Economic Theory and Local Content Quotas for Television

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Preface

It's not common for those involved in the practical and creative world of film and television production to become involved in the arcane world of economic theory. Partly this is because of the dense jargon involved, and partly because the relevance is rarely apparent.

Earlier this year, a remarkable document was published attacking SPADA's proposed quota model and hiding behind a torrent of econobabble designed to discount the worth of our ideas.[1] I approached that document with considerable trepidation, as one with neither formal economic training nor a fully functioning left brain. After wading my way through many pages I was appalled at the emotional and ill-informed claims disguised as economic theory. Take this as an example:

> *However, the case [for quotas] rests on the notion that these programmes somehow contribute to local culture or national identity – the 'consumption externalities' argument above. Yet there is no inexorable link between the provision of local programming and the promotion of local culture. Nor is the financing of television programmes necessarily the best way of promoting local culture. Spending public money in other ways, such as encouraging gardening with native plants, could potentially be a better way for promoting national identity.*

In some despair, I spoke to several economists to try and understand whether the claims made were based on generally accepted economic theory. The good news was that economic theory needs to be considerably stretched to accommodate the complexities of broadcasting and that the theories propounded were at least highly arguable. Not that the paper accepted this or even attempted to provide a unbiased analysis.

Thus came the idea to try and rebut economic theory with different economic theory. We've indulged in our own version of econobabble in this paper. Unlike Chen and Palmer's effort, we accept the idea of different arguments, acknowledge strengths and weaknesses and generally point out where economic theory can be useful and where it is simply too narrow in its approach.

This paper is not always an easy read either. However policy analyst David Hay is to be congratulated for his painstaking attempts to make theory generally understandable to a layperson and for his unbiased and intelligent approach to his discipline. It's refreshing to be confronted with a warts-and-all analysis rather than a piece of agitprop designed to scare, not inform.

And those of us in the television business treasure the value of impartial information. We look forward to the Government's proposals for a quota system as a key enhancer of our national culture on screen and to improve the range and diversity of local programmes. Oh, and we like native plants too.

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[1] Jacobsen, V. *Local Content Regulation of NZ Television*. Chen & Palmer 2000

Executive Summary

Background

In April 2000, the Screen Producers and Directors Association (SPADA) produced a discussion paper titled "Television Programme Quotas: A Blueprint for New Zealand". The proposal was largely devoted to the mechanics of implementing a quota system. The key points it made in favour of introducing such a system were:

- ♣ The current system of promoting New Zealand made programmes through production subsidies is inadequate as a sole intervention mechanism.
- ♣ A quota will promote New Zealand culture and national identity by increasing the quantity, diversity and accessibility of locally-made programmes about New Zealanders for New Zealand audiences.
- ♣ The quota system should be seen as policy mechanism that sits alongside, and works in concert with, broadcasting subsidies and a charter for Television New Zealand Limited (TVNZ).
- ♣ The proposed quota system is administratively simple and inexpensive to operate.

In August 2000, Chen and Palmer produced a lengthy critique titled "Local Content Regulation of New Zealand Television: An Assessment of the SPADA Proposal". Its key arguments were that:

- ♣ The regulation of local content represents a significant intervention into the television industry, which will impose costs and may generate benefits.
- ♣ A comprehensive and rigorous approach to understanding these costs and benefits is required to properly analyse such a proposal.
- ♣ The standard tools of economic analysis should be employed to subject the cultural industries to the same logic and rigour as is applied to policies in other sectors.
- ♣ When this is done, the arguments in favour of local content regulation are found wanting, on a number of counts.
- ♣ Even if there were a case of "market failure", the Government could employ policy options other than quotas to address the perceived problem. In particular, the Government should increase the level of production subsidy that it provides through New Zealand On Air (NZOA).

The purpose of this document is to provide a comprehensive response to the arguments made in Chen and Palmer's paper.

Key Points

The points we present are as follows:

Introduction

- Economic theory does provide powerful conceptual tools for analysing policy issues. However, a genuinely rigorous analysis of broadcasting issues would attempt to incorporate insights provided by the other social sciences. In particular; political science, psychology and sociology have a great deal to offer.
- This paper is intended to demonstrate, to an audience of non-economists, the strengths and weaknesses of economic theory and how this theory can and should be applied to the issue of local content quotas for television.

The Audience

- ♣ The economist should be primarily concerned with the welfare of consumers (in this case, audiences). We define the focus of economic analysis in this case as the production and allocation of “audience attention”.
- ♣ The key issues in broadcasting policy revolve around what audiences should, should be able to, or should not, “pay” attention to, and how audience attention can or cannot be regulated.
- ♣ Liberal democratic society has three fundamental domains of regulation: the government, the market and society. They thrive by achieving a balance between all three. Promoting market regulation without due regard for these other domains of society can have negative consequences for society as a whole.

Welfare Economics

- ♣ Welfare economics is the most important "standard tool" of economic theory for analysing policy issues. When welfare theory is applied to broadcasting, it clearly demonstrates the nature of market failure of commercial free-to-air media.
- ♣ The policy solutions that naturally flow from welfare analysis are infeasible. They demonstrate the fundamental error of policy developed solely from economic theory and the problems incurred trying to re-create society in the image of a simple economic model.

Welfare and Consumer Sovereignty

- ♣ Two standard assumptions of economic theory are that consumers’ preferences are fixed, and/or that consumers are “sovereign”. Economic theory does not handle well the issue of how consumer preferences are formed; yet this is fundamental to any discussion of broadcasting policy.
- ♣ Economic theory and the other social sciences provide strong arguments that the media can and do influence audience preferences, including audiences’ preferences for media content itself. The economist’s assumption of consumer sovereignty is not an adequate assumption in this context because it does not address the complexities of human behaviour.

External Benefits

- Another key assumption of economic theory is that the consumption of goods and services is entirely or predominantly of private benefit to the consumer. The most powerful arguments in favour of regulating broadcast content revolve around the public or "external" benefits that broadcasting creates. Chen and Palmer attack these arguments. However, others have previously done a better job of this, and it is their attacks to which we respond.
- ♣ Where economic theory fails, liberal political theory comes into play. The sovereignty of individuals is aggregated into the sovereignty of the state, which determines policy in the best interests of all citizens.
- ♣ The current Government has set a direction for broadcasting policy, which clearly implies that significant external benefits exist, and that the state has a role to play in ensuring that citizens are provided with broadcasting that serves the public interest.

Externalities in Economic Theory

- ♣ We explain the theory of externalities in some detail. We then apply it, to explore some of the key issues in broadcasting policy and the policy reforms of the late 1980s.
- ♣ Officials have previously advised the Government that quotas are inefficient, in an economic sense. While resource and production quotas would, as a general rule, create inefficiencies in other sectors, that rule does not automatically apply in the broadcasting sector, which is 'inefficient' (read complex) by nature.
- ♣ The natural inefficiency of the broadcast media highlights the need for a degree of protective regulation for the interests of the audience.

Quotas and Subsidies

- ♣ Quotas and production subsidies in combination provide a more equitable and more potentially efficient initial allocation of rights between the misaligned interests of broadcasters and audiences than either approach by itself.

Quota System Design and Specification

- ♣ The underlying principles for establishing market regulation by creating tradeable property rights provide a basis for testing the soundness of the SPADA proposal. Some specific issues and broad principles for detailed policy development are tested.

Summary and Conclusions

- ♣ This paper shows that economic theory supports the case for the protective regulation of the electronic media.
- ♣ The broadcasting industry should bear some direct responsibility and some of the burden for the privilege it enjoys and the benefits it acquires from commanding and exploiting the scarce resource of audience attention.
- ♣ Our analysis is based on a set of deliberately chosen principles. We invite readers to consider whether they believe any one of these principles could legitimately be abandoned, and what the consequences would be for policy if they were.

Introduction

Chen and Palmer’s paper purports to use rigorous economic theory to analyse the issue of local content regulation:

> “The approach used in this report relies on the standard tools of economic analysis, subjecting culture to the same logic and rigour as is applied to government policies in other sectors.... Justifications [for the regulation of local content on television] have been put forward, but they are found lacking when considered analytically in a rigorous economic framework.”

We disagree that an analysis of broadcasting policy that is based solely on economic theory can be genuinely rigorous. There is an enormous wealth of insight about broadcasting available within the discourses of Political Science, Social Psychology, Sociology and Cultural Studies, for instance. These have much to offer to the analysis of broadcasting policy. A brief summary is set out in Appendix One to this paper.

However, the purpose of this paper is not to shift the grounds of debate but to take up Chen and Palmer’s challenge.

Chen and Palmer claim to have applied some of the “standard tools” of economic analysis, and their arguments would appear reasonable; either to someone who is not well versed in economic theory, or to someone who is but has not carefully studied the economic literature on broadcasting and broadcasting policy.

This paper is intended to guide a non-expert reader through some of the key policy issues that should be addressed, and techniques of policy analysis that should be employed, when applying economic theory to a discussion about local content quotas.

Our primary intention is to assist the reader who is interested in broadcasting policy issues to contribute more effectively and confidently to broadcasting policy debates now and in the future. In the course of the exposition, it will become evident where the errors lie in Chen and Palmer’s critique of the SPADA proposal.

Most undergraduate economics courses teach that economists see themselves (or *should* see themselves):

> "…as spokesmen for the diffuse and otherwise weakly represented interests of the general citizenry, acting as a counterweight to the pervasive special interest pressures exerted by the beneficiaries of particular government programs."(Nelson, 1987: 55)

The outcome of any economic analysis of broadcasting issues will depend critically on whose interests one has at heart. In this paper, we take the position that the debate about local content quotas is a public policy issue, and therefore that the economic analysis should revolve around the "diffuse and weakly represented" interests of media audiences.

These interests are not uniform. For instance one could regard audiences as being *consumers* of media, or as *citizens* in a liberal democratic state, or as *individuals* or *members* of various social and cultural groupings within society. In each case, one would define their interests differently.

Most economic analysis proceeds from the view that the audience is a commodity, to be produced by broadcasters and consumed by advertisers. We believe this is plainly the wrong starting point for discussing broadcasting as a public policy issue.

The Audience in Economic Theory

Economists do not entirely agree what the essential "commodity" is in broadcasting. For instance, Besen (1976) says:

> "The basic service that a television station has to sell is the use of its *time*." (435).

Collins, *et al* (1988) say:

> "…it can cogently be argued that the appropriate unit of analysis is the *programme segment*, especially that segment between two successive commercial breaks, or *the channel*, or the *total broadcasting service*."(6)

Their preferred definition is:

> "…the total set of broadcasting outputs which result from the interaction between the set of audience needs which broadcasting attempts to satisfy and the historically given set of productive resources that the broadcasting industry has at its disposal for the fulfilment of that task." (6)

Brown and Cave (1992: 379), try to have it both ways. On the one hand they imply that it is the programmes shown on broadcast television that are the commodities being consumed. However, they also note that:

> "Programs are made available 'free' to audiences, while those *audiences* are sold wholesale to advertisers… this process involves advertisers in an intermediate relationship between consumers and broadcasters" (380).

Owen, *et al* (1974) claim that:

> "The first and most serious mistake that an analyst can make is to assume that TV stations are in the business to produce programs. They are not. TV stations are in the business of producing *audiences*. These audiences, or means of access to

> them, are sold to advertisers. The product of a TV station is measured in dimensions of *people and time*." (4, emphasis added)

Masson *et al* (1990), agree:

> "For broadcast television the only true 'market' is the one for sales of audiences to advertisers."

The difficulty with most of these definitions is that they presume that television is defined as a commercial free-to-air medium. They do not accommodate pay television, nor do they acknowledge a role for public broadcasting.

Audience attention

It would be more helpful to define the commodity of broadcasting as *audience attention*. By doing so, we explicitly recognise the following concepts:

♣ Audience attention is a scarce resource: people have only a limited amount of time for paying attention to the media.

♣ Audiences will treat the media as one among a number of alternative activities (substitutes) to which they may pay their attention.

♣ Pay TV services, commercial free-to-air and public broadcasters all compete for audience attention (but only commercial free-to-air services compete to sell audiences to advertisers.)

♣ Broadcasting may be regulated to preventing the audience from paying attention to some messages (pornography, violence) or to encourage audiences to attend to other messages (party political broadcasts). Such regulation is intended to create social benefits and control certain social costs.

What lies at the heart of any policy debate about broadcasting are differences of opinion and differing interests regarding what audiences should or should not "pay" attention to.

The law is quite definite about what audiences should *not* pay attention to. Those prohibitions are contained in censorship and defamation laws, and in the Broadcasting Act 1989 - particularly as regards the statutory functions of the Broadcasting Standards Authority.

In the past, the law has also been used to prescribe what people *should* pay attention to (or at least, have difficulty avoiding). For instance, Section 78 (1) of the Broadcasting Act 1989 (repealed on 10 March 1990), stated that "Every election programme broadcast by means of free-to-air television broadcasting shall be broadcast simultaneously on all free-to-air television broadcasting stations." In another example, Cocker (1996) recalls that in July 1979 and again in October 1980, Sir Robert Muldoon was granted time simultaneously on radio and television to make announcements regarding wages policy.

Commercial broadcasters and advertisers both want audiences to pay attention to advertisements.

Watching advertisements is how viewers pay for their television service. Some viewers argue that the "price" they have to pay is too high (ie, too many advertisements per hour of programming). They may therefore feel that their attention is undervalued.

Pay TV provides a service for which audiences pay in cash, rather than attention. Viewers who find the "price" of advertising is too high, or who cannot obtain programmes they wish to watch on free-to-air TV (eg. live sports matches), must pay a money price instead.

Finally, groups such as the Mental Health Foundation and the Children's Television Foundation also express concerns and preferences about what audiences pay attention to (because of the social costs involved), while civil libertarians will defend people's right to watch whatever they choose because they believe that such freedom produces social benefits.

In this context, SPADA's quota proposal promotes the idea that New Zealanders should be able (if they so desire) to pay attention to programmes made in New Zealand. The proposal is a mechanism for ensuring local content is available in adequate quantities.

Regulation and Deregulation

The SPADA proposal involves a partial re-regulation of a deregulated industry. There is a great deal of misunderstanding involved in the concepts of regulation and deregulation. It can be argued that there is no such thing as "deregulation". As Pusey points out:

> "A first assumption of social democrats everywhere is that nation societies (and federations such as the emerging Europe) have not one co-ordinating mechanism but two. On the one side they have states, bureaucracies and the law, and on the other, economies, markets and money. It is with these structures we collectively coordinate our relations with the rest of the world, our work, our social interactions, and most other aspects of life we understand as 'civil society' and normatively define with notions of citizenship, democracy and human rights." (1993: 15)

Deregulation is therefore not the removal of regulation, but the movement of regulation from one of society's regulatory mechanisms to the other.

The choice of regulatory mechanism depends on the nature of the rights involved. What we normally call "deregulation" often involves a transformation of socio-political rights into tradeable property rights, and this is not always a desirable thing. An example will help clarify these issues. Take the case where no specific right exists – such as the implied right to bear children – and say that we wished to regulate the rate of childbirth.

The Nobel prize-winning economist James Tobin, in his article "On Limiting the Domain of Inequality" (1970) gives an example of how property rights could be created where previously a *liberty* had existed.[2] Suppose, for instance, the Government sought to follow China's lead and restrict population growth:

> "Should each and every mother be limited to two children or less? Or should each woman be issued two – or two and a fraction tickets, whatever is consistent with zero population growth – and be allowed to transfer whole or fractional tickets to other women? Or should the government fix an annual quota of births and auction the tickets to the highest bidders?
>
> "The first system is the most egalitarian, but excludes many voluntary transfers of 'birth rights' that would in principle increase the utility of all parties concerned. The second system allows such transfers, but also opens up the possibility that rights to have children will be concentrated in the rich. At least the poor and others who give up their rights will be well compensated. This is not the case under the third system, the auction, where the rich can still buy up the rights but

[2] Using *liberty* in the sense proposed by Hohfeld (1961); a liberty being a right each person holds equally and which confers no obligations on others to observe it – unlike a claim-right, such as a property right, which imposes an obligation on others not to interfere with one's property.

> to the benefit of the general taxpayer rather than of would-be mothers who lose out in the auction." (271)

The first of Tobin's options implies a form of state regulation, the second and third options are varieties of market regulation: one either makes an initial allocation of rights to mothers, or makes an initial allocation to the state.

No doubt some readers will find the very idea of trading in birthrights offensive, and argue that all mothers should hold these rights equally. Tobin agrees, and he coined the term *specific egalitarianism* to describe the idea that "…certain scarce commodities should be distributed less unequally than the ability to pay for them."

> "There are some rights and privileges, and some duties, which the society desires to distribute precisely equally among its members,… The distribution is supposed to be wholly independent of income and wealth. Furthermore the distribution is supposed to be independent of individuals' preferences; society would not approve of an individual's voluntary assignment of his share to someone else even if the assignee were of equal or lower income…. Allowing a free market in votes could not augment the power of the electorate as a whole; it would only serve to distribute it differently." (269)

The equal allocation of votes is clearly a case where a political right should not be converted to a property right: it is a founding principle of representative democracy that the right to vote is *inalienable* – it cannot be transferred to another person. Because it cannot be transferred it is beyond the realm of economic theory, which is almost entirely concerned with the allocation and exchange of property rights.

The State, the Market and Society

In order to properly understand the place of broadcasting policy within society's regulatory systems we have to take Tobin and Pusey's concepts a step further. Hay (1999) says that societies have a third regulatory system, which resides in the set of shared beliefs, values, history and culture that comprises the peoples' social environment.

While this is hardly news to social anthropologists, historians or political scientists, it has started to make an impact in the field of economics only relatively recently (Putnam, 1993; Fukuyama, 1995). The idea can perhaps most easily be explained using a model from organisational psychology. Tushman and O'Reilly (1997) emphasise the importance of organisational culture as a form of social regulation:

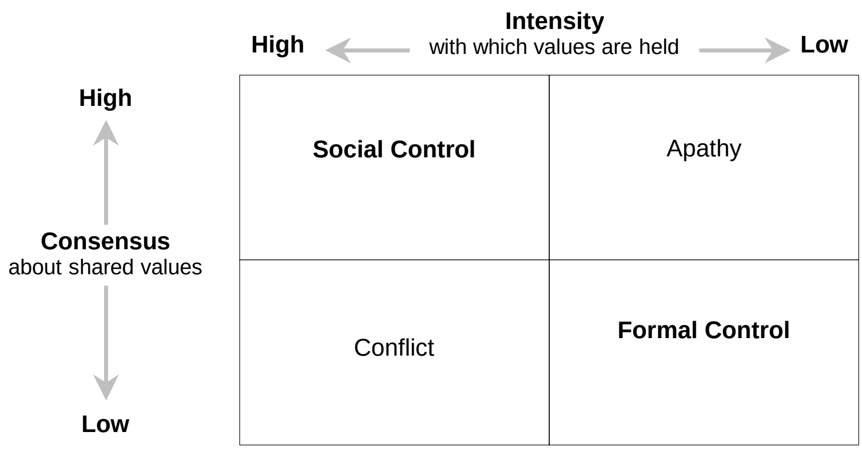
> "In the same way that… formal control processes guide behaviour, culture serves as a social control system. If we care about others, for instance, we like them and want them to like us, and if we have some agreement about what is important, we are under their control. That is, if I care about you and we agree about what is important and how to act, whenever we are together, we effectively control each other." (103)

This idea of a "social control" may be contrasted with the idea of "formal control", which relies on rules, regulations and the implicit or explicit use of coercive power.

The creation and maintenance of social control depends on two things: the degree of consensus among team members about "what is important and how to act" and the intensity or commitment with which those values and beliefs are held. As the grid diagram in Figure 1 shows, if both consensus and intensity are high, social control can be effective. If both are low, only formal control and (actual or implied) coercion can be effective – otherwise there would be no possibility of society at all.

Putnam and Fukuyama suggest that societies with a high degree of shared values, especially shared positive values, such as trust, acceptance of diversity and mutual tolerance, tend to be successful in social and economic terms.

Figure 1: Social Control and Formal Control



The mass media contribute significantly toward the process of defining and promoting these shared values: witness the coverage of “Team New Zealand” in the America’s Cup campaign, or the fervour that surrounds any All Black test match. The values of teamwork, professionalism and pride in national achievement are celebrated as virtues that we all share, or should share, as New Zealanders.

The values and aspirations we share have both commercial and political value. Advertisers and politicians alike seek to align themselves with the characteristics that we celebrate when we are proud to call ourselves New Zealanders.

Another, more sinister possibility is that they seek to define or shape national identity in a manner that reflects their own products or ideas in the most favourable light.

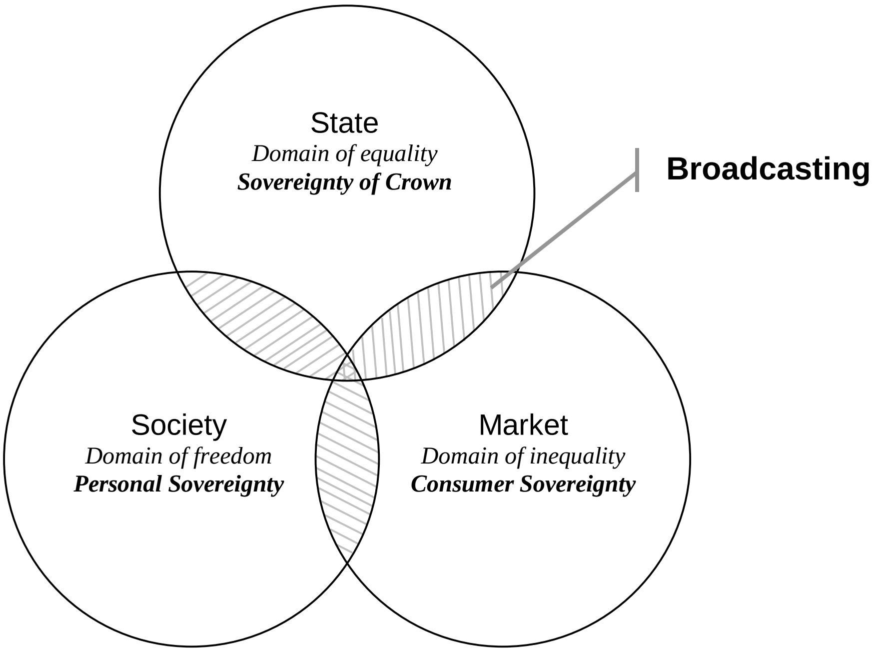
Social Control and Liberalism

So who should have the power to define that shared set of values, and thereby promote the form of society and the means of social control?

In a liberal-democratic society, it is a fundamental assumption that the domain of social control is also the domain of freedom: freedom of thought, opinions, religious beliefs, and cultural practices. In fact, this fundamental right to freedom is embodied in the New Zealand Bill of Rights Act 1990.

This concept, and its relation to broadcasting policy in a liberal democracy, is demonstrated in Figure 2, below.

Figure 2: Three Domains and Broadcasting Policy



The media play an important role within each domain, and in creating and maintaining the relationships among them.

The Domain of Equality

The State is the domain of *equality* because every citizen has an equal right to vote, and because all citizens are equally subject to the rule of law. The media have an important role to play in this domain:

- Voters rely on information about competing parties and their policies in order to make their voting choices, and they are dependent on the media to act effectively as the "fourth estate" of Government to keep the rest honest.
- The Government depends on opinion polls and public debate in the media to govern effectively.
- The courts are sensitive to the prevailing climate of public opinion in passing judgement on many issues and also rely on the media to communicate the message that crime doesn't pay.
- The judicial, parliamentary and executive arms of Government therefore all rely on the media as a key source of information about the world, and as a means of communicating policies and decisions that contribute to the creation and maintenance of good government.

The Domain of Inequality

- The Market is the domain of *inequality*, because where a market economy exists, one does not expect each person will have equal shares of income and property.
- Advertising provides much of the information consumers require to make their purchase decisions. Producers use the media to influence purchasing decisions. Both producers and consumers therefore rely on the media in important ways to ensure the efficient functioning of the market.

The Domain of Freedom

- The domain of *freedom* recognises the third important liberal ideal: that people must have freedom of thought, opinion, religious belief, cultural expression and values. However, in order for social regulation to be effective in a liberal society, some fundamental values and beliefs must be commonly shared. These are the values of tolerance, diversity, and the ability of all citizens to engage in (or at least receive), free and frank debate about issues of social, political and economic importance.
- Again, the media has a profoundly important role to play in this domain – both in promoting those liberal values, and in providing what Louis Althusser (1989) described as the "public sphere" within which the ongoing debate is held.

Interdependence and domination

Liberalism depends on the maintenance and development of all three "domains", holding each in proper relation to the others. One ideal of a liberal society is that the state should not dominate either society or the economy as totalitarian states do. Another, which has emerged in the modern liberal-democratic welfare state that New Zealand enjoys, is that the state should intervene to mitigate the inequalities that the unfettered free market would inevitably bring.

Finally, and perhaps most importantly of all, the liberal ideal also holds that people, either as voters or as consumers, are sovereign individuals who should have the ability to make free and informed choices in regard to their involvement in either of the other two spheres. How they do so is a function of the information they receive over their lifetimes, and a great deal of that either comes directly from, or is significantly influenced by, the electronic media.

Summary

In this section we have established the context for economic analysis. This context has three key components:

1. The analysis must focus on the audience, and its roles, rights and interests as citizens, as consumers and as members of society.
2. That society is New Zealand, which is a liberal-democratic nation.
3. Economic theory is being applied to an issue of public policy.

The public policy issue is not just about the concerns of the broadcasting industry. It is about the sort of society we live in, how we understand our society's past and present, and how we provide and support the institutions that allow us to discuss and decide among ourselves the direction and timing of social, political and social change in the future.

Chen and Palmer state that their intention is to apply the "standard tools" of economic analysis to culture. One of the primary tools of economic theory that should be applied in any policy debate is "welfare" theory.

The literature on economics and broadcasting policy includes two well-known examples of such application:

- Noll, Peck and McGowan (1973) estimated that, at that time, households consuming free-to-air television valued it at 4% of after-tax household income. This amount was about seven times the advertising revenues generated by the industry at that time. They argued from this basis that providing more television channels would improve economic welfare.
- Spence and Owen (1975) use a formal mathematical model to compare the relative contribution to welfare of four polar cases: advertiser-supported TV or pay TV, with either limited or unlimited channels. At the time, the Federal Communications Commission forbade per-program charges for most programs, so the key policy question was whether, by allowing pay-per-view television, economic welfare would be improved.

These were not academic exercises – both contributed to significant policy changes in the US. In this section we outline the concepts of welfare economics and use it to describe the reasons why free-to-air commercial broadcasting is systematically subject to "market failure".

Welfare Economics

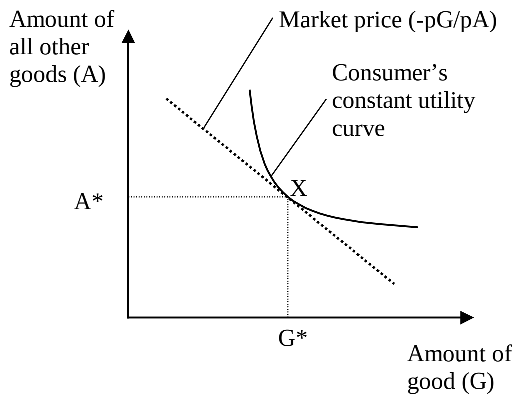
Television provides satisfactions to those who watch it. It increases their utility, or happiness - but by how much? And what is it worth to them?

Economists accept it is impossible to directly measure a consumer's utility, or state of happiness. However, one can observe that a consumer prefers one (affordable) set of goods to another and assume that the preferred set of goods provides greater utility than any other affordable set of goods. Economists use "willingness-to-pay" as a proxy for a numeric measure of utility:

> "Given two situations represented by the two consumption bundles... we want to measure how much the consumer would be willing to pay (or be paid) to be in one situation rather than the other. The resulting number turns out to be closely related to certain ways of measuring utility and is useful for evaluation of proposed policy changes." (Varian, 1987: 243)

In Figure 3, an individual chooses to consume a particular amount of good G (at point G*), and a particular amount of all other goods (A*). This is their preferred consumption bundle, at point X.

Figure 3: Individual's Consumption Choice



Passing through this point is a sloped line, which represents the relative price of A in terms of G. We also see a curved line, which represents a set of trade-offs that would keep the consumer equally happy.[3] This "constant utility curve" indicates that:

- ♣ To persuade this consumer to give up some of G while remaining equally satisfied, one would have to offer her more A (money) than the market price.
- ♣ To persuade her to consume less of A while remaining equally satisfied, one would also have to offer her more G (the good) than the market price.
- ♣ If her income increased, or G became cheaper, she could consume more of G and A, her overall utility would have increased, so her constant utility curve would lie somewhere above and to the right of the one shown here.
- ♣ If her income increased, or G became cheaper, she could consume less of G relative to A. Her utility curve would move downward and to the left. Thus, an increase in the price of G represents a decrease in her total utility, and an effective cut in overall income.[4]

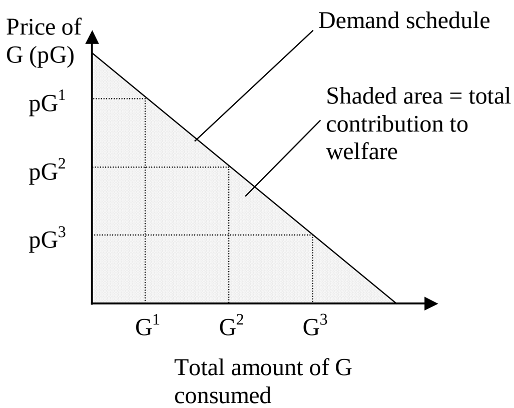
In summary, this person's consumption choice is a function of three things: their total income, the price of good G, and the utility or satisfaction that they obtain from consuming G relative to A. The model shows us how the consumer has chosen to maximise her utility, given her income and the price of good G relative to all other goods.

[3] If they spend their entire income, then Income = (P^A x A) + (P^G x G). By manipulating this equation, we obtain the function A = (Income/ P^A) – P^G/ P^A.G The coefficient – P^A /P^G is the slope of the line.

[4] This is a very simple example, for explanatory purposes only. Any good intermediate level microeconomics textbook (e.g. Varian, 1987), will explain the finer points of this type of model.

In Figure 4, we see what might happen to the total consumption of good G as its price changes, aggregated across a whole economy.[5] At price pG^1, only a few consumers will be able to afford G, and the amount G^1 will be consumed. As the price falls (to pG^2, then pG^3), more of G is consumed (at G^2, and G^3). Theoretically, we could raise the price until none of good G was consumed, or lower it until we knew how much would be consumed if the price were zero. The line through these points is the demand schedule for good G.

Figure 4: Aggregate Consumption and Welfare



The area under the demand schedule is a way of representing the total value of good G to all consumers. This area can be regarded as good G's total contribution to the welfare of society, relative to the welfare provided by all other goods, expressed as a monetary value.

This concept of welfare economics can be used to evaluate proposed policy changes by comparing the welfare of two or more proposals or situations.

Audience Welfare and Market Failure

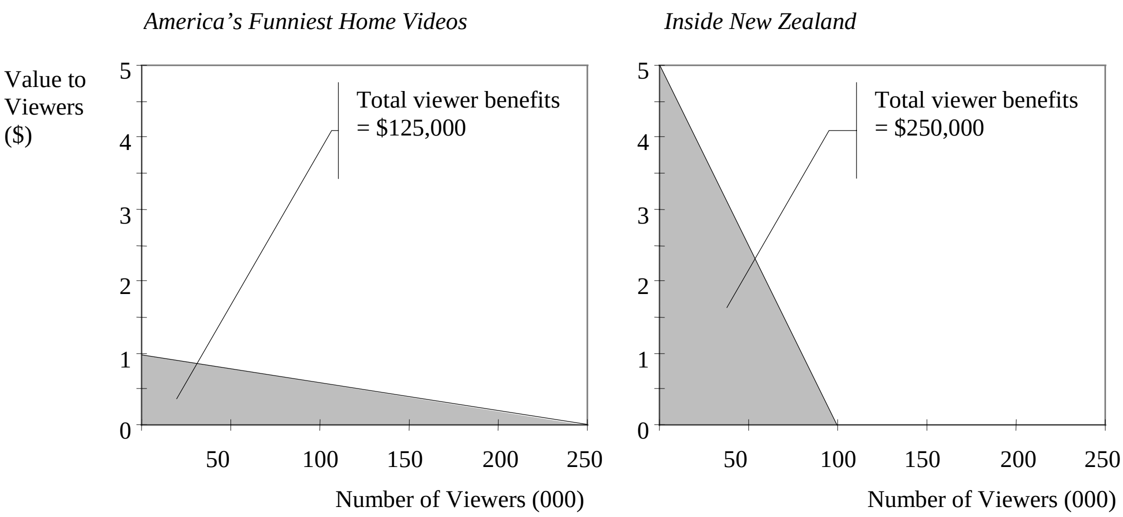
The key ideas were demonstrated by Treasury (1985), with a highly theoretical model similar to that shown in Figure 5, below. The argument may be constructed as follows:

The audience for *America's Funniest Home Videos (AFHV)* is potentially large, but viewers may place a relatively low value on the programme. If they were charged for watching it, audience numbers would decrease rapidly, and fall to zero when the price rose to $1.00.

By comparison, the potential audience for *Inside New Zealand* may be smaller, but viewers may place a relatively high value on the programme. If they had to pay for watching it, audience numbers would fall to zero when the price rose to $5.00. Calculating the total welfare on this basis, we see that the *Inside New Zealand* produces twice the social benefit of *AFHV*: $250,000 as compared to $125,000.

[5] Assuming all other prices remained constant.

Figure 5: Comparative Welfare of Programmes



So far we have discussed only the *gross* social benefit. However, resources are consumed in the production and distribution of programmes. These resources could be consumed elsewhere in the economy, so the production costs should also be incorporated, in order to reflect *net* social benefit.

Say an episode of *AFHV* costs US$200,000 to produce. However, the American network that produced it has recouped its cost in the USA and sells it to the New Zealand broadcaster for NZD$5,000. Therefore the net social benefit of *AFHV* is $120,000 (to New Zealand).

Say an episode of *Inside NZ* costs only $130,000 to produce. However, the programme will not have significant overseas sales so the cost is borne entirely by the broadcaster and funder.[6] The net social benefit of *Inside NZ* (to New Zealand) is also $120,000.

From a policy perspective, therefore, welfare economics suggests we should be indifferent between the two programmes: either would supply an equal amount of net social benefit. The intensity of one audience's passion and the expense of satisfying it are balanced by the size of the other audience and the lower relative cost of production.

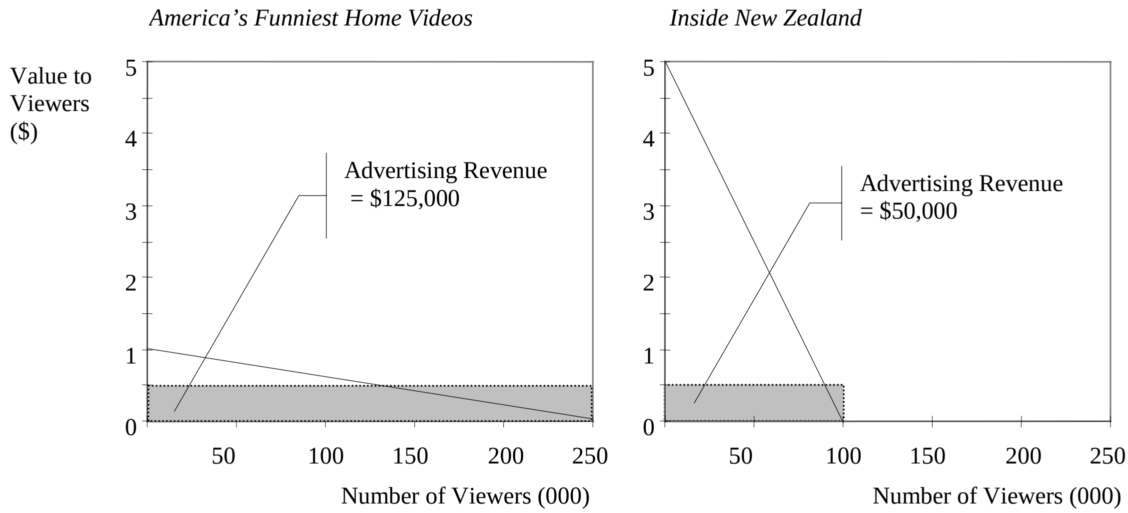
Welfare and Advertising Revenue

Although the locally made product is equal to the imported one in terms of welfare impact, this will not influence the broadcaster's choice of which programme will screen.

Figure 6, below, shows what will ultimately decide the matter presuming the total advertising revenue per viewer for both programmes is 50 cents.

[6] While the social benefit figures are entirely fictional, the costs are based on those reported by Horrocks (1995; 88-89), and the 1995 NZOA funding schedule for "low-budget" documentary series.

Figure 6: Welfare and Advertising Revenue



AFVH will attract $125,000 in revenue, while *Inside NZ* will only attract $50,000. Net of costs, *AFVH* produces a positive 'product margin' of $120,000 while *Inside NZ* produces a loss of $80,000. In order for a programme like *Inside NZ* to be screened, it must be subsidised by the broadcaster, or an external source of finance like NZOA, or some combination of both.

The Lowest Common Denominator

The proposal that media content should be regulated is often met with the accusation that the proposer is elitist or self-interested.

Defenders of commercial broadcasting, on the other hand, like to claim that the free market is democratic, because it supplies programming for the largest audiences. The counter-accusation is usually that commercial broadcasting, by maximising audience size, plays to the lowest common denominator, disregarding any other values, such as "quality".

The example above demonstrates that – name-calling aside – from an economic perspective there is clearly an issue of market failure on the demand side. Commercial free-to-air television and radio broadcasters intend to maximise the size of their audiences, not reflect the intensity of the audience's preferences.

Economic Theory and Policy

Nobody (to the best of our knowledge) has yet produced a welfare analysis that demonstrates the sum of welfare impacts in a market that includes free-to-air commercial television, pay and public television. Fraser (1996) applied welfare analysis to license-fee supported public television, and the analysis could also apply to subscription funded pay television. The analysis by Spence and Owen managed to incorporate pay and free-to-air television – but only as polar cases, not as an integrated market.

A fully integrated welfare analysis could be feasible. However, there is a more fundamental difficulty in applying welfare analysis to broadcasting that would cast doubts on the usefulness of such an analysis, which we will explore in the following section.

Despite these shortcomings, welfare theory has assisted us to pinpoint why it is that free-to-air television does not optimise economic welfare – but how will it help us decide what to do about that?

Some economists have claimed that this market failure arises because broadcasters cannot effectively exclude audiences from receiving broadcasts, so they are unable to force people to pay for access to programmes. Logically, it follows that the policy problem would be solved if broadcasters were all able to receive payment directly from each audience member.

However, such a policy would require that:

- ♣ every programme was broadcast in a strictly pay-per-view basis, *and*
- ♣ every consumer had an equal share of money to spend on television consumption alone (in order to provide for social equity in access to the electronic media), *and*
- ♣ there was a competitive market consisting of television channels vying for their attention.

Under those conditions, television content would come close to reflecting both the size and the intensity of audience preferences.

In fact, the *Committee on Financing the BBC* (Peacock Committee: 1986) saw this as the probable outcome of technological change. The first recommendation in the Peacock Report was that all television sets sold in the UK market be required to be fitted with a “peritelevision socket” in anticipation that the broadcasting license fee would eventually be phased out by pay-per-view television.

This demonstrates the sort of policy mistake that can occur by following a single strand of economic theory to its logical conclusions. Fourteen years later, it is still fashionable to claim that technological change will inevitably bring about the demise of free-to-air television as we know it. However, the dominant form of television broadcasting remains free-to-air; pay or subscriber services are not strictly pay-per-view (in fact the trend is toward “bundling” services and channels); people have *unequal* endowments of cash to spend on media consumption, and although there are now many channels in the market, these are controlled by an oligopolistic (non-competitive) industry.

Summary

Any genuinely rigorous economic analysis of broadcasting policy issues should at least attempt to address the welfare implications of policy – and preferably from an audience perspective.

Welfare analysis is a powerful policy tool, but it does not provide all the answers. The theory has helped us clarify one of the shortcomings of commercial free-to-air television: its failure to respond to the intensity of audience preferences.

The theory cannot, however, assist us to decide what to do about that problem. The logical conclusion to which the analysis directs us is based on a fundamental misunderstanding of what the industry does and why.[7]

---

[7] For example, the Peacock Committee's recommendation was based on a misunderstanding of the electronic media industries. As the new media (internet) industry is discovering, electronic media is based predominantly on giving away programming (content) for free, and selling advertising as a means of getting consumers to "pay" for it, by paying attention to advertisements.

Chen and Palmer point out that economists generally assume that a consumer's preferences are fixed:

> "The optimality of market outcomes assumes that tastes are fixed. This makes the argument that support of local culture is necessary in order to change tastes hard for economists to handle. However, if tastes can change, then the issue of intervention to influence tastes arises....

In the preceding section we focused on the welfare effects of varying prices. Consumer preferences were not variable; in economist's language they were held to be *endogenous* (determined outside the economic model).

But what if a producer increases prices in order to pay for more advertising, and that advertising persuades more consumers to purchase the producer's products? Then the change in two related variables (price and consumer preferences) has led to change in the third (quantity). In this case, consumer preferences are determined *endogenously*; that is, within the economic model.

Has economic welfare genuinely increased in this instance? In general, we would say it has, because we assume that the consumers are the best judges of their own interests and would not consume the product if it did not benefit them.

However, we are not interested in how the media influences consumers' preferences for baked beans or toilet paper, but how it influences peoples values, beliefs, voting choices and, of course, their media consumption itself.

Audience Preference Formation

We should not simply *assume* that media influences public opinion and values. Appendix One to this paper indicates that the subject is a matter of some debate in the social sciences. However, economic theory provides a very sturdy argument that media successfully influences beliefs, preferences and behaviour.

If a product or service does not deliver value to its consumers, the market will not provide it. Rational consumers may act mistakenly, in the short-term, and the market will therefore provide some products of little or no value. However, consumers will learn from their mistakes, and therefore act rationally in the long-term. A product or service that is valuable will therefore persist in the market.

The advertising, marketing and public relations industries seek to influence attitudes and behaviours. The existence of a multi-billion dollar global advertising and public relations industry indicates that it is the collective view, of a great number of rational economic actors, across a long period of time, and in many different societies, that the media does influence people's attitudes, beliefs and behaviours.

Like many economic ideas, this is a simple argument, built on one stylised but observable fact (the large amounts of money spent on advertising) and a highly plausible assumption about human behaviour (the rational behaviour of those who spend that money). It doesn't tell us a great deal about how media influences behaviour, or what policy responses might be appropriate. But it does provide justification for what we all intuitively know to be true: that media does influence social behaviour and that influence is both powerful and valuable.

Four Views of Media Influence

Figure 7 provides a four-quadrant model of the interaction of possibilities regarding the extent of media influence and the formation of consumers' media consumption preference, which outlines the main positions that social scientists and economists have adopted.

Figure 7: Preference Formation and Media Influence

Media Consumers' Preference Formation

Media Influence	**Endogenous (Influenced by media)**	**Exogenous (not influenced by the media)**
Very influential	**Mass Audience:** Will watch what it gets, and learn to like it. (Reith, McCready) Media doesn't tell us what to think, but tells us what to think about. (Cohen)	**Stubborn Audience:** Knows what it wants and will watch that only (Steiner). Media can mostly reinforce existing preferences.
Not influential	**Indirect influence:** Media does not influence viewers directly, but contributes to social environment that shapes preferences (Noelle-Neumann).	**Active Audience:** Class consciousness dominates media influence. Audiences co-opt media messages into their culture or sub-culture. (Fiske). Rational utility-maximising consumers (Treasury)

In the top left quadrant, the media does influence audiences, and in the long-term that media consumers will develop a taste for the products supplied by the market. This reflects what is known as the Lord Reith's "BBC knows best" principle, which Treasury repeated in its submission to the RCBRT:

> "It is occasionally [pointed out] to [the BBC] that we are apparently setting out to give the public what we think they need – and not what they want, but few know what they want, and very few what they need"(1985; 49).

Much has been made, in debates about broadcasting policy, of the "BBC knows best" view. It is often condemned for its elitism, and for its implicit support of a particular view of what constitutes "quality".

However endogenous preference formation need not be linked to "elite" broadcasting only. John McCready, as head of programming for TVNZ, introduced New Zealand to Australian rugby league by playing it every Friday night. He also decided to support *Shortland Street* for an entire year, on the grounds that it would take the New Zealand audience that long to develop a taste for home-grown situation drama of this type. His assessment that the audience would form a preference for these programmes was correct; *Shortland Street* is now an institution on our screens, and rugby league is so popular that it is now screened predominantly on pay TV. McCready did not so much decide what was "best" for the audience, as have a good sense of what programme audiences could come to like, if given sufficient exposure to them. This is the 'art' of a programmer.

Cohen's "agenda-setting" theory of media influence fits well with this notion: the media influences as much by what it omits, as by what it broadcasts. The effect of such influence is more difficult to identify, but no less profound.

In the top right quadrant, media consumption choices are exogenous and the media strongly influences the choice of media consumed. At the extreme, this might seems logically impossible. However, it is possible that media consumption choices could be initially shaped by external influences (such as ethnicity, cultural or religious belief), and that the audience only consumes media messages that fit with – and subsequently reinforce – those preferences. Economic models that purport to show the benefits of increased competition either implicitly or explicitly rely on this assumption (eg, Steiner, 1952).

In the lower right quadrant are media consumers who fit Fiske's (1987) optimistic neo-Marxist model: their media consumption preferences are shaped exogenously, and the media is not influential. They are supposed to be an "active audience" who co-opt media messages and their meanings into their own worldview (and therefore may be resistant to the dominant capitalist ideology, Fiske hopes.) Oddly enough, orthodox economists share the same assumption about consumer preferences – here resides the rational utility-maximising consumer of media products whose preferences are fixed and whose consumption choices are not affected by the media.

In the lower left quadrant are media consumers whose tastes for media consumption are formed by the medium itself, but where we presume the media are not directly influential in forming those tastes. Again, this may be logically impossible at the extreme. However, it is possible that someone who constantly reads about *Shortland Street* in the *NZ Woman's Weekly*, or hears it discussed at morning tea every day, might be encouraged to sample the programme and consequently develop a taste for it.

It would be wrong to presume that, in reality, audiences fall into just one of these categories. However, if the earlier argument is accepted – that the media does influence consumer preferences – then it is logically consistent to accept that the formation of audience preferences for programmes is predominantly *endogenous*.

Implications for Policy

If audience preferences for programmes are predominantly *endogenous*, then we are obliged to abandon the strict assumption of consumer sovereignty. That is, broadcasting markets will *not* systematically produce what audiences demand. Rather, to a considerable extent, the consumer can be "taught" to demand what the market produces.

The Peacock Committee gave this issue serious consideration in terms of the influence of advertising:

> " (if) consumers' tastes are not formed by consciously conducted trial-and-error processes but by "outside" forces, notably by advertisers who can manipulate consumer choices.... (this) implies that replacing the license fee with advertising revenue for the BBC would not be in the interests of listeners or viewers."
> (1986; 28)

In short, the Peacock Committee's recognition that preference formation could be endogenous led it to support an ongoing role for license fee supported public broadcasting.

In its conclusions and recommendations, the Peacock Committee also recognises that consumer sovereignty is imperfect, and that some people "…will accept guidance or stimulus from others where they perceive that their knowledge or taste is limited." (128).

In other words, some media consumers might actually prefer that other people (ie, programmers) should shape their viewing choices.

Much economic theory presumes that people's choices are both individualistic and determined by sequential trial-and-error "tests". If that were true, then there would be no market for magazines such as *TV Guide* and the *Listener*. Nor would there be any market for *Fashion Quarterly*, *NZ Home and Garden*, internet portal sites, or any of a multitude of similar media products.

In short, people can and do look to the media for guidance in their lifestyle choices. Television channels make considerable efforts to brand themselves both to appeal to *and* shape the tastes of their audiences.

Who Chooses for Whom

Chen and Palmer's paper tries to attack the notion that somebody other than the audience should influence content with the following argument:

> "An implied argument for local content regulation is that individuals need to be educated through exposure to demand local content programming. This view implies that there is insufficient demand for local content because people have not acquired a taste for it. Even if an individual prefers local programmes, the opportunities for viewing them may be constrained because others do not have a taste for them But everyone would in fact want to watch local programmes if they acquired a taste for it (sic). The supposed remedy is exposure to local content."

Unfortunately this misses the entire point surrounding the need for regulation. The argument is not that audiences 'need to be educated' nor that there is insufficient demand for local content. The argument, pure and simple, is that the constraints of the market model fail to deliver adequate choices for audiences. Audiences will always choose their viewing diet: it is the provision of real choice that is the fundamental policy issue.

Summary

In the previous section, we used welfare economics to explain the nature of "market failure" in commercial broadcasting. In this section, we have seen that welfare analysis rests on the assumptions of fixed preferences and consumer sovereignty.

While we cannot meaningfully analyse welfare by holding preferences outside the model, it is also very difficult to incorporate them within it, if consumption is a function of preferences and preferences are a function of consumption.

The real problem is that "welfare" in this case is actually about who we are as New Zealanders and who we want to become. These are issues for political and social philosophy, and for public debate and discussion, which exceed the capability of welfare analysis.

The next issue is whether the concept of a greater good can effectively be incorporated into economic theory.

External Benefits

A common assumption of economic theory is that each consumer obtains a purely (or substantially) private benefit from the purchase and consumption of goods and services. This assumption, like the assumption of consumer sovereignty, is highly questionable when applied to broadcasting.

When another member of society, or society as a whole, obtains significant benefits from the production and consumption of goods, economic theory provides some important conceptual tools for discussing those circumstances. In particular, we need to pay attention to the body of theory that deals with the creation, allocation and exchange of these 'external' cost and benefits.[8]

Supporters of broadcasting regulation rely heavily on the idea of external benefits. That is, they claim there will be benefits to society as a whole of regulating broadcast content, as opposed to the benefits that might accrue directly to individual media consumers. The notion of societal benefit has underpinned all broadcasting regulation internationally.

Opponents tend to focus on difficulty of measurement, a standard response when faced with a strong argument. Chen and Palmer's paper, for instance, mentions external benefit arguments under the heading 'Consumption Externalities' and their rebuttal focuses on the difficulty of measuring external benefits. They seem unaware of the history of the use of these arguments in New Zealand and abroad.

For example, Treasury employed similar arguments in its 1985 submission to the Royal Commission on Broadcasting and Related Telecommunications (RCBRT):

> "The justification for government intervention on the basis of such spill-over (ie, external) benefits should be evaluated with caution. Information on the extent of such positive externalities is difficult and costly to obtain with any precision, and if the level of benefits is not substantial the costs involved in the government intervening to support such activities may outweigh the benefits of doing so." (43)

Treasury's submission relied on Noll, Peck and McGowan's *Economic Aspects of Television Regulation* (1973), which was a direct attack on the Carnegie Commission's (1967) report titled *Public Television: A Program for Action*. Rather than deal with Chen and Palmer's exposition, we will directly address the arguments put up by Noll *et al*, which are more comprehensive.

Before doing so, it is worth noting that Noll, *et al* are focusing their analysing on the interests of the broadcasting industry. This is clear from the way their discussion of external benefits is framed:

> "Regardless of the merits of a primarily non-commercial system, the stakes of the commercial broadcasters in maintaining their current paramount position are too great to make undermining their position a viable policy alternative. The remainder of this chapter deals with the narrow issue of a modest expansion in the present non-commercial system." (210)

[8] They are called 'external' benefits because they accrue to persons or third parties outside of the direct relationship between an individual producer and consumer.

External Benefit Arguments

Noll *et al* set out a series of arguments dismissing each of the Carnegie Commission's justifications for public television. The following repeats and extends the section of Hay's thesis (1999) that summarises each of Noll *et al*'s dismissals and supplies counter-arguments to each.

Contribution to Cultural Heritage

Noll *et al* say one form of external benefit is that which accrues to future generations – their cultural inheritance. Just as present-day lovers of drama benefit from Shakespeare's plays "…If public television supports and extends the production of culture in the present, future generations will benefit." (213)

However, they say this holds for any medium that produces culture, and television is "…a relatively expensive medium for augmenting the cultural legacy. Only if certain culture unique to television is highly valued would support for public television be an efficient way to increase the cultural inheritance of future generations." (213) Their point was repeated in the Treasury submission to the RCBRT:

> "it seems difficult to argue that a cultural service delivered via broadcasting – say television drama – is any more "cultural" or publicly beneficial than, cultural services delivered by other media – say live theatre." (43)

There are actually two parts to this argument: the first says that television is very expensive, compared to other cultural product. The second implies that other cultural products should be considered separately from, and as an alternative to, television.

In response to the first part of this argument, we might say that television is not relatively expensive if its power and reach are taken into account. The contribution that a programme like *Tangata Whenua* or Kenneth Clark's *Civilisation* can make to one generation of viewers is enormous because, and only because, the programmes were broadcast on television.

The second part of the argument is breathtakingly specious: Noll, *et al* and Treasury both deny McLuhan's dictum that the medium *is* the message. How could Fred Dagg have become part of New Zealand's cultural legacy without television? Why did James Belich's ten-year old book *The New Zealand Wars* not become the focus of popular debate until the television series? Why else is New Zealand's cultural heritage used to sell Japanese utility vehicles and McDonalds' "Kiwiburgers" on television? A nation's cultural legacy is self-evidently dependent on, and contiguous with, the means available for its transmission and dissemination.

This argument also entirely neglects Owen and Wildman's point (1992), when they discuss how cultural products can be distributed across various media over time. For instance, a T.S. Eliot poem becomes an Andrew Lloyd Webber stage production, then a soundtrack album a movie, a television special, a rental video and so forth.

Television could be regarded as one among many alternative cultural products; but it is probably better seen as part of a cycle of transformation and dissemination of those products. Also, in many cases, the other cultural products and their channels of dissemination succeed or fail to have social impact as a function of television's influence. The Olympic games, test rugby matches, the Nelson's *Wearable Art* show can all be viewed as either alternatives to the medium of television or wholly interdependent with it.

Experimental Value

There may be an argument that public television's lesser dependence on commercial success can lead to greater experimentation and risk-taking. Noll, *et al* (clearly ignorant of the New Zealand experience) dismiss this argument on the grounds that "No public broadcasting programme has switched to the commercial system… Moreover, the commercial system has yet to copy from the American public system…" (214).

Hay (1999) claims that a competitive commercial media environment will tend to be risk-averse. It will broadcast programmes for the mass audiences that it has invested effort and expense into researching, and which it knows it can sell to advertisers.

One strong justification for subsidising local content is that subsidies can be used to underwrite commercial risk. *Shortland Street* required an initial subsidy, but eventually became financially viable. The same could be said for Mai FM.

It might well be good policy for the connection between commercial risk and the value of funding for "experimental value" to be more explicitly set in legislation and/or NZOA funding criteria.

Setting a Standard

This is a justification Noll *et al* only imply, within a footnote to their argument on experimentation, where they note that public TV may have provided a "comparative norm" for commercial programming: "One example is the influence of the popularity and technical success which *Sesame Street* may have had on commercial children's programs." (214: footnote 5).

In New Zealand, Easton (1994), argues along similar lines for public news services:

> "...public-owned radio and television set a standard for reportage not only for broadcasting, but in the printed media.... they are constrained and encouraged to separate opinion from fact. Otherwise we turn to Radio New Zealand and TVNZ."

The presence of a public broadcaster usually provides a challenge to other broadcasters to lift their game. This is an external benefit to consumers of the media other than those who tune in to the public broadcaster.

The counter-argument to this is that Government provision of a good prevents private entrepreneurs from entering the market, which creates a self-justifying claim for continued government provision (Noam, 1988). This is sometimes described as the government "crowding out" private investment.

However, crowding-out may be deliberately undertaken by the government to prevent private sector suppliers from providing goods of an unacceptably low standard. For instance Housing New Zealand might crowd-out slum landlords from the housing market, thereby ensuring that nobody has to live in a slum. Should we feel sorry for, or compensate, the slum landlord as a consequence?

Diversity in Public Affairs Programming

A public broadcaster, being less concerned about audience maximisation, can give alternative and non-mainstream views more attention. Allowing a greater range of views improves the democratic process by enabling citizens to make better informed judgements when choosing governments. Noll *et al* provide two counter-arguments to this proposition:

> "First, only viewers will receive the entertainment (sic) value of the programs. Second, if political or social change does come about because public television provides a forum to a hitherto unrepresented view, the broadcasts must have caused the distribution of opinions on the issue among viewers to shift in favour of the change... However, since nonviewers presumably made a conscious choice not to view the programming... and since their distribution in terms of political values and socioeconomic characteristics is unlikely to be identical with that of the viewers, the two groups need not reach identical conclusions about the benefits to be derived from the social change that resulted from the new programming." (214)

Both of these arguments ignore the fundamental proposition that the benefits of an improved democratic process may accrue to non-viewers, which was the original hypothesis. The last part of their argument assumes that viewers' political proclivities and viewing choices are directly correlated, and that they only prefer to watch programmes that reinforce their political views.

What Noll *et al* have failed to recognise is the fundamental difference between news production and news distribution. Hay (1986), describes media as a kind of warehouse operation, where various elements are brought together, repackaged and refined, and sent out for distribution. News is a very good example: many radio stations take a pre-produced news feed from a bureau service, and all news rooms and bureaux take the bulk of their stories from press releases and other media. This means that relatively little news is *produced*, in an economic sense, other than a relatively small output of investigative journalism. A story that is broken by one broadcaster will bring it to bring it to the attention of other news programmes, and place it on the media "agenda".

For example, relatively few people may have actually watched the debate between Hon. Tariana Turia and Merepeka Raukawa-Tait on *Face the Nation*, earlier this year, but the ensuing debate over "post-colonial stress disorder" and use of the word "holocaust" to describe the process of colonisation was so widespread in other media that these terms have now entered New Zealand's cultural lexicon.

External Benefits and Public Goods

A public good is a particular class of external benefit – one that has greater value to the society as a whole than it could have to any private producer or consumer. Palmer (1992) claims that the mere existence of the news media service produces external benefits that could be classed as public goods:

> "Despite the fact that the mass of people are not interested in the political process, or informed about it, the media do perform the function of keeping the politicians on their toes. The media are an important linkage in the political system and therefore of constitutional significance." (202)

In other words, it would hardly matter if hardly anybody "consumed" the evening news, a long as it is "produced" the mere fact that it existed would be of great public benefit.

In saying this, Palmer is echoing John Stuart Mill's definitive statement as to why people should have a right to freedom of expression, and the nature of the external benefit it produces:

> "Were an opinion a personal possession of no value except to the owner; if to be obstructed in the enjoyment of it were simply a private injury; it would make some difference whether the injury was inflicted on only a few persons or on many. The peculiar evil of silencing the expression of an opinion is, that it is robbing the human race; those who dissent from the opinion, still more than those who hold it. If the opinion is right, they are deprived of the opportunity of exchanging error for truth: if wrong, they lose, what is almost as great a benefit, the clearer perception and livelier impression of truth, produced by its collision with error." (1972: 85)

Mill is clearly saying that freedom of speech is not simply a matter of private choice. It confers such a strong 'external benefit' on society's members that it is a public good.

Other External Benefits

Noll, Peck and McGowan's list of justifications is hardly exhaustive. SPADA, among others, has outlined an additional justification: the media's contribution to promoting national identity.

One could easily point to other external benefits, such as contributing to the development of a knowledge economy, or helping educate the nation's children, or promoting racial and social harmony. One could even claim that television advertising oils the wheels of commerce, informs consumers of their potential consumption choices, and thereby enhances economic efficiency, which also provides a wider public benefit!

The Measurement Problem

One can argue back and forth, interminably, about the precise nature, extent and value of externalities in broadcasting. However it would be an outrage to common sense to suggest that they do not exist. Nor should they be disregarded simply because their welfare impacts cannot easily be measured.

We do not shy away from regulating media content to control external "costs" that might accrue to society from broadcast programming. Defamatory, violent and pornographic programmes, or programming and presentation that are inconsistent with "public taste and decency" are all controlled by legislation. In none of these cases do we insist that the potential external "costs" of broadcasting such things should be quantified before we ban them.

Our summary of social science research into media effects, presented in Appendix One, shows that it has proven difficult, if not impossible, to discern the influences of media consumption on any individual. Welfare analysis cannot help us measure the private costs and benefits of media influence either, for precisely the same reason. However, but a veritable army of public relations consultants, marketing firms and advertising agencies can vouch for the fact that the various media are influential on whole populations, and that influence is very valuable.

Policy Outcomes

As it happens, the debate about the value of external benefits is largely irrelevant (little wonder given the difference between rarefied economic theory and the realities of broadcasting in a small country with high expectations).

The Government is clear that it seeks particular outcomes from its proposed changes to broadcasting policy. Some of these objectives clearly reflect an awareness of the external benefits and public goods that accrue to society from the broadcast media. These were stated in a recent Cabinet minute:

> "At its meeting on July 3, 2000 the Cabinet:
>
> a. **noted** that New Zealand governments have acknowledged a role in ensuring that desired kinds of broadcast content are available to the New Zealand public in addition to what may be provided commercially;
>
> b. **agreed** to the following set of objectives to guide the development of the Government's broadcasting policies to ensure that desired kinds of broadcast content are available to the New Zealand public:
>
> (i) Ensuring all New Zealanders have reasonable and regular access to broadcasting representing the uniqueness and diversity of New Zealand life, recognising that the histories and stories of whanau, hapu and iwi are integral to any description of that life;
>
> (ii) Meeting the information and entertainment needs of as many interests as reasonably possible, including those that cannot be met by commercial broadcasting;
>
> (iii) Contributing to public awareness of and participation in the political and social debates of the day;
>
> (iv) Providing for minority interests and increased choice;
>
> (v) Encouraging innovation and creativity in broadcasting while aiming to continually increase audience satisfaction with the quality of the content;"

The role of economic theory at this point is not to address the fundamental issues about what should be the outcomes of broadcasting policy, but to seek the most efficient and effective solutions for delivering those outcomes that the Government seeks to achieve. It is to those issues we turn in the ensuing sections.

Summary

In this section we have argued that the most relevant application of economic theory to broadcasting policy relates to the external costs and benefits of media consumption, and the concomitant social impacts. We have recited some of the arguments regarding the nature and extent of broadcasting policy.

We have also noted that the question of measuring external costs and benefits is something of a red herring.

The Government has decided that the external benefits of broadcasting are significant and important enough for their output to be regulated. The policy questions now revolve around how do so most effectively and efficiently.

The previous sections of this paper have demonstrated that the assumptions of "standard" economic theory do not necessarily apply when discussing broadcasting as a public policy issue.

They have also served an altogether different purpose; the reader who has not been trained in economics should now have a sound enough grasp of the relevant economic principles to understand the most appropriate tool that economic theory provides for analysing the issue of broadcasting quotas.

The economic theory of externalities is largely concerned with finding ways that external costs and benefits can be "internalised" to the relationship between consumers and producers. In general, the preferred solution is to create tradeable property-rights in whatever it is that confers such costs and benefits.

This body of theory can help us think more clearly and precisely about when it is desirable to create tradeable property rights and when it is not. It can also help us understand some of the advantages and disadvantages of alternative allocation mechanisms (such as quotas), and what some of the desirable characteristics of these other mechanisms might be.

This section and the one that follows may be technically complex for the non-expert reader, but we encourage you to bear with us, because this is where we get to the very heart of the policy issues.

Externalities

Economists interested in the regulation of air and water pollution recognise that pollution is a "cost" that the polluter imposes on the rest of society. That cost is "external" to the transaction between the producers (polluters) and consumers of the goods they produce.

Both the producer and the consumer obtain a benefit from pollution, because the costs of the goods do not reflect the full costs of production, including the costs borne by society as a whole.

An externality is therefore a by-product of a production process that imposes burdens on parties other than the intended consumer of a commodity. For example, both air pollution and water pollution are "negative" externalities, which impose burdens on society and the environment.

Externalities can also be "positive": apple orchards and beehives provide mutual positive benefits to the producers of honey and apples, and they supply an external benefit to the consumers of both products.

One way of controlling externalities and thereby ensuring the producers and consumers face the true costs (or receive the full benefits), of production is by creating tradeable property rights in them.

Externalities and the Coase Theorem

The economic theory that advocates the creation of property rights in externalities, their allocation and their efficient exchange was first outlined in an article by Ronald Coase titled *The Federal Communications Commission* (Coase, 1959), and further developed in *The Problem of Social Cost* (1960).[9]

Coase's Theorem can be demonstrated in the model presented in Figure 8 below. In Figure 4 above, it was demonstrated how an individual chooses to maximise utility given her income and a set of prices.

If that diagram is duplicated, then the *copy* rotated so that its corner (origin) is at the top right, then the two diagrams are fitted together, a diagram known as an "Edgeworth box" is created. This represents a two-person economy (although it may equally represent two *groups* of people). We will call them person A and person B.[10]

In this economy, there are only two goods: wealth and smoke. Person A is a smoker and prefers to be able to smoke more. Person B is a non-smoker, and prefers that there is less smoke (therefore that person A will smoke less). The right to smoke is a property right specifying the total amount of smoke that may be produced, which A and B must somehow share. In this little economy there is also fixed amount of wealth (representing "all other goods").

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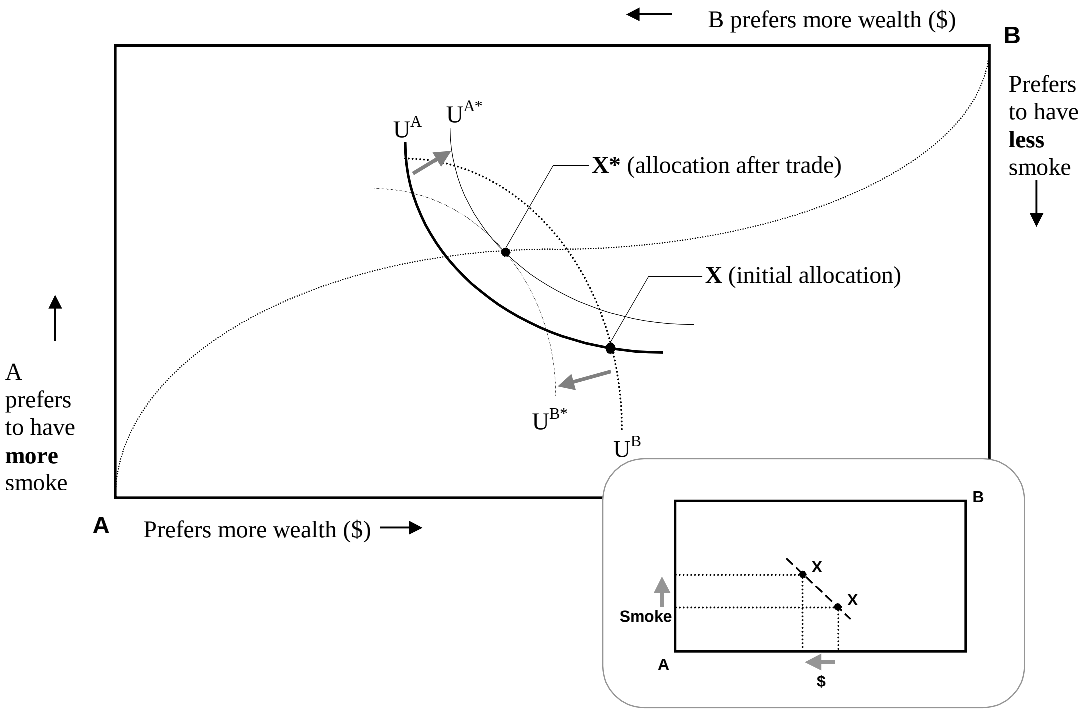
[9] The "Coase Theorem" was first proposed in relation to the externality of radio-frequency interference. The theorem was one of the foundations of New Zealand's Radiocommunications Act (Fountain, 1988).

[10] In a two-dimensional diagram, we can only have two people in this economy. Using mathematics, we could create a multi-dimensional "space" with as many people as we please. Conceptually, this could represent an entire economy.

Figure 8: Welfare Gains from Market Exchange



This is how the model works:

- Initial allocations of wealth and smoke are set at point X.
- Both A and B have utility curves (U^A and U^B), convex to their respective origins (ie, at bottom left and top right of the box), representing their constant utility trade-offs between wealth and smoke. These must both pass through point X.
- It is possible for A and B to trade with each other, to any point within the "lens" shape created by these initial utility curves. In this case they trade to point X*.
- At X* their new utility curves (U^{A*} and U^{B*}), are both "higher" – that is, further from their respective origins – than they were before. This means both are better off than before, and that the total welfare of the society has increased.
- The curves U^{A*} and U^{B*} are at a point of tangency. This means that neither A nor B can now be made better off without making the other worse off. That is, if A moves to a "higher" utility curve, B must necessarily move to a "lower" utility curve and vice-versa.
- This is an "efficient" equilibrium point. An efficient economy, in this sense, is one in which all goods can be freely traded. It follows that freedom to trade will maximise economic welfare.
- The point of tangency X* lies on a line running from A's origin to B's, which is called the 'contract curve'. This represents all the possible points of tangency between their respective sets of utility curves, and therefore all the efficient equilibria.

- In the little insert box, you can see the slope of the straight line running through points X and X* represents the agreed price, or the amount of wealth A has paid and the amount of smoke A has gained for it. Given normal utility curves, the line always slopes downward to the right, as one must give up some wealth in order to gain more property (smoke).

Limitations

This model does have some shortcomings:

- Efficiency says nothing about the fairness with which goods and wealth are distributed. Either A or B could have the lion's share of both wealth and smoke, but as long as the allocation between them lies on the contract curve (before or after trade), the outcome is equally "efficient".
- It only optimises welfare to the extent that it relies on the underlying assumption of welfare economics; that consumers are rational consumers who know their own best interests. The example of "smoke" is a good one – it is arguable that A is acting irrationally and against their own best interests by preferring to smoke (because they were influenced by advertising?)
- There are only two parties because this is a two-dimensional representation. It is better to think of A and B as two *groups* of people; in theory, economic efficiency is only achieved if there are many producers and many consumers, interacting in a competitive market.
- The concept of efficiency is tautological: by definition, if a good or service is not allocated in a market it is allocated inefficiently. When economists say that a particular policy is "inefficient" (such as quotas for television), it simply means that the set of rights and obligations involved will not be traded in a competitive market. By this standard, no government intervention could be "efficient" unless it involved privatisation.

These concepts are a key theoretical foundation for arguments in favour of market regulation. They also have broader policy implications – eg. in the creation of fishing quotas and radio frequency rights in New Zealand. The concepts are crucial to understanding the arguments both for and against regulation of the media.

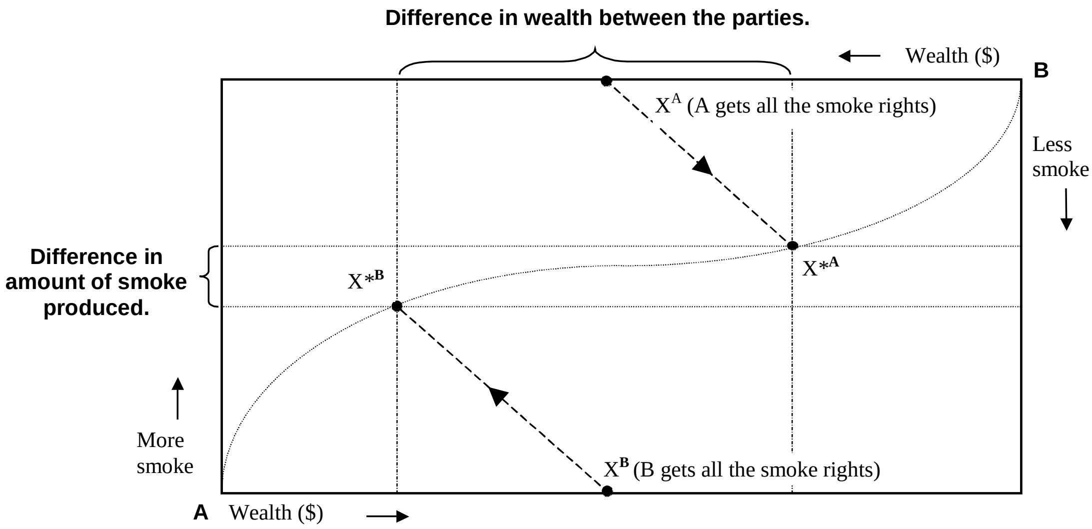
Initial Allocation

Obviously, the initial allocation of rights is important, as per Tobin's discussion about the domains of equality and inequality described above.

One interpretation of the Coase theorem is *any initial allocation point will produce* ***equally*** *efficient outcomes*. This claim is dangerously wrong, and it is important to understand why, because it points to one of the significant shortcomings in New Zealand's current broadcasting policy framework.

This is demonstrated in Figure 9, below. Let us say the initial allocation of rights was entirely in favour of person A, the smoker, at point X^A. This means A has rights to all the smoke (A and B have equal wealth). Given that both have "normal" utility curves, they will trade along a downward-sloping line, to a point represented as point X^{*A}. This indicates that person B has paid person A to smoke less.

Figure 9: Initial Allocations



If the initial allocation of rights was entirely in favour of person B, the non-smoker, at point X^B, then B has rights to all the smoke. A and B will trade along the sloping line, to point X^{*B}, indicating that person A, who wants to smoke, has paid person B so they can do so.

As the diagram shows, the different initial allocation produces very different outcomes, in terms of the wealth and the right to smoke (or not-smoke) of the two parties. That is because the trading line (X^B to X^{*B}) always has a negative slope under normal circumstances.

The "wrong" interpretation of the Coase theorem (that equally efficient outcomes can be achieved regardless of the initial allocation), only holds true if the trading line is vertical, implying that both parties are indifferent to smoke – in which case there would be no need to allocate rights at all.

The theory demonstrates that decisions about the initial allocation of rights are probably the single most important issue when creating property rights because, in all normal cases, they will have significant equity impacts for the affected parties.

Allocating Broadcasting Rights

Some key issues to do with the deregulation of broadcasting in New Zealand can be explained using this model. When the New Zealand government passed the Radiocommunications Act 1989, it created property rights out of the right to broadcast. Previously a Broadcasting Tribunal allocated these rights on the basis that they incorporated social, political and economic dimensions.

The model outlined above shows that a key policy decision was whether to allocate the rights equally among all citizens (person A), or to allocate all the rights to broadcasters (person B).

If the rights were allocated to citizens, broadcasters who wanted to have a right to broadcast would somehow have to strike a deal with the audience – presumably regarding price and program content. This would have imposed absurdly high transactions costs for broadcasters to negotiate with each audience member individually, but the Government could have overcome that by appointing an agent to act on the audience's behalf.

That was, in effect, the role the Broadcasting Tribunal played prior to deregulation: the Tribunal had some power to impose conditions on warrants that compelled broadcasters to act in the public interest. This naturally imposed costs on broadcasters, which amounted to the "price" they paid to audiences for the right to broadcast.

The alternative was to allocate rights to broadcasters; meaning citizens who wanted to influence program content would have to strike a deal with broadcasters, regarding price and content. However, it would be difficult to effectively co-ordinate the diffuse interests of all citizens to effectively negotiate with broadcasters.

The response from Government was to create an agent to purchase broadcasting outputs from broadcasters on the citizens' behalf. This is, in effect, the role currently played by New Zealand On Air.

Referring back to Figure 9, we recall the difference in outcomes when either A or B is allocated all of the initial property rights. If B obtains the initial allocation, A ends up with less wealth and less property rights, after trade, than if A had obtained the initial allocation. In other words, the Radiocommunications Act 1989 necessarily created an equity advantage in favour of broadcasters, to the disadvantage of citizens.

In the following section we shall demonstrate how quotas and subsidies together provide a more equitable solution for both audiences and broadcasters. Before doing so, however, we need to address the issue of whether or not quotas are inefficient.

Economic Efficiency and Quotas

Officials have previously advised the Government that broadcasting quotas are inefficient, and that subsidies for the production of local content would therefore be a preferable intervention. The Edgeworth Box model can help us understand what was intended by that advice, and whether it was well founded.

The model set out above has been used to discuss the allocation and distribution of externalities, but it also presents a compelling and elegant argument that says one can optimise economic welfare by creating tradable property rights in everything for which it is possible to do so. It is this argument that officials would no doubt have been alluding to.

Recall that the model represents an entire economy. In this instance, the economy is restricted to two people and two goods because it is represented on a two-dimensional plane. However, if it were not restricted to two dimensions it could theoretically represent unlimited numbers of people and goods.

Also, it need not represent just a single starting point (initial allocation) and a single end point (trading to a point on the contract curve). One could conceive of it as a dynamic model of constant interaction and mutual adjustment between all of the parties and goods involved.

In an abstract sense, then, it depicts an *n*-dimensional economy in which the tendency of all market exchange is always toward, rather than away from, a welfare-maximising distribution of the economy's goods and services.[11] That dynamic movement is welfare-maximising to the extent that it is responsive to informed consumer demand.

By contrast, in a centrally planned economy production targets and resource allocations are set in manner that represents the priorities established by bureaucrats. Fixed resource and production quotas would not permit the dynamic reallocation of resources and redistribution of outputs during each planning period. Such a system is likely to optimise consumer welfare only by accident, if at all (no matter how well-intentioned the bureaucrats).

Therefore, when officials advise the Government that "quotas are inefficient", they are raising the spectre of the failures of totalitarian central planning. They would be quite right to do so, if they were talking about quotas for the total output of baked beans, or toilet paper, or any other one of a multitude of consumer products that can be created and sold in more-or-less competitive markets.

However, as we have seen in the foregoing sections of this paper, the broadcasting sector is not like the baked beans and toilet paper sector. Broadcasters do not respond efficiently to consumer demand; they do not naturally tend to optimise consumer welfare, and they have considerable power to manipulate consumer preferences. On top of all that, the broadcasting industry's structure is far from competitive and it is likely to become less so in the face of further deregulation and technological change.[12] In short, a free market in broadcasting will not provide for an efficient allocation of society's resources, either in theory or in practice.

Under those circumstances, a system of protective regulation of the media, which applies quotas to only a proportion of total media output, and also provides broadcasters with reasonable flexibility in their choice of programming outputs, would provide an efficient and potentially more equitable means for optimising social and economic welfare.

When officials advised our Government that quotas are inefficient, they were stating a principle that economic theory demonstrates is true in most cases. However, they either wilfully ignored, or were ignorant of, the economic theory that specifically applies in regard to the broadcasting industry.

[11] In practice, an optimal equilibrium could never be achieved, since consumer preferences, resources and industry structures are in constant flux. It is the tendency of market economies to produce constant and dynamic movement *toward* an elusive optimal equilibrium that economists regard as important.

[12] Hay (1999) demonstrates this in theory using graphical economic modelling. Observers of industry trends will not require theory to recognise the validity of this claim.

Summary

The Edgeworth Box model presented in this section is a most valuable tool to help us focus clearly on the key policy issues the Government faces, when considering broadcasting content regulation. These issues are:

- The right to broadcast is not just an economic right; broadcasting also has social and political dimensions, which confer social costs and benefits.
- These non-economic costs and benefits are predominantly “external” in nature. That is; they have broader effects than the private utility obtained by individual consumers.
- Because of their social and political character, the externalities involved are not good candidates for conversion into tradable property rights.
- The current system of allocating broadcasting rights may be efficient, in a limited sense of the term, but it was certainly inequitable at inception.
- A source of inefficiency in the current system resides in the fact that broadcasters do not respond to audiences’ price signals, but rather to those of advertisers.
- Another source of inefficiency resides in the fact that the television industry is oligopolistic, rather than competitive.[13]
- Regulation will necessarily involve a trade-off between the interests of the audience and the interests of the broadcasting industry.
- Some policy options for regulating broadcast content are likely to optimise the relative welfare of both parties, and affect the efficiency of the economy as a whole, more than others.

In the next section, we will investigate how quotas might address these issues, using the conceptual tools we now have at our disposal.

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[13] We have not analysed this issue in depth, as it is more or less self-evident. Sky TV, CanWest and TVNZ are on track to form a either a duopoly or a trio of vertically and horizontally integrated discriminating multi-channel providers.

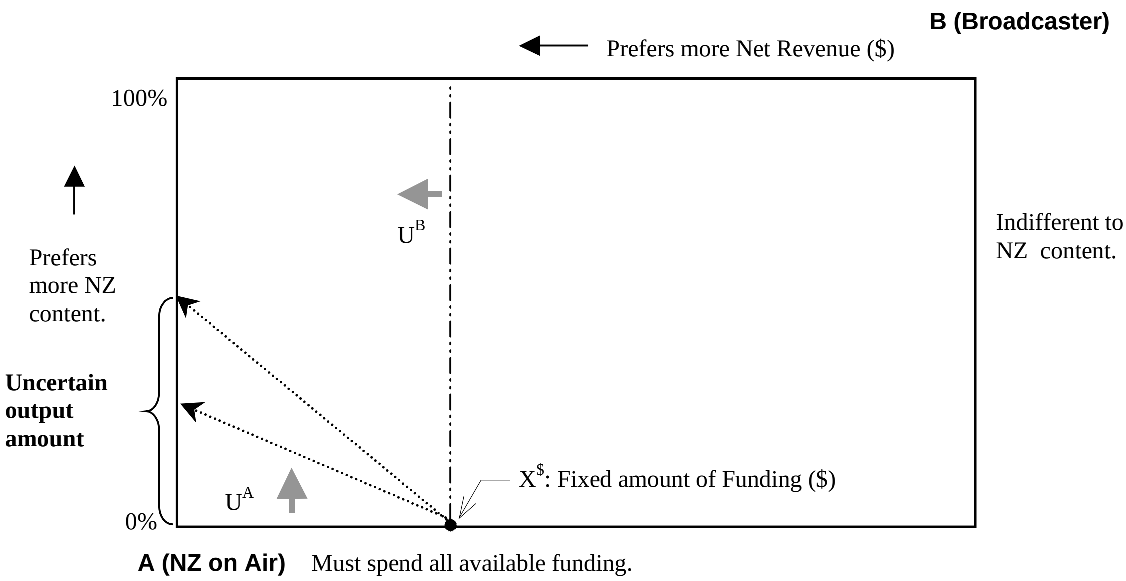
We saw in the previous section that the term 'efficiency' can have a specific and rather narrow application in economic theory, which can be far from neutral regarding the rights of two parties whose interests are not aligned. For reasons set out in the earlier sections, it is clear that the broadcasting industry is simply not 'efficient' in that sense, nor is it likely to spontaneously become so.

In this section, we will show that quotas and subsidies used in isolation are sub-optimal methods for achieving the Government's desired outcomes. However, using quotas and subsidies in combination has strong advantages.

Subsidies Alone

The model in Figure 10 shows how the subsidy system works in terms of our theoretical model.

Figure 10: Subsidies Alone



The initial allocation point is at $X^\$$. A's initial utility curve (U^A) lies on the horizontal axis, indicating that A prefers more NZ content, but is theoretically indifferent to wealth, because the whole allocation must be spent in each financial year. B's initial utility curve (U^B) is a vertical line, indicating that B's objective is to maximise net revenue, and that B is ultimately indifferent to the amount of NZ content it broadcasts.

Under these conditions, the amount of New Zealand content A obtains is dependent largely on the amount B wants to acquire, and the price they both agree. However, B is under no obligation to screen any output of New Zealand content at all and is theoretically indifferent as to how much is produced. Because A seeks to spend all available funding, B has power to set the terms of trade in his favour.

In theory, then, NZOA can only subsidise programmes that broadcasters think will maximise their net revenue. This limits its power to pursue Government policy in terms of shaping social outcomes. For instance, NZOA has little control over scheduling, which is important to ensure that programmes will be shown in time slots that are attractive to target audiences.

In practice, NZOA does manage to strike some effective deals with broadcasters over scheduling and quality. However, the television channels still exercise considerable powers, including the power of veto, in determining which programme ideas and genres NZOA can even consider.

Looking at this from the perspective of accountability for expenditure of public money, the NZOA subsidy system means the Government knows how much money is going to be spent – more so since the abolition of the Public Broadcasting Fee – but there is a lack of certainty, before the fact, about the amount, quality and timeliness (ie, scheduling) of output that will be created.

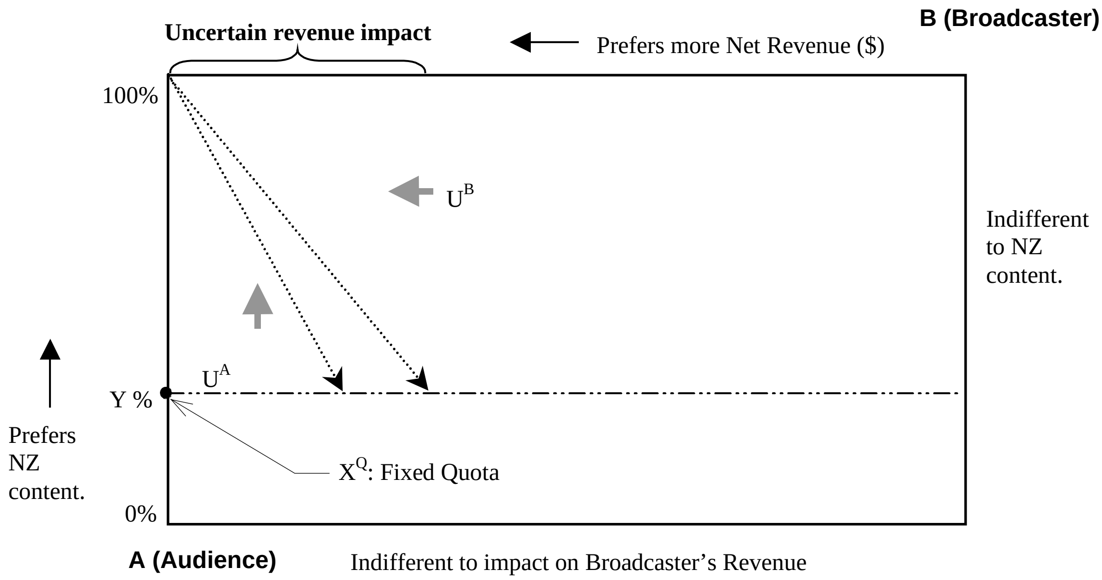
There is an inevitable tension, which economic theory cannot resolve, between the need for public accountability and the need to prevent any Government from interfering with the editorial independence of the media. While one would obviously not want the Government to specify precisely what was broadcast and when, it is also desirable that taxpayers' funds are used wisely and effectively.

Deregulation of broadcasting placed considerable "market power" in the hands of broadcasters, without considering how this might disempower citizens – both as media audiences and as taxpayers. The funding intervention system works well when there are willing buyers, but there is no safeguard when those buyers choose to purchase different programmes for reasons of pure self-interest.

Quotas Alone

Figure 11 demonstrates the disadvantages of a stand-alone quota system. The initial allocation point is at X^Q. A's utility curve is the horizontal line emanating from X^Q. B's initial utility curve (U^B) lies on the vertical axis (not shown, but the arrow U^B indicates the direction of preference).

Figure 11: Quotas Alone



This proposes that A, the audience, prefers New Zealand content, but it is theoretically indifferent to the impact on broadcasters' revenue (hence the utility "curve" U^A is a straight horizontal line). B prefers more net revenue and is theoretically indifferent to NZ content, therefore suffers a loss in utility by being compelled to provide it.

In practical terms, it shows that broadcasters would shoulder the responsibility for achieving the Government's social outcomes, and the cost of doing so would not be carried on the public accounts.

This is not necessarily unfair to broadcasters; many Government policies impose costs on business that are intended to create benefits for society as a whole (ACC levies, for instance), and sometimes either the costs or the benefits are difficult or impossible to quantify. These policies simply become part of the business environment in which firms choose to operate.

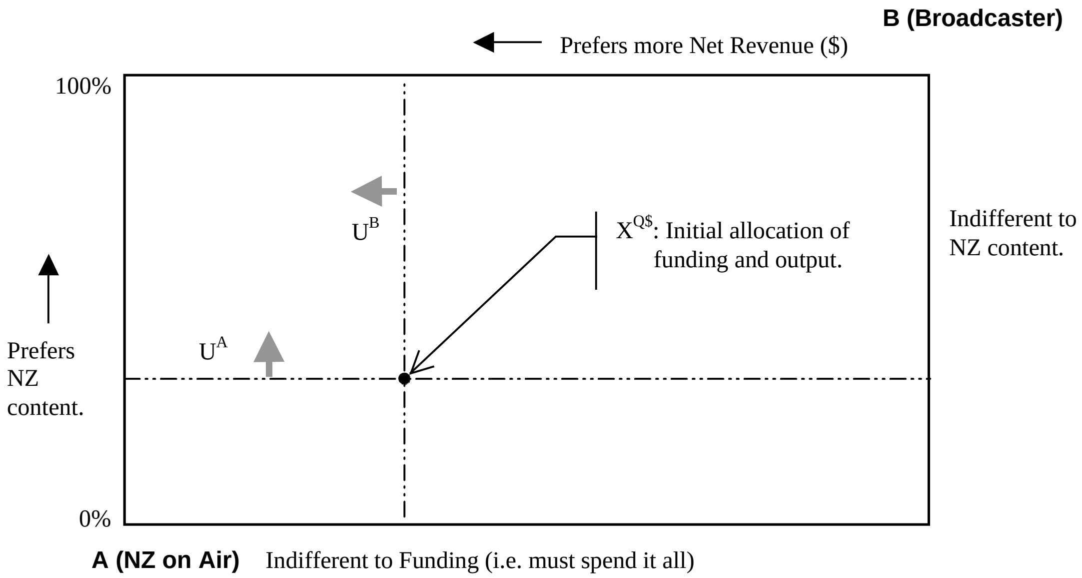
Of course, the opposite is also true; Government policies can also create opportunities for business (such as import tariffs) that impose costs on consumers. The key consideration for the Government in either situation is whether the sum of social and economic benefits outweighs the sum of social and economic costs.

Where social cost and benefits are not quantifiable the balance of costs and benefits comes down to a matter of the Government's political judgement. The ultimate arbiters of whether that judgement is correct are the citizens of New Zealand, at each general election.[14]

Quotas and Subsidies Combined

The model in Figure 12 demonstrates how the initial allocation point is set (at point $X^{Q\$}$) when quotas and subsidies are combined.

Figure 12: Subsidies and Quota Combined



In effect, the Government would set an initial allocation of subsidy and output that both obliged broadcasters to have regard for its social objectives and provided a taxpayer subsidy for the production of some or all of the required outputs. The final allocation point will lie either on or above the horizontal line, and either to the left or right of the vertical (depending on whether the Government provides a net fiscal subsidy to broadcasters or vice-versa).

Under these circumstances, broadcasters will inevitably haggle with the Government over whether the subsidy is sufficient to produce the desired outputs, and there will be constant pressure to increase funding.

On the other hand, the Government has an incentive to ensure the funding pool is restricted. Rationing would compel broadcasters to compete more vigorously for the pool of available funding, giving NZOA greater power to negotiate over the scheduling, content and quality of programmes it funds.

[14] Chen and Palmer's paper mutters darkly about public choice theory. This is the economist's view that politicians and bureaucrats conspire to make decisions that disregard the authentic preferences of consumers and thereby distort market allocation and efficiency. To a political scientist, however, this is simply democracy in action.

The combination of quotas and subsidies means the Government will not only achieve greater transparency in the public accounts regarding the costs of meeting its social objectives than it would with a quota scheme, but also have greater certainty regarding the quantity and scope of outputs it purchases than it does with the subsidy scheme.

The combination of quotas and subsidies can also provide significant flexibility. It sets boundary conditions for the minimum amount of output to be screened, and the price the Government is willing to pay to subsidise this. Within those boundary conditions, broadcasters retain a degree of flexibility to decide what they will or will not broadcast. The degree of flexibility largely depends on how the quota system is designed, and how the quotas are specified.

The economic theory of externalities can inform the design and specification of a quota system. In the next section we test the SPADA proposal against some of the desiderata for establishing tradable property rights.

Summary

In the previous section we saw that quotas are not necessarily inefficient and that there is a case for protective regulation of the media. We also noted the potential equity impacts of allocating externality rights to either broadcasters or audiences alone.

In this section we have demonstrated that either subsidies or quotas alone will have equity impacts on audiences or broadcasters respectively. However, the combination of quotas and subsidies together creates an initial allocation point that is more equitable for both.

We have also introduced two implicit objectives of policy other than the standard economic theory issue of efficiency: transparency in the Government accounts, and sufficient flexibility in a quota system for broadcasters to meet their social responsibilities without excessively compromising their ability to manage to their obligations to their shareholders.

Quota System Design and Specification

Fountain (1988) sets out the some of the desiderata for establishing an effective market in tradeable externality rights. He says that rights have to be specified in terms of:

- **Volume:** the amount of externality rights to be created should strike the appropriate balance between the costs and benefits of its production.
- **Alienability:** for externality rights to be transferable the bundle of rights that constitute ownership must be completely and unambiguously defined.
- **Enforceability:** the rights and obligations of ownership must be enforceable, as must any conditions of trade.
- **Divisibility:** externality rights should be created in units that are sufficiently divisible to allow them to be freely traded or transferred.

Hay (1996, 1999) suggests that some other considerations also need to be taken into account, including:

- **Specification:** externality rights are not necessarily singular and homogenous. In terms of fishing quotas, for example, the issue of the interaction of species populations and how by-catch is treated provide an example of how this issue should be considered in policy development.
- **Initial allocation:** the initial allocation of rights should be based on rules that are fair to both incumbent operators and subsequent entrants to the market.
- **Legitimacy:** if any system of property rights is to endure, then the rules that create and sustain the possession and exchange of those rights must be seen to be fair, and to achieve outcomes that are desirable for the parties involved.

These desiderata for creating a system of tradeable externality rights also provide a useful starting point for considering issues in the creation of a quota system that is effective, equitable and enduring.

Volume and Specification

In the case of broadcasting, quotas could be either a fixed number of hours per week, or a percentage of total broadcast hours. To maximise flexibility, the SPADA proposal allocates quota in a tiered system that applies a variable number of quota points per year, related to turnover, affordability and revenue system.

The points system has two parts: the transmission quota, which defines the total quantum of New Zealand content for a channel, and genre quota, which ensures that a subset of the transmission quota will be further divided among different types of New Zealand content (listed below).

Transmission Quota: Share vs Reach

The SPADA proposal segments broadcasters into three separate tiers:

1. National free-to-air channels (TVNZ, TV3)
2. Limited coverage channels (Prime, TV4), and
3. Pay TV channels (Sky, Saturn)

Each tier has different quota targets. The targets are essentially a function of the 'reach' of the channels.

The analysis above might suggest that if the focus of the intervention is on audience attention, then perhaps a tiered approach should focus on the 'share' of each channel. That is, the more people who pay attention to a channel, the higher the number of quota points it should attract.

One advantage of focusing on share would be that the highest compliance level would fall on the highest rating (generally meaning the highest revenue generating) channels.

Using channel share as a basis for quota would obviously require robust measurement. The existing ratings monitoring system already measures audience size, but it would not be sufficiently sensitive for this task when considering smaller channels.

There is evidently a range of issues to be taken into account here. The SPADA proposal is relatively straightforward, and requires no additional investment in measuring share. However, using share as an allocation principle might be preferred by the industry and additional investment could have spin-off benefits for channels and advertisers alike.

Genre Quotas

The quota system is not designed to promote New Zealand programming as a single uniform category. It includes specific types of programming, aimed at either general or specific audiences. The SPADA proposal suggests six genre categories:

- ♣ Drama and comedy
- ♣ Children's drama and animation
- ♣ Children's programmes (non fiction)
- ♣ Documentary
- ♣ Maori and Maori language
- ♣ Performance (music, arts and entertainment featuring the performing arts)

Each has a points weighting, dependent on whether a programme is first-run or a repeat, whether it is scheduled attractively and whether it has a high policy priority. The system is designed to set minimum amounts in each genre, but also to permit broadcasters flexibility in scheduling.

Obviously, the specification of quotas is based on the outcomes the Government is seeking to achieve. The SPADA proposal is focused primarily on one of the Government's desired outcomes listed on page 25 above.

> "Ensuring all New Zealanders have reasonable and regular access to broadcasting representing the uniqueness and diversity of New Zealand life, recognising that the histories and stories of whanau, hapu and iwi are integral to any description of that life;"

However, the Government also seeks other outcomes, and suitable quotas for relevant programming outputs could also be contemplated for them. For instance, the goal of "contributing to public awareness of and participation in the political and social debates of the day" suggests that quotas for programmes of investigative journalism or analysis and debate could also be included.

Flexibility

The specification of each genre in the SPADA proposal is relatively flexible. "Drama" encompasses a wide variety of programme styles, for instance. Detailed discussion over funding for particular programmes would obviously take place between the broadcaster and NZOA, but broadcasters are not limited to programming subsidised ("approved") by NZOA.

Fine details are to be the responsibility of an independent monitoring authority. This is an extra safeguard to ensure that the mechanics of the system are not so enshrined in legislation that evolution and innovation (often based on consumer trends) are unnecessarily impeded.

Initial Allocation

This requires a fairness test. The SPADA proposal suggests that pay television channels should be subject to a genre quota only (because of the different programming mechanism used by pay television where whole channels are purchased and screened with little or no intervention by a New Zealand programmer).

However, the foregoing analysis suggests that audiences pay for television either by watching advertisements or by direct money payments to the broadcaster. If our focus is on what audiences should or should not pay attention to, then the allocation of quotas should be indifferent to how a broadcaster obtains its revenue. Therefore an economist might argue that a different quota for subscription channels is unfair and that such channels should be treated no differently from free-to-air channels.

The issue of how to treat new entrants to the market creates a problem if share is used as an allocation rule, because the share of a new entrant will not be observable immediately. There may be a case for applying 'reach' as an initial allocation rule, followed by share at a stage when it becomes discernable.

Alienability and Divisibility

For externalities to be traded at the lowest possible transaction costs, they need to be sufficiently divisible. In the case of broadcasting quotas, it is a moot point whether they should be tradeable at all.

Transferable Quotas

Part of SPADA's intention is to ensure that some programmes or programme types are available across different channels for different audiences. This is seen as essential to achieve the desired outcomes. If television companies are permitted to trade quota among their channels, some programme genres could migrate to a single channel.

The proposal suggests that the permission for transfers among a broadcaster's channels should be at the discretion of a regulatory body. There should also be some general advance rules about transferability, to allow broadcasters some certainty of operation. There are a number of detailed policy decisions involved here, but previous experience in establishing transferable rights in fisheries and radio spectrum should provide useful guidance.

Transferable quota may be desirable in some cases. SPADA suggests the example whereby, if TV One continues to brand itself as an adult channel, its children's quota targets could be added to those of TV2.

The concept of transferability is also implied in SPADA's proposal for limited coverage channels, where those channels select only two of the genre quotas with which to comply. We note that there is considerable potential for abuse here if not monitored correctly.

Decisions regarding transferability should depend on how each genre or specific quota type contributes to the social outcomes the Government is seeking to achieve. The SPADA proposal contemplates very limited transferability because it focuses on fostering a sense of national identity, requiring a relatively even distribution of relevant quota across all national channels. However the proposal acknowledges that some transferability may be required to avoid illogical outcomes.

Temporal Transfer

SPADA's quota points system does permit the quotas to be 'cut' in different ways, and this has some beneficial consequences. One is that it permits accounting of points across periods.

The SPADA proposal allocates a total of points per calendar year, and provides incentives for particular time-slots, but it does not require a channel to broadcast quota programmes uniformly over the year. Nor does it address the issue of under-provision or over-provision of points in any year, or whether such surpluses or deficits can be carried over between periods.

These are all matters of fine detail, but they will need to be addressed. A virtue of a points-based system is that it will allow for these 'accounting' issues of quota delivery to be more easily addressed.

Enforceability

When one sells property, one ‘alienates’ it. However, in order to do so, one must have an unambiguous right of possession in the first place, and there are usually legal rules that apply to the registration and transfer of title.

Experience with other rights regimes (radio frequency, fisheries) indicates the need for a registry to keep track of quota obligations, especially if quota is to be transferable.

A monitoring agency will have to monitor the output of quota programming and, if there is a dispute over the amount of quota produced, judge whether the rules have been violated. The output of television channels is sufficiently observable for competitors, consumers and regulators all to monitor broadcasters’ performance. Thus, the costs of monitoring would be relatively low.

The issue of imposing effective sanctions for non-compliance, and perhaps differing levels of sanction for levels of non-compliance also needs to be addressed.

We will not explore any of these issues in detail; rather we note that there will be a number of such issues involved in establishing a quota system. The ‘rules’ for a quota system are no more or less involved than for establishing a system of transferable rights in any resource or externality. In each case, the policy needs to be clear in principle and pragmatic in implementation, in order to minimise the subsequent costs of enforcement.

Legitimacy

The issue of legitimacy has two components: there needs to be a constituency of support for the policy outcomes the Government is seeking to achieve, and agreement among the affected parties that the policy interventions designed to achieve those outcomes are reasonable in impact and equitable in implementation.

In this paper, we have put forth an argument, soundly based in economic theory, that protective regulation of the broadcasting industry is required to protect the interests of New Zealand citizens. We do not expect all broadcasters will be persuaded by this argument. However, we do expect policy makers to recognise that it is the diffuse and weakly represented interests of New Zealand’s citizens that are primarily at stake, not the unified and relatively powerful lobbies of the commercial broadcasters.

The legitimacy and endurance of a quota system will be enhanced if the people of New Zealand were to be consulted on the outcomes being sought and the nature of the intervention being proposed to achieve them.

For broadcasters, legitimacy will rest on whether the impacts are fair between competing broadcasters. To achieve fairness, a quota system needs to be a transparent and pragmatic structure, dispassionately applied, which takes the complex realities of a mixed-model broadcasting system into account.

Summary

The SPADA paper proposes the basic mechanics of a quota system. This section has applied the desiderata for creating a system of transferable externality rights to the SPADA proposal, and in doing so has tested some aspects of the proposal and identified areas that require further consideration or more detailed policy development.

It is therefore critical, when quotas are implemented, that the finer details should be developed on a foundation of sound principle and a pragmatic sense of what is realistic, cost-effective and sustainable in practice.

Above all, it will be necessary to focus on achieving outcomes that are broadly supported and seen to be valuable by the people of New Zealand.

Conclusions

Chen and Palmer threw down a challenge when they insisted that the broadcasting sector should be subjected to the same logical and rigorous economic analysis that is sometimes applied to government policy in other sectors.

We welcome this challenge, because it has afforded an opportunity to explain, both for the non-expert and for policy makers unfamiliar with the application of economic theory to broadcasting policy issues, how economic theory can indeed provide a valuable contribution in this debate. It has also provided an opportunity to discuss the limitations of economic theory and consider how real-world issues rarely fit neatly into models.

Producing sensible and desirable outcomes from a multi-disciplinary approach is the inherent challenge of developing broadcasting policy.

Protective Regulation

The particular purpose of this paper has not been to promote or defend a specific proposal for implementing local content quotas. It has been to take the logical prior step of putting forward a robust case, soundly based in economic theory, for the protective regulation of the electronic media.

We have focused on the issue of protective regulation of all media, regardless of ownership. We have not included significant discussion of the role of public ownership and the proposed charter for Television New Zealand, for instance.

There is a limited range of policy tools, other than direct ownership, available to the Government for implementing a regulatory regime. In this analysis we recognise that any form of regulation, or indeed deregulation, involves a distribution or redistribution of costs and benefits within society.

The essence of our analysis has been that both the benefits and the potential costs created in society by the electronic media are significant, and that the broadcasting industry should bear some direct responsibility and some of the burden for the privilege it enjoys and the benefits it acquires from commanding and exploiting the scarce resource of audience attention.

The Method of Economics

Any economist must make certain critical decisions when embarking on a piece of analysis. The sum of these decisions embodies the economist's method. Our method was developed on the basis of the following principles:

- **Choice of perspective matters.** We maintain that the diffuse and weakly represented interests of the populace should form the primary focus of analysis, rather than the unified and powerful lobbies of industry stakeholders. The economic impacts on the industry are a necessary, but subsidiary, focus of analysis. This is especially true if the analysis contributes to a debate in public policy, as opposed to purely theoretical development.
- **Social and institutional context matters.** Economic theory is *developed* as if it was a set of universal theoretical 'truths', but is has to be *applied* within the

context of the specific cultural, social and political and institutions that apply in any particular case. In this analysis we have discussed broadcasting economics in the context that New Zealand is a liberal democratic nation state with a distinctive cultural, political and social heritage that we assume to be worth preserving and developing.

- ♣ **Underlying assumptions matter:** The standard tools of economic analysis, which often lead to policy prescriptions in favour of market freedom, rest on a number of strong assumptions. Each needs to be tested for validity in every case where economic analysis is applied. Our analysis rests on the assumptions that:

  i. Broadcasting markets will not respond to price signals from the audience.

  ii. Media consumer preferences can neither be assumed to be fixed nor endogenous to the analytical model.

  iii. Benefits and costs of media consumption cannot be assumed to be private to the individual consumer.

  iv. The television broadcasting industry in New Zealand is essentially non-competitive.

- ♣ **Method matters.** Economics is not a unified system, but a set of tools and concepts. Each situation requires that the appropriate tools and or concepts be chosen to fit the needs of the issue at hand. In this case we have chosen an Edgeworth Box model to analyse the broadcasting policy in terms of the distribution and allocation of externalities. There may be other applicable tools, but this one pulls together all of the key issues most effectively in this situation.

- ♣ **Theoretical limitations matter.** We insist on caution before drawing conclusions based on economic theory alone, without reference to other perspectives from the human and social sciences. We also insist that policy analysis based in economic theory should resist the temptation to re-shape the real world in the image of a theoretical model. To do so invites the risk of undermining the credibility of the analyst, the discipline of economics, the policy that is proposed, and the government that implements it.

In our opinion, each one of these principles is essential for the logical and rigorous application of economic theory to public policy issues in broadcasting.

We do not claim that Chen and Palmer’s analysis is entirely “wrong”. However it does appear that their analysis was not founded on the same set of principles we have chosen to adhere to in this paper. We invite readers to consider whether they believe any one of these principles could legitimately be abandoned, and what the consequences would be for policy if they were.

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Appendix One

Media Influence

Broadcasting policy can be discussed using a variety of discourses. These are primarily: Political Science, Social Psychology, Sociology and Cultural Studies.

- **Political Science** is concerned with the power of the media to influence political beliefs and voting patterns, how the media sets the "agenda" for public debate by reinforcing certain ideas and beliefs and marginalising others. It is concerned with the structure and role of the public sphere within which policy issues are debated.
- **Social Psychology** is concerned with the effect of the media on shaping social norms and values, or personal identity and self-image, including the effects of media on mental health. The Mental Health Foundation has been an regular contributor to debates about broadcasting policy in New Zealand.
- **Sociology** has sought to investigate how media shapes society, specifically the relationship of the media to particular groups within society: women, indigenous peoples, social sub-cultures. It is also concerned with how the media "legitimises" some groups and alienates or demonises others.
- **Cultural Studies** is a relatively recent academic pursuit, arising out of a fusion of literary theory and sociology, but encompassing many aspects of the foregoing disciplines as they relate to the media. Its central premise is that media are "texts" that can be decoded by expert analysis.

Effects Research

The effects research tradition developed predominantly in the United States after World War II. This research was intended to have direct policy applications, inasmuch as it attempted to "...identify the programming and broadcasting practices to be circumscribed and those to be encouraged" (Cocker 1996: 26). Underlying this research tradition was the notion that media messages had a relatively direct or "hypodermic" effect—as if media messages directly injected ideas into people's minds. Researchers sought to apply the method of scientific experiment to discover these effects.

By the end of the 1950s, it was evident that "…(this research) didn't show any dramatic results—nothing like the results that the early students of mass communication had anticipated" (Katz, 1988). Lasora, (1992, 164), makes this summary:

> "…(Klapper, 1960) noted that mass communication 'ordinarily does not serve as a necessary and sufficient cause of audience effects, but rather functions among and through a nexus of mediating factors and influences,' including selective perception, exposure, attention and retention; group dynamics; and opinion leadership. More recent research has confirmed the indirect, subtle, and contingent nature of many, if not most, mass media effects on audience."

Cumberpatch and Howitt (1989) were less generous, stating that effects research "…offered a desert of inconsequential findings." The apparent failure of effects research to produce robust findings meant it had little influence on policy, and this weakened the case for protective regulation of the media.

However, effects research failed only to the extent that it attempted to discover the direct effects of specific media "messages" on individuals. What it discovered was that media influence is part of the social environment – it influences people's ideas and beliefs only to the extent that it influences the whole social realm in which they exist. And while direct effects on individuals are hard to identify, it is possible to perceive effects on whole populations.

The Spiral of Silence

In Europe, the research of Elisabeth Noelle-Neumann (1984), into what she describes as the "Spiral of Silence" has generated a significant amount of research and academic debate. Salmon and Moh (1992) review Noelle-Neumann's theories, as well as the many empirical studies, critiques, counter-critiques and commentaries that have attempted to replicate, test, challenge or assess the theory. They summarise her idea thus:

> "Noelle-Neumann contends that individuals have a virtually innate fear of social isolation. To be alone, apart from, or at odds with the crowd is more than most individuals can endure. To wear an unpopular fashion or to express an idea that many consider old-fashioned or, even worse, socially unacceptable is to risk incurring the wrath of others, a prospect that most find too unattractive to risk. As a result of this concern, individuals must constantly monitor the environment, searching for cues regarding which sentiments, ideas, knowledge, or fashions are shared by many or only by a few." (148)

Noelle-Neumann bases this notion on the ideas of German sociologist Ferdinand Tonnies who conceived of public opinion as a social force, an informal mechanism of social control: "Public opinion always claims to be authoritative. It demands consent or at least compels silence, or abstention from contradiction" (Tonnies, 1922: 138).[15] Noelle-Neumann claims the mass media are a powerful force in shaping public opinion and a rich source of social cues, to the extent that they are *ubiquitous* and *consonant:*

- Media messages are *ubiquitous* to the extent electronic and print media pervade society, and
- Media messages are *consonant* to the extent the media produces a remarkably homogenous diet of news and information.

In a media environment that has these features, people may tend to suppress opinions they perceive as not fitting in with prevailing public opinion, and Noelle-Neumann saw this as a powerful factor in the rise of Nazism in Germany prior to the war.

We cannot help but accept the ubiquity of the media in modern society. Therefore much of the debate about broadcasting policy has revolved around the question of diversity of media content.

Agenda-Setting Theories

In the United States empirical research into media effects turned "… away from persuasion, to the equally sinister possibility… that media may determine what the public takes to be important." (Iyengar *et al.,* 1982). This so-called agenda-setting function of the media is encapsulated by the idea that "The press may not be successful in telling people what to think, but it is stunningly successful in telling its readers what to think about." (Cohen, 1963: 13)

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[15] Abraham Maslow's theory of psychological health, in *Motivation and Personality* (1987), provides support for this idea: in his hierarchy of human needs, social and belongingness needs come immediately after the fundamental needs for food, clothing shelter and safety.

Lang and Lang (1983) claim that the failure of effects research indicates that the media may be more effective at reinforcing beliefs than changing them. In setting an "agenda" the media agenda diverts attention away from potentially important political issues and marginalises alternative viewpoints. This is consistent with results found by early effects researchers in the 1940s (Leitch, 1992: 50). Derek Fox (1988) describes how the Maori community in New Zealand has experienced this marginalising effect. The "invisibility" of Maori language, culture and political perspectives in New Zealand's media over many years has provided a powerful impetus for the establishment of independent Maori radio, television and print media.

While research has generally supported the validity of agenda-setting theories, it also indicates it is not a simple phenomenon (McCombs and Shaw, 1972; Weaver, 1987). It has been found to be more pronounced in regard to issues, such as US foreign policy, where the audience has little or no possibility of direct experience and limited alternative sources of information, (Iyengar *et al*., 1982). It is less pronounced if audiences have direct experience of events or multiple sources of information providing a variety of perspectives.

This notion of a media "agenda" explores the idea that the media tends to focus public attention on only a few issues at any one time. And what the media chooses to ignore may be as important, from a policy perspective, as what it chooses to emphasise.

Third Party Effects

In America, Davison has developed a line of enquiry into "Third-Person Effects", which Lasora (1992) describes as the idea that:

> "…a message might lead to action not because of its direct impact on those presumed to be its target but because others (third persons) believe it will have such an impact on that audience and they act on that belief, regardless of whether or not the message has direct effects on the presumed target audience at all." (165)

Surveys indicated that between 30-50% of polled respondents tended to believe that media messages will have a more powerful effect on others than on themselves, 40-50% perceive equal effects between themselves and others. The residual 5-7% believed that the media has a more powerful effect on themselves than on others.

The idea of third party "effects" is really not about media effects at all, but about how media policy is debated. There is often an element of "moral panic" involved in debates about the media and media policy, especially when the "third parties" include children, or any section of society deemed to be more susceptible to media influence than others.

However, such claims occur in many areas of policy debate where the common good is at issue. One can take a negative view, and say that protagonists in such debates invoke the welfare of the general public, or of other individuals, to mask self-interest or to promote personal beliefs. On the other hand, people involved in policy debates might also be genuinely concerned about the impacts of policy on people unable or unwilling to represent themselves, and on society as a whole.

Why shouldn't media policy be shaped in response to parents' concerns about the effects of television on their children, regardless of any evidence of direct effects? It would be dishonourable and undemocratic to dismiss their concerns as merely "third-party" effects.

Summary

It is hard to measure exactly how one person’s media consumption affects that person’s behaviour, or the extent to which they are aware of it themselves. If one seeks to successfully influence the behaviour of people, as voters or as consumers, one does not seek to influence them directly. Rather, one’s objective should be to influence the whole climate of opinion that they experience – the social cues to which they will respond.

While television does not determine the whole social climate it does play a dominant role, among all media, in shaping the climate of public opinion – so while radio or newspapers may break a story, it is television that chooses which stories predominate, and which are left to wither.