The Australian Children’s Television Foundation’s 20th Anniversary Symposium

Cultural Protection and Competition Policy – the Case of Children’s Television

20 March 2002
Melbourne

Professor Allan Fels
Chairman
Australian Competition and Consumer Commission
1. INTRODUCTION

I am very pleased to be here today to speak at the twentieth anniversary of the Australian Children’s Television Foundation. The Foundation is to be congratulated on its valued work in promoting and supporting Australian produced children’s television over two decades. An entire generation of Australian children have been able to watch kids that speak like them and do the same sorts of things that they do, and hopefully know that the last letter in the alphabet is zed not zee.

This outcome has not occurred without some considerable effort by many of the people here today, particularly Dr Patricia Edgar, who has lobbied long and hard to get quality Australian children’s programming on commercial television. As we are all aware, this result is one that might not have occurred, had there been no regulatory intervention in the form of program quotas.

In my speech today I would like to talk about regulatory intervention and what is often called ‘cultural protection’. In doing so, I wish to acknowledge the major contribution from Commissioner Ross Jones to the preparation of these remarks.

The Australian Competition and Consumer Commission (ACCC) and its Chairman may seem at first sight to be an odd choice to be invited to speak at a conference though I take it that the purpose is to hear an economics, competition-oriented perspective on policy for children’s television. After all, it is true that the ACCC is a firm believer in competition and there is little doubt that competition generally provides the most efficient and most effective way to ensure that consumers get what they want at the best price. On the other hand, protection typically allocates resources into activities that would not otherwise get them or get them in insufficient quantities.

The ACCC has a role in regulation as well as protecting and promoting competition. Sometimes the structure of the market does not lead to the most competitive outcomes and regulation may be needed. For example, the ACCC regulates a number of areas in the telecommunications industry where governments have taken the view that the market power of large firms may not lead to the most efficient outcome for consumers. In other cases, regulations themselves confer special privileges on
particular groups in society at significant cost to the economy as a whole. I want to come back to this point later and talk about the ACCC’s role in removing parallel importation regulations which have had the effect of raising the prices of a wide range of goods.

It may be that the regulations which are introduced are appropriate for that time or that circumstance but over time they become ineffective or maybe they cease to serve the public interest. Maybe there are unforeseen consequences of the regulation. Whatever the reason, regulation is generally a second best option.

Generally in the economics view there are two standard preconditions for regulatory intervention. The first is that the market must be unable to provide the goods or services in the appropriate quantities, (what economists usually refer to as market failure), and the benefits of the regulations must exceed their cost. Some people argue that market failure is very common in relation to what we might call cultural products. It may be these products have special characteristics that the market has trouble dealing with. For example, it may be that the consumption of these products provides benefit not just to the individual but to the wider society. Under those circumstances, subsidies to encourage consumption are not uncommon. State funding of education is an obvious such example. It may also provide a justification for the subsidisation of the production of certain types of cultural products.

Another concept in economics is that of merit goods ie goods whose supply may not be justified by consumer demand, even the imaginary demand if they could vote for its supply by paying a price. Such goods nevertheless have a merit that go beyond the market demand notion. Also, the reasons why society is prepared to see public provision of certain goods and services goes beyond the libertarian, utilitarian calculus of economics eg the provision of education is not fully explained by market ideology.

Culture is an elusive concept that is not easily defined. We all have different views about what is culture, and these views reflect our own individual values. But generally we tend to see culture as something derived from activities we undertake as a society and from our historical, artistic and traditional heritage. While culture
certainly has personal significance to each one of us, it is regarded as having much greater significance for society as a whole. Therefore, while the consumption of cultural goods and activities generates direct personal benefits to us as individuals, it is also thought to generate substantial indirect benefits to our society. Indeed, it is fair to say that a cohesive national culture and identity would not be possible without shared cultural experiences.

It is often argued that cultural products have certain characteristics that lead to positive spill-overs. Cultural products such as films and television programs typically reflect the values and customs of the society that produces them. In the broadest sense, it is argued by supporters of cultural regulation that a sense of national identity and national culture is developed by exposure to domestic cultural products. Economists would say that these attributes or benefits are external to the actual production of the products. That is, they are benefits that cannot be taken into account in the decisions of those buying the programs. They will take account only of the potential profits to them, not the wider benefits to the community. Consequently they will buy fewer than would be optimal if all the benefits could be taken into account.

There may be other instances of market failure associated with cultural products. It has been argued that consumption of indigenous cultural products assists in the enhancement of cultural identity. The basis of this idea is that there is some merit in the consumption of domestic programs. This raises all sorts of value judgements about who decides what TV programs give me the appropriate ‘good’ values.

Similarly, it may be that certain cultural products have the feature that consumption depends on experience. As such, it is claimed, that it may be appropriate to subsidise the initial consumption to encourage the formation of consumer tastes. Of course such claims can have a nanny state paternalism connotation that many would object to in a free society. This is clearly a very complex and controversial issue and one that goes beyond what I want to focus on today.

The validity of these arguments has received some credible support. For example, the Industries Assistance Commission, in its report on assistance to the performing arts
back in 1978 acknowledged the existence of sufficient external cultural benefits to justify continued government assistance.

The existence of the market failure is not in itself, sufficient reason for regulation. To justify the regulation it has to be shown that the regulation will, in the first instance, achieve the desired outcome, and second, that the cost does not outweigh the benefits from the regulation. In the cultural industries, it is very important to consider the methods used to achieve what may well be desirable social objectives. Further, even if intervention is justified, it may well be that there is need for analysis and debate as to the effectiveness and the efficiency and the competition consequences of the regime for intervention that has been put in place.

It is essential that the regulations imposed are the most efficient in delivering the desired outcome. Typically, more than one option is available to achieve a particular outcome. Each needs to be evaluated and it is the most efficient which should be chosen. The aim should be to ensure that regulation is kept to the minimum level necessary to achieve its objective, that it minimises the restrictions on competition and is well targeted so as to avoid the risk of unintended consequences. It is also important that the instrument chosen is transparent.

It is also essential to ensure that the level of assistance or protection that is provided will result in an optimal level of the desired outcome. Both over and under provision means a loss of welfare to society. So it is most important that care be taken when evaluating the extent of the assistance.

As a consequence, it is important that there be regular reviews of the regulation to test its ongoing effectiveness and relevance. As circumstances change over time, it should not be assumed that an assistance method used at one point in time remains the most efficient forever. This is particularly important in the evaluation of existing policies that may have been implemented in conditions significantly different to those prevailing currently.
2. Broadcast regulation

One area of considerable regulation is in the broadcasting industry. Traditionally broadcasting was radio based and relied entirely on advertising support. Some people have argued that these two features have provided the justification for much of the regulatory structure that has developed around the industry. Being radio based, broadcasting operated with a fixed and often limited amount of spectrum. It was un-encoded, given the high cost of encryption/decryption. Consequently it was not possible to exclude consumers from receiving the signal and therefore it could not charge consumers directly for the programs that were broadcast.

The consequences of this were that broadcasting had to develop its own revenue model. It had to be funded by advertising or by direct subsidies from the government or some combination of both. Given the limited number of available channels, it is not unreasonable to expect that the competition between this small number of competitors would not necessarily maximise consumer welfare. Putting it simply, if there are only a small number of broadcasters, they are likely to each try to maximise their advertising revenue by maximising audience. In a small market, this is likely to lead to broadcasters providing similar programming to cater to the mass market and offering similar programming at similar times.

These types of arguments have been used to support a significant amount of regulation of broadcasting such as licensing requirements, regulatory rules regarding content, and subsidies to certain types of broadcasters and certain types of broadcasting content.

This regulation may explicitly or implicitly restrict competition. Australia has explicitly limited the number of free-to-air broadcasters to a greater extent than justified by spectrum scarcity. A few years ago proposals for the ‘sixth channel’ which would have allowed the entry of another free-to-air commercial channel were dropped and more recently the moratorium on new free to air entry has been extended to December 2006. Australia also prevented the development of alternative business models such as subscription television until 1995, further limiting competition and consumer choice.
Such regulatory restrictions on competition in broadcasting have had a significant effect on the profitability of the incumbent broadcasters and the quality of the programs. Regulatory restrictions on the number of broadcasters typically lead to regulations on the quantity and location of advertising which can be shown. Thus in Australia, there are limits on the number of advertisements per hour and limits on the types of advertising that is allowed in certain time periods. This is an example of how regulation of one element, in this case, entry, leads to the need for further regulatory intervention.

The restrictions on new entry in free-to-air improves the profitability of the incumbents but comes with an obligation. The free-to-air commercial networks are required to show a certain proportion of Australian programming. This programming is typically more expensive than comparable foreign programming. The restrictions on competition by limiting entry supposedly provide the profits for the free-to-air networks to fund this expensive Australian programming.

One important issue I touched on previously is that the regulations must be efficient. That is their cost should not be greater than the benefits derived. One unfortunate element of the current system is that it is difficult to calculate the costs and benefits of the arrangement. The costs of the system are hidden in a maze of transfers, both internal and external. For example, there is the cost to consumers in terms of the reduced choice in programming because of the entry restrictions. In return they get more Australian programming than may otherwise be the case. But what of the effect on the free-to-air networks? They subsidise the Australian content requirements from their profits. Now given that much of this production is in house, it is extremely difficult to estimate whether the benefit derived from the protection from competition is equal to the amount that they transfer into local production. Given the prices at which television stations have sold in Australia, it is not unreasonable to suggest that there are very lucrative profits to be made in free-to-air broadcasting from the restrictions on entry.
So while it may be possible to argue that some form of regulation of programming on free-to-air television may be justified, the method by which the objectives of increased local content are being met, may not be the most efficient.

I might briefly comment on the nature of the content regulation on Australian TV. Commercial television stations are required to broadcast Australian programs for at least 55 per cent of the total transmission time between 6am and midnight, as well as comply with sub-quotas for the transmission of minium quantities of first release adult drama and documentaries. There are also quotas for the transmission of children’s programs generally as well as specific requirements for first release and repeat children’s drama.

Quotas are generally a very inefficient and distorting mechanism to provide protection. The effects of this regulatory regime are difficult to quantify. There is only one serious study that I am aware of that attempted to do this. Franco Papandreo of the University of Canberra in a seminal economics study conducted an extensive cost-benefit analysis of Australian content regulation in the mid 1990s. That study accepted the argument that domestic content regulation satisfied the necessary preconditions for intervention, namely the existence of market failure and some improvement in benefit to the society from the intervention.

However, it also found that the regulatory mechanisms used were not efficient. It found that the transmission quota contributed the least to the objectives of the regulation. The recent Productivity Commission Inquiry into Broadcasting reached similar conclusions indicating that it did not think that the transmission quota was meeting its social and cultural objectives.

One conclusion from these studies is that the achievement of a high amount of Australian content ie over 55 per cent in aggregate would have occurred anyway in an unregulated market, but it seems less likely that the drama and the children’s quotas would have been achieved.
3. Children’s programming

What about specific regulation of children’s programming? It would seem that the arguments that relate to market failure with regard to Australian programming in general apply even more for children’s programming (there is also a further argument that to a degree children’s TV can be seen in a broad sense as part of a nation’s education policy). It seems reasonable to assume that specific programs targeted to children, especially expensive to produce children’s drama, will not be produced in the absence of regulatory requirements. The potential audience is likely to be considerably smaller than that for prime time adult programming while the cost is unlikely to be much less. Restrictions on advertising also reduce the revenue earned by free-to-air networks from children’s programming.

The combination of minority audiences, advertising restrictions and relatively high cost make children’s programming commercially doubtful for the free-to-air broadcasters. Consequently it is no surprise that these broadcasters will try to minimise programming costs and this is likely to be reflected in the quality of the programs.

There has been general agreement in Australia that the needs of children with regard to television programming may have to be addressed by mechanisms other than relying on market forces. Over the past 20 years, surveys by the Australian Broadcasting Authority’s predecessor, the Australian Broadcasting Tribunal (ABT), showed a high degree of community support for additional expenditure on children’s programming.

The Papandreo study indicated that there was a high intensity of demand for children’s programming ie consumer surveys show that a substantial part of the population want there to be children’s programs on TV, and want this very strongly. The basis of the survey was to ask how much consumers would pay for different types of programs and children’s programs rated highly. However, the relatively limited market size, the restrictions on advertising and the availability of cheap overseas children’s programming would inevitably bias free-to-air networks away from the provision of Australian children’s programming.
It is interesting in this regard to speculate on the impact of subscription television on children’s programming. The high intensity of demand for children’s programming would be likely to make such programming an ideal business for subscription television. Indeed, surveys of pay TV viewing indicate that dedicated children’s channels rate very highly with pay TV households and may be a valuable subscription driver. It is probable that the demand for such programming and the willingness of households to pay directly for such programming will lead to an expansion of the market for children’s programming.

However, it cannot be assumed that such demand expansion will automatically spill over into increased demand for Australian children’s TV production as distinct from children’s programming from any and probably, the cheapest source. As noted earlier, the production of television programs has unusual characteristics. Given that almost all of the costs of production are incurred in making the first copy, average cost per copy declines continuously. As a consequence the cost of supplying copies of a program produced in one country to another country is extremely low. This means that the prices of overseas programming sold to Australian broadcasters will be very low. Australian broadcasters should be able to pick up foreign children’s programming very cheaply.

Of course, the same economics apply to Australian producers of children’s programming. There may be significant opportunities to sell children’s programming overseas. However, there are two elements which might limit this. First, the larger is the domestic market, the easier it is to cover production costs domestically and thus sell into overseas markets extremely cheaply. Australia may be disadvantaged vis-à-vis the larger English language markets in the US, UK and Canada which can afford larger production budgets and can more easily cover production costs from the domestic market.

Second, for producers in small markets such as Australia, export opportunities are most likely to be enhanced if the program adopts what might be called a more ‘international look’ rather than having a strong Australian focus. Unfortunately such
an approach would conflict with any objective of providing children’s programming that promoted and encouraged Australian cultural values.

That there are benefits from domestic children’s production seems to be generally accepted in Australia. These benefits relate particularly to the external benefits described earlier. These benefits may be considerably in excess of the production costs but either are difficult to quantify or impossible to be charged for by the producers of the programming. Children’s programs which educate as well as entertain produce a range of benefits to the society as well as the children who watch them.

Unfortunately, it may be that the regulatory regime introduced to achieve higher quality children’s programming may be misdirected and/or inefficient. Production quotas are likely to bias the programming towards quantity rather than quality. The free-to-air networks (where incentives in terms of quality may differ from those of the ABC) may have an incentive to minimise the production cost of such programming and maintain as much of the excess profits provided by the entry restrictions as they can. It may well be that a more efficient mechanism would be to encourage programming via subsidisation of the productions rather than a quota.

It may be that subsidies targeted to the production of quality children’s programs with desirable educational, cultural and entertainment qualities may be more efficient mechanisms.

The issue of the most efficient mechanism to produce the programming is also relevant in the context of in-house versus independent production. The system which allows the free-to-air networks to produce their local quota in-house may not be the most efficient. The free-to-air networks receive financial assistance to produce local programs via the prohibitions on new licences, which is a most non-transparent mechanism. Should they be inefficient in domestic production or should they engage in internal transfer pricing, artificially increasing the costs of in-house production to shift the profits from the broadcasting to the production arm, perhaps to give an inflated impression of the impact of the regulation on them there may be less children’s production of a given quality than otherwise.
The free-to-air networks have long claimed that the only way they can meet the content obligations imposed on them is to protect them from further competition. This argument has received a sympathetic hearing from governments and no new commercial networks have been allowed in Australia since 1965.

It is not necessarily the case that allowing new competition into free-to-air would mean the end of local content. New entry could be made conditional on meeting the domestic content requirements set by the government. If the Australian market is too small to support a larger number of broadcasters complying with the content requirements, then some will fail. But this happens in any other industry. If the market could support only three commercial networks it may be that the new entrants could meet the content requirements more efficiently than the incumbents. The current regulatory arrangements are contrary to effective competition policy and protect the existing networks at a considerable, and hidden, cost to the community in terms of reduced program choice and higher cost for advertisers.

It is entirely probable that the current regulatory arrangements for Australian content will come under considerable pressure over the next few years. Digital broadcasting, free-to-air multiplexing, an explosion of pay TV content, and other technological developments are likely to make the current regime need review. It may be that a new regime more effectively targeted to the need for quality children’s TV will have to emerge. It may have more discussions than current policy eg in a digital, multichannel world the establishment of separate channels devoted entirely to children’s TV.

4. Regulation and the CD market

I would like to briefly turn now to another regulatory issue in the cultural industries. The Government is about to introduce legislation that would allow the parallel import of intellectual property. The history of this goes back more than a decade.

The Copyright Act was amended in 1991 to relax the restrictions on the parallel importation of books. The amendments addressed the issue of availability but not
price. They allowed Australian publishers and distributors to retain exclusive import rights, and hence territorial copyright, subject to maintaining reasonable availability..

It would seem that the 1991 reforms have improved the availability of books but the impact on price is less clear.

In early 1999 the ACCC was asked to report on the potential consumer benefits of repealing the importation provisions as they apply to books and computer software. That report found that Australian consumers had consistently paid more for books and computer software over the past decade or so than overseas consumers. The ACCC has long held the view that the importation provisions of the Copyright Act contributed to these price differences by allowing copyright holders to price discriminate to the detriment of Australian consumers.

Allowing competition from parallel imports should lead to more competitive pricing and better choice of product for consumers. The example of the sound recordings market supports this view.

In 1998 reforms were introduced which allowed the parallel importing of sound recordings. There is evidence that that the repeal of the importation provisions has given some competitive impetus to the industry. Non specialist retail outlets have now become significant suppliers of top 40 CDs which account for the majority of CD sales. Recent ACCC surveys show that the average price of best selling CDs from non-specialist music stores is around $23, or 18% below the average of the specialist stores.

It is likely that further downward price pressure will be occur as a result of the win by the ACCC in taking action against two major international sound recording companies. Polygram (subsequently taken over by Universal) and Warner Music Australia took action to prevent retailers from stocking parallel imports. They had threatened to withdraw significant trading benefits from retailers who stocked parallel imports and in some instances had cut off, or threatened to cut off, supply to retailers who stocked parallel imports. A few weeks ago the Federal Court imposed fines in excess of $1 million on the two companies.
It is likely that there is the potential for further price falls. The current weakness of the $A has limited the countries from which cheaper imports are available. Nevertheless, the ACCC estimates that as a result of the removal of the ban on parallel imports, average CD prices in Australia are as much as $8 less than they might otherwise have been given the depreciation of the $A and general inflation. Competition flowing from the reforms has helped to prevent prices rising as much as they might have. Certainly prices have not increased in nominal terms in recent years after many years of regular annual price increases.

There had been claims by the opponents of parallel import reform that such action would destroy the domestic sound recording industry and that the major international sound recordings companies operating in Australia would reduce their investment in Australian artists. There is no evidence that this has happened. In any case the reforms were balanced by extra targeted assistance to the industry.

There has been increased international debate about the effects of the bans on parallel imports in recent years. While it is acknowledged that there is market failure associated with the production of many goods incorporating intellectual property, copyright protection is the mechanism to deal with the problem. However, there is no justification for extending copyright controls into distribution, as the bans on parallel imports attempts to do.

It is likely that the debate about parallel imports will extend considerably beyond sound recordings. Many economists have formed the view that the import provisions are a sign that intellectual property laws may have been captured to operate unduly for the benefit of producer interests at the expense of consumer interests. Freer trade in goods incorporating intellectual property elements is desirable. Just as it is in the interests of Australian film and television producers here today to be able to freely export their product globally, it is in the interests of Australian consumers to be able to access intellectual property at competitive prices.

The ACCC’s continued view has been that parallel import restrictions are the worst way to protect local culture. The main beneficiaries are multinationals. Consumers
pay very highly for at best a small trickle down to Australian performers and writers. If they need help, direct subsidies should be given. We have recommended various forms of this.

Also, producers see the debate from their side only. In fact, unnecessarily high prices are detrimental to culture because they restrict access to it.

5. **Conclusion**

In conclusion, let me assure you here today that there is no inherent conflict between competition policy and legitimate cultural assistance. The application of competition policy to broadcasting will not destroy social and cultural objectives. In circumstances such as with children’s programs where assistance is appropriate, it is the task of competition policy to ensure that the most efficient regulatory instruments are used. It is essential to ensure that the regulatory regime is not captured by particular interest groups for their own personal benefit and that it is efficient and non distorting as possible.

I am sure that the Australian film and television production industry will expand and thrive in such an environment

Thank you