PROTECTING INEFFICIENT PRODUCERS HARMS CONSUMERS:

PRELIMINARY COMMENTS ON IFTA'S PROPOSAL AND DR. MARK COOPER'S SUPPORTING PAPER

by

Bruce M. Owen*

When sellers face more efficient competitors, there is always a temptation to call on the power of government to restrict or restrain the competition. Few groups of sellers seeking protection from competition have been as persistent, in the face of repeated rejection, as "independent" Hollywood entertainment producers. They and others purporting to represent their interests were largely responsible for promoting the now discredited Financial Interest and Syndication ("finsyn") Rules.[1] Those rules (and the similarly-spirited Prime Time Access Rule) restricted broadcast network vertical integration into ownership rights to prime time entertainment series. The old rules were adopted by the Commission early in the 1970s and finally repealed in the mid-1990s. The chief policy rationale for their adoption was that the rules would promote source diversity, and the chief policy rationale for repeal was that the rules had no demonstrated relationship to source diversity.

> [The FCC] never drew the link between the rules, which on their face impede the production of television programs--not only by constraining negotiations between networks and outside producers but also by reducing the networks' incentive to produce by limiting the extent to which a network can exhibit its own programs in prime time--and the interest in diverse programming. The Commission may have thought the link obvious, but it is not. The rules appear to handicap the networks and by handicapping them to retard new entry into production; how all this promotes programming diversity is mysterious, and was left unexplained in the Commission's opinion. SCHURZ COMMUNICATIONS, INC. V. F.C.C. 982 F.2d 1043 (7th Cir. 1992) at 1055.

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* Morris M. Doyle Centennial Professor in Public Policy and Director, Public Policy Program, Stanford University; Gordon Cain Senior Fellow, Stanford Institute for Economic Policy Research; Professor, by courtesy, of Economics, Stanford University; Special Consultant, Economists Incorporated. Nothing in this document purports to represent the views of Stanford University.

[1] 47 C.F.R. § 73.6586) (1990); see *Network Television Broadcasting,* 23 F.C.C.2d 382, 387 (1970) aff'd sub nom. *Mt. Mansfield Television, Inc. FCC* 442 F.2d 470 (2d Cir. 1971).

Remarkably, the same discredited arguments and objectives are being trotted out again. A group styling itself The Independent Film & Television Alliance (IFTA) has asked the Commission to set aside a quota of entertainment content, which "independent" producers would have the exclusive right to supply to the broadcast networks.[2] A similar proposal was made and rejected in the 2002 proceeding.[3] The logic is that if the networks are restricted in producing their own content they will be forced to buy from the independents, or to buy at higher prices. True enough. The economic benefit to independent producers from such an arrangement is obvious. But is there benefit for anyone else? In particular, are there benefits for the consumers presumably represented by the Consumer Federation of America?

To address the benefits from restricting competition, the IFTA has attached this time a 75-page paper by Mark Cooper, research director of the Consumers Federation of America.[4] Dr. Cooper concludes that restricting competition in the manner proposed by IFTA will increase "source diversity." Given "dramatic changes in the television market,"[5] this claim makes even less sense now than it did in the 1970 rules struck down by the Seventh Circuit in 1992.

While Dr. Cooper does not himself define source diversity, the Commission went to some trouble to lay out clear definitions and evaluations of the various definitions of diversity in its 2003 *Order*:

> 42. "Source diversity" refers to the availability of media content from a variety of content producers. The *Notice* explained that source diversity can contribute to our "retail" goals of viewpoint diversity and program diversity. Past Commission

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[2] "IFTA defines 'independent' producers and distributors as those companies and individuals apart from the major studios that assume the majority (more than 50%) of the financial risk for production of a film or television program and control its exploitation in the majority of the world." IFTA Comments at n. 1. "IFTA's membership includes such well-known independent film companies as LIONSGATE, The Weinstein Company, and Lakeshore International." Id at 2.

[3] *Report and Order and Notice of Proposed Rulemaking*, 18 F.C.C.R. 13,620 (2003) at ¶ 43.

[4] "The Impact of the Vertically Integrated, Television-Movie Studio Oligopoly on Source Diversity and Independent Production."

[5] *Report and Order and Notice of Proposed Rulemaking*, 18 F.C.C.R. 13,620 (2003) at ¶ 44.

> efforts to regulate source diversity centered on broadcast television. The Prime Time Access Rule (PTAR) and the Financial Interest and Syndication (Fin-Syn) rules limited vertical integration between program producers and broadcast television networks. The Commission eliminated those regulations when it could not justify them in light of media marketplace changes.

And the Commission concluded that there was no need to use ownership regulation to increase source diversity:

> 43. The record before us does not support a conclusion that source diversity should be an objective of our broadcast ownership policies. …
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> 44. When prime time television viewing was dominated by three broadcast networks, the Commission elected to require broadcast networks to purchase prime time programming from unaffiliated producers in order to encourage diversity on television. In light of dramatic changes in the television market, including the significant increase in the number of channels available to most households today, we find no basis in the record to conclude that government regulation is necessary to promote source diversity.
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> 45. …. Given the explosion of programming channels now available in the vast majority of homes today, and in the absence of evidence to the contrary, we cannot conclude that source diversity should be a policy goal of our broadcast ownership rules.

The September 2006 *Further Notice* initiating this proceeding does not mention source diversity. It is very difficult to understand why Dr. Cooper thinks the Commission, or anyone else, should now endorse government regulation to increase source diversity.

Dr. Cooper also forays into economics, alleging evidence of network economic power and concentration in the entertainment services he considers, and quoting lengthy passages from dated economics texts which warn of the possible dangers from vertical integration. Little of this makes sense. However Dr. Cooper may conceive or measure economic power or media concentration, he can hardly claim credibly that it is greater now than it was in the past. Yet it was in the past, before new media competition had reduced horizontal concentration in national video distribution, that regulatory restrictions on broadcast network vertical integration were rejected. The finsyn rules were denounced by academic experts from the outset (Crandall 1971), by the Commission's staff in the late 1970s (Network Inquiry Special Staff), by the Commission itself as early as the 1980s (until political intervention by President Reagan forced a temporary about face[6]), by the Seventh Circuit in 1992, and finally and definitively by the Commission more than a decade ago.

Ultimately, Dr. Cooper seeks to reinitiate the vertical integration debate as if nothing had happened since the time of the 1970 rules. But the framework against which the need for any rules must be judged has not remained stagnant. The Commission has long had a coherent and rational set of tools for addressing economic policy issues, including related diversity concerns.[7] The major lesson these tools offer for ownership policy is that *horizontal* concentration, not vertical integration, must be the focus of any debate on ownership restrictions. Horizontal concentration is measured in a relevant market that makes sense from the point of view of customers (viewers and advertisers). It is inconceivable that concentration today, measured reasonably, could be anything but much less than in the years of fin/syn quotas.

More important, much of communication policy has been turned upside down since the 1960s. In those years suppression of competition was a common FCC policy. Competition with "the" telephone company was heretical. Cable television was not free to compete until the 1970s. Domestic communications satellites had not yet been freed to fly, and the first direct broadcast satellites lay twenty years in the future. ABC was then recently and barely an effective competitor to CBS and NBC. The World Wide Web and broadband to the home were unknown. Despite the "dramatic changes in the television market," Dr. Cooper would apply the same policies to network programming production as those favored by the 1960s FCC Office of Network Study.

The history of economic and antitrust analysis of broadcast network integration into program production, which is a matter of (voluminous) record beginning in the 1930s, is, overall, one of progress; progress in freeing the forces of market competition to serve

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[6] Matthew McAllister, "The Financial Interest and Syndication Rules," http://www.museum.tv/archives/etv/F/htmlF/financialint/financialint.htm (Museum of Broadcast Communications), (visited 12/10/2006).

[7] Network Inquiry Special Staff, *New Television Networks: Entry, Jurisdiction, Ownership and Regulation, Final Report*, (October 1980).

consumers, and progress in understanding sound economic analysis. I attach a list of some of the major post-1970 analytical critiques of Commission regulations restricting network vertical integration, rather than repeat all this history.

Entertainment distributors, whether at the local or national level, and whether they deal directly or indirectly with the viewer, must compete to attract audiences to sell to advertisers and/or for subscriber revenues. Video distributors compete not only with each other, but also with the many media by which consumers obtain information and entertainment and advertisers acquire access to audiences. Key to success and even to survival in this competition is the ability to identify programming (or more generally "content") that will be attractive to audiences. Equally important is the ability to acquire such programming at the lowest possible cost.

Whether to make or to buy content is a central problem faced by managers in nearly all businesses. Indeed, the make-or-buy decision is central to the very concept of a business firm. Its analysis has a long history in economics, dating at least to Adam Smith. In modern times, the issue is commonly framed in terms of the relative efficacy of a hierarchical organization versus contractual market exchanges in creating worker and supplier incentives compatible with the objectives of the enterprise.[8]

As horizontal media concentration continues to decrease, and competition for audiences and advertisers to increase, it is not surprising that increased vertical integration would be among the strategies considered and used by broadcast networks competing for survival. Whether this is so or not requires a far more sophisticated analysis than Dr. Cooper has put on offer.

A decade ago the completely discredited fin/syn quotas were finally repealed. The framing of the present revival of the issue most useful to the Commission's work is to ask whether there is any more reason to suspect a market failure with respect to the broadcast networks' choice of business organization now than there was decade ago. What has

[8] The classic works are Coase, "The Nature of the Firm," ECONOMICA, 4(n.s.), 1937, 386-405 and Williamson, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS. 1975.

chiefly changed in the interim is that the market has become less concentrated. Viewers and advertisers have more choices, not fewer, and the shares of the broadcast networks have declined, not increased.

This reality leaves the Commission with no sound basis to insert itself into the business decisions of individual distributors, at the risk of raising costs and prices in the market, when neither horizontal concentration nor diversity concerns remotely raise issues requiring such a risk. Making broadcasters and like media less efficient will only hasten the replacement of traditional content with new media content. Reduced economic efficiency, coming at the ultimate expense of consumers, is too high a price to pay, simply to benefit members of IFTA.

Attachment

Partial Listing of Analyses Critical of Limitations Imposed by FCC Financial Interest and Syndication Rules

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