
Is there Still a Place for Public Service Television? Effects of the Changing Economics of Broadcasting

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1. Economics and the Challenges of Broadcast Policy-Making

Robert G. Picard

Whenever we turn on our television sets we are reminded how much it has changed in our lifetimes. Some of us remember the days when television was a single channel; others when there were only public service and advertising supported channels; and some of us only recall when basic broadcasting and paid satellite services became available. Whatever the length of our memories, we are all aware that the number of channels is growing, that the switch to digital broadcasting has added more services, that many of us are spending significant amounts of money for pay services, and that we can now watch streaming television and television programmes on many types of devices.

Television is thus no longer the narrow conceptualisation we had for it in the past. It now represents a far broader and more complex set of technologies and distribution platforms, with many different types of providers and financing models. It is no longer just a broadcast stream, but includes catch-up and recording services, and a range of paid and free video-on-demand services that allow us to watch individual programmes of our choosing. It is increasingly linked to telecommunications and internet services that are expanding the potential uses of that programming and our interactions with broadcasters and other programme distributors, advertisers, and other viewers.

These changes are running far ahead of broadcast policy, taxing the abilities of regulators and policy-makers to keep up with its rapid pace. The fundamental principles and trajectory of existing broadcast policies are based on the economics of technological and market conditions present a century ago and this compounds the challenges facing policy-makers today because contemporary conditions are so different.

The structure and financing of the UK television market have undergone significant changes since the BBC began regular television broadcasting in 1936. It is now comprised of three coexisting subsectors: licence-fee-funded broadcasting, advertising-supported television, and pay television. The development of the latter sectors provided significantly more choice for consumers and increased competition for audience attention, but each primarily relied upon different sources of revenue than previous sectors (Barwise and Picard, 2012).

Policy changes towards television over the past 60 years have been driven by improved use of spectrum, desires to provide more choice for viewers, and views that monopolistic provision of television by a state-created broadcaster produced inefficiency and hampered national economic development (Coase, 1950, 1966). Despite the strong growth of advertising-supported and pay television, economic criticisms of public service broadcasting have been increasingly heard, arguing that the economic rationales for its establishment no longer apply. It has been argued that licence-fee funding for public service broadcasting keeps the public from being able to use market mechanisms to influence content (Peacock, 1986) and distorts the television market (Peacock, 2004). A variety of arguments for its future have been put forth: that licence fees for the BBC should be reduced (Broadcasting Policy Group, 2004), that the BBC should provide only the programming that the market will not (Peacock, 2004), that it be turned into a voluntary subscription service (Broadcasting Policy Group, 2004; Peacock, 2004; Armstrong, 2005), and that significant parts of its operations should be privatised (Broadcasting Policy Group, 2004). Another alternative has been

put forward that argues that financing for public service content should be available through a contestable fund from which all broadcasters could seek funding for content the market will not support (Broadcasting Policy Group, 2004; Oliver, 2009; Ofcom, 2007).

These positions have been countered by arguments that public service broadcasting and the BBC play crucial roles in citizenship, culture, and education and that there are ample economic and social rationales for public intervention in broadcasting and maintaining a strong BBC (Graham and Davies, 1997; Graham et al., 1999; Helm et al., 2005; Seabright and von Hagen, 2007; and Foster and Meek, 2008).

The development of pay television and the switchover to digital broadcasting have clearly ameliorated two fundamental economic rationales for public service broadcasting: spectrum constraints and inability to exclude those who don't pay from receiving broadcasts (Barwise and Picard, 2012). These crucial developments mean that policy-makers will no longer be confronted by key aspects of television market failure as they consider options for television policy. In the coming years the government will issue a green paper on its ideas for UK broadcasting, conduct a BBC charter review, and a new Communications Act is expected to be put in place. The structure of the television market, the growing roles of digital distribution, and the role, governance, size, and funding of public broadcasting and the BBC will be a key part of these debates, with the latter being particularly addressed in the charter review.

This report explores what is driving the changes in broadcasting, how they are altering the traditional dynamics of broadcasting systems and provision, how digital switchover and pay television services are fundamentally modifying the economics of traditional broadcasting, and the implications of these changes for broadcasting policy. These changes are not unique to the United Kingdom, but are being felt in television markets around the world.

After considering these fundamental issues, the report turns to questions particularly germane to the British context. This is particularly important because UK policy-makers will soon begin considering how policy might and should change. The report thus asks whether broadcasting is different from other industries, what the ideal market for consumers and citizens would look like, the contributions and limitations of the market to broadcasting, and how the various funding mechanisms might help the broadcast system move closer to the ideal.

The report is intended to provide knowledge and background that will help policy-makers and the public make better decisions about where UK policy should direct broadcasting in the coming decades. Debate over the policy options is vital and will be contentious; the extent to which it is well informed will influence the quality of the subsequent choices.

The report is the outcome of a symposium on the economics of broadcasting organised in January 2013 by the Reuters Institute for the Study of Journalism at the University of Oxford, together with the BBC Trust. It brought economists, policy-makers, and broadcast executives together to present and consider different views on the fundamental issues. The event was funded by the BBC Trust, but the ultimate selection of the speakers and topics was made by the Reuters Institute.

Subsequent to the symposium, the speakers produced chapters for this publication based on the presentations and discussions at the event. They represent a range of views on the future of television policy based on the

changing nature of television and traditional rationales and means of broadcast regulation. The views represent those of the authors and are not necessarily those of the Reuters Institute or the BBC Trust.

Television Change and the Place of Public Service Broadcasting

The report is divided into two sections. The first reviews the television environment and how economic conditions have changed through the development of multichannel and digital broadcasting. The second section addresses the question of whether there is a future for public service broadcasting. The authors address the economic bases of television regulations and arguments surrounding them and whether continued public intervention in television broadcasting is warranted.

In the first section, Helen Weeds argues that the contemporary conditions of broadcasting produce excludability and extensive consumer choice through advertising-supported television and pay TV – thus improving the market and removing some of the fundamental rationales for broadcast regulation. Weeds further argues that public broadcasting creates positive externalities not provided by the market that are important for society and that contemporary public intervention is consequently justifiable but not at the levels that harm commercial firms, investment in broadcasting, or reduce the total welfare of the broadcast systems. Consequently, Weeds argues that the scale and scope of public service broadcasting need reappraisal.

Joshua Gans shows that television is not a simple economic good and how technical forces are altering the environment of television in ways that affect consumption and financing opportunities. He argues that the social nature of television has been expanded by the digital age and that this may create new opportunities that are commercially attractive.

Dieter Helm questions those who argue that the contemporary technical changes in markets profoundly separate broadcasting from its past and that significant change in policy is needed because of digitalisation. He argues that most market failures associated with television remain and that the new environment creates an additional market failure related to search and information provision.

The second section is begun by Jonathan Levy who argues that television requires special intervention which other products and services do not because of society's non-economic goals for television. He contends that the abilities of policy-makers to influence content supply and consumption are diminishing in the UK and the US and that traditional regulatory approaches are unlikely to adequately redress content provision deficits. Pursuing non-economic goals for broadcasting can require other intervention to address the needs of citizen/consumers and the incentives to produce public interest content, he maintains.

Andrew Graham raises the issue of the roles of broadcasting policy and argues that it is gaining renewed attention because minimalist policies have shown themselves ineffective in banking, finance, and media. Broadcasting is not an ordinary product and deserves increased oversight, he argues, because it is a merit good, because consumption does not take place as an ordinary market transaction, and because it serves crucial social and democratic functions.

Mariana Mazzucato asserts that arguing that public service broadcasting crowds out investments in private broadcasting ignores its many contributions as a facilitator of the market that reduces risks to

investment and private firms and contributes to the development of the industry, its technologies, and its funding. The role of public broadcasting, she argues, cannot be merely one of addressing market failures but needs to be seen as building and enabling the television market. It should be conceived as part of a public-private partnership for building an optimal broadcasting system.

Diane Coyle and Paolo Siciliani show that the technical limitations which created market failures that served as the rationale for public service broadcasting have been removed by contemporary technological developments, but they argue that digital technologies are making other market failures in broadcasting more acute and continue to underscore the public good nature of broadcasting and that consumers and citizens continue to need some universally accessible content as a social good.

They warn that distribution through digital platforms is aggravating the trade-off between investing in programme variety serving many audiences and investing in quality popular content for large-scale audiences. Coyle and Siciliani also argue that the dynamics of the digital market, with significant economies of scale and network effects, pose a challenge for maintaining competition and opportunities for new entrants in the value chain.

Finally, Gavyn Davies reflects on the past and future of the BBC, arguing that it was developed to serve important social functions and that society will continue to benefit from universal access to quality programming. The BBC will need funding at an adequate scale to continue providing that service in the future because it remains relevant despite changes in the technological landscape, he asserts.

The authors in the second part of the volume recognise the changing nature of television economics, but make clear cases for continued intervention in broadcasting through public service broadcasting. Their support for public service broadcasting, however, is essentially unqualified and tends to cast the policy choices emerging in the contemporary debate as a choice between maintaining public service broadcasting or eliminating it.

Although this is perhaps the nature of polarised political debate that often results in compromise in actual policy, no serious suggestions have been made to abolish the BBC, even by its harshest critics, although significant changes have been suggested for other public service television enterprises such as ITV. With regards to the BBC, essential questions revolve around the extent to which the current scale and scope of the BBC remains necessary, given the contemporary economics of broadcasting. At some point in the coming years, one can expect the debate to more sharply focus on those issues.

Discussions instigated by the authors in this volume will be important in considering the future of television broadcasting in the United Kingdom and their ideas will contribute to the debate that will take place in the coming years. Whatever one's position on the emerging policy choices, comprehending the underlying issues and the varying points of view will be crucial for engaging in the debate and setting the next course for UK television policy.

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SECTION I

RECONSIDERING THE TELEVISION ENVIRONMENT

2. Digitisation, Programme Quality, and Public Service Broadcasting

Helen Weeds

On 24 October 2012 the analogue terrestrial television signal was switched off in the UTV¹ region, completing the process of digital switchover in the UK begun in 2007. All households with television now have access to multichannel TV, whether this is several dozen channels on digital terrestrial television (DTT) or several hundred on satellite and cable distribution platforms. Telecoms operators have launched IPTV platforms to offer television services to their subscribers. Many households also have access to a selection of non-linear services such as video-on-demand (VOD) and over-the-top (OTT) services, aided by improving broadband connections. Meanwhile the internet offers an enormous selection of content from which consumers may satisfy informational and entertainment needs traditionally met by television. The transition to fully digital television marks an appropriate point to re-examine the economics of television broadcasting and the case for public service broadcasting.

The UK's system of public service broadcasting (PSB) may be seen as a response to two concerns that arise in television broadcasting:

- *Consumer concern*: will the market provide what people want to watch?
- *Citizen concern*: will the market provide, and will people watch, what we want them to watch?

The consumer concern recognises that there may be market failures in broadcasting such that it fails to deliver the outputs that consumers themselves want to watch. The citizen concern recognises that broadcasting can serve broader social purposes, making television viewing a matter for more than just the individual consumer. These social purposes include education, which benefits other individuals and the economy, and the dissemination of information such as accurate news coverage, an important element of a well-functioning democracy.

These priorities are captured by the BBC's Reithian mission to 'inform, educate and entertain'. The Communications Act 2003 sets out, less succinctly, a variety of purposes for PSB in the UK. These include the provision of diverse programming catering to all interests and communities, investment in high-quality programming, and the promotion of educational and other social benefits, including an informed and tolerant population. These aims are combined with an element of industrial policy in the form of a bias towards nationally and regionally produced content.

The UK's system of public service broadcasting is facing a number of challenges in the post-analogue world. The TV licence fee, which supports the BBC's public service activities, is currently frozen in nominal terms until BBC charter renewal in 2016; over the longer term multichannel households may prove resistant to substantial increases in its value or object in greater numbers to the principle of a compulsory licence fee. Pressures on the advertising revenues which support the other public service broadcasters (publicly owned Channel 4 and private operators ITV and Five) threaten the future sustainability of this model of provision. These developments may require the existing system to be overhauled, and scaled back to some extent,

¹ Formerly Ulster Television.

if not immediately then at some point in the not-too-distant future. The following question will then need to be addressed: how much, if any, public intervention in broadcasting is really appropriate and, if the UK's system of PSB is to remain effective, how should it be delivered in the future?

The next section examines the public good nature of television broadcasting and the provision of television services. The third section considers consumer market failures in the analogue and digital worlds. Turning to citizen aspects of television broadcasting, the fourth section assesses the effectiveness and impact of public service broadcasting following the transition to digital, and this is followed by a conclusion.

The Economics of Television Broadcasting

Television broadcasting has often been described as a public good. In this section I explore this claim and its implications for market provision.

IS TELEVISION A PUBLIC GOOD? In economic terms a public good is defined by the following two properties.

- *Non-excludable*: it is infeasible (or prohibitively expensive) to exclude those who do not pay; this creates a free-rider problem as consumers need not pay in order to consume the good.
- *Non-rival* in consumption: consumption by one consumer does not reduce the amount available for other consumers; i.e. the marginal cost of supplying an additional consumer is zero.

The first property makes market provision of public goods problematic. Most goods, including television broadcasts, are costly to provide. Non-excludability makes it difficult to levy consumer charges. In the absence of other revenue sources suppliers struggle to recoup the cost of provision and the good is underprovided by the market; in extreme cases it may not be provided at all. The second condition implies that the socially optimal level of provision is high: with zero marginal cost allocative efficiency achieved by providing the good to every consumer who values it (in economic terms, to every consumer with positive willingness to pay).

The analogue terrestrial television system developed in the UK from the 1930s onwards displayed both of these properties, making the service a public good. However cable and satellite systems developed since the 1980s² built-in encryption technologies and other measures to exclude non-payers; with the completion of digital switchover there is now no television distribution technology in the UK for which exclusion is infeasible.³ These developments mean that the first property of a public good no longer holds and hence television broadcasting is no longer a pure public good. Nonetheless, based on the second condition alone (or sometimes on a different concept of a public good from the economic definition given above) several commentators continue to describe television as a public good, pointing to the social optimality of providing the service to all consumers that desire it.

² In the 1980s cable franchises were awarded and began to be built out in the UK. In 1989 the UK saw the launch of its first satellite broadcasting services, British Satellite Broadcasting (BSB) and Sky Television, which merged to form British Sky Broadcasting (BSkyB) in 1990.

³ Digital terrestrial has both a free-to-air service, Freeview, and a pay TV service, Top Up TV.

COMMERCIAL PROVISION OF ANALOGUE BROADCASTING In the analogue world in which consumers cannot be charged directly for viewing, market provision of television broadcasting can be supported by advertising revenues, overcoming the under-provision problem described above.⁴ Although they pay no monetary fees, consumers *pay* for broadcasts by watching the advertisements that interrupt the programming and buying the advertised products. Commercial television is a two-sided market: broadcasters show programming to attract viewers and sell access to those viewers to advertisers. The sale of advertising airtime is not a public good – advertisers can be excluded and the provision of airtime to advertisers is rivalrous – thus can take place as a market activity. Commercial free-to-air television funded from advertising revenues can sustain considerable amounts of television broadcasting. However, there is no guarantee that advertising-funded broadcasting achieves optimal outcomes for viewers. This issue is explored further in third section.

LICENCE FEE FUNDING In the absence of other funding sources, many public goods are provided out of general taxation. This, of course, is not costless: there are few forms of taxation that do not cause economic distortions, discouraging the desirable activity (such as working or saving) that is taxed. While a few countries use general tax revenues, a more common approach is to finance public broadcasters wholly or partly out of TV licence fees levied on households that own television sets (as in the UK).⁵ This may be variously regarded as a hypothecated tax or as a compulsory subscription. As a form of taxation it is regressive, with the same amount being paid by all households regardless of income (unless they choose not to have a television set at all).

Supporters of the licence fee often point to its desirability in terms of pricing at marginal cost, which in this case is zero: once the licence fee has been paid, viewing is free at the point of consumption. (The same could be said of pay TV subscription, though not pay-per-view: once the subscription fee has been paid viewing is free at the point of consumption.) But consumption as a whole is not free: the licence fee must first be paid – in this regard the licence fee is more akin to a subscription fee – and this gives rise to some distortions. A few households do not value watching television highly enough to pay the licence fee and are excluded even though they could be served at zero marginal cost. However, close to universal television uptake suggests that in practice this inefficiency is relatively small.⁶

A potentially more significant inefficiency arises when the licence fee coexists with pay TV. In order to subscribe to the pay TV operator's package the consumer must also pay the licence fee, even if she has little or no desire to watch the public channels. This distorts consumer choices regarding pay TV.⁷ Suppose that a consumer would purchase the pay TV package on a stand-alone basis. If her *incremental* willingness to pay for the package on top of the licence fee is too small then she will be excluded from consuming this good: this is a form of allocative inefficiency. Even if incremental willingness

⁴ The BBC started out as the British Broadcasting Company, a commercial entity founded in 1922 by a group of radio equipment manufacturers to transmit radio broadcasts in order to promote the sale of radio sets. Thus the first (radio) broadcasts in the UK were supported by the profits on equipment sales, another way of mitigating the free-rider problem associated with broadcasting.

⁵ Note that the TV licence fee system assumes that the problem of non-payment can somehow be overcome. In the absence of technological exclusion via encryption this has been achieved through an enforcement system based on criminalisation.

⁶ According to the Broadcasting Audience Research Board (BARB) 26.5 million out of 27.4 million domestic households in the UK (96.7%) own a television set as of Jan. 2013.

⁷ Representations of consumer preferences illustrating these distortions can be found in Armstrong and Weeds (2007a), s. 3.1.

to pay is sufficiently high that the consumer subscribes to the package, some surplus is transferred to the public broadcaster (whose service the consumer may not value), a diversion that reduces the funds available to provide the pay TV service. The inefficiencies arise from the compulsory nature of the licence fee: rather than having a free choice to take (and pay for) either one or both of the two services, the consumer's choice is transformed into a single choice between having the public channels alone or taking the pay TV package in addition to the public channels. Those consumers who would prefer to take the pay TV package alone cannot do so and are made worse off by the constraint. While it is unclear how many potential subscribers are deterred from taking pay TV because of the licence fee or to what extent pay TV revenues are reduced, these effects of the licence fee may not be trivial.

PAY TV As noted above, the adoption of encryption technologies and other exclusion methods means that the first property of a public good no longer holds in television broadcasting: non-payers can be excluded at reasonable cost. With this ability commercial broadcasters can now charge viewers directly rather than relying on advertising revenues alone to finance their services. The question then arises as to whether a pay TV model can efficiently provide television broadcasting.

Television programming has a high 'first copy' cost but once produced can be made available to additional consumers at no further cost. Distribution platforms have high fixed costs (e.g. terrestrial transmission masts or satellite transponders to make the broadcasts, and aerials or dishes to receive them) but once installed a consumer can receive any number of programmes at no further cost.⁸ A similar cost structure – high fixed and negligible marginal cost – is found in other creative industries: the same point could be made for movies and recorded music, for example. This cost structure creates a challenge, though not an insurmountable one, for market pricing: from the private as well as the social perspective it is desirable to supply all consumers with positive willingness to pay, extracting varying amounts of surplus from each one to contribute towards the fixed cost of providing the good.

Market provision typically achieves this through price discrimination: similar products are supplied to individual consumers at different prices to boost consumption while permitting the provider to generate the revenues necessary to recover fixed costs. In the pay TV sector price discrimination is typically implemented through bundling: channels (or, increasingly, non-linear services such as video-on-demand) are combined into a package sold for a single subscription fee. Although consumers may be offered some choice between different packages or the option to add higher tier 'premium' channels to the basic package, the combining of individual channels (or downloads) into packages is commonplace. The economics of bundling tells us that this approach – which is a form of second-degree price discrimination – can achieve close to the efficient allocation while overcoming the problem of provision entailed by marginal cost pricing.⁹

There are further benefits to consumer pricing beyond the ability to recover costs. Price signals inform suppliers as to which products are most highly prized by consumers. The informational role of consumer prices is particularly important in an industry such as television broadcasting where

⁸ This may be less true of IPTV distribution and over-the-top video services: incremental internet traffic is not costless, especially at times of day when capacity constraints are binding, and many consumers face caps on their monthly broadband usage.

⁹ Coase (1946) suggested multi-part tariffs, another form of second-degree price discrimination, as a solution to the marginal cost controversy.

consumers have diverse tastes and these change over time. Alternative mechanisms that might be employed when market prices are absent, such as consumer surveys, often fail to reveal the true preferences of a large body of consumers. Furthermore, organisations that are free from market discipline may find it easier to ignore consumer demands, satisfying their own preferences over those of consumers. Competitive markets also provide incentives for innovation and cost efficiency.

It might be pointed out that other industries with a similar cost structure, such as movies and recorded music,¹⁰ exist with market provision and no significant public intervention. These, too, use price discrimination to mitigate allocative inefficiency: 'windowing' in movie release is a form of inter-temporal price discrimination whereby consumers with a high willingness to pay who are impatient to see the movie at first release pay more for it than those who are willing to delay consumption and purchase in subsequent release windows.¹¹ Even if these methods fall short of achieving precisely the socially optimal outcome, there has never been a proposal to replace or supplement market provision in these industries with a form of public provision akin to public service broadcasting. The case for public service broadcasting must rest on something more than the high fixed/low marginal cost structure which broadcasting shares with other creative industries.

Consumer Market Failures in Television Broadcasting

As discussed above, even in the analogue world, market provision of television broadcasting is not undermined by its public good properties: advertisers are willing to pay for access to viewers and these revenues can support considerable amounts of television broadcasting. However, free-to-air commercial broadcasting does not guarantee that the *characteristics* of the programming that is provided best serve the preferences of viewers. Three main characteristics are important to consumers of television programming:

- *Diversity*: there are many genres of television programming; individual consumers have different preferences over these, and each consumer likes variety in programming.
- *Quality*: within each genre consumers prefer programming with superior production qualities, e.g. better acting in a drama, more special effects in an action movie, speedier and more accurate news coverage.
- *(Lack of) advertising*: consumers generally regard advertising as a nuisance, preferring to watch the chosen programme without interruption (though note that if viewers avoid watching advertisements, e.g. by using recording devices, the business model underlying commercial free-to-air broadcasting cannot be sustained).

MARKET FAILURES OF ANALOGUE TELEVISION BROADCASTING In addition to non-excludability, analogue terrestrial broadcasting in the UK had another

¹⁰ Challenges to the recorded music industry in the early 21st century arose mainly from the ease of private copying of digitally recorded music, resulting in unauthorised reproduction and non-payment becoming widespread. In this sense recorded music might now be said to display more of the characteristics of a public good than television broadcasting. Access control technologies ('digital rights management') are being developed by providers to restrict unauthorised copying and distribution of digital content.

¹¹ Although note that delay involves some inefficiency.

important characteristic: with limited spectrum available for broadcasting only a small number of television channels could be broadcast (a maximum of five by the time the analogue system was switched off). This restricted the choice available to consumers at a particular point in time to just a handful of programmes.

In a literature dating back to the 1950s (see e.g. Steiner, 1952; Beebe, 1977; Spence and Owen, 1977), economics has been used to assess market outcomes of free-to-air, advertising-funded broadcasting with a limited number of channels. Having discussed the conclusions of this literature at length elsewhere (see Armstrong and Weeds, 2007a), I shall confine myself here to a brief summary. Free-to-air analogue broadcasting is prone to focus on mass market tastes, supplying lowest common denominator programming whilst failing to meet the needs of groups that are smaller in number yet whose preferences may be strongly felt. Put another way, there is too little diversity of programming. This is because advertising-funded broadcasters care primarily about attracting 'eyeballs', i.e. the size of the audience, perhaps with a preference for certain demographic groups, rather than the value of the content to consumers. Inability to extract consumers' willingness to pay for higher quality also means that investment in programme quality tends to be too low from the social point of view. Meanwhile programmes are accompanied by too much advertising from the perspective of viewers.

The system of public service television broadcasting developed in the UK since the 1930s¹² may be rationalised as a response to the market failures of analogue terrestrial broadcasting. The system is subject to regulation under UK statute and two European Directives. The Communications Act 2003 requires public service programmes, taken together, to cover a wide range of subject-matters and appeal to many audiences and interest groups (i.e. to provide diversity) and to maintain high quality standards in their contents and production.¹³ The amount and scheduling of television airtime devoted to advertising is subject to constraints under the Audiovisual Media Services (AVMS) Directive, adopted in 2007 to amend the Television Without Frontiers (TVWF) Directive adopted in 1989.¹⁴ Taken together, these regulations mandate greater diversity and high-quality programming, and limit excessive advertising, in line with the viewer preferences noted above.

TELEVISION BROADCASTING IN THE DIGITAL WORLD Technological changes (often referred to collectively as 'digitisation') have transformed television broadcasting in two important ways. First, since all distribution platforms now have the capability to exclude non-payers, commercial providers have the option of charging viewers directly. Secondly, digital signals make better use of the available spectrum (or other transmission medium), vastly increasing the number of channels that can be broadcast.¹⁵

These developments profoundly alter the economics of television broadcasting. A recent literature on the economics of television broadcasting

¹² The UK's system of public service television broadcasting began with the launch of the BBC's television service in the 1930s, followed by the introduction of commercial television (ITV) in 1955, launches of two further analogue channels Channel 4 (S4C in Wales) in 1982 and Five in 1997, and the introduction of additional digital-only BBC channels in the 1990s.

¹³ Communications Act 2003, part 3, chapter 4, para. 264(4).

¹⁴ Under the AVMS Directive, advertising is limited to 12 minutes per hour (as before), but the daily limit of three hours of advertising previously imposed under the TVWF Directive was abolished. For most programmes broadcasters are allowed to choose the most appropriate moment to insert advertising, but cinematographic works, children's programmes, and news programmes may be interrupted by advertising only once per 35-minute period.

¹⁵ However, differences remain in the relative capacities of different distribution platforms, with satellite and cable far outstripping DTT.

assesses market outcomes in the light of these changes.¹⁶ These models capture consumer preferences for greater diversity and higher quality programming, and their dislike of advertising, and use this framework to analyse choices of competing broadcasters given consumer preferences and their business model (free-to-air or pay TV).

The main findings of this literature are as follows. Pay TV achieves programming outcomes that are at or close to the viewer optimum: by charging viewers directly the incentives of broadcasters are better aligned with those of consumers than when they rely on advertising funding alone. Comparing pay TV with free-to-air, viewers' willingness to pay for the programming they desire gives an incentive to serve small groups with strong preferences, increasing diversity of programming. Similarly the ability to extract viewers' willingness to pay increases the quality of programming to a level that is roughly appropriate given audience size. Broadcasters balance revenues from advertising against its annoyance to viewers, reducing the amount of advertising shown. Although programming outcomes are closer to the viewer optimum, viewers are not necessarily better off however as they pay to watch. Armstrong and Weeds (2007a) find that, if there is little scope for improving programme quality, viewers would be better off under free-to-air, but with variable programme quality they are better off under pay TV.

Digitisation relaxes capacity constraints, allowing a much greater number of channels to be broadcast. This taken on its own mitigates the problem of insufficient diversity: even with free-to-air, as the number of channels increases broadcasters find it more profitable to serve niche interests than further to subdivide the mass market. However a trade-off arises between diversity and quality: audience fragmentation across a larger number of channels reduces programme quality. This is because production costs are independent of the number of viewers: raising quality incurs a larger fixed production cost while its benefit increases with the number of viewers, thus a larger audience provides a greater incentive to invest in programme quality. Quality and diversity of programming need to be assessed together: if channel entry is excessive, diversity will be high but quality too low (and the opposite for insufficient entry). Outcomes are sensitive to the modelling approach: using variants of the Salop (1979) model of differentiated goods with free entry, Armstrong and Weeds (2007b) finds that endogenous quality worsens that model's tendency towards excess entry, while Weeds (2012) finds excess entry to be mitigated.

Analogue broadcasting, with its constrained capacity and reliance on advertising funding, provided a rationale for public intervention to increase the quality and diversity of programming and to limit advertising, but this does not carry forward to digital broadcasting. Multichannel pay TV achieves broadly optimal programme outcomes. Even if market and socially optimal outcomes do not always coincide, the extent and even the direction of any market failure are difficult to determine, making intervention problematic: there is little guarantee that a regulator or non-market entity would do any better. In the digital world consumer market failures no longer provide a strong basis for major public intervention in television broadcasting.

¹⁶ See Anderson and Coate (2005); Choi (2006); Armstrong and Weeds (2007a); Armstrong and Weeds (2007b); Seabright and Weeds (2007); Peitz and Valletti (2008); Crampes et al. (2009); and Weeds (2012).

Citizen Aspects and the Impact of a Public Broadcaster

In the digital world the case for public service broadcasting must rest on citizen aspects of television broadcasting. Television is a powerful medium for conveying messages to a mass audience – as advertisers recognise. Some programming serves an educational purpose; people might pick up skills that are helpful to others by watching, say, life-saving techniques in a medical drama; accurate news coverage and discussion of current affairs play an important role in a well-functioning democracy; and some commentators claim popular television promotes social cohesion and understanding through so-called ‘water cooler’ effects.¹⁷ Although the extent and importance of such benefits may be hotly debated, they provide a rationale for some intervention in television broadcasting even in the digital age.

SOCIAL BENEFITS AS POSITIVE EXTERNALITIES In economic terms, social benefits from broadcasting can be characterised as positive externalities generated when consumers view and act upon the relevant programming. (Note that there may also be negative externalities associated with television viewing, such as the claimed link between violence on television and violent behaviour.) Microeconomic theory tells us that in the presence of positive externalities goods tend to be underprovided by the market, because the transaction between buyer and seller takes no account of benefits to other parties. If externalities cannot be internalised then there is a case for public intervention to increase the supply of socially beneficial programmes (and to limit harmful ones).

This rationale for intervention would call for a targeted approach in which public funds are used to produce programming which confers social benefits and to distribute this material as widely as possible. This might look rather different from the UK’s existing system of public service broadcasting, however: a large part of licence fee-funded programming (e.g. popular entertainment) would seem to generate few positive externalities, and individuals who choose not to have television and so do not pay the licence fee share in the social benefits from consumption by others while not contributing towards them.

EFFECTIVENESS OF PUBLIC SERVICE BROADCASTING There is a challenge facing a public service broadcasting system motivated by positive social externalities. It is not enough simply for socially beneficial programming to be produced and broadcast: it must also be watched. If few viewers watch the programmes their messages go unheard and little social benefit is created.

Digitisation creates an attention problem for public service broadcasting. Now that all television households have multichannel TV and many use the internet and over-the-top services to access video and related content, consumers have a vast range of television and other services to choose from to satisfy their entertainment and information needs. In the face of so much choice it is difficult to ensure that socially beneficial programming is actually watched. In the early days of BBC television this problem did not arise: the BBC had a monopoly over broadcasting and the viewer’s only alternative was to switch off and do something else. In today’s world of competing television and media providers the effectiveness of public service

¹⁷ On the final point, movies and popular music also provide a talking-point for social gatherings at work and, unlike television, offer opportunities to share experiences at cinema showings and live concerts, yet these are not deemed worthy of major public intervention.

broadcasting cannot be guaranteed in this way. As Richard Eyre, then Chief Executive of ITV, succinctly put it:¹⁸

Free school milk doesn't work when the kids go and buy Coca-Cola because it's available and they prefer it and they can afford it. So public service broadcasting will soon be dead.

If public service broadcasting is to remain effective in achieving social aims it must meet two challenges. First, socially beneficial programming must be made appealing to consumers so that they choose it over the many alternatives. This may require an approach akin to 'product placement' in advertising, conveying the message within popular programming. In 2004 Culture Secretary Tessa Jowell was criticised for taking an expansive view of what constitutes public service broadcasting when she stated:¹⁹

I would say that those episodes of EastEnders that tackle difficult issues of child abuse, drug taking, teenage pregnancy, and so forth, are actually – when they do it responsibly – providing an important public service.

Yet a product placement approach to PSB might well require *more* social messages to be conveyed through light entertainment. However, achieving this without overburdening popular programmes with pious messages or dumbing down the message to make it more palatable may prove difficult. Moreover the need for consumer appeal does not imply that a public service broadcaster should chase ratings for their own sake.²⁰ This sentiment was expressed by Patricia Hodgson, then Chief Executive of the Independent Television Commission,²¹ when she contrasted the BBC's screening of the unexceptional *Celebrity Sleepover* and the more PSB-focused *Blue Planet*, stating:²²

Beating ITV with Blue Planet is a triumph! Beating it with Celebrity Sleepover is a tragedy!

The second challenge is that with increasing numbers of consumers migrating to new media to obtain entertainment and information, public service broadcasters must follow these trends otherwise they will simply be left behind. This argument would seem to justify the BBC's diversification into digital broadcasting and the internet: if it did not do so an increasing proportion of the population would move out of reach. But entering new areas is costly both to the public service broadcaster, which must incur the cost of launching the services, and to commercial providers who operate, or wish to operate, in those fields. Diversification creates new points of contact where public and commercial providers collide, often in nascent markets where new services are being developed and providers are entering the market. The distortion of market provision is a less apparent but significant cost of public service broadcasting in the digital world.

¹⁸ Richard Eyre, 'Public Interest Broadcasting – A New Approach', MacTaggart Lecture at the Edinburgh International Television Festival, 27 Aug. 1999, available at http://www.geitf.co.uk/sites/default/files/geitf/GEITF_MacTaggart_1999_Richard_Eyre.pdf.

¹⁹ As reported by Colin Robertson, 'Jowell: Reality Shows could be PSB', Southwark.TV, 2 Mar. 2004.

²⁰ A licence fee-funded broadcaster such as the BBC has a further reason to be concerned about reach: public acceptability of the licence fee is likely to depend on continuing to reach large audiences. This, rather than the dissemination of socially beneficial messages, would seem at times to have driven the BBC's competition for audiences.

²¹ The Independent Television Commission (ITC) licensed and regulated commercial television services in the UK between 1991 and 2003, after which it was merged with four other regulatory bodies to form Ofcom.

²² Patricia Hodgson, 'Freedom to Flourish: The Future of Communications', Fleming Lecture at the Royal Television Society, 5 Mar. 2002.

MARKET IMPACT OF PUBLIC SERVICE BROADCASTING Since 1997 the BBC has launched several new digital television and radio services, developed its catch-up TV service (BBC iPlayer) and created extensive online services including the high-profile BBC News website. These services are funded from the TV licence fee and provided free of charge to users. As a result providers of commercial alternatives face lower consumer willingness to pay and smaller audiences, reducing their revenues and threatening their viability. It is likely that that there is significant ‘crowding out’ of private provision as a result of BBC’s digital services.

This effect has been recognised by Ofcom, among others. In its market impact assessment²³ of the BBC’s digital television and radio services, Ofcom wrote:²⁴

There are potentially significant costs associated with the BBC’s activities. There is a real risk that the BBC’s involvement in some market segments may leave insufficient revenues for commercial operators wishing to supply those segments now or in future. Also, uncertainty about the future strategy of the BBC’s new services may exacerbate the risks associated with new market entry or content innovation, by extending the range of services over which commercial operators may face competition from the BBC in future. Combined with the BBC’s large budgets and relatively loose remits this may, in time, diminish overall levels of competition, investment and innovation.

Yet Ofcom appears to believe that the BBC’s activities stimulate the provision of high-quality programming by commercial competitors, stating in the same document:

The BBC currently plays a role guiding competition to deliver higher quality, more diverse programming than it might deliver on its own. (para 2.11)

Economic analysis suggests that this view of the relationship between quality provision by a public broadcaster and its commercial rivals is flawed. When a public broadcaster raises the quality of its output this reduces, not increases, the quality of competing commercial services (in economic terms quality levels are strategic substitutes not strategic complements; see Armstrong and Weeds (2007b), s. 3). The underlying mechanism is as explained above: programme quality is increasing in audience size, thus by taking consumers away from commercial providers higher quality public service output reduces their incentives for quality investment.

Under the BBC charter, a decision to approve a new BBC service should take account of both its public value and market impact. In Ofcom’s view negative substitution effects are likely to be more significant than positive market creation effects (which might arise if the BBC service complements commercial services and drives increased investment).²⁵ This suggests that public benefits from PSB need to be balanced against both direct cost of provision and indirect costs to other (actual and potential) market participants and to consumers. Comparing this trade-off for the analogue and digital worlds, it is likely that the benefits are largely unchanged while the

²³ Under the current BBC Royal Charter and Agreement, which came into effect on 1 Jan. 2007, a Public Value Test (PVT) must be carried out before any significant change to the BBC’s UK public services. This requires a Public Value Assessment (PVA) to be carried out by the BBC Trust to assess the value of the service to licence fee payers and a Market Impact Assessment (MIA) to be carried out by Ofcom to assess its effect on other services in the market.

²⁴ Ofcom, *Assessment of the Market Impact of the BBC’s New Digital TV and Radio Services: An Analysis by Ofcom, Conducted as an Input into the Independent Reviews of the BBC’s New Digital TV and Radio Services*, 13 Oct. 2004, para. 2.5, available at <http://stakeholders.ofcom.org.uk/binaries/broadcast/reviews-investigations/psb-review/bbcnews.pdf>.

²⁵ Ofcom, *Methodology for Market Impact Assessments of BBC Services: Statement*, 22 May 2007, paras. 1.6–1.7, available at <http://stakeholders.ofcom.org.uk/binaries/research/tv-research/bbc-mias/bbc-mia-meth.pdf>.

costs, both direct and indirect, have risen considerably in the transition to digital broadcasting. In this case the appropriate response would be to scale back public intervention in broadcasting to a level where its costs and benefits are in balance. Yet modest curtailments of the activities of public service broadcasters owe more to the current climate of austerity than to any reassessment of the role of PSB in the digital world.

Concluding Comments

This chapter has discussed the role of public service broadcasting following the transition to digital television and the emergence of non-linear and online services. It finds that traditional consumer market failures of analogue, free-to-air broadcasting do not carry over to the digital world: the market will provide the programmes that people broadly want to watch. The rationale for public intervention in broadcasting must now rest on citizen concerns. While there is a case for continued intervention to increase the provision of programming that conveys positive social externalities, its effectiveness is limited if consumers increasingly turn to other broadcasters and alternative products to satisfy their needs for information and entertainment. Attempts to overcome this attention problem by entering the digital arena bring public service broadcasters into greater conflict with commercial providers, increasing the scope for harmful market impacts. The time has come for a fundamental reappraisal of the role and extent of public service broadcasting.

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3. Television Wants to be Shared

Joshua Gans

My recent book *Information Wants to be Shared* (2012) puts forward the hypothesis that allowing consumers to share information easily can be an important feature of business models for content provision. The reasons are twofold. First, information, as an economic good, has a non-rival characteristic, meaning that the costs of producing information are independent of, and often much greater than, the costs of distributing it. This is certainly true of broadcasting where the size of the audience does not impact on the cost of providing programming. From an economic perspective, what this implies is that it is efficient for information, once produced, to be widely disseminated and that we should look for ways for all users to contribute towards the cost of producing that information. That widespread dissemination and voluntary choice to contribute to information funding can conflict is a challenge that does not diminish the aim here.

Second, on the demand-side, information can be more valuable to consumers if it can be shared. This might arise from benefits associated with shared consumption (e.g. the ability to discuss the news with your friends) but also from the way information competes for attention. When trusted friends and colleagues can recommend the consumption of information to you, it competes more effectively for your attention. But such recommendations are more likely to be forthcoming if your friends know you have access to that information. This is perhaps why pay-walls for news organisations have been more effective when they are 'leaky'. For instance, the *New York Times* pay-wall allows readers to share individual articles freely with non-subscribers. Thus, what subscribers are paying for is the curation or filter of the *New York Times* precisely when they do not want to search for interesting news themselves.

In this chapter, I will apply this same thinking to the television industry and, in particular, how that industry is changing in the face of the proliferation of digital technologies. I will argue that this has not only impacted on the advertising-based business model for commercial television but, importantly, on the type of content that would remain profitable under commercial models. This has consequences for the type of content that might fail to be provided by commercial television and where public broadcasting may have a role in filling the gap.

A Simple Model of Television Demand

To begin, I sketch here a simple model of television demand. Consumers are assumed to value television based on two components. The first component is the familiar utility for entertainment; that is, how much intrinsic enjoyment a consumer receives from watching a programme. I will denote that component by u . The second component is understudied: it is the utility a consumer receives from shared consumption of a television programme. This arises because watching a programme gives consumers more utility if they can share the experience with people they know – a water cooler effect. If a consumer interacts with n people who also view the programme, this component is an increasing function, $U(n)$. The total number of people a consumer could possibly interact with is $N > n$.

There are also things that detract from the enjoyment of television. One thing is having to pay for it (say, a price or subscription fee of p). Another thing is advertising. As these interrupt television, consumers would prefer to

avoid them. The cost associated with a certain quantity of ads, a , is simply assumed to be a . Putting all this together, if a consumer watches a programme that costs p to view and has ads, a , and if n of their social network also watch it, their overall payoff is:

$$v = u + U(n) - p - a$$

This model means that television is not a simple economic good. In particular, demand is impacted on by both the expectations and the reality of how a consumer's social network consumes television. When a programme is popular in a social network, a provider can both charge more and supply more ads. When a programme is not popular, it cannot. But the existence of the network makes demand, especially when a programme is new, more elastic with respect to both price and advertising. This is why advertising can work well as a business model. It is often difficult to change price upwards when a programme becomes popular but it is not as hard to increase advertising levels and to charge advertisers more in those cases.

Timing and Advertising

The tension with respect to advertising is, of course, that consumers would like to avoid ads. As long as there has been television advertising, there has been concern about whether consumers pay attention to them. Did they use ad breaks as an excuse to visit the bathroom? Did they move to work on a crossword? Did they perhaps talk with other people in the room?²⁶

But of greater concern was the use of technology to avoid ads. This was an initial use of the VCR (see Greenberg, 2008) and later of digital video recorders (such as TiVo). These technologies allowed consumers to watch programmes and skip the annoying ads. In the case of the VCR, this did not even show up in television ratings and so the volume of ad viewers became even more uncertain.

One force working against the use of technology to avoid ads is that invariably they require time-shifting. That is, it was a challenge to avoid ads if the intention was still to watch the programme close to the time it was broadcast. That meant that ad avoidance was as much a by-product of a willingness to view programmes at a different time than the broadcast time as it was a direct benefit in of itself. Importantly, if programmes had a high social component, then the incentive to time-shift was diminished and this increased the likelihood that consumers would also not avoid ads.

Thus, an important driver of the effectiveness of ad-supported television were consumer's choices on the timing of their viewing. The more that they wanted to coordinate with others for social reasons, the more they would view television when broadcast, alongside the ads that were part of that broadcast. For this reason, advertisers and broadcasters needed to be concerned about the temporal agglomeration of viewing and the technological forces that were pushing against that.

The Impact of Digitisation

Digital technologies have transformed the television landscape. In particular, it has resulted in both improved quality of video distributed and also a proliferation in the ways in which video can reach consumers. Of most interest is the ability to pull pure video content into homes based on a

²⁶ As it turns out, this actually may be good news for advertisers. When people watch television with other people, they often engage with the ads themselves. See Jayasinge and Ritson (2013); and also Ritson and Elliott (1999).

schedule set by the consumer. To be sure, video cassettes and then DVDs allowed this, but downloadable programmes have brought the long-envisioned 'on-demand' notion to reality.

In principle, this should change little about the business models to support television. Just because consumers can opt to view content at a time of their own choosing does not prevent advertising being associated with it. Moreover, the same forces pulling consumers to watch television at the same time are still present. However, this is not a new equilibrium but still a transition. It is costly to expect many viewers to stream a programme online simultaneously as bandwidth can still be strained. This is especially so since the existing methods of distribution still exist. Thus, incumbent broadcasters have strong incentives to push consumers away from download options. Hence, simultaneous broadcast and streaming is rarely seen.

In the absence of simultaneity, the less socially inclined will time-shift using download television. This can still have an impact on the more socially inclined as some interactions might be lost but the overall reduction in value is muted. What is more serious is what occurs for ad-adverse consumers (see Anderson and Gans, 2011). They have more options too. First, there are now legitimate, although delayed, download options (such as through iTunes) that at a cost are similar to time-shifting using DVRs. Second, there are opportunities for gaining television content unofficially.

In both these cases, one side-effect is positive: the metrics for advertising actually improve. It is easier to measure the audience viewing ads. In addition, time-shifting and on-demand options improve the viability of certain types of programming that may have been previously unviable. Programmes such as *Lost* that involved long, multi-year story arcs become feasible. Previously, with pure broadcast, such programmes would suffer from diminishing audiences where those who missed out could not easily catch up with the crowd. With a stock available on-demand, viewers can catch up and in the process rejoin the crowd and the social benefits this may confer.

But, against this, is a more difficult balancing act: it is harder to coordinate viewership to support a strong advertiser-based option. That is, with a significant share of viewers waiting to view content, the social effects from simultaneity are diluted. This removes the social acceptability of discussing television at the water cooler in fear of transmitting spoilers. Thus, television becomes less temporally agglomerated.

It would be a mistake to conclude from this, however, that the advertising model is diminishing in importance. On the contrary, what it implies is that it is less likely to be supported by the bundle of programming that would previously constitute a channel. Instead, advertising will be more effective where there is a strong social element that drives simultaneity, while other forms of revenue will be required for content without that element. In a sense, traditional simultaneous broadcast will involve more of the programming that is valuable consumed simultaneously and less of other forms of programming. In this way, there is an efficiency in the reallocation.

In addition, it is worth emphasising that these same pressures apply to subscription or fee-based television as well; especially where there is a social component to demand. In that situation, the ability of technology to pull consumers across a greater temporal dimension in their viewing may have the consequence of diminishing the value of such television. Again, it is programming that compels a social element and perhaps generates it that will be relatively more attractive in competition for viewer's immediate attention and so the mix of viable programming will be altered by these pressures.

Thus, we have a picture here of forces acting to compete for the social component of viewers and hence developing content that reinforces that social dimension in order to coordinate consumers more in their temporal viewing habits. This will guide consumers' immediate viewing choices, with other programming being watched at times when there is no compelling socially driven option. These pressures have always been there but the technological changes have made them starker. In particular, there is a greater relative return to mass-market rather than high-quality niche programming.

If I had to conjecture what types of programming this would favour, on the advertising-based side, news, sporting events as well as reality television programming (including *Survivor*-like contests and talent contests like *Britain's Got Talent*) will fare well. On the subscription-side, higher quality dramas like *Game of Thrones*, *Downton Abbey*, and *Lost* that achieve a cult-status will be favoured. What will fall increasingly by the wayside will be sitcoms, self-contained drama (like *Doctor Who*), and documentaries. In other words, the social component will drive out the intrinsic entertainment component in the programming offered via traditional television models.

Globalisation

The great connectedness afforded by the internet has created opportunities to leverage the social component of television demand but also challenges. The opportunities arise because a consumer's social network is potentially larger and so the quality of television programmes can be more readily communicated. This increases both the potential for hits but also for niche programming that appeals to particular groups (the so-called 'long tail': see Bar-Isaac et al., 2012).

The challenges arise because this connectedness transcends international boundaries. Previously, content providers would engage in nation-specific licensing that would allow local broadcasters to choose the timing of programming. Thus, they could leverage different seasons in ensuring that programmes are matched for when an audience may be largest. This would also occur in terms of the day of the week and exploit national differences in terms of when it is best to broadcast a programme.

But the social component of programming demand as well as connectedness has made the demand for simultaneity global. Consequently, keeping to delayed broadcast harms consumers' ability to interact on global social networks. Thus, they have a stronger incentive to find alternative means of procuring television content. That is why delayed programming is associated with greater file sharing of television and broadcasters have been forced to move towards a more globally synchronised schedule. This has deepened the relative weight on programming based in the country of origin.

Short-Videos

Thus far, I have not mentioned the important new market for shorter videos (namely, YouTube). This now captures a considerable share of viewer attention and is essentially an advertising-supported medium. What are the impacts of this?

Most importantly, the attention captured by shorter videos is likely substituted from television. There are exceptions (such as snippets of talent shows driving demand for the full version of those shows). But in the aggregate one expects a strong substitution effect.

This is a challenge for broadcasters seeking to bundle content into channels but there is also a possibility that the news may not be all that bad on the advertising revenue front. This is because shorter videos have less opportunity for interrupted placement of ads and possibly less opportunity for ads *per se*.²⁷ That gives traditional longer-form programming a competitive advantage in the market for video ads (see Athey et al., 2012).

Public Broadcasting

One view of public broadcasting is that it should provide programmes that are under-served in the market relative to an assessment as to what might be socially desirable (see Barwise and Picard, 2012). The above analysis has suggested that the most commercially valuable programming may shift towards programmes that have a strong social component and potentially more mass-market appeal. This would reduce the need for public broadcasters to provide sporting, news content, and reality television but increase the opportunities for self-contained sitcoms and drama as well as traditional public broadcaster areas such as documentaries and educational content.

Conclusion

This chapter has offered some thoughts about the impact of digitisation on television broadcasting. It has emphasised the importance of social components of demand that arise both from the value of joint consumption of television as well as the impact of referrals from trusted people in driving attention towards particular programmes. The analysis has suggested that the type of content that will be commercially most attractive will have an increasing social component in the future.

Of course, this analysis is somewhat speculative; albeit grounded in economic theory. Hopefully it can provide some inspiration to those examining trends in the industry to examine the social component of television further.

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²⁷ Of course, the scope for ad targeting is improved and also, the ability to take action to skip an ad may mean that ads that are actually viewed are on average more effective.

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4. Regulating Broadcasting

Dieter Helm

Every major infrastructure and utility industry has its own lobby proclaiming that it is *different* – that it requires special treatment. The broadcasting industry is no exception. Recently the claim to this ‘specialness’ has been bolstered by the claim that rapid technical change – notably digitalisation – is a ‘game changer’, requiring a number of policy responses which vary in accordance with the vested interests that lie behind the market participants. It is argued that the increased capacity to choose in real time, and the proliferation of channels has changed the nature of the broadcasting market.

The argument is then carried over to a series of policy recommendations, notably that the current policy interventions in respect of the BBC and licensing more generally are no longer appropriate.

Technological change matters, as does the peculiar features of each activity. But the exceptionalism claim should be treated with a large dose of scepticism. This brief chapter argues that the basic economic concepts that inform market design, the identification and measurement of market government failures, and competition analysis remain highly relevant. The emphasis may be changed by new technologies, but remarkably little turns out to be *different*.

The next section reviews the main economic characteristics of the broadcasting market, and in particular the various public goods that broadcasting provides. Then I consider whether and to what extent technical change has changed the nature of these market characteristics. The following section focuses on public service broadcasting in its narrow and wider senses – in platforms and in programmes, and then there is a conclusion.

The Economic Characteristics of Broadcasting

Broadcasting is a public good in the economic sense. A public good is defined by the nature of the costs, the non-rivalry in consumption, and the excludability of consumption.

The marginal cost of providing broadcasting services to an additional customer is zero. Hence there is a gap between the average and marginal costs. Since the marginal costs are zero, broadcasting is non-rival in consumption. Consumer surplus is maximised if all customers that wish to consume it can, even if the marginal benefit approximates zero.

Broadcasting is also non-excludable – unless some intervention or contract restricts access. This is required because otherwise there is no incentive to create and broadcast programmes. Whilst it has always been possible to enforce the licence fee as an exclusion device, and now enforce subscriptions, the underlying cost structure remains unaltered. Indeed were the abilities to use the law to exclude a determinant of whether a good is public, there would be few if any public goods at all.

Broadcasting creates externalities distinct from the public goods. These range from narrow to broad in their impacts. Narrow externalities arise from the value in use of the information provided to other activities. Wider externalities relate to social benefits of shared information, cultural transmission, and news services, many of which are necessary to the functioning of the economy and the democratic process. In some cases, this is vital to the national interest – for example in emergencies and epidemics.

The broadcasting market has significant elements of market power. A small number of companies control significant parts of the broadcasting

industry. This is true in most major economies, including the US. These dominant incumbents face a range of entrants, and indeed a major impact of digitalisation and related technical changes has been to render fringe entry easier. But the impact of fringe competition is limited and the market shares of the major players remain sufficient to expect significant competition issues in the absence of regulation.

These are not the only market failures, but they are the main ones, and they are very significant. They are also well-known. To date they have required significant policy interventions in most countries. This includes the provision of public service broadcasting, the subsidisation of news and other so-called public interest programming, and numerous competition interventions.

The Impact of Digitalisation and Other Technical Changes

There is nothing new about technical change in broadcasting. The history of broadcasting has been one of continuous technical change. Technical change alters the cost characteristics of the industry. Early advances increased the number of channels, and introduced colour to replace black and white.

In the last decade, there have been a series of advances. Broadband forces convergence between the internet and conventional broadcasting, and with it the convergence between the conventional TV, personal computers, tablets, and other mobile devices. Broadband also makes it possible to view past programmes on demand, and increasingly makes real-time viewing possible. The schedule of programmes becomes multidimensional, supported by search engines. With broadband the cost of producing and broadcasting a programme – and the creation of new channels – falls. As a result, new channels can be created and new entry into programme making can be expanded. The scale economies are reduced. These changes are in the technical sense radical, but in themselves they change very little in the underlying market failures, and they add one additional market failure.

Focusing on the existing market failures, none of the above changes the public good aspects of broadcasting. The marginal cost is still zero. Consumption is still non-rival. Excludability remains a problem. Externalities remain. The additional market failure arises in respect of search and information provision in respect of the 'experience good' characteristics. Faced with a bewildering array of channels and programmes, the consumer now faces search costs. How does the consumer know what to watch and whether it will deliver what the consumer wants?

The answer to this problem has traditionally been that channels provide filters. They produce or buy in the programmes, and each has developed particular characteristics. The BBC for example provides a quality threshold. News programmes on the BBC are expected to pass tests which others channels may not – and when standards slip, there are major consequences. It is a phenomenon across the broader publications and media outlets, from peer review, to branded publishers, to public service standards. The consequence is somewhat paradoxical – the more channels and programmes proliferate, the greater the need for screening mechanisms. Given the economics of search – and the fact that it is inefficient for each consumer to bear the costs individually – the case for such filters increases with more choice.

In theory the answer might be for the market to create filters as a competitive business. In practice, across a very wide range of activities in the

economy where quality matters, the market fails to deliver. In many cases quality regulation is required.

The case therefore for a retreat from intervention in the face of digitalisation is unconvincing, and indeed more intervention may be required as the market fragments. The detailed design of interventions may need to be tweaked, but nothing more.

Public Service Broadcasting

Public service broadcasting arose in the context of a broadcasting monopoly, when the technology provided for only one provider. In the British case, the BBC was built up to fulfil the public interest role of broadcasting, and it has changed and adapted that role over time, in the face of new channels and the development of the internet and broadband. Other countries have tried more pluralistic models, but none has developed anything remotely like the BBC.

The BBC solves a number of market failures. It provides a public good, and finances this through a club membership fee – the licence fee. This is set at a level dictated by government, and it is for government to decide the trade-off between the level of the licence fee and how much of the consumer surplus is captured, given that the marginal cost is zero. The BBC's Royal Charter provides a peculiar kind of British institutional architecture. It is neither controlled by government nor completely independent of it.

For much of its history the BBC both made the programmes and broadcast them through its channels. The monopoly was vertically integrated. In recent times, this vertical integration has been broken down. The BBC continues to produce programmes, but it is in effect a central buyer, with a host of independent production companies offering their services.

This central buyer model fulfils a number of functions. It is a filter, applying the BBC brand through the channels these programmes are broadcast through. This sets quality and helps to ameliorate the search problem for consumers. It can discriminate and subsidise different kinds of programme according to its estimation of the public value of the programme. It can also encourage competition, by subsidising new entrants. It is a central buyer which socialises the costs of different programmes.

This in turn allows the BBC as central buyer to determine the mix of programmes, based upon its interpretation of public service broadcasting. It can decide how much news, drama, sport, comedy, and so on to provide. Given that the market is not going to provide this programme mix and is unable to cross-subsidise, it is very unclear how the market failures can otherwise be solved. Certain high-cost public interest programmes could only be otherwise provided by high subscription charges. But this does not overcome the fundamental problem that they are public goods – and high subscription charges for minority specialist programmes excludes a number of potential customers, and especially those for whom there may be important externalities. A market in which news is provided to subscription customers, but not to the masses, is one that is unlikely to be socially optimal.

Digitalisation does not alter these fundamentals, though it may reduce costs. The public interest is not satisfied by the private ability to pay in the context of zero marginal costs and major externalities.

Yet these considerations do not address the problem of who decides what the public interest is, and in particular whether and to what extent the BBC can be relied upon to pursue the public interest rather than its own corporate interest. Why should we assume that, as a central buyer, the BBC will act in the public interest?

The extent to which the public interest should be delegated to the BBC, and the form of governance that the BBC operates within are not new questions. They have been asked since the BBC was founded. Digitalisation does not alter the question or the answers. Recent cases have highlighted the problems of the existing forms of oversight and regulation – from Saville, to *Newsnight*, to the Hutton inquiry, the BBC's judgement has been repeatedly called into question. The filters have either been bypassed or they are inadequate. With no precise definition of public service broadcasting, there will always be challenge, controversy, and debate. But these problems do not invalidate the model.

The BBC is not the only answer to the market failures. There are others – and lots of other international models. Part of the public service obligations can be delivered by other broadcasters. From the development of a second independent channel through to the Public Service Publisher model proposed by Ofcom some years ago, there have been many proposals in Britain. The relative merits are much debated, but none of these merits is much affected by technical change.

Conclusions

This brief chapter has considered the extent of the digitalisation impact on broadcasting. It has been argued that, whatever the merits of the licence fee and the role of the BBC as the premier public service broadcaster, they are not much altered by digitalisation.

The economic fundamentals of broadcasting – and in particular the centrality of public goods – remain largely unaltered, and the proliferation of channels and the possibilities of real-time programme choice introduce significant new search costs for consumers.

Thus broadcasting policy cannot escape the key policy questions which have bedevilled it since the 1920s. Britain found a uniquely British solution in the BBC, and over time the BBC has developed its role to cope with one change after another in the broadcasting market. It has evolved to become probably the most respected broadcaster in the world.

The evolutionary changes which have been particularly important in recent years have not been directly driven by digitalisation, though they have had a significant impact. The emergence of the BBC as a central buyer of programmes has forced its internal vertically integrated model into the open. Broadband has given a different technological interface to the conventional television, and the internet has facilitated the development of the BBC's website and the iPlayer.

Ironically, these changes have focused more attention on the traditional problems of broadcasting – the scope and level of the licence fee; the exercise of choice over public service broadcasting; the standards the BBC applies to its editorial functions; and the nature and extent of its national and international news services; amongst others. Not much has changed, and much needs to be done to readdress these core issues, rather than be distracted by the claim of the vested interests that the game has changed and hence the BBC should be radically reduced and even broken up. The interests of the other broadcasters are obvious.

SECTION II

IS THERE A FUTURE FOR PUBLIC SERVICE BROADCASTING?

5. Why isn't Broadcasting Just Another Good or Service?

*Jonathan D. Levy*²⁸

The Reuters Institute for the Study of Journalism, jointly with the BBC Trust, took on a daunting task when it set out to examine the above-posed question and the following subsidiary queries. How should the regulatory framework adapt to an evolving broadcast industry? Is it reasonable to use broadcast regulation to react to deficits in the overall provision of content in the entire media environment (including unregulated aspects)? What are the main concerns in terms of potential anticompetitive effects? The short answer to the question of why broadcasting isn't just another good or service is that broadcasting exhibits standard characteristics of market failure in the technical economic sense and that broadcasting serves important non-economic goals.

Free-to-air (FTA) broadcasting is a public good, i.e. it is non-excludable and non-rival in consumption. Even from an economic point of view, the technical changes that make pay television possible do not solve completely the public good problem. Broadcast content also generates externalities (mostly positive, e.g. a more knowledgeable citizen benefits fellow citizens; expression of shared cultural values can strengthen social cohesion and national identity), another symptom of market failure. Closely related to the externalities point is the fact that broadcasting advances important non-economic goals such as diversity of viewpoint and media plurality, which many countries value as a means of providing citizens with the information necessary to discharge the responsibilities of citizenship and to promote civic engagement. Many societies also see broadcasting as a tool for the preservation of domestic culture. This is not a major issue in the United States, but the United Kingdom (and the EU in general) places much greater weight on this desideratum.

The externalities and non-economic goals considerations suggest a 'universal service' imperative for broadcasting. The term universal service is more commonly used on the telecommunications side, traditionally referring to availability of wireline voice telephone service to almost everyone and at a reasonable rate.²⁹ On the broadcasting side, the implicit concept has been service available to virtually everyone with no user charge.

The technology of video content delivery, which includes FTA broadcasting, has evolved substantially over the past few decades. The advent of pay television platforms, principally cable and satellite, has substantially increased the range of choices available to citizen/consumers. The reduced transmissions costs associated with pay and digital platforms, coupled with the ability to charge consumers, have made it profitable to target many categories of niche tastes. Tools like the VCR and more recently the digital video recorder (DVR) provide time-shifting flexibility. Internet downloads and streaming support not only time diversity but *place* and *device* diversity, making it possible to consume video on a laptop, tablet, or smartphone, as long as the viewer has an internet connection or mobile data plan.³⁰ However, due in part to the audience fragmentation that the newer delivery technologies have induced, the economic model for the type of content that

²⁸ The opinions expressed herein are those of the author and do not necessarily represent the views of the US Federal Communications Commission or any other member of its staff.

²⁹ In the US, the concept of universal service is explicitly being expanded to include a minimum broadband capability.

³⁰ Of course, not all content is available with this flexibility. In the US, cable companies are in the process of rolling out 'TV Anywhere' type services by which authenticated users can access subscription content via an internet connection, but not all platforms and not all content producers have implemented these arrangements.

meets non-economic goals, in particular news and public affairs programming, is under significant pressure.

Hence, regulation alone is unlikely to be adequate to deal with the overall content provision deficits mentioned in the introductory paragraph of this chapter. A role for regulation does remain, but it appears that other policies, including those beyond the purview of a national media/telecommunications regulatory agency, will be needed to address content provision deficits. These policies include direct subsidy (of content and of some infrastructure), possibly a national digital literacy educational initiative, and other measures to enhance broadcaster incentives to produce news and public affairs programming.

With respect to the major competitive concerns, space considerations limit the discussion to two: horizontal concerns related to assessing the substitutability of FTA and new platforms (both with respect to economic and plurality goals) and vertical concerns with respect to relations between content providers and distribution platforms.

Context

Policy analyses and policy choices are a function of a country's media market structure and the overall legal and social environment. The discussion herein focuses on the US and the UK. The two nations have differences and similarities. In terms of viewing, FTA television is still very popular in both countries. The FTA share of total viewing has certainly dropped over the years, most strikingly in the US, where total viewing of non-broadcast channels overtook broadcast channel viewing ten years ago. However, the (relatively few) major FTA channels still attract on average much larger total audiences than even the most popular of the (many) non-broadcast channels.³¹ Pay television is much more popular in the US than in the UK, with roughly 87% of US television households but only about 58% of UK homes choosing to subscribe.³² The availability of satellite TV service in both countries means that pretty much any household has access to a pay service; in the US cable television is available to over 99% of households.³³ The figure is much lower in the UK.

The continuing decline in broadcast audience shares, at least in the US, has not yet been accompanied by corresponding declines in advertising revenues, and pay television revenues and subscriptions remain robust.³⁴ Total viewing of 'traditional' television, whether it be FTA or 'linear' pay television (simultaneous point-to-multipoint distribution, as opposed to 'over the top' internet streaming or downloads) continues to increase. Moreover, local US FTA television channels and the major FTA public service

³¹ In the US, the term 'broadcast' refers only to channels provided FTA using radiofrequency spectrum. Non-broadcast channels are delivered via cable, satellite, and other pay television platforms. The terms 'broadcast' and 'non-broadcast' are not used in precisely the same fashion in the UK.

³² The US figure (total multichannel subscribers as a fraction of total television households) is calculated from SNL Kagan, *US Multichannel Industry Benchmarks* visited 22 May 2013, available from <http://www.snl.com/Sectors/Media/USMultichannel.aspx>. For UK data see Barwise and Picard (2012), 16 n. 26.

³³ SNL Kagan, *US Multichannel Industry Benchmarks*. The figure provided is number of homes passed by cable as a fraction of total US housing units.

³⁴ See Television Bureau of Advertising, *Industry Trends: Ad Spending*; visited May 2013, available at <http://www.tvb.org/trends/4705> and SNL Kagan, *US Multichannel Industry Benchmarks*. A recent industry report noted that, for the 12 months ending Mar. 2013, the US multichannel video sector experienced its first net subscriber loss – of less than 0.1 per cent. A drop in traditional cable subscriptions was not quite offset by increases in telephone company and satellite video. This may be a harbinger of things to come, but it is too early to discern any robust trend. See Leichtman Research Group, *Multichannel Video Industry Has First-Ever Annual Net Subscriber Loss*; visited May 2013, available at <http://www.leichtmanresearch.com/press/052013release.pdf>.

broadcasting channels in the UK benefit from must-carry regulations that effectively mandate their retransmission by pay television platforms. Of course, viewing of video over the internet is increasing rapidly (from a small base), but the substantial majority of video is consumed the old-fashioned way. Traditional television is likely to remain significant for a reasonably long time to come, at least until high-speed broadband is available ubiquitously and at reasonably low prices.

In terms of the cultural and regulatory environments, a major difference relates to content regulation. In the US, it is essentially prohibited (with quite limited exceptions) by the First Amendment to the Constitution. The UK permits a considerably greater level of content regulation. The other major difference to note is in the support for public subsidy of video content. Although there may have been some erosion in recent years in the UK public's support for video content subsidies (via the television receiver licence fee that funds the BBC's activities), public subsidies in the UK remain massively higher (by at least an order of magnitude) than in the US. The two countries are similar in that the business model for public service television is under pressure from market fragmentation and new delivery platforms.

Consequences of Evolution and Possible Policy Responses

The video delivery capacity expansion caused by the advent of multichannel pay television platforms such as cable and satellite television and digitisation has led to the fragmentation of the video audience. Fragmentation has at least two consequences. First, the cross-subsidisation of non-remunerative content by advertising-supported broadcasters is less viable than before. Second, audience shares for programming that serves specific public interest objectives (news, public affairs, documentary, etc.) are reduced; hence direct content subsidies to this type of programming are less efficient than before. This has serious implications for the plurality/diversity goal of media policy.

The FCC's media policy goals are generally encapsulated in the three terms 'competition, localism, and diversity'. The FCC has employed multiple concepts of diversity but 'viewpoint diversity' is a prominent one. In this formulation, the goal is for the media to deliver a wide range of viewpoints on political and social issues in order to provide citizens with the information they need to discharge the obligations of citizenship. These obligations include voting, petitioning the government for particular actions, attending a public meeting, etc. To the extent that some political and social issues are locally focused, the localism goal comes into play as well.

The UK has more detailed descriptions of its media policy goals, both by Ofcom and the BBC. Of particular interest here is Ofcom's enunciation of its 'plurality' goal. In a recent document titled *Measuring Media Plurality*, Ofcom defines the goal as 'ensuring that there is a diversity of viewpoints available, and consumed, across and within media enterprises; and preventing any one media owner or voice from having too much influence over public opinion and the political agenda' (emphasis added).³⁵ The goal is similar to the US diversity goal, but there are some interesting contrasts. First, the US goal of diversity should be understood as instrumental, i.e. citizens' civic participation is enhanced when they actually acquire and then act on media content. The UK goal is more explicitly stated, *requiring* not only presentation but consumption of media content. Second, the UK goal references both

³⁵ Ofcom, *Measuring Media Plurality*, 5 Oct. 2012, p. 1; available at <http://stakeholders.ofcom.org.uk/binaries/consultations/measuring-plurality/letters/advice.pdf>.

internal and external plurality, i.e. it is not sufficient for the total menu of media content to be diverse; certain individual programmes must present contrasting views. An analogous US requirement, referred to as the Fairness Doctrine, was eliminated 25 years ago, due to Constitutional concerns and the finding that, in practice, the doctrine did not fulfil its avowed purpose.³⁶

In earlier days, when the number of television outlets (and hence consumer choice) was quite limited, there was a closer relationship between exhibiting public interest content and viewing of it. The author is American but nonetheless assumes that there really was a time when the BBC was widely known as 'Auntie'. One certainly hopes this is so if only because it is a perfect counterpoint to the nickname 'Uncle Walter' bestowed on the prominent news reader (referred to in the US as an 'anchor' and in those days specifically as an 'anchor man') for the CBS network, Walter Cronkite. In those days the notion of television as a national hearth at which we gathered and received information from a trusted authority figure to which we were all related made a lot of sense.

However, times have changed. It is still possible to employ public subsidies to ensure that public interest content is placed before the public, and this can be done on a wider variety of platforms than before – broadcast television, pay television, the internet. But one can no longer assume that this content will be widely consumed. With respect to commercial sources of news and information, the financial pressures associated with audience fragmentation suggest that the number of independent sources of news, especially local news, will decline.³⁷ The same is true for the quantity of news and its composition. In the US, there is a considerably greater amount of local television news than in the UK. A large number of US television stations provide considerable local news, but a large number do not, and the number that do has fallen over the years. Another likely consequence of financial pressure on television news is a shift away from costly reporting such as investigative journalism. In the UK, television news historically was more regional than local, but the quantity of that has also fallen over the years. In this context, it is interesting to note the new 'Local Digital Television Program Service' (L-DTPS) that Ofcom has just licensed in roughly two dozen cities around the UK.³⁸ A full analysis of this development is both premature and beyond the scope of this chapter. Nevertheless, it is an intriguing experiment, which goes against the tide a bit.

What to Do

The above discussion suggests that government policy to address, in particular, the non-economic goals of broadcasting should focus on both the

³⁶ The Fairness Doctrine required broadcast stations to provide coverage of controversial issues of public importance and to provide a reasonable opportunity for presentation of contrasting views. Interested parties could complain to the FCC if they did not consider a station's coverage of issues adequate. The FCC's decision to eliminate the doctrine drew on Constitutional principles and also on a finding that it imposed substantial burdens on broadcasters without compensating benefits. Indeed, the decision ending the doctrine grew out of an extended administrative proceeding in which a station's coverage decisions were contested by interested parties. It appeared that one (unintended) effect of the doctrine was to cause stations to shy away from coverage of certain issues to avoid 'litigation'. See FCC, *Syracuse Peace Council*, 2 FCC Rcd 5043 (1987), *recom. denied*, 3 FCC Rcd 2035 (1988).

³⁷ Television advertising expenditures have a cyclical component but have remained relatively stable in nominal terms. The levels for 2012 are roughly the same as 2004. See Television Bureau of Advertising, *Industry Trends: Ad Spending*. Price level increases during this period mean that expenditures have dropped in real terms. Nevertheless, the situation for television, at least in the US, is quite different from that of newspapers, a sector in which advertising revenues have declined precipitously in recent years.

³⁸ See Ofcom, *Licensing Local Television*, 10 May 2012, available at <http://stakeholders.ofcom.org.uk/binaries/consultations/localtv/statement/local-tv-statement.pdf>; and *Awards of L-DTPS Licences*; available at <http://licensing.ofcom.org.uk/tv-broadcast-licences/local/awards>.

demand- and the supply-side. That is to say, it may be necessary to target citizen/consumers with some sort of educational effort as well as to address the costs and incentives to produce public interest content.

As noted, delivering content on multiple platforms, including the internet, will not guarantee that content will be located and consumed. Moreover, on the internet, the concept of 'internal plurality' is difficult to imagine let alone realise. Citizen/readers assemble their own bundles of content and can skip instantaneously from one story or article to another. Many may actively seek out content that reinforces their previously formed opinions (one may even wish to say biases). These challenges are well beyond the scope of traditional broadcast regulation. They suggest consideration of education for 'digital literacy' – an effort to create 'conscientious readers', who can aggregate information from multiple sources and assess its reliability (Mullainathan and Shleifer, 2005). With respect to national and international news, the internet has certainly expanded the range of sources available, both with respect to traditional media (online presence of newspapers and television stations from around the country and around the world) and new media, whether web-only news sites or commentary/blogs. Moreover, due to the extremely low cost of content storage, the internet has vastly increased the total quantity of accessible information. A digitally literate reader can certainly benefit from this resource. At the local level, however, at least in the US, it appears that the internet has added little to the quantum of local news available. Most local US news on the internet resides on the websites of traditional media.³⁹

On the supply-side, countries such as the UK, with a tradition of public support for significant subsidies to broadcasting, could broaden the scope of their efforts. If the audience is gravitating away from the broadcast platform, then perhaps subsidies should be targeted to or at least partially redirected to other platforms. In this context, it remains interesting to an outside observer that Ofcom rejected several years ago its Public Service Publisher (PSP) proposal, which would have at least in part decoupled the subsidy to public service content production from the FTA broadcast platform.⁴⁰ In some sense, however, BBC initiatives (notably the iPlayer) can be viewed as embodying this mechanism.

The recent FCC staff report on *The Information Needs of Communities* (INC Report: see Waldman, 2011) found deficiencies in specific news categories in the US – in particular investigative reporting and state-level news (including coverage of state government). The public good/externality character of investigative reporting is particularly notable. Public policy measures, whether subsidies or other, may usefully be directed at these areas. With respect to investigative journalism, at least in the US, the challenge is particularly acute because in the interest of maintaining independence, investigative journalism entities are generally reluctant to accept government funding. It may be possible to route government funding through an intermediary grant-making organisation, which might mitigate this problem. In some sense, this is the philosophy behind the Corporation for Public Broadcasting in the US.

In the US, where there is no attempt to mandate internal plurality, even external plurality is under pressure in the smaller of the 210 local television markets. There is a trade-off between ownership plurality and productive

³⁹ See Hindman (2011). There are a limited number of internet-only local news sites, e.g. the Voice of San Diego, available at <http://voiceofsandiego.org>.

⁴⁰ See Chris Tryhorn, 'OFCOM Scraps "Public Service Publisher" Plans', *Guardian*, 12 Mar. 2008, available at <http://www.guardian.co.uk/media/2008/mar/12/ofcom.digitalmedia>.

efficiency. In smaller markets, the number of independent commercial television outlets that are viable may be quite small. This is an issue of current debate and open regulatory consideration in the US. Every four years, the FCC, pursuant to Congressional mandate, reviews its broadcast ownership rules, including local market limits on radio and television station ownership.⁴¹ Moreover, in recent years, a variety of cooperative arrangements among stations in the same market have developed, some subject to regulation and some not. Among the latter are 'shared service agreements', under which stations in the same market can pool newsgathering resources.

The impact of these arrangements is still being debated. Some parties argue that, in their absence, there would be less local news and that it is possible for stations sharing newsgathering resources nevertheless to maintain separate editorial viewpoints and bring different perspectives to the same material. In the UK, the *de facto* decision appears to be that many markets can only support one independent commercial entity. There are no limits on local commercial radio station ownership; as noted above, Ofcom has recently licensed a single local digital television service in a few dozen cities. Incumbent television stations in the UK are national with some regional content.

The FCC's *INC Report* was prepared by Commission staff and outside consultants but was NOT officially adopted by the FCC. The following recommendations drawn from that report should be considered in this context.

As noted above, the journalism culture in the US (and probably many other places as well) is resistant to government support, especially for investigative journalism because it could compromise the independence of the enterprise. Hence, it may be difficult for government policy to support or encourage independent non-profit investigative journalism. There are examples in the US of entities that produce investigative journalism on a non-profit basis, funded primarily by philanthropy, so it may be possible to make some adjustments in the tax code to encourage this type of support. ProPublica is a leading US example of this organisational form. Its website offers the following description of its activities:⁴²

ProPublica is an independent, non-profit newsroom that produces investigative journalism in the public interest ... Each story we publish is distributed in a manner designed to maximize its impact. Many of our 'deep dive' stories are offered exclusively to a traditional news organization, free of charge, for publication or broadcast. We published more than 80 such stories in 2012 with more than 25 different partners ... Almost all our stories are available for reprint under a Creative Commons license ... The Sandler Foundation made a major, multi-year commitment to fund ProPublica at launch. Other philanthropic contributions have been received as well, and more are needed ... ProPublica also accepts advertising. And we are constantly exploring possible new revenue streams, including ebooks, although philanthropy, in large gifts and small, will continue to be our principal source of income for the foreseeable future.

⁴¹ See FCC, *Notice of Proposed Rulemaking* in MB Docket No. 09-182 and 07-294 (2011), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-11-186A1.pdf. See paras. 194–208 for a discussion of shared service agreements and related arrangements.

⁴² <http://www.propublica.org/about>.

Most pay television outlets in the United States carry one or more channels of a service called C-SPAN. Its website offers the following description of its activities.⁴³

C-SPAN (Cable-Satellite Public Affairs Network) is a private, non-profit company, created in 1979 by the cable television industry as a public service. Our mission is to provide public access to the political process. C-SPAN receives no government funding; operations are funded by fees paid by cable and satellite affiliates who carry C-SPAN programming.

C-SPAN produces three video channels, one primarily devoted to the US House of Representatives, one primarily devoted to the US Senate, and a third channel with additional coverage of national events. C-SPAN also streams content from its website and provides content via broadcast radio in the Washington-Baltimore area and nationally via a satellite radio subscription platform. There are state-level public affairs networks in 23 of the 50 states in the US and one in the District of Columbia. Building on the example of C-SPAN and the state networks, it might be possible to increase the amount of state-level news and information in the US, both by expanding the concept to other states and by expanding the number of outlets that carry existing state networks.

In addition to seeking additional sources of funding for public interest content, it is also worth exploring measures to reduce costs. One possibility mentioned by the *INC Report* is to adapt the 'medical resident' model to journalism schools. Making actual on-the-job experience an integral part of journalism school training would not only further improve the skills of journalism school graduates but could also provide media outlets with a frequently replenished stream of low-cost staff. Another avenue for cost reduction open to government at all levels is making public information available online in user-friendly format in order to reduce the cost of monitoring government performance. An increasing number of government organisations do this, but there is certainly room for expansion of the concept. Coupled with this is what is referred to as 'computational journalism', the development of techniques and software (which could be supported by public investment in the tools) that make it practical and inexpensive for journalists and others to analyse large quantities of public data (see e.g. Hamilton and Turner, 2009).

Performance Metrics

No discussion of regulatory tools in this area would be complete without at least a brief discussion of how the regulator can measure media performance and hence assess the utility of policy measures. This is a particular challenge with respect to non-economic objectives. As the Ofcom advice on measuring media plurality states: '[a]n assessment of sufficiency [of plurality] at any point in time is challenging, as it requires a subjective judgement'.⁴⁴ Ofcom's overall performance evaluation procedure for public service broadcasters includes measurement of inputs such as spending and of outputs such as quantity of viewing and consumer satisfaction as measured by fairly detailed surveys. It is not clear that any of these measures can truly address how well the plurality goal is being met. With respect to plurality and indeed the other goals, it is likely that these evaluation techniques work best as indicators of

⁴³ See <http://www.c-span.org/About/About-C-SPAN>.

⁴⁴ Ofcom, *Measuring Media Plurality*, p. 2.

trends over time in performance rather than as assessments of whether the level of performance is satisfactory at any given time.

In the US, there is no detailed or explicit public evaluation of broadcaster performance. By statute, television station licences are renewed if 'the station has served the public interest, convenience, and necessity' and there have been no serious violations of the Communications Act or FCC rules, or other violations that, taken together, constitute a pattern of abuse.⁴⁵ Historically, the FCC has required broadcasters to keep a public file of information on various aspects of station organisation and activities. Any member of the public is entitled to view the file at the station's offices. Pursuant to FCC rule, one item that has to be included is an 'issues-programs list'. This list, to be created quarterly, includes a list of programmes that have provided the station's most significant treatment of community issues, as determined by the station. This information was not required to be submitted to the FCC, and it has apparently played no significant role in the license renewal process, as virtually all licenses are routinely renewed. In its 'enhanced disclosure' proceeding, the FCC sought to require television stations to provide a different and more detailed accounting of its programming. For a variety of reasons, the FCC vacated its initial decision in this area but, following a recommendation in the *INC Report*, did adopt a requirement that television stations place most of the material in their public file into an online database maintained by the FCC. The FCC continues to examine the possibility of restructuring the issues/programs list and of applying the enhanced disclosure requirements to radio stations.⁴⁶

In view of the inherent difficulty of quantifying performance metrics, particularly with respect to the non-economic goals of broadcast policy and in view of the severe limits on content regulation of any kind in the United States, making information on television station activities readily available may provide incentives for stations to maintain good performance or improve performance. The public will be able more easily than before to monitor changes over time in a station's performance and to compare performance of different stations, both within a single market and for similar stations in different markets.

In both countries, non-broadcast channels also contribute to public interest programming, but they receive much lower levels of scrutiny in this regard.⁴⁷ In the absence of clear performance metrics for broadcasters and given that increasing competition from other media makes explicit policy intervention by government less practical and maybe less necessary, it is possible that the best that policy-makers can do is ensure some transparency in reporting information about stations and rely on public pressure to impose what discipline it can.

Major Competitive Issues

Media regulators in the US and the UK must evaluate a number of competitive issues, horizontal and vertical, that arise with respect to FTA television and other video distribution platforms. Space permits attention to just a few. At the horizontal level, perhaps the biggest issue is assessing the substitutability of FTA broadcasting and other platforms, e.g. pay television

⁴⁵ See 47 U.S.C. §309(k).

⁴⁶ See *Second Report and Order* in MM Docket No. 00-168 and MM Docket No. 00-44 (2012), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-12-44A1.pdf; and *Notice of Inquiry* in MB Docket No. 11-189 (2011), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-11-169A1.pdf.

⁴⁷ Note that in the UK some of the digital FTA channels have very limited public service requirements.

and internet, both for economic and plurality goals. In the presence of new and unregulated platforms, some obligations placed on traditional broadcasters may become unsustainable and/or unnecessary. This is a difficult matter; the FCC has received some guidance from Congress but is treading cautiously in various areas.

One indicator of the current state of play is the Commission's Annual 'Video Competition Report'. The report is produced at the direction of Congress and is organised around three 'strategic groups' of providers: multichannel video programming distributors (MVPDs), broadcast television stations, and online video distributors (OVDs). The report analyses the three groups separately, although they clearly exhibit some interdependence. Based in part on the legislative history of the Cable Act of 1992, the Commission determined long ago that broadcast television alone is not a sufficient substitute for cable to constrain its prices, and hence that MVPD remains a separate product market.⁴⁸ Viewing of linear video programming, i.e. FTA broadcasting plus cable and direct-to-home satellite television, continues to rise. The time and location shifting function of OVDs suggest that, at least to some extent, these services complement rather than substitute for linear delivery platforms. This is something that could change, particularly as high-speed broadband service, both wireline and wireless, becomes even more widely available. The FCC considered this issue in the Comcast-NBCU merger transaction. The agency concluded 'that most consumers today do not see online video distributor (OVD) service as a substitute for their multichannel video programming distributor (MVPD) service, but as an additional method of viewing programming.'⁴⁹

Another horizontal issue, the conflicting impact of local market ownership limits on different public policy goals, has already been discussed. Common ownership of television and/or radio stations within a local market may increase programming variety or even ensure the survival of outlets that would not be viable independently. However, common ownership would reduce the number of independent 'gatekeepers' in the market which could reduce viewpoint diversity.

The major vertical issues involve the interaction between content providers and distribution platforms, primarily but not exclusively in the presence of vertical integration. Vertically integrated satellite cable programmers (cable operators who also own programming networks) are prohibited from discriminating against unaffiliated MVPDs in the supply of programming. Recently, the FCC substituted case-by-case review for its former flat prohibition on exclusive programme distribution contracts by vertically integrated satellite cable programmers.⁵⁰ The FCC also has an open proceeding on retransmission consent.⁵¹ This is the process by which local FTA television stations can negotiate with MVPDs over the terms and

⁴⁸ See FCC, *Fourteenth Report* in MB Docket No. 07-269 (2012), n. 5, available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-12-81A1.pdf.

⁴⁹ However, it also found that 'as a vertically integrated company, Comcast will have the incentive and ability to hinder competition from other OVDs, both traditional MVPDs and standalone OVDs'. This led the FCC to impose certain conditions on the merged entity. See FCC, *Memorandum Opinion and Order* in MB Docket No. 10-56, paragraphs 61, 79; available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-11-4A1.doc.

⁵⁰ See 47 U.S.C. § 628 and FCC, *Report and Order* in MB Docket Nos. 12-68, 07-18, 05-192; *Further Notice of Proposed Rulemaking* in MB Docket No. 12-68; *Order on Reconsideration* in MB Docket No. 07-29, available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-12-123A1.pdf. Note that the prohibitions are more detailed than mentioned and include a general prohibition of cable operators engaging in 'unfair methods of competition or unfair or deceptive practices, the purpose or effect of which is to hinder significantly or to prevent any multichannel video programming distributor from providing satellite cable programming or satellite broadcast programming to subscribers or consumers'.

⁵¹ FCC, *Notice of Proposed Rulemaking* in MB Docket No. 10-71 (2011), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-11-31A1.pdf.

conditions (compensation, in particular) under which MVPDs can retransmit the local television station signals.

In the UK, satellite, rather than cable, is the dominant pay television platform, so the vertical issues described above are of particular importance with respect to the satellite platform Sky TV. In 2010, Ofcom required Sky to offer two sports channels – Sky Sports 1 and 2 – ‘to retailers on platforms other than Sky’s, at prices set by Ofcom’.⁵² The same decision raised the possibility that Ofcom would ask the Competition Commission to review competitive concerns relating to the markets ‘for the sale of premium movie rights and premium movie services’. These issues were referred to the Competition Commission. It found that ‘competition was not effective’ in the retail market for pay television but did not find that Sky’s position in the two markets specified gave rise to an adverse effect on competition.⁵³

The FCC is also required to ‘establish regulations governing program carriage agreements and related practices between cable operators or other multichannel video programming distributors and video programming vendors’; the rules established pursuant to this requirement include a prohibition on discrimination on the basis of affiliation or non-affiliation by MVPDs that unreasonably restrains the ability of unaffiliated programmers to compete fairly.⁵⁴ For example, The Tennis Channel filed a complaint alleging that cable operator Comcast was impermissibly discriminating against it by placing the channel on a less favourable channel tier than Comcast’s affiliated sports programming networks (e.g. the Golf Channel). The Commission found in favour of the Tennis Channel, but the DC Circuit Court of Appeals recently overturned the Commission’s decision on evidentiary grounds.⁵⁵

Vertical interactions between content providers and distribution platforms can also arise with respect to the internet. Resolving them in a manner that preserves incentives for innovation by content providers (aka application providers) and the incentives for investment in facilities by internet service providers (ISPs) is a continuing challenge. The technological and business landscape is changing rapidly, and the FCC’s policy initiative in this area, the Open Internet Order, is currently under judicial review.⁵⁶ That order enunciates a ‘no unreasonable discrimination’ rule for providers of fixed broadband internet service with respect to lawful network traffic. It also states that ‘pay for priority’ arrangements (i.e. payment by a content or application provider to a broadband provider in order to induce the broadband provider to directly or indirectly favour some traffic over other traffic in transmission to a subscriber or subscribers) would be unlikely to

⁵² This action was later overturned by the Competition Appeal Tribunal. See Ofcom, *Pay TV statement* (31 March 2010), page 1 available at http://stakeholders.ofcom.org.uk/binaries/consultations/third_paytv/statement/paytv_statement.pdf, visited May 22, 2013; and *In the Competition Appeal Tribunal; British Sky Broadcasting Limited et al. v. Office of Communications* (8 August 2012), paragraph 5 *et seq.*, available at <http://www.catribunal.org.uk/238-7780/Judgment-Non-confidential-version.html>, visited 3 July 2013. The Competition Appeal Tribunal upheld Ofcom’s jurisdiction but found that, in this particular case, the requirement Ofcom had imposed was not justified.

⁵³ UK Competition Commission, *Movies on Pay TV Market Investigation*, 2 Aug. 2012, pp. 8–9, available at http://www.competition-commission.org.uk/assets/competitioncommission/docs/2010/movies-on-pay-tv/main_report.pdf.

⁵⁴ See 47 U.S.C. §536 and 47 C.F.R. §76.1301(c).

⁵⁵ See *Tennis Channel, Inc. v. Comcast Cable Commc’ns, L.L.C.*, Memorandum Opinion and Order, 27 FCC Rcd 8508 (2012), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-12-78A1.pdf; *rev’d sub nom. Comcast Cable Commc’ns, LLC v. FCC*, No. 12-1337 (D.C. Cir., decided 28 May 2013).

⁵⁶ See FCC, *Report and Order* in GN Docket No. 09-91 and WC Docket No. 07-52 (2010), esp. paras. 54–5 (transparency); paras. 63–4 (no blocking of lawful content by fixed broadband providers); paras. 68–9 (no unreasonable discrimination by fixed broadband providers); para. 76 (pay for priority); paras. 35–6 (interference with peer-to-peer video file traffic); paras. 93–4 (treatment of mobile broadband), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-10-201A1.pdf. *Appealed sub nom. Verizon v. FCC* No. 11-1355 DC Circuit.

satisfy the 'no unreasonable discrimination' rule. Moreover, two years prior to adoption of the Open Internet Order, the Commission concluded an enforcement proceeding against a major cable ISP for interfering with certain peer-to-peer traffic, often used for sharing video files.⁵⁷ The possibility that an ISP might discriminate against independent 'upstream' content (which might or might not compete directly with content provided by the ISP) cannot be ignored.⁵⁸

Conclusion

Technological change has reshaped the media environment over the past 20 years or so, vastly expanding citizen/consumer choice and, it is safe to say, consumer welfare. However the same mechanisms that expand consumer choice make it more difficult for governments to pursue their public policy goals for the media, particularly the non-economics ones. There are certainly policy options that remain open to governments for promoting, say, diversity or plurality. These policies include but are not limited to the traditional tools of broadcast regulation. However, they are unlikely to provide the level of influence over the media environment that the old tools afforded governments in the old days. Hard as it may be for policy-makers and regulators to admit it, the new world of media has reduced their level of influence and they may just have to live with that reality.

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⁵⁷ See *Memorandum Opinion and Order* in WC Docket No. 07-52; File No. EB-08-IH-1518 (2008), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-08-183A1.pdf. Reversed on other grounds, *Comcast v. FCC*, 600 F.3d 642 (2010), available at [http://www.cadc.uscourts.gov/internet/opinions.nsf/EA10373FA9C20DEA85257807005BD63F/\\$file/08-1291-1238302.pdf](http://www.cadc.uscourts.gov/internet/opinions.nsf/EA10373FA9C20DEA85257807005BD63F/$file/08-1291-1238302.pdf).

⁵⁸ Although the *Open Internet Order* does not apply the 'no unreasonable discrimination' rule to mobile broadband services, similar business arrangements may well develop in the mobile space. Recently, the sports network ESPN raised the possibility of paying one or more wireless carriers to ensure that subscribers accessing ESPN content over the wireless network would not have that content counted against their monthly data cap. See A. Sharma, E. A. Spencer, and A. Troianovski, 'ESPN Eyes Subsidizing Wireless-Data Plans', *Wall Street Journal*, 9 May 2013, available at <http://online.wsj.com/article/SB10001424127887324059704578473400083982568.html>.

6. Is Broadcasting Just Another Good or Service?

Andrew Graham

Earlier chapters in this volume have made clear that the question of whether broadcasting is, or is not, just another good or service is amenable to both economic and political analysis. It is, however, by no means simply an ivory tower question. On the contrary, it impinges directly on major issues of public policy. For example, if broadcasting is just another service, marketable like anything else, do we close the BBC? And what would broadcasting look like if it were to be transferred wholly to the private sector? Would we, for example, feel fully at ease if there were a plethora of private sector companies of whom one, possibly looming much larger than now, might be BSkyB? Alternatively, if broadcasting is not just another service, how should it be organised?

One has only to put these questions about policy to recall how much the context within which broadcasting policy has recently changed. Indeed, it is not just broadcasting policy where the context has altered, but the whole question of our view about the functioning of markets. As recently as ten years ago the so called 'Washington Consensus' ruled the day: the state should be minimalist; regulation, if needed at all, should be 'light touch'; and the more that goods and services were distributed through the marketplace the greater the welfare of society. At that time, the question of whether broadcasting was just like another good or service would have carried behind it the presumption that, if it were just another good or service, then it could – indeed *should* – be left to the natural functioning of markets.

In contrast, post the crash of 2008, we move to a world in which, entirely understandably, there is huge cynicism about the working of capitalism. Alongside this and driven by it, within the academic world, we find a much closer scrutiny of the assumptions underlying the working of markets and a much closer examination of why it often appears to be the case that they function so much less well than in the picture painted by the acolytes of liberal economics.

Broadcasting and the world of the media has had its own, equally dramatic, turmoil. As recently as 2010, News International was riding high. At the outset of that year they had launched the bid for BSkyB. By December, everything was proceeding according to plan, indeed even better than planned. Vince Cable had spoken unwisely and, he thought, off the record, about the nature of their bid and been forced to resign. As a result, all seemed clear for the bid to go ahead. Yet if we wind the story forward a mere seven months, the News International story implodes. By July 2011, with the hacking scandal breaking day by day, they were forced to close the *News of the World* and withdraw their bid for BSkyB. What is more, shortly thereafter, Rupert Murdoch was declared not a fit person to run a major public company.⁵⁹

Alongside this, the BBC has moved through its own set of highs and lows. Its most recent peak was undoubtedly at the end of summer of 2012. In the afterglow of the Olympics and with the UK looking like a highly successful country and with its major broadcaster projecting across the globe an appealing image of a country at peace with itself, the BBC stood more admired than at most times in the last decade. Yet just months later, by November 2012, the BBC was mired in the disaster of the Savile scandal.

⁵⁹ The House of Commons Culture Media and sport select committee said he was not a fit person to run a major public company: <http://www.bbc.co.uk/news/uk-politics-17898029>. However, the 'fit and proper' test was administered by Ofcom who decided that Sky was a fit and proper company to hold a broadcast licence: <http://www.bbc.co.uk/news/business-19658811>.

Then, within days, that horror was dramatically compounded by the shameful *Newsnight* report supposedly claiming that a senior Conservative politician was a paedophile – only for it to be shown that *Newsnight*, a supposedly trusted part of the BBC's factual reporting, had not carried out even the most basic journalistic checks into the veracity of its story (see the Pollard and MacQuarrie reports).⁶⁰

I will return below to the relevance of this changing context for how we should think about broadcasting policy, but, for the moment, carry forward two thoughts. First, the question of whether most markets in goods and services function well is now much more open to question. Second, the changing fortunes of News International on the one hand and the BBC on the other are a salutary reminder that we are not dealing with the innumerable tiny firms of textbook competition but with major media players and with issues of market dominance and power.

Analysis: Economic Arguments

The changing context for broadcasting does not, however, imply that economic analysis has no insights to offer. I have written about these on numerous earlier occasions (Graham and Davies, 1997; Graham, 1998, 2000; Graham et al., 1999), so I will not repeat myself. In any case, as mentioned, earlier contributors to this volume have already set out the three main considerations. These are the question of whether broadcasting is a public good, the extent to which it generates externalities and the issue of whether broadcasting can be a merit good.

Of these three, the only one on which more needs to be added here is that of merit goods. These are goods and services which benefit individuals but which even well informed people are not aware of in advance of the purchase and, in some cases, not for long periods thereafter. The obvious and rather mundane example is taking care of one's teeth in one's childhood and, more generally, many other aspects of healthcare. Merit goods also include a wide range of things which can be described as 'experiential' goods. That is, it is only *after* one has experienced them that one realises how useful it was to have done so. Most education is of this kind.

There are two cases for focusing on this. First, economists find merit goods particularly hard to model, since most economic models operate on the basis of the core assumptions of economics, namely that consumers are rational and well informed so they will buy the things they want. The problem with merit goods is that, by definition, the consumer only becomes well informed about them after – sometimes long after – they have bought them.

Second, as a moment's reflection will reveal, much of broadcasting is experiential and so lies, at least potentially, in the realm of merit goods. There is a programme on, let us say, the natural world. If one had to pay for it in advance, one might well not watch, yet many of those who have seen the Attenborough series will find that their whole conception of themselves and the natural world will have been altered by seeing the kinds of things that he is able to bring to us. And, because this has been done as part of public service broadcasting, it is totally free at the point of use. As a result, many more of us will have 'consumed' such programmes than would have been the case if we

⁶⁰ See, respectively, ReedSmith, *The Pollard Review: Report*, 18 Dec. 2012, available at http://downloads.bbc.co.uk/bbctrust/assets/files/pdf/our_work/pollard_review/pollard_review.pdf; and BBC Trust, *Findings of the Editorial Standards Committee of the BBC Trust*, 14 Dec. 2012, pp. 10–24, available at http://downloads.bbc.co.uk/bbctrust/assets/files/pdf/appeals/esc_bulletins/2012/newsnight_2nov.pdf.

had had to buy them. Note also that, while it is true that the programme is 'consumed' (we watch it and there is a clear sense in which it has gone), one characteristic of merit goods is that they have some of the qualities of investment: the programme has passed, but the effects linger on in our minds giving a pay-back spread out over months or even years.

To continue the example, but going in the opposite direction, there can be 'demerit goods'. Drugs are the most obvious example. People will pay a fortune to purchase them. They achieve an instant high but the long-run effects are extraordinarily damaging. Thus, seen from the viewpoint of the market, the good that will, in fact, benefit us, but of which we are not yet aware of the benefits, we will be unwilling to buy; whereas the good that brings an immediate rush of satisfaction we pay for gladly, even though it harms us. As a result, a pure profit-seeking broadcaster would produce far too many demerit goods and not enough merit ones, whereas a public service broadcaster, *given different purposes*, will seek to put on broadcasts that expand our experience rather than cramp and diminish us.

This question of the *purposes* for which broadcasters exist is one to which I will return below.

Analysis: The Institutional Framework

Public goods, externalities, and, to a lesser degree, merit goods, are part of the standard framework of economic analysis. There is, however, something fundamentally missing from this analysis: namely the institutions that create and frame the market in the first place. We may think of this in two dimensions – the economic and the political. Consider first the economic. As already noted, one of the core assumptions of standard economics is that for markets to work well, consumers need to be well informed both about their own preferences and about the goods and services that they are to buy. As a result, the provision of information to consumers has to *precede* the market, not be part of it. And broadcasting is one of the key ways in which today's consumers gain all kinds of information, not just about broadcasting.

There is a deeper sense in which institutions need to precede the market. Before Adam Smith wrote *The Wealth of Nations*, he wrote *The Theory of Moral Sentiments*. In the earlier work Smith effectively set out a great deal about the factors he expected already to be in place before markets could function well. Fundamentally these included a set of property rights and the ability to form legally enforceable contracts. Moreover, even though Smith was writing well in advance of the extension of the vote in the 19th century, much of what he expected to be in place for markets to work would, today, be seen as the by-products of a non-corrupt and well-functioning democracy.

To state the obvious, if markets need the framework that today comes from the laws of a well-functioning democracy, we have moved from the economic to the political. It will be equally obvious that democracy is not just another good or service. We do not sell our votes because most of us think this would be an affront to our position as citizens; it is somehow against the whole idea of being a fully functioning member of a society that we would sell this right. Or, ask the question, how much would you pay for democracy? At one level it makes no sense, because you cannot go to a supermarket and buy it. At another level, we know that, where democracy has not existed, people have valued it so highly that they have been willing to lay down their lives to achieve it.

And when people are laying down their lives fighting against tyranny, at, or close to, the top of anyone's list of strategic objectives lies control of the

main television and radio channels (with, these days, the social media coming up close behind). Putting this another way, broadcasting has huge potential either to hinder democracy or to be part of its flowering. This factor alone makes it quite unlike most goods and services.

Remembering this, return for a moment to the changing context described above and, in particular, to the alternating highs and lows achieved by both News International and the BBC. As noted there, as recently as 2010, it would have appeared likely that News International would achieve full ownership of one of our major broadcasters. Yet, only months later, think what was revealed to us as citizens of the United Kingdom and what this might have implied about our democracy.

Stripped of its frills, the evidence revealed in the Leveson inquiry, together with what can be observed around the world, suggests that Rupert Murdoch had a strategy based on three elements. First, in each of the three jurisdictions within which he and his companies have operated – Australia, the United States, and the United Kingdom – he has chosen to acquire one upmarket newspaper and one downmarket newspaper. Second, using the upmarket newspaper, he was able to acquire access to all of the ‘top people’ in the relevant society (irrespective of whether the top people were celebrities or senior politicians or other people in positions of influence). Third, owning also a downmarket newspaper, he has been able to print stories about the ‘top people’ in the downmarket newspaper. Moreover, at least in the UK according to the Leveson evidence, the printing of such stories (plus the *potential* to print such stories) has been used as leverage on these people. A stronger word than ‘leverage’ might occur to many of us.

What on earth is happening to a supposedly democratic country if one of its major newspapers can buy one of its major broadcasters and so gain yet further control of the people who determine the laws of the country? The celebrities had been infiltrated, the police had been corrupted and the politicians had been deprived of their right to speak out on behalf of the electorate.

The BBC has itself recently committed some huge blunders. Nevertheless, few people think that these blunders have uncovered anything remotely comparable to the illegal phone hacking by the employees of News International. As a result, if public service broadcasting contributes to democracy – and there can be little doubt that this public space within which the issues of the day are debated without control either by the state or a media mogul is a massive contributor to the democratic structure of the UK – then the need for a well-functioning BBC would seem to be at least as substantial now as at any time in the past.

A Thought Experiment

The question of whether or not the media needs any public intervention has, of course, been around for a long time. The most famous defence of the free press was that of John Milton and the publication of *Areopagitica* in 1644. Milton’s core claim was, if that the press is free to publish whatever it wishes, truth will eventually drive out falsity. Perhaps so, but it is not at all obvious that Milton’s optimism is justified by evidence from the largest media market in the world – the USA. It is, for example, hard to read the recent publication by Thomas Mann and Norman Ornstein: *It’s Even Worse than it Looks: How the American Constitutional System Collided with the New Politics of Extremism*, and still hold to Milton’s conclusion.

To mention three points in particular: first, Mann and Ornstein report that, sometime *after* Obama's birth certificate has been published and made available to anybody in the media who cared to consult it, surveys still find that more than a third of those replying to some questionnaires believe that Obama was born outside the USA. Not much sign there of truth driving out falsity. Second, Mann and Ornstein report that, in the 2012 election, there was a much larger disconnect between the arguments of the Republicans and how they related to reality than that between the Democrats and their basis in reality. I refer you to Mann and Ornstein to check the facts.

Speaking of 'fact-checking', the third point to emerge from Mann and Ornstein is that, even on the basis of the facts, something strange has been happening in America. As they remark, 'if you looked at where the scales should have been, and where they were, they were weighted. And they weren't weighted for ideological bias. They were weighted *to avoid being charged with ideological bias*' (emphasis added).

The question of bias is, of course, central to how the BBC behaves. We take it as one of the BBC's core characteristics that it eschews bias and, instead, seeks to do its utmost to handle issues impartially and objectively. Having fallen down so badly in the *Newsnight* affair, the BBC ought at the moment to be redoubling its efforts to achieve these goals. I therefore put it to the BBC that they might find it a useful thought experiment to ask themselves how they would behave if they were a significant public service broadcaster in the USA. It would not be an easy task. But that, of course, is precisely the point of the thought experiment. They would have to sharpen both their practices and their thinking.

As part of that thinking I would suggest that those in senior editorial positions in the BBC consult Bernard Williams's brilliant volume *Truth and Truthfulness*. Here, in his characteristically clear and acerbic manner, Williams sets out to despatch the fashionable postmodernist view that there is no such thing as truth. As he cuttingly remarks, 'The tension between the pursuit of truthfulness and the doubt that there is (really) any truth to be found comes out in a significant difficulty, that the attack on some specific form of truth ... itself depends on some claims or other which themselves have to be taken to be true.'

Williams does not, of course, fall into the trap of thinking either that there is something as simple as *the* truth or that truthfulness consists merely of a recitation of facts or that facts are uncomplicated. On the contrary, he argues (a) that without narratives we cannot understand the world and (b) that narratives or stories may well carry a point of view. Nonetheless, carrying a point of view or not, we can all, Williams argues, still differentiate between the situation in which someone is trying to be a truth-teller and when they are not. Indeed, it is of the very essence of argument that our ability to contest the plausibility – one might say the truthfulness – of a particular version of history is that one contests the facts. What is more, Williams suggests, truth-tellers, that is, those upon whom we rely to tell us the truth, themselves have certain characteristics. They have an integrity and a concern with veracity and authenticity.

If the BBC is to re-establish the trust of the British, then integrity, veracity, authenticity, and a deep concern to be a truth-teller must be its watchwords.

Broadcasting Policy and the Market

There is another book I suggest as reading for those framing broadcasting policy: *Firm Commitment* by Colin Mayer. To see the relevance of Mayer, we must return to the arguments made at the beginning of this chapter and in particular to the fact that during the last decade we have come to see the functioning of markets through new and more sceptical eyes. No longer do we take it as almost for granted that markets, semi-automatically, produce the best of all possible worlds.

The merit of Mayer's book is that he combines scepticism with clear analysis, and, above all, with a fresh solution. The essence of his argument lies in three points.

First, he shows that in the early days of capitalism, firms often had clear purposes. Indeed, they had what we would nowadays call Mission Statements. These were, of course, the objectives of the owners. However, as capitalism developed, it became clear that owners could not necessarily generate all the capital they needed from their own resources. As a result, there was the great breakthrough in the 19th century of the creation of limited liability and, as a result, a massive injection of shareholder capital. This injection of shareholder capital did, however, bring with it two problems: (a) the running of the firms lay more and more in the hands of managers and these were increasingly divorced from the shareholders who were the owners; and (b) the shareholders, being a widely distributed body of people, had almost no interest in the original purposes of the firm, being concerned, instead, with the share price and with movements in that share price over an increasingly short-term horizon.

Second, according to Mayer, what then happened is that the literature of economics and that of management went almost entirely in a mistaken direction. Observing this disjunction between owners and managers, or as economists call it 'the principal-agent problem', most articles in the academic literature attempted to 'solve' it by seeking ways of aligning the interests of the principals with those of the agents. However, as Mayer shows, given that shareholders had become increasingly short-term and no longer had any concern for the overriding purpose for the firm, this has frequently proved to be a disaster. The modern shareholder, having in mind nothing except monetary gain, is solely obsessed with the movement of a share price – and the movement of that share price sometimes over just weeks or hours or days. As a result, all kinds of monstrosities occur. A dramatic example, given by Mayer is that of BP. It had massively polluted the Gulf of Mexico. Nevertheless, shareholders had been only too glad to allow the rundown in maintenance and repairs that led to this disaster because it boosted the short-term profits of the firm and therefore boosted the share price. No matter the damage to the environment, no matter the long-run damage to the profits of BP. All that mattered was the short-run game.

What is more, the BP debacle is by no means an isolated case. The problem ranges from the mis-selling of financial products by the banks to the substitution of horsemeat for beef – indeed to anything where there is a short-run financial gain, no matter the longer run costs.

Third, Mayer's solution to this situation is not to wish to abandon the use of the marketplace. On the contrary he is, rightly, a great defender of it. But what he regards as essential is that we should have markets operating within the context of a reformed capitalism based on long-term shareholdings and with owners who have purposes.

The relevance of Mayer's arguments to the world of broadcasting and whether it should be treated as simply another good or service follow on naturally. Most obviously, we do not have remotely in place in the UK either of Mayer's requirements for well-functioning capitalism. Thus, even if broadcasting were just any other good (which it is not!), there would be good grounds for not relying on the kind of capitalism we have today to produce the kind of broadcasting that we require. To put this point in its sharpest form, I doubt that many of us would wish to see the BBC for sale, with BSkyB as the bidder and with Rupert Murdoch as the owner.

Second, as it happens, the BBC meets both of Mayer's criteria. It has a very long-term shareholding – the UK public in perpetuity – and it has different purposes from that of the maximisation of profits. Its role, often stated but still worth repeating, is to inform, educate, and entertain.

It is also highly pertinent to observe that the phone-hacking scandal that led to such a crisis for News International only eventually broke surface because of tenacious reporting by the *Guardian* (the 2011 Orwell lecture by the editor of the *Guardian*, Alan Rusbridger shows how they were left alone for over a year as the only newspaper willing to pursue the story and how, during this period, everyone, including the police, tried to warn them off).⁶¹ And what are the two key characteristics that distinguish the *Guardian* from almost all of the rest of the British media? It has the objective of 'liberal journalism' laid down by its founder C. P. Scott and, being owned by the Scott Trust, it has a single shareholder totally committed to the long term.

Concluding Remarks

It has been argued that broadcasting is most certainly not just any old good and service. Given the existence of public goods, externalities, and, even more so, merit goods, there is a good case for the presence of a public service broadcaster. In addition to meeting these requirements better than the market, a public service broadcaster also plays a crucial role in ensuring that other markets, including other markets in broadcasting, are able to operate. Most importantly of all, it plays an even more important role in the functioning of our democratic society.

Finally, as has just been suggested, the BBC (as by far the most obvious part of public service broadcasting in the UK) has different purposes than those of most firms operating within the market. The *lack* of appropriate purposes for most of today's private sector firms and the *lack* of longer term shareholdings ought to be far more at the centre of public debate than is currently the case. Seen from this new perspective, we are fortunate, indeed, that in the newspaper world, the *Guardian* exists and that in world of broadcasting, we have the BBC. British democracy would be a much weaker institution without these two players.

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7. BBC: From Crowding Out to *Dynamising In*

Mariana Mazzucato

The BBC is today accused of (potentially) ‘crowding out’ private broadcasters: critics accuse it of ‘stealing’ audience that otherwise would watch private channels, thus diminishing potential income from advertising and, consequently, private investments.⁶² The BBC is not alone in being criticised for supposedly crowding out investments. This is a common accusation that many successful public organisations are facing, from international state investment banks (like BNDES in Brazil, and CDB in China, both earning high returns on equity) to large public funding agencies in the USA (like ARPA-E which is leading energy investments).⁶³ Criticism often argues that the public sector thus stifles innovation.⁶⁴

In economics, the ‘crowding out’ hypothesis is used to analyse the possibility that public sector investments will reduce private sector investments because both depend on the same pool of savings (pushing up interest rates which reduce the willingness of private firms to borrow, hence invest). Keynesian analysis has argued against this possibility during periods of under-utilised capacity, characteristic in today’s economy (Stiglitz, 2012, for the case of counter-cyclical activity in general; Zenghelis, 2011, for the case of green infrastructure). But even in the boom there are many parts of the risk landscape where private business fears to tread, so that public investment does not crowd out but *crowds in* private sector investment through its ‘de-risking’ activity. Nowhere is this more obvious than in the history of technological change, where the state has often funded the highest risk investments both upstream and downstream in the innovation chain (Mazzucato, 2011).

Yet the words that we use to describe the ‘crowding in’ process should not use the negative situation as a benchmark: crowding out. In fact, the public sector not only ‘de-risks’ the private sector by sharing its risk, it often ‘leads the way’ – courageously taking on risk that the private sector fears. At the heart of US capitalism, usually described as a ‘market system’, the state has funded most of the revolutionary technologies, not simply fixing markets but leading them with ‘mission-oriented’ investments that cannot be explained via ‘market failure’ theory (Mowery, 2010). Thus rather than analysing public sector investment via the need to correct ‘market failures’, it is necessary to build a theory of how the public sector shapes and creates markets, more in line with the work of Karl Polanyi in 1944 (see Polanyi, 2001). And the BBC is a perfect example.

The State as Mission Maker Not Market Fixer

Across the globe we are hearing that the state has to be cut back in order to foster a post-crisis recovery. The assumption is that, with the state in the backseat, we unleash the power of entrepreneurship and innovation in the private sector. The media, business, and libertarian politicians draw from this convenient contrast, and feed into the dichotomy of a dynamic, innovative, and competitive ‘revolutionary’ private sector versus a sluggish, bureaucratic, inertial, ‘meddling’ public sector. The message is repeated so much that it is

⁶² See Weeds, in Ch. 2 above.

⁶³ Advanced Research Projects Agency – Energy, for more information, see <http://arpa-e.energy.gov/?q=about>.

⁶⁴ This discussion builds on a new book by Mazzucato, *The Entrepreneurial State: Debunking Myths about Private and Public Sector Innovation* (Anthem Press, 2013).

accepted by the many as a 'common sense' truth, and has even made many believe that the 2007 financial crisis, which soon precipitated into a full-blown economic crisis, was caused by public sector debt, rather than the truth: by private sector debt.

And the language used has been forceful. Such ideological language is not exclusive to current governments having to grapple with this prolonged economic and financial crisis, but it has its intellectual and political roots in the ideas of economists like Milton Friedman and politicians like Margaret Thatcher and Ronald Reagan, to name a few.

Indeed, the increasing percentage of public services, across the globe, that are being 'outsourced' to the private sector is usually done using precisely this 'efficiency' argument. Yet a proper look at the real cost savings that such outsourcing provides, especially taking into account the lack of 'quality control' and high (unexplained) costs that ensue, is almost never carried out. Indeed, examples where outsourcing in the public sector is resisted, such as the BBC's choice to build in-house the platform for its iPlayer, has meant not only that it has saved money over time but also that it has been able to keep the BBC a dynamic innovative organisation that can attract top talent, retaining its almost universal reach in the UK in both radio and TV – what public broadcasters in other countries can usually only dream of.

Understanding the role of the public sector, beyond the need and ability for it to correct market failures, requires moving away from the usual contrast between a bureaucratic public sector and a dynamic creative innovative private sector. In 2011 I wrote a book called *The Entrepreneurial State*, arguing that entrepreneurship is not (just) about start-ups, venture capital, and 'garage tinkers'. It is about the willingness and ability of economic agents to take on risk and real 'Knightian uncertainty': what is genuinely unknown.⁶⁵ Attempts at innovation usually fail – otherwise it would not be called 'innovation'. This is why you have to be a bit 'crazy' to engage with innovation ... it will often cost you more than it brings back, making traditional cost-benefit analysis stop it from the start. But whereas Steve Jobs talked about this in his charismatic 2005 Stanford lecture on the need for innovators to stay 'hungry and foolish',⁶⁶ few have admitted how much such foolishness has been 'seriously' riding on the wave of state-funded investments. Most of the radical, revolutionary innovations that have fuelled the dynamics of capitalism – from railroads to the internet, to modern-day nanotechnology and biotechnology – trace the most courageous early and capital-intensive 'entrepreneurial' investments back to the state. Not only in terms of upstream research, but also high-risk early-stage funding to companies often provided by the likes of the government-funded Small Business Administration (and its SBIR programme), rather than private venture capital. All of the technologies that make Apple's iPhone so 'smart' were government-funded (internet, GPS, touch-screen display, and the recent SIRI voice activated personal assistant) – and Apple itself received its early-stage financing from an SBA programme. And while pharmaceutical companies like to justify their high prices in the name of the high risks they take in research, the path-breaking investigative work of Angell (2004) has shown that 75% of the most innovative new medicines (new molecular

⁶⁵ 'Knightian uncertainty' refers to the 'immeasurable' risk, i.e. a risk that cannot be calculated. This economic concept is named after University of Chicago economist Frank Knight (1885–1972), who theorised about risk and uncertainty and their differences in economic terms.

⁶⁶ See John Naughton, 'Steve Jobs: Stanford Commencement Address, June 2005', 9 Oct. 2011, *Guardian*, available at <http://www.guardian.co.uk/technology/2011/oct/09/steve-jobs-stanford-commencement-address>.

entities with priority rating) come from public labs, such as the National Institutes for Health, not private pharma.

The irony is that today, more than ever before, there is lots of talk about the need for public-private partnerships, alliances, 'open-innovation', and ecosystems of actors to make sectors, including broadcasting, more dynamic. Yet by ignoring the true role of the public sector in such alliances and 'ecosystems' we have risked not only creating ineffective partnerships, but also in many cases have created parasitic rather than symbiotic ecosystems (Mazzucato, 2013).

Standard economic theory justifies state intervention when the social return on investment is higher than the private return – making it unlikely that a private business will invest: from cleaning up pollution (a negative 'externality' not included in companies' costs) to funding basic research (a 'public good' difficult to appropriate). The BBC invested in 'public good' areas, for example, when it developed PrestoPrime, whose goal was to develop practical solutions for the long-term preservation of digital media (BBC, 2013). Yet the BBC, and the state in general, does much more than investing in public goods. Indeed, in the USA the market failure explanation (through externalities and public goods) explains less than one-quarter of the R&D investments made by the public sector. These have instead been driven by big visionary projects – like putting 'a man on the moon', or creating the internet, and modern-day nanotechnology. All these required a vision, a mission, and a plan – much more than a simple calculation of social and private returns (Mowery, 2010).

Building such missions requires *confidence* about what the state's role in the economy is. As eloquently argued by Keynes in the *The End of Laissez Faire* (1926), '[t]he important thing for Government is not to do things which individuals are doing already, and to do them a little better or a little worse; but to do those things which at present are not done at all'. This requires *making things happen* in specific spaces – calling for not just bureaucratic skills (though these are critical, as pointed out by Max Weber) but real technology-specific and sector-specific *expertise*. It is only through an exciting vision of the state's role that such expertise can be recruited, and is able to then map out the landscape in the relevant space. Indeed, a key part of the 'secret' of DARPA – the agency that invented *and* commercialised the internet within the US Department of Defence – has been its ability to attract talent and create excitement around specific missions. And it is no coincidence that a similar agency in today's US Department of Energy, ARPA-E, is not only leading US green investments, but also having fun on the way – in the words of Grunwald (2012), working in ARPA-E 'feels like Google'.

While many of the examples I draw on come from the US – purposely to show how the country that is often argued to most represent the benefits of the 'market system' has one of the most interventionist governments when it comes to innovation – more modern-day examples are coming from 'emerging' countries. Indeed, visionary investments are exemplified today by confident visionary State Investment Banks in countries like Brazil and China – not only providing counter-cyclical lending but also directing that lending to new uncertain areas that private banks and venture capitalists (VC's) fear. And here too, like in DARPA, expertise, talent, and vision matter. In the UK, the BBC is a notable example of a visionary, risk-taking institution working to create innovative programmes, technologies, processes, services, and solutions that the private sector would not dare to undertake.

The BBC as the Dynamic Element Catalysing UK's Creative Industry

The BBC generates high return on its investments and significantly contributes to the UK economy (according to a study based on a method developed by Deloitte, the BBC generates £8.3 billion of Gross Value Added, or two pounds of economic value for every pound of the licence fee (BBC, 2013).) The BBC also invests in in-house R&D, creating innovative products such as the iPlayer (mentioned above) or Ingex, a system used for tapeless studio recording based on inexpensive PC hardware that it uses to digitise its vast archives. And, contrary to what critics claim, the BBC is the dynamic element in the UK's creative industry – the catalyst that directly or indirectly generates the chemical reaction that makes private companies (incumbents and indies) invest in risky innovative enterprises. The BBC was a key player in the collaborative effort to develop Stagebox, an open-standard-based project that allows HD multi-camera productions to use standard internet technologies to link equipment. The Stagebox project is an example of collaborative innovative enterprise that involved private companies such as Bluebell, Leading Light Technologies, CoreEL, and Xilinx (BBC, 2013). Would they have developed the same open-source technologies without the BBC?

The BBC innovation model is purposively open regarding technical standards, so that others in the industry can draw on its knowledge to develop their own products. By following this open standards model, the BBC is able to invest in areas that are not commercially viable in the short run but that have strategic long-term potential for audiences and the UK's creative industry. But the BBC also is able to harvest returns from its investments, holding a portfolio of 134 patent families that it licenses to third parties. This way, the BBC is able to generate licensing revenue (for example, from the technology that underlies the online platform Radioplayer) which flows back to the UK and itself, thus allowing it to engage in the next round of innovative investments. This is something only a few state-owned institutions can be proud of: to develop innovative, breakthrough technologies and also reap financial results!

The BBC also invests in training and mentoring of small enterprises and young individuals, which otherwise would probably struggle to find opportunities to develop (and fund) their productions. The BBC then plays also the role of 'business angel'. In 2008, for instance, the BBC acquired a 25% stake in the UK independent producer Big Talk Productions, funding it with further £1,125,000 in loans. The company generated not only revenues of £11 million in 2011 alone, but also received recognition for its productions, such as the comedy series *Rev* (aired on BBC2), which was named BAFTA's Best Situation Comedy in 2011. Indeed, in many sectors, as private finance has become increasingly short-termist and risk-averse (with venture capitalists wanting returns within three years), such state financing of early-stage companies has become increasingly important.⁶⁷

The list of benefits that BBC generates to the United Kingdom goes on and on. From showcasing the country's talents and culture to promoting foreign direct investments (£32 million of co-production funding from overseas broadcasters in 2011–12). So why is the BBC under attack, when it is seen by the world audience and industry professionals as *the* example of

⁶⁷ See Mariana Mazzucato, 'Tax Payers Helped Apple But Apple Won't Help Them', *Harvard Business Review*, 8 Mar. 2013, available at http://blogs.hbr.org/cs/2013/03/taxpayers_helped_apple_but_app.html?utm_source=Socialflow&utm_medium=Tweet&utm_campaign=Socialflow; and also FINNOV, *Do Financial Markets Reward Innovation?*, Policy Brief (Spring 2010), available at http://www.finnov-fp7.eu/sites/default/files/FINNOV_POLICY_BRIEF%20Spring%202010.pdf.

innovative integrated media company? Indeed, the BBC has succeeded in doing exactly what Keynes claimed, above, is the point of government: not spending on just anything – a little better or worse than the private sector – but on those areas not being pursued at all by the private sector. If it is to be blamed for ‘crowding out’ private broadcasters, it is necessary to prove that the latter would engage in the part of the landscape that the BBC has dared to pursue. Critics have not used proper metrics, but ideology, to make the accusation. The challenge, however, is to think about what type of metrics might be used to describe this landscape, and the BBC’s actions within it, not so much in terms of fixing market failures, but in terms of shaping and creating markets. Karl Polanyi showed that the notion of the market as self-regulating is a myth unsupported by the historical origins of markets: ‘The road to the free market was opened and kept open by an enormous increase in continuous, centrally organised and controlled interventionism’ (Polanyi, 2001: 144). In his view, it was the state which imposed the conditions that allowed for the emergence of a market-based economy. His work helps us understand the role of the state in shaping and creating markets, not only fixing them. To talk about the future of the BBC, what we need is not static neoclassical economic analysis, but Polanyi-Keynes type investigation of the emerging broadcasting market and landscape, and the role of the public sector in making things happen that otherwise would not.

Concluding Remarks

And this is the punch line: when organised effectively, the state’s hand is firm but not heavy, providing the vision and the dynamic *push* (as well as some ‘nudges’ – though nudges don’t get you the IT revolution of the past, nor the green revolution today) to make things happen that otherwise would not have. Such actions are meant to increase the courage of private business. This requires understanding the state as neither a ‘meddler’ nor a simple ‘facilitator’ of economic growth. It is a key partner of the private sector – and often a more daring one, willing to take the risks that business won’t. The state cannot and should not bow down easily to interest groups who approach it to seek handouts, rents, and unnecessary privileges like tax cuts. It should seek instead for those interest groups to work dynamically with it in its search for growth and technological change. Understanding the unique nature of the public sector – as more than an inefficient ‘social’ version of the private sector – impacts the nature of the public–private collaborations that emerge – as well as the ‘rewards’ that the state feels justified to reap. An entrepreneurial state does not only ‘de-risk’ the private sector, but envisions the risk space and operates boldly and effectively within it to make things happen. Indeed, when not confident, it is more likely that the state will get ‘captured’ and operate in areas that should be served by private businesses but are not – possibly ‘crowding it out’. When not taking a leading role, the state becomes a poor imitator of private sector behaviours, rather than a real alternative. And indeed, the usual criticism of the state as slow and bureaucratic is more likely in countries that sideline it to play a purely ‘administrative’ role.

So it is a self-fulfilling prophecy to treat the state as cumbersome, and only able to correct ‘market failures’. Who would want to work in the state sector if that is how it is described? Is it a coincidence that the ‘picking winners’ problem – the fear that the state is unable to make bold decisions on the *direction* of change – is discussed especially in countries that don’t have an entrepreneurial vision for the state, i.e. countries like the UK where the state

takes a backseat and is then blamed as soon as it makes a mistake. Major socio-economic 'challenges' such as climate change and 'ageing' require an active state, making the need for a better understanding of its role within public-private partnerships more important than ever.

My participation in the Reuters Institute and BBC Trust symposium 'The Economics of Broadcasting' made me realise just how important the implications of these points are for the BBC's own understanding of its role in the broadcasting landscape, and the development of a future strategy that is bold and courageous, shaping and creating the future of broadcasting. And the need to build a more symbiotic landscape, with less fear of crowding out and more courage to build something new. An aim that cannot be understood using the economists' jargon of fixing market failures. If the BBC restricted itself to only doing the latter, it would produce old-style boring documentaries and news programmes, never achieving the kind of market share that it continues to achieve today – producing even cutting edge soap operas (which the critics fear the most precisely due to their ability to achieve real influence). The BBC must not fear competing with private broadcasters (and get accused of 'crowding out'), it must do so fiercely, but on visionary terms.

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8. The Economics of Public Service Broadcasting: A Research Agenda

Diane Coyle and Paolo Siciliani

In the analogue era, the constraint of spectrum scarcity meant there was room for only a handful of TV channels. What's more, the technology did not permit the exclusion of non-paying audiences, and this 'non-excludability' ruled out subscription-based pay TV. Commercial broadcasters therefore had to transmit their channels free to air (FTA) and rely on advertising revenues. The two-sided-nature of this business model – needing to attract audiences and advertisers alike – meant that commercial programme-making was aimed at attracting mass audiences with broadly popular programmes.

Under these circumstances, public intervention was usually justified by the need to cater for a wider variety of programmes, including those of niche interest. In particular, public service broadcasting was justified in order to guarantee the provision and consumption of 'merit good' programmes, those reckoned to be beneficial for wider reasons such as good citizenship. The restricted choice of channels available helped ensure that this kind of programme would not only be broadcast but also watched by large numbers of people.

The traditional approach to PSB therefore did rely on key market failures such as consumption externalities and information asymmetries, especially the social benefits arising from bringing a large popular audience to programming with civic or educational benefits; but spectrum scarcity and non-excludability due to analogue technology were nevertheless the specific market failures that helped PSB intervention achieve its aims and were normally cited as the main externalities public service broadcasting aimed to address.

Multichannel Pay TV: The First Phase of Digital-Disruption

The first wave of digitalisation – which culminated with the digital switchover from analogue broadcasts to DTT in 2012 – dramatically increased the transmission capacity of legacy broadcasting platforms, enabling digital multichannel TV platforms (i.e. both satellite and terrestrial television); and it allowed effective content encryption for terrestrial viewers, thus creating the possibility of pay TV business models across satellite, cable, and terrestrial platforms.⁶⁸

It was therefore readily assumed that digitalisation would overcome the problems of too little variety and too low quality under analogue FTA commercial broadcasting: audience fragmentation over multichannel platforms would prompt the emergence of specialised channels targeting niche audiences; and the new technical ability to charge audiences would deliver the revenues to underpin quality.

However, it is far from clear that digitalisation has had the expected consequences. In particular, the high fixed costs of TV production and the unique attraction to advertisers of large numbers of viewers mean that all commercial broadcasters continue to have strong incentives to attract a mass audience.

⁶⁸ Gavyn Davies points out that the imposition of the licence fee was an exclusion mechanism, albeit a legal rather than a technological mechanism. However, it was only thanks to the technological advancements brought by digitalisation that it became possible for commercial broadcasters to implement partial exclusion in a practical and convenient way.

Consider first the costs of producing and transmitting TV programmes. It is tricky to envisage what the market would provide in a 'counterfactual' world with no existing PSBs. The reason is that the 'crowding out' effect of PSB programming is unknown – to what extent do these broadcasters inhibit the supply of similar programmes by non-PSB commercial broadcasters? Those who argue for a very narrow scope for PSB programmes believe that digital pay TV providers would broadcast a similar variety and quality of programming.

But this might not be the case. The audience fragmentation due to the mass adoption of multichannel digital platforms could reduce the incentive to invest in programme range and quality. As Helen Weeds explains in her chapter, in the digital pay TV business model, consumers should be willing to pay more for higher quality so the higher the expected number of viewers, the stronger is the incentive to incur high ('first copy') programme costs, because there is no extra cost of broadcasting to additional viewers. Therefore, multichannel audience fragmentation could bring about a trade-off between programme variety (in an attempt to target niche audiences) and programme quality (driven by scale economies thanks to large paying audiences). Dieter Helm suggests (p. 27) that in the pay TV world, services for minority tastes are therefore the *most* vulnerable, and therefore there is an enhanced argument for a public service 'central buyer' who can cross-subsidise between genres (as well as seeking to expand the range of programmes appreciated by individuals for citizenship and social reasons).

The importance of scale economies due to high and relatively fixed production and transmission costs might as a result favour foreign productions, typically from the US, which benefit from their access to large domestic audiences. By the same token, domestic productions might be commissioned with an eye on foreign markets, with the aim of reselling programmes abroad (especially the US). Under both circumstances the risk is that UK (and, even more, the UK's national – not to mention regional) culture and civic life might be underrepresented. Similarly, the local provision of quality programming for 'minority interests' could be adversely affected by the economics of digital pay TV.⁶⁹

Turning to advertising revenues, a similar trade-off between programme variety and quality is at work under FTA broadcasting as well. Net advertising revenue (NAR) has stayed broadly flat (both in nominal terms and, to a lesser extent, as a share of overall industry revenue⁷⁰) over the last decade, although channel proliferation has led to a dramatic increase in total and first-originated hours of FTA TV output. The share of NAR attributable to main PSB commercial channels (notably, ITV and C4) has decreased less than proportionally to their corresponding reduction in terms of audience shares.⁷¹

The commercial FTA channels are therefore said to trade at a premium, meaning that the price of advertising on a particular channel is above the

⁶⁹ It is worth noticing that the opportunity to tap into foreign markets in the pursuit of new sources of revenue is increasingly important also for independent content producers reliant on commissions from FTA commercial broadcasters. See e.g. Adam Crozier, ITV CEO, *ITV plc Preliminary Results 2012*, 27 Feb. 2013, available at <http://www.itvplc.com/media/news/itv-plc-preliminary-results-2012>. ('A key part of the Transformation Plan is building an international content business. ITV Studios achieved strong organic growth both in the UK and overseas, with revenues up by £100m to £712m, driven by our ongoing investment in creative talent and developing new programmes. We're now building on our healthy creative pipeline with selective acquisitions in key and emerging creative markets.') Arguably, this trend may be a reflection of the gradual decline in total spending in UK originations dating back to 2006. See Ofcom (2012), fig. 2.30 at p. 144.

⁷⁰ Ibid., respectively, figs 2.22 at p. 136 and 2.23 at p. 137.

⁷¹ It is worth remembering that the observed pattern is conservative due to the presence of a price cap on advertising over ITV's flagship channel. See Competition Commission, *Review of ITV's Contracts Rights Renewal Undertakings – Final Report*, 12 May 2010, available at http://www.competitioncommission.org.uk/assets/competitioncommission/docs/pdf/inquiry/ref2009/itv/pdf/final_report.

average for all channels.⁷² The main driver for such a premium is the unique ability to regularly attract mass audiences, maximising the ‘campaign reach’ prized by advertisers running brand-building campaigns.⁷³

The corollary of a premium for mass audiences is, however, a discount for niche audiences. Therefore, the greater the audience fragmentation due to channel proliferation, the more the advertising revenue deflation experienced by smaller channels struggling to sell an ever-increasing airtime inventory.

Accordingly, the brand-building nature of TV advertising arguably also implies a trade-off between variety and quality due to the imperative for mainstream commercial FTA channels to cling to their unique ability to regularly bring in mass audiences.

The ‘traditional’ market failures from the analogue era might therefore have survived digital switchover, due to the adverse economics of serving niche audiences in the multichannel world. Both the cost structure of TV, in the subscription model, and the interaction between advertisers and audiences, in the FTA model, tend to work against the provision of a wide range of programming and against additional investment in quality.

A further issue in the subscription model is the fact that potential viewers who are unwilling to pay will be excluded even though the cost of serving these untapped audiences would be trivial once the fixed (‘first copy’) cost to produce the content has been incurred. There is now a larger public good problem than in the analogue world, in other words. The near-zero marginal cost means it is economically inefficient not to broadcast to the additional viewers.⁷⁴

The classic solution was thought to be found in price bundling: by selling access to a portfolio of channels catering for a broad range of tastes to a large base of heterogeneous viewers, consumers’ willingness to pay would be more uniform. Diversification within bundles could give all customers something they enjoyed and would pay for.⁷⁵ However, the possibility of selling premium channels separately (i.e. mixed bundling) makes this approach less likely.

The analysis is complicated by the fact that not only do subscription and FTA business models coexist in the market, but consumers may also access both platforms at the same time rather than choosing just one or the other. The complexities make it very hard to draw robust inferences about what range and quality of products would be available in any counterfactual world. However, the simple ‘crowding out’ argument that subscription channels would broadcast the same types of programmes as FTA PSBs is not obvious.⁷⁶

The simple model also assumes that all rivals will invest in range and quality. In reality, though, the use of premium content exclusivity (e.g. sports events and Hollywood movies) is widespread in subscription TV.

⁷² Ibid., paras. 5.27–5.30.

⁷³ Ibid., paras. 5.49–5.65.

⁷⁴ This classic public good characteristic is a feature of a wide range of digital goods that can be provided at zero marginal cost.

⁷⁵ For a schematic presentation, see Armstrong and Weeds (2007).

⁷⁶ In the literature there seems to be a consensus that variety/diversity of programming under pay TV is higher (see e.g. Peitz and Valletti, 2008). By and large, however, whilst programme quality under pay TV can be higher when the pay TV broadcaster also sells advertising airtime (see Armstrong, 2005), without advertising on pay TV channels quality could be higher under FTA. That is, as long as the nuisance from advertising for viewers is not too high compared to the profit margin earned on airtime sales (see Lin, 2012). However, viewers may have differing degrees of tolerance for ads, with those who particularly dislike ads-interruption adopting ads-avoidance-technologies (e.g. PVR). Needless to say, the greater the diffusion of these technologies, the smaller the pool of eyeballs that could be reached by ad campaigns and the weaker are the incentives to invest in quality programming to sell advertising airtime: i.e., to the extent that those who value the content the most are also those more likely to use ads-avoidance-technologies (see Anderson and Gans, 2011).

On the one hand, the ability to appropriate financial returns by granting exclusive rights may be a powerful incentive to invest in higher quality. On the other hand, pay TV prices are bound to rise as a result (i.e. in line with increase concentration on the supply-side), thus increasing the likely number of viewers excluded. This is particularly so when the sale of exclusive rights triggers bidding wars.⁷⁷

While in principle premium content exclusive rights are available to FTA broadcasters too, over time pay TV operators have systematically outbid the former.⁷⁸ This trend might simply reflect the fact that the pay TV business model is superior when it comes to extracting economic rents from subscribers; that is, as opposed to the FTA business model's ability to capitalise on eyeballs reached by charging advertisers.⁷⁹

Nevertheless, there are reasons to suspect that the cost escalation in the acquisition of exclusive rights for premium channels might come at the expense of other (fungible) content included in the portfolio of pay TV channels.⁸⁰ This 'crowding-out' by premium content could occur if the pay TV operator does not expect to be able to increase subscription fees by as much as needed to invest in high-quality content across the board.⁸¹

The observed stickiness in overall net advertising revenue suggests that similar 'crowding-out' effects might ultimately bite for FTA commercial broadcasters as well, insofar as they were caught into bidding wars for exclusive access to rivalrous premium resources (e.g. on-screen talent).

The bidding wars for premium content may be a symptom of risk-aversion, whereby rival broadcasters seek to secure access to scarce resources believed to drive large audiences in a predictable way, in an attempt to reduce uncertainty.⁸² Increasing rivalry due to channel proliferation – resulting in audience fragmentation – is bound to fuel this kind of risk-aversion.

It is not straightforward to describe the likely broadcasting landscape absent PSB intervention but it would probably feature the coexistence and joint-consumption of both FTA and pay TV commercial channels, with the former focusing on general programming for the mass audience, while the latter focused on exclusive premium content, plus a fringe of niche channels.

⁷⁷ See Weeds (2012). It is worth observing that when the cost of a quality provision is higher, the level of programme quality offered by the broadcasters might actually be lower. Moreover, when rival broadcasters face higher costs for increasing programme quality, then a strategic effect might exist that reduces competition, and as a result, increase profits: see Lin (2012).

⁷⁸ The topical example is the sale of TV rights to watch UK Premier League football. In 2006, the EU Commission forced the Premier League to sell TV rights to at least two separate broadcasters. The stated purpose was to encourage the return of some matches to free-to-air channels and to stimulate competition, driving down prices, and encouraging more people to watch football on TV. However, it was pay TV new entrants who sequentially ventured into the market to challenge the UK pay TV incumbent (BSkyB), with the result that the revenues raised by the FAPL over successive auctions has grown steadily ever since. The cost per game increased by almost 60% from £4.12m over the three seasons up to 2009/10 to £6.53m from the next season. See Enders Analysis, *Football and the EU: Careful What you Wish for*, 21 Feb. 2013, available from <http://www.endersanalysis.com/content/publication/football-and-eu-careful-what-you-wish>.

⁷⁹ In this respect, Ofcom reported that subscription revenue grew on average by an annual rate of 6.7% over the 5 years up to 2011, as opposed to a meagre 0.5% for net advertising revenue. See Ofcom (2012), fig. 2.22 at p. 136.

⁸⁰ E.g. Enders Analysis reported that the substantial increase in the cost of FAPL rights that will kick in in 2014 may be offset at least partly against other programme budget revisions. See Enders Analysis, *Live FAPL Rights Reach Dizzy New Heights*, 15 June 2012, available from <http://www.endersanalysis.com/content/publication/live-fapl-rights-reach-dizzy-new-heights>.

⁸¹ E.g. in the UK there is growing evidence that the penetration of pay TV (digital and cable) platforms have plateaued: see Ofcom (2012), fig. 2.40 at p. 154. Moreover, a combination of an ageing population and relatively lower spending power for younger age cohorts militates against a sustained growth in the average disposable income for discretionary spending: see Enders Analysis, *Demographic Trends – Old Money and the New Media Dilemma*, 19 Sept. 2012, available from <http://s106656.gridserver.com/content/publication/demographic-trends-%E2%80%93-old-money-and-new-media-dilemma>.

⁸² Other common tactics to reduce uncertainty are: to rely on familiar formats (i.e. crime and legal); to prioritise low-costs genres (e.g. comedy and entertainment); to plan for longer narrative arcs; to hire actors and/or writers with established reputation; and to purchase foreign productions that have already proved to be popular: see Hargreaves Heap (2005). Arguably, the last two options can well be rivalrous in nature in case exclusivities are granted over their exploitation.

However, there are grounds to believe the quality and variety would be *less* than in the PSB world. FTA broadcasters would need their flagship channels to draw mass audiences on a regular basis; whereas pay TV operators would arguably still concentrate their programming budget on the acquisition of premium content on an exclusive basis to drive subscription revenue.

Digital broadcasting overcomes spectrum capacity shortages and enables the exclusion of non-subscribers in pay TV services, but does not overcome other important externalities. Technological change enables the provision of many niche services in a multichannel world. But there are economic drivers working against the provision of a wide variety of high-quality content. These are the high fixed costs and near-zero marginal costs of providing TV programming, the preference advertisers have for a mass audience, and the possibility of using premium content to capture subscribers.

Content Convergence Online: The Second Phase of Digital Disruption

Digital switchover has not drastically altered the way the public engage with television. By and large, viewing is still largely a shared experience,⁸³ tethered to the main TV screen in the living room,⁸⁴ and according to the linear scheduling by broadcasters.⁸⁵

However, the advent of online distribution of long-form TV content promises to unlock entirely new patterns of consumption, where people can watch what they like, when it suits them, on portable devices and, possibly, while on-the-go. It is sometimes assumed that this will militate against shared viewing.

So far reality has fallen short of early expectations about the speed and extent of the shift to on-demand viewing.⁸⁶ The popularity of time-shifted viewing – either off recording devices or through online catch-up services – could be thought of as a form of quasi-linear viewing, in the sense that these technologies provide a buffer to cope with the abundance of what is on offer in linear digital multichannel platforms, rather than representing a form of departure from the traditional broadcasting model.⁸⁷ This may help to explain why the vast majority of time-shifted viewing still occurs within two days of the original (linear) broadcast.⁸⁸

However, as pointed out by Gavyn Davies in the next chapter (p. 70), recent evidence on young audiences' decreasing use of (linear) radio stations might prefigure a paradigm shift along generational lines.⁸⁹ Indeed, across the Atlantic the debate is shifting from 'cord-cutters' (those who decided to trade down from traditional cable pay TV to, primarily, subscription-based OTT services such as Netflix) to 'cord-nevers', typically young adults coming out of college with no intention to buy cable pay TV in the first place.

⁸³ Deloitte (2012b), figs 3 and 4 at pp. 6–7.

⁸⁴ Ibid., fig. 2 at p. 5.

⁸⁵ E.g. live TV scheduling is still used by about 70% of owners of recording devices (PVRs) when seeking out TV content: *ibid.*, fig. 13 at p. 23.

⁸⁶ See Barwise and Picard (2012).

⁸⁷ Indeed, this is even more the case when recording devices are merely used to avoid ads e.g. by starting the playback of the recorded programme only a few minutes after the scheduled time.

⁸⁸ E.g. BARB have recorded the time-shifted viewing habits of households with Sky+ boxes beyond the conventional 7-day window (up to 28 days) since 2008. Whilst their figures show that the amount of playback within the 7 days initially dropped from 89% in 2008 to 85% in 2010, over the last two years it seems to have plateaued at 84% of all playback (almost 70% within the first two days). See BARB, *What's New, What's Next*, Jan. 2013, available at <http://www.barb.co.uk/whats-new/267>. See, also, Ofcom (2012), at p. 180 ('According to Ofcom's media tracker research, the main reason why people use online TV and film services is to catch up on TV or films they missed when broadcast (59%)').

⁸⁹ Ofcom found that people aged 16–24 are most likely to use TV catch-up services (48%), an increase of 7% points since 2010: see (Ofcom, 2012), fig. 263 at p. 173.

It would be unwise to pretend to know how commercial business models will evolve as a result of the mass adoption of IP distribution for long-form TV/audiovisual content, which one, if any, will prevail, and how the everlasting tension along any media supply chain between content and distribution will pan out.⁹⁰ Still, some of the impacts of this second phase of digital disruption with respect to the market failures outlined above are already evident.

Generally speaking, the advent of IP distribution drastically reduces some entry barriers since any content provider can now technically bypass traditional broadcasters to reach potential viewers (although significant barriers in the form of marketing or audience attention remain). To the extent that this process of disintermediation further intensifies audience fragmentation due to the proliferation of TV-like content offerings online, this second phase of digitalisation might make the market failures currently at play in (quasi)linear TV broadcasting all the more acute.

For the proliferation of content would tend to make consumers more fickle, which might in turn increase risk aversion on the part of broadcasters less able to take consumer loyalty for granted. The original imperative to retain audience numbers means that the risk profile of any 'flop' in terms of non-returning viewers is likely to be heightened in a fully converged media landscape.

The main new strategy developed to increase consumer retention is what has come to be known as 'big data', which basically consists of meticulously monitoring consumer activity online. This data-gathering drive affords a granularity of insight into consumer tastes not seen before, which could then be used to 'curate' the content offering, increasing the relevance of content recommendations.⁹¹ In future, though, 'big data' could also be used to 'curate' the production of content to increase the chances that it will appeal to observed consumer tastes.⁹² In other words, it is possible that such an intense focus on what audiences currently watch could result in offering them more of the same.

These content strategies are most likely to be pioneered by new OTT entrants,⁹³ whose risk profile due to 'flops' is bound to be higher than for established TV broadcasters. Nevertheless, reliance on 'big data' can be easily

⁹⁰ E.g., back in 2000, the European Commission was concerned that a combination between a dominant ISP and two of the largest music labels could monopolise the then nascent market for online music delivery by leveraging the gatekeeper role of the former. See Miguel M. Pereira, *Vertical and Horizontal Integration in the Media Sector and EU Competition Law*, 7 Apr. 2003, European Commission, p. 6, available at http://ec.europa.eu/competition/speeches/text/sp2003_009_en.pdf. As we all know, the gatekeeper role was instead going to emerge from an intermediate stage in the value chain – that of portable music devices – and without recourse to vertical integration, either upwards or downwards.

⁹¹ The OTT service Netflix constitutes a prominent example of the use of personalised recommendations empowered by data algorithms: see The Netflix Tech Blog, 'Netflix Recommendations: Beyond the 5 Stars', 6 Apr. 2012, available at <http://techblog.netflix.com/2012/04/netflix-recommendations-beyond-5-stars.html>. See also Netflix, 'Netflix Long Term View', pp. 3–4, available at http://files.shareholder.com/downloads/NFLX/2399389974x0x656145/e4410bd8-e5d4-4d31-ad79-84c36c49f77c/IROverviewHomePageLetter_4.24.13_pdf.pdf ('For Netflix, the user's home page is the personalized ranking of what we think will be most relevant for that specific user at any given time. By analyzing terabytes of data from every recent click, view, re-view, early abandon, page views and other data, we are able to generate a personalized homepage filled with the content most likely to please. Our aim is to keep inventing and tuning algorithms to generate higher satisfaction, viewing, and retention, for whatever the level of content we can afford in that territory.')

⁹² *Ibid.*, p. 6 ('Over the years, we've successfully developed the art of estimating how much our members will watch a given show or movie based upon how it has performed to date in other, earlier channels (theatrical for movie; broadcast and cable first-run for TV) and on how comparable titles have performed on Netflix. ... With Originals, we are now extending that concept to estimate the attractiveness of projects that are brought to us by professional producers.')

⁹³ Besides Netflix, the ranks of new OTT content producers/sponsors include the likes of Amazon, Microsoft (for its Xbox Live platform) and Google's YouTube. See e.g. Greg Satell, 'What Netflix's "House of Cards" Means for the Future of TV', *Forbes*, 3 Apr. 2013, available at <http://www.forbes.com/sites/gregsatell/2013/03/04/what-netflixs-house-of-cards-means-for-the-future-of-tv>.

imitated,⁹⁴ thus potentially unleashing a process of conformism in supply, whereby risky creativity might ultimately be taken over by safer 'incrementalism'.⁹⁵ The international scale of these new OTT entrants suggests that this 'big data' drive will surely transcend traditional national boundaries, thus increasing the importance of being able to reach (and thus appeal to) audiences on a global scale.

Whilst 'big data' can and will be purposefully applied both in FTA and pay TV broadcasting, it is the two-sided nature of the former business model that makes FTA broadcasters particularly interested in leveraging this new trend. Joshua Gans argues that broadcasters' ability to build the popularity of a programme through social networks will be an essential weapon in the battle to keep audiences in the habit of watching linear TV. 'Non-storable' genres such as reality TV and premium sports events will be particularly important.

Unlike the traditional 'water cooler effect' of discussing last night's viewing, this feedback-loop mechanism occurs live at the time of watching via social networks. The contemporaneous viewing means that the broadcaster as well as advertisers can monitor, and hence exploit, this new source of data on consumer tastes.⁹⁶

Joshua Gans also observes how the combination of time-shifting and this virtual contemporaneous 'water cooler effect' can support the development of TV series with a long and complex narrative arc, thanks to the fact that latecomers who are enticed by the 'buzz' can easily join (live) the virtual community by catching up on missed episodes.⁹⁷

The use of social networks such as Twitter and Facebook to comment live on what is being watched is an example of elementary 'second screen' application – the use of an additional monitor (a tablet or smartphone) while watching television – for the opportunity for social engagement and interaction offered by the synchronisation between TV content and 'second-screen' applications confers an insurmountable first mover advantage on the TV broadcaster, who will know the plot of the programme in advance and be able to develop compelling interactions.⁹⁸

This is a potential competitive advantage because, besides the provision of complementary content (e.g. background factual information), second-screen applications could be used to sell advertising. This form of synchronous advertising could prove to be a compelling proposition to the extent that it reduces the risk of viewers avoiding ads. This form of advertising might appeal to both FTA and pay TV broadcasters.

The risk of ad avoidance could be further reduced by increasing their relevance thanks to a finer targeting over online distribution platforms empowered by 'big data'.⁹⁹ But it is an open question how much targeted

⁹⁴ However, to the extent that the first mover is able to maintain its position by preventing rivals from attracting enough critical mass (and corresponding online traffic) needed to gather their own data, this strategy might indeed confer an insurmountable first mover advantage.

⁹⁵ See, in this sense, Andrew Leonard, 'How Netflix is Turning Viewers into Puppets', 1 Feb. 2013, Salon, available at http://www.salon.com/2013/02/01/how_netflix_is_turning_viewers_into_puppets/print.

⁹⁶ E.g. according to Twitter, 40% of all UK Twitter traffic at peak TV viewing time is about TV, with the majority of users belonging to the upmarket ABC1 demographic: see Twitter, 'Tune in with Twitter – Driving Discovery and Engagement with TV', available at www.broadcastnow.co.uk/Journals/2013/01/17/g/f/h/TwitterTV.pdf. See, also, *Boston Globe*, 'Cambridge's Bluefin Labs Decodes Social Media Chatter', 25 Nov. 2012, available at <http://www.bostonglobe.com/2012/11/25/cambridge-bluefin-labs-decodes-social-media-chatter/SLDp9nflJK0tFQKBpuVZhP/story.html>.

⁹⁷ It is worth noticing how these long-running TV series that succeed in growing a devoted community of fans can become self-standing brands, thus potentially cannibalising the brand equity of both the content producer and the broadcasting channel.

⁹⁸ Arguably, one exception could be that of foreign productions already screened abroad.

⁹⁹ Besides concerns about privacy and data security, it is worth reflecting about the concern that the audience is increasingly becoming the product and the advertiser the customer.

advertising will benefit FTA broadcasters, given that a higher level of granularity in terms of audience segmentation might impinge on their ability to reach mass audiences on a regular basis.¹⁰⁰

If anything, therefore, the second phase of digital disruption could tend to worsen the trade-off between content variety and quality, to the extent that it leads to the provision of programmes that not only generate mass audiences on a regular basis, but especially drive live social interaction online.

A similar trend could affect pay TV broadcasting. On the one hand, it is often argued that digital convergence will make it feasible for OTT rivals to be able to outbid pay TV incumbents for exclusive premium content.¹⁰¹ On the other hand, one of the main advantages of OTT propositions to ‘cord cutters/nevers’ is that they can avoid having to pay for a long tail of undesired channels normally included in traditional pay TV bundles.¹⁰² These two forces would tend to undermine the established price bundling strategies of pay TV operators that secured funding for niche channels.

By investing in their own content, OTT rivals insure themselves against the risk of being starved by traditional content providers of the quality content which is key to driving customer acquisition.

Netflix, in the best-known example to date,¹⁰³ decided to release the first series of its first production, *House of Cards*, all at once, thus spurring so-called ‘binge viewing’, whereby viewers watch numerous episodes in one session.¹⁰⁴ This novel form of distribution risked discouraging the contemporaneous use of social media whilst watching so as not to spoil the experience of those who haven’t indulged in ‘binge viewing’.¹⁰⁵

Far from allaying remaining concerns linked to traditional ‘consumer’ market failures, digital convergence might therefore actually aggravate them due to pressures on both the FTA and the pay TV broadcasting models, which would tend to penalise content diversity/variety. There is a risk that increased rivalry would feed into higher risk aversion and, in response, conformism in programming; while bidding rivalry might ultimately drive up premiums charged for exclusive content.

¹⁰⁰ It is perhaps not surprising therefore that, so far, targeted advertising initiatives in the UK have been launched primarily by operators with little to lose in terms of cannibalisation of revenues from the sale of TV advertising airtime, such as BSkyB, Virgin Media and, more recently, Tesco: see Reuters, ‘Tesco Plans Targeted Advertising with Launch of Free TV Service’, 6 Mar. 2013, available at <http://uk.reuters.com/article/2013/03/06/uk-tesco-tv-launch-idUKBRE9250I720130306>. Among the PSB broadcasters, only C4 has so far introduced ‘sub-demographic’ targeting for the 4oD catch-up online service, although the stated ambition ‘is to translate this for linear TV’: see ‘Your House, Your Advert’, *Television: The Journal of the Royal Television Society*, Mar. 2013, p. 31. See also Deloitte (2012a); and also Felix Salmon, ‘Content Economics, part 1: Advertising’, Reuters, 21 Feb. 2013, available at <http://blogs.reuters.com/felix-salmon/2013/02/20/content-economics-part-1-advertising>.

¹⁰¹ See, with respect to premium movies, Competition Commission, *Movies on Pay TV Market Investigation: A Report on the Supply and Acquisition of Subscription Pay-TV Movie Rights and Services*, 2 Aug. 2012, para. 7.10 at pp. 7–3, available at http://www.competition-commission.org.uk/assets/competitioncommission/docs/2010/movies-on-pay-tv/main_report.pdf.

¹⁰² See e.g. Brandon G. Withrow, ‘Will 2013 Be the Year of the Cord-Cutters and Cord-Nevers?’, Huffington Post, 22 Feb. 2013, available at http://www.huffingtonpost.com/brandon-g-withrow/cord-cutters_b_2713905.html. For an economic discussion, see Waterman et al. (2012).

¹⁰³ In Apr., Amazon launched 14 televisions pilots, which it financed, in order to monitor customer feedback to decide which ones to produce as full series. See Brad Stone, ‘Amazon Tries to Push Into Original TV Programming’, 27 Mar. 2013, Bloomberg Business Week, available at <http://www.businessweek.com/articles/2013-03-27/amazon-tries-to-push-into-original-tv-programming>.

¹⁰⁴ See Liz S. Miller, ‘Binge-Viewing Netflix’s House of Cards: I Just had a Very Long Day of Drama’, PaidContent, 1 Feb. 2013, available at <http://paidcontent.org/2013/02/01/binge-viewing-netflixs-house-of-cards-i-just-had-a-very-long-day-of-drama>.

¹⁰⁵ See Liz S. Miller, ‘House Of Cards, One Week Later: Spoiler Alerts and the DVD Question’, PaidContent, 10 Feb. 2013, available at <http://paidcontent.org/2013/02/10/house-of-cards-one-week-later-spoiler-alerts-and-the-dvd-question>. See Joshua Gans, ‘“House of Cards” Wants to be Shared’, 6 Feb. 2013, Digitopoly, available at <http://www.digitopoly.org/2013/02/06/house-of-cards-wants-to-be-shared/>. However, immediate release and the ensuing ‘binge viewing’ do not prevent the kind of user feedback or expert review that people often rely on to decide whether or not to consume an ‘experience good’ such as a TV programme. Quite the contrary, it could be argued that the ‘buzz’ created by this innovative marketing approach must have provided a welcome demand boost.

Ultimately, the distinction between advertising-based FTA and pay TV business models could become progressively blurred,¹⁰⁶ as digital convergence could spur operators to explore new hybrid business models with combinations of elements from both. However, the idea that digital convergence will promote total disintermediation of content provision is far-fetched.

Audiovisual content is and will remain an 'experience good' in nature. Therefore the explosion of content offerings over the internet is likely to mean the emergence of some new form of content agglomeration, and hence of intermediation. In this respect, as argued below, content distribution over the internet might merely replace legacy content aggregators with a new breed of internet gateway keepers.

The new technologies are simply new instruments in the broadcaster's toolbox, and it is up to the individual organisation to decide how to exploit them in a way that is consistent with its strategic mission. In this respect, institutional differences matter.

Pay TV and OTT operators will be profit maximisers. Whilst it is objectively challenging to translate the multifaceted objectives of PSB institutions into a simple objective function that is easy to model,¹⁰⁷ it is clear that it is not only (or at all in the case of the BBC) profit maximisation through either advertising or subscription revenues.

Having said that, as pointed out by Helen Weeds and Jonathan D. Levy, the key issue for public service broadcasting is not whether there is a justification for intervention, but rather whether intervention can actually be effective in a digitally converged media landscape.

For it will be increasingly difficult for the PSBs to retain audience attention when plenty of commercial content is just a click away. In the analogue era, lack of choice made it relatively straightforward to nudge the viewer towards the range of programmes defining the public service remit, but the explosion of choice under digital convergence makes it very easy for viewers to avoid watching these at all if they so wish.

It might be argued that only those viewers with a strong preference for specifically public service programmes will still seek them out, but these viewers would plausibly be willing to pay at the point of use to watch them anyway. So there is a potential challenge to the near-universal reach of PSBs.

However, this view is premised on an implausibly narrow understanding of what programmes are provided under the public service remit. It has never been the case that the viewer was 'forced' to watch edifying programmes that would broaden his/her horizons and, thus, be a good thing for society overall. Public service broadcasting is a far subtler art, encompassing a range of programmes and the links between programmes

¹⁰⁶ In this respect, it could be argued that the traditional distinction between FTA and pay TV adopted by regulators and competition watchdogs is under increasing pressure, given that digital convergence allows both types of operator to compete over both sources of revenues: advertising and pay-per-viewing. Accordingly, the decision of whether to opt for one business model in particular could be thought of as a strategy of differentiation, whereby rivals position themselves at the opposing extremes of what has become a continuum between FTA and pay TV in order to soften pricing rivalry and be able to exert market power over their corresponding sides – i.e. advertisers and subscribers. Needless to say, such a strategy of 'maximum differentiation' in terms of business models would come under strain in a crowded media landscape, where new entrants can opt for hybrid business models, thus unravelling incumbents' strategic positioning.

¹⁰⁷ There are hardly any attempts to model the objective function of PSBs in a mixed economy: see González-Maestre and Martínez-Sánchez (2010). A trade-off might arise between the maximisation of consumer welfare and audience reach, which in the canonical 'spatial' model of competition is reflected in the trade-off between quality and variety discussed throughout this chapter. This is definitely an area for further research. Nevertheless, PSBs are subject to strict discipline in terms of value for money: see Picard (2003).

either via linear schedules or newer means (see Helen Weeds, at p. 9 above).¹⁰⁸ Public service paternalism is less nannyism than it once perhaps was.¹⁰⁹

However, viewers' choice-set has already been greatly enlarged with the advent of multichannel digital platforms, yet PSBs have held on, by and large, to their share of viewers (thanks in part to their launch of digital channels). Audiences regard watching TV as relaxation and their choices may be subject to a 'default bias', keeping them with familiar channels at the top spots of any TV EPGs.

This EPG prominence is put in jeopardy by the relentless process of disintermediation brought about by digital convergence. Even more concerning for advocates of continued PSB intervention is the prospect that, paradoxically, the explosion of choice would see the emergence of new online commercial gatekeepers whose function will be to steer the audience overwhelmed by 'choice overload'.

Prominence might become a scarce resource to be sold to those content providers with the highest willingness and ability to pay. This regime change would tend to replicate, if not amplify, the same dynamics underlying the quality–variety trade-offs and the risk for conformism in programming due to risk aversion described above. However, the two-sided nature of these online gatekeepers would tend to make sure that the most popular brands will always be prominent, and these might include the PSBs.¹¹⁰

The landscape of content provision following the second digital disruption is of course a matter of speculation. However, the former scenario has led to the suggestion that back-stop regulation is required to guarantee prominence online to PSBs (see Foster and Broughton, 2012). Whereas, under the latter scenario, it would not be mere viewer inertia keeping PSB content popular, but rather the continuing appeal of PSB programming.

Besides, digital convergence might give rise to a strong polarisation of content offered online, with both 'superstars' and 'long-tail' effects. Low entry barriers combined with search costs spurs content providers to design their products to either aim at broad-based audiences or target narrow niches (see Bar-Isaac et al., 2012). As mentioned above, these dynamics operate on a global scale. This polarisation, though, would come at the expense of content offers which are crowded out by increased competition from both of these.¹¹¹ If this 'squeezed middle', which could for example include UK dramas, children's programmes, and accessible current affairs programming, is thought of as high-quality content that unites, in an attempt to cater for different audience tastes and preferences in a way that neither caters to the lowest common denominator for the largest possible audience, nor just serves a narrow niche, it will be a gap appropriate for public service providers. In a highly competitive converged media landscape, an editorial strategy serving

¹⁰⁸ The PSB broadcaster would schedule new and/or 'challenging' programmes alongside established and/or popular ones in a way to entice the audience to watch them. This practice is labelled 'hammocking', and is based on the principle that the information asymmetry due to the fact that TV programmes are 'experience goods' can be addressed through the signalling power of a trusted brand (akin to repeat purchasing).

¹⁰⁹ Indeed, this criticism was first raised by Coase back in 1966: see discussion in Armstrong and Weeds (2007).

¹¹⁰ See Baye et al. (2012). This tension is strongly reminiscent of the debate whether 'organic search' – where search results are in principle unadulterated – is being manipulated by the platform owner to promote affiliated content producers. Suffice to say that this debate has attracted antitrust scrutiny: see Joaquín Almunia, VP of the European Commission responsible for Competition Policy, 'Statement of VP Almunia on the Google Antitrust Investigation', 21 May 2012, available at http://europa.eu/rapid/press-release_SPEECH-12-372_en.htm?locale=en.

¹¹¹ As explained above, Joshua Gans highlighted the possibility of a similar middle gap in the spectrum of content on offer under digital convergence, where the main driver is the use of social media to either interact live or build strong communities around long-running TV series. Therefore, those programmes genres that either lack a long narrative arc or do not, like live events, induce viewers to comment on social networks while watching might be undersupplied by commercial content providers. See Tim Harford, 'Changing Channels: Why TV has had to Adapt', 23 Feb. 2013, available at <http://timharford.com/2013/02/changing-channels-why-tv-has-had-to-adapt>.

the middle might be ultimately crowded out in the commercial marketplace.¹¹² For it is riskier than the alternatives, given the economics of online content.

However, in a crowded commercial media landscape, PSB content might fail to stand out amid the many choices on offer, no matter how sound the strategy. PSB prominence will need to be supported both through updated, relevant prominence rules and PSBs' own reputation and brand values. A 'focal point', a popular and trusted brand, would help to guarantee online prominence.¹¹³

The BBC brand (and the iPlayer) is proving to be an effective 'focal point' so far. To keep it this way, though, it is essential to maintain the broadest range of output in terms of both genres and audience preferences covered. To achieve this, the BBC is likely to need sufficient scale in the face of the high fixed cost economics of broadcasting, a wide range of programming, and to develop successful editorial and technological strategies. In addition, the regulatory protections for the BBC and other PSBs, such as prominence, will need updating.

Conclusions

The changing salience of the several market failures in broadcasting, due to digital technologies, raises a number of questions about the nature of the public service intervention required. The key questions for further research are:

1. How can public service providers sustain their ability to both provide and also bring audiences to multiple content genres, given changes in content availability, distribution technology, and audience habits?
2. How can the public service intervention be shaped best to support innovation and new entry given that the dynamics of digital markets, due to both large economies of scale in distribution and network/platform effects and the revenue attraction of providing content to appeal to mass audiences, will drive concentration?
3. As the scale of economies are making media markets increasingly global, what are the specific needs to support national cultures, and national media providers?
4. How will the regulatory framework for PSBs need to be updated to enable them to continue delivering consumer welfare in the world of online digital broadcasting?

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¹¹² It is worth noting how this theoretical framework can also be applied to the provision of impartial news and current affairs coverage under digital convergence: see Sambrook (2012).

¹¹³ It is worth noticing that the need for a 'focal point' tends to militate against alternative solutions proposed in the past where instead of a single PSB broadcaster 'an arts council of the airwaves' is set up, with an authority responsible for disbursing public funds in a fragmented way on a content-by-content basis.

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9. A 2020 Vision for the BBC

Gavyn Davies

I resigned as BBC Chairman on 28 January 2004, and have hardly made any public comments on the BBC or its affairs since then. Nor have I spent much time thinking about the role and structure of BBC, as may become painfully apparent! However, it has been fascinating to get a chance to look back at what has happened in the past 10 years, and to consider whether the changes in the broadcasting landscape have done anything fundamentally to alter the case for public service broadcasting and the role of the BBC.

It will not come as much of a surprise to my friends and former colleagues at the BBC to hear that I have not changed my mind in any significant respect about the value and role of the organisation. In fact, I believe that the profound changes in the technological landscape in the past decade have in many ways strengthened the case for a large, publicly funded organisation like the BBC to exist.

It is the fate of the BBC to be questioned and examined more than any other public organisation in the UK, except perhaps the National Health Service. That has always been true throughout its history. How many times have we been told that the BBC has outlived its usefulness, given the profound changes taking place in the media landscape? That tradition goes back at least into the 1950s. Yet the BBC's work remains critical for the future of our British democracy.

To do this important work, such an organisation must retain scale, indeed universal access, and in my opinion, it must continue to provide services which are free at the point of use. These services must inform, educate, and entertain, as they have always done, and must do so in a way which the private sector, left to its own devices, would fail to accomplish. There is no reason why the BBC cannot continue to do all of this long after the end of its current charter period in 2017.

Changes in the Landscape in the Past Decade

I would like to start with some observations about the way in which the landscape has changed in the past decade. Many of these changes were accurately predicted, or were already in train when I was at the BBC, but there have also been some significant surprises.

Many people argue that the technological landscape has changed so quickly in the past decade that the BBC must change with it, or face extinction. That, of course, is true if we are talking about distribution mechanisms, the ways in which BBC content is delivered to the final user. I am very optimistic that the BBC can handle these issues successfully, as it has always done. It has retained very high levels of reach in the past decade, as the market has changed dramatically all around it.

In the BBC's history, it has coped with many changes in distribution – the arrival of television, colour television, digital television and radio, the web and iPlayer. In each case, the BBC has not only been able to cope with the change, it has actually been in the vanguard of making the new technology rapidly acceptable to the general population.

But the real role of the BBC is not about distribution mechanisms, it is about the creation and dissemination of high-quality content. And in that regard, I do not think that changes in the landscape matter as much as many people contend. In today's world, we see many examples of high-quality content being distributed widely, but with high purchase prices being

incurred by consumers, and with very small audiences as a result. We also see many examples of very low-quality content being distributed free of any charge to the user. What we do not see is many examples of high-quality content being distributed free at the point of sale, because private sector funding cannot cope with the costs of creating the content.

At present, some newspaper websites are an exception to this rule, but I do not expect this to last for long, since the economics do not make much sense. If we want high-quality content delivered to large audiences, with no charge at the point of use, then a publicly funded model seems to be the only viable option.

It was already clear in 2004 that most consumers would soon gain access to multichannel digital television services, though there was too much pessimism about how difficult the switchover process might turn out to be. I remember thinking, quite mistakenly, that switching off the analogue signal in 2013 would prove to be a political nightmare. Fortunately, the government and the BBC cooperated well in accelerating this process, and I believe that the role of Freeview, launched by Greg Dyke when he was director-general, was crucial.

We have now reached a point where 96% of all UK consumers have access to multichannel digital television services, and the days of spectrum shortage are effectively over. Along with this change has come a substantial shift towards subscription services, led by Sky, which has become dominant in the provision of sports and movies to British households. The BBC has lost access to many sports rights, which I regret, but I now accept this as inevitable. There is much else left for it to do.

While the BBC has been very successful in maintaining its market share among households who already had access to multichannel services in 2004, there has inevitably been a loss in overall market share as more households gained access to much greater choice. However, now that the switchover process has ended, the erosion in BBC market share should also end, provided of course that the BBC can continue to provide programmes which people want to watch.

The switchover process has ended with the BBC retaining a one-third market share of television services, and a one-half share of radio services, which are somewhat higher figures than I might have predicted a decade ago. Meanwhile, other public service television providers have faced greater difficulties than the BBC in maintaining market share. ITV1 (itv, after its recent rebranding), for example, has seen its television share falling from 40% in 1992 to 16% today, a decline which has forced it to rethink its commitment to public service genres such as arts programming, regional news, and the like.

The problems faced by ITV have occurred largely because of changes in the advertising market, which have seen its share of advertising revenue declining sharply. New forms of advertising on the internet have provided competition for ITV, Channel 4, and Five, and the slump in advertising spend since 2007 has been unprecedented. Furthermore, ITV's advertising rates have been held down by public regulation, following the merger of Carlton and Granada. Not many people argue today that any of the BBC's domestic services should be financed by advertising.

The trials and tribulations of ITV, Channel 4, and others have always been of direct relevance to the BBC. In business, it is usually nice to see a rival in trouble, but that is not the case in this instance. Since the 1950s, the BBC's programming has greatly benefited from the competition it has faced from

ITV (and indeed all of the commercial broadcasters including Sky, which have done many things better than the BBC did before them). Competition is extremely healthy for an organisation which has no imperative to face the test of the marketplace. Furthermore, whenever ITV has faced difficult economic times, the political process has become more hostile to the publicly funded BBC.

So it would be nice in many respects to imagine that the commercial public service broadcasters (or PSBs) can be returned to full health. But that seems improbable. More likely, they will slowly drift towards becoming fully commercial broadcasters, leaving the BBC to fulfil the public service remit on its own.

One critical conclusion from this saga is that the public funding of PSB has proven more durable than a model based on private funding plus regulation. As privately funded PSBs have faced increasing difficulty, the role of the BBC has become ever more important as the only viable provider of PSB.

Outside the world of traditional broadcasting, the technological landscape has changed even more dramatically in the past decade. Again, many of the broad outlines of these changes were predicted 10 or 15 years ago, especially by John Birt and his colleagues at the BBC in the 1990s. They launched the BBC website in 1997, and the BBC's digital television services in 1998. When I became Chairman in 2001, this extension of the BBC's boundaries was still highly controversial, and vehemently opposed by the private sector. But without these innovations, the BBC would certainly have been in deep trouble as technology and consumer habits changed in the new century.

The increased use of the internet by domestic consumers, first on PCs and then on mobile phones and tablets, has meant that a BBC without a significant online presence would already have become an anachronism. BBC News Online now commands about 30% of the UK news market, roughly the same as all of the British newspapers put together. This has naturally created a great deal of opposition from the press, which has been unable to monetise its web presence partly as a result of competition from free BBC services.

But newspapers in other countries have faced similar difficulties, and they have not had the BBC to contend with. To a large extent, this stems from an inherent problem with monetising web services, not from the presence of the BBC in the mix. Furthermore, few observers would argue that the nation is worse off as a result of this mixed economy in web services. After all, no one seriously argues that the scope of the National Health Service should be curtailed solely in order to leave room for profitable private sector health services to expand.

What matters is the overall welfare of the public, and that should also be the case in broadcasting and the web. Note that I am arguing here for a mixed economy in this field, not for the dominance of a monopoly public provider, which would certainly be very unhealthy.

People are now consuming more and more of their audio and visual experiences via the web, rather than via broadcasts or recorded materials. Most of this is free-to-air. It turns out that users are very reluctant to pay subscriptions or even to watch ads. Even a simple process of registration is heavily resisted by users.

Furthermore, an increasing proportion of television viewing is being undertaken by time-shifting through VCRs and the digital equivalents. At present, around 10–15% of all television viewing is done in this way. This, of

course, is providing a new headache for advertising-funded programming, since consumers are finding it easier and easier to skip the ads. My wife remarked to me that it was very odd finding that she had to watch the ads on ITV Player, and that she did not like it. That, she said, was like television in a previous era.

In view of all these changes, it is perhaps somewhat surprising that the presence of the traditional television set, updated of course for technical advances, has maintained a central role in most people's lives. Given the growth of the web, and of services like YouTube, I would not have predicted a decade ago that the number of hours spent watching television per person would have risen rather than fallen in this new world.

Yet this is exactly what has happened. It has now risen to 4.0 hours per person per day from 3.6 hours a decade ago. It is our national habit. As new forms of digital entertainment have grown, people have simply added these to their schedules, without reducing their exposure to television. A new habit, which is increasing rapidly, is to watch television while simultaneously using websites on mobile phones and tablets.

Radio listening has also proven robust, though there has been a slight fall in traditional radio listening as the availability of digital music, whether legal or illegal, has grown very rapidly.

The BBC, of course, is a content provider rather than a distribution mechanism, so it should not really matter how people choose to consume the creative output of the BBC. However, because the BBC's funding mechanism, the licence fee, is entirely dependent on broadcast television, a shift in public habits away from television could have proven to be a major threat to the organisation, and to the provision of PSB in this country. That has not yet happened, though one day it might.

There is no doubt that television has maintained a central role in all of our lives in part because of a drop in the cost of large-screen TVs, and lately because of the integration of TV services and the internet. This seems likely to remain the case well into the next charter period after 2017. One day, it is possible that traditional television will cease to have a universal place in all our homes, in which case it will become impossible to maintain the present licence fee arrangements. Fortunately, this is not likely to happen by 2017. The question of whether it is practically possible to levy a licence fee, as distinct from the amount which should be charged, is not likely to rear its head for some time yet.

The Debate on BBC Governance

I would now like to turn to the governance of the BBC, a subject which is almost bound to receive a disproportionate share of attention in the debate about the new charter. I have often found it surprising that people and politicians who generally support the BBC and its objectives frequently do not support its governance structure. They appear to make almost no connection between the success of the BBC in serving the public and in winning public trust on the one hand, and the independence of its governance arrangements on the other. Furthermore, the leadership of BBC management is often very lukewarm in its support of the governance structure, in part because it sees the trustees, and formerly the governors, as being out of touch with programmes and audiences. In addition, self-regulation has fallen out of favour in many other parts of our national life. Yet it is surely no coincidence that the BBC has served the public so well under its current governance arrangements, which have been broadly unchanged for decades.

Although the old Board of Governors was replaced by the BBC Trust in the most recent charter, I do not believe that there were any really fundamental changes in the governance mechanism. Crucially, the role of the Chairman of the BBC, which is the linchpin of the governance system, was left basically unchanged. The relationship between the Chairman and the director-general has always been critical for the success of the BBC, and much of the work of the Chairman is done in private where it can be most effective. Furthermore, although the BBC Trust was made more independent of the management team than had been the case under the old system, the BBC continued to be essentially self-regulated.

Any governance system for the BBC needs to fulfil at least three objectives.

1. It must ensure the independence of BBC programming, especially news coverage, from the political system. The BBC is a public body, but it is not a state broadcaster. It serves the public, and not the government. If the licence fee payers ever cease to believe this, then we might as well close the BBC down.
2. The governance system needs to ensure that the BBC seeks the maximum degree of quality and distinctiveness in its programming. This is a never-ending battle, since the management will always seek to maximise audience share, for reasons of competition and career advancement.
3. The trustees need to ensure that the BBC provides value for money to the licence fee payer. This is also not easy in a huge organisation which is generally not subject to market pressures, and which operates in a service industry where productivity is very difficult to measure accurately.

I would argue that the existing governance system has fulfilled all three of these roles pretty well for a long period of time, often under enormous pressures. Of course the BBC has done many things wrong, but it always seeks to correct its mistakes in an open and honest manner. Its capacity for self-flagellation is unrivalled. And of course the public knows all this, which is why trust in the BBC remains very high, even at times of maximum stress.

Trust in the BBC, which was already high in 2004 despite the criticisms levied by the Hutton inquiry, rose further up to 2011, a period in which trust in other organisations fell sharply. Trust dipped during the recent tribulations, as it has in previous similar periods, but has already started to rise again.

It is difficult to think of another organisation, either public or private, again excepting the NHS, which can make similar claims to these. This has not occurred in spite of the governance system, it has occurred because of it. The burden of proof should be on those who wish to change such a successful system, rather than on those who seek to defend it.

Critics tend to draw attention to the following alleged drawbacks of the system.

1. They say that the system leads to regulatory capture, in which the BBC Trust makes decisions which are in the management's interest, rather than the public interest.

2. They argue that the system does not allow for sufficient contestability, under which the BBC's incumbent staff would compete with external providers for public money to provide BBC services.
3. It is argued that the system does not give sufficient weight to the interests of private providers of competing services which may be crowded out by public provision.

I agree that these are dangers which need to be watched carefully, but there is no proof that any alternative system would be any better at handling them. Other systems may be more transparent than the current BBC system, but they may be much more subject to regulatory capture by private companies, and they might be far more slow-moving than the current mechanism. Furthermore, they would be almost bound to seriously compromise the role of the BBC Chairman, which, as I say, is the linchpin of the present arrangements.

There are some suggestions for a new governance regime which are perfectly sensible on the surface, including Mark Oliver's idea of a public sector broadcasting trust, covering all of the PSBs and offering advice to the government on critical BBC matters, but this would surely create confusion over the role of the BBC's internal board. Making changes for the sake of change is always appealing to politicians, but it does carry costs.

When I was Chairman, I argued consistently for the maintenance of the governance system, and whatever mistakes we made I do think that we protected the independence of the BBC well. Greg Dyke, as director-general, was not a fan of the Board of Governors, and he preferred external regulation, which he thought would not be too intrusive. Greg worked extremely well with both of his Chairmen, and was entirely right about the need to change the culture of the BBC, which is a creative organisation or it is nothing, but he did not enjoy the formality of governors' meetings very much at all.

I was not confident that Ofcom would prove to be a sufficiently strong supporter of public service broadcasting, and feared it would be captured by influential private companies, although such concerns have been greatly alleviated by the actual behaviour of Ofcom since then.

Following a long-standing BBC tradition, I also argued that the National Audit Office (NAO) should not be permitted to audit the BBC's financial activities, believing that they would tend to pick on highly sensational investigations rather than on the nitty-gritty of everyday spending, which is what really determines value for money for the licence fee payer. This hostility to the NAO eventually proved impossible to sustain in a climate of political scepticism about the BBC's internal accounting arrangements. We have yet to see the full effects of these changes. There have been some examples of political sensationalism already, but in retrospect I do not think that this was a battle worth fighting.

My final point on governance is the following. The BBC is very different from a private monopoly or oligopoly, which is seeking to make profits by selling its products to customers. In such a situation, exemplified by a private energy company or the rail network, there is a sharp distinction to be made between the protection of the shareholders and the protection of the public. The interests of the shareholders are protected by the board and its chairman, while the interests of the public are protected by the regulator. They are doing entirely different jobs. In the case of the BBC, in contrast, the shareholders and the public are not distinct. They are one and the same. Therefore you do not need two separate entities – a regulator and a BBC

Board – to do only one job. I have never been able to persuade people of the importance of this distinction, but I continue to believe that it is valid.

The Economics of Public Broadcasting in the New World

I would now like to turn to the economics of broadcasting, a subject which continues to lie at the heart of the BBC's future as a publicly funded organisation. Andrew Graham and I wrote about this subject in the 1990s, arguing that broadcasting was a classic public good, which should be provided free at the point of sale to all potential users in the country.

In those days, broadcasting clearly fulfilled the criteria which are normally used by economists to define a public good. It was non-excludable, in the sense that, once it had been provided for one citizen, it could not be denied to any other citizen. And it was non-rivalrous, in the sense that one citizen's consumption of a broadcast did not deny that broadcast to any other.

Furthermore, we pointed out that setting up a mainstream broadcaster – like the Sky satellite network, for example – was subject to massive economies of scale, which would tend to create concentration of power in only a few hands. Such an industry would not be perfectly competitive, and therefore could not be left safely to the free market, at least not without considerable regulation.

Finally, we argued that there were considerable externalities in the provision of broadcasting, both good and bad. In particular, the role of a public broadcaster in providing news coverage and education to the citizens of the UK was, we believed, critical for the creation of a healthy democracy. All of these arguments suggested that there was something different about broadcasting, something which meant that it should be provided, at least in part, outside the commercial sector.

In the late 1990s, the government report which I chaired into the financing of the BBC argued that these criteria would remain valid as new technologies spread through the sector, notably satellite broadcasting, multichannel, and the rise of the web. These arguments were employed to justify a considerable increase in the BBC's licence fee, in order to enable the BBC to increase its footprint into the new distribution mechanisms.

The question for today is whether these traditional arguments for treating broadcasting and web distribution as public goods have now changed. For the most part, I believe that the arguments remain intact.

It remains clear that there are still positive externalities in the provision of public information, whether through traditional broadcasting or web services. It also remains true that the distribution of programming or web content involves incurring virtually no marginal cost at the point of use. There is some marginal cost, of course, when content is accessed via the web, but it is not very large relative to the cost of creating that content in the first place. That remains a classic characteristic of a public good.

While many of the arguments have therefore not changed, one important argument has changed, and that needs to be admitted. Whereas free-to-air broadcasting used to be a universal good – if you provide it for one citizen you automatically provide it for all – that is no longer true in the digital world.

It is now very straightforward, both in digital television services and in web provision, to restrict coverage to those people who have paid directly to receive the service. In other words, it is now possible to fund the BBC entirely through subscription, with people buying either the entire BBC package in one payment, or subscribing to individual channels and services separately.

Subscription has clear advantages, since people pay only for the services they wish to consume. Under the subscription model, the element of compulsion, which is necessary in the licence fee, would disappear, and the severe problem of having to collect the licence fee from people who do not want to pay it would also disappear. When I examined this option as Chairman, surveys suggested that, given a choice, around 60–70% of the population said that they would subscribe to the overall BBC package at a price close to the existing licence fee, which would currently imply a subscription charge of around £150. Even if this were true, it would obviously involve a very significant curtailment of BBC's services, since a large proportion of the current revenue would be lost. If the subscription fee were increased in order to avoid this, the number of subscribers would certainly decline, and it could no longer be claimed that the BBC represented a universal national service.

Furthermore, once the BBC had to compete for subscription fees, it is almost inevitable that the type and direct commerciality of services would change. Why should a subscription fee-based BBC not charge subscriptions for football and movies? Over time, I think this would inevitably change the focus of the organisation in a fundamental way. Finally, making a charge at the point of sale, in order to finance the provision of services which incur zero marginal costs in distribution, is economically inefficient, and carries welfare costs which are not necessarily immediately visible to the political system.

We can already see that the case for making the BBC a subscription service is attractive to many people, and it undoubtedly represents the main alternative to the present system. However, if the nation wants all of the benefits which are derived from the universal coverage of the BBC, a system based on subscription, by definition, cannot provide the right answer.

The Distinctiveness of BBC Services

Finally I would like to comment on an issue which always and rightly occupies a central place in discussions about the BBC, which is the distinctiveness or otherwise of its output. This of course gets to the heart of its public service role, and therefore ultimately to its *raison d'être*. There is no future for the BBC if it simply offers a different version of what is already available via commercial services. And I have always felt that the BBC is subject to some fair criticism on these grounds.

In my early days as Chairman I got off to the wrong start on this issue by suggesting that the BBC tended to 'over-serve' the middle classes while underserving young people, the north, and minority groups, including our immigrant communities. This was widely believed by the governors and the management board at the time, and we had lots of figures to prove it. I am sure the issue is still debated. Greg Dyke was rightly concerned that a universal licence fee system could not be maintained if large minority groups were permanently not attracted to the BBC's services. But my remarks gave entirely the wrong impression about content. They understandably created an outraged response which forced me to apologise for creating the wrong impression about my true beliefs on the distinctiveness of BBC content.

The most difficult task which the BBC faces, and has always faced, is to provide distinctive and uplifting content while simultaneously attracting mass audiences for much of its output. Doing one without the other is not enough. And the fact that it needs to do both inevitably means that there will always be a debate about whether it has got the balance right.

Distinctiveness does not necessarily mean elitism, or not always at any rate. But I think it does involve an unyielding commitment to serve all parts of the audience in a serious way, without dumbing down their interest and passions. Sometimes, the desire to reach a maximum-sized audience with each and every programme, or channel, can get in the way of this endeavour. There is evidence that a significant minority of the audience believes that there has been a trend towards dumbing down in television programming.

The tyranny of the audience figures is one which is very hard to overcome, although successive generations of BBC leaders have tried very hard to do this. In a 2010 report for Policy Exchange, titled *Changing the Channel*, Mark Oliver says the following:

BBC management obtain ratings on a daily basis, while monthly and weekly reach are the focus of management resource allocation decisions. Worse still, BBC value for money exercises often focus on cost per viewer or listener hour rather than comparing cost with quality and distinctiveness delivered. This all tends to make the BBC an organisation that tries to maximise reach first and quality/distinctiveness second. It should, instead, be an organisation that seeks to maximise quality and distinctiveness, subject to a certain realistic minimum requirement for reach and share of overall consumption.

One great and distinctive series, like David Attenborough's *Africa* or Miranda Hart's *Miranda*, is worth more than a lot of the acreage which fills daytime television. BBC management knows this very well, but it is a message which always has to be reinforced by the Trust.

Conclusion

A great deal of what I have said has covered familiar debates. I have argued that the case for the BBC's public service role remains intact, despite profound changes in the technological landscape. These changes will alter the mix of the distribution systems used by the BBC, but will not alter its core responsibility, which is to provide distinctive and uplifting content on a universal basis, free at the point of use. The licence fee system is not about to collapse, since television use has proven remarkably resilient, and subscription does not provide a viable alternative means of funding for a universal service. The independence of the BBC's governance system is an important reason why the BBC has maintained public trust, and it is worth defending. The argument that broadcasting and web content no longer represent public goods is invalid: the commercial sector cannot and will not do what the BBC should do.

When I resigned from the BBC on 24 January 2004, I hastily wrote a resignation statement, having had the pleasure of reading an advance copy of the Hutton Report at 4.00 am in the morning. I would like to take the liberty of ending by quoting a short extract from this statement:

The BBC is not owned by any government, but is held in perpetuity by its governors and management for the British people. The public should not take its existence entirely for granted.

It is frequently under attack, both from competitors, and from others who do not share or understand its principles. Its friends are too often silent when it is under threat. In the charter debate now under way, the massive silent majority which loves the BBC needs more often to make its voice heard.

Otherwise its future may not be secure.

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