreign economic policy sought to reduce tariffs via bilateral trade agreements. The US struck an agreement with France in 1936, in which France agreed to reduce restrictions on film exports in exchange for tariff reductions on a wide range of export products, notably wine (Ulf-Moller, 2001, p.47). The American government continued its rigorous promotion of exports, increasing its information gathering efforts via the Commerce Department and using State Department funds to pay for foreign press junkets featuring Hollywood film celebrities. (Ulf Moller, 2001, p.47; Segrave, 1997, p.93)

Overseas, foreign governments attempted to protect their markets from what they perceived to be an onslaught of US culture by, in addition to imposing quotas, banning films or imposing censorship procedures (ex. China, Cuba), which were sometimes withdrawn after protests from the US Embassy (Segrave, 1997, p.85). In 1934 movies were included in international tariff negotiations, at Hays’ request, and in 1937, President Roosevelt intervened to ease trade restrictions on US films (Segrave, 1997, p.95). Foreign governments, including Australia, Chile, Argentina, Columbia, Peru, Hungary, Germany, and Italy, then passed currency repatriation restrictions (Segrave, 1997, p.95), which were somewhat successful. Only Japan mirrored America’s offensive strategy, trying to meet the US head on with its own film cartel (Segrave, 1997).
Although Europe was the US’s biggest film market, at least one major studio foreign department headed threatened to pull out of the European market entirely. Because the US domestic film market was so strong, providing upwards of sixty percent of revenues, foreign markets were a luxury – the icing on the cake so to speak (Segrave, 1997, p.104). It did not help that prior to the Second World War, a total of 58 countries (10 in UK, 11 in Latin America, 26 in Europe, 11 in Asia and the Middle East) were practicing cultural protectionism against American film via the use of state monopolies, import taxes, quotas, license requirements, and preferential tariffs (Segrave, 1997, p.119).

France had imposed a full embargo and much of Europe, excepting Turkey, Sweden, Switzerland, Finland, Spain, and Portugal, was closed to US film. Twenty nations alone were using currency restrictions, which prompted a visit by President Roosevelt’s official envoy Harry Hopkins to London in an effort to unfreeze US money, with the result that in 1943 the money was freed. The “always helpful” State Department, aided by the US military, later stepped in too to “restructure the Axis film industries in a way more favorable to Hollywood” (Segrave, 1997, p.119). The State department also absorbed the foreign trade representatives of the Commerce Department, taking on responsibility for the motion picture industry and immediately collecting intelligence reports in every single film market with the aim of constructing a plan to force down barriers to American film trade (Segrave, 1997, p.131).
In 1945, Eric Johnston replaced Hays as head of the MPPDA, which was then renamed the Motion Picture Association of America (MPAA). At this time the Motion Picture Export Association was also formed. Johnston had been an appointed official in the Truman and Eisenhower administrations and came to the MPAA from a position as head of the US Chamber of Commerce (Epstein, 2005). A year later the French and US governments signed an accord which lifted most trade restrictions on US imports, although the French retained a screen quota that reserved 16 weeks a year for domestic films (Segrave, 1997, p.165).

In 1947, 23 nations met in Geneva, Switzerland to sign the General Agreement on Tariffs and Trade (GATT), a multilateral trade liberalization and economic cooperation pact. Although Hollywood was already one of the biggest industrial exporters, the United States fought to get all film restrictions removed. However, under Article IV of the GATT, Special Provisions relating to Cinematograph Films, film became a culturally exempted item and nations were authorized to set quotas although the agreement specified that such quotas must be in the form of time reserved for films of national origin computed on the basis of screen time per theatre per year and could be subject to negotiation (WTO Secretariat, 1998). Moreover, even in its current form, the GATT (now the WTO) allows governments to fund domestic film production with film subsidies (WTO Secretariat, 1998). The State Department made fighting cultural protectionism in the film industry a priority issue and Secretary of State Dean Acheson requested to have
the film industry put on the agenda of a forthcoming international trade conference, where he would attempt to obtain “fair and nondiscriminatory treatment” (Segrave, 1997, p.161).

Beginning in the 1950s, as audiences began to decline at home and frozen currency continued to be a problem in Europe, the MPEA sought to expand to Asia. Johnston met with government officials in Indonesia, Japan, Thailand, Hong Kong, Malaysia, Singapore, Taiwan (Segrave, 1997, p.214). Indonesia put up particular resistance in the form of strict censorship, with Indonesian President Sukarno stating that he feared American films would incite the Indonesian people to jealousy once they saw a better standard of living. In fact, in 1964 the Indonesian communist party launched a boycott of American films and in response the MPEA boycotted Indonesia until 1966 (Segrave, 1997).

Britain, after failing to maintain its 30 percent exhibitor quota, developed a British Film Production Fund which was to subsidize only film companies incorporated under the UK. However, because most of the major studios had wholly owned British subsidiaries they were eligible for the fund and took 80 percent of the available subsidies (Segrave, 1997, p.210). Spain limited American imports to one hundred films annually and tried to institute a ratio restriction with the result that the MPEA immediately launched a boycott and the US Ambassador to Spain, John Lodge, intervened, bringing together an MPEA representative and the Spanish Commerce Minister (Segrave, 1997,
p.211). In Japan, where a film quota of 185 films yearly was successfully implemented, the native film industry began to bounce back (Segrave, 1997, p.215).

In 1960 Eric Johnston and the Commerce Department developed a list of seventeen film trade restrictions and appealed for government aid in fighting the barriers. Three years later, upon Johnston’s death, Jack Valenti, then Special Assistant to President Lyndon Johnson was brought in to head the organization (Epstein, 2005). By 1968 Valenti had noted that the motion picture industry was the only US business that had the two unique advantages of negotiating on its own with foreign governments and having the State department negotiate for it directly (Miller, 2001).

**Beyond Taxes, Tariffs, and Quotas: Video-warfare 1970-1995**

In 1971, Jack Valenti laid out what he felt were the ten biggest threats to Hollywood abroad, affecting between three and twenty nations. Two were quotas. Two were taxes. Four were local requirements. One was currency remittance and the last was subsidies (Segrave, 1997, p.203). The 1970s would be marked by one other threat, but one which Valenti did not predict and which did not, in his eyes, overshadow the problem of barriers to the foreign box-office. That threat was home video recording.

The Sony Electronics Corp had developed Betamax, a video recording format, and in 1976 the company launched an advertising campaign that emphasized the home video recorder’s ability to ‘time-shift’ television. Universal Studios responded by
requesting that all the major studios join it in a law suit against Sony for infringement of copyright law. However, only the Walt Disney Company agreed to be a co-plaintiff (Wasko, 1994, p.126). The other studios remained uninterested despite Disney’s argument that videotapes would be used to steal movies off of television. Though Jack Valenti did create an Anti-Piracy Division at the MPAA, Universal noted that “most people in high places are not worried about what might happen ten years down the road…” (Wasko, 1994,p.126) and truthfully, little was heard from the Anti-Piracy Division over the next decade.

Many of the studios simply did not understand that their future lay in holding the rights to intellectual property. In 1979, Fox studio sold the video rights to its library for just $8 million to a small company called Magnafilm and later had to buy them back (Epstein, 2005, p. 210). Columbia Pictures refused a proposal to create a video division and assigned its library video rights to its smaller sister studio, RCA. MGM sold off its video rights to Ted Turner of Turner Broadcasting System (now part of Time Warner) and Disney stipulated that its film library was off-limits to video (Epstein, 2005, p.10).

Although Sony suggested a royalty fee as a compromise, the issue went to trial in 1979, receiving a great deal of publicity, with Jack Valenti famously comparing the VCR to the Boston Strangler attacking a woman home alone. After a decision in Sony’s favor which was overturned in the US court of Appeals in 1981, the case went to the Supreme Court where the decision was famously reversed again in a historic five to four vote in
1984 (Wasko, 1994, p.129). Even as the major studios regretted their loss, they got busy entering the home video market and discovering a huge supplement to box-office revenue. By the late 80s even Disney had found that video ‘sell-through’ allowed it to sell millions of copies of even its less popular films, at the right price (Epstein, 2005). Sales of television programs too were becoming significant, comprising one fifth of the world gross (Segrave, 1997, p.234) in 120 markets.

In the early 1980s, a group of film and television executives went to the USTR to discuss objections to trade barriers in the form of ‘cultural exceptions’ and raised also the problem of video copyright infringement (Segrave, 1997, p.250). By now the MPAA had 300 employees in sixty nations overseas working to monitor foreign legislation and campaign against trade barriers with the help of the USTR and the State dept. Valenti, who had then led upwards of eighty negotiations with foreign governments, was particularly frustrated at ‘cultural sovereignty barriers’ in India, Indonesia, Spain, Korea, and Canada

17 (Segrave, 1997, p.251). Still, though cultural protectionism was still the issue of the day it had been joined by the matter of intellectual property rights.

In 1984 the International Intellectual Property Alliance (IIPA) was formed - a private sector coalition of seven associations representing books, software, film and music, to represent the United States content industries in “bilateral and multilateral efforts to improve international protection of copyrighted materials” (IIPA, 2005). That

17 Though it should be noted that at this time, Hollywood had 80-90 percent market share of the Canadian film market.
year, the US Congress passed legislation that made ineffective IPR protection a discriminatory trade practice under Section 301 of United States Trade Law in response to IIPA lobbying, marking the first time that intellectual property became part of the US trade agenda (IIPA, 2004). In 1985, the IIPA submitted a white paper to the USTR on the subject of piracy, recommending the use of bilateral diplomatic strategies, aggressive Section 301 investigations, and sanctions threats on non-complying nations (Ryan, 1998, p.71), marking the first of its annual recommendations to the USTR’s Section 301 agenda.

Although several Asian nations were threatened with trade restrictions if they did not improve their copyright laws (Wasko, 1994, p.162), the first real attempt to insert an audiovisual clause into a bilateral free trade agreement came in 1987, when the US attempted to convince Canada to drop all barriers to US films. When Canada insisted that the audiovisual issue be left off the table, the MPAA prepared a congressional brief that referred to the incident as a trade crisis and convinced 41 California members of Congress to send a message to the House Ways and Means Committee quoting from it (Segrave, 1997, p.266).

In 1989 the European Community adopted the ‘Television Without Frontiers’ directive, which required European television channels to carry at least 50% European programming. Under pressure from Jack Valenti and President Ronald Reagan, British Foreign Secretary John Major agreed to add the words, ‘where practicable’ to this
requirement, thereby greatly weakening the directive (Granville, 2004; WTO Secretariat, 1998b).

Later in 1989, the industry woke up to the problem of physical video piracy, noting a fifty percent increase in domestic video raids. Enlisting the help of the FBI and of Interpol, they sought to fight domestic video piracy which had reached up to 5-10 percent by the early 1990s pushed by the high incidence in California and New York (Wasko, 1994, p.161). Incidentally, 1991 was the first year someone was arrested for bringing a camcorder into a theatre.

In far eastern markets, the early 1990s sparked a piracy flood as a result of the ‘video revolution’ and soon afterwards, the introduction of video compact discs (VCDs). However, unlike digital piracy, VHS tapes and VCDs were still physical products that could be subjected to police raids. Hollywood showed some concern, particularly in countries like Japan and Korea where the piracy rate was high, but negotiations still focused heavily on fighting quotas, particularly in South Korea (Wasko, 1994).

Valenti did note, however, the rising importance of copyright and singled out 66 countries with inadequate IP protection, assigning MPAA film executives to investigate the illegal copying of videos (Segrave, 1997, p.254) and hiring former FBI assistant director William Baker to head his global anti-piracy division (“Video Pirates, Beware!,” 1992). He also hired a new head of the domestic piracy division, the former head of the
FBI office in Washington, DC, noting that 40 to 50% of estimated video piracy was domestic, as opposed to worldwide (“Video Pirates, Beware!,” 1992).

Additionally, the IIPA (of which the MPAA was a member) recommended eleven, mostly Asian, countries to the USTR for Special 301 review of their intellectual property infrastructure, of which eight were added to the bilateral diplomacy agenda (Ryan, 1998, p.86). In 1992, the USTR investigated eight of the IIPA recommendations (there were 14) and in 1994, two out of six, also considering the needs of the PhRMA (the pharmaceuticals manufactures trade association) patent agenda, which had submitted six to nine countries of its own each of those three years (Ryan, 1998, p.86). Also in 1994, the IIPA on behalf of the MPAA pushed the USTR to take up the issue of film rental rights in several countries (Ryan, 1998, p.88)

By 1995, though foreign film rentals and video sales were growing, making foreign revenue worth 45 percent of Hollywood’s total take, physical video piracy became still more of a problem, particularly in Russia. The reaction by the studios, however, was “very narrow…circumscribed” and involved checking the auditorium for camcorders, hand delivering film prints to foreign theatres and locking them in a safe between showings (Segrave, 1997, p.279).

In the early 1990s, Jack Valenti’s main focus was on getting content quotas and protection stripped away in the North American Free Trade Agreement (NAFTA). Though NAFTA sections regarding Mexico required intellectual property protection, as
well as lowering screen time quotas, Canada held out and USTR rep Carla Hills 
eventually gave in, allowing Canada to exempt its cultural industries from the 1992 
NAFTA pact. Valenti was furious (Segrave, 1997, p.266). When he heard that film 
director Wim Wenders, in response to America’s vast European market share (see table) 
had called for strict quota regulations against the US major studios at a European film-
making panel, he announced that America ‘was in a World War of Trade’ (Wasko, 1994).

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<th>Market Shares of US Films in Europe (percent)</th>
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* Brussels only  ** Non-European films, i.e. US and other countries

Valenti’s perception that the European Community sought to block US films from entry under the rhetoric of protecting native culture led him to urge the US government to keep the issue of audiovisual (including motion pictures, video tape production, radio, television, and sound recordings) strictly on the table at the ‘Uruguay Round’ negotiations of the GATT. Audiovisual services are classified as commitments involving ‘programming content’ as opposed to technologies for information transmission, which are classified under telecommunications (WTO Secretariat, 1998b).

Although Hollywood insisted that films were a cultural export commodity just like any other economic product, the French preferred to classify cinema as a national art (Ulf-Moller, 2001, p.xiii). The treatment of audiovisual services became perceived as an ‘all-or-noting’ issue, with the American view emphasizing films as commercial products which ought to be subject to the same rules as all other commercial services and the opposing view arguing that audiovisual products are cultural, “fundamental instruments of social communication” and cultural identity and thus merit exclusion from trade disciplines (WTO Secretariat, 2001b).

At a meeting on October 15, 1993, President Bill Clinton, Valenti, and sixteen leading Hollywood figures issued a statement to the effect that audiovisual services must be included in the Uruguay round agreement, to which the European Union negotiators responded by continuing to seek the inclusion of a ‘cultural exception’ (Granville, 2004).
Audiovisual services, although primarily a US vs. EU battle, became the most inflammatory GATT issue, dividing even the developing nations who mostly banded together (India sided with the US; Brazil with the EU) (Singh, 2000). In the end it was the EU position, hardened by the French government’s determination to protect its film industry, which prevailed and the US was forced to concede in order to conclude the agreements (Granville, 2004). French director Jean Jacques Bienex cautioned his peers against complacency after the win, arguing that an audiovisual services commitment would have completely eliminated European culture – “I wouldn’t exist if there were no subsidies,” he said (Segrave, 1997, p.274).

At the end of the Uruguay Round just thirteen countries had made audiovisual commitments, and a much larger number had taken exemptions to ‘Most Favoured Nation treatment’ in this area. The United States is incorrectly noted as having taken an ‘MFN’ exception when in reality it was the only nation, apart from the Central African Republic, which made commitments in all six audiovisual subcategories (WTO Secretariat, 1998a, 1998b).
### Summary of Specific Commitments - Audiovisual Services

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<td>Dominican Republic</td>
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<td>Mexico</td>
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<td>New Zealand</td>
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<td>Nicaragua</td>
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<td>USA</td>
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<td>X</td>
<td>X</td>
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<td>6</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>17</strong></td>
<td><strong>10</strong></td>
<td><strong>7</strong></td>
<td><strong>8</strong></td>
<td><strong>7</strong></td>
<td><strong>6</strong></td>
<td><strong>55</strong></td>
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</tbody>
</table>

**Source:** World Trade Organization
Even after the round, the United States continued to make the argument, which it maintains today, that although the audiovisual may have unique cultural features, the argument that the sector should not be subject to service sector trade regulations fails to take into account the fact that other sectors which also fulfill critical social policy objectives have been accommodated under the GATT (WTO Secretariat, 2000a). It should be noted that the conclusion of the Uruguay Round in 1994 established the grounds for the creation of the World Trade Organization (WTO) on the 1st of January, 1995, the only global international organization whose purpose is to oversee the rules of trade in multilateral negotiations and to provide an international forum for trade disputes. The WTO agreements, which came out of the GATT, were signed by the majority of the world’s trading nations (World Trade Organization, 2006c).

Following the Uruguay Round, the ministers of the European Commission unanimously voted to double the money given to the film and television industry over the coming five years to $495 million in order to develop their native film industries (Segrave, 1997, p.275). Substantial subsidy programs were initiated in the 1990s by several WTO member nations, including Australia and Canada in addition to the EU (WTO Secretariat, 1998b). Ironically, the two-year fiscal period 1995/1996 was the last in which the United States would use federal public funding ($900 thousand) to support domestic film and video art productions, which had come in the form of small National Endowment for the Arts (NEA) subsidies for nonprofit films. (WTO Secretariat, 1998a).
In the spring of 1995, the MPAA met with the IIPA, the American Film Marketing Association (AFMA), and the Recording industry Association of America (RIAA) to develop a ‘Global Audio-Visual Strategy’ document aimed at implementing to lift cultural protectionism in newer film markets: China, Vietnam, Russia, South Africa, as well as targeting old stalwarts – the EU, Canada, Mexico and South America (Granville, 2004). The document recommended the partnership of US Officials and private sector representatives so as to better explain the US position and gain access to high up foreign government officials. It cited a speech by Don Abaison, Assistant US Trade Representative for services and intellectual property, who had said in February, “We are not about to get into a back and forth debate about the value of French culture versus our culture. The U.S. will focus on ensuring that the new broadcasting technologies, which will greatly expand the choices open to consumers, are not subject to restriction” (Granville, 2004).

### European Public Support for Film and Video, 1994 (million ECUs)

<table>
<thead>
<tr>
<th>Country</th>
<th>Total Subsidies</th>
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<tbody>
<tr>
<td>Germany</td>
<td>76 440</td>
</tr>
<tr>
<td>Austria</td>
<td>14 902</td>
</tr>
<tr>
<td>Belgium</td>
<td>8 150</td>
</tr>
<tr>
<td>Denmark</td>
<td>10 470</td>
</tr>
<tr>
<td>Spain</td>
<td>21 703</td>
</tr>
<tr>
<td>Finland</td>
<td>6 204</td>
</tr>
<tr>
<td>France</td>
<td>124 950</td>
</tr>
<tr>
<td>Greece</td>
<td>4 921</td>
</tr>
<tr>
<td>Ireland</td>
<td>1 673</td>
</tr>
<tr>
<td>Italy</td>
<td>74 408</td>
</tr>
<tr>
<td>Netherlands</td>
<td>9 090</td>
</tr>
<tr>
<td>Portugal</td>
<td>5 489</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1 888</td>
</tr>
<tr>
<td>Sweden</td>
<td>16 304</td>
</tr>
<tr>
<td>Total EU</td>
<td><strong>376 592</strong></td>
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<tr>
<td>Iceland</td>
<td>5 356</td>
</tr>
<tr>
<td>Norway</td>
<td>7 929</td>
</tr>
<tr>
<td>Switzerland</td>
<td>7 897</td>
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<tr>
<td>Eurimages</td>
<td>21 139</td>
</tr>
<tr>
<td>EFDO</td>
<td>11 245</td>
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<tr>
<td>Nordic Film F.</td>
<td>6 439</td>
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<tr>
<td>Gen. TOTAL</td>
<td><strong>10 219</strong></td>
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Source: FIAPF, OECD, ‘Film Funds 1994’
Shortly thereafter Hollywood was thrilled to receive the support of House Speaker Newt Gingrich, who vowed to ‘use the weight’ of the House of Representatives to bring down international trade barriers on behalf of the American film industry and that Congress should ‘easily pass’ retaliatory trade measures against non-complying nations (Segrave, 1997, p.252). Indeed, trade sanctions were used against Malaysia, Indonesia, and Singapore, whose copyright enforcement procedures were not considered up to par and other measures were used in Korea in an effort to further cut quotas and open up the film industry there (Wasko, 1994, p.230).

_Some of the Information Industries Lobby in the Digital Economy 1989-1996_

In the early 1990s something larger than the film industry’s audiovisual dilemma was happening as well. Digital technology was taking off. The ‘Internet Revolution’ was sweeping in and the information industries of America were concerned about intellectual property rights.

As explained in Chapter One, pharmaceuticals and software, like film and music, are ‘experience goods,’ whose value cannot be estimated until they have been tried. To get around this, film companies offer ‘trailers,’ songs are played on the radio, software companies offer free trials, and pharmaceuticals rely on brand equity and product samples. However, the businesses are still extremely risky, with more product failures
than successes, and so the intellectual property that goes into the winning products is at the heart of the businesses’ revenues.

Digital technology makes information even easier to reproduce though still expensive to produce, thus exacerbating the ‘appropriation problem’ faced by the information industries. When intellectual property becomes cheap to reproduce, easily compressed and highly portable, the incentive to appropriate it without investing in the high sunk costs of production becomes very high. Even the formulas for pharmaceuticals can be sent around the globe via email in minutes.

The globalization of the Internet offered a powerful new tool by which to communicate and particularly for the copyright industries, by which to cheaply and globally distribute their products. However, digitization was a double edged sword, threatening to exacerbate the risks of piracy (already being experienced by all these industries) by lowering the appropriation risks and costs. For the patent industries, the digital era and its hastening of globalization afforded an excellent opportunity to further extend their global reach and coordination, though not the possibility of digital distribution.

It is not perhaps not completely surprising then that although the copyright industries had the most to gain and the most to lose from the digital era, it was the patent industries which first made the move to protect their intellectual property on a global scale. In order to remain competitive, business interests must “mobilize to advocate for
changes in trade policy to contribute to their global business strategies” (Ryan, 1998, p.8). It was not enough to recognize that intellectual property is important; action had to be taken to ensure that global IP protection standards measured up to patent industry’s global expansion plans.

In 1989, American pharmaceuticals manufacturers were leading the global market with a share that exceeded $37 billion and in the period from 1990-1994, exports of computer software had doubled (Ryan, 1998, p.2,9). Both industries produced significant trade surpluses for the US economy and both were assertively expanding into emerging third world markets with loose intellectual property protection and governments that opposed intellectual property reform, so now they turned to the US government to aid them in the achievement of world competitive intellectual property rights (IPRs). Without the backing of the US government or the threat of trade sanctions, changing foreign IP policy would be near impossible (Ryan, 1998, p.79)

Using the forum of the GATT’s Advisory Committee on Trade Policy and Negotiation (ACTPN), Pfizer, a leading pharmaceuticals manufacturer, and IBM, a top software producer, had sought to drum up support for their agenda, working closely with the Pharmaceutical Manufacturers Assoc and the Chemical Manufacturers Association to educate key people in Congress on the subject of IP. They formed the Intellectual Property Committee (IPC) in 1986, whose members were primarily software and
pharmaceuticals manufacturers but included one copyright interest (Time Warner),
(Singh, 2000; Ryan, 1998).

Although a study of business-government trade policy interactions at that time
had found US lobbying groups to be, on average, poorly run, the IPC and the copyright
industry’s IIPA were well managed and highly effective (Ryan, 1998), able for the most
part to quickly adapt their business-government relations strategies to the shifting needs
of members. Their effectiveness is particularly marked by their ability to collect and
disseminate intelligence to and from globally networked representatives. Furthermore,
the USTR favored requests for aid in confronting noncompliant trade barriers from
globally competitive export sectors and the information industries had certainly
contributed to the American economy.

Although few people at the USTR understood much about IPRs, under pressure
from the pharmaceutical and software industries the office insisted that the protection of
patents, copyrights, and trademarks be included on the agenda of the GATT Uruguay
Round negotiations in the form of an agreement on Trade-Related Aspects of Intellectual
Property Rights (TRIPS) (Ryan, 1998). By the time the Uruguay Round negotiators met
in Montreal in 1990, IPRs had become a hot button agenda item and one of US
government’s highest priorities. The IP industries brought in expert specialists to educate
policymakers, emphasizing that the enforcement of IPRs helped to encourage indigenous
innovation activities. This example of function-specific diplomacy greatly helped their cause (Ryan, 1998, p.93).

Although dozens of nations had adopted better IP laws on the books since 1989, facing pressure from the USTR’s Special 301 watch list reports and veiled threats, few of them actually enforced them (Ryan, 1998, p.86). The USTR’s efforts had been focused mainly on agreements to draft IP legislation; TRIPS would change that focus to enforcing IPRs. The US government insisted that the Uruguay Round agreements had to be accepted in their totality, which developing nations saw as a threat, although the package included a Dispute Settlement Understanding agreement that would allow them some relief from the threats of US section 301 trade sanctions (Ryan, 1998, p. 93).

One of the biggest initial setbacks to the US strategy, however, came from within the IP industries themselves. The IIPA, representing the film, music, and book industries, had published reports which indicated extensive piracy problems for these businesses in the developing nations. However, the copyright businesses strongly opposed the inclusion of copyright reform on the GATTs agenda, arguing that the international standards were fine as they were and better enforced via the USTR’s Section 301 (Ryan, 1998, p.107, Singh, 2000).

At this time, as previously discussed, MPAA head Jack Valenti was far more concerned with fighting screen quotas and getting an audiovisual agreement onto the agenda. Furthermore, the film, music, and book industries feared the loss of bilateral
policy options by the end of the negotiations, which they saw as unpredictable (Ryan, 1998, p.107). The USTR hosted several hostile meetings with the copyright interests to urge them that TRIPS would best serve their long-term interests. Seeing that the USTR was firmly committed to the strategy, the film, music, and book businesses reluctantly pledged their support (Ryan, 1998, p.107).

The so-called Group of Ten developing nation GATT members, four of which appeared on the IIPA and PhRMA Section 301 trade agendas from 1989-1994, opposed the inclusion of IP as well, although for different reasons. Seeing IPRs as contrary to the needs of emerging markets they refused to negotiate until the USTR initiated sanctions against South Korea and Brazil, scaring the Group of Ten to the GATT table with the threat of bilateral trade sanctions for all of them (Ryan, 1998, p.108).

Throughout the negotiations the American trade negotiators remained in close contact with the IPC, the IIPA, and PhRMA, although the MPAA was not particularly active on the subject of TRIPs. However, the TRIPs agreement was successful and in 1994, the final agreement institutionalized global standards for intellectual property rights in what is seen as “the most important legal advance for the world trading system since the establishment of the General Agreement on Tariffs and Trade (GATT)” (Ryan, 1998, p. 1).

Hollywood became more active during the negotiations of the World Intellectual Property Organization treaties, signed by 160 countries two years after TRIPS in 1996.
(Schiesel, 1996). As in TRIPs, the American software industry first led the campaign for WIPO, arguing that the growth of digitization was cause for tighter international copyright laws, although this time it was quickly joined by the Recording Industry Association of America (RIAA) and the MPAA (Schiesel, 1996). The Software Publishers Association (SPA) and the RIAA were predominantly concerned with piracy which was costing them $13 billion and $2 billion a year, respectively, and which they thought would grow quickly as pirates discovered the Internet. The MPAA’s top issue for WIPO, which would have an audiovisual section, was ‘national treatment’ – the equal treatment of foreigners and locals for US film producers operating overseas who were blocked from receiving European royalties on the sale/rental of video tapes (Schiesel, 1996). The new treaty on phonograms would now cover audiovisual, as well as sound recordings, and extend protection for US entertainers – a proposal that the Hollywood trade association had had a strong bearing on (Schiesel, 1996). Overall the WIPO treaties – one covering artistic works and the other covering recorded music – reflected a change in international copyright law in response to digital technology, encouraging the copyright industries to create digital content.

**Guarding the Home-front: Our Problem is Domestic, not Digital 1993-2000**

Throughout the late 1980s and early 1990s, several electronics hardware firms were developing technologies to digitize entertainment content. Although this proved too
expensive at first, in 1993, Sony and Toshiba introduced a product called the digital video disc (DVD), a CD-size optical disc that would digitally store a full-length feature film (Epstein, 2004, p.212). The product would not debut until 1996.

DVDs were much more efficient than existing VHS tapes. They did not have to be recorded individually but could instead be ‘stamped out’ in the masses at the factory, allowing much greater economies of scale. This meant huge profits for the movie studios but also huge risk in the form of digital piracy. Thus, there was much argument and opposition before the product could be introduced. Despite the growing popularity of Video Compact Discs (VCDs) overseas, the threat of unauthorized copying meant that Hollywood was delayed the DVD’s release, although it was a natural market substitute for the DVD (Wood, 1996). However, though they were extremely concerned about domestic disc piracy, at this time the industry did not think about global protection standards for digital content.

Without Hollywood’s blessing, the electronics manufacturers could not proceed, given that a DVD without content is worth nothing. All the value lies in its ability to port intellectual property. However, when the electronics manufacturers and Hollywood had finally agreed on a format and appropriate encryption, the computer and music industries insisted on taking part in the process with their own concerns about technical specifications on inter-compatibility, as well as piracy (Burgess, 1996). The music industry at this time was already consumed by the problem of digital intellectual property
rights, as the majority of copyright laws governing music are administered domestically but the Internet is linked to international networks (WTO Secretariat, 1998b).

Although Time Warner and Sony put their titles out on DVD immediately when it came out, only one other studio followed suit right away and some, like Paramount (owned by Viacom) waited over two years until 1998, worried about theft (Burgess, 1996, Epstein, 2004, p. 214). Despite the initial caution, by 1999, DVDs represented 11 percent of the studios home entertainment revenues compared to 30 percent from video rentals and by 2003, DVD rentals represented 76 percent and video rentals represented only six percent (Epstein, 2004, p. 214). Although the video business produced more than $1 billion in revenue for 2005 it is swiftly shrinking and will likely soon disappear.

Strangely, the movie studios responded to the growth in domestic DVD sales by cracking down on domestic video piracy, although the future of the industry was clearly in digital video content (see table at left). However, in 1996 the video market was still dominant. So, throughout the year the MPAA’s anti-piracy units, in
partnership with local law enforcement, conducted 1,200 raids in several cities across the country, increasing the number of unauthorized copies of videocassettes seized by 30 percent over the previous year (Wood, 1996).

Although the MPAA was conducting some investigations abroad, having opened units in Brussels, Singapore, and Rio de Janeiro in the past few years (Wood, 1996), the main focus of the association was on domestic physical (as opposed to digital) video piracy. Illegal video pirates had a ten percent share of the US rental market. Meanwhile, the music and electronics industries were discussing copyright standards for the digital audio disc, forecasting that rather than “buying an album or a single from a shop, music will be delivered to consumers online” (Rawsthorn, 1996). Although the sound quality of music distributed online at that time was poor, the music industry was convinced that consumers soon download music from their computers onto digital discs and thus sought to gain stronger digital copyright protections to dissuade international copyright thieves (Rawsthorn, 1996). The industry was quickly proven correct.

In 1997, the International Federation of Phonographic Industries (IFPI), the global music industry body, and the RIAA partnered to attempt to shut down South Korean websites offering entire music albums for free download (Hayes, 1997). The difficulty at that time, noted industry executives, was that in South Korea nothing illegal had occurred. No copyright laws existed in that nation for the protection of digital content, although the IFPI had successfully argued for the inclusion of copyright protection of the
digital delivery of music into the WIPO treaties (Hayes, 1997). South Korea would not become party to the WIPO treaties until June 24th, 2004 (IIPA, 2006).

The software industry was also concerned about foreign digital piracy, reporting in 1997 that it had lost $3 billion in revenues (Borell, 1997). That year it placed pressure on the US government to force China to do something about software piracy (Borell, 1997), particularly in light of the WIPO treaties negotiated the year before, which China still to this day has not signed. A congressional hearing was held on the state of intellectual property rights in China and soon afterwards, the US government used trade pressure to push the nation to comply. The software industry also conducted ‘International Day,’ that year a software summit of trade associations at which software industries of the US, Europe, and Japan discussed a worldwide strategic anti-piracy plan (Borell, 1997).

Even so, in 1998 China was still a huge piracy zone, just as much for illegal copies of VCDs of American films as for software titles. After a few years of attempting to enforce anti-piracy regulations, the Chinese government had simply begun to turn a blind eye to illegal sales of VCDs (Faison, 1998). 500,000 pirated video discs were shipped daily into China from Macao, according to the music industry’s IFPI association, although China had signed an intellectual property rights agreement with the United States in 1995 (Faison, 1998). Despite the open concessions of Chinese officials that little was being done to enforce movie copyrights, the US government had let IP protection
“drift of [the] list of priorities” as they prepared for President Clinton to visit China that summer (Faison, 1998).

The then assistant United States trade representative for IP in Washington stated that fighting piracy in China was a long-term goal but admitted that he was unaware of the extent of China’s piracy problem (Faison, 1998). More significantly, the MPAA’s chief representative in Asia, Michael Connors stated that he “didn’t have any complaints” and was unaware from his base in Singapore that pirated films had become so common in China (Faison, 1998). He noted that pirated movies were a worldwide problem but that the MPAA was setting up a team of investigators to “crack down on the problem” domestically in New York City (Faison, 1998).

Later that year, when asked what the top priorities were for the member studios of the MPAA, Jack Valenti listed piracy amongst them but focused on self-regulation, quotas, and trade wars, specifically “the fight against barriers governmentally imposed all around the world” and how to avoid being “baffled by foreign governmental regulations” (Valenti in Macnab, 1998). He listed his greatest achievement at the MPAA as “making sure that the American movie can move freely and unhobbled around the world (Valenti in Macnab, 1998). “Piracy,” griped Valenti, was going to be the “great new danger” of the digital era because “the idea of private property is a foreign concept in some countries” but then he noted that given the number of people attending US cinema
theatres, his worries were “a little misplaced” (Valenti in Macnab, 1998). At that time, the box office was already a loss leader, making little money for Hollywood on its own.

A year later, as DVD sales were taking off, Valenti submitted a report to the USTR to the effect that Malaysia, as well as 62 other countries, had become a dangerous hub for international movie piracy (Boliek, 1999). He estimated that these countries, particularly Israel, Kuwait, China, and Paraguay, had cost the American film industry $12.4 billion in potential trade losses (Boliek, 1999). The IIPA noted also that Malaysia’s enforcement of copyright agreements was poor and that illegal copying was occurring of both DVDs and VCDs (Boliek, 1999).

That same year, 1999, the Hong Kong film industry nearly crashed due to video piracy. Although VCD technology was unpopular in the United States, where the DVD ruled, in Asia the format proved cheap and convenient, especially for copying (“Pirate’s Paradise,” 1999). Unlike VHS cassettes, VCDs did not degrade in quality with copying and could be produced quickly in bulk. They could be played on any DVD player and unlike DVDs, featured no regional coding restrictions. The Hong Kong film industry quickly shrank from 300 movies annually in the early 1990s, when it was the world’s...
largest exporter after America, to 100 by 1997 and just 50 films by 1998 ("Pirate’s Paradise," 1999). As the pirate’s market share grew to 40%, box-office revenues fell by 15-20% a year throughout the decade ("VCD’s killed," 1999).

Similar problems had occurred in Taiwan, which had shut down its film industry a few years earlier, and in mainland China. The Hong Kong film industry predicted its own demise in two years, with the Motion Picture Industry Association head, Woody Tsung, stating that Hong Kong had the worst piracy situation in the world ("VCD’s killed," 1999). He expressed hope that a possible box-office revival would save the industry, noting the success of the movie ‘Stormriders’ in 1998, despite piracy ("VCD’s killed," 1999).

Unaware of this occurrence overseas Hollywood was focused on the home front. The MPAA had lobbied House Speaker Newt Gingrich, who had pledged his support to the industry in 1995, very hard for a piece of legislation called the Digital Millennium Copyright Act (DMCA). The law was passed in 1998 and prohibited the “circumvention of a technological protection measure that effectively controls access to a work’ for any reason, and the manufacture or provision of any technology designed to assist in circumventing technological protection” (Litman, 2001, p.126). The DMCA was so strict that that no fair use privilege was written into the legislation at the insistence of the content industries, who claimed that it would encourage piracy (Litman, 2001, p.138).
Absurdly, it was not until 2000 that journalists and digital industry consultants claimed the film industry was “experiencing its first jolts from Internet piracy,” (Snider, 2000) although the music industry was at that moment already suing Napster, the peer-to-peer music file swapping site. Though some trade was occurring in digital movie files, the industry believed that the ‘average’ person was not going to be downloading film files for a while, stating that films had come at the end of the “grand food chain of cyber-piracy,” (Snider, 2000). MPAA spokesman Rich Taylor claimed that the MPAA knew that digital online piracy had arrived but until then the MPAA’s online anti-piracy enforcement efforts in early 2000 consisted of an educational campaign and notifying universities about problem websites (Snider, 2000)

_A Faulty Deposition and a Change of Heart 2000-2001_

In the Spring of 2000, all six major media corporations sued Emmanuel Goldstein, an Internet journalist, for a violation of the DMCA (“Hollywood and the Hacker,” 2000). Mr. Goldstein, who ran an online newsletter – _The Hacker Quarterly_ – had published a code called DeCSS, able to unscramble encrypted DVD content (“Hollywood and the Hacker,” 2000). Although one would have to buy the DVD to unscramble it in the first place, and although intentional DVD pirates could simply copy DVDs without having to break the CSS encryption, the studios asserted that Goldstein
was violating the portion of the DMCA that prohibits encryption ‘circumvention’ (Litman, 2001).

Jack Valenti was called in as a witness to the case in June, during which he was asked a number of questions pertaining to digital technology. During his deposition he stated that he had never had a conversation with the hardware makers of DVDs about piracy, nor did he understand how the encryption technologies worked (Valenti, 2000b). He had no idea whether it was possible to put a DVD de-encrypted by DeCSS on the internet, although he was firm on why such a decryption was a violation of the DMCA he had lobbied so hard for (Valenti, 2000b).

Although the DeCSS code originated in Norway, Valenti was unaware as to whether any DeCSS websites existed overseas. He had had no idea that it was possible to pirate DVDs without even using the DeCSS code or that those techniques were being used in Hong Kong. Valenti stated that he had spoken publicly about the problem of camcorders being used to copy movies as a major MPAA concern but emphasized that it was in analog form (Valenti, 2000b). He did not know if such films could be shown on the internet and was unaware as to what, exactly, his chief technology officer, was concerned with. Additionally, Valenti did not know whether it was possible, or legal, to put a DVD copy online or what the quality of a de-encrypted DVD was, or even what, exactly a DVD burner was (Valenti, 2000b).
Valenti was very firm on the fact that piracy was a worldwide problem costing the film industry billions of dollars but did not know what portion of that piracy was digital, as opposed to analog. He was unsure as to whether anyone at the MPAA had done a breakdown of how much loss was due to specific piracy sources, such as camcorders or VHS tapes. He admitted that he went online only to email and had never used a search engine or surfed the web (Valenti, 2000b).

In an April 14 letter to Senator Dianne Feinstein of California, Valenti had written that “just a few keystrokes on an ordinary household computer” could enable people worldwide to make perfect copies of DVD movies. However, he said he had gotten that information from someone more ‘technically aware’ at the MPAA and did not know whether what he had said was actually possible (Howe, 2000).


One week after his deposition Valenti announced that the matter of digital piracy was so important to the MPAA that the organization was going to create a “digital strategies” department to look for industry solutions to the problem. Although no one had yet been hired to run it, he stated that he would hire a department chief by the end of the month (Albiniak, 2000). At that time, Disney was the only one of the big studios publicly lobbying congress for a law that would require internet-service providers to recognize an online digital watermark that would identify copy protected content and protect it from
digital piracy (Albiniak, 2000). “[digital piracy] is the most devastating thing that has happened to the entertainment industry in 75 years,” testified Disney Head Michael Eisner before the House-Senate Joint Economic Committee (Albiniak, 2000).

As DVD sales continued to grow and foreign revenue became increasingly important to the industry, the MPAA began to take more visible action against the problem of digital piracy, noting that the music industry suffered highly from it already. A lawyer who had specialized in IP issues for the software industry since the 1980s theorized in a newspaper interview that Hollywood was becoming much more worried about piracy because “their traditional strength” was “evaporating” (Evangelista, 2000). Jack Valenti publicly claimed that he would file a thousand lawsuits a day if necessary to protect control of the industry’s ‘creative works’ (Evangelista, 2000).

The movie industry began to take the path set out by the software and music companies before it – an educational campaign now accompanied by selective enforcement, such as joining four major broadcast networks in a lawsuit against a Canadian website for retransmitting over the air broadcasts of television shows and movies through the Internet (Evangelista, 2000). However, although the music industry moved quickly to try to control Internet music distribution services and offer some legal competition, the movie industry offered nothing despite the fact Hollywood blockbusters were showing up on hundreds of websites worldwide shortly after release. Critics said the movie industry’s fight against digital piracy was “more show than substance”
(Evangelista, 2000). By the end of 2000, the MPAA had approximately 150 people working at its anti-piracy division and has hired numerous people since then, culling them from the FBI, the USTR, and other agencies of the US Government.

The MPAA Digital Strategy Department was finally initiated in 2001, and declared that it would monitor current and future media technology to pinpoint potential copyright threats before they arose (“Glickman Named,” 2004). By mid 2002, entertainment industry executives were meeting with government officials to discuss what substantive action could be taken to solve the problems of digital piracy. Andrew Setos from Fox Entertainment Group (News Corp) emphasized the necessity of digital rights management, a software solution to protect audiovisual content in a way that is persistent, while Elizabeth Frazee from Time Warner pushed for government intervention in helping to ratify agreements between the content and consumer electronics industry, which was pushing for ‘fair use’ provisions on behalf of customers (Department of Commerce, 2002).

Although a music industry executive noted that it was possible to compete with piracy by offering something better, Preston Padden from Disney countered with the argument, supported by the other film executives and Jack Valenti, that the film industry deserves a marketplace where property rights are respected because it 80-100 million to make a film and the industry contributes to the American economy (Department of Commerce, 2002). The film industry noted specifically the need for the government to
implement legislation into the domestic IP infrastructure that responds to the issues of the ‘analog hole’ – analog video players drop encryption when they translate digital signals – and of peer-to-peer online piracy (Department of Commerce, 2002).

In 2003, Americans spent $22.5 billion on DVDs and videocassettes compared with $9.2 billion at the box office, where receipts fell slightly and would continue to fall over the next three years (“Romancing,” 2004). Although the growth of DVD sales, which overtook VHS sales in 2001, was bringing in much needed revenue, propping up the high costs of film production, Hollywood grew ever more concerned about piracy. Content licensing to home entertainment products was now producing the bulk of industry revenues, emphasizing the industry’s vulnerability to inroads by pirates.

The MPAA was well aware the growth of DVD player sales, a good sign for DVD movie sales, was catching up overseas with US consumption but that simultaneously the incidence of DVD counterfeiting in Asia was rising fast. VHS and VCD piracy had now been replaced by three forms of DVD piracy: using a camcorder in the theatres then burn the content to DVDs, making unauthorized copies of legitimate DVDs, and burning DVDs from video files obtained online (“Romancing,” 2004). The last method, like all online crimes, is the most difficult to trace and thus gives rise to the most concern. Where there are physical tapes and disc factories, there can be police raids. When the content becomes completely digital how will the authorities know where to look?
In the past five years the film industry has used some of its old strategies, and some new ones, to fight the new problem of digital piracy. It has launched an educational commercial and advertising campaign against piracy, featuring film industry technicians and other low-profile ‘behind the scenes’ workers. Since 1990 the association has had three ‘Directors of Worldwide Anti-Piracy’ operations (all recruited from top positions at government law enforcement agencies), William Baker from the CIA (‘Romancing,’’ 2004), and Ken Jacobsen and John Malcolm, both previously of the FBI (Meyer, 2001; ‘Testimony of John Malcolm,’’ 2004). The MPAA has used litigation, raided countless disc factories domestically and abroad, and lobbied congress for stronger domestic IP legislation. The defendants in its lawsuits now include peer-to-peer operators as well as websites and the more traditional illegal disc manufacturers, such as the case of MGM Studios vs. Grokster, in which the US Supreme Court unanimously ruled that Grokster was liable for copyright infringement in the form of encouraging users to violate copyright law (Mennecke, 2006).

In 2004, the Film & Television Action Committee and the International Cinematographers Guild asked the Department of Commerce to take action against foreign governments' filmmaking subsidies (‘H’wood orgs,’’ 2004). Additionally, in early 2006 the MPAA has announced an even greater escalation in the anti-piracy war, launching seven lawsuits against indexing servers, including, incredibly, the NZB Newsgroup indexing site (Mennecke, 2006).
In the 2000 Universal vs. Corley deposition, Jack Valenti claimed that the MPAA had only two government relations representatives designated to lobby congress. Today there are eleven government relations personnel listed on OpenSecrets.Org, including current MPAA head Dan Glickman, a former congressman and agriculture secretary in Bill Clinton's administration who replaced Valenti in 2004 (Valenti retired) and vowed to make piracy his top priority. Another is Ken Inouye, the son of Hawaii senior Senator Daniel Inouye, Co-Chairman of the Commerce Committee.

The MPAA’s lobbying efforts have resulted in tough proposals by US Attorney General John Ashcroft to crack down on worldwide entertainment piracy, which led to the expansion of the CHIP (Computer Hacking and Intellectual Property) program and the establishment of an IP Task Force (“Testimony of John Malcolm,” 2004). Additionally, there have been increased federal law enforcement efforts by the Department of Justice and the Department of Homeland Security, including Operations Digital Gridlock, Fastlink, and Buccaneer and overseas Operations Spring and Big Broom (“Testimony of John Malcolm,” 2004). In fact Operation Big Broom, which concluded in late January of 2006, resulted in the arrest of 807 people and the seizure of almost 6 million optical discs across Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, New Zealand, the Philippines, Singapore, South Korea, Taiwan and Thailand. The MPAA noted that it had heavily cooperated with both law enforcement
agencies and national governments across the Asia-Pacific region for a total of three regional ‘sweeps’ in 2005-2006 netting 17 million optical discs (Ellis, 2006).

Furthermore, the MPAA has been successful in Congress, convincing Senator Fritz Hollings to support legislation in 2002 that would require a piracy-detection system to be built into all digital entertainment devices, including computers (‘Mr PC,’ 2002).

The Digital Transition Content Security Act of 2005, a bill sponsored by House Judiciary Committee chairman James Sensenbrenner (R-Wisc) and congressman John Conyers (D-Mich), also on the Judiciary Committee seeks “to require certain analog conversion devices to preserve digital content security measures,” in essence plugging the ‘analog hole’ 18 (LeClaire, 2005). If passed, it will also require electronics manufacturers to produce devices capable of detecting irremovable watermarks on content via a ‘Content Generation Management System’ and Video Encoded Invisible Light (VEIL), both protection signal technologies (Baksh, 2006). The Digital Transition Content Security Act precedes yet another bill, the Digital Content Protection Act of 2006, for which the legislation was introduced in February of 2006. The act, if passed, will prevent redistribution of digital over-the-air television from Internet piracy and at the same time limit the fair use of copyrighted content (Baksh, 2006). Additionally, in March, 2006 current MPAA chairman and CEO Dan Glickman thanked House Speaker Dennis Hastert

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18 This refers to the problem of analog video players ‘dropping’ digital encryption when they translate signals from digital to analog.
who unveiled the Republican High-Tech Working Group and pledged to “protect American intellectual property in the digital age” (MPAA, 2006).

Most significant of all is the MPAA’s double-pronged strategy to get the US government to target foreign movie piracy in its negotiations with foreign governments. The first part has been to convince the US government to prioritize the issue of foreign traffic in illegal copyrighted goods by linking it to the existing anti-terrorism initiative and the second part has been to urge the USTR and the State Department to move intellectual property rights and enforcement to the top of the US bilateral free trade agreement agendas.

In a 2003 hearing before the House International Relations Committee, Jack Valenti stated that the preferred funding method of organized criminals worldwide was to get rich “from the high gain/low risk business of stealing America’s copyrighted works” (“Prepared Statement of Jack Valenti,” 2003). Providing the committee with a supplementary report written by Mike Ellis, his director for Anti-Piracy in the Asia/Pacific region, Valenti reminded the policymakers that US industry does not have the tools to launch a grand initiative to protect IPR; only US government does (“Prepared Statement of Jack Valenti,” 2003).

Valenti attempted to build a case to link terrorism and IPR violations, claiming that the participants at a 2001 IPR conference hosted by Interpol in Lyon, France unanimously agreed that trafficking in pirate products accounts much of international
terrorist network funds (“Prepared Statement of Jack Valenti,” 2003). He contended that
the link between piracy and organized crime was widely endorsed by the US government,
numerous foreign governments, the European Commission, and Interpol, citing the
establishment of the Interpol IP Crime Action Group and the report of the Police Service
of Northern Ireland Anti-Counterfeiting and Racketeering unit that Irish paramilitary
organizations prefer to fundraise by counterfeiting19 (“Prepared Statement of Jack
Valenti,” 2003). September 11 did not only change the way that Americans look at the
world, Valenti argued, “It also changed the way American law enforcement looks at

In 2004, John Valenti sent his new MPAA Worldwide Anti-Piracy Operations
Director John Malcolm, a former deputy assistant attorney general responsible for
overseeing the Department of Justice’s Computer Crime and Intellectual Property
Section, to testify before the House Government Reform Committee. As Valenti had
done many times before him, Malcolm began his argument by emphasizing that the
American film business is the only industry in America that has a surplus trade balance
with every single country in the world, asserting that the continued economic health of
the film industry is in the national interests of the United States (“Testimony of John

19 It should be noted that Northern Ireland has never appeared in the USTR’s special 301 reports, nor has it
appeared on the yearly piracy reports submitted by the IIPA and thus one may conclude that the piracy
problem in this area is not pronounced.
Referencing the MPAA’s anti-piracy programs in over 60 countries Malcolm asserted that in 2003 the MPAA had participated in no less than 32,000 raids and seized 52 million pirated optical discs (“Testimony of John Malcolm,” 2004). He avowed that the pirates, with rare exceptions, were dangerous criminal syndicates and large gangs who fund their piracy operations with capital obtained by drug dealing, gun running, human trafficking and vice versa (“Testimony of John Malcolm,” 2004). Like Valenti, Malcolm quoted Interpol Secretary General Ron Noble who was alleged to have said that IP crime is the “preferred method” of funding for some terrorist groups (“Testimony of John Malcolm,” 2004). As a final piece of evidence he offered the dubious argument that the countries that are big piracy offenders, like Pakistan, Malaysia, and Indonesia are also countries where terrorist organizations are known to operate (“Testimony of John Malcolm,” 2004), although they are also countries classified as developing and there is an established connection between developing markets and weaker IP regimes. As countries develop their economies and industries begin to innovate, the emerging market will often creates its own impetus to protect IPRs.

By 2005, global piracy had exploded in many emerging markets (see table below). An Interpol report indicated that the global piracy market was worth 450 billion dollars, dwarfing even the global narcotics trade (300 billion dollars) and accounting, remarkably, for seven percent of all world trade (Mustafa, 2005).
## Estimated Losses due to Motion Picture Piracy (1995-2005)

($ millions USD)

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<td><strong>58.4</strong></td>
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* 2000 avg. yearly losses were calculated using 2004 numbers for countries for which 2005 data could not be obtained.
- Countries with data for less than 7 years were not included, with the exception of Hong Kong.
- Countries with average levels of piracy below 5.0 million were not included.
- N/A refers to data that could not be obtained on motion picture piracy for that year.

**Source:** Data compiled from *Intellectual Property Alliance Individual Special 301 Reports 1995-2006*
Film Diplomacy: Hollywood Protection on the Foreign Trade Agenda

Of all the actions that the MPAA has taken to fight digital piracy between late 2000 and early 2006, the most significant in terms of long-lasting global industrial impact is their bilateral audiovisual trade initiative, most visible beginning in 2002. Information industry business-government-relations professionals necessarily examine the ramifications of current bilateral trade agreements and domestic legislation to ensure that they simultaneously protect content from intellectual property piracy overseas and maximize content licensing rights. The MPAA, well beyond a mere consideration of free trade agreement (FTA) impacts, has worked closely with the Commerce Department to “ensure that piracy remains at the top of our bilateral commercial agenda with key countries” and that where there are violations the State Department will bring “the weight of US diplomacy to bear on international piracy situations” (“Testimony of John Malcolm,” 2004).

Far from attacking simply tariffs, taxes, and quotas, the film industry association’s reach has shifted and expanded to control intellectual property in these negotiations in all its iterations, including but not limited to anti-piracy measures, e-commerce, IPRs, digital rights management, and ancillary licensing rights. Because of the blurring of information industry boundaries in the digital era and the fact that films are now just one business amongst the many media interests of the ‘big six,’ the film industry coalition also considers the protection of intellectual property across a wide variety of business sectors.
new media, videogames, software) that weren’t as relevant before in order to maximize content licensing rights in the ancillary markets.

From 2002 to 2006 the film industry’s new audiovisual strategy has manifested itself in bilateral FTA negotiations between the United States and Chile, Singapore, Australia, Bahrain, Thailand, Korea, Oman, Panama, Malaysia, UAE (United Arab Emirates) and in regional FTAs with the Andean nations (Peru, Columbia, Ecuador) CAFTA-DR (Central American, Dominican Republic) and SACU (South African Customs Union).

In 2000, in a communication to the WTO, the United States emphasized that the time had come for the perceptions about the audiovisual sector in trade negotiations to change. The missive emphasized that while the audiovisual sector has “sometimes been framed as an "all-or-nothing" game,” there is no reason to choose between total liberalization and the complete exclusion of culture from trade agreements (WTO Secretariat, 2000a). For the first time, the US indicated that it wished to develop “an understanding” on subsidies that took into account each nation’s “need to foster its cultural identity by,” including steps to “subsidize theatrical film production” as long as they were “carefully circumscribed” (WTO Secretariat, 2000a). The United States was joined in its sentiments by famously neutral Switzerland, who declared in its own 2001 Communication to the WTO that “despite the ideological trade policy debate about audio-visual services, private operators have obviously managed to find a way to live
fairly closely together” and thus there is “no reason” why trade policy terms can’t be
created “without unduly encroaching on Members' competence to pursue their national
audio-visual policies” (WTO Secretariat, 2001).

Such a statement by the United States, although somewhat cautious, indicates a
strong departure from the Hollywood attitude against cultural protectionism for over 70
years. More importantly, it belies a move in other directions as reflected in the MPAA’s
2001 statement to Congress that it sought to prevent foreign governments from adopting
market-closing measures for digitally delivered content (Bernier, 2004). After a long life
as the ‘be all and end all’ of American film industry foreign trade issues, cultural
protectionism may be slipping off the agenda.

In 2002, the US Government supported the film industry by calling for countries
to schedule WTO commitments that “reflect current levels of market access in areas such
as motion picture and home video entertainment production” while simultaneously
asserting the need to keep free of trade barriers in electronically delivered audiovisual
products (Bernier, 2004). Since then, a WTO communication from Hong Kong has noted
that out of 62 nation’s initial or revised ‘offers’ to the WTO, 26 include offers in the
audiovisual sector, predominantly in areas regarding motion pictures and videotape,
including six new-revised offers (WTO Secretariat, 2005).
The subsequent US FTA negotiations are characterized by the following strategies:

1) The demand that enforcement measures be implemented against copyright violators
2) The greater acceptance of subsidies and other financial support strategies for native film industries
3) The yielding of traditional arguments that quotas, local content requirements and other trade barriers be completely removed in the audiovisual sector (Bernier, 2004)
4) The demand that digital trade/e-commerce be free from trade barriers (Bernier, 2004)
5) The adoption of the ‘negative list’ approach to scheduling trade commitments, meaning that nations are bound in all services sectors except where they specifically list reservations or exceptions (Bernier, 2004).

The last of these strategies, the ‘negative list’ approach, was first used by the United States in the NAFTA (North-American Free Trade Agreement) and is highly significant in that it generally results in a much fewer number of reservations or exceptions from each party (Bernier, 2004). With the ‘positive list’ approach parties need only abstain from commitments to make a reservation as opposed to specifically listing it. Thus, instead of pressure in just those audiovisual sector areas in which a party demands a specific commitment that has not made, there is pressure to defend all reservations, sensitive or not. Furthermore and most importantly, those states which are not well
educated in this area (particularly less developed nations with fewer resources) may end up “fully committed by default” (Bernier, 2004, p. 4).

In 2002, the United States signed an FTA with Chile which reflected the beginning of a loosening of US resistance to ‘cultural protectionism.’ In the area of traditional telecommunications (satellite broadcasting, direct television etc.) Chile reserved the right to maintain its existing cross-border trade measures and also maintained the right to maintain market access measures, with specific sector exceptions explicitly mentioning live entertainment services but not audiovisual services (Bernier, 2004). Chile also negotiated to maintain its general requirement that programs broadcasted on public television, not including cable or satellite television, include up to 40 percent Chilean content (Bernier, 2004). However, the negative list approach indicates that this was the only area of the audiovisual sector in which Chile chose to impose quotas or local content requirements.

Singapore, which signed an FTA with the US in 2003 that entered into force in 2004, made two reservations in the cultural services area – the first indicating an exception to basic obligations concerning national treatment\textsuperscript{20} and MFN treatment\textsuperscript{21} in the area of public broadcasting services only, not including pay services and the second indicating the same in the area of printed materials (Bernier, 2004). The Singaporean

\textsuperscript{20} This states simply that if a nation grants a particular right to its own citizens, it must also grant that advantages to the citizens of other nations while in that country.

\textsuperscript{21} MFN or ‘Most Favoured Nation’ treatment simply means a nation must grant each nation under the agreement any trade advantages or privileges that it has granted to any other nations.
national treatment and MFN reservations marked the beginning of a trend of similar reservations in the audiovisual sector by other countries negotiating FTAs with the United States.

In the negotiations with CAFTA-DR, which concluded in 2003 except for Costa Rica and the Dominican Republic (2004), the six countries (El Salvador, Guatemala, Honduras, Nicaragua, Costa Rica, Dominican Republic) made few significant reservations in the services sector. El Salvador, Guatemala, Nicaragua and Honduras made reservations concerning market access restrictions but all explicitly chose to leave the audiovisual sector open (Bernier, 2004). Like Singapore, these four countries also indicated exceptions to national and MFN treatment, but they are minor. As an example, Guatemala indicates that international entertainers performing in Guatemala must have a consent letter from a legally recognized Guatemalan artist union and that preference may be given to nationals in mixed performances (Bernier, 2004).

Costa Rica, in contrast, instituted a few more reservations in addition to the ones undertaken by the other four, including one that stated that foreign programming should be limited to 60% of programs aired on domestic television daily and one which institutes minimum ownership by Costa Rican citizens or companies in the audiovisual industries (Bernier, 2004). Significantly, the nation stated that “government supported subsidy programs for the promotion of cultural activities are not subject to the limitations” (Bernier, 2004, p.12). The reservations made by the Dominican Republic are very similar
except that for every three soap operas broadcast for a local audience, one must be locally produced and filmed (Bernier, 2004).

Looking at these negotiations between 2002 and 2003 alone it is clear that the United States allowed myriad instances of content requirements, subsidies, and other barriers to free trade in film it would have likely opposed in the past. In fact, as laid out earlier in this chapter there are several instances throughout the post World War I era where the United States did ardently fight such measures with protests and threats of economic sanctions! Given the history of the US as a particularly strong negotiator with high bargaining leverage, one can only conclude that after 2002 cultural exceptions were no longer a high priority.

Australia’s list of reservations in the audiovisual sector is particularly complicated and developed, with strong safeguards in place for the promotion of Australia’s cultural industries. For example, the nation retained its commercial television quotas, although it did agree not to increase them, which require that 55% of programming be Australian and that television pay services spend 10% of their program budget on new Australian drama with a provision to increase that amount to 20% and or extend it to other genres (Bernier, 2004).

Tellingly, in the area of ‘new media’ services, which includes audiovisual content on the internet and interactive audio/video services, the United States was not so lenient. The only measures allowed here were those which ensured that Australian content would
not be denied to Australian consumers and this restriction applied only to businesses operating in Australia.

Consider the negotiations with Morocco, which began in 2003 and concluded in 2004. Morocco chose not to impose any local content requirements or quota measures. Rather, two reservations taken involved existing requirements that production companies established in Morocco must be organized as limited liability corporations and that they must have produced, as a Moroccan-established business, at least one feature-length film or three short films in Morocco (Bernier, 2004). Like the CAFTA-DR countries, Morocco chose to make a national treatment and MFN exception with respect to cultural activities, explicitly including subsidies in support of cultural industries (Bernier, 2004). Another reservation requires cable/satellite services that provide encryption based subscription services to have a local representative and the last reservation allowed for the possibility of local content requirements but only in the area of investment in radio/television/cable broadcasting by American investors (Bernier, 2004). Although these reservations, along with Australian measures, seem to indicate significant US concessions, it is important to consider that no reservations or exceptions were allowed in the online and non-broadcasting environment. Remarkably, even the possibility of adopting new exceptions in these areas has been excluded, a condition that occurs in all the following trade agreements (Bernier, 2004).
Each of the preceding five agreements also included stricter provisions for intellectual property protection and the enforcement of such protection. Morocco, which launched free trade negotiations with the US in 2003 and concluded them in 2004, included measures to further protect IPRs and institute enforcements against piracy as well (Shelby, 2005). In general, for all negotiations IP protections were brought to the standards implemented by the two 1995 WIPO treaties, and very close to those implemented domestically by the US government (Smith, 2003, 2004, 2006). Enforcement mechanisms and obligations by national governments to carry them out, particularly in the national courts, were advanced and clarified (Smith, 2003, 2004, 2006).

A common provision specifically noted that courts must impose “deterrent and fully compensatory civil damages, including the use of the retail price of the product (rather than the pirated price)” as a measure of the right holder’s loss (Smith, 2003). Specifically, the damages charged must be high enough to deter future criminal activity (Smith, 2003).

Provisions with regards to piracy were highly strengthened. They included requirements that customs and criminal authorities could act ‘ex officio’ without the need for a right holder complaint, that piracy be criminalized on a commercial scale, that criminal penalties be high enough to deter piracy and that optical media production should be carefully regulated (Smith, 2003).
The US-Bahrain, US-Peru, and US-Oman FTAs, which concluded negotiations in 2004 and 2005 (Peru & Oman), respectively, are a strong example of the implementation of these provisions. The text of the Bahrain agreement requires that the copyright law be updated to reflect the ‘full scope of exclusive rights’ of copyright holders, including the right to publish online (Smith, 2004). Additionally, protections against the circumvention of rights management information (similar to those in the DMCA) are outlined, as well as requirements for the modernization of protection for computer programs and databases (Smith, 2004). Criminal penalties against piracy are significantly increased, particularly in the areas of circumvention and rights management information violations, and the ‘ex officio’ provision holds in both the criminal and customs areas, with specifications to hasten infringement proceedings. Additionally, clear standards of secondary liability are outlined for online service providers, as well as provisions to necessitate cooperation with rights holders. Furthermore, the Bahrain FTA brings the nation’s legal infrastructure for IPRs up to the level of the two WIPO treaties and sets the ground for full protection in an e-commerce era (Smith, 2004). As a result, Bahrain’s piracy level has dropped 35% (to 15%) since 1998 (Mennecke, 2006).

The US-Peru FTA includes national treatment and MFN treatment in all categories, unlike the CAFTA-DR, Singapore, or Chile negotiations. Like Bahrain, Peru agreed to criminalize end-user piracy, legalizing the seizure, forfeiture, and destruction of equipment used to produce counterfeit goods (Smith, 2006), a provision also found in the
CAFTA-DR, Morocco, Bahrain, and Oman texts although not in the Chile text. Peru even authorized enforcement against ‘goods-in-transit,’ deterring pirates from utilizing ports or free trade zones and in the case of conviction, both statutory and actual damages will be awarded for copyright and trademark infringement (Smith, 2006).

The Oman FTA text goes even one step further, requiring criminal authorities to maintain an inventory of goods and implements marked for destruction, and to permit a delay in order that such items be used as court evidence (Smith, 2006).

In certain cases, the issue of IP enforcement has even been used as a bargaining leverage tool for the US to delay the onset of FTA negotiations. Although discussions for a US-Philippines FTA began in 2004, as of March, 2006 negotiations had still not actually commenced (though the two countries have begun to lay the groundwork). In mid 2005 the US Deputy Secretary of State Robert Zoellick acknowledged that the United States was unsatisfied with the Philippines’ efforts to curb IPR violations, noting that arrests for such offenses rarely resulted in convictions (Calica, 2005). Additionally, the Philippines holds a spot on the USTR’s 2005 Priority Watch List, just “one rung” below the Super 301 Watch List whose listed nations face immediate economic retaliation (Calica, 2005). The US Government has opted to ‘help’ the Philippines by conducting an out-of-cycle Special 301 review to urge the Philippine government to update its IP regime and protection infrastructure, as well as enforcing provisions under
the existing bilateral Trade and Investment Framework Agreement (TIFA) (Calica, 2005).

Similarly, in 2005, the IIPA recommended that negotiations for an FTA with the South African Customs Union (Botswana, Lesotho, Namibia, South Africa, Swaziland) be curtailed until the SACU countries agreed to sign on to the complete IPR chapter, which was similar in content to those used in the Singapore, Morocco, Bahrain, Australia, and CAFTA-DR negotiations (Smith, 2005). Thus far, none of the countries had complied with TRIPS, although Botswana and Namibia had come close from a legislative, if not enforcement, standpoint (Smith, 2005). Given the lack of rule enforcement on the ground it was the IIPA’s argument that the FTA should incorporate “the most advanced IPR chapter possible, with the strongest possible substantive and enforcement provisions” (Smith, 2005).

In other cases, the US has pushed the beginning of FTA negotiations to hasten the development of IP protection legislation. In 2004, Thailand (which begun FTA negotiations with the US at this time) was amongst the world’s top IPR piracy offenders, with pirated DVDs taking up 40% of market share and pirated VCDs at 70% of the market (Brilliant, 2004). Cable piracy also was a serious problem (Brilliant, 2004) and overall, Thailand had been on the US Special 301 Watch List for nine consecutive years. Under the auspices of the US-Thailand FTA, Thailand would have to take concrete action to reinforce intellectual property protection and enforcement. One discussed provision
required that Thailand sign on to both WIPO treaties and lengthen the copyright period, as well as making IP piracy a ‘public’ criminal offense with penalties strong enough to deter further criminal action (Brilliant, 2004). Another specifically demanded the creation of stronger optical media laws (Brilliant, 2004). Thailand, however, has resisted such measures, both in this area and in other areas of intellectual property protection (ie. Pharmaceutical patents), with the result that in the spring of 2006, negotiations, far from being concluded, are in a state of suspension.

Pakistan, too, has resisted the inclusion of strict IPRs in 2005 negotiations for a bilateral investment treaty (BIT) with the United States (Mustafa, 2005). In the draft proposal the US asked that Pakistan pay damages to US companies in the case of copyright infringement, as well as canceling existing content licenses, and that in instances where payment fails the World Bank should pay and consider the amount as a loan to Pakistan (Mustafa, 2005). Pakistan, in response, has simply refused to incorporate the IP issue.

In each of the preceding FTA negotiations there was the inclusion of an ‘electronic commerce’ chapter that remained largely the same in each agreement. Every chapter begins with general statements to the effect that electronic commerce, specifically including trade in ‘digital products’ by ‘electronic means’ provides significant opportunities for economic growth and that it is imperative to avoid unnecessary barriers in this area of trade (Bernier, 2004). Essentially every possibility for digital content
licensing falls under these chapters, presumably including digital media downloads, subscription and pay based digital content services, and other similar iterations. Although these electronic commerce chapters do not really modify any of the obligations made under the services agreements, they do confirm that commitments and obligations made in the area of services definitely apply to electronic or digital commerce, regardless of whether the nation’s domestic law treats digital content as a ‘good or a service’ (Bernier, 2004).

Specifically, the sections on digital products use various measures to ensure that there will be no barrier to digital trade or commerce. Parties are prohibited from applying customs duties to digital products in the manner of tangible goods, nor can they apply such duties to ‘carrier media’\textsuperscript{22} bearing digital products, except where duties apply only to the cost/value of the carrier media alone (Bernier, 2004). This means, essentially, that a shipment of DVDs can be subject to duties only on the discs themselves, not the films contained on those discs. Furthermore, the principles of national treatment and MFN treatment were specifically applied to digital products and their producers (Bernier, 2004). Only in the area of digital commerce does the film industry still seem worried

\textsuperscript{22} ‘Carrier Media’ refers to “any physical object capable of storing a digital product by any method now known or later developed, and from which a digital product can be perceived, reproduced, or communicated, directly or indirectly, and includes, but is not limited to, an optical medium, a floppy disk, or a magnetic tape” (Bernier, 2004, p.18).
about cultural protectionism, belying a very real recognition that its future lies completely in its ability to profit from digitally distributed intellectual property.

The strong evidence throughout the post-2002 FTAs indicating a decline in American opposition to cultural protectionism in favor of digital era rights appears to reflect the shift in focus that occurred between 2000 and 2001 in the MPAA’s issue advocacy. The American negotiators have begun to let in subsidies and tariffs and content requirements, although they continue to strongly challenge strict screen quotas (the box office, is, after all, still the lead driver for ancillary market success).

The 2006 FTA negotiations with Korea are a strong example of the strict quota dispute, as the Seoul government agreed to cut theatre screening days reserved for local films in half (from 146 to 73), buckling under US pressure despite strong protests from the local film industry (Choi, 2006). Prior to this concession, the US had threatened to refuse to go forward with FTA talks, but the Korean capitulation led to the official announcement of an FTA negotiation start date (Choi, 2006). Also launched around this time were the start of FTA negotiations with Malaysia and United Arab Emirates, both discussions in which IPRs are expected to play a large role. In fact, US investors cite IPRs as one of the biggest factors when deciding whether or not to come into Malaysia and a 2005 survey of global 1,000 firms indicated that 28% of senior executives worldwide now consider IPRs one of the main considerations in conducting foreign direct investment (Odyssey, 2006).
Truly, as the US government continues to step up the incorporation of intellectual property and audiovisual provisions into its bilateral trade regime, it is doing its best to take the risk out of foreign dependence for Hollywood’s ‘big six.’ For 70 years the US government helped Hollywood turn the domestic box-office into a global success, populating the world’s movie theatres with American films. Now that filmed entertainment profits have left theatres at home to chase living rooms overseas, the MPAA and IIPA again have the ear of America. From the moment the industry recognized what the globalization of digital technology meant for the future of film, sometime between 2000 and 2001, mere months passed before that recognition was reflected in the activities of US law enforcement and in the bills deliberated in the US Congress. Little over a year passed before that recognition surfaced in the actions of the State Department and the USTR, the faces of American foreign diplomacy.

In speeches to congress the MPAA has continuously emphasized that the concerns of the US film industry are not Hollywood concerns, they are American concerns; digital film piracy is not a crime against movie moguls, it is a crime against American workers. The American government has made it very clear that it agrees. The issues may have changed, and even the positions taken by the industry may have changed, but one thing has stayed the same. When a barrier rises to Hollywood’s long-term global business strategy, the American film industry’s not-so secret weapon is always Uncle Sam.
Chapter 4. Brave New Digital World

“We are facing a very new and a very troubling assault... We are going to bleed and bleed and hemorrhage, unless this Congress at least protects one industry...whose total future depends on its protection from the savagery and the ravages of this machine.” - Jack Valenti, 1983, on the VCR

“A public domain work is an orphan... everyone exploits its use, until that time...when it becomes soiled and haggard, barren of its previous virtues.” Jack Valenti, 1995

Just five or six years ago revenues from foreign DVD sales of American films quietly crossed a profit point that changed the structure of the entire industry: America’s biggest film market was now no longer America but the Rest of the World. What’s more is that foreign markets, particularly emerging ones, will only continue to rise in importance for film industry market stakes as growing economies generate new expendable income. Just by grouping the dominant Asian markets (Japan, India, China) and their derivatives (Indonesia, Bangladesh, Pakistan, the Arab nations, East Africa, Egypt, Iran, and Morocco) one can account for 80% of the world’s total population and an even higher percentage of 15-30 year olds – Hollywood’s key demographic (Kapur, 2002).

Were it not for digital technology, the growing reliance on foreign revenue would likely have manifested itself most in terms of film marketing. Already, the ‘Big Six’ international distributors must design separate advertising campaigns for each major foreign market (Japan, Germany, Britain, Spain, France, Australia, Italy and Mexico), taking into account local standards, laws, cultural taboos, dubbing/sub-titling
requirements, weather, holidays, and other local quirks (Epstein, 2005, p.205). In spite of these difficulties, just a fraction of a film’s overall advertising budget is apportioned to foreign marketing as opposed to the amount spent in the US and Canada (Epstein, 2005, p.206). Were the box-office not a loss leader but still the main source of industry revenue, it is likely that the foreign budget for box-office advertising would have exploded in response to the realization that foreign markets are the main source of future film profits.

However, as we have seen in previous chapters, the main implications of American film’s new foreign dependence are not played out in film marketing strategies but in strategic legislative and policy-oriented action. Given that digital technology had facilitated the circumstances for intellectual property licensing revenue to become the industry’s ‘bread and butter,’ rather than box-office profits, this thesis argues that what the new reliance on foreign markets did was to make those circumstances global. The effect, as laid out in the empirical chapters, was to make the IPR infrastructure of foreign markets critically relevant in a way it had not been before.

Thus, it is of little surprise that though Hollywood hardly knew it should be concerned about digital movie piracy in 2000, by the end of 2001 (when it became clear that foreign IPRs were just as important as domestic IPRs) the MPAA had integrated digital-era piracy concerns into the industry’s global business strategy. Furthermore, this thesis posits that the association’s shift in issue advocacy closely mirrors, and is
indicative of, the economic decline of the box-office and the rise of overseas revenues from content licensing, particularly in digital media such as the digital video disc.

From World War I to the present day the industry has turned to the US government to knock down barriers to global film trade and by proxy, barriers to Hollywood’s global expansion. It seems only natural that when faced with a new threat to its global hegemony, the American film industry should first turn to its long-time partner to aid it in the global war against film piracy. Simply looking at the reflection of that partnership in the audiovisual trade strategy of the United States, it seems apparent that the film industry believes the key to maintaining its livelihood and existing profit margins lies in the complete worldwide control of its digital intellectual property. Such control not only includes broad and offensive measures against the ‘appropriation’ problem of the information industries ie. against copyright piracy but also the prevention of foreign market barriers before they happen.

What remains to be seen is whether the shift in profit structures that has focused on intellectual property licensing as the crux of the American film industry’s business is best dealt with through the vigilant enforcement of IPR legislation and digital rights management technologies. The film industry trade association’s efforts to maintain trade liberalization in the area of digital commerce are an indicator that the industry realizes it may have to accept new alternatives. Like the music industry before it, it may turn from litigation to the adoption of new business models that reflect the realities and
characteristics of the digital environment. Today, Hollywood recognizes that not only is content king, but that the kingdom is a digital one. But how will the industry and its trade association manage its content? Will it continue to build gates against new disruptive technologies or will it find ways to adapt its business model to the digital future?

The Incumbent and Innovation: Are Code and Law the Best Solutions?

There comes a time in every industry when it becomes prey to the steamroller of technological progress, sometimes referred to as ‘disruptive innovation.’ After eight decades of the American box-office, it seems that time has come for Hollywood. Share prices for ‘Big Six’ stocks, News Corporation in particular, have fallen 25% behind the S&P 500 since 2004 (“King Content,” 2006). In contrast, Internet start-up Google, which went public in 2004 and offers almost all its services for free, now has an estimated market worth equal to the combined value of Disney, News Corp., and Viacom (“King Content,” 2006). How is this possible, when the financial figures of these media behemoths don’t look all that bad?

One billionaire investor, quoted in the Economist, defended his decision to pull nearly 670 million USD out of American media stocks and reinvest the funds into emerging-market firms, arguing that “the market thinks something’s going to get [Hollywood], whether it’s piracy, personal video recorders, or Google” (“King Content,” 2006). Whether he is right or wrong, one thing is clear: the digital economy is the future
and the American film industry’s role in that future critically depends on its ability to function within it.

Just as the nascent motion picture industry cannibalized the business of vaudeville theatre, so too is digital distribution pushing aside the traditional business of movie theatre exhibition. Clayton Christensen, the Harvard Business School professor who coined the term ‘disruptive innovation,’ notes that in a wave of innovation, the market leaders of that period are disrupted by pioneers of the next era (“Blood of Incumbents,” 2004). Industry newcomers, by first targeting under-served or non-consumers, eventually take over the market by offering a product that panders to what customers really want.

When digital technology took-off in the mid-1990s, it weakened entry barriers to the film market to their lowest point in almost eighty years. Although film pirates had been around since the mid-1970s it took a long time for the film industry to realize that digital pirates were something else entirely. Although DVD and optical disc pirates merely offer a copy of an existing product, as did VHS counterfeiters, peer-to-peer networks and illegal servers are new market entrants utilizing the ease of online distribution to offer consumers a brand new service in the form of digital film downloads. What’s more, unlike their physical piracy predecessors, many of these online networks offer films for free.

In 2002, Rob Reid, head of legal online music service Listen.Com (Rhagsody), made the argument at a Commerce Department Digital Rights Management workshop
that the fact that information wants to be free should not be the content industry’s biggest problem. He pointed out that for both music and film, there were millions of copies of unsecured content, in both digital and physical form, and that the key to competition with free services is to “create consumer experiences that are better” because one can’t “litigate or legislate the services out of existence” or “litigate or legislate the fact that there are 15 billion unsecured digital masters out there” (Department of Commerce, 2002).

Jack Valenti, in attendance at the workshop on behalf of the film industry, responded that if Reid thought it was possible to compete with free services “God bless him, and may Allah praise him” but he “[didn’t] believe [one could], ever” (Department of Commerce, 2002). Accordingly, the film industry has spent the early part of the 21st century fighting disruptive technology via the comprehensive IP protection and anti-piracy legislative campaign outlined in the preceding chapter. In his efforts to plug every source of unsecured copies, Valenti even went so far as to ban the copies of Oscar nominated films, ‘awards screeners,’ sent to Motion Picture Academy voters, generating a swift outcry from independent filmmakers (whose films are not exhibited widely and thus rely heavily on screeners), film critics, Academy members and executives from the major studios’ own Specialty Divisions (Levy-Hinte, 2004). When this failed to move the MPAA head, a suit was brought against him with the result the court ruled that the ban was an illegal and unfair barrier to the independent film community (Levy-Hinte, 2004).
Although the screener ban generated a lot of ill-feeling and Valenti left the MPAA soon after, the trade association’s top lobbyist continues to defend its actions with the argument that “if common-sense rules of the road that respect copyrights are established, if freeloading is discouraged…at the end of the day, the customer will win (“Testimony of John Feehery,” 2006).

Valenti’s strategy, however, which severely restricts and retracts existing fair-use privileges for media, has come under fire by consumer rights groups, such as the Electronic Frontier Foundation and the Center for Democracy and Technology. These coalitions argue that legislation such as the Digital Millennium Copyright Act, the Digital Transition Content Security Act, and the Digital Content Protection Act, amongst others, stops not just piracy but also people wishing to copy content in ways that do not negatively impact film industry sales or for personal use.

Stanford law professor and digital rights scholar Lawrence Lessig states that legislation which impacts file sharing should tackle “how best to preserve its benefits while minimizing…the wrongful harm it causes artists…The law should seek that balance” (Lessig, 2004, p.87). The point of copyright law, from a constitutional standpoint is to protect intellectual property enough to promote innovation while not seeking total control. Lessig argues, in fact, that to go too far in the direction of protection actually discourages innovation. When the copyright of a creative property expires and it is released into the public domain, it becomes a tool for others, such as the
Disney Company, to create new content (Lessig, 2004). When Hollywood takes legislative action to block all content reproduction and to unnaturally extend copyright, it halts innovation. Although the industry has been threatened before by new technologies that allow consumers to reproduce content, the response and level of IP protection sought by Congress and the courts is unprecedented (see table below).

<table>
<thead>
<tr>
<th>CASE</th>
<th>WHOSE VALUE WAS &quot;FLAINTED&quot;</th>
<th>RESPONSE OF THE COURTS</th>
<th>RESPONSE OF CONGRESS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recordings</td>
<td>Composers</td>
<td>No protection</td>
<td>Statutory license</td>
</tr>
<tr>
<td>Radio</td>
<td>Recording artists</td>
<td>N/A</td>
<td>Nothing</td>
</tr>
<tr>
<td>Cable TV</td>
<td>Broadcasters</td>
<td>No protection</td>
<td>Statutory license</td>
</tr>
<tr>
<td>VCR</td>
<td>Film creators</td>
<td>No protection</td>
<td>Nothing</td>
</tr>
</tbody>
</table>

Source: Free Culture by Lawrence Lessig (2004)

Similarly, although the development of Digital Rights Management technologies is supposed to prevent illegal counterfeiting of film products, the technologies merely delay the arrival of a new disruptive innovation, at best, and at worst retard the functionality and usefulness for consumers of both content and electronic hardware designed to play that content. The technology industry, in particular, has criticized Mr. Valenti for high-profile suits he initiated against companies which developed software to circumvent encryption codes for the sole purpose of making back-up copies of legally purchased film and music products (“Glickman Named,” 2004).
Despite all of the MPAA’s efforts, global film piracy has continued to steadily rise over the last few years. Furthermore, even if the MPAA’s legislative campaign coupled with digital rights management software were to create ‘fool-proof’ protection for Hollywood’s intellectual property, the consumer demand for affordable digital film content will not disappear. Thus, given the “abundance of virtually costless ways to supply consumers with what they want to watch, whenever they want it,” (“King Content,” 2006) other content producers will step in, leaving established media in the dust although no one is more ideally positioned to supply that demand than the ‘Big Six’, with their libraries of proven film content. The financial incentives may seem slim, when the audience for independent internet films numbers in the low millions at best, but to the small producer these numbers still pose a huge opportunity. Eventually, as the audience grows and these producers build a following, the possibility will emerge to compete head to head with the incumbent for that market segment.

Already there is an initiative - the Creative Commons - founded by Lawrence Lessig, which offers content producers flexible and easily customized IP licenses that can be used to protect and legally approve acceptable uses for their work without going to the extent of control proposed by Hollywood (Lessig, 2004). The Creative Commons effort will eventually even offer a specialized machine-readable ‘tag’ that can be appended to the content to specify the particular licensing terms defined by its owner.
Although, like most incumbents, Hollywood paid scant attention to the problem at first, the growth in consumer demand for online downloads has begged a response from the industry. Thus, with the likelihood that encryption software can only hold pirates at bay until the next disruptive technology comes along, at best, and with the growth of these new entrants in the online marketplace it has become necessary for Hollywood, like the music industry, to offer an online product that serves as a legal alternative to piracy and a competitor to new producers. Towards that end, five of the ‘Big Six’ studios launched a service called MovieLink in 2002 (Olsen, 2002).

MovieLink, which was a rental-only service, was not particularly successful. Its business plan was modeled similarly to that of DivX (Digital Video Express), the video movie rental system debut by Circuit City in 1998. DivX disks were essentially disposable DVDs that had to be played on specially equipped DVD players with attached modems for billing purposes. No longer offered, DivX was a tremendous failure. In 2002, a website called J-Walkblog.Com compared the two services (below).
<table>
<thead>
<tr>
<th></th>
<th>Movielink</th>
<th>divX</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Distribution method</strong></td>
<td>Download from the Net</td>
<td>Purchase a limited use disc</td>
</tr>
<tr>
<td><strong>Marketing</strong></td>
<td>&quot;...powerful Internet movie rental experience&quot;</td>
<td>&quot;Unprecedented convenience, flexibility and movie availability at economical prices.&quot;</td>
</tr>
<tr>
<td><strong>Hardware</strong></td>
<td>A PC with a high bandwidth connection</td>
<td>Propriety player (~$100), also plays standard DVDs</td>
</tr>
<tr>
<td><strong>Software</strong></td>
<td>Microsoft Windows, Internet Explorer 5, Windows Media Player 7</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Movie viewing</strong></td>
<td>On a computer monitor</td>
<td>On a TV screen</td>
</tr>
<tr>
<td><strong>DVD &quot;Extras?&quot;</strong></td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Movie plays on a single device?</strong></td>
<td>Yes, the computer that downloaded it</td>
<td>Yes, tied to a single divX player</td>
</tr>
<tr>
<td><strong>Automatically deleted/deactivated?</strong></td>
<td>Yes, to watch the movie again outside of the 24-hour window, it must be downloaded and purchased again.</td>
<td>Yes, but the movie can be re-purchased.</td>
</tr>
<tr>
<td><strong>Cost per movie?</strong></td>
<td>$2.99 - $4.99</td>
<td>$4.50</td>
</tr>
<tr>
<td><strong>Customer base</strong></td>
<td>U.S. only</td>
<td>U.S. only</td>
</tr>
<tr>
<td><strong>Source:</strong></td>
<td>J-Walk Blog, November 2002 Archives</td>
<td></td>
</tr>
</tbody>
</table>

Although MovieLink aimed to offer consumers a convenient way to watch films legally on their PCs, it did not provide consumers with any ‘value-added’ over free peer-to-peer networks. The selection – only 175 films – was poor, the quality was fairly low, download times were long, the movie could only be watched on the PC, and the film came with no extra features (Olsen, 2002). Simply put, MovieLink failed to compete with ‘free’ by offering the consumer a better experience.

By early 2006, with piracy still on the rise and the music industry proving that profits can be made through legal download services, Hollywood had launched a number of digital distribution schemes, beginning with smaller content items for the video iPod.
Disney, NBC Universal, and Viacom all offered downloads from some 50 of their most popular TV shows on the Apple iTunes network service (“Testimony of John Feehery,” 2006). Additionally the three studios, plus News Corp, have entered agreements with Verizon to distribute their television shows through its new FiOS network and NBC Universal is working with Aeon digital and WurldMedia to distribute its films through peer-to-peer networks and over the Internet (“Testimony of John Feehery,” 2006). Disney also has MovieBeam, a video-on-demand movie service offering wireless distribution and on-demand high-def films to US customers (“Testimony of John Feehery,” 2006).

In March, digital distribution services debuted that allow consumers to actually purchase films. Nervous about angering large retail chains, such as Wal-Mart, who is one of the largest DVD sellers, or cinema-chain owners, many of the studios tested the ground in Europe first (Pfanner, 2006). Universal Pictures International partnered with LoveFilm in Britain to debut a ‘download to own’ service while Warner Brothers partnered with German media giant Bertelsmann to launch a similar service, In2Movies, in Germany, Austria and Switzerland (Pfanner, 2006). For the purchase price, LoveFilm offers consumers two digital files (one for their PC and the other for portable devices) and a DVD in the mail while In2Movies utilizes peer-to-peer technologies to speed up downloads and allows customers who make their computers available to the network to earn credit towards future purchases (Pfanner, 2006). By April of 2006, two existing
online movie rental companies in the US had announced their own ‘download to own’ options. One was MovieLink and the other, CinemaNow (Greeson, 2006).

In both Europe and the United States the studios’ offerings face the same skepticism by media critics who point out that the service’s price points ($20-30 for MovieLink and CinemaNow, $35 for LoveFilms and In2Movies) are unrealistic (Pfanner, 2006). Although consumers are willing to pay $.99 to download a song or $2.50 to download a TV program from the popular iTunes service, skeptics point out that spending up to $35 on a digital film copy that can be purchased in the stores for half the price doesn’t make sense, particularly because one of the primary drivers of e-commerce is price-competition (Greeson, 2006). Again, there is not enough value added. Unlike a physical DVD, these digital files take two hours to download, cannot be played on a Macintosh/Linux computer and cannot be played on a DVD player (Greeson, 2006). Strangely, although CinemaNow does not allow copies of regular films to be burned onto a DVD, consumers may make DVD copies of new ‘adult film’ titles (Greeson, 2006).

Although the studios are now making a conscious effort to adapt the Hollywood business model to the digital economy, they have failed to offer consumers a package that competes with free services. Despite the fact that digital downloads are virtually costless for the seller, none of these savings have been passed down to the consumer. Neither does the consumer have access to a variety of content unavailable via traditional channels. With access to film libraries containing a host of films, television shows, and
documentaries that haven’t been released for years, studios are in a position to satiate the minority tastes of myriad consumers, but they haven’t.

Other content providers, including music, have found ways to compete with free by offering the consumer something innovative. Lessig, in his book, Free Culture, cites the case of Prelinger’s a for-profit company whose film archive contains nearly 45,000 never-copyrighted films which are sold as stock footage. When Prelinger digitized 1,300 films and then posted them online for free downloads, stock footage sales soared as people were able to locate quickly the material they wished to purchase (Lessig, 2004, p.124).

One small segment of the Japanese film industry, Anime, has also found a way around the appropriation problem (“Anime,” 2004). After Anime films and cartoons appear on Japanese television, the makers send out a few copies via DVD or over mobile phone networks or fans record the show from television and redistribute the episodes for free using peer-to-peer networks. The fans make a collective effort to translate and subtitle the dialogue then post an English version of the show online. US companies then license the shows with the most English translations, following which the fans scour the Internet and remove free versions of the show, ensuring that the anime companies can sell their DVDs for some profit (“Anime,” 2004). Although one would think all the unsecured copies would kiss this nascent industry, sales of anime grew 13% between 2002 and 2004 and the high growth rate looks set to continue (“Anime,” 2004).
Forward looking Hollywood executives, such as Kevin Tsujihara, president of the Warner Brothers Home Entertainment Group, recognize that services such as In2Movies are just a start and require some tweaking before they become legitimate competitors to disruptive innovation. "I don't think there's a silver bullet," Tsujihara has said about using the Internet to distribute movies, "We're going to have to test as many models as we can." (Pfanner, 2006).

Either way, the key to competing with free will likely be in the industry’s ability to offer consumers something more, either through customization, lower price-points, or increased functionality. The ‘Big Six’ are in an excellent position to compete through customization, with their assets across a variety of horizontal media. Already, DVDs come with a variety of extras such as interviews and deleted scenes. However, media firms have access to much more, including related soundtracks, software, videogames, books and ancillary merchandise. What if consumers could order their own custom digital download, with a range of prices depending on the number of extras? The digital download of blockbuster film Harry Potter and the Sorcerer’s Stone could be bundled a choice of digital product items that could include, in addition to deleted scenes and actor interviews, an e-book/digital audio book, the film soundtrack, related software, coupon codes for related merchandise at the Warner Brother’s store, or the movie-based videogame. The Big Six media conglomerates are in a unique position to offer such
bundles, assuming they can achieve synergy across their various divisions and bundled packages would likely be difficult for pirates to emulate.

Like all internet industries, to compete on price-point, Hollywood must set the prices of digital film downloads low enough to undercut physical DVD retailers or offer so much value added that consumers really believe they are getting a worthwhile deal. High prices work best with inelastic luxury goods or in monopoly markets. Most importantly, the digital product must have high functionality. It is no use to sell something that only works some of the time in some machines. Subscription services like that used by Harvard Business School to sell electronic case studies, allow the user to make as many copies as he/she wants but require a user-name and password to access the copies that is linked to the buyer’s account, decreasing incentive to pass along the password.

Still, though Hollywood may need to tweak its digital distribution strategy, there are other signs that the industry is adapting to the opportunities and challenges of a global digital millennium. In a recent speech before Congress, current MPAA head Dan Glickman highlighted some new MPAA initiatives in the coming year, including new research undertaken to better understand consumer attitudes towards the American film industry- a first for the association. Rather than competing simply on the basis of superior distribution or higher amounts of capital, Hollywood is “doing some strategizing to bolster [its] own effectiveness” through a better understanding of what people want
 (“Glickman Calls,” 2006). Such a tact seems to indicate that Hollywood is gearing up and preparing for a future in which there is real competition in the film industry from a number of different directions. Online content producers and pirates pose two sources of competition. The native film industries of foreign markets pose another. However, this time instead of stifling their growth Hollywood has new incentive to help foster their development.

The Eagle No Longer Flies Alone: Fostering Foreign Native Industries

It is highly evident that as countries develop and innovate, they tend to become more concerned with developing a stronger IP infrastructure. When they are developing and have little in the way of intangible intellectual properties to protect, the pull in emerging markets is towards legislation that avoids IPRs because they have the most to gain economically from appropriating other people’s content. However, once countries start to produce creative content of their own, the impetus is created to protect it.

Hollywood, by ceasing to fight cultural protectionism and subsidies via its audiovisual trade scheme has helped boost the native industries of several countries, which the MPAA says is part of its overall anti-piracy strategy. Additionally, there has been strong growth in co-production agreements between the US and other countries and outsourcing of post-production and digital special effects is on the rise as well.
India, for instance, functions as an outpost for post-production but also produces more films than any other nation worldwide, exporting them to 95 countries (Nielsen, J. and D. Taglioni, 2004). Brazil and Egypt have become key producers of television content. Hong Kong, recovering from its piracy scare in the late 90’s has bounced back and is now the world’s largest film exporter and producer, after the US and India (Nielsen, J. and D. Taglioni, 2004). A few years ago Hong Kong set up the Film Development Fund to help promote long term industry development through training courses in everything from film management to film financing – the fund also gave birth to the Asia Film Financing forum” which is meant to promote cooperation with other foreign markets (Nielsen, J. and D. Taglioni, 2004).

Thailand, too, is emerging as an audiovisual industry player, producing film and television programs which it supports with national and international trade fairs. The Thai government assists by arranging meetings between the Thai film industry and foreign direct investors (Nielsen, J. and D. Taglioni, 2004). Another one is the Egyptian film industry, which not what it once was is still producing television, particularly for clients in Arab countries where cinema is forbidden (Nielsen, J. and D. Taglioni, 2004).

Most telling is the fact that in 2002, American films overseas fell by 16% against local films in box-office screenings. That same year, the biggest success stories of Japan, Germany, Spain, France, and India were Japanese, German, Spanish, French, and Indian films respectively (Kapur, 2002). As America becomes more and more dependent on
foreign markets, the balance appears to be tipping in their favor. However, it is worthwhile to note that since the early 21st century, German banks have accounted for one-third of all Hollywood funding (Kapur, 2002). Exchange has been opened up in both directions.

Overall, it seems clear digital technology is changing the face of the global film industry. Though Hollywood’s first response to these changes has been to try to legislate them ‘out of existence’ there is a growing recognition the industry will have to adapt and adjust to digital technology in significant ways. Furthermore, Hollywood has made it clear through a number of tactics ranging from the inclusion of an e-commerce chapter in the audiovisual trade agreements to the choice to debut ‘download to own’ services in Europe first, that because digital technology leaps across national borders, so to must film strategy. A new business model for the industry, above all, must be a global business model designed to be profitable not only under the auspices of the domestic IP infrastructure but in the global environment of emerging market conditions as well. Hollywood survived the introduction of Television, the VCR, and Cable/Pay-Per View, all of which it predicted would cannibalize its business. It is likely that Digital Piracy will not spell the end of Hollywood either. However, the degree to which America continues to lead the international film market very much depends on Hollywood’s ability to make sure not only that its content is protected but that it is the best content available and that it
truly appeals beyond the American audience. To survive digitization, Hollywood must become Global-Wood; only then can it truly win its foreign market challenge.
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