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The FCC and the Unfree Market for TV Program Rights

by

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Should the Federal Communications Commission step in to prevent temporary programming blackouts caused by bargaining impasses between MVPDs and broadcasters? Blackouts are black eyes for the industry and for the FCC because they garner heavy negative media coverage. But some say that negotiations between the broadcaster "must carry" and "retransmission consent" rights holders on the one hand, and cable and satellite companies on the other hand, are part of the competitive free market process, with which the Commission should not meddle. The problem, of course, is that the TV program market is not free and competitive, partly because of rules promulgated by Congress or by the FCC itself. These rights yield no productive value for the economy, but merely transfer profits from one industry group to another in a way that is costly to consumers. The rules create rather than correct a market failure.

The media business is complex. Media companies buy or produce "content" such as TV and radio programs, comic strips, or news coverage. The media sell or give away content to listeners, viewers and readers. Media companies also deliver readers and viewers to advertisers. Competition is rampant, not only for audiences and advertisers, but for content.

Changing technology presents additional challenges. In the last century many new technologies came along – and in some cases, went away. New media technologies included AM and FM radio, digital radio, many forms of recorded music and video, television, color television, cable television, satellite television, digital television, and the Internet. The printing press has survived this onslaught but is now much diminished in importance as a medium of communication. But all this churning bespeaks a market for content that is robustly competitive – except where it isn't. And where it isn't, it's largely on account of regulatory interventions that no longer make much sense, even if they once did make sense.

The problem is that industries faced with acute pressure from competition and technological changes often seek assistance from the government. By its nature, the demand for protection originates from the established firms who aim to stop or at least attenuate inroads by new entrants and new technologies. New entrants and technologies threaten established firms precisely because they offer more or better services and lower prices to consumers. Government protection for the established suppliers often works by depriving consumers of such benefits. Protection for established firms is therefore likely to be harmful to the public, keeping prices high and slowing the availability of new products and services.

Media businesses in particular have made frequent use of government protection. Our elected representatives enjoy photo ops with showbiz celebrities, and they greatly value face time on the local TV evening news. TV broadcasters have one of the most powerful lobbies in Washington. The FCC does what Congress tells it to do, and it likes to feel that it is useful to the industries it regulates. What could be more useful than maintaining a safe and stable environment for the media businesses that matter to Congress?

Many FCC rules and regulations arise from these impulses to manage competition, though they are often papered over with attempts at public interest rhetoric. Nothing could better illustrate FCC attempts to manage the market than the weird history of TV broadcasts carried on cable television, satellite and other broadband services.

Decades ago, in the 1950s, cable systems simply offered better reception for local TV signals. That was fine with the TV stations, and therefore fine with the FCC, which concluded it had no jurisdiction anyway. Then in the 1960s cable systems started to carry TV stations from distant cities. This was definitely *not* fine with local TV stations, which were losing part of their audience. Suddenly the FCC decided it *did* have jurisdiction, and it ordered cable systems to stop importing distant stations. Clearly this FCC action harmed TV viewers, who were denied a wider choice of programs. In effect, the FCC created a new right, the right to be free of competition from out-of-town stations, and awarded that right to all local stations. Economically, this was equivalent to taxing cable operators and subscribers and using the proceeds of the tax to send out economic security payments to local TV stations.

About a decade later, in the late 1970s, because of low transmission prices resulting from the introduction of domestic communication satellites, there was an explosion of new cable networks such as HBO and CNN. This greatly diminished the competitive significance of distant broadcast signals. Lacking continued broadcaster interest in continued protection, the FCC deregulated distant signal carriage as a sop to reformers. Then, in the 1980s, as dozens and then hundreds of new cable networks became available, cable systems themselves began to lose interest in carrying the less popular (non-network-affiliated-UHF) local TV stations. In a free market, weaker local TV stations probably would have paid cable systems for carriage. But the FCC, of course, required cable systems to carry all local stations without charge.

The FCC “must carry” rules made cable somewhat less profitable than it would have been, slowing the growth of the cable industry, and denying choices to consumers in unwired areas. Again, the FCC created a new right, which it awarded to TV stations, to be free of the burden of paying for local cable carriage. Consumers and cable operators once again essentially wrote a check to the FCC, which the FCC passed on to the TV stations. The IRS got nothing out of the transfer, and the public got less than nothing.

The early 1990s brought growing awareness that the future profitability of the broadcast networks was clouded by competition from cable networks, not to mention new broadcast networks such as Fox. CBS led a lobbying campaign to introduce another new property right called “retransmission consent.” At that point cable systems were already paying for programs on TV stations they were obliged or permitted to carry under the FCC’s many rules. Since 1976 cable operators have enjoyed by law a compulsory license from the owners of the actual TV programs, for which they pay a small percent of their gross receipts into a central pool redistributed to program producers by the Register of Copyrights.

After passage of the 1992 Cable Act, the popular network-affiliated TV stations could demand to be paid a “retransmission consent” fee by cable operators. Except for local news shows and the like, broadcasters generally don’t own copyrights in their programming. (TV stations merely acquire licenses to broadcast network or syndicated programs in local markets, not the right to license those programs to other distributors.) “Retransmission” in effect created yet another new property right, and assigned ownership of the right to TV network affiliates, the largest and most important of which are owned by the broadcast networks themselves. Non-network broadcast stations continue to benefit from must-carry.

Unlike program producers and networks, TV stations do nothing to “earn” this right, and the benefits to them are not rewards for innovation or production of valuable services. The economic value of a retransmission right comes solely from the ability of its owner to extract cash (or carriage) from cable systems and other multi-channel video program distributors (MVPDs). In fact, now that nearly everyone gets all TV signals by cable or satellite or Internet, broadcast stations are largely useless relics of a bygone technology, and the spectrum that is still reserved for their use has far better and more valuable uses.

In practice, the broadcast networks have mostly used their retransmission consent rights to induce cable operators and other MVPDs to carry new cable networks owned by the broadcasters. When a new cable network enters the business, with a relatively low audience share, it must pay cable operators for carriage in order to achieve nationwide coverage. Once that is achieved, the most popular and successful cable networks start charging cable operators for their programming. The retransmission consent right makes it possible for broadcaster-owned cable networks to avoid paying for carriage during their startup period, and it permits them to reach economic viability much earlier and more cheaply than otherwise. Once again, cable operators and subscribers in effect are writing checks to the FCC, which passes the proceeds on to the wealthiest broadcasters.

The key to this system of taxes and subsidies is the ability of the FCC, with congressional sanction, to create new property rights and to decide who should own those rights. These are powerful tools that *could* be used for worthy ends, such as correcting or reducing the adverse effects of various market failures. But they can also be used to disadvantage consumers and one or another category of competitor in order to benefit a category more favored by the regulatory agency. Such transfers are nurtured and energized by political influence and the collective action difficulties faced by consumers with relatively small and diffuse interests in any given regulatory issue. Broadcasters, as the only group with the ability to control TV access by politicians to large fractions of local voters, have enormous power in this game. They seldom lose.

It is often difficult to predict exactly what will happen if a regulatory intervention, much less a whole set of interventions, were to be repealed. In this case, however, the prediction is very easy to make. Absent regulatory intervention there would be no TV broadcast industry today, and cable operators and other MPVPs would pay nothing to broadcasters. The MPVDs would acquire program rights directly from the program content owners. Without broadcasters to tax MVPDs and viewers there would be more programming and lower program prices. With less certainty, one can say that cable, satellite and telephone broadband providers would be facing additional competition from wireless broadband suppliers using the spectrum currently devoted to wasteful TV broadcasts. In such a world there would be no need for most FCC regulation, including “net neutrality” or content regulation.

The lesson: By all means let a competitive market in TV programming operate free of regulatory intervention. But first, create a truly free market by repealing artificial and unproductive legacy rights, such as must carry and retransmission consent, which are no longer needed – if ever they were – in today's competitive communications marketplace.

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