

The Broadcast and Media Industries: Policy in a Time of Change

Notes for a talk by Irwin Stelzer*

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Let me begin with the usual declaration of interest, past and present. In the past I served as a consultant to BSkyB; in the present, I am a consultant to News Corp and News International. Let me also state at the start that the wonderful thing about the IEA is that it provides a forum in which people like me can try out ideas -- and after discussion, correct any errors, or simply change our mind. So I look forward to your comments.

I approach this subject with some trepidation. During my long stay in Britain I have learned that there are two subjects -- three, if you count Iraq -- on which American

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views are, to put it mildly, unwelcome. The first is the NHS; criticism by an American usually invokes a response that we in Britain don't need to take lessons from a country with 40 million people who are denied health care. Never mind that in my country the uninsured are guaranteed health care by the 90% of hospitals that operate on a not-for-profit basis; or that the appalling performance of the over-funded NHS suggests that you might usefully take lessons from somewhere, if not the United States.

The second institution that Americans criticise at their peril is the BBC. In the days before "The Sopranos" and "The West Wing" criticism of the BBC as "elitist" usually would evoke a response about pornography, trash, mindless programmes and annoying commercials. Fortunately, there is now some willingness here to concede that Americans are capable of producing at least some quality programming, although enthusiasm for some US news, most notably Fox News, remains, er, muted. In the interests of comity let's concede that both systems have their virtues, as is demonstrated by the transatlantic trade in programmes: you ship programmes and formats to us that we very much enjoy, and we ship programme formats to you that appeal to British audiences. Of course, when we copy each other's

programme formats, we have to adapt them to the tastes and language differences of each national audience.

So I have come to praise the BBC, not to bury it. Like the NHS, it quite properly has a role in integrating British society, and one that many American critics fail to appreciate. I think that is because we have a greater aversion to concentrated power, witness our system of checks and balances; and to monopoly power, witness our vigorous antitrust policy, one which Britain has only very recently begun to emulate, thanks to the efforts of your Chancellor.

Nor do I think it useful to hurl charges of monopoly power at the BBC. It certainly possesses such power, although not in the narrow sense often used by economists, a point to which I shall return in a moment. But that power is unlikely to be significantly diluted, given the political power of the organisation and its recent deal to renew its charter for ten years -- a full decade, in an industry that is changing every day -- and assure itself of a rising revenue stream for a good portion of that period. So for the moment let's not waste any energy and time wishing for a differently structured industry.

And I will avoid discussing the BBC's persistent anti-Americanism, so deeply engrained in the organisation's DNA that it no longer notices it, and doesn't bother to examine the validity of such a criticism even when your Prime Minister points it out. This may be a result of what Timothy Garton Ash has characterised as a "persistent ...attitudinal" bias, "a set of shared secular, liberal, urban, European values and prejudices so deep under the skin that many don't even notice they are there."¹ So it should be no surprise that secular, liberal, European BBC has a bias against religious, conservative, America. Suffice it to say that when I returned to America after watching the BBC coverage of the 2000 elections I was startled to find that George W. Bush was being sworn in as my President rather than Al Gore, and had a similar experience four years later when I returned to Washington eager to learn of Mrs. Kerry's plans for redecorating the White House.

Finally, I will avoid extended comment on the recent settlement -- one hammered out between those two equal parties, the elected representatives of the British people, and the bureaucrats of the BBC. I know that the terms are considered onerous for the broadcaster, and will limit myself

¹ "The BBC is worth every penny, but this elephant must tread carefully," [The Guardian](#), December 7, 2006.

to one question: Is there anyone here from a major business organisation, operating in an industry characterised by a rate of technological change so rapid that it threatens existing values, who would reject a long-term guarantee of his company's existence and income, the latter increased at only a tiny bit -- the estimate is 0.45% -- below the projected inflation rate, regardless of whether anyone wants his product or not? With an option to come back for more if the going gets really tough, as it already has, prompting the BBC to begin lobbying for an increase in its borrowing limit? In short, is there anyone who would reject a government plan to immunise his firm for the foreseeable future from Schumpeter's gale of creative destruction? I suspect not. No wonder these terms have been characterised by the Financial Times as "giving Mr. Thompson an advantage that other media executives envy in an era of brutal revenue pressure from disruptive new rivals."²

But politics is the art of the possible, and it does little good to rail against BBC's present position, or against the recent settlement. It is most often -- but not always, as Margaret Thatcher proved -- the job of policymakers to play with the cards with which they are dealt in framing policy for

² Financial Times, January 15, 2007.

the future. As Sir Anthony Jay has pointed out, “The free market may, and in my view should, be the ultimate destination, but it is neither desirable nor practicable to head straight for it immediately.”³

It seems to me that there is broad agreement as to the goals of media policy. Although we can't define it, we all know that “diversity” in media, if not in society, is a good thing. Only once have I seen that proposition challenged, and that was when a member of a Parliamentary Committee asked me if I was aware of the danger of having several newspapers available. When I replied that I feared I could see no danger in that happy circumstance in which Britain finds itself, he gravely noted, “The more newspapers there are, the more errors there will be.” I was too stunned to ask him if he had been a regular reader of Pravda.

We also know that competition is a good thing. It maximises the rate at which innovations are introduced; it assures newcomers with something to offer the public access to audiences; it prevent profiteering.

And we know that public broadcasting is a good thing. There can be what we economists such as Gavyn Davies call market failure, and society benefits from having some

³ Anthony Jay, “Do We Need the BBC? Rethinking Public Service Broadcasting”, September 2005, mimeo p.2.

mechanism by which gaps created by such failure can be filled. I believe there is as much agreement about that proposition as there is disagreement about just what constitutes market failure: does it exist when there are multiple cartoon channels, some of them relying significantly on local (made-in-Britain) content, but none featuring only made-in-Britain cartoons? To what extent does the absence of British-made programming constitute market failure?

Some would list among the goals of media policy an absence of bias. I would not, since bias is unavoidable. In my view, we are best served by relying on competing biases, so that the public can hear many points of view. The only danger in the British context is if one of those voices is permitted to cloak itself in the mantle of the “unbiased”, while anyone with a contrary point of view risks being dismissed as “biased”.

How do we take all of these things that we know, plus what we might call “the facts on the ground” were they not more aptly called “facts in the air”, and weave them into a broadcast policy that is likely to result in a diverse, competitive, innovative media sector that well serves the various publics?

I would start with an important principle, learned early by those charged with enforcing competition policy: it is often not so much the predatory acts of entrenched incumbents that stifle competition, but the very presence of a dominant firm free to threaten destruction of newcomers based, not on superior efficiency or a more appealing product, but on sheer market power. New entrants need to attract capital, either from the public capital markets or from private venture capitalists. If potential investors see a powerful, unconstrained competitor lurking in the wings, they will be reluctant to provide the necessary funding.

In the broadcast/media business that translates into a need to make sure that the one non-market player, the organisation with guaranteed income and no need to woo customers,⁴ is properly regulated. The market cannot do that job. As Mark Thompson, BBC's director-general has claimed, "The BBC is exogenous to the market."⁵ Anyone thinking of providing a new service, be it a traditional television channel or one of the new media services, must consider what BBC's response will be -- something Sky

⁴ Of course, in the long run the BBC must satisfy enough politicians and license-payers to prevent a policy revolution and its demise. To do that, it feels must run popular programming of the type that is plentifully supplied by the private-sector: no market failure there. The alternative would be to shrink, and offer only such programmes as are not otherwise available, which some would argue is what Public Service Broadcasting should be restricted to -- an argument reserved for another time.

⁵ Financial Times, May 4, 2006.

failed to do when it decided to launch a 24-hour rolling news service, and counted on substantial revenues from the cable companies that deserted it or reduced payments when a free service became available. Of course, there has been entry; no deterrent can be 100% effective. But we will never know how many ideas foundered on the reef of possible BBC retaliation.

It is important to understand that we are not here dealing with monopoly power in the traditional, narrow sense of large market shares. Much has changed since Lord Reith proudly listed among BBC's advantages "the brute force of monopoly". But one thing has not: no failure to innovate, no failure to meet the public's needs, no shoddiness of product, no anticompetitive act, can reduce the flow of revenue to this uniquely endowed Corporation, at least not in a substantial portion of the lifetime of its decade-long charter. It is the elephant in the room, with no need to trample any adversaries so long as its looming presence deters them from entering the room in the first place.

The situation is not unique to BBC or to broadcasting. For a long time any inventor of new software had to consider how Microsoft would respond -- whether it would develop a competing service and bundle it with its monopoly offering,

or set a pricing schedule that made it economically unattractive for manufacturers of hardware to treat the newcomer on even terms with the Microsoft product.

It is of course the case that the Government has put in place mechanisms intended to avoid just such a stifling of competitive entry and innovation. The new regulatory Trust, its Chairman also to have the title of Chairman of BBC, is to perform “public value” tests, and Ofcom is to make “market impact assessments”, with the Trust to make the final decision. This procedure, along with the ability of the BBC to, shall we say, make its voice heard during the appointments process, puts any competitors in the position of the prize fighter, returning to his corner between rounds after taking a frightful beating, and being told by his seconds, “He can’t lay a glove on you,” to which the battered warrior responds, “Well, then keep an eye on the referee, because someone is beating the hell out of me.” As Chris Giles has put it:

The new BBC governance arrangements may prove to be better, or worse, than the last. But PSB is so difficult to define, and its objectives so slippery, that I cannot foresee the management having much difficulty in persuading the new BBC Trust that it is following its public service remit, even if it is not in many areas. In fact, to assume that the management would not try to play games

requires a naivety that is rare in the modern world.⁶

The difficulty of defining objectives, and of setting up standards of accountability, intrinsic in the process of oversight of BBC, is no small matter. As one observer has put it, referring to civil servants involved in the regulatory process, “A system of accountability is easier to implement when the tasks assigned to civil servants take the form of simple and verifiable rules. It is also stronger when *ex post* verification is undertaken by an independent third party ...”.⁷

I would go further, and argue that the new charter is an open invitation to BBC to expand in any way it chooses, trampling actual and potential competition under foot. Consider that the Corporation is permitted to “engage in other compatible activities”; “establish or acquire subsidiaries through which commercial activities may be undertaken”; use technologies “yet to be developed”; and engage in “other activities which directly or indirectly promote the Public Purposes” so long as those are peripheral to its main activities. All this to be decided by a Trust the members of

⁶ Chris Giles, “The Public Interest Challenges for the Communications Sector Over the Next 10 years: Contestable Service Funding”, in Ed Richards, Robin Foster, Tom Kiedrowski, Communications: The Next Decade. London: Ofcom, November 2006, p.105.

⁷ Lars Bergman, Chris Doyke, Damien Neven and Lars-Hendrik Röller, “The Tasks of Regulators and Regulatory Institutions,” in Europe’s Network Industries: Conflicting Priorities. London: Centre for Economic Policy Research, 1998, p.129.

which are not exposed even to the sort of vetting accorded a new member of the Monetary Policy Committee.

In my view, this procedure is the route to stultification of innovation and entry, for the very existence of these tests will in the end discourage entry. As anyone who has had any experience with the application of such tests can tell you, they favour the powerful. Let me use an analogy -- environmental regulation. Large companies have no serious objection to environmental regulations, almost no matter how onerous. True, the large company will have to create a compliance department, staffed with lawyers, economists and lobbyists, and that will raise the cost of doing business. But that will affect every firm, and so create no competitive disadvantage. And the resources and skill devoted to complying with, or gaming the regulatory system will deter new entry by smaller, less affluent potential competitors.

In the case of broadcasting, BBC and Sky have the resources to fight out the implementation of “public value” and “market impact” tests: they can answer the massive questionnaires hurled at them by the regulators, appear at their hearings, hire lobbyists, and do all that these regulatory criteria demand. But some poor soul with an idea and a vacant garage in which to develop it, faced with having to

jump through these hoops to gain assurance that he will not prove to be cannon fodder for the army of BBC expansionists, will find this entry barrier insurmountable.

That will be true whether the newcomer has as his target BBC's traditional area of activity, or the newer areas it proposes to dominate, or its commercial arm. The prospect of a round of expensive proceedings cannot offset the fear of being squashed by an organisation driven by a desire to expand, with no constraint on its costs or any need to offer a superior service. Surely the British Internet Publishers' Alliance has it right when it warns, "The BBC's unmatched resources and branding advantages present the market with a dominant competitor. Their activities, *and even the mere suggestion of them*, means that many ideas never even get off the drawing board because they are clearly unviable in light of the BBC's ambitions."⁸

How then, to reconcile the legitimate need for a public service broadcaster to plunge in when market failure dictates, with what seems to be the competing need to maximise innovation and entry?

First, sever the commercial arm. No amount of regulation can prevent overt or covert, express or implied,

⁸ BIPA Response to the Government's White Paper and the BBC's 'Creative Future', 28 April 2006, mimeo p.2. Emphasis added.

cross-subsidisation -- the use of license-fee money to finance commercial activities. Note that BBC proposes to use its “brand” to “take on Google and AOL,” according to Mr. Thompson.⁹ And he is no doubt absolutely correct -- the BBC brand is a valuable asset and competitive tool. But that brand was bought and paid for by the license-fee payer, who should not be asked to provide the capital to enable BBC to enter markets already well served, even if by American firms. The day of national champions ended in Britain some time ago, to the benefit of the economy, and should not be revived. That policy is best left to the French, more willing to accept the double-digit unemployment that accompanies such rabid nationalism.

Second, we have to recognise that we are dealing with an industry in which economic rents are an important component of cost. Stars such as Jonathan Ross get what they get (£18 million over three years¹⁰, the rounding error in Beckham’s contracts), programmes in which they appear cost what they do, because the talents are deemed by the broadcasters to be non-duplicable. That means that bidding for broadcasting rights reaches the levels we have seen because there are economic rents to be had. It seems to me

⁹ Financial Times, May 31, 2006.

¹⁰ Sunday Times, January 14, 2007.

that it would make sense to bar BBC from using the funds it conscripts from the public to raise costs, and eventually increase the need to conscript still more funds, by bidding for rights. After all, if there are others willing to pay for these rights, by definition there is no market failure -- private-sector players are willing and able to make the programmes available to the public. There is no gap requiring filling by a public-service, tax-funded broadcaster. Best leave that chore to companies constrained in their bidding by the need to earn their cost of capital.

Third, even the best regulator -- and Britain has been fortunate in attracting many able people to these posts¹¹ and, in the case of broadcasting, people well trained because of prior stints at the BBC; so well trained that they would like to see a BBC-clone in operation, financed by conscription rather than subscription -- is no substitute for the market in allocating resources. So it is incumbent upon policymakers to build into the regulatory regime as many market tests as possible, just as policymakers in the environmental field must build in carbon trading and pricing if they are to bring emissions down in an optimally efficient way.

¹¹ "Regulation has become an established profession, no less important in a world of complex organisation than its forebears in medicine, law and the medieval guilds." Ed Mayo and Philip Cullum, "The Consumer Agenda on Regulation," in Richards, *et al.*, p.87.

That can be accomplished by having independent producers bid for the £3 billion annual pot of money over which BBC presides, or at least for a portion of that pot. As one commentator puts it, "...the BBC... on its own cannot be trusted to spend the money in the public interest."¹² Any public agency with a guaranteed income should be exposed to contestability: BBC is no exception. The contest can be for funding programmes, or operations, or channels, for one-shot or multiple years.¹³ This is, I should add, no panacea; it is merely one of the better available "second best" solutions.

A bidding system would have an added virtue: it would automatically identify market failure. If the BBC governors or whoever would be responsible for implementing this regime identify programmes that are worthy but which, because of their limited appeal cannot mount a credible bid for support, they can finance it from the portion of their revenues reserved for such purposes. Yes, there will still be room for argument about which programmes are "worthy". And yes, most of those chosen for special subsidisation are likely to appeal to the narrow group of mostly upper-income elitists who prefer to have their entertainment subsidised by less

¹² Chris Giles, *loc .cit.*

¹³ This is not the place to discuss the construction of any such bidding process. The advantages and disadvantages of various approaches are neatly summarised in Tom Weyman-Jones, "Deregulation", in Peter M. Jackson and Catherine M. Price (eds.), Privatisation and Regulation: A Review of the Issues. London and New York: Longman Group Limited, 1994, p.113-115.

wealthy taxpayers. But no non-market system is perfect.

Better still would be some system of subscription-charging. If Mark Thompson is right that “the overwhelming majority of the public is pretty happy to pay” the license fee, and indeed pay substantially more,¹⁴ the BBC would thrive under such a system, which has the added advantage of freeing viewers from the compulsion of having to pay for what they do not choose to watch lest they get caught by a roving spy device favoured by those on the left who are appalled by eavesdropping by security services intent on preventing terrorist mayhem. Why government spying on its citizens to find out whether they are innocently watching television is more acceptable than having it do so to see if any are planning to blow up the tube is something I find extraordinarily puzzling. And the puzzlement will increase if the spy trucks set out to feel the collar of anyone watching a broadcast on his or her cellphone, or Blackberry, or PC.

But I digress, and hasten to point out that subscription television is not a perfect solution. As Alfred Kahn has pointed out:

Pay or subscription television ... has the disadvantage of imposing a positive charge, with the result that some families are deterred

¹⁴ Mark Thompson, The Smith Institute Media Lecture, “Delivering Public Value: The BBC and Public Sector Reform,” 11 October 2006, reprinted by [The New Statesman](#). Pp. 12 and 14.

from viewing from which they would derive positive satisfaction, even though the marginal costs of supplying them are zero. On the other hand, it has the major advantage of affording a market test with respect to both the appropriate quantity of resources to put into television and their proper distribution between different kinds of programs.¹⁵

I said at the start that I would deal with the possible, not the more desirable revolutionary alternative of a free market, in which the best programmes, offered on the most attractive terms, delivered over whatever system the public decides best suits it, win the day. In which the multiplicity of channels and delivery systems assures diversity and the availability of competing biases. In which markets matter more and ministers less. In which armies of lobbyists have no purpose, and have to seek honest work.

But I recognise that is unrealistic. As unrealistic as the privatisation of the telecoms, electric, gas and water industries. Sorry; I forgot where I am.

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¹⁵ Alfred E. Kahn, The Economics of Regulation: Principles and Institutions. Vol. II, pp.41-42. First published in 1970-1971 by John Wiley & Sons Inc, and republished in single volume format in Cambridge, Massachusetts and London by the MIT Press.