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THE ECONOMICS OF BROADCASTING AND ADVERTISING

THE ECONOMICS OF BROADCASTING AND GOVERNMENT POLICY

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The broadcasting industry, with its various methods of finance, its intricate organization and its close, and peculiar, relations with the government offers a rich field for study by the economist. But I will not dwell on those aspects of the industry which would mainly be of interest to students of industrial organization. I wish to consider a more general question. I want to examine the part the economics of broadcasting has played in the formulation of government policy and to consider what conclusions we should draw from this in making our own policy recommendations and in the conduct of our researches.

We must first note that economic factors are taken into account in a world in which ignorance, prejudice, and mental confusion, encouraged rather than dispelled by the political organization, exert a strong influence on policy making. I will illustrate this by a quotation from the Canadian Royal Commission on Broadcasting of 1957 (the Fowler Commission). The Commission was discussing the proposal to finance the broadcasting service by means of an annual license fee for set-owners. This is what they said:

This certainly seems a logical way for a group of people to make a joint purchase of a service they want. It is not strictly equitable as presumably a flat fee would be charged and all licencees would not make the same use of the service; but it seems much more equitable than the ear-marking of a particular tax paid both by those with radio and television sets and by those who hope never to have one in the house. The yield from the licence fee is reasonably predictable and the support required or desired to be given can easily be adjusted upwards or downwards, by changing the amount of the individual licence fee.

But the Commission concluded:

The flaw in this approach to the problem is that virtually nobody favours it, and many people feel quite strongly in their opposition. The arguments against it range from the inefficiency and excessive cost of collection, through the likelihood of evasion and difficulty of enforcement, to the simple claim that a licence fee is a nuisance tax and generally unpopular.

Thus we see that a method of finance which was considered "logical," "more equitable" than the alternatives, which could be "easily adjusted" to meet the changing requirements of the service was politically impossible because it would be "generally unpopular."¹ The

¹ See the *Report of the Royal Commission on Broadcasting* (1957), pp. 274-75.

main reason for this unpopularity, heightened in Canada, as always, by describing the hardship a license fee would impose on the old-age pensioner, is an objection to paying for anything. This is, of course, bad economics. It is our duty to point this out, but at the same time we can hardly ignore, in deciding whether or not to advocate particular government policies, the extent to which political considerations will prevent the execution of those policies in a manner which is economically efficient. In Britain the BBC is financed by the proceeds of a license fee, but the BBC has not usually been allowed by the Treasury to receive the total proceeds, while the level of the fee has not always been as high as officials of the BBC desired. If the withholding of part of the license fee and the reluctance to raise it were due to political considerations unconnected with the needs of the service and if most licensees would have been willing to pay a higher fee to secure the additional service that this could have made possible, a reason for the introduction of commercial television is provided which would have been absent if one assumed that the license fee was fixed at an "optimum" level, however that may be defined.

Of course we may hope that, over time, the influence of the economics profession will be such as to make it more difficult to gain political advantage by the propagation of bad economics. But there are other features of the system which I think we must regard as permanent. The first is that the businessmen in the broadcasting industry will try to make as much money as possible. I know that there are some economists who would argue that businessmen merely seek a reasonable return on their capital. But consider the facts. We know from recent figures that the profits of television stations in the first fifty TV markets represented, on an average, 36 percent of gross revenue and that the rate of return on capital for some stations was 200 or 300 percent per annum (after taxes). One wonders what an unreasonable rate of return would be. I personally believe that the only reason the rate is not 500 percent per annum (after taxes) is that the businessmen have not yet discovered how to achieve this. If one reads the trade press about changes in programming, it is apparent that the aim is almost invariably to gain audience (which facilitates the sale of time) and that the adjustments in rates which occur are designed to increase the receipts of the stations. I do not wish to moralize. As has been said, a man is seldom more innocently employed than when he is making money.

So much for the first permanent feature. The second is that we cannot expect a regulatory commission to act in the public interest, particularly if we have regard to its actions over the long period. I am not primarily thinking of the fact that commissions in the United States tend to be responsive to the wishes of Congress or committees of Con-

gress or that, appointed and reappointed by the executive, their views are liable to be in tune with those who have political power. What I have in mind is a feature which, with the best will in the world, it seems to me very difficult to eliminate. However fluid an organization may be in its beginning, it must inevitably adopt certain policies and organizational forms which condition its thinking and limit the range of its policies. Within limits, the regulatory commission may search for what is in the public interest, but it is not likely to find acceptable any solutions which imply fundamental changes in its settled policies. The observation that a regulatory commission tends to be captured by the industry it regulates is I think a reflection of this, rather than, in general, the result of sinister influences. It is difficult to operate closely with an industry without coming to look at its problems in industry terms. The result is that the commission, although thinking of itself as apart from and with different aims from the industry, will nonetheless be incapable of conceiving of or bringing about any radical changes in industry practices or structure. In fact, the regulation of the broadcasting industry by the Federal Communications Commission resembles a professional wrestling match. The grunts and groans resound through the land, but no permanent injury seems to result.

It is of course wholly proper that public discussion of broadcasting policy should have centered on programming, since public policy must be appraised by considering its effects on the programs. But the discussion, particularly in Britain but also in the United States, has taken on a somewhat peculiar character and has tended to confuse rather than clarify the basic issues. Perhaps the best example is to be found in the Pilkington Report of 1962.

The report examines the question of whether it is desirable "to give the public what it wants." It states that at first sight this aim seems to be "unexceptionable" but adds that, "when applied to broadcasting it is difficult to analyse." The reason is that not everyone wants the same things. It is somewhat surprising that the Committee should have thought this peculiar to broadcasting. Had they realized that this was a general problem that every economic system has to solve in dealing with every product or service and that, in most Western countries, it is solved with the aid of a pricing system, I think the Committee would have been led to a more useful discussion of the question. I would not wish to imply that we fully understand the logic of a pricing system or that special institutional arrangements are not necessary for its tolerable performance. But an understanding of the pricing system does lay bare the nature of the problem. As it is, what follows in the report is a discussion of an economic problem without benefit of economics.

I can give you the flavor of the argument by quoting some passages,

the character of which will not be altogether unfamiliar to those of you who know only the American literature:

No one can say he is giving the public what it wants, unless the public knows the whole range of possibilities which television can offer and, from this range, chooses what it wants to see. For a choice is only free if the field of choice is not unnecessarily restricted. The subject matter of television is to be found in the whole scope and variety of human awareness and experience. If viewers—the public—are thought of as “the mass audience,” or “the majority,” they will be offered only the average of common experience and awareness; the “ordinary”; the commonplace—for what all know and do is, by definition, commonplace. They will be kept unaware of what lies beyond the average of experience; their field of choice will be limited. In time they may come to like only what they know. But it will always be true that, had they been offered a wider range from which to choose, they might and often would have chosen otherwise, and with greater enjoyment . . . “[T]o give the public what it wants” is a misleading phrase: misleading because as commonly used it has the appearance of an appeal to democratic principle but the appearance is deceptive. It is in fact patronising and arrogant, in that it claims to know what the public is, but defines it as no more than the mass audience; and in that it claims to know what it wants, but limits its choice to the average of experience. In this sense we reject it utterly. If there is a sense in which it should be used, it is this: what the public wants and what it has the right to get is the freedom to choose from the widest possible range of programme matter. Anything less than that is deprivation. . . .

It is I think apparent that these passages, full of sound and fury, do not give us any criteria by which to decide whether any particular program should be transmitted. It is easy to talk about “the widest possible range of programme matter” but there is surely some point at which, as more and more resources are devoted to increasing the supply of programs, the gain from additional broadcast programs is of less value than the loss in output elsewhere. And if the resources devoted to broadcasting are limited in this way, it follows that the provision of programs which are liked by one group will have deprived some other group of programs that they would have liked. According to what principles is it to be decided which demands are to be satisfied? The Committee never tells us this. But later they tell us how this problem should be solved. I will quote another passage:

The broadcasting authorities have certainly a duty to keep sensitively aware of the public's tastes and attitudes as they now are and in all their variety; and to care about them. But if they do more than that, this is not to give the public “what someone thinks is good for it.” It is to respect the public's right to choose from the widest possible range of subject matter and so to enlarge worthwhile experience.

Up to now we have heard of respect for the public's right to choose and of need for the widest possible choice. It is at this point that the trap closes. They continue:

Because, in principle, the possible range of subject matter is inexhaustible, all of it can never be presented, nor can the public know what the range is. So, the broadcaster must explore it, and choose from it first. This might be called “giving a lead”: but it is not the lead of the autocratic or arrogant. It is the proper exercise of responsibility by public authorities duly constituted as trustees for the public interest.

Thus the committee avoids the question of how it should be decided which programs to transmit and for the phrase “what the public wants,” they substitute another and better, “what the public authority

wants." What the public authority should want, how it would get the information which would enable it to do what it should, and how in practice it would be likely to act are questions which all disappear in a cloud of pious platitudes.²

In the United States it is improbable that many would seriously suggest that a public authority such as the Federal Communications Commission should be given the power to determine in detail what programs should be broadcast, and while sentiments similar to those found in the Pilkington Report will no doubt continue to be expressed in the United States, there is no likelihood that they will lead to the establishment of a broadcasting system operated by some organ of the government (leaving aside the question of whether this would be held constitutional by the Supreme Court). The broadcasting system in the United States is likely to continue as a decentralized system, operated in the main by private enterprise. What programs will be broadcast will therefore be determined by the economics of the industry. Put shortly, the programs that will be broadcast will be those that it is most profitable to broadcast. I would not wish to argue that all the businessmen consider is money. A television station operator earning 200 percent per annum (after taxes), if he had been grasping and less aware of the finer things, might no doubt have earned 210 percent per annum. I do not doubt that some programs will be broadcast which reduce the profits of the station, but I am quite certain that the broad pattern of programming will be determined by profitability. My view is that we should not bewail the fact that businessmen maximize profits. We should accept it and use it. The task which faces us (and the task of good government policy) is to devise institutional arrangements which will lead the businessman, as it were by an invisible hand, to do what is desirable (by making it profitable for him to do so).

I would emphasize that belief in the invisible hand does not imply that the government has no part to play in the economic system. Quite the contrary. If it is in general true that men, following their own self-interest, act in a way that is of benefit to society, it is, to quote Edwin Cannan, "because human institutions are arranged so as to compel self-interest to work in directions in which it will be beneficent."³ Our task as economists is to help in the devising and improving of those institutions. In doing this, we should not ignore the noble side of human nature when this can be brought into play. But we should never forget the words of Alfred Marshall to which Robertson has drawn our attention: "progress chiefly depends on the extent to which the *strongest*

²These quotations will be found in the *Report of the Committee on Broadcasting*, 1960 (Cmd. 1753, June, 1962), pp. 16-18.

³See the *Econ. Rev.*, July, 1913, p. 333.

and not merely the *highest* forces of human nature can be utilized for the increase of social good."⁴

I think we should ponder these words of Cannan and Marshall when we contemplate the institutional framework within which the broadcasting industry operates in the United States. It is obviously incredibly bad. But how should it be improved? The allocation of the major resource used in the industry, the radio frequency spectrum, is carried out by a method which is inefficient, inequitable, and inflexible. I have explained my grounds for holding this view on other occasions and there is no need for me to spend much time going over them now, particularly as there is really no dispute about the correctness of my position. If I may quote Dr. Goldin when he was with the FCC, but giving, I need hardly say, his personal views, the present procedure for choosing among competing applicants for the radio frequency spectrum is "ritualistic, formalistic, wasteful and inefficient."⁵ I have proposed that radio frequencies should be disposed of to the highest bidder because it would avoid the costs of the present procedure, would tend to allocate these frequencies to those who could use them most efficiently, would prevent the unjustifiable enrichment of those (commonly wealthy) private individuals who obtain these grants from the FCC, and would facilitate changes in the use of radio frequencies when this seemed to be called for.

I would not argue that there should be no government regulation of the broadcasting industry. But such regulation is not inconsistent with use of the pricing system. There is no industry which is not in some way regulated. What is extraordinary if we contemplate the allocation of the radio frequency spectrum is that it makes no use at all of the pricing system. Of course there would be difficulties in introducing a pricing scheme. Dr. Goldin has said that "after the initial shock of rationally considering the use of the pricing mechanism in frequency allocations, the virtually unanimous view of communications specialists" would be that these practical difficulties were too great and he adds that until I, or a friendly ally, make a study of how such a system would actually operate, my suggestion will not get into "the mainstream."⁶ I think that this is right. The FCC is rather like a whale stranded on the seashore, waiting while the local inhabitants, ignorant of whale anatomy, try to show it the direction in which it should swim. If we are to get sensible government policy in this area, it will, I am afraid, have to come from the work of economists outside the government service (and, for that matter, outside the industry).

⁴ See A. C. Pigou, ed., *Memorials of Alfred Marshall*, p. 310.

⁵ *Land Econ.*, May, 1965, p. 168.

⁶ *Ibid.*

The position is the same if we think of another fundamental question: the finance of the industry. With commercial broadcasting, the person who pays for the broadcast of a program is the advertiser. It follows that the programs broadcast are those which maximize the profits to be derived from advertising. The market for broadcast programs is one from which the consumer is barred: what he would pay plays no part in the determination of programs. The result is that some sectors of the public feel that they are not being catered for. The FCC is uneasily aware that all is not well. And so it has exhorted the businessmen to act in the public interest and, incidentally, against their own. It seems clear that in this case the highest motive was not the strongest.

The obvious way of dealing with this problem is to introduce some form of pay-television. If this were done, consumers who were willing to pay more for resources used in the broadcasting industry than were the advertisers could secure the kind of programs they wanted. This proposal has been strongly opposed by the broadcasting industry. This opposition comes, as Dr. Frank Stanton of CBS has told us, not because the industry has any "economic axe to grind," but because it would not be in the best interests of the public.⁷ It is I think a universal rule that businessmen never act from higher motives than when they are engaged in restricting potential competition. Of course, the opposition has been successful. Proposals for pay-television were first made in the late 1940's, but in spite of determined attempts to secure the approval of the Federal Communications Commission, all that has been granted is authorization for experimental pay-television services operating under restrictive conditions which make it impossible for pay-television to realize its potentialities. So far only one such service has been started, that in Hartford, Connecticut. I do not know what the future will be. But there are no signs that the Federal Communications Commission intends to change its policy of support for the commercial broadcasting system.

What should be done? The task of charting a sensible future for the broadcasting industry is not one which can be left to the industry, which has its own interests to protect. It cannot be left to the Federal Communications Commission, which cannot conceive of any future which is not essentially a repetition of the past. Who, therefore, is to perform this task? I suggest that it has to be assumed by academic economists. You may recall what Adam Smith said about university education: "The parts of education which are commonly taught in universities, it may, perhaps, be said are not very well taught. But had it not been for those institutions, they would not have been com-

⁷ CBS Statement on Pay-Television by Dr. Frank Stanton, President of Columbia Broadcasting System, May 19, 1955.

monly taught at all; and both the individual and the public would have suffered a good deal from the want of those important parts of education.”⁸ The position seems to me similar in the present case. I would not argue that academic economists are technically the best qualified to investigate what government policy should be towards the broadcasting industry. But unless they do it, no one else will.

⁸ Adam Smith, *Wealth of Nations* (Modern Library edition), p. 721.