

CONSUMER WELFARE AND TV PROGRAM
REGULATION

Bruce M. Owen

ABOUT THE MERCATUS CENTER AT GEORGE MASON UNIVERSITY

FOR OVER 25 years, the Mercatus Center at George Mason University has been the world's premier university source for market-oriented ideas—bridging the gap between academic ideas and real-world problems. A university-based research center, Mercatus works to advance knowledge about how markets work to improve our lives by training graduate students, conducting research, and applying sound economics to offer solutions to society's most pressing problems.

This study is a publication of the Mercatus Center at George Mason University. The opinions expressed in it do not necessarily represent the opinions of the Mercatus Center or George Mason University.

Mercatus Center
George Mason University
3351 North Fairfax Drive, 4th Floor
Arlington, VA 22201-4433
(703) 993-4930
mercatus.org

first release, May 24, 2012

ABOUT THE AUTHOR

Bruce M. Owen directs the Stanford University Public Policy Program. Previously, he was CEO of Economists Incorporated, an economic consulting firm in Washington, DC. In the Carter administration, he served as chief economist of the Antitrust Division of the U.S. Department of Justice and, in the Nixon administration, he served as chief economist of the White House Office of Telecommunications Policy. He received his PhD from Stanford and has taught at Duke University as well as Stanford. Dr. Owen has published books and articles on mass media economics and regulation policy, among other topics. He is currently working on a new book dealing with the economics of political corruption in America.

ABSTRACT

GETTING RID OF obsolete regulation of the broadcast and distribution of video programming is essential to the efficient operation of a market that has the potential to greatly increase the benefits to consumers. Services that increase video program distribution capacity have been delayed and suppressed for many years, and consumer benefits were lost as the Federal Communications Commission (FCC) pursued ill-defined and ephemeral “public interest” and “localism” objectives.

It is past time to stop extending interventions originally intended for old technology to a range of new competitive media. No longer is there any rational public policy basis for a government agency to dictate how much or what content the viewing public can see, any more than there ever has been for printed media. There is no market failure to which the current regulatory framework is responding and no longer any reason for FCC bureaucrats to decide how much of the spectrum should be used for each of many existing and future commercial services. Spectrum reform, along with the repeal of other broadcast programming restrictions contained in the proposed Scalise-DeMint Next Generation Television Marketplace Act, provide a roadmap for the necessary reform. With an adequate supply of tradable rights in spectrum, we will find out how much additional competition is possible among traditional wired and wireless, analog and digital, and fixed and mobile delivery services.

THERE ARE FEW alleyways of the administrative state more obscure or more littered with obstacles to efficient markets and improvements in consumer welfare than the interventions regulating ownership and licensing of TV stations and programs. What distinguishes TV programs from other mass media content, including both traditional print and new online media, is the extreme eagerness of Washington to engage in efforts to prevent markets from working freely, often in response to interest group pressures and opportunities for political advantage and with almost complete indifference to the welfare of consumers.

This paper first briefly describes some unusual economic features of media content and the characteristics of free markets in media content and then lists some of the legacy interventions that prevent video markets from operating to the advantage of consumers. Lastly, it considers what reforms will be required to eliminate the distortions currently impairing these markets.

The occasion for this discussion is the Scalise-DeMint Next Generation Television Marketplace Act, a bill recently introduced in both Houses of Congress to repeal numerous provisions of mass media regulatory law.¹ This bill would eliminate various distortions in video content markets caused primarily by two categories of interventions: copyright law and video program distribution restrictions. Scalise-DeMint deals with these directly. The bill would repeal compulsory licenses, must-carry rules, retransmission consent, and a variety of other mandates on regulated entities, including broadcast ownership rules that have become irrelevant in the Internet age. However, there are background distortions to deal with as well, chief among them the nationalization and allocation of spectrum by bureaucrats rather than markets. Spectrum auctions, while a step in the right direction, do not establish free markets in spectrum. Today, licensees can buy and sell licensed rights to use various parts of the spectrum, but they cannot decide what use to make of a given spectrum assignment. That needs to change.

1. *Next Generation Television Marketplace Act of 2011*, S. 2008, 112th Cong., 1st sess.

MARKETS IN VIDEO CONTENT

VIDEO PROGRAMMING, LIKE music and other recorded performances distributed on a variety of media, can be easy to steal. It should be obvious that few producers will have much interest in making attractive video or audio products that are easy to steal and can be stolen with impunity. The prospect of earning a return on investment for video programs, at least on average, is what motivates commercial program production. Sadly, much programming distribution, particularly on the Internet, is pirated.² Private and collective efforts to detect or prevent theft of electronic video property have not been very successful, and this has led to avoidance of vulnerable distribution channels and other restrictions on supply that reduce consumer welfare.³ This is a problem for both audio and video programming, which share the characteristic of being nonrivalrous goods.⁴

Free and efficient markets in video programs and spectrum require a role for government—to define and enforce tradable property rights. Depending on the costs and technologies of theft, government enforcement of property rights may be essential to the very existence of markets. Protection of property rights, long considered an essential role of government, is a necessary condition for promoting consumer welfare. Economic activities such as investment and work take place because of incentives. If the potential rewards (or costs) from such activity accrue to others, we will invest or work too little or too much. Efficiency requires that both the costs and the benefits of economic activity “belong” in the first instance to those who engage in the activity. This belonging is a right that is meaningless in the absence of defense by the state. (The alternative is self-help in defense of asset values, generally by resort to acts or threats of violence.⁵) Also essential for efficiency is that these rights be exclusive (that is immune from initial problems such as free riding

2. See Government Accountability Office, “Intellectual Property: Observations on Efforts to Quantify the Economic Effects of Counterfeit and Pirated Goods” (report, GAO-10-423, Washington, DC, April 2010), 3-5.

3. *Ibid.*, 9–13.

4. A nonrivalrous good is one that can be consumed without reducing the available supply. Video programming does not degrade or disappear upon consumption, as candy bars or automobiles do. Instead, video programming remains available at zero marginal production cost for other potential consumers. Of course, sometimes there are nontrivial marginal costs of physical reproduction, packaging, and distribution, as there are with music CDs, DVDs, and all printed media. But for TV programs sent out over the air or distributed on other electronic media, marginal reproduction and distribution costs are close to zero.

5. Some libertarian thinkers dispute the necessity for a government role in the defense of private property rights. See, for example, Bruce L. Benson, *The Enterprise of Law: Justice without the State* (San Francisco: Pacific Research Institute, 1990); David Friedman, “Private Creation and Enforcement of Law: A Historical Case,” *The Journal of Legal Studies* 8, no. 2 (1979): 399–415; David Friedman, “A Positive Account of Property Rights,” *Social Philosophy & Policy* 11, no. 2 (1994); Elinor Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Action* (Cambridge, UK: Cambridge University Press, 1990); Murray N. Rothbard, *Conceived in Liberty* (Auburn, AL: Ludwig von Mises Institute, 1975); and Paul R. Milgrom et al., “The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs,” *Economics and Politics* 2, no. 1 (1990): 1–23.

and the tragedy of the commons) and alienable⁶ and traded in competitive markets. These characteristics also require state action, such as enforceable contracts and antitrust law.

Competitive markets typically contribute most to economic welfare when prices reflect marginal costs. Clearly no one is going to spend millions of dollars making a TV show or movie without charging viewers anything to watch it, unless advertisers are willing to pay the freight. Markets for nonrivalrous goods tend to emphasize price discrimination. If a producer charges a uniform price to each viewer of a TV show, many viewers will not be willing to pay that price and will be excluded. That makes little sense from the producer's perspective because it would cost nothing to supply the TV show to those excluded viewers at a lower price. Any uniform price leaves money on the table. Producers would like to offer each viewer a price just low enough to sell the product to that consumer. This produces greater revenue and creates incentives for more production. Price discrimination in these and other circumstances can increase economic welfare. For this to work, viewers who purchase access at relatively low prices must be discouraged from arbitrage, that is, engaging in resale competition with the producer.

Competitive markets in nonrivalrous goods can also work by bundling or packaging products. TV programs can be sold, for example, as bundles in a monthly subscription. Consumers purchase access to the bundle and then can view each program at a zero marginal price. The monthly subscription can be viewed as an option to consume any or all of a large collection of TV shows at a zero price. If there are competing packagers or distributors producing substitutable bundles, the result can resemble the outcome of discriminatory pricing for each program. That is, the bundling approach and the discrimination approach are each capable of welfare-enhancing outcomes, although neither is likely to be perfect.⁷ Bundling often reduces costs for the consumer by transferring assembly functions to a packager who can perform assembly more efficiently.

Advertising adds another dimension to this description of potentially efficient free markets in nonrivalrous TV programs and similar products and brings into the

6. Richard A. Posner, *Economic Analysis of Law* (Boston: Little Brown, 2011), 39–111. As Posner points out (at 40, n. 1), property law has ancient roots.

7. There are numerous economic models of the effects of bundling and various definitions of what constitutes bundling. These models generally find that whether bundling is welfare-enhancing or not depends on various assumptions about cost and demand conditions. See, for examples, W. J. Adams and J. L. Yellen, "Commodity Bundling and the Burden of Monopoly," *Quarterly Journal of Economics* 90, no. 3 (1976): 475–98; Yannis Bakos and Erik Brynjolfsson, "Bundling Information Goods: Pricing, Profits and Efficiency," *Management and Science* 45, no. 12 (1999): 1613–30; Mark Armstrong, "A More General Theory of Commodity Bundling," MPRA Paper No. 37375, posted March 15, 2012, <http://mpa.ub.uni-muenchen.de/37375/>. The models supply no support for a presumption that bundling in the real world should be discouraged by policymakers. For an antitrust perspective, see *Brantley v. NBC Universal*, 9th Circuit Court of Appeals, slip opinion filed March 30, 2012, <http://www.ca9.uscourts.gov/datastore/opinions/2012/03/30/09-56785.pdf>.

discussion a variety of online nonvideo content and service providers. In general, media markets are two sided. Media firms purchase or produce, and then distribute, content to attract audiences. Audiences are valuable not only because they may be a direct source of revenue but also because their “eyeballs” can be sold to advertisers. The prices audiences pay (if any) are lower than they would otherwise be to increase the number of eyeballs that can be sold to advertisers. There is a tradeoff between the negative effect of commercial interruptions on audience size and viewer willingness to pay and advertiser willingness. Both extremes exist together in the market. Viewers pay relatively high prices for commercial-free, high-quality programming on networks such as HBO, while other networks combine advertising revenues with revenues from multichannel video programming distributors (MVPDs) who bundle programs into tiers and sell options to view individual programs at a zero incremental price. MVPDs include cable television operators, satellite television providers, local telephone companies, and others who buy or produce programming and then provide bundled services to individual TV households.

Markets for TV programs have many of the same characteristics as markets for printed content. Perhaps the best way to imagine how TV markets would work in the absence of government regulations is by analogy with older but much freer markets for print content. Periodical and book-publishing markets are highly competitive and robust and respond rapidly to changing consumer tastes and to technological change. Daily newspapers, now in rapid decline, are characterized by economies of scale in printing and distribution relative to the extent of local markets and, accordingly, have been less competitive. Still, no one has seriously suggested economic regulation of daily newspapers.

Of course, all print media today are beset by additional competition from online content and online distribution of traditional formats. Life in a competitive market can be tough for suppliers but highly rewarding for all but the most inflexible or nostalgic consumers. The decline of print media is the result of innovation by suppliers and free choices by consumers. Many of us sigh at the demise of the corner bookstore, while welcoming the greater convenience of portable access to virtually every book in print and many that are out of print. Traditionally, nothing of the sort was allowed to happen with regulated media such as television. Instead, regulation retards innovation, blocks entry by more efficient competitors and technologies, and transfers welfare from consumers to producers. A good example is the contrast between the rapid adoption of digital technology in computing and Internet-related industries and the very slow adoption of digital technology in television broadcasting—where FCC regulators and industry-wide committees, rather than entrepreneurial competitors, set the pace of change.

FEDERAL INTERVENTIONS IN TV MARKETS

FEDERAL NATIONALIZATION OF the electromagnetic spectrum occurred in 1927. Since that time, the spectrum has been allotted by the FCC together with the Department of Commerce, which coordinates federal and state agency spectrum uses.⁸ Whatever may have been the case in 1927, most economists agree that the spectrum can be allocated by private markets, provided that adequately defined property rights are first allocated to private owners by auction or other means.

In making spectrum allocation decisions, the FCC has been heavily influenced by industry interests, both directly and through congressional patrons of the broadcast and broader entertainment industries. For example, for decades the FCC made first radio and then TV licenses artificially scarce to protect the economic interests of broadcast networks and big-city stations.⁹ The evidence for this is found in the extremely high prices at which broadcast licenses were bought and sold, reflecting the capitalization of scarcity rents.¹⁰ This artificial scarcity of a crucial input to broadcasting resulted in massive losses of consumer welfare, both in programming that was never produced or viewed and (probably) in the costly construction of cable television—and later satellite television—facilities by the private sector to mitigate the continuing unmet consumer demand for video programming. The argument is that in a free market for spectrum, broadcasting would have been a more efficient way to satisfy the demand for advertiser-supported video programming than cable and satellite television, which require enormous investments in physical capital and ongoing maintenance. Proving such a counter-factual is notoriously difficult, and no one has quantified the welfare loss, but the construction of (probably) unnecessary cable and satellite facilities alone cost many tens of billions. The untapped consumer willingness to pay for additional video content, over many decades, doubtless was a far greater welfare loss.

This primal intervention—nationalization of the spectrum and allocation

8. Thomas W. Hazlett, “The Wireless Craze, the Unlimited Bandwidth Myth, the Spectrum Auction Faux Pas, and the Punchline to Ronald Coase’s ‘Big Joke’: An Essay on Airwave Allocation Policy,” *Harvard Journal of Law & Technology* 14, no. 2 (2001): 348.

9. That regulators sought to promote broadcasting by restricting entry and reducing competition is the best explanation of regulatory policy choices during most of the history of the industry. See generally, Bruce M. Owen and Ronald Braeutigam, *The Regulation Game*, (Boston: Ballinger 1978); Bruce M. Owen, *Economics and Freedom of Expression*, Boston: Ballinger 1975. This explanation of the economic effects of broadcast regulation is not necessarily the only possible explanation. For example, regulators simply may have made, inadvertently, a long series of bad choices. A more general theory of broadcast regulation fits nicely into interest group models of “Type 2” political corruption. See Lawrence Lessig, *Republic, Lost: How Money Corrupts Congress—And A Plan To Stop It* (New York: Hachette 2011); Bruce M. Owen, “The Costs of Political Corruption in America,” Stanford Institute for Economic Policy Research, Stanford, CA, Policy Brief, May 2012.

10. See Harvey J. Levin, *The Invisible Resource: Use and Regulation of the Radio Spectrum* (Washington, DC: RFF Press, 1971); and Bruce M. Owen and Steven S. Wildman, *Video Economics* (Cambridge, MA: Harvard University Press, 1992), 15.

designed to create an artificial scarcity—led to ever-increasing intervention as outside suppliers attempted to circumvent the blockade, often with new technologies.¹¹ For example, when cable television systems began to compete with local TV stations in the 1960s by “importing” signals from distant cities, the FCC suddenly asserted jurisdiction over cable systems—despite the absence of statutory authorization—and froze distant-signal imports. This was done explicitly to protect broadcaster profits and in spite of the fact that viewers were thereby denied an increased supply of programming and diversity.¹² Nevertheless, the FCC’s rhetorical defense was that its move would protect viewers’ interest in diverse programming—particularly local programming.

The emphasis on local programming arose initially from the FCC’s decision to accommodate as many members of Congress as possible with a TV station in each congressional district.¹³ As it turned out, viewers preferred relatively expensive national network programs to cheaper local programs, and stations quickly learned to comply by affiliating with networks and broadcasting national network programming, especially in prime time. Most locally produced programs and programs about local issues attract relatively few viewers and consequently are confined to hours of the day and week when few households use television. Still, the FCC has never abandoned the localism fiction, which has long served as the principal rationale for FCC regulations protecting broadcasters from competition.

A series of measures beneficial to broadcasters followed in the wake of restrictions on distant-signal importation. Cable operators were forbidden to charge subscribers for individual programs in order not to “siphon” popular programs from broadcast to cable—in other words, to protect broadcasters from having to compete for popular programming. Cable operators, and later satellite TV operators, were required to carry all local stations at no charge (must-carry rules).¹⁴ In other words,

11. The political economy of agency capture is the subject of numerous academic writings. For examples and reviews, see Ernesto Dal Bó, “Regulatory Capture: A Review,” *Oxford Review of Economic Policy* 22, no. 2 (2006): 203–225; Jean-Jacques Laffont and Jean Tirole, “The Politics of Government Decision-Making: A Theory of Regulatory Capture,” *Quarterly Journal of Economics* 106, no. 4 (1991): 1089–1127; Michael E. Levine and J. L. Forrence, “Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis,” *Journal of Law Economics & Organization* 6 (1990): 176–98; and George Stigler, “The Theory of Economic Regulation,” *The Bell Journal of Economics and Management Science* 2, no. 1 (1971): 3–21. The entry for “Regulatory Capture” in Wikipedia (http://en.wikipedia.org/wiki/Regulatory_capture) includes numerous examples.

12. See Owen and Wildman, *Video Economics*, 17–18. The “Carroll doctrine” was an FCC policy providing that a broadcast licensee can contest a grant of a competitive license by the FCC on grounds that the new licensee could cause economic injury to an incumbent. The standard was set in *Carroll Broadcasting Co. v. Federal Communications Commission*, 258 F.2d 440 (DC Cir., 1958). It was repealed by the FCC 30 years later in *Report and Order in MM Docket No. 87-68*, 3 FCC Rcd 638 (1988), clarified 4 FCC Rcd 2276 (1989).

13. Hazlett, “The Wireless Craze.”

14. The FCC must-carry rules (first adopted by the Commission in 1972) were later made into law as part of the Cable Television Protection and Competition Act (1992) and ultimately approved by the Supreme Court (in the face of First Amendment challenges) in *Turner Broadcasting v. FCC* 520 U.S. 180 (1997).

broadcasters received for free a service that increased their audiences and profits by improving local reception quality; cable operators were forced by law to offer that service to broadcasters for free, only charging subscribers.

Broadcasters eventually ceased to rely on over-the-air signals to reach local audiences, because the vast majority of viewers no longer use antennas to receive local stations.¹⁵ Nevertheless, the FCC has permitted broadcasters to retain their still-valuable but unneeded (for broadcasting) spectrum licenses, which do not permit other uses of the spectrum. That spectrum would be of great value to consumers if made available for mobile communications and other potential uses that we cannot now foresee. But broadcasters retain their dedicated spectrum allocations and the FCC continues to forbid repurposing the broadcast spectrum to other uses. The FCC substitutes its bureaucratic judgment for market forces in deciding which uses are best for all parts of the spectrum. In doing so, it relies on no information regarding private sector willingness to pay for alternative uses. It is therefore virtually certain that overall spectrum utilization is economically inefficient.

The FCC generally permits its licensees to buy and sell spectrum use rights (that is, licenses), subject to FCC review and approval. Thus, the feasibility of market transactions in spectrum rights is not in question. About all that is needed to create efficient markets in spectrum rights is to permit licensees to use their assignments for purposes other than the use originally designated, subject to noninterference with adjacent users. Providing adjacent spectrum users with a legal remedy for interference (trespass) would provide incentives to reallocate spectrum through market transactions.

Other inscrutable policies have unfolded with respect to property rights in video content, as Congress and the Supreme Court have defined new copyright regulations and definitions in response to changes in technology that threaten incumbent industry interests. Some of these copyright provisions are predicated upon, and thus tend to lock in, legacy FCC regulations. For example, when cable systems began to import TV signals from distant broadcast stations in the 1960s, program suppliers protested that their copyright interests were being infringed. Producers of TV programs generally sell TV stations nothing more than a license to broadcast programs locally. Cable systems at first paid nothing to the distant stations or to program suppliers. This reduced the value of the program producer's property, because the program imported from the distant market could not be sold to TV stations in the local market. The Supreme Court resolved this dispute in cases during the 1960s, declaring in *Forthnightly Corp. v. United Artists* that cable systems were nothing more than "extended antennas" and hence did not engage in "performances" of

15. Thomas W. Hazlett, "The U.S. Digital Transition: Time to Toss the Negroponte Switch," (working paper, AEI-Brookings Joint Center, no. 01-15, 2001).

the copyrighted material.¹⁶ This ruling effectively expropriated program producers' property rights and reallocated them to cable operators. The effect was to reduce the incentive to invest in TV program production.

Economic efficiency requires that exclusive tradable property rights exist for all scarce goods. But property rights alone may not be sufficient to ensure the existence of adequate supply in a competitive market in cases where transaction costs are high. High transactions costs could prevent rights from being transferred to their most valuable uses and users. High transactions costs may require that the initial allocation of rights be targeted to the most efficient users—users who otherwise may be unable to purchase the rights in the marketplace. In *Fortnightly* the Court did not rely on fair use or claims of high transaction costs; it simply allocated ownership rights to cable systems rather than to program producers or distant broadcast licensees on the basis of a physical analogy between household antennas and cable operator antennas. Surely this was an economic error.

Among the effects of *Fortnightly*, as noted, was a reduction in the incentive to produce programming. Further, the allocation to cable operators of the right to import and perform a program freely meant that a program producer would have to pay the cable operator not to import its program to retain its right to sell the program to local broadcasters. As there were thousands of cable operators versus hundreds of stations, this possibility faced high transaction costs. Broadcasters derived the ability to pay for the program from advertiser demand for audiences, whereas the value of the right to cable operators was based on the willingness to pay of potential cable subscribers attracted by the program. In the aggregate, for typical broadcast and cable programming, a given audience is willing to pay more for TV programming than advertisers are willing to pay for access to the audience. If the *Fortnightly* rights had been awarded to program producers, they could readily have licensed those rights to cable operators or cable networks instead of competing local stations. This would have yielded a larger and more efficient supply response than the allocation made by the Court.

The Supreme Court's property right allocation was revised by the Copyright Act of 1976, in which Congress granted cable operators a compulsory license to rebroadcast programs airing on distant TV stations (but only to the extent imported distant signals were permitted by the FCC) in return for a fee to be established by an arbitration panel stationed at the Library of Congress. Compulsory licenses to video content, with congressional administrative agency arbitration of rates, became increasingly popular with Congress in other situations. The scheme was later applied to copyrights in broadcast content conveyed by satellite to home receivers in rural areas and to a variety of online content distribution, and for such "digital rights" as

16. *Fortnightly Corp. v. United Artists*, 392 U.S. 390 (1968); and *United States v. Southwestern Cable Co.*, 392 U.S. 157 (1968).

ring tones for mobile phones.¹⁷ In all of these cases, Congress intervened in property rights markets that did not yet exist (and, because of the intervention, would never be permitted to exist) on the tacit assumption that transactions costs of setting up and trading in the market would be so expensive as to prevent efficient trades.

There was never empirical evidence, however, that trading would face prohibitive transaction costs, justifying the compulsory license. The issue of how and when initial free market institutions would be established is a more difficult problem. Congress might have attempted to facilitate the establishment of such markets, but industry pressures led Congress to overreach, preempting private market formation and allocating rights in response to the effectiveness of rival industry lobbying.¹⁸ In fact, cable operators made the argument in the run up to the 1976 Copyright Act that a compulsory license was essential to carriage of distant broadcast signals because of the transaction costs and uncertainty of obtaining licenses from individual program rights owners. Given that in 1976 a vigorous market already existed in which hundreds of TV stations individually purchased first-run and off-network syndicated programming from dozens of licensors, this cannot be regarded as more than a start-up issue. One solution has been the establishment of cable networks that intermediate or aggregate individual programs into multichannel packages purchased by cable operators. Start-up problems more generally can be dealt with by providing for a reasonable transition period to the new regime.

Much later, in 1992, a quite different episode of property rights allocation was undertaken by Congress. According to the FCC's current (2012) website,

The Communications Act prohibits cable operators and other multichannel video programming distributors from retransmitting commercial television, low power television and radio broadcast signals without first obtaining the broadcaster's consent. This . . . "retransmission consent" may involve some compensation from the cable company to the broadcaster for the use of the signal. Alternately, local commercial and noncommercial television broadcast stations may require a cable operator that serves the same market as the broadcaster to carry its signal. A demand for carriage is commonly referred to as "must-carry." If the broadcast station asserts its must-carry rights, the broadcaster cannot demand compensation from the cable operator. While retransmission consent and must-carry are distinct and function

17. *Digital Millennium Copyright Act*, Public Law 105-304, U.S. Statutes at Large 90 (1976): 2541, codified at U.S. Code 17 (1998) § 101 et seq.

18. The phenomenon of rival interest group influence on congressional and agency market interventions is discussed at more general level in Bruce M. Owen, *Type 2 Political Corruption: Sources, Impacts, Solutions* (draft book manuscript, forthcoming).

separately, they are related in that commercial broadcasters are required to choose once every three years, on a system-by-system basis, whether to obtain carriage or continue carriage by choosing between must carry and retransmission consent.¹⁹

The result of the new retransmission “right” is that cable operators must pay fees in cash or kind to broadcast networks and their owned stations and strong network affiliates and independent stations, while weaker TV stations may demand cable carriage for free. Cable operators already pay for copyright owners’ program content through the compulsory license arbitration mechanism. As part of that mechanism, stations are compensated for programming they produce, such as local news.

“Retransmission consent” is a brand-new property right—in addition to the rights of program producers that are licensed to local broadcast stations or networks and then (under the current compulsory license) to MVPDs. An argument in favor of creating this right is that networks and stations select programming and promote their schedules in a way that makes the value of the bundle higher than the sum of the stand-alone values of the individual programs, because it increases overall viewing of the signal. (A somewhat analogous “compilation copyright” exists for printed materials.) On a much larger scale, performing rights societies such as ASCAP and BMI perform a similar “whole is greater than sum of parts” function in music licensing.²⁰

In contrast to music blanket licensing in which user fees pay for the content as well as the compilation, retransmission consent corresponds only to the compilation, and the compilation is of a few hundred programs or series rather than hundreds of thousands of songs in the case of music blanket licenses. In a free market, it seems doubtful that broadcast stations would act as intermediate compilers of, and therefore receive compensation for, content used by cable networks or MVPDs, other than content produced by the station itself. For starters, the most valuable programs—the ones broadcast in prime time—are selected, compiled, and promoted by broadcast networks, not affiliated stations. There are hundreds of non-broadcast MVPDs today and many more online video content providers, and all of them either produce their own content or license it from original producers. A best guess is that local broadcast station compilation value would be small to none in a free market for video content.

If the preceding argument is correct, retransmission consent is equivalent to a law giving broadcasters a right to tax cable operators. Its principal economic effect may be to give broadcast networks a competitive advantage in establishing new cable networks, carriage of which is often exchanged for retransmission consent.

19. FCC, “Cable Carriage of Broadcast Stations,” last updated May 26, 2011, <http://www.fcc.gov/print/31951>.

20. *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1 (1979).

It may also lead to more frequent breakdowns of contract negotiations between broadcaster-owned cable networks and cable and satellite operators, evidenced by program “blackouts” during bargaining impasses.²¹

There are even more FCC regulations substituting for markets in video programming. For example, there is the network nonduplication rule, the syndicated exclusivity rule, and the sports blackout rule.²² Upon the request of a television station with exclusive local rights to distribute a network or syndicated program, an MVPD generally may not carry a duplicating program broadcast by a second (distant) station into the first station’s market. The sports blackout rule prohibits MVPDs from carrying a sporting event if the event is blacked out on local broadcast television stations in a given market.

One method for marketing TV programs that does not work is having the exact same content marketed to the same potential customers in the same area at the same time by competing distributors. Marketing efforts by one distributor tend to spill over to the benefit of the other, creating free-rider problems and discouraging effort. Price competition in the sale of a nonrivalrous good leads to disaster for sellers, because marginal cost is zero. Almost all TV programs (and other types of media content) are sold in unregulated markets through distributors with exclusive rights to particular territories and marketing windows.

The nonduplication rules were adopted to undo some of the damage caused by the distant-signal compulsory license. Most unregulated TV programs are licensed by producers or rights owners to local stations and MVPDs on an exclusive basis, both as to territory and time. Given this free market outcome, duplication of programming in a market due to importation short circuits the market for video programming. Recognizing the inefficiency (reduced output) that results, the nonduplication rules mitigate the welfare loss associated with the compulsory license. Once the compulsory license is repealed under Scalise-DeMint, the nonduplication rule will become moot.

Sports blackouts occur when professional sports team owners decide that their interest in gate receipts exceeds their interest in TV licensing revenues, based on the belief that TV coverage reduces live attendance. Live attendance, of course, depends on the team’s popularity (largely explained by win-loss records) and on

21. I have argued elsewhere that such blackouts can be a kind of market failure because neither licensors nor licensees internalize the third-party losses of viewers. The same observation also applies to impasses resulting in labor strikes and management lockouts and to many other supply disruptions stemming from contract disputes.

22. Network nonduplication and syndicated exclusivity rules, 47 C.F.R. §§ 76.92(f) and 76.106(a); sports blackout rule 47 C.F.R. §§ 76.111, 76.120, 76.127-130. These and other rules were mandated by the 1999 Satellite Home Viewer Improvement Act of 1999 (“SHVIA”). The SHVIA was enacted as Title I of the Intellectual Property and Communications Omnibus Reform Act of 1999 (“IPACORA”) (relating to copyright licensing and carriage of broadcast signals by satellite carriers, codified in scattered sections of 17 and 47 U.S.C.), Pub. Law No. 106-113, 113 Stat. 1501, Appendix I (1999).

ticket prices. Some observers argue that team owners' beliefs on this score are mistaken or that anticompetitive league rules produce inefficient incentives with regard to blackouts. This is not the place to review these contentious issues. In any event, when a team owner chooses to refrain from licensing TV coverage to local video media, that decision can be undone when either local stations or MVPDs are required to carry signals or networks that include video coverage of the blacked out game originally intended for other markets. This can happen in some cases under must-carry rules and in other cases because of FCC ad hoc program access requirements imposed in certain merger transactions.²³ The effect of the sports blackout rule, as with nonduplication, is to reinstate property rights taken from team owners or leagues by the operation of other FCC interventions.²⁴ The blackout rule also becomes moot under Scalise-DeMint because the underlying interventions would be removed.

REFORM OF TV PROGRAM MARKETS

THE SCALISE-DEMINT Next Generation Television Marketplace Act was introduced at the end of 2011 in both houses of Congress to deregulate broadcast programming affected by the must-carry and retransmission-consent rules, among other provisions of the Communications Act of 1934. The question addressed here is whether the provisions of Scalise-DeMint are sufficient to render the market for TV programs competitive and efficient. Any such analysis is hampered by the difficulty of predicting how competitive markets would work but for the present interventions. To illustrate, no one (including academic specialists) foresaw that airline deregulation would lead to the phenomenon of hubbing by airlines seeking to minimize operations costs due to postderegulation competition. How video program markets will be reformed by deregulation remains to be seen.

Still, largely unregulated online video content markets are already taking shape. Online video distribution involves the purchase of online rights from the content producer or its assignee, the invention of a site through which the content is marketed to online viewers in various forms—such as bundles, packages, channels, or

23. The FCC's order in the *Adelphia* case gave competing MVPDs a right of access (at arbitrated prices) to certain programming owned by the parties to a vertical merger transaction involving MVPDs and regional sports program suppliers. The same rights transfer mechanism has been used in subsequent cases. See FCC, "MB Docket No. 05-192: Memorandum Opinion and Order" (report, FCC 06-105, Washington, DC, July 21, 2006), http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-06-105A1.pdf.

24. Different sports leagues have different ways of distributing TV revenues, and this leads to different incentives of the owners to seek blackouts. The NFL and the NBA distribute revenue equally to all teams. Thus, an owner gets the same revenue whether his team is blacked out or not. That owner would prefer to be blacked out if it generates a few more dollars of revenues in the stands. However, MLB has TV rights controlled by each team, and there are no blackouts for local games because the owner gets TV revenues only if the game is shown.

subscriptions—and a method of generating revenue from viewers, advertisers, or both. YouTube and Hulu are early examples of such sites, employing very different content and marketing strategies. Many networks and stations also maintain websites, generally emphasizing complementary content rather than the same content made available to viewers.

Online video markets are nascent because online distribution rights for existing content are being licensed cautiously and experimentally by their owners, and made-for-online-distribution video content is just developing. Traditional video content owners are seeking to define an online distribution window for content designed to be released sequentially to a series of distribution windows. It is perhaps too early to tell whether online distribution is amendable to this use as an outlet for content in the format of popular TV series. It may turn out that online video distribution is best suited for new content formats or genres more akin to YouTube than to current cable or broadcast networks. Early experience with both nonvideo and video content shows that small-scale content suppliers can compete effectively by sharing advertising revenue with large-scale advertising aggregators. A similar mechanism may permit small content suppliers to tap into user willingness to pay, if piracy issues can be solved. In any case, there is no reason to believe that online and traditional multichannel video distribution will not remain at least as competitive as it is today. There is already as much or more competition than in most markets for other, unregulated, consumer products.

Successful online marketing of online video requires effective packaging or bundling of subsets of the many thousands of individual video productions. The marketing identity of the packager must be promoted as a signal for a certain level of quality or category of content. Alternatively, it is possible that general-purpose or specialized search engines will eventually supply such information as or more efficiently than specialized, heavily promoted aggregators. If so, then individual content producers could engage in direct marketing. If advertising is involved, some aggregation of advertiser demand will also be required. Google and other firms already offer advertisers access to multiple sites. MVPDs such as cable systems and telephone companies have been moving to try to acquire online rights to the content they already deliver over traditional broadband video channels so that their current content will be available on both media.

While online video distribution may well describe the future, it is not clear whether that future involves wires, wireless, or both. The answer depends in part on spectrum allocation. The portion of the spectrum currently allocated to broadcasters is, from a technical perspective, ideal for mobile broadband distribution. If there were free markets in spectrum, it is quite likely mobile broadband providers such as AT&T, Verizon, Sprint, and T-Mobile would find it profitable to purchase spectrum rights from broadcasters in order to provide sufficient capacity to distribute (among other services) online video, possibly at a price competitive on the margin with land-line broadband. If the FCC auctions off a significant amount of former broadcast

spectrum, as now seems likely given recent congressional action, there would be at least four terrestrial multichannel video distributors, plus the two satellite companies DirecTV and Dish Network, competing for fixed service subscribers, and at least four competing for mobile subscribers. All eight are suppliers or potential suppliers of online video services. If current MVPDs are not performing competitively, mobile operators will have stronger incentives to emphasize online video among their mobile services. Online video is already available for smart phones and mobile tablet devices. In short, this is a competitive market that does not require regulation, and it should not be constricted by legacy regulations.²⁵

As indicated above, the distortions in TV broadcasting are caused primarily by two categories of interventions: copyright laws and program distribution restrictions. Scalise-DeMint deals with these directly. The bills would repeal compulsory licenses, must-carry rules, retransmission consent, and a variety of other mandates on regulated entities, including ownership rules. However, there are background distortions to deal with as well: spectrum property rights reform is an important element in ensuring an efficient and competitive market in video programming. All FCC licensees (not just broadcasters) should be free to use their spectrum for any commercial purpose.

The practical effect of spectrum reform plus Scalise-DeMint would be to eliminate the special legacy privileges of broadcasters because they are classified for obsolete regulatory purposes as over-the-air broadcasters. Both reforms are necessary. The repeal of compulsory licensing of distant signal and other broadcast content used by MVPDs is of course an immediate boon to broadcasters, but probably not for long. The market will likely move toward direct deals between program producers or broadcast networks and MVPDs. Cable systems that have upgraded to offer digital services are no longer chiefly dependent on distant signals, given the availability of hundreds of cable networks. The end of compulsory licensing offers no real threat to cable operators or other MVPDs.

This would not necessarily mean local broadcasters would disappear from the ranks of content providers. MVPDs generally lack facilities to produce local news and sports programming. Former local broadcasters will have a unique position in offering local content, which they can exploit both in deals with local MVPD outlets and direct to subscribers online, with or without local and national spot advertising. Although broadcast networks will eventually seek to bypass local stations and deal directly with MVPDs, this will happen slowly, not least because of the complications involved in negotiating with content providers for rights. Also, there remains

25. Most urban and suburban households now have at least two available terrestrial (cable and telephone company) MVPDs and two satellite MVPDs (DirecTV and Dish Network). With sufficient spectrum transferred from broadcasters, at least the four major wireless telephone companies (AT&T, Sprint, T-Mobile, and Verizon) should be able to provide comparable broadband video service to mobile and perhaps fixed devices.

a demand for local content, especially news and sports. The local broadcasters are positioned to continue to provide these and even expand because of access to subscriber and advertiser-derived revenues. To the extent such programming is produced by local broadcasters, it is already delivered primarily by cable or satellite, not over the air. Turning off the transmitter, or using it to provide mobile or other services, will actually save considerable sums now spent for electric power.

Getting broadcasters to accept such a reform requires, at a minimum, that they get to keep at least a chunk of the revenue from their sale of their spectrum rights. Congress has now approved “incentive auctions” that award broadcasters a relatively small share in the proceeds from the sale of broadcast spectrum.²⁶ Contrary to news reports, broadcasters did not receive this spectrum for free. Most broadcasters paid full market value for their spectrum rights, purchasing them from prior licensees. It remains to be seen whether broadcasters will be willing to accept Congress’s offer.

CONCLUSION

FROM THE PUBLIC’S perspective, getting rid of obsolete regulation of broadcast and MVPD video programming is essential to the efficient operation of a market that has long been an important (but could have been a much more important) source of consumer welfare. Consumers today pay more than \$100 billion annually for MVPD services,²⁷ implying a willingness to pay (actual payments plus consumer surplus) well in excess of that amount.²⁸ MVPD or equivalent services that increase video program distribution capacity were delayed and suppressed for many years, and this consumer value was lost. This was in the effort to protect initial broadcast licensees from competition in the (nominal) pursuit of ill-defined and ephemeral public interest and localism objectives.

It past time to stop extending interventions originally intended for an old technology (broadcasting) to a range of new competitive media. Even if one thought the restrictions on competition and entry that have existed from 1927 to the present day were originally justified by assumptions about spectrum scarcity and vague notions of the public interest in local content or sources, it is now clear these assumptions are incorrect. No longer is there any rational public policy basis for a government agency or its legislative overseers to dictate how much or what content the viewing

26. Amy Schatz and Siobhan Hughes, “Wireless Firms to Gain More Access to Airwaves,” *Wall Street Journal*, February 17, 2012; and Edward Wyatt and Jennifer Steinhauer, “Congress to Sell Public Airwaves to Pay Benefits,” *New York Times*, February 16, 2012.

27. National Cable & Telecommunications Association, “Industry Data,” <http://www.ncta.com/Statistics.aspx>.

28. Every consumer has some maximum amount they would be willing to pay rather than go without a particular program. These amounts differ across consumers. If the supplier charges a uniform price, most buyers pay less than the maximum amount they would be willing to pay. The difference is called consumer surplus, a measure of each consumer’s net gain from buying the program.

public can see, any more than there ever has been for printed media. There is no market failure to which the current regulatory framework is responsive. There is no reason to think that regulators can improve on even less-than-perfect market outcomes in this sector of the economy. Most important, there is no reason for FCC bureaucrats to decide how much of the spectrum should be used for each of many existing and potential commercial services.

Program producers, aggregators (cable and former broadcast networks), and local distributors (MVPDs) should be allowed to reach agreements among themselves for the creation and delivery of programs and audiences in competitive markets without regard to which technology is used to produce or deliver their goods. Their freedom of contract will promote an efficient and expanding supply of video content to compete for advertising revenue and viewers' dollars. An adequate supply of tradable rights in spectrum will reveal how much competition is possible among traditional wired and wireless, analog and digital, and fixed and mobile delivery services. Judging by the patterns of history, regulating in the expectation that competition will be inadequate will only help ensure that very result.