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PREFACE

The ongoing prohibition of household Pay TV services in Australia __ which is an extreme form of government regulation of business __ is being reviewed by the Federal Government.

Public debate on the Pay TV issue has centred around a number of parliamentary and departmental inquiries, and has been conducted against a background of announced and foreshadowed reforms to the highly regulated telecommunications and broadcasting sectors. The key issues are the extent to which government should specify the providers, transmission methods and program content of Pay TV.

In this discussion paper, the Office of Regulation Review (ORR) analyses arguments advanced for government control of Pay TV, in an economic social welfare framework. It attempts to sort out those characteristics of the market and service which both require and are likely to be amenable to regulation. Its objective is to provide a focus so that the regulatory regime developed for Pay TV strikes an appropriate balance between the objectives and practical limits of regulation.

The paper is part of the ORR's public information program. The ORR __ formerly the Business Regulation Review Unit __ is part of the Office of the Industry Commission and is responsible for administering the Federal Government's regulation review policy: it reviews new regulation, monitors progress and participates in programs for the reform of existing regulation, and provides public information on regulatory matters. Research for this project was undertaken by Steven Rimmer, and the paper was authored by Tom Nankivell. The views expressed are those of the ORR and do not necessarily represent those of the Industry Commission.

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OVERVIEW

Household Pay TV is prohibited in Australia. Consequently, unlike their counterparts in other Western countries, Australian consumers are denied access to this service, thereby forgoing the benefits of expanded consumer choice, program diversity, specialised 'niche market' programming and viewer convenience associated with Pay TV.

This is despite the many recent government reports which have argued that Pay TV is both feasible and desirable; the successful operation of satellite services to clubs and hotels in Australia since 1986; and the expectation that, with the expiration of a moratorium on household Pay TV in September 1990, the Federal Government would promptly announce arrangements for its introduction.

The delay in announcing arrangements reflects government concerns about the effects of introducing the service in the current economic environment, about its impact on other media and about the need for regulation to control aspects of its operation and programming.

However, the Office of Regulation Review (ORR) considers that the arguments put forward for prohibiting Pay TV, and most of those advanced for regulating aspects of it, are unsustainable.

For some of the arguments, regulation of the television market is in fact unnecessary to achieve the 'economic efficiency' objective sought. For example, television regulation has in the past been advocated to overcome the problems of 'destructive competition' and 'wasteful duplication' of infrastructure, but evidence from established overseas markets suggests that these problems need not arise: the service is amenable to sustainable market competition. Regulation has also been advocated to reserve Pay TV carriage to Telecom fibre-optic cable because of its extra benefits as a means of two-way communications, but firms wanting to supply Pay TV services would have a clear commercial incentive to take full account of all the complimentary and competing uses of different infrastructures when choosing the best technology to invest in. Hence, 'market forces' should generate an optimal level of investment in fibre-optic infrastructure (and its alternatives).

The goals underlying other economic arguments should not be addressed through Pay TV regulation. One such argument is that giving AUSSAT a monopoly on Pay TV carriage would increase that body's value prior to its privatisation. A second such argument is that Pay TV should be prohibited

to avoid exacerbating the current account deficit. However, the government's revenue objective should not be obtained through anti-competitive market regulation; nor should it's current account objective be pursued through covert trade protectionism in the Pay TV market. Such macro-economic objectives are generally better addressed through macro-economic measures.

In some arguments for regulating Pay TV services, the underlying goal is inappropriate. For example, restrictions on Pay TV have been advocated to protect free-to-air networks from the effects of competition, but changes in firms' viability and market share resulting from competition are not normally undesirable: rather, they generally reflect a shift in resources to firms better placed to satisfy consumer needs.

Many traditional arguments for the social regulation of television __ such as to control programming, advertising and ownership __ are invalid in the Pay TV context. The goals and effectiveness of much social regulation of free-to-air television are themselves questionable. More importantly, though, the specialised characteristics of Pay TV __ for example, viewers subscribe directly for the service and much programming is targeted at niche markets __ suggest that the appropriate regulatory model for Pay TV is more in line with that applying to the video industry.

Some arguments for regulating Pay TV have theoretical merit, although the ORR considers that they would warrant only limited additional regulation in practice. For example, regulation may be justified to safeguard against Pay TV stations 'siphoning' broadcasting rights for events of national significance away from free-to-air networks, even though Pay TV stations are unlikely to have sufficient audience reach to be capable of outbiding free-to-air networks for such rights. Applying some existing censorship provisions to Pay TV may also be warranted to prevent the screening of socially deleterious material. And there is also clearly an ongoing role for government to define and protect radio spectrum property rights.

More generally, though, in the ORR's view, what it sees as a history of costly and misdirected regulation of broadcasting and telecommunications justifies a careful approach to further government intervention in these markets.

Overall, the ORR considers that, to enhance economic efficiency and consumer welfare, Pay TV should be introduced promptly and with minimum regulation.

1 INTRODUCTION

Although Pay TV has operated overseas for more than 30 years and now extends to most Western nations, successive Federal Governments have prohibited its introduction in Australia.

In recent times, though, a number of studies have been conducted into the feasibility and desirability of introducing household Pay TV into Australia, with virtually all supporting its introduction.

In its 1982 'Report on Cable and Subscription TV Services', the Australian Broadcasting Tribunal (ABT) advocated the introduction and regulation of Pay TV based on the free-to-air television regulatory model.

In 1986, the Minister for Communications announced a four year moratorium on the introduction of Pay TV to households, but permitted Pay TV by satellite broadcasting to clubs and hotels.

In its 1989 report titled 'Future Directions for Pay Television in Australia', the Department of Transport and Communications (DOTC) supported the introduction of Pay TV. It also placed emphasis on the market and competition to meet community needs and standards.

In November 1989, the House of Representatives Standing Committee on Transport, Communications and Infrastructure tabled its report 'To Pay Or Not To Pay: Pay Television and Other New Broadcasting-Related Services'. The majority of members argued that, in principle, Pay TV should be allowed to proceed. The report suggested that regulatory arrangements should be based loosely on the free-to-air model, albeit with some notable differences: for example, no local content regulations for Pay TV operators, subject to a review after the first five years.

With the expiration of the moratorium on household Pay TV services in September 1990, the Federal Government was expected to determine and announce arrangements for its introduction in early 1991, but a final decision has been delayed. This delay reflects concerns over the effects of introducing the service in the current economic environment, its impact on other media and how its program content should be regulated.

Against this background, the ORR has appraised the various arguments advanced for continuing to prohibit household Pay TV or for regulating it if introduced.

2 THE MARKET ENVIRONMENT

This section discusses some aspects of the Pay TV market of relevance to the subsequent analysis. A more comprehensive discussion of the Pay TV market can be found in the report by the House of Representatives Standing Committee on Transport, Communications and Infrastructure (1989).

Pay TV technologies

There are currently over forty alternative communication systems which can be used to transmit verbal and visual data, of which four are usually cited as primary technologies for delivery of Pay TV signals. Each alternative has different characteristics which impact on service quality and cost.

- Ultra High Frequency (UHF) is the only Pay TV technology which is available in Australia immediately. While it is broadcast in a manner similar to free-to-air television, consumers require a decoder to be able to unscramble the signal;
- A Multipoint Distribution System (MDS) is a network of central receiving stations (cells) which receive Pay TV signals through cable, satellite or other broadcast modes and then transmit such signals directly to consumers, up to a distance of 15 kilometres from the station. It also requires the consumer to acquire a decoder to be able to accept signals;
- The Direct Broadcast Satellite (DBS) uses satellite infrastructure to broadcast over a large area of the planet directly to consumers. It requires the consumer to have both a decoder and an earth receiving station/dish to accept signals; and
- Cable signal utilises coaxial or optical fibre technology to transmit signals directly to consumers. It can provide over 40 channels and optical fibre allows for interactive (two way) services.

Table 2.1, reproduced from the 1989 Report of the House of Representatives Standing Committee on Transport, Communications and Infrastructure, lists some characteristics of each system and cites the Committee's preferred 'choice' of a mix of cable and MDS.

The ORR notes, however, that while this table provides a comparative assessment of four Pay TV technologies, the dynamic nature of technological developments in the telecommunications and broadcasting field might have already made some of the conclusions obsolete. For example, for UHF, MDS and DBS combined, the number of possible broadcast channels in any one broadcast area has in the past been limited to a maximum of seventeen. However, in the United States, a private consortium is reported to be planning to implement a satellite Pay TV network in 1993 using satellite dishes which can pick up 100 channels (The Economist 1990 and The Bulletin 1990). This has implications for licensing systems and the competitiveness of different Pay TV technologies.

Table 2.1: Comparative advantages of Pay TV delivery systems

Source: House of Representatives Committee on Transport, Communications and Infrastructure 1989.

Pay TV's target market

Pay TV is only one of a number of visual broadcast and media services: others include free-to-air television, video outlets, and cinemas.

The Australian television broadcasting market is generally competitive. In major cities, at least five free-to-air services already exist and, were cable, satellite and multipoint distribution permitted, many more channels could be available.

Pay TV operators and the various free-to-air television stations would compete directly with each other for audience, program material and advertising revenue. Consequently, they would have a strong commercial incentive to have regard to consumer preferences for different types of programs and levels of advertising.

However, because the commercial viability of Pay TV operators depends heavily on direct viewer subscriptions, they have an added incentive to tailor their programming and advertising content to their viewers' specific requirements. In this context, the head of one of the firms seeking to supply Pay TV in Australia has referred to a monthly 'referendum' of those taking the service who can elect not to continue with it. Further, because Pay TV consumers need to outlay a subscription fee to receive the service, they are generally less tolerant of advertising. And since Pay TV operators cannot expect to gain access to as large an audience as those gained by free-to-air operators, much Pay TV programming and associated advertising targets niche markets rather than broad mass markets.

Pay TV services would also compete with home videos for the viewer's dollar. This is because the popularity of videos __ VCR penetration is now well over 50 percent of households __ has been attributed, in part, to their flexibility in satisfying consumer preferences for specific types of programs. As discussed above, Pay TV can cater more effectively for specific viewer tastes than can free-to-air television.

The potential size of the Australian Pay TV market is unknown but, given overseas evidence, it could well be substantial. If, with a subscription fee of $40 per month, its market penetration were to reach 40 per cent of Australian households (2.08 million), revenues from Pay TV in Australia would be in excess of $1 billion per year.

3 THE REGULATORY ENVIRONMENT

Electronic media are regulated directly by legislation, in particular the Broadcasting Act 1942, under which the ABT is designated the regulatory authority. The Minister for Transport and Communications and the ABT control the distribution of licences and aspects of licensing conditions such as advertising, local/foreign content and ownership.

Australia's regulatory arrangements in this regard are more restrictive than those in other advanced nations such as the United States, Japan and the United Kingdom.

The regulations, and the goals/benefits for which they are intended, are discussed in some detail in Section 5.

Regulations introduce three different sorts of costs.

First, there are the direct costs to tax-payers of regulatory bodies, which are usually well documented. For example, in 1990-91, appropriations to the ABT were $9.3 million (Budget 1990, 418). The ABT is not the sole government agency involved in television regulation __ the DOTC also plans and monitors the industry __ so its costs are only a component of the fiscal cost to government of media regulation. Unless only lightly regulated, the introduction of Pay TV would require expanded funding of a regulatory body.

Second, there are the costs incurred internally by the regulated firm. Complying with government regulations requires extra staff to carry out functions such as filling out forms and preparing submissions to 'lobby' regulatory bodies __ licence renewal applications are a particularly onerous requirement in this industry. The costs incurred in undertaking these tasks are known as 'paper burden' costs. While the extent of such costs are unknown, a study commissioned in the mid 1970s by the Committee for the Economic Development of Australia estimated that government media regulations might require an increase in employment in the radio industry of some 8 to 10 per cent (Wiltshire et al, 1976).

The third type of cost, and potentially the most significant, derives from the distortion of market forces caused by regulation. Interference in the market can reduce consumer satisfaction by restricting the range of choice available to consumers: in the case of the current prohibition of household Pay TV, this cost is likely to be substantial. Also, where regulation limits

competition in an industry generally, higher prices may be charged (for example, to television advertisers) or product quality may decline.

The considerable cost and complexity of the existing electronic media regulation has been recognised by the Federal Government: the Minister for Transport and Communications has foreshadowed an overhaul of broadcasting regulation, and the progressive introduction of competition to the telecommunications sector.

In contrast to the heavy regulation of free-to-air television and the total prohibition of household Pay TV services, there has been little regulation of other new electronic media services, with a consequent increase in viewer choice. For example, the home video industry has not been impeded by government rules and regulations and has developed quickly (see Section 2). Similarly, 'Sky Channel' satellite broadcasting to Australian clubs and hotels has operated successfully outside an extensive regulatory regime.

4 ASSESSING ECONOMIC RATIONALES FOR PAY TV REGULATION

The ORR's approach

The competitive market paradigm indicates that, in the absence of 'market failure', the operation of market forces will generate 'economically efficient' outcomes. In simpler English, this means that firms, in response to the profit motive, will produce *the* range of goods and services that most satisfies consumer preferences and enhances community welfare, *unless* there is some flaw in the market.

Consequently, the economic justification of regulation of an industry generally requires, in the first instance, the identification of some form of 'market failure'.

Further, because government regulation generally creates its own market distortions and entails significant costs (see Section 3), the economic justification of a regulation requires, in the second instance, that the costs of 'government failure' associated with the regulation do not exceed those of the market failure that it was designed to correct.

These concepts, when applied to Pay TV, indicate that, unless there is some form of significant 'market failure' associated with the provision of broadcasting services, then there is no economic reason for government to regulate either the structure or performance of this industry. And to the extent that significant market failure can be identified, regulation should be directly targeted at correcting it in the most efficient manner.

The ORR has used this approach __ which is in line with the government's policy of 'minimum effective regulation' __ in the following assessment of economic arguments for regulating Pay TV.

Natural monopoly issues

A 'natural monopoly' may arise where an individual market can be served at a lower cost by one firm rather than by a number of firms. Goods and services open to natural monopoly supply are often characterised by high fixed infrastructure costs and low marginal costs of supply. In such markets, competition between firms may result in wasteful duplication of infrastructure and destructive competition (IAC 1989, p. 79).

Natural monopoly is therefore a form of market failure, and the economic literature suggests that government regulation may be warranted to restrict entry to such markets and/or to control the prices charged by the incumbent monopolist.

Some aspects of television transmission technology appear consistent with the theoretical requirements for natural monopoly. For example, for cable technologies, there are economies in having only one connection to each dwelling, although the cost saving for this aspect of the service amounts only to between 7 and 14 per cent.

In practice, however, market forces and/or recent technological developments appear to have effectively overcome any such problems.

For example, analysis of the Japanese television industry suggests that it is not a natural monopoly and that the problems of destructive competition do not occur. The industry __ which is characterised by the small scale of cable networks and extensive competition __ has developed successfully without extensive involvement of the national telephone company 'Nippon Telephone and Telegraph', and with the government eschewing the ownership of infrastructure (Gibson 1983).

In relation to America, Hazlett (1990) has shown that the past US policy norm of granting exclusive franchises in cable provision is inefficient. The process of allocation itself generates considerable lobbying costs and, typically, the value of a successful franchise after it has been awarded increases to a degree which indicates that it earns excess monopoly profits. Where comparisons could be made between competitive and monopolistic provision (only about one percent of US cable television providers faced competition), studies showed that consumers served by competitive providers benefited from lower prices__ down by as much as 23.5 per cent.

The pending introduction of extensive DBS satellite services in America (see Section 2) __ which will compete for subscriptions with existing regional statutory monopolies which use cable __ should make the industry more amenable to competition.

In many Western European countries, changes in communications technologies, particularly the availability of multi-channel cable, have facilitated the move to a less regulatory approach to the industry (DOTC 1989a).

Given the evidence of sustainable competition in established overseas markets, the ORR considers that regulation of Pay TV on natural monopoly grounds is unwarranted.

Externalities in related technology

'Externalities' are a form of market failure that arise when there are benefits and/or costs to society from a particular product which are not reflected in the market incentives facing producers and/or consumers of the product. As a consequence, the level of consumption of the product will be inappropriate from an economic efficiency perspective.

In relation to Pay TV, it has been argued that reserving its provision to selected technologies or firms may provide positive externalities to society, in that it may reduce the cost of other services using the same infrastructure, or increase the value of the government owned instrumentality that operates the infrastructure.

Reserving cable provision for Telecom

In supporting the *eventual* **introduction of a sophisticated Telecom carried fibre optic cable approach to Pay TV, the House of Representatives Standing Committee on Transport, Communications and Infrastructure appears to have considered, in part, that there might be positive externalities associated with cable, such as the ability to perform other functions including interactive two-way communication. The proposed timing of the introduction of this means of carriage seemed to be concerned to prevent early private provision to households of the cabling, thus opening up potential competition across a wide set of telecommunications services.**

Such overrides of market forces might be justified were the particular market unable to 'internalize' the externalities, but the ORR can see no reason to believe this applies to the case of cable television. A firm choosing to invest in cable will be aware that additional functions can be sold directly to consumers or sold and leased to other firms. Hence, it will not only consider initial revenue from selling Pay TV signals but will also base investment decisions on perceived future income from other potential users of cable, such as telecommunication carriage.

Reserving satellite provision for AUSSAT

Restricting the provision of Pay TV services to satellite transmission by AUSSAT has recently been advocated on the grounds that giving that instrumentality a monopoly in Pay TV transmission would increase its market value prior to its sale to the second communications carrier.

While this is clearly the case, the ORR considers that such an outcome would not enhance economic efficiency, for two reasons.

First, any increase in the value of AUSSAT resulting from such a restriction would simply reflect the higher prices it could charge because of the absence of competitors. In effect, the higher value of AUSSAT would not represent a positive externality to the economy: rather, the additional revenue to government would simply constitute a 'transfer' to it from Pay TV operators in the first instance, and Pay TV subscribers and advertisers in the second.

Second, the reduction in competition entailed would have adverse economic effects in both broadcasting and telecommunications markets. In this context, it is not clear that current AUSSAT technology is, or will remain, the most efficient mechanism for providing Pay TV signals. For example, if AUSSAT infrastructure were used, the technology employed could require consumers to use a 60 to 100 cm receiving dish, which would cost approximately $500 to $800. This compares with the projected costs of US $200-300 for dishes on the forthcoming DBS system in the United States. Furthermore, by obliging the second carrier to provide the service by AUSSAT satellite technologies, potential economies of scope through joint cable delivery of telecommunications and Pay TV would be forgone.

Protecting free-to-air services

An important motive for inhibiting the introduction of Pay TV in Australia appears to be the desire on the part of the Federal Government to protect existing free-to-air television from additional market competition while the industry plan of 'aggregation' is implemented. This plan aims to provide additional free-to-air television services to regional and rural Australians (House of Representatives Standing Committee on Transport, Communications and Infrastructure 1989, p. 3). As such, the plan can be seen as a form of community service obligation (CSO) __ similar to the requirement for Telecom to provide universal access to telephone services. The commercial networks claim that this policy has been costly to them, at a time when some stations are experiencing financial difficulties.

However, in a report into the likely impact of Pay TV on commercial television in Australia, Cox (1990) argued that, particularly in its early years, Pay TV is unlikely to have a discernible effect on the free-to-air networks' revenue base. This is because, as with any newly introduced technology, Pay TV can be expected to take some time to build up an

audience and, as witnessed overseas, most television advertising remains with the free-to-air networks anyway: for example, in the United States, Pay TV has eaten up only a five percent slice of television's advertising cake.

More importantly, though, the ORR considers that the arguments for restricting Pay TV __ based on the performance and viability of free-to-air networks __ are unsustainable for the following reasons.

Changes in market share and industry size resulting from competition from alternative service providers are not a market failure. Rather, they generally reflect the re-allocation of society's resources to firms and industries which are better positioned to satisfy changing consumer needs.

If the aggregation plan has imposed additional costs on free-to-air networks, the appropriate action for government is to compensate those networks directly from the budget: not to restrict Pay TV services. This is because compounding costs and inflexibilities generated by regulation with additional regulation tends to further reduce economic efficiency.

Siphoning

'Siphoning' occurs when Pay TV obtains sole rights to a particular media program. In the process, access to free-to-air providers (and viewers) is restricted.

Siphoning can be considered a form of market failure insofar as it restricts access to a service for which consumption is 'non-rivalous': that is, where one person's consumption of the service does not reduce the amount available for others to consume.

In the debate about Pay TV in Australia, regulation has been advocated to prevent events of major national interest (for example, the Melbourne Cup) being siphoned away from free-to-air television, to the detriment of viewers.

However, for siphoning to be commercially viable, a Pay TV channel would need to attain a substantial audience anyway. This is because acquiring exclusive rights to popular programs is very expensive, so recouping payments for such programs requires large revenues. Indeed, for a Pay TV channel to be willing to out-bid a free-to-air network to acquire and show a particular program, the additional subscription and advertising revenue that it would expect to accrue __ consequent upon showing the program __ would need to exceed the additional advertising revenue expected by the free-to-air network.

Consequently, in practice, the ability of Pay TV to win exclusive rights to a major event is very limited because of the competitive advantage of the audience reach of free-to-air television. This is reflected in the overseas experience, where siphoning has been insignificant.

Further, regulating against siphoning would involve practical difficulties. For example, determining what programs should be protected would require somewhat arbitrary judgements, particularly given the diversity of tastes and interests of viewers.

Nonetheless, the ORR considers that the possibility of siphoning may warrant some regulation as a safeguard to the operation of household Pay TV services: it does not, however, warrant extensive intervention.

Balance of payments effects

One concern expressed about the introduction of Pay TV is that it could have detrimental effects on the current account of the balance of payments, at a time when Australia's foreign debt is high by historical standards.

Much of the infrastructure and equipment required for Pay TV would be imported if local firms were not competitive with foreign suppliers, although some infrastructure which could be used for Pay TV services __ such as AUSSAT's new generation satellites __ will be imported regardless of whether Pay TV proceeds.

Similarly, a substantial proportion of program content could be sourced abroad. This would occur if locally produced programs were to cost much more than foreign programs of a similar standard, because stations would have a clear commercial incentive to source their content requirements from overseas. This possibility is reflected, in a converse way, by the Canadian experience where, in the 1980s, Canada's restrictive local content regulations appear to have forced most Pay TV providers out of the market, thereby reducing competition and consumer choice.

On the other hand, the introduction of Pay TV in Australia could result in an expansion of domestic industries serving the local market and, if dynamic gains resulting from competition were to be reflected in more competitive cost structures of local producers, an expansion into export markets.

Nonetheless, if additional imports of equipment and programs exceeded any exports resulting from the introduction of Pay TV to Australia, there would be an increase in the current account deficit.

However, the ORR considers that such incidental effects on the balance of payments do not justify restrictions on the Pay TV industry.

This is because any change to the current account in the short-run should result in pressures for off-setting adjustments through other economic variables, such as the exchange rate, in the long-run. In this context, such changes to the current account should not be seen as some form of market failure requiring government intervention: rather, they simply reflect changing patterns of trade.

Following on from this, the appropriate goal for government industry policy should not be to minimise the size of the current account deficit through protectionism in particular markets, such as television services: rather, it should be to encourage economically efficient resource use by industry and thereby maximise national wealth and consumer well-being.

5 ASSESSING RATIONALES FOR THE SOCIAL REGULATION OF PAY TV

The ORR's approach

As discussed in Section 4, in the absence of market failure, competitive markets will generate economically efficient outcomes. Efficiency, from an economic perspective, deals with not only the attainment of material ends, but also with the attainment of social ends (and, indeed, cultural and environmental ends). Consequently, the competitive market paradigm indicates that, in the absence of market failure, market forces should deliver the appropriate supply of 'social' goods and services.

From this perspective, 'social' regulation is based upon the premise that there are some characteristics of the product or service that enhance or detract from community welfare and are not provided for adequately by the market __ that is, that there exists some form of social market failure.

As discussed in Section 3, free-to-air television is already subject to extensive social regulation, covering such areas as program content, advertising timing, community service obligations and ownership.

In assessing the case for social regulation of Pay TV, the ORR has looked at whether the rationales specified for regulating the free-to-air networks also apply to this segment of the industry.

Program content

Currently, electronic media programming is regulated by a mix of licence conditions, the Broadcasting Act 1942, ABT standards and industry codes of practice, often called self or co-regulation.

Program mix

Free-to-air television stations are required to both provide an 'adequate and comprehensive' service and broadcast certain amounts of specified program types: such as children's shows, Australian drama and local news services. These requirements have a mix of objectives: including ensuring diversity of choice, encouraging Australian content, and improving the quality of programming.

In the ORR's view, the desirability of these requirements is questionable. This is because the program 'quality' and level of Australian content specified by regulators is unlikely to be more in line with community preferences than that chosen by television stations competing for viewer ratings. Also, where the aim is to assist the local program production industry, this could be achieved more directly and efficiently through direct subsidies.

In addition to these general concerns, the ORR considers that particular characteristics of Pay TV mean that its program mix should not be regulated. Specifically, those characteristics are: that Pay TV viewers subscribe directly to the company which provides the service; that Pay TV operators therefore have a direct mechanism for gauging consumer satisfaction with the service provided; and that Pay TV programs are generally aimed at niche markets, and are therefore not amenable to program mix regulation. Indeed, these characteristics suggest that the appropriate model for regulating the program mix of Pay TV is not that applying to free-to-air networks: rather, it is that applying to videos __ that is, no regulation.

Community service obligations

Some interest groups advocate the regulation of Pay TV to require broadcasters to provide time for community groups, community education and the provision of programs for the 'disadvantaged'.

To the extent that it is profitable, Pay TV will cater for minority interests since it can offer a relatively large number of channels. In overseas markets, Pay TV provides programs for children, persons interested in hobbies such as cooking, and news/sporting shows.

In any event, the ORR considers that Pay TV should not be regulated for community service broadcasting, for three reasons. First, given the characteristics of Pay TV noted above, it would be inappropriate to force community programs onto Pay TV. Indeed, forcing Pay TV operators to provide air time for community groups would be akin to forcing magazine editors to provide column space for articles written by community organisations __ including those with no particular relationship to the market targeted by the magazine. This would reduce both consumer satisfaction and producer viability. Second, given the limited audience reach of Pay TV, it is unlikely to be an efficient medium for broadcasting general community programs, and there are already various publicly funded

free-to-air broadcasters, such as ABC and SBS, which provide a dedicated means of community service broadcasting. Third, regulating Pay TV channels to provide time for community groups would reduce the transparency of the assistance provided to such groups.

Assistance to community groups could be more efficiently and transparently delivered by direct funding. Such an approach would allow community groups to determine for themselves the most valuable use of their funds, while not precluding them from 'buying time' on Pay TV channels.

Censorship

Censorship regulations are intended to ensure that product characteristics do not display excessively violent or immoral attributes. Such regulation might be justified where negative 'spin-offs' (or external social costs) are associated with their provision, such as an increase in injuries, violence or crime.

The ORR considers that, as Pay TV consumers pay directly for specific services and programming formats, the rationale for censorship of excessively violent or immoral content might be less convincing than with free-to-air television, although it may still be valid. Appropriate censorship regulations __ again possibly reflecting those applying to videos __ may therefore be justified for Pay TV.

Advertising

While most of the revenue of the Pay TV industry would be derived from subscriptions, income could also be generated from advertising. In the United States, approximately 10 per cent of revenue of the Pay TV industry comes from advertising.

The Broadcasting Act 1942 calls for the broadcasting regulation to protect the 'public interest'. While the notion of the public interest is vague and open to interpretation, the ABT argues that government rules and regulations are needed to protect the public from annoying or excessive advertising formats. The ORR discussed regulation of advertising time on free-to-air television in detail in its April 1990 submission to the ABT (ORR 1990).

Whatever the merits of the ABT's argument when there are few suppliers to choose from, the ORR considers that the case for this sort of regulation is minimal with wide choice available __ as there would be with Pay TV __ because competition reduces the scope for stations to screen material not desired by consumers. Indeed, as discussed in Section 2, if Pay TV channels were to broadcast advertising which viewers found annoying, there would be a decline in subscriptions. Given the major reliance of Pay TV operators on revenue from this source rather than from advertising, advertising formats would need to be modified in line with consumer preferences or the financial viability of the provider would be threatened. In this way, the market facilitates an optimal balance between programming and advertising, where the changing interests and preferences of all parties are taken into account.

Ownership issues

Current ownership rules in the Broadcasting Act 1942 restrict the number of licences any person, including a foreigner, can hold in a television or radio station. Cross-media ownership rules also limit the extent to which owners of electronic media can operate other media services, including newspapers.

Industry concentration

These rules are based partly on a concern that the media may be amenable to undue concentrations of ownership, which could reduce competition in the industry and, potentially, result in the narrow opinions of owners being reflected in the content and views broadcast.

The introduction of Pay TV offers scope for an increase in the number of owners of electronic media and a significant increase in viewer choice.

There would also be a commercial incentive for existing broadcasting firms to integrate horizontally into this broadcast medium, to take advantage of the economies of scale and scope entailed. Provided that the broadcasting market is open to competition and is contestable, such economies should be passed on to consumers in the form of lower prices and/or a higher quality and range of services. In this context, some level of industry concentration should be regarded as economically desirable.

In any event, to the extent that *undue* levels of concentration in the media industry arise following the introduction of Pay TV, the ORR considers that such problems should generally be dealt with using existing anti-trust legislation __ in this case, the Trade Practices Act 1974 __ rather than additional industry specific regulation.

Foreign ownership controls

A further goal of ownership rules is to restrict the level of foreign control of Australian based media organisations, partly to ensure that domestic broadcasting services have an Australian feel or perspective.

However, special restrictions on foreign ownership (and, therefore, on foreign investment and expertise) in the media are at odds with the treatment of other industries; they reduce the competitive pressures for efficiency in the Australian media; and, given the variety of media outlets and choices available to consumers, the restrictions are unlikely to have a significant (nor necessarily beneficial) effect on the quality and content of programs screened.

Whilst foreign ownership restrictions for Pay TV might be advocated in order to bring about consistency with other government media policies, the ORR considers that they would be unnecessary and potentially a denial of more efficient provision of media services.

Licensing arrangements

Broadcasting licences are currently allocated by a complex and time consuming process which involves the Minister for Transport and Communications and the ABT. The Minister determines service/licence specifications and calls for expressions of interest. The ABT receives and assesses applications and issues licences.

There are a three main rationales for media licensing. First, licensing can be used to prevent congestion of broadcasting channels, and to define and protect spectrum property rights. Second, where technical limitations or other factors restrict the number of firms in an industry and thereby inhibit effective competition, licensing may be used by the government __ on behalf of the community __ to extract the excess profits (or 'economic rents') which might otherwise accrue to the firms in the industry. In such cases, firms would be expected to increase their bids for licences to a level consistent with the higher prices they could charge. Third, governments or regulators sometimes use licences in an attempt to determine the 'most attractive' firm to operate in an industry.

On the first point, the ORR considers that allocating the broadcast spectrum warrants appropriate regulation, although it draws attention to criticisms of current methods which do not ensure that this scarce resource is assigned in its most valuable way (BTCE 1990).

On the second point, the case for regulation is less clear. On one hand, given the number of technological options potentially available for carriage of Pay TV services (see Section 2), it is unlikely that any one operator would be able to gain sufficient market power to generate sustainable excess profits. In this case, licensing to extract excess profits would not be required. On the other hand, were the government to restrict the means of carriage, requiring bids for broadcast licences could be justified.

On the third point, the ORR considers that granting licences on the basis of subjective bureaucratic notions __ such as who constitutes a 'fit and proper' media operator __ is unwarranted. Issuing licences on this basis is excessively costly, often requiring lengthy processes of consultation and formal inquiries. Indeed, during its assessment of the current ABT licence allocation system, the DOTC found that:

> **full public participation in inquiries has been inhibited; and a legalistic approach has been taken by parties in relation to relevant issues and judicial review has become common (DOTC 1989b, p. 17).**

Moreover, although such a bureaucratic and legalistic approach may provide an opportunity for organised interest groups to advance their particular agendas, it can often take insufficient account of the opinions of ordinary viewers and consumers.

The ORR considers that the allocation of licences should be made on commercial grounds, because the market generally provides a more efficient mechanism for determining the adequacy of different licensees.

6 CONCLUSION

Of the various arguments advanced to support the case for the ongoing prohibition or regulation of household Pay TV in Australia, the ORR considers that most are unsustainable. Many of the problems underlying the arguments for regulation in fact have 'market' solutions: an example is the perceived problem of externalities associated with fibre-optic cable provision. In other arguments, the underlying goal is of doubtful economic merit and, in any case, amenable to being achieved more efficiently through direct measures: such arguments include calls for restrictions on Pay TV to protect free-to-air networks. Additionally, the traditional arguments for the social regulation of free-to-air television __ such as to control content, advertising and ownership __ generally do not apply to Pay TV.

Further, the ORR judges that, while some arguments for regulating Pay TV __ such as to safeguard against siphoning __ have theoretical merit, they warrant only limited additional regulation in practice, and certainly do not justify prohibition of Pay TV services.

More generally, in the ORR's view, what it sees as a history of costly and misdirected regulation of broadcasting and telecommunications justifies a careful approach to further government intervention in these markets: except where there is a clear role for regulation __ for example, to enforce radio spectrum property rights __ market forces should generally determine the structure and performance of these industries.

Overall, the ORR concludes that, to enhance economic efficiency and consumer welfare, Pay TV should be introduced promptly and with minimum regulation.

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