

## THE MYTH OF ‘FREE’ TV

By J.H. Snider\*

“It is difficult to get a man to understand something when his salary depends upon his not understanding it.”<sup>1</sup>

—Upton Sinclair

Beginning in the 1950s, local TV broadcasters have argued that because they provide a “free” (i.e., ad-supported) product to the American people, the government should treat them more favorably than other commercial businesses that charge consumers for their products. Today, thanks to this special treatment, local TV broadcasters routinely earn profit margins from 40 percent to 60 percent on this “free” service—a remarkable feat for any business. As *Washington Post* editor Leonard Downie has observed: “There is no legal way to make this much money in the U.S. except in local television.”<sup>2</sup> In the name of preserving free TV, the government has also transferred from the public to broadcasters control over assets worth at least \$100 billion in the last decade alone.

This paper calls into question the vast subsidies given to broadcasters in the name of free TV. By subsidy I mean any government policy that increases the profitability and asset value of local TV broadcasters. By “free TV” I mean advertising-supported programming. By “pay TV” I mean audience-supported programming, usually in the form of a monthly subscriber fee paid to cable or satellite multi-channel services.

The argument is divided into two parts. The first describes the technical and political history of free TV. The second provides a typology of subsidies given in its name.

### The Economic Origins of “Free” TV

The history of the free TV argument illustrates that broadcasters’ and their allies’ support for free TV has been a function of economic necessity and political expediency, not concern for the public weal. In its early days, free TV was a technological and economic necessity for broadcasters. There was no profitable way for broadcasters to charge audiences for programming. When competitors invented technologies that changed these economics, broadcasters turned this economic necessity into a political virtue. But as new technologies have allowed broadcasters themselves to charge audiences for content, the broadcasters have sought every opportunity to do so and have redefined the meaning of free TV to include only those services where it is uneconomical to charge.

---

\* J.H. Snider is a Fellow at the New America Foundation. Comments are welcome at [snider@newamerica.net](mailto:snider@newamerica.net).

In the United States, radio broadcasting took off as a commercial enterprise in the 1920s. During its early years, broadcasters expressed substantial uncertainty and disagreement about the best business model to maximize profits.<sup>3</sup> Some doubted whether it was even possible to make money from broadcasting because of the practical impossibility of charging audiences for programming. Amateurs and non-profits ran many early radio stations. In England, a tax on radio set purchases funded the British Broadcasting System. In some countries, local and national governments directly funded the broadcasting system. In the U.S., radio set manufacturers such as GE and RCA owned many of the early stations. The business model was that programming would give consumers a motivation to buy radio sets. The money would be made off the sets, not the programming. Another model was to have a retailer or consumer product manufacturer create a station to promote their wares. An auto dealer, for example, might create a station specifically to advertise his own merchandise.

Enough confusion existed that in 1925, *Radio Broadcast*, a leading trade publication of the day, created a contest, “Who is to Pay for Broadcasting and How?” Eight hundred people entered the contest. In selecting a winner, the editors wrote that “suggestions there were of all kinds, and the problem of deciding which one of all the group was the best was not found at all easy.”<sup>4</sup> The winning entry proposed a consumption tax on vacuum tubes, which at that time were a major radio component.<sup>5</sup>

Not until the late 1920s was there a consensus that advertiser-supported broadcasting was the most profitable way to support a broadcasting business. At the time, this business model was called “Toll Broadcasting,” and it was widely derided as a terrible abuse of the new broadcasting technology.<sup>6</sup> Herbert Hoover, the future President who then served as Secretary of Commerce, captured this spirit in 1922 when he reportedly found it inconceivable that “we should allow so great a possibility for service, for news, for entertainment, for education, and for vital commercial purposes, to be drowned in advertising chatter, or used for commercial purposes.”<sup>7</sup> This profound distaste for advertiser-supported broadcasting led to the formation of non-profit broadcasting, popularly known as “public” or “non-commercial” broadcasting, a defining feature of which was a restriction or outright ban on advertiser financial support.<sup>8</sup>

A major constraint on early business models was primitive technology. While it was cost-effective to charge a handful of advertisers, there was no economical technology for charging millions of viewers for the privilege of watching an over-the-air broadcast. At the time, it wasn't economical to exclude those who hadn't paid; for example, by scrambling broadcast signals at the transmitter (the broadcast tower) and unscrambling them in the receiver (the home radio set). As a result of these economics, there was no serious discussion about the possibility of financing broadcasting through audience subscriptions or any other direct payment scheme.

## *The Emergence of Television*

A generation later—in the late 1940s—TV broadcasting was introduced to supplement radio broadcasting. About the same time, TV manufacturers began to seriously tinker with technology to allow audience payment for broadcast content.

In comparison to radio, TV was well suited for direct audience payments because mobility was less important. Whereas radio could be used in cars and other mobile environments, TV was tethered to a single physical location. It was therefore an ideal medium for the new wire-based cable TV technology, which promised better reception and more channel offerings than existing broadcast television. And unlike broadcasting, Cable TV was wire-based. This made it relatively easy to charge viewers on a subscription basis. Consumers who hadn't paid for cable TV service could simply be disconnected from the cable TV wire.

At first, however, it was thought that over-the-air TV broadcasting (wireless) would be the medium to charge audiences for TV. UHF broadcasters, in particular, hoped that technology allowing them to charge audiences as well as advertisers could give them a competitive advantage over VHF broadcasters.

In 1945, the FCC began licensing VHF channels (channels 1 to 13, with channel 1 later eliminated), and in 1952 began licensing UHF TV channels (channels 14-83, with 70-83 and 37 later eliminated). By the time UHF channels were allocated, the VHF channels, dominated by affiliates of the major TV networks, were already entrenched. VHF dominated in part because VHF receivers offered better reception and in part because only a tiny fraction of U.S. households initially had UHF receivers. This lack of receivers led to a chicken-and-egg problem. Without a UHF receiver, UHF programming could not be watched. Without viewers, stations couldn't attract the advertising necessary to support high quality programs. And without high-quality programs, potential audiences had little incentive to acquire TV sets with UHF tuners. UHF entrepreneurs believed that this chicken-and-egg situation would cripple their upstart service.<sup>9</sup>

At the same time, UHF entrepreneurs saw that new technology might allow them to charge over-the-air audiences for UHF channels. They believed that this technology would allow them to earn a return on their programming even if only a relatively small number of Americans watched their programs. But no cheap and simple technology evolved to allow UHF broadcasters to discriminate between free riding and paying customers.<sup>10</sup> And in any case, the allure of charging viewers instead of advertisers for TV diminished as Americans acquired UHF receivers, and it became clear that UHF TV could become hugely profitable just relying on advertising revenues. By the mid-1960s, it became clear that audience-financed programming would be the most profitable business model for cable TV; and advertiser-financed programming would remain the most profitable business model for over-the-air TV.

## **The Political Use of Free TV**

As the economics of broadcasting changed, so did the lines of political battle. The early political battles tended to center on whether the government should encourage a non-profit or for-profit business model for the broadcasting industry.<sup>11</sup> By the 1950s, this battle was won by the for-profit broadcasters: They would get the lion's share of the public airwaves as well as a panoply of other government subsidies. But now a new battle opened up within the ranks of the for-profit television broadcasters.

The incumbent TV broadcasters, who were entrenched on the VHF channels (channels 2 to 13), strongly opposed audience-supported TV on both cable (wired) and UHF (over-the-air) channels. Audience-supported TV promised to both break up their highly profitable monopoly on TV programming as well as introduce a new stream of revenue that could finance both niche and high quality productions. Accordingly, with the support of theater owners, the incumbent broadcasters launched a lobbying campaign to cripple audience-supported TV.

As part of this lobbying campaign, economic expediency was transformed into political virtue, and the distinction between "free TV" and "pay TV" was invented. Now advertiser-supported TV was to be labeled "free TV" and subscriber-supported TV "pay TV." What had been labeled a "toll" service a generation earlier was now relabeled a "free" service.<sup>12</sup> Where both advertiser- and audience-supported TV had previously been lumped together as commercial TV, now they would be portrayed as different as night and day.

From this period on, politicians and broadcasters would use the idea that "free TV" is a public good as one of the justifications to support a U.S. industrial policy favoring ad-supported local TV broadcasters over all of their competitors. That expensive industrial policy remains in place today, despite the fact that 87 percent of U.S. households have voted with their wallets to receive their primary TV signal by subscription cable or satellite service.

One reason the early years of the free TV argument is interesting is that the broadcasting industry engaged in a substantial public policy debate about the rationale for free TV. Later, the public policy rationale for favoring free TV would largely be taken for granted. Another reason is that the argument in favor of free TV always involved a prediction about the likely evolution of a world that allowed audience-supported ("pay") TV to flourish. Now that pay TV has had a chance to develop, we can evaluate the early free TV arguments not just in light of theory but actual experience.

In what follows I do not attempt a comprehensive account of policies justified under the free TV banner over the last 50 years. Instead, I focus on presenting what I believe to be a representative, if high-profile, sample.

## **Political Fights Over Free TV: 1952-2002**

On February 25, 1952, Zenith Corporation filed a petition with the FCC to establish a wireless service that could charge viewers for broadcast programming. Although Zenith had been experimenting with technologies to facilitate pay TV since 1931, its 1952 petition ignited broadcaster opposition for the first time. The FCC studied the matter for three years then issued a notice of proposed rulemaking on February 10, 1955, which received comments from more than 25,000 different individuals. On October 17, 1957 the FCC issued its First Report announcing that it would allow limited trials of the new service.<sup>13</sup> Trials would last for up to three years and be allowed in the approximately 20 cities that already had four stations, including network affiliates for ABC, CBS, and NBC. At the end of the trial, the FCC would evaluate the results, and then decide whether to move ahead.

The established advertiser-supported broadcasters were strenuously opposed to any test of this new service. They felt that once this type of service got a foothold, it would be impossible to stop. So when the broadcasters didn't get what they wanted from the FCC, they began an intense lobbying campaign to get Congress to reverse the FCC's decision. The broadcasters backed up their position with three arguments.<sup>14</sup>

**The Efficiency Argument:** Broadcasters asserted that advertiser-supported ("free") TV enhances consumer welfare more than would audience-supported ("pay") TV. The gist of the argument was that consumers would get the same programs under both pay and free television, but with pay television they would have to pay for it. Thus, pay television reduces consumer welfare.

The major trade association representing local TV broadcasters, the National Association of Radio & Television Broadcasters (henceforth, the "NAB")<sup>15</sup> issued a 15-page pamphlet in 1956 entitled "On Record Against Pay-TV." Distributed to Congress and the FCC, the pamphlet began with this quote from Storer Broadcasting Company, one of its member station groups:

Pay-to-see television will add nothing to present programming except a bill.... [It] cannot be regarded as an addition to free television—it is a substitute for free television. The end result can only be that the public will receive approximately the same programming it now receives free—but will receive a bill along with it. Free television robbed of its talent must itself inevitably turn to pay-television or deteriorate to mediocrity and worse. In either event the public will receive less service for more money.<sup>16</sup>

**The Equity Argument:** Broadcasters asserted that pay TV would favor wealthy elites at the expense of the general public. Only the wealthy would be able to watch the new pay TV. The rest of the public, the vast majority of citizens, would be left without programming. The equity argument was a logical corollary to the efficiency argument: by definition, a product that is free is more affordable than a product that must be paid

for. In the words of the Columbia Broadcasting System (CBS), also quoted in the broadcasters' pamphlet "On Record Against Pay-TV:"

The privilege of looking and listening would exist in direct proportion to the resources of the family pocketbook.... [C]ontrol would be placed in the hands of a small minority which could black out both channels and programs and frustrate the majority wish.<sup>17</sup>

**The Political Argument:** Broadcasters asserted that pay TV was politically unpopular. In 1957 and 1958, broadcasters distributed follow-up pamphlets to Congress demonstrating and explaining the public's opposition to pay TV. The results of seven newspaper polls were cited, and numerous letters of support from organizations and individuals were quoted. The extent of popular support was overwhelming:

The final outcome of the Pay Television proposal presently before the Federal Communications Commission will be decided, ultimately, on the basis of whether or not Pay-TV is in the public interest.

And the nation's viewers, as they become acquainted with the nature of this proposed system through television and other mass media have given a clear answer to this question. They have written TV stations and networks. They have expressed themselves through their civic organizations in resolutions, and in testimony before Congress. Independent newspaper surveys reveal a public that is anywhere from 72 percent to 99 percent opposed to paying for its home TV entertainment. And Congress as well as the FCC has received thousands of comments from viewers stating their enthusiasm for today's free television, and protesting any authorization of Pay-TV.<sup>18</sup>

What explained this popular support? The broadcasters' very own arguments against pay TV.

It is evident that pay television does not have the public's support....[The average citizen] realizes that a well-to-do minority would be able to support such a system very profitably even though the great majority would reject it. He also knows that this minority would provide sufficient money to siphon off present programs from free television. Pay-TV would not provide better programs than free television but subscription television could be more profitable. In the end the heavy payments of the minority would deprive the majority of information and entertainment they now receive from free, advertising-supported television.<sup>19</sup>

Over the years, the broadcasters' efficiency, equity, and political arguments in favor of free TV would evolve as pay TV got a foothold and earlier arguments became implausible. The efficiency argument would increasingly focus on using free TV to check the cable TV industry's growing monopoly power (by 1990, 60 percent of

Americans got their broadcast TV via cable TV). The equity argument would increasingly focus on protecting the poor, rather than the mass of Americans, from the expense of pay TV (by 2001, only 13 percent of Americans exclusively relied on free TV sources for their TV programming). And the political argument would stop seeking to ban pay TV and merely seek to prevent future encroachments. The definition of the free TV industry would also change. As broadcasters came to rely on satellite and cable TV to distribute their programming, and as digital TV technology opened up new avenues to charge audiences for watching their programming, the percentage of broadcasters' revenues derived from advertising would be reduced. A distinction between terrestrial-over-the-air, satellite-over-the-air, and cable-delivered broadcasting would have to be made. And as ad-supported Internet services took hold, broadcasters would also lose their distinction as the only provider of "free TV." A distinction would have to be made between traditional free TV and all its newer forms.

The culmination of the 1950s free TV lobbying campaign—the first of many to follow—was that the FCC in its Third Report and Order on March 23, 1959, allowed each proposed pay TV technology to be tested in only one market in the U.S. and only one channel within that market. In March 1960 Zenith announced plans to initiate a pay TV test in Hartford, Connecticut, and on February 23, 1961, the FCC authorized their plan. The Committee Against Pay TV challenged the FCC's decision in court to the U.S. Court of Appeals, DC Circuit. When the Committee Against Pay TV lost there, they appealed to the U.S. Supreme Court, which on October 8, 1962 declined to review the lower court's decision. The Hartford Pay TV experiment ended six years later as a business failure. The Hartford experiment appeared to demonstrate that the broadcasters were right: There was little demand for pay TV and pay TV added little if anything to program diversity.

On December 12, 1968, the FCC issued its Fourth Report and Order. This legalized wireless pay TV, but only in markets and for programs that didn't harm existing free TV broadcasters.<sup>20</sup>

### *The Cable TV Threat*

Meanwhile, cable TV was beginning to look like a more efficient vehicle for the introduction of pay TV.<sup>21</sup> When cable TV was first introduced in the late 1940s, it was used as a "master antenna service" to bring cable TV to rural, mountainous, and other areas that either didn't have access to over-the-air broadcast TV or were in borderline areas with poor reception. It showed no programming in competition with local broadcasters and in any case lacked the channel capacity to do so. Broadcasters liked this type of cable TV because it added more eyeballs to their audience and thus attracted more advertising revenue. By the early 1960s, however, it became clear that at least some cable operators had plans to not only enhance existing broadcasting services but also compete with them. Cable TV systems with dozens of channels were envisaged. These systems could both retransmit existing broadcast programming and add their own competitive programming.

The first large-scale implementation of wired pay TV in competition with local broadcast TV was planned to take place in San Francisco and Los Angeles in the mid-1960s. The broadcasters reacted with fury. Using their strong allies, the theater owners, as their public face, they set up the Citizens Committee for Free TV, co-chaired by a prominent California broadcaster, Gerri Teasley.<sup>22</sup> The committee gathered more than 1 million signatures, more than twice the necessary number, to put a referendum (“An Act to Preserve Free Television in California”) on the state ballot.<sup>23</sup> If passed, the referendum would ban pay TV in California.

One ad run by the Citizens Committee had this jingle: “Pay TV/Before you’re done/You’ll charge for air/And rent the sun!”<sup>24</sup> Another showed a masked burglar sneaking into a room with an old woman sitting in a rocking chair, then fleeing out the window with the woman’s television set. A print ad showing a child with tears in his eyes looking at a blank TV screen includes the text: “What kind of a monster would do this to your child—would come into your home and put a padlock on his TV fun? What kind of a monster would force you to feed your TV set bucketfuls of dollars—or suffer the humiliation of being labeled a ‘cheapskate’ in the eyes of your children? There is such a monster. It’s a greedy thing called Pay TV.” Another print ad was headlined “DON’T WATCH TELEVISION WITH BREAD MONEY.”

Both TV stations and local newspapers owned by companies with broadcast interests often refused to carry the ads of their political opponents who supported pay TV. For example, all three network-affiliated local TV stations in San Francisco, as well as the major daily newspaper, *The San Francisco Chronicle* (whose parent company also owned broadcast stations), refused to accept pro-pay TV issue ads.<sup>25</sup>

On November 3, 1964, the referendum banning all forms of pay TV in California won with overwhelming support. The vote was 4.5 million to 2.3 million, close to a 2:1 margin.<sup>26</sup> Sixteen months later the California Supreme Court struck down the law, ruling that it violated the First Amendment and was thus unconstitutional. When in October 1966 the U.S. Supreme Court refused to hear California’s appeal, the judicial battle ended. By then, however, the company that had sought to introduce pay TV into California was bankrupt and out of business. Henceforth, broadcasters would use less direct means than outright bans to reign in pay TV.

### ***The FCC Assault on Cable TV***

By the mid-1960s, at the broadcasters’ prodding, the federal government turned its attention to wired forms of pay TV. On April 23, 1965, the FCC issued a report and order mandating that cable TV systems carry local broadcast stations (“must-carry”) and not duplicate any program offered by a local broadcaster (“non-duplication”). On March 8, 1966, the FCC issued a report and order essentially banning pay TV from the top 100 TV markets—the largest metropolitan areas in the United States.<sup>27</sup> This was a devastating blow to the cable TV industry because it would mean that it was not only illegal to provide service to the vast majority of U.S. households, but also to the households that were most densely concentrated and therefore affordable to wire. In

1970, the FCC made it illegal for cable TV operators to compete with local broadcasters for the most profitable categories of sports, movies, and series-type programs. These restrictions were further tightened in 1975.

In 1974 broadcasters created the “Special Committee on Pay Television” to launch a major grassroots effort to apply pressure on Congress and the FCC to both retain existing competitive restrictions on cable TV (which faced a constant drumbeat of attack by economists and pay TV interests) and add new ones. The effort bore fruit in 1975, when the FCC issued a report and order with additional cable TV restrictions.<sup>28</sup> But just as the state courts in California overturned laws restricting pay TV, the federal courts now did the same.

In 1977, the broadcasting industry suffered what appeared to be a devastating setback. In *Home Box Office v. Federal Communications Commission*, the U.S. District Circuit Court threw out almost all the regulations limiting pay TV, arguing, among other points, that they violated the First Amendment and were thus unconstitutional. Six months later, on October 3, 1977, the U.S. Supreme Court upheld the lower court’s decision.

After the Supreme Court’s *Home Box Office* decision, pay TV witnessed explosive growth. Between 1977 and 2002, the percentage of Americans exclusively relying on free TV for their TV programming would decrease from 83 percent to 13 percent.<sup>29</sup> The balance would subscribe to cable and satellite TV.

In recent years, two of the broadcasters’ biggest lobbying campaigns culminated in passage of the Cable Act of 1992 (granting broadcasters cable TV must-carry) and the Telecommunications Act of 2002 (granting broadcasters new spectrum under flexible terms). Both campaigns justified massive subsidies for the broadcasting industry as the price of preserving and enhancing free TV.

### ***The Battle for Must-Carry***

Must-carry is a rule requiring a multi-channel video distributor, usually a cable TV or satellite TV provider, to carry local broadcasters’ TV signals. Today, the vast majority of Americans get their broadcasting programming not over the air but through one of these multi-channel video distributors.

In December 1987, the U.S. Appeals Court in Washington DC ruled that the FCC’s must-carry rules requiring cable TV systems to carry local broadcasters’ TV signals were unconstitutional, a violation of the First Amendment. The broadcasters’ response was to launch a massive lobbying campaign to get Congress to pass must-carry legislation. By having Congress pass must-carry rules rather than the FCC, the broadcasters felt they could check the courts; courts are typically much more deferential to legislative branch laws than to those of an independent agency.<sup>30</sup> The growing market power of the cable industry would also give broadcasters new grounds to argue their case.

Must-carry was important to the financial success of all broadcasters but especially to UHF broadcasters, who usually lacked network affiliations. Without must-carry, a cable TV company could potentially kick a broadcaster off a local cable system—thus depriving them of a large fraction of their advertising base—or charge the broadcaster for cable carriage. In such a situation, the value of a TV station would plunge.

In April 1988, the broadcasters chose Milton Maltz to chair their Free TV campaign committee, whose goal was to win broadcasters must-carry rights. Given the theme of the campaign, the choice of Maltz was ironic. Several years before, *Fortune* magazine had described Maltz as one of the wealthiest men in America. The heart of Maltz's privately owned broadcasting company was 11 radio stations, seven of which were in major markets. He also had six struggling UHF TV stations. In 1998 he would reportedly sell those six UHF TV stations for more than \$1 billion.

The gist of Maltz's pitch to his fellow broadcasters could have come out of the 1950s: "Increasingly, cable and VCRs are siphoning programming away from free television; other technologies threaten to accelerate the trend. The ultimate result is not more choice or variety for the American people. Instead, they will be expected to pay for what they once got free.... It is time for the greatest marketers in the world—TV broadcasters—to start telling this story... selling the benefits of free television."<sup>31</sup>

On July 17, 1989, the free TV campaign was publicly launched. At the start of prime time news on local TV stations throughout the United States, retired TV news anchorman Walter Cronkite aired this special message to the American public:

What you are watching is called Free Television. It's part of a system—born more than 50 years ago—that is unlike any other in the world. Through your Free TV window, you've been witness to triumph and tragedy... to love and laughter, learning life. It's offered free to all, even the cable systems that carry it. Imagine the impact if it were gone. Join us in the coming months, as we celebrate and stand watch, over Free TV.<sup>32</sup>

The broadcasters found a receptive audience. Over the next four years members of Congress would liberally sprinkle the phrase "free TV" in bills, reports, committee hearings, the floor of Congress, press releases, and hometown speeches.

In 1992, Congress granted local TV broadcasters must-carry, retransmission consent, and preferred channel positioning. ***Must-carry*** required that cable operators carry the programming of all local TV broadcasters. ***Retransmission consent*** gave broadcasters the option of not accepting cable carriage if cable operators didn't pay them enough for this privilege. ***Preferred channel positioning*** made it illegal for cable operators to move broadcasters to a less desirable channel number, often derided by broadcasters as "cable Siberia." Specifically, cable companies had to give broadcasters their over-the-air channel number or any other number if it were mutually agreeable. In 1996 Congress extended these basic broadcaster carriage rights to telephone video services and in 1999 to satellite TV systems, effective January 1, 2002.

## *The Battle for Digital Spectrum*

The free TV argument was also central to the broadcasters' lobbying effort to acquire spectrum for digital TV. In 1986, the FCC was petitioned to allocate for wireless telephone service the unused spectrum allocated to the broadcasting industry. Of the 67 channels allocated for broadcasting, only about 13 were actually used to broadcast TV programming in any given market. The broadcasters countered that they needed the spectrum so that free TV could be preserved in the coming age of high definition TV. Accordingly, the FCC prevented any other industry from securing rights to this unused spectrum. In 1992 the FCC took the next step of formally reserving the spectrum so that broadcasters could eventually simulcast their standard definition TV channel programs on their new high definition channel.

In 1993 Congress exempted all spectrum reserved for local broadcast service, including the newly reserved spectrum for HDTV, from ever being allocated via spectrum auctions. And in 1996, Congress granted incumbent broadcasters twice their existing spectrum so that free TV would be preserved in the new digital TV era. In addition, Congress granted broadcasters spectrum "flexibility." This gave the broadcasters the right to use up to 90 percent of their spectrum for any type of pay service they might desire as long as the balance was used to broadcast one standard definition free program. The reasoning was that transitioning to digital TV would be expensive and pay services would help broadcasters afford this transition. Congress argued that the grant of spectrum was a "loan" to help the broadcasters transition from free analog to free digital TV. But the loan required no interest payments and no definitive payback date, so, by conventional banking criteria, it was functionally identical to a gift.

In his testimony to Congress asking for the new digital spectrum on favorable terms, NAB's president twelve times used the word "free" and once the word "non-subscription" to describe the programming offered by the local television industry.

In 1996, the FCC estimated the value of this new spectrum, if sold to wireless telephone operators, at up to \$70 billion. The estimate was derived from recent sales of comparable spectrum for wireless telephone service. A wide variety of commentators and senior government officials, including the FCC Chairman Reed Hundt and Senate Majority Leader Robert Dole, called this one of the great corporate giveaways of the twentieth century. In response, broadcasters hired DK Research to extensively test audience responses to the wording of various free TV messages. Then the broadcasters ran a \$9 million free TV public service advertising campaign that ran on local TV stations throughout the United States, but especially in the congressional districts of key lawmakers. In preparing for this campaign, the National Association of Broadcasters sent local TV station managers in February 1996 a "Spectrum Auction Action Tool Kit." The local station managers were encouraged to adapt the following model text for a TV public service announcement (I have highlighted the word "free" to emphasize its frequency.)

For more than 40 years, we at WXYZ have been proud to serve this community. During times of celebration and times of crisis, from man's first walk on the moon to last night's weather report, we have worked to bring a wealth of information and entertainment to our viewers, and we have provided it all for **free**.

That record of service, however, is under siege from some in Congress who are pushing to adopt revenue raising proposals that threaten to end **free** TV in America. This latest scheme to fill the Treasury's coffers involves public auctions of parts of the airwaves, or spectrum. The spectrum issue was originally promised to local television broadcasters so we and our television viewers could make the transition to a new generation of digital television that provides breathtaking pictures and sound....

The communications world is rapidly moving to digital technology. It's the wave of the future. Local TV stations, however, must continue to broadcast our current "analog" signals for a number of years while simulcasting the new high quality digital signal on a second channel so consumers won't have to buy new digital TV sets until their existing sets wear out. It's the new channels that some in Congress now want to take away and auction to the highest bidder.

If that happens, most local **free** TV stations like ours won't be able to compete with other communications businesses like cable and telephone companies, all of whom are going digital and all of whom charge you for their products. Local TV stations simply can't afford to make a multi-million dollar investment in new equipment and pay millions more for the spectrum at the same time. No one else could ever pay that price and provide a service that's **free** to all. If local TV stations can't compete, all that will be left is pay TV.

**Free** television is a great American success story. It is one of the hallmarks of our society and one of the few free services still available to all Americans—regardless of social strata. Spectrum auctions will kill **free** TV. Don't let the story end this way....

President Clinton's top economist, Joseph Stiglitz, who later won the Nobel Prize for economics, denounced this argument, stating that advertiser-supported television is extremely profitable and will always be a viable business, even if digital spectrum is put on the auction block. Moreover, if policymakers are concerned that it won't be viable, all they need to do is stipulate that licenses won at auction must be used to provide ad-supported TV.<sup>33</sup> It is ironic that the broadcasters' new spectrum licenses, given in the name of preserving free TV in the digital era, included no credible stipulation that 100 percent or even 10 percent of the spectrum would be used for ad-supported programming.

## The Decline of Free TV

Despite all this rhetoric about saving free TV, broadcasters and their government allies have for the last 15 years taken every opportunity they could to kill free TV in the name of saving it. Saving free TV, as we have seen, was a major rationale behind the Cable Act of 1992, which gave broadcasters must-carry and retransmission rights on cable TV. It was also a major rationale behind the Satellite Home Viewer Act of 1999, which did much the same for satellite TV.

In early 2002, a band of prominent broadcasters came together to plot their transition to pay TV. As one member, the owner of a 63-station TV chain, put it: “The single largest issue facing us, independent of the economy, is the ability for us as an industry to get to the real value of what we deliver to the consumer by being paid for it.”<sup>34</sup>

Today, the vast majority of Americans get their so-called free TV not over the airwaves but over pay TV services such as satellite and cable TV. And in order for these satellite and cable TV companies to get carriage of this TV—thanks to the double whammy of must-carry and retransmission consent—they must pay for it. These costs are then passed on to consumers. Admittedly, payments are not necessarily direct or in cash. For example, many TV station groups have bargained with pay TV providers to get their own cable and satellite TV networks carried—at discounts from market rates—as compensation for the right to carry their local broadcast stations. But whether compensation is direct or indirect, in cash or in kind, the subscription TV consumer ultimately pays—and still must watch the same volume of advertising as the shrinking minority of homes that still rely on over-the-air signals.

The free spectrum granted to broadcasters in the Telecommunications Act of 1996, as we have seen, was also done in the name of preserving free TV. But the fine print of the Telecom Act allowed broadcasters to use 90 percent of their spectrum for any type of fee-based data service, including pay TV. The rationale here was that broadcasters needed these extra revenues to subsidize their free TV services. But there is no requirement that such subsidies actually occur, nor any economic incentive why they should occur. So now we have broadcasters planning to use that “pay” spectrum for phone service, last-mile broadband Internet service, and a dizzying array of other fee-based data services.

FCC Chairman Michael Powell, while lauding free TV out of one side of his mouth, has predicted out of its other side that in the near future it all will be pay TV.<sup>35</sup> He doesn’t mention this is the likely consequence of his “spectrum flexibility,” “market-based,” and “deregulatory” public policy initiatives for the broadcasting industry.

### *Ending the ‘Fair Use’ of ‘Free TV’*

Today, one of the biggest attempts to reign in “free TV” is digital rights management. For example, Congress is considering legislation that will allow broadcasters to insert “broadcast flags” in their digital TV programming. This will prevent consumers from being able to save copies of free TV programming and later skip over the ads. It will also

drastically narrow “fair use” of broadcast TV programming, which includes making free copies of TV programs for personal use and using snippets, like quotes from a book, for commercial purposes. All these uses of free TV programming in the future will have to be paid for.

Already, copyright law makes it illegal for libraries to keep long-term copies of free broadcast programming without special compensation. This is in contrast to newspapers and other fee-based media, which libraries can store and use for the same price the man on the street pays for them. Now, with “broadcast flags,” even short-term use of “free TV” will require that libraries pay a premium to broadcasters.

In conclusion, advertising-supported broadcast media developed as an economic necessity. In the early days of broadcast media, it was the most economical way to provide radio and TV. But as time passed, new technologies developed that made it economical (and more spectrum-efficient) for competitors such as cable TV, satellite TV, and video store operators to charge for TV. Broadcasters then sought to make their handicap into a virtue deserving of public subsidy. They sought to convince the public they were getting a free service while never acknowledging that this free service had huge opportunity costs born by the public. As public policy moved to discourage free TV, these opportunity costs surprisingly increased rather than decreased. We shall now catalog these opportunity costs.

## **The Cost of Free TV**

Obviously, advertising-supported TV programming provides a valuable consumer service; otherwise, consumers would not watch it. But that doesn’t make it free or imply that it should be free. There are many valuable products that the public pays for. That’s how markets work and maximize consumer welfare. There are also many products that are widely valued, or which share the virtue of what economists call “public goods” (i.e., the marginal cost of an additional unit—or viewer—is zero), that thrive without government subsidy. Here, we shall briefly look at the consumer cost to watch ad-supported (“free”) TV and government subsidies to local TV station owners to enhance the profitability of this type of programming.

### ***Consumer Costs***

**Equipment (“Fixed”) Costs.** To watch “free TV” requires a TV set. TV sets range in price from under \$100 to over \$5,000. To get a high quality signal, tens of millions of Americans would also have to purchase an external antenna, usually placed on an apartment or home roof. Antennas range in price from a few dollars to several hundred dollars. Having a professional install an antenna on a roof can cost hundreds more. The antenna must then be connected to rooms with TVs. Most Americans don’t like exposed wiring in their homes, so the wiring must be snaked within walls. For a large house with many TVs, this can cost thousands of dollars or perhaps not even be doable without all but tearing down the house. Even with the above equipment, a large fraction of Americans are unable to get a high quality local broadcast signal over-the-air—perhaps

because they live near mountains or tall buildings or because they live in rural areas—and thus are willing to pay for either cable or satellite TV delivery.

With broadcast digital TV, the cost of TV equipment tends to be higher. Today, most broadcast digital TVs cost at least twice as much as a high-powered personal computer. Indeed, digital TVs are essentially computers, albeit highly inflexible computers. With digital TV, consumers will periodically need to purchase new equipment, just as they need to do with other computers, in order to take advantage of new information offerings. Consumers may also need to purchase new wiring.

**Time Watching Ads.** To watch TV programming, advertiser-supported TV requires viewers to watch advertisements. The deal is that consumers get to watch programming in return for watching unavoidable ads. Today, primetime local broadcast TV devotes about 25 percent of its time to advertising and the balance to programming.<sup>36</sup>

Obviously, consumers like to watch some of the advertising they receive. But there is also abundant evidence that consumers view advertisements as a cost, not a benefit, of TV watching. Many consumers are willing to pay for cable TV channels such as HBO that don't include advertising.<sup>37</sup>

Recently, TV broadcasters have sued Replay TV because it offers a product that makes it easy to skip over ads.<sup>38</sup> With Replay TV, the consumer downloads TV programming onto a computer hard disk. The consumer then replays the TV without the ads. Broadcasters have called such a procedure “theft” because the viewers are stealing the programming without paying for it with time spent watching advertisements.<sup>39</sup>

**Program Quality.** Advertising has a significant impact on program quality and diversity.<sup>40</sup> One of the rationales behind public TV was to provide programming that advertising supported broadcasters could not. It is illegal for public TV to provide the type of intrusive and time consuming advertisements offered on commercial TV.

Advertisers prefer programming that delivers audiences with preferred demographics. These demographics are not necessarily representative of the public. Preferred demographics include upper-class Americans with lots of money to spend and Americans between the ages of 18-39 who are not hardened in their buying habits. Programming that focuses on the interests of the young and old as well as the poor and minorities, thus receives proportionately less funding and prime time exposure. Says one national network TV producer: “We are reaching the audiences we want and we are making the sponsor very happy. The 18- to 39-year-old audience buys beer, Nike running shoes and BMWs. They are making the economy soar....”<sup>41</sup>

Obviously, advertisers prefer to spend their dollars on media that provide programming favorable to their interests. Local TV stations, in turn, take this into consideration when planning their programming. They try to avoid programming that current or potential major advertisers would dislike. For example, local TV stations avoid exposes of local car dealers, comparative price rankings of major local retailers, and critical reports of

products offered by major consumer product manufacturers and advertisers such as Proctor & Gamble. Advertisers also often dislike appearing next to certain types of programming, including controversial or politically incorrect programming relating to issues such as abortion, homosexuality, and drugs; depressing or somber programming such as a live funeral procession of a U.S. President, or a fictional depiction of nuclear holocaust; or programming without natural pauses such as public meetings, natural catastrophes, and national emergencies. In some cases, such as the funeral procession of a president or a national emergency, the local broadcast station will run the programming even without an advertiser. But usually programming won't be produced and shown unless it can find a high-paying advertiser.

**Product Costs.** Advertising costs, like any other cost of doing business, must be added into product costs. The higher the advertising costs, the higher the product costs. It is possible that those who pay for the products are systematically different from those who watch the programming. But this assumes that advertisers are irrational and will subsidize programming with a lot of free riders. According to economic theory, such an inefficient advertiser, if part of a competitive industry, should not long stay in business.

Many serious thinkers have argued that advertising, rather than alleviating market failure, actually causes it. For example, if two advertisers engage in an information arms race, where each increase in advertising cancels the effect of a competitor's advertising, the price of products could increase without a commensurate increase in consumer knowledge.

Others have argued that advertising, irrespective of product costs, leads to a decline in morals, happiness, productivity, or some other valuable trait. Daniel Bell, for example, argues that advertising causes individuals to adopt a consumption rather than production ethic.<sup>42</sup> John Kenneth Galbraith argues that advertising creates false needs that detract from worthier goals.<sup>43</sup> Robert D. Putnam argues that watching entertainment TV, whether advertising supported or not, has led to a decline in America's social capital, with highly negative consequences for our democracy, children's development, health, and physical safety.<sup>44</sup>

Whether or not the reader agrees with these critiques of advertising, it is clear that many Americans question the value of ad-supported TV. Some families, especially among the highly religious, won't even allow a TV into their homes. One socially conservative FCC commissioner didn't own a TV set until he became a commissioner. TV-Turnoff Network lobbies to encourage parents to unplug TV sets and get more involved with their children's learning.<sup>45</sup> The American Academy of Pediatrics says television gets in the way of healthy brain development and recommends that kids under two not watch TV at all.<sup>46</sup> Some public schools celebrate a no-TV day for one day a year.

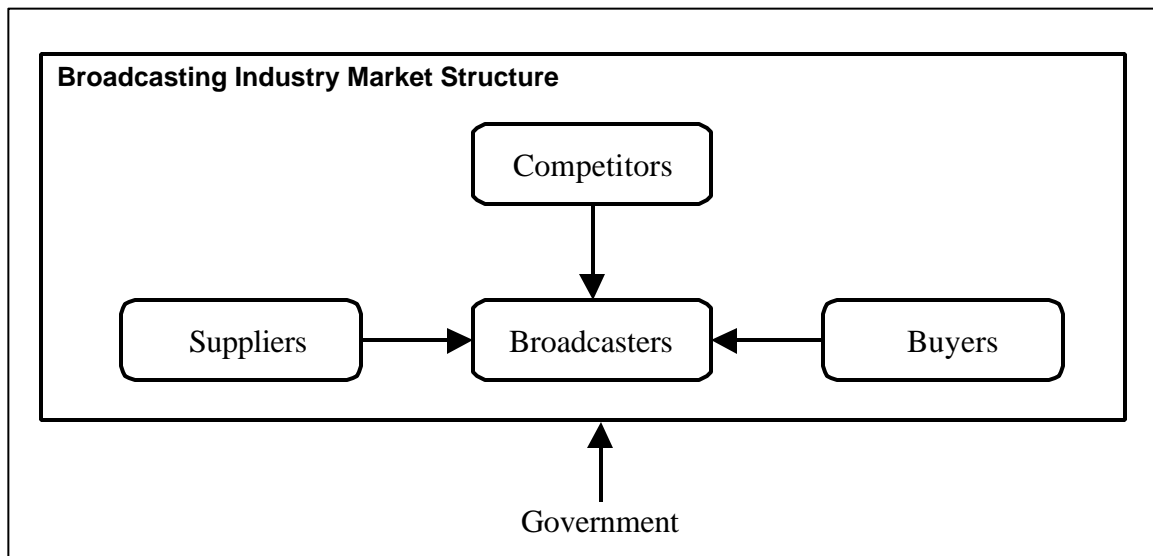
### ***Government Subsidies***

Over the years, the government has enacted a large number of policies to enhance the profitability and market value of local TV stations. I call these policies "subsidies" even

if they don't appear to come out of the pockets of the general public. It is simply assumed that any government industrial policy that enhances the market power of one information industry (e.g., TV broadcasting) but not another (e.g., Internet content providers) ultimately reduces consumer welfare.

Government subsidies to broadcasters can be divided into those given directly and those given indirectly by changing laws affecting broadcaster suppliers, buyers, and competitors. These forces affecting broadcast industry profitability and asset values are modeled in Figure 1. The model is loosely derived from Harvard Business School Professor Michael Porter's model of industry market structure.<sup>47</sup>

**Figure 1. Government's Impact on Broadcast Industry Market Structure**



The same entity may simultaneously be a supplier, buyer, and competitor. For example, a viewer is a "supplier" while watching ads but a "buyer" when paying a fee for the programming; and a cable TV company is a "supplier" while carrying a local TV broadcast program and a "competitor" when it also carries its own programming.

A broadcaster is defined as a commercial company with an FCC license to use one of channels 2 through 69 on the TV dial for the purpose of transmitting at least one TV signal. Consistent with this definition, we can divide the broadcasting industry into two component businesses: content ("programming") and conduit ("telecommunications"). The two are closely linked in that content is transmitted over conduit and the profitability of each business is dependent on the other. An example of content is a TV news program; an example of conduit is spectrum.

A buyer is an individual or product that purchases the broadcasters' end-product. Buyers may be advertisers or viewers.

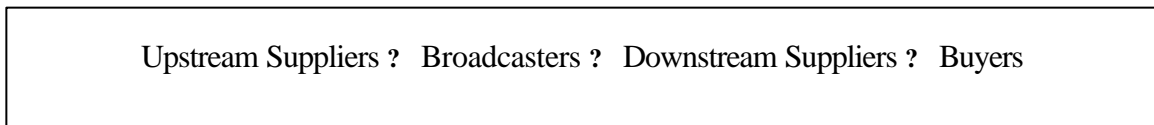
A supplier is a company that provides inputs to the broadcasting industry. Suppliers can be divided into those that provide downstream and upstream products to broadcasters.

An upstream product is an input to production; a downstream product is an input to product distribution. An example of an upstream supplier is Hollywood. An example of a downstream supplier is cable TV.

Competitors are any potential entrants or substitutes for broadcaster products. Direct competitors provide an identical product; indirect competitors provide close substitute products.

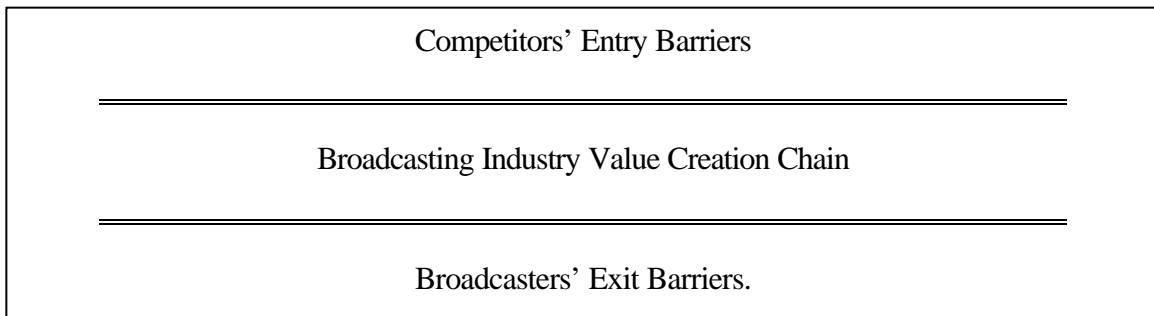
The broadcasting industry’s value creation chain runs from upstream suppliers, to broadcasters, to downstream suppliers (the distribution channel), and buyers (see Figure 2). For example, broadcasters buy programming from Hollywood (the downstream supplier), distribute it through cable TV (the upstream supplier), and sell the audiences thus captured to advertisers (the buyers). Each player in the creation chain, including broadcasters, adds value to the finished product. It is in the broadcasters’ interest to concentrate the profits (or, more generally, what economists call “surplus”) from this value creation chain in its own node of the chain.

**Figure 2. Broadcasting Industry Value Creation Chain**



Entry and exit barriers determine the profitability of both competitors and broadcasters. The higher the barriers for competitors to enter the broadcasting business, and the lower the barriers for broadcasters to exit the broadcasting business and enter other businesses, the higher the profits of broadcasters and the lower the profits of competitors.

**Figure 3. Profitability of Broadcasting Industry Value Creation Chain**



In the name of enhancing free TV, Broadcasters lobby the government to enact public policies ensuring that the interaction of these forces serves to maximize their own long-term profitability and wealth. Legg Mason Precursor founder Scott Cleland, a prominent telecommunications analyst, has gone so far as to observe that the broadcasting industry now pursues a “congressional business model,” seeking profits through government subsidies, not market competition.<sup>48</sup>

## *Direct Subsidies to Broadcasters*

**Spectrum.** Broadcasters lobby to build a telecommunications network at public expense. Unlike wire line telecommunications providers, which seek preferential access to public roads and byways, broadcasters seek preferential access to spectrum, colloquially called the “public airwaves.”

Spectrum rights licensed to local TV broadcasters are typically worth far more than their physical assets. For example, in the very largest TV markets, the physical assets of a station may be worth less than \$10 million while the spectrum assets are worth hundreds of millions of dollars.

Broadcasters’ spectrum can be divided into two major categories: retail and wholesale. Wholesale spectrum is what broadcasters use for sending information from the field back to their stations. For example, a reporter may visit a crime scene and send raw footage over-the-air back to the station. Wholesale spectrum, often called auxiliary spectrum or ENG spectrum (for Electronic News Gathering), is shared by all broadcasters rather than allocated to individual broadcasters. Retail spectrum is what broadcasters use to transmit signals to the home. Americans are very familiar with this spectrum because it is labeled channels 2 through 69 on their TV sets. Broadcasters are currently allocated 402 MHz for retail uses and hundreds of additional MHz for wholesale use. The current market value of this spectrum is in the vicinity of \$500 billion. Broadcasters pay no monetary compensation to the government for use of this asset.<sup>49</sup>

**Land.** Broadcasters lobby for free or discounted rights to build broadcast towers on public property.<sup>50</sup> Broadcasters transmit their signals from towers. To maximize coverage, broadcasters seek to place transmitters several thousand feet above ground level. To achieve such heights, they can build a tower from ground level or place a short tower on a tall object such as a skyscraper or mountain. To build a several thousand foot tower from ground level can cost as much as \$2 million.<sup>51</sup>

In the West especially, but also throughout the United States, the government owns many mountains ideal for broadcast towers. Broadcasters seek to receive the use of this land at below market rates. Once they get exclusive access to this land and build a tower, they can resell unused tower space to other wireless providers. In certain urban areas, broadcasters may be able to place their antennas on top of tall public buildings. In New York City, nine TV stations transmitted from the top of the World Trade Center, a publicly owned building.<sup>52</sup>

**Zoning.** Broadcasters lobby to build broadcast towers in communities that don't generally allow 2,000-foot-high structures. This requires federally mandated zoning exemptions for broadcasters. Sometimes there is fierce opposition to such exemptions. Many residents believe that a 2,000-foot high tower near their homes reduces property values, endangers their safety, and creates an eyesore.

The resulting broadcast towers can be extremely profitable. A broadcaster can lease space on a tower to dozens of different wireless services, including multiple mobile telephone operators. A well-situated tower near a major urban area can bring in revenue of more than \$1 million a year and operating profits of more than 80 percent of revenue.<sup>53</sup>

**Government Information.** Along with other press entities, broadcasters lobby to gain convenient and subsidized access to government information. Advantageous access may be codified in law or simply institutionalized as a matter of practice. Consider Congress. Broadcaster privileges include free office space and staff support within the U.S. Capitol; special tables and documents in committee rooms; privileged doors to Congressional buildings; free access to conduits throughout the Capitol for audio/video connections; exclusive rights to video coverage of Congressional proceedings; press aides in every Congressional office to educate them about government affairs, privileged and extensive access to government officials, agendas, and documents; and, on occasion, subsidized transportation, including parking spaces at the U.S. Capitol and Reagan National Airport.

**Legal Immunity.** Along with other press entities, broadcasters lobby for legal immunities not accorded other professions.<sup>54</sup> These immunities relate to the gathering and distribution of information, and include immunity from subpoenas, libel claims, deception, and trespassing. Some legal immunities are embedded in law; others result from public officials' de facto fear of coming into conflict with an institution with great power to influence public opinion. Broadcasters, unlike most print publishers, are also exempt from the requirement to deposit a free copy of their work in the Library of Congress.

**Taxes.** Broadcasters lobby for exemption from taxes. Fixed telephone, mobile telephone, satellite, and cable TV telecommunication providers all pay some type of sales tax based on revenues. Free TV broadcasters, however, are exempt from sales tax because only subscriber revenue, not advertising revenue, is taxed. Broadcasters may also be exempt from sales tax on some of their own purchases. Arizona, for example, grants broadcasters an exemption from sales tax on digital TV equipment. California broadcasters have sought tax exemptions for TV production. Most TV shows are produced in California. In New York City, ABC, CBS, and NBC have won sales-tax exemptions, property-tax abatements, and discounted electricity prices.<sup>55</sup>

Broadcasting is also extremely well suited for barter transactions and income tax management. Broadcast stations are often at the center of barter systems because advertising time on mass media is widely sought by local businesses and thus forms a type of universal currency. Barter offers unique flexibility to control the recognition of profits and losses and to assign monetary values to transactions.<sup>56</sup> Broadcasters have also

sought to reduce income taxes by lobbying for amortization of spectrum licenses, even though spectrum is not a depletable asset.<sup>57</sup>

For many years, broadcasters could also avoid capital gains tax by selling to an organization purportedly controlled by minorities.<sup>58</sup> This exemption was closed in 1995 in the wake of revelations that it was providing large media companies, hiding behind minority front groups, with tax breaks worth hundreds of millions of dollars. Since then, there have been numerous attempts to reinstate some type of capital gains tax break for sale of broadcasting properties to minorities. A reduction of the capital gains tax from 28 percent to 20 percent may have lessened pressure to reinstate this tax break.

### ***Indirect Subsidies: Suppliers***

Broadcasters seek to buy from suppliers at the lowest possible cost. This applies to both upstream and downstream suppliers. The distinction between upstream and downstream suppliers is useful when trying to make sense of broadcasters' apparently inconsistent lobbying arguments. Depending on whether a supplier is upstream or downstream, a broadcaster must often make entirely opposite economic and First Amendment arguments to justify a particular subsidy. For example, a broadcaster wants an upstream supplier to have no intellectual property rights in relation to itself, but it wants the opposite intellectual property relationship with a downstream supplier or buyer. In other words, a broadcaster, but no one else, deserves a copyright free zone.

***Upstream Suppliers.*** Perhaps the most important upstream supplier for a broadcaster is its audience. Although it is non-intuitive to think of advertising audiences as suppliers, this is how TV economists view them.<sup>59</sup> Broadcasters buy audience attention ("eyeballs"), which they then sell to advertisers. It is in the broadcaster's interest to ensure that these eyeballs watch the maximum endurable amount of advertising per hour and cannot filter out ads. Accordingly, broadcasters are pushing Congress to pass digital rights management laws that will make it impossible for consumers to store broadcast programming and filter out advertising at a later viewing time. Broadcasters call such filtering "theft." In prior lobbying campaigns, broadcasters won elimination of any limits on the amount of ads per hour that they could show.

Program suppliers are also another upstream supplier. It is remarkable that radio stations pay only a trivial percentage of their revenue for the rights to use the songs they broadcast. By law, the record companies must allow broadcasters to use their product for free. It is also remarkable that local TV broadcasters get national network programming for "free." All they give the networks for their programming is some of the advertising time within their programs. Networks are so pleased to get local broadcasters' over-the-air, satellite, and cable TV distribution for their ads, that they see no reason to charge directly for their programming.

One way broadcasters get programming at the lowest possible cost is to hinder upstream suppliers from selling to competitors. This gives broadcasters extra bargaining power.

Even though they have been greatly weakened since the 1970s, the sports, movie, syndicated, and network exclusivity rules continue to serve this function.

Today, the copyright law is a major way that broadcasters keep costs low. For example, unlike cable, satellite, and Internet providers, terrestrial broadcasters are not required by law to pay record companies when they air one of their programs. Broadcasters also are allowed to copy, store, and broadcast for profit the songs provided by record companies. If a consumer did this, he could be thrown in jail. Indeed, if Napster had distributed its programming over a licensed broadcast station rather than over the Internet, it would have been perfectly legal.

When a broadcaster acquires a program, he also automatically acquires so-called moral rights. These moral rights allow broadcasters to edit, crop, and otherwise change purchased programming without permission from the author of the programming. In Europe, authors retain these moral rights when their work is purchased.

***Downstream Suppliers.*** Broadcasters seek to get distribution of their programming at the lowest possible cost. With cable TV must-carry rules, they are guaranteed free distribution on local cable TV, even if the area of the cable TV system is larger than the area of the over-the-air broadcast signal. Broadcasters are also guaranteed minimum technical quality of carriage, so even if an over-the-air UHF channel has a snowy image or is impossible to receive behind a dense object such as a tall building, the cable TV version of the channel must be as good as the UHF signal at the transmitter. In the late 1990s, must-carry rights for a TV channel without a major network affiliation were worth as much as \$13.88 per subscriber.<sup>60</sup> Broadcasters also have control of the channel number at which the cable TV company offers its programming. Broadcasters have a similar set of must-carry rights with satellite TV providers. The big difference is that must-carry rights are negotiated on a cartel basis. If a satellite provider wants to carry one local broadcast channel from a local market, it either must carry all the local broadcast TV channel from that market or carry none at all.

Broadcasters have also won more than \$1 billion in government backed loans for rural TV service. The idea is to subsidize the delivery of local broadcast programming to rural areas that wouldn't otherwise receive such programming in an easily accessible way.<sup>61</sup>

Broadcasters have lobbied against allowing downstream suppliers from having any control over the broadcast content they carry. Thus, they oppose allowing cable TV companies to modify broadcast programming in any way, including providing localized emergency information when broadcasters are unable to provide this information because of the large geographic area of their signals.

In general, broadcasters seek copyright laws that make Internet distribution of their programming illegal or legal depending on whether they have exclusive rights to that programming. Thus, radio broadcasters, which have automatic rights under copyright law to rebroadcast music recordings without compensation for performers, believe they have an inherent right to redistribute music over the Internet. But TV broadcasters, which have exclusive contracts with national TV networks, call this "theft" and have vigorously fought it.<sup>62</sup>

## *Indirect Subsidies: Buyers*

Local broadcasters have three types of buyers: advertisers and audiences. In the early days of broadcasting, advertisers were the only buyers. But with the advent of cable and satellite TV, audiences have also become buyers.

**Advertiser Buyers.** Broadcasters lobby to prevent any bans or restrictions on advertising, including gambling, liquor, auto, and pharmaceutical advertising. For example, broadcasters oppose mandatory disclosures of harmful pharmaceutical side effects because this would discourage pharmaceutical advertising.

Broadcasters lobby to prevent any changes that might reduce the tax advantages of advertising. They oppose sales taxes on advertising. They oppose eliminating the corporate income tax deductibility of advertising for products with negative externalities such as liquor and gambling. They oppose treating advertising expenditures for income tax purposes as an investment to be written off over multiple years as opposed to in the year in which they were incurred. Of course, people who buy information as consumers, rather than advertisers, get no such favored tax treatment.

**Audience Buyers.** More than 80 percent of Americans now receive their local broadcast TV programming via a pay TV service such as cable or satellite. Although broadcasters get free carriage of their programming on these distribution outlets, audiences don't get analogous viewing rights. Specifically, broadcasters can use either must-carry rights (zero cost carriage) or retransmission consent (a negotiated fee for carriage) depending on their bargaining strength. A home shopping channel that a cable or satellite TV provider doesn't want opts for must-carry. A local network-affiliated TV station with high ratings opts for retransmission consent. In the case of satellite TV, viewers now pay an average of about \$5 permonth for a package of local broadcast TV channels. A substantial part of this revenue goes to pay the retransmission consent fee negotiated with local broadcasters.

Broadcasters can also get cable carriage of additional channels as part of their retransmission consent negotiations.<sup>63</sup> The big broadcast station groups all own cable and satellite networks. They can demand carriage of these networks as part of their retransmission consent negotiations. The consequence is that over 90 percent of all cable TV networks are now either owned by cable TV operators or by local broadcast owners. Independent entrepreneurs have practically no chance of securing cable carriage for themselves. The cost for viewers of this is not higher prices but reduced innovation and diversity in TV programming.

## *Indirect Subsidies: Competitors*

Broadcasters seek to increase barriers to entry into broadcasting for potential competitors while lowering their own barriers to enter competitive industries and exit the broadcasting industry.

***Competitors' Barriers to Entry.*** Broadcasters have a cost advantage over competitors because of their subsidized access to telecommunications infrastructure and programming as well as their relatively tax-free status. Telecommunications infrastructure includes free or discounted use of spectrum and land as well as free or discounted use of satellite, cable, and telephone distribution. Programming includes free or discounted use of music, sports, movie, syndicated, and network programming. Taxes include sales tax waivers on production equipment and customer purchases. The type of cost discrepancy between broadcasters and competitors was recently highlighted when the U.S. Copyright Office determined that over-the-air commercial broadcasters could transmit music programming over the Internet at half the price per song of their Internet-only competitors.

Broadcasters have also lobbied for exclusive access to advertising revenues. For example, they have lobbied to ensure that non-profit broadcasters cannot directly compete against them for advertising. They argue that unless public broadcasting remains as free of ads as possible, it will be corrupted and violate its public interest purpose. Not surprisingly, when broadcasters make this claim they describe themselves as commercial or for-profit TV, not free TV. In truth, the phrase "free TV" may be much more accurately applied to public TV than commercial TV. The difference is that everyone knows that public TV receives some government subsidies, but few know that commercial TV not only receives subsidies, but also that these subsidies have produced dozens of billionaires over the years.

Broadcasters have also sought outright bans on competition. For example, they have always opposed any allocation of spectrum for a competing broadcast service.<sup>64</sup> On occasion, however, they have not been successful. For example, they opposed DBS, at one point even suggesting that the DBS spectrum could be better used to allow broadcasters to provide free HDTV service.

***Broadcasters' Barriers to Entry and Exit.*** At the same time that broadcasters lobby to erect barriers to entry for others seeking to enter the broadcasting business, they lobby to lower barriers to entry for broadcasters seeking to enter others businesses or simply to exit the broadcasting business. Broadcasters, for example, have lobbied aggressively to win as much flexibility as possible to use their spectrum to enter new businesses. They have lobbied to allow themselves to sell their licenses to the highest bidder, regardless of the use the bidder intends to make of the spectrum. They have lobbied to allow portions of their spectrum to be leased to others who have non-broadcasting business models. They have lobbied for retransmission consent, which gave them a strategic advantage over other entrepreneurs seeking to start cable and satellite TV networks. They have lobbied to prevent any transfer taxes when they sell their licenses.

## **Broadcaster Counter Arguments**

It is remarkable that despite the many thousands of references to free TV in congressional and FCC records, there is, to the best of my knowledge, no systematic effort to prove that the benefits of free TV outweigh its huge costs. This appears to be simply taken for granted. The National Association of Broadcasters has confirmed this lack of a systematic study to weigh the costs and benefits of free TV. I contacted the NAB and asked its head of research, Rick Ducey (who has subsequently left), if he could recall any such study. He could recall none but referred me to NAB's senior vice president & General Counsel, Jack Goodman, who also could recall no such study. One NAB report corroborated this lack of cost-benefit analysis: it described free TV as "an institution of inestimable value to our society."<sup>65</sup>

I have also reviewed the academic literature and could find no careful weighing of the costs and benefits of subsidizing the free TV industry. It is clear that a fraction of those that depend on free TV are poor; it's less clear the extent to which those dependent on free TV are poorer than those who don't. But the studies tend to be dated<sup>66</sup> and Nielsen and FCC data are based on correlations, not causal analysis.<sup>67</sup> For example, it's possible that people who rely on free TV do so because they live in rural areas without high quality cable TV, or because they are highly religious, such as Christian fundamentalists and Hasidic Jews, and find TV offensive. Both demographic groups also happen to be poorer than the average American, so without a control for rural location and moral sensitivities, a conclusion that poverty leads to free TV watching may prove to be spurious.

It is true that broadcasting has the economics of a public good; the marginal cost of adding an additional viewer is zero. Since under classical microeconomic theory price should equal marginal cost, this suggests that ideally viewers should pay nothing to watch TV and that TV's fixed costs should be subsidized. But the reality is that a large number of products in our information economy share this type of economics, yet few receive government subsidies. Indeed, many information products, including software and entertainment, sell for hundreds of times more than their marginal cost of distribution. The burden then is to state why over-the-air broadcasters and not other information providers should receive government subsidies. For example, the Internet now provides a wealth of advertiser-supported information. Why should free TV broadcasters receive government subsidies but not free Internet providers? Why should Paxson Communications, which owns a large group of local broadcast stations, receive billions of dollars of subsidies but not Yahoo!, which also provides an advertiser-supported service?

## Conclusion

Free TV started as an economic necessity for broadcasters and evolved into a lobbying rationale to keep down competitors. Now, as the technology of broadcasting is changing, broadcasters are moving into fee-based services. But while they are abandoning free TV whenever it is profitable to do so, they don't want to sacrifice the subsidies they are getting in its name. The clever political solution that broadcasters and their congressional and FCC allies have worked out is to advocate saving free TV by allowing broadcasters to generate revenues from fee-based services, including pay TV. But if this pattern continues, the end result will be the death of TV at the hands of the very people who claim to be supporting it.

Under such circumstances, it is vital that broadcasters and their allies provide verifiable evidence that subsidies given in the name of preserving free TV not only go to free TV but also don't actually serve to undermine free TV.

But it is not even clear that free TV is worthy of government subsidy. The time has come for the General Accounting Office and the public interest community to do a careful cost-benefit analysis to determine if free TV is worth its cost.

Even if ad-supported TV is determined to be a vital national interest, it is possible that there are more efficient ways of delivering it. Thomas Hazlett has made one such proposal.<sup>68</sup> Let's assume that every American has a sacred right to continue receiving local ad-supported TV from the current crop of incumbent broadcasters. Currently, these broadcasters use the most valuable airwaves available on earth to distribute their programming. But the programming could also be delivered over the much less valuable spectrum that can be used with satellite TV delivery. Every American could be guaranteed their current free TV fare, just not over the same airwaves. This would appear to be a creative win-win because free TV is preserved while resources are used more efficiently. Yet broadcasters would be sure to oppose it because the current regulatory regime is even more favorable to themselves.

The myth of free TV is that it is free. Free TV is the most profitable business in the United States, but only because it has been subject to vast subsidies. The time has come to carefully evaluate the costs of free TV and try to minimize them. It is also time to drop the phrase "free TV" from political usage. Perhaps a more apropos phrase would be "government-subsidized TV."

## ENDNOTES

---

<sup>1</sup> From “Webster’s Electronic Quotebase,” ed. Keith Mohler, 1994.

<sup>2</sup> Speech at Woman’s National Democratic Club, Washington, D.C., May 15, 2002.

<sup>3</sup> Barnouw, Erik. *Tube of Plenty: The Evolution of American Television, Revised Edition* (New York: Oxford, 1982 p. 43-4); Smulyan, Susan. *Selling Radio: The Commercialization of American Broadcasting 1920-1934* (Washington, DC: Smithsonian, 1994, Chapter 3).

<sup>4</sup> Cited in Smulyan 1994, p. 65

<sup>5</sup> Smulyan, supra note 2, 65

<sup>6</sup> Barnouw pp. 74-75; Smulyan, pp. 68.

<sup>7</sup> Smulyan, p. 70.

<sup>8</sup> Many in the non-profit sector advocated a common carrier system for broadcasting, similar to the model used for transportation, telephones and telegraphs. Common carriage would have separated control over transmission and content, effectively requiring broadcasters to allow others to buy airtime for programming. This model was never adopted for wireless services.

<sup>9</sup> The chicken-and-egg problem would be solved in 1962 with the “UHF All-Channels Receiver Act.” which mandated that all TV sets sold in the U.S. include a UHF receiver. See Barnouw.

<sup>10</sup> Scrambling TV signals at the transmitter and descrambling them at the receiver was much harder to do with 1950s analog technology than with 1990s digital technology. With 1950s cable TV technology, subscribers who didn’t pay could simply be disconnected from the cable TV wire at a box located outside their house.

<sup>11</sup> Robert W. McChesney, *Telecommunications, Mass Media, and Democracy: The Battle for the Control of U.S. Broadcasting, 1928-1935*, 1995.

<sup>12</sup> Barnouw p. 54.

<sup>13</sup> 22 F.R. 8313 (1957).

<sup>14</sup> The regulatory and legislative and lobbying history is full of abundant repetitions of the efficiency, equity, and political arguments. For example, see U.S. Congress House Committee on Interstate and Foreign Commerce. 1958. Subscription Television Generally. 85<sup>th</sup> Cong., 2<sup>nd</sup> sess., Jan. 14, 15, 16, 17, 21, 22, and 23; U.S. Congress House Subcommittee on Communications and Power. Committee on Interstate and Foreign Commerce. 1969. Subscription Television. November 18, 19, 20, 21, 24; December 9, 10, 11, 12. U.S. Congress Senate Subcommittee on Antitrust and Monopoly. Committee on the Judiciary. 1975. Pay Cable Television Industry. 94<sup>th</sup> Cong., 1<sup>st</sup> sess., May 21, 22, June 24, 25; and U.S. Congress Senate Subcommittee on Communications. Committee on Commerce, Science, and Transportation. 1989. Cable Carriage of Local Broadcast Signals. 101<sup>st</sup> Cong., 1<sup>st</sup> sess., Oct. 25.

<sup>15</sup> The National Association of Radio and Television Broadcasters subsequently changed its name back to its original name, the National Association of Broadcasters. From the 1920s until the present the NAB has remained the umbrella group representing general local broadcaster interests. Systematic conflicts among NAB members have been represented by separate organizations, including MSTV (for network affiliated TV stations) and INTV (for independent TV stations). As the broadcasting industry evolved and stations were acquired by large media conglomerates with a broad mix of stations, the lines of political conflict within the local TV broadcasting community changed and dissipated.

<sup>16</sup> National Association of Radio & Television Broadcasters, “On Record Against Pay-TV,” pamphlet, 1956, p.6. Other major broadcasters were quoted making the same argument; for example: “With subscription TV the public will be required to pay for programs which it now obtains free of charge,” (ABC); and “Free television programming would suffer irreparably and the public would have to pay for what it now receives free,” (NBC).

<sup>17</sup> National Association of Radio & Television Broadcasters, “On Record Against Pay-TV,” pamphlet, 1956, p.9.

<sup>18</sup> National Association of Radio & Television Broadcasters, pamphlet, 1957.

<sup>19</sup> National Association of Radio & Television Broadcasters, pamphlet, 1958.

<sup>20</sup> 15 F.C.C.2d (1968)

<sup>21</sup> Richard A. Gershon, “Pay Cable Television: A Regulatory History,” *Communications and the Law*, June 1990, p. 12

- 
- <sup>22</sup> David Gunzerath, “Darn That Pay TV!”: STV’s Challenge to American Television’s Dominant Economic Model,” *Journal of Broadcasting and Electronic Media* 44(4), 2000, p. 662
- <sup>23</sup> David H. Ostroff, “A History of STV, Inc. and the 1964 California Vote Against Pay Television.” *Journal of Broadcasting* 27(4), 1983, p. 382.
- <sup>24</sup> For a description of the ads, see Gunzerath pp. 667-8, and Gershon p. 15.
- <sup>25</sup> Gunzerath 2000, p. 667.
- <sup>26</sup> Ostroff 1983, 381.
- <sup>27</sup> This ranged all the way from New York City with 5.8 million TV households down to Augusta, Maine, with 138,000 TV households.
- <sup>28</sup> 52 F.C.C.2d 1 (March 20, 1975).
- <sup>29</sup> National Cable Television Association, *Cable Television Developments—Spring 1995*, p. 2; and Hazlett’s Negroponte Switch.
- <sup>30</sup> E.g., Justice Kennedy wrote in upholding the must-carry rules passed by Congress in 1992: “we are not at liberty to substitute our judgment for the reasonable conclusion of a legislative body.” However, Justice O’Connor dissented, stating that the principle of judicial deference “does not require wholesale deference to judgments about rapidly changing technologies that are based on unquestionably outdated information.” *Turner Broadcasting System v. Federal Communications Commission* 520 U.S. 180.
- <sup>31</sup> National Association of Broadcasters, “The Free Television Campaign Kit,” June 15, 1989.
- <sup>32</sup> *TV Today*, July 24, 1989.
- <sup>33</sup> Christopher Stern, “ABC’s Iger Says Auction Could Kill Free TV,” *Broadcasting & Cable*, February 26, 1996, p. 8. See also Roger G. Noll et al., *Economic Aspects of Television Regulation*, Washington, DC: Brookings, 1973, p. 136.
- <sup>34</sup> Doug Halonen, “Broadcast Factions Banding Together: Networks, Stations Hunting for New Revenue Streams,” *Electronic Media*, January 14, 2002, p.1.
- <sup>35</sup> Doug Halonen, “Powell: TV Wastes Spectrum,” *Electronic Media*, December 3, 2001, p.4.
- <sup>36</sup> American Association of Advertising Agencies report, Clutter Watch 2001,” cited in Louis Chunovic, “TV Clutter Reaches All-Time Highs,” *Electronic Media*, February 18, 2002, p. 4.
- <sup>37</sup> Bruce M. Owen and Steven S. Wildman, *Video Economics* (Cambridge: Harvard University Press, 1992).
- <sup>38</sup> Amy Harmon, “Skip-the-Ads TV Has Madison Ave. Upset,” *The New York Times*, May 23, 2002, p.C3.
- <sup>39</sup> Nick Wingfield, “Group Sues Major Media Firms On Behalf of Users of ReplayTV,” *Wall Street Journal*, June 7, 2002.
- <sup>40</sup> e.g., see Erik Barnouw, *The Sponsor: Notes on a Modern Potentate* (New York: Oxford University Press, 1978); Ben H. Bagdikian, *The Media Monopoly, 2<sup>nd</sup> Ed* ( Boston: Beacon Press, 1987); Owen and Wildman;
- <sup>41</sup> Art Buchwald, “Irrelevancy Begins at 40,” *Washington Post*, April 4, 2002, p. C2.
- <sup>42</sup> Daniel Bell, *The Cultural Contradictions of Capitalism* (New York: Basic Books, 1976).
- <sup>43</sup> John Kenneth Galbraith, *The Affluent Society* (New York: New American Library, 1958).
- <sup>44</sup> Robert D. Putnam, *Bowling Alone: The Collapse and Revival of American Community* (New York: Simon & Schuster, 2001).
- <sup>45</sup> Lisa Rein, “Virginia TV-Turnoff Bill Ticks Off Industry,” *Washington Post*, February 26, 2002. p. B1.
- <sup>46</sup> Sally Beatty, “In Battle for Toddlers, TV Networks Tout Educational Benefits,” *Wall Street Journal*, April 1, 2002, p. 1.
- <sup>47</sup> Michael Porter, *Competitive Advantage* (New York: Free Press, 1985).
- <sup>48</sup> Comments to broadcasters at their annual convention. “Yahoo’s Yang Warns NAB Not to Slow Convergence in Washington,” *Communications Daily*, April 13, 2000, p. 5.
- <sup>49</sup> Broadcasters currently claim to provide \$9.9 billion a year in non-monetary compensation for both TV and radio spectrum (they don’t break down the \$9.9 billion between radio and TV industries). These numbers, however, are not verifiable and have had to be taken purely on trust. There is ample reason to believe that the market value of the broadcasters’ contributions is a negligible fraction of their claimed contributions (e.g., Kaiser Report, EM article).
- <sup>50</sup> Petition of the National Association of Broadcasters Regarding Rental Schedule for Communication Uses, before the Office of the Secretary, U.S. Department of Interior, December 13, 1995. See also Statement of the National Association of Broadcasters, Submitted to the House Subcommittee on National Parks, Forests, and Public Lands, and The House Subcommittee on Environment Energy and Natural Resources on the Issue of Oversight of Federal Communication Sites, July 12, 1994.

---

<sup>51</sup> Broadcasters' estimate for members of Congress. See National Association of Broadcasters, Spectrum Auction Action Tool Kit, February 1996.

<sup>52</sup> It was leased to a private company in July 2001.

<sup>53</sup> National Association of Broadcasters, "Broadcast Towers: Managing Your Vertical Real Estate," Panel discussion at NAB 1998, April 6, 1998. At this panel broadcasters were advised: "You have two key assets: a tower and a license," and "If you're going to build a tower, why not build it big enough to be a profit center." A number of towers in recent years have been so overloaded with revenue producing transmitters that they have collapsed. One presenter promised that a very popular tower can bring in revenues of a "couple million dollars a year."

<sup>54</sup> For example, media lawyer John P. Burger argues that broadcasters shouldn't be penalized for using hidden cameras and that trespass laws shouldn't be used to punish journalists gathering news. In Bill Kirtz, "Tips from the Trenches," *Quill*, March/April 1999, p. 33.

<sup>55</sup> Ralph Nader, "Socialism for the Rich," *The New York Times*, May 15, 1999.

<sup>56</sup> For general background, see Treasury Regulation Section 1.61-2(d)(1); IRS Revenue Rulings 79-24 and 80-52; International Reciprocal Trade Association, <http://www.irta.com>; Edward Wyatt, "A Whole Other Type of E-Trade," *The New York Times*, October 20, 1999, p. C1.

<sup>57</sup> Alan Murray and Jackie Calmes, "Tax Report," *Wall Street Journal*, September 4, 1991, p. A1.

<sup>58</sup> Jonathan Rauch, "Color TV: Diversity Mongering at the FCC," *The New Republic*, December 19, 1994; and Erwin G. Krasnow, "A Case for Minority Tax Certificates," *Broadcasting & Cable*, December 15, 1997, p. 80.

<sup>59</sup> Bruce M. Owen and Steven S. Wildman, *Video Economics*, Cambridge: Harvard University Press, 1992.

<sup>60</sup> John Higgins, "Paxson Renders Unto TCL," *Broadcasting & Cable*, May 4, 1998, p. 6. One public broadcaster leased just its must-carry rights to a commercial broadcaster for \$4.25 million over an 8-year term. Wayne Walley, "Public Broadcaster Sells Must-Carry Rights," *Multichannel News*, October 14, 1996, p. 95.

<sup>61</sup> Adriel Bettelheim, "Senators Unveil Satellite TV Subsidy Bill," *CQ Weekly*, February 26, 2000, p. 418.

<sup>62</sup> Kevin Maney, "Ruling Stops iCraveTV Transmissions to USA," *USA Today*, February 9, 2000, p. B1; David Hatch, "NAB's Fritts: Now New Net Protection," *Electronic Media*, June 19, 2000, p. 8.

<sup>63</sup> Doug Halonen, "Looking Back at Retransmission," *Electronic Media*, March 4, 2002; see also Testimony of Neal Schnog before the Committee on Energy and Commerce, U.S. House of Representatives, Hearing on The Status of Competition in the Multi-Channel Video Distribution Marketplace, December 4, 2001.

<sup>64</sup> E.g. "... allowing cellular frequencies to be used for the transmission of news, sports, weather, etc., would, in essence, turn the service into a broadcasting service, and therefore run counter to the primary purpose for which the service was created—to improve the nation's mobile radiotelephone service." In comments of the National Association of Broadcasters, In the Matter of Amendment of the Commission's Rules to Authorize Cellular Carriers to Offer Auxiliary and Non-Common Carrier Services, Federal Communications Commission, RM-7823, November 26, 1991, p. 6.

<sup>65</sup> National Association of Broadcasters, "Free Television Under Siege," May 1988, p. 2.

<sup>66</sup> E.g., Janay Collins, Joey Reagan, and John D. Abel, "Predicting Cable Subscribership: Local Factors," *Journal of Broadcasting*, 1983, 27:2, 177-183; Douglas Webbink, 1986, "The Demand for Cable and for MDS," unpublished working paper, Federal Communications Commission; Robert Kieschnick and B.D. McCullough, "Why Do People Not Subscribe to Cable Television? A Review of the Evidence," unpublished working paper, Federal Trade Commission, September 1998.

<sup>67</sup> E.g., Federal Communications Commission, "Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable And Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996," FCC 02-33, February 6, 2002.

<sup>68</sup> Thomas W. Hazlett, "The U.S. Digital TV Transition: Time to Toss the Negroponte Switch," AEI-Brookings Joint Center for Regulatory Studies, Working Paper 01-15, November 2001.