Cultural protection and competition policy—children's television

Following is an edited version of a presentation given by Commission Chairman, Professor Allan Fels, to the Australian Children's Television Foundation's 20th Anniversary Symposium in Melbourne on 20 March 2002.

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 you, 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.

Regulatory intervention

In discussing regulatory intervention—which is often called cultural protection—I first want to acknowledge the major contribution from Commissioner Ross Jones to the preparation of these remarks.

Then, having just endorsed program quotas, to go on to say that regulation is generally a second-best option. And that if there is to be regulation two standard preconditions should be satisfied.

Inability to provide enough products especially cultural ones

This is 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 for 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 example. It may also justify subsidising the production of some types of cultural products.

Merit of goods or services go beyond market demand

Another concept in economics is that of merit goods, that is goods whose supply may not be justified by consumer demand, even the imaginary demand if consumers could vote for its supply by paying a price. Such goods nevertheless have merit that goes 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, for example, the provision of education is not fully explained by market ideology.

Culture an elusive concept

We all have different views about what is culture, and these views reflect our 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. 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 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 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 enhances cultural identity and 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 the appropriate 'good' values.

Similarly, it may be that for some cultural products consumption depends on experience. So, it is claimed that it may be appropriate to subsidise the initial consumption to encourage the formation of consumer tastes. Such claims can have a nanny-state-paternalism connotation that many would object to in a free society. This is clearly complex and controversial and goes beyond what I want to focus on today.

Support from the Industries Assistance Commission

The Industries Assistance Commission, in its report on assistance to the performing arts in 1978 acknowledged there were sufficient external cultural benefits to justify continued government assistance.

Market failure is not in itself sufficient reason for regulation. It has to be shown that the regulation will achieve the desired outcome at a cost that does not outweigh the benefits from the regulation. In the cultural industries, methods used to achieve what may well be desirable social objectives must be considered. Even if intervention is justified, it may be that the effectiveness, efficiency and competition consequences of the intervention need to be debated.

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 that should be chosen. The aim should be to ensure that regulation is kept to the minimum level needed 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.

So it is important that a regulation be reviewed regularly to make sure it is still effective and relevant. As circumstances change it should not be assumed that an assistance method remains the most efficient. This is particularly important when evaluating policies that may have been implemented in conditions that have changed significantly.

Broadcast regulation

An example of considerable regulation is found in the broadcasting industry. Traditionally, broadcasting was radio based and supported entirely by advertising. 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 seems likely that such competition might not maximise consumer welfare.

Putting it simply, if there are only a few broadcasters, each is likely to try to maximise its advertising revenue by maximising its 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.

Such arguments have been used to support a significant amount of regulation of broadcasting such as licensing requirements, regulatory rules for content, and subsidies to some types of broadcasters and 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 alternative business models such as subscription television from developing until 1995, further limiting competition and consumer choice.

Such regulatory restrictions on competition in broadcasting have significantly affected profitability of the incumbent broadcasters and program quality. Regulatory restrictions on the number of broadcasters typically lead to regulations on the quantity and location of advertising that can be shown. Thus in Australia, advertisements per hour and types of advertising allowed at defined times are limited. 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 must show a specified proportion of Australian programming. This 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 of the reduced choice in programming because of the entry restrictions. In return they get more Australian programming. But what of the effect on the free-to-air networks? They subsidise the Australian content requirements from their profits. 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 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.

Nature of TV content regulation in Australia

Commercial television stations must broadcast Australian programs for at least 55 per cent of the total transmission time between 6 a.m. and midnight, as well as comply with sub-quotas for the transmission of minimum quantities of first release adult drama and documentaries. There are also quotas for the transmission of children's programs as well as specific requirements for first release and repeat children's drama.

Imposition of quotas is generally an inefficient and distorting way to provide protection. The effects of this regulatory regime are difficult to quantify. The only serious study that attempted to do this appears to be that by Franco Papandreo of the University of Canberra who, 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 inefficient and that the transmission quota contributed the least to the aims of the regulation. The recent Productivity Commission inquiry into broadcasting reached similar conclusions indicating it did not think the transmission quota was meeting its social and cultural objectives.

One conclusion from these studies is that much Australian content, that is, more than 55 per cent in aggregate, would have occurred anyway in an unregulated market. But it seems less likely that drama and children's quotas would have been achieved.

Children's programming

It would seem that the arguments that relate to market failure for Australian programming in general apply even more for children's programming (there is also a further argument that some 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 at children, especially expensive drama productions, 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 television needs of children 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 the community strongly supports additional expenditure on children's programming.

The Papandreo study indicated that there was a high intensity of demand for children's programming, that is, consumer surveys show that a substantial part of the population want children's programs on TV, and want this strongly.

In essence, the survey asked how much consumers would pay for different types of programs and children's programs rated highly. However, the relatively limited market size, restrictions on advertising and 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 to speculate on the effect of subscription television on children's programming. The high demand for children's programming would be likely to make such programming an ideal business for subscription television. And surveys of pay TV viewing do 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 it will lead to the market for children's programming expanding.

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 is extremely low. This means that the prices of overseas programming sold to Australian broadcasters will be low.

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 that might limit this.

First, the larger the domestic market, the easier it is to cover production costs domestically and thus sell into overseas markets cheaply. Australia may be disadvantaged in 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 the aim 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 much higher than the production costs but are difficult to quantify, or impossible to be charged for, by the program producers. Children's programs that educate as well as entertain benefit 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 (for which 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. A more efficient mechanism might be to encourage programming by subsidising productions rather than having a quota.

It may be that subsidies targeting the production of quality children's programs with desirable educational, cultural and entertainment qualities may be more efficient.

In-house versus independent production

The issue of how programming can be produced most efficiently is also relevant to debate on in-house versus independent production. The system that 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 help to produce local programs via the prohibitions on new licences, which is a most non-transparent mechanism. They might be inefficient in domestic production. Or they might engage in internal transfer pricing, artificially increasing the costs of in-house production to shift the profits from the broadcasting to the production arm, and giving an inflated impression of the impact of the regulation on them. This could all result in fewer children's programs of a given quality.

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 with 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 mean that the current regime needs reviewing. It may be that a new regime more effectively targeted to the need for quality children's TV will have to emerge. It may expand on current policy, for example, in a digital, multichannel world by establishing separate channels devoted entirely to children's TV.

Regulation and the CD market

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 Commission 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 Commission 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 that allowed the parallel importing of sound recordings. There is evidence 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 Commission surveys show that the average price of best-selling CDs from non-specialist music stores is around $23, or 18 per cent below the average of the specialist stores.

It is likely that further downward price pressure will occur as a result of the win by the Commission 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 of more than $1 million on the two companies.

Prices may fall further. The current weakness of the $A has limited the countries from which cheaper imports are available.

Nevertheless, the Commission 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 best way to deal with the problem. However, there is no justification for extending copyright controls into distribution, as the bans on parallel imports attempt 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 Commission's continued view has been that parallel import restrictions are the worst way to protect local culture. The main beneficiaries are multinationals. Consumers pay 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.

Conclusion

Let me assure you 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. For example, with children's programs for which 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 as 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.

Competition and efficiency in health care delivery: the role of the ACCC

The following is a summary of the official opening address by Commissioner Sitesh Bhojani to the 12th Annual National Health Summit 2002, Sydney, on 25 March 2002.

Three objectives of health policy have been identified by Dr Richard Scotton, Health Economist, as equity, better health and efficiency.[1]

In examining the implications of the three objectives of health policy Dr Scotton starts with the 'central proposition' that the equity objective is, and always has been, the primary rationale for government funding of the health care system. Either the government stays in the 'cross-subsidisation business' in a very big way, or the access of the less healthy and the poor to health services will be 'seriously curtailed'.

1 See *Managed competition: the policy context* by Dr Richard Scotton, Melbourne Institute Working Paper no. 15/99, June 1999, pp. 2–5, 8.