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17 December 1999



H Silver
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Broadcast Inquiry
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Dear Sir

We are pleased to provide the following materials to further elaborate our submission of 10 December 1999.

Also enclosed is an independent analysis of the broadcast fee capping issues for your further information.

We also intend to provide another submission on the digital radio issue and on diversity which we touched on in our first submission.

We will be in a position to provide these in January.

Please let us know if you have any further questions.

Yours faithfully

Emmanuel Candi
Executive Director

By way of further notes on the s152 (Copyright Act) broadcasting competition policy issue, we provide these further comments.

THREE PRICE CAPPINGS

There are three types of cappings (which were introduced in 1969):

- 1 The commercial broadcasters fee is capped at less than 1% of each station's turnover.
- 2 The ABC radio stations' fee is capped at half of one cent per head of population.
- 3 No fee applies to broadcast use of US and Canadian recordings. This is a price capping of zero.

The ceilings are contained in sections 152(8) and 152(11) of the Act. Section 152 is generally concerned with applications to the Copyright Tribunal for the determination of amounts payable for broadcasting published sound recordings. Para-phrased sub-section (8) provides that:

"The Tribunal shall not make an order that would require a broadcaster to pay, in respect of the broadcasting of published sound recordings an amount exceeding 1% annual gross earnings of the broadcaster." In other words, ie: regardless of the reasonable rate the Tribunal cannot order more than 1%.

The ceiling on licence fees payable by the ABC is contained with section 152(11) which provides that the licence fee cannot exceed ½ a cent per head of population in Australia.

The effect of s152(8) and (11) is that the broadcasters refuse to negotiate reasonable fees and will not do so until the ceilings are removed.

MARKET DISTORTIONS

The cappings create distortions regarding what is played and the amount of new Australian material that can be produced. The cappings, of course, also have cost recording artists and record labels millions of dollars in foregone fees over the last 30 years.

THE PRICE CAPPINGS ARE A SUBSIDY

It is simply inappropriate for any subsidy that radio broadcasters might receive to be provided by sound recording creators. Subsidies are provided by government from the entire tax base.

NO OTHER PRICE CAPPINGS

There are no price cappings for any copyright item other than those in s152. Moreover, no such ceiling has ever been in place in respect of the broadcast licence for musical works (ie the fee payable to the songwriters/music publishers via APRA) and licence fees for the exercise of that right are currently an average of just above 2% with "music" stations paying 3.5% to APRA (set this year by the Tribunal in APRA v FARB, as yet unreported).

Further, the government in 1996 abandoned price cappings generally except in regard to community service obligations such as stamps and some telephone services.

BROADCAST FEES OVERSEAS

The cappings result in fees that are significantly below comparable market rates for such licences and are inconsistent with competition policy and good broadcasting policy.

Market rates for sound recording broadcast licences overseas, exceed one per cent. By way of international example, the broadcast licence rates in the United Kingdom set by their Tribunal in 1995 are between 2% and 5% depending upon the level of the broadcaster's gross revenue and music airtime. In 1999, the Canadian rates were set at 3.2% of a broadcasters revenue and in New Zealand the rate is 1.75% (for all stations regardless of music format).

COMMERCIAL BROADCASTERS: NO IMPACT UNTIL 2003

The removal of Section 152(8) from the Act will have no immediate impact on commercial broadcasters. The sound recording industry, through Phonographic Performance Company of Australia Limited ("PPCA") has reached an industry agreement with the Federation of Australia Radio Broadcasters ("FARB") which represents commercial radio broadcasters in Australia.

Under the terms of that agreement, the 'capped' licence fees for FARB's members have been agreed upon until 30 June 2003. As such, there will be no immediate impact on the commercial broadcasting industry from the introduction of the ability to charge market rates until after 2003.

NEW BROADCAST SERVICES

The removal is crucial also in terms of licensing new licencees and new transmission services that are emerging with the technological Super-highway. Clearly, unless proper market rates can be put in place with these new entrants, the inequities and distortions caused by the ceilings are further aggravated and entrenched.

ABC

The ABC should pay market rates like any other broadcaster subject to the Copyright Tribunal's final arbitration.

The basis for calculating the ceiling, as it applies to the ABC, introduces two further inequities which are not present in relation to section 152(8).

The figure of half a cent per head of population has not been indexed and has remained unchanged since the introduction of the Act in 1969. There has been substantial inflation in Australia during that 25 year period. Indeed, adjusted for inflation, half a cent in 1969 is now 4 cents. However, making this observation we do not advocate for a CPI adjustment – we advocate for an open bargain situation but subject to the Copyright Tribunal's jurisdiction (as is the case for musical works).

Since 1969, the ABC has established ABC-FM and Triple J, both substantial users of recorded music. Accordingly, the fee in real terms has decreased substantially given the substantial music broadcasting undertaken by the ABC through the addition of these two stations combined with the decrease in the ½ cent fee caused by inflation.

The ABC's reliance on the ½ ceiling may also offend the governments competitive neutrality policy.

SBS

The SBS falls under s152 as well. It, however, is not subject to the ½ cent per head of population price capping but instead to the 1% under subsection (8). As is readily apparent the ABC and the SBS, although both government owned or “public” broadcasters, are treated differently but both have the benefit of a price capping. Whilst a number of observations could be made, this anomaly highlights the absurdity of the ABC’s position and of the price cappings generally.

BROADCASTERS’ POSITION

The broadcasters have “opposed the removal” of the cappings “on the basis that they were concerned that PPCA would make excessive demands for royalties if the ceilings were removed”. (*Source: para 4.30 Copyright Reform and the Digital Agenda Discussion Paper, July 1997*)

This response is, of course a complete nonsense. The fees (royalties) are subject to jurisdiction of the Copyright Tribunal and if broadcasters do not agree with a PPCA rate the Tribunal is there to adjudicate. Further still, it is highly likely that once the ceilings are removed both radio and PPCA will apply to the Tribunal to set the first uncapped rate to ensure that all aspects of each sides views are taken into account. The radio industry has much experience in, and is vigorous in its approach to, Tribunal fee applications.

COPYRIGHT TRIBUNAL DETERMINES THE FEE

The appropriate uncapped fee will be the fee the Copyright Tribunal judges to be a fair market rate for each relevant type of broadcaster. The Tribunal will take all relevant matters into consideration. The ABC and the radio industry, via FARB, are expert and very experienced in Tribunal cases.

The Copyright Tribunal has a long standing and expert role in resolving copyright licences and fees. The Copyright Tribunal has the power to set rates and terms in relation to 9 other matters, ranging from fees payable by educational institutions for copying TV programs and films to incorporating songs in records. In all of these matters there are no cappings or ceilings, except for the section 152 fees payable by radio stations for using sound recordings. This again highlights the absurdity and inequity of the cappings in sections 152(8) and (11) and the need for their immediate removal.

MINOR AMENDMENT REQUIRED

Very minor legislative changes are required to repeal the cappings. Indeed, the repeal of Section 152(8) and (11) is achievable as a one sentence amendment to the Digital Agenda Copyright Amendments. It would read as follows:

Section 152:

- (i) Repeal sub-sections (8), (9), (10) and (11)(b)(i) of Section 152.”

Note: Sub-sections (9) and (10) are consequential to (8) and (11)

Repeal of these sub-sections, would leave the Copyright Tribunal’s jurisdiction in place but remove the ceiling on the Tribunal’s ability to order what the broadcast rates will be.

This suggested repeal fixes the 1% price capping and the ½% (ABC capping). It does not deal with the zero price capping on American and Canadian repertoire.¹

It is submitted that the removal of the 1% and ½ cent price cappings be a priority competition/copyright broadcasting policy reform for the year 2000.

¹ Canada now has a broadcast right and should be added into the Australian Copyright Act's 'protected' countries in 2000. Note the Canadian Copyright Board (Copyright Tribunal equivalent) ordered a top rate of 3.2%.

March 1999

**Report Prepared for the
Phonographic
Performance Company
of Australia (PPCA) and
the Australian Record
Industry Association
(ARIA)**

An Economic Assessment

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Abbreviations

ABA	Australian Broadcasting Authority
ABC	Australian Broadcasting Commission
ARIA	Australian Record Industry Association
CLRC	Copyright Law Review Committee
CoAG	Council of Australian Governments
<i>CPA</i>	<i>Competition Principles Agreement</i>
NCP	National Competition Policy
PPCA	Phonographic Performance Company of Australia
SBS	Special Broadcasting Service
US	United States of America

1

Chapter One

Summary and
Overview

Chapter One

Summary and Overview

1.1 Background

For the past few years there has been discussion in a number of policy fora regarding the need to upgrade the *Copyright Act 1968* to cope with the emergence of the digital economy.

While the *Digital Agenda Copyright Amendments* have focused on 'big picture' reforms, one issue that appears to have been sidelined is the regulation of licence fees for the broadcast of sound recordings.

As part of the ongoing community consultation the Attorney-General's 1997 discussion paper on digital copyright reform noted that:

No proposals are made in relation to ... the ceilings in s 152 on the amounts payable for broadcasting sound recordings as ... [this issue is] currently under separate consideration by the Government.

Copyright Reform and the Digital Agenda — Proposed Transmission Right, Right of Making Available and Enforcement Measures, Discussion Paper, Canberra, July 1997, para. 1.22.

The issue of whether/how to regulate fees for broadcasting sound recordings is still being considered by the Government.

To facilitate the thinking about the current regulation of broadcast fees the PPCA and ARIA have requested The Allen Consulting Group make an assessment, consistent with National Competition Policy (NCP), and in the context of the Government's *Digital Agenda Copyright Amendments*, regarding the regulation of fees payable for the broadcast of sound recordings. This report embodies the Group's assessment.

1.2 The Regulation of Broadcast Fees

The pricing of copyright fees for the broadcasting of sound recordings is regulated in a number of ways:

- firstly, where parties cannot agree on an appropriate fee the Copyright Tribunal has the power to determine such a fee. This determination is made taking into account all relevant matters and so aims to set a fair price that, in theory, should represent the true market value.¹ This approach is used with respect to other rights attaching to copyright, minimises transaction costs associated with individuals enforcing their own copyrights, overcomes information asymmetries and constrains any market power that collecting societies may have. As such, this regulatory tool is not considered problematic and is not the focus of this paper;
- secondly, the *Copyright Act* incorporates a general cap on the level of licence fees that broadcasters may have to pay for broadcasting sound recordings. This cap, set

¹ "The starting point will be a search for a market. If there is a market, probably the market value will be the value which prevails. If there is no market, or if the object ... is not well sought after so that comparable sales are not easily found, the court will have to construct or endeavour to construct, a notional bargain between a willing but not anxious seller and a willing but not anxious buyer. This becomes a much more theoretical exercise." — Shepherd, *Copyright Tribunal*, unpublished, 1995, p 9.

at one percent of a broadcaster's gross revenue, limits the Copyright Tribunal's ability to set a price equivalent to that which would be determined by the market;²

- thirdly, as a result of the reservation regarding first publication (hereafter called 'national treatment') in the International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations (hereafter called the Rome Convention), the *Copyright Act* protects the broadcast of US music differently to the broadcast of music from most other countries.³ As a result, in effect, fees for the broadcast of US sound recordings are not recoverable by the Australian owner/marketer of those recordings. In effect, it can be said that the broadcast of US music is capped at a maximum price of zero percent of broadcasters' revenues; and
- fourthly, the *Act* treats the ABC differently to all other broadcasters licensed under the *Broadcasting Services Act 1992*, including the Special Broadcasting Service (SBS), and sets a cap for broadcast fees at 0.5 cents per head of population.

1.3 The Consequences of the Price Caps

Ultimately, a property system, however conceived, must be measured in terms of broader issues of efficiency, equitability, privacy and freedom.

Wunderlich, "Property Rights and Information" in Lamberton (ed), *The Information Revolution*, Annals of the American Academy of Political and Social Science, Vol. 412, Philadelphia, p.80.

The fee cap for the broadcast of sound recordings fails this test on two grounds: efficiency and equitability.⁴ These criteria are discussed in the following sections.

1.3.1 Reduced Efficiency

Efficiency is an important goal in any regulatory regime:

Economic efficiency plays a vital role in enhancing community welfare because it increases the productive base of the economy, providing higher returns to producers in aggregate, and higher real wages. Economic efficiency also helps ensure that consumers are offered, over time, new and better products at lower cost.

The Independent Committee of Inquiry, *National Competition Policy*, AGPS, Canberra, 1993, p.4.

There may be times when price caps advance economic efficiency by correcting market failures. However, in this case there is no market failure related justification for existing price caps. Rather, the caps appear to be provided on the basis that they are a form of subsidising broadcasters, or, as was argued in 1969, to protect broadcasters from an unbudgeted expense. Given the profitability of the industry, and the indirect nature of the subsidy, it is reasonable to suggest that even if the price caps provide no direct harm, there would be better ways of subsidising broadcasters (eg, direct government subsidy funded through the progressive tax system).

The existing price cap arrangements create a number of overlapping and reinforcing distortions with respect to:

² To our knowledge, no other country or copyright-related tribunal is subject to such a price cap. For example, the UK Copyright Tribunal is not bound by a cap on the fees payable for broadcasting sound recordings. Following an examination of the UK market it determined the appropriate market value to be between two and five percent of gross revenues

³ Some other countries, most notably Canada, are also regulated on the same basis as the US. For simplicity's sake, and given its position as the major producer of English sound recordings, the US is used as the generic example.

⁴ The caps are neutral with respect to privacy and freedom

- the volume of music broadcast — by capping broadcast fees below the price level that would be obtained by the market (or the Copyright Tribunal mimicking the market mechanism), broadcasters are encouraged to increase the broadcasting of music relative to news, editorials, talk-back, etc;
- revenue for the underlying copyright owner — while more music is being broadcast, actual revenues for the owners of sound recordings decrease. The PPCA estimates that net revenues are some \$12.9 million lower than they would be without the caps;⁵
- the creation of new sound recordings — with lower expected revenues from the bundle of rights, particularly since the removal of the prohibition on parallel imports, the incentive to create new sound recordings is diminished. As there will be more broadcasting, but a reduced number of new sound recordings, it is also realistic to forecast increased repetition in radio broadcasts;
- the quality of music created and broadcast — because of reduced incentives, the use of price caps tends to have a deleterious effect on product quality. While music quality is a nebulous concept, evidence of the effect of price caps in other regulatory regimes suggests that it is reasonable to assume that the existence of a cap on broadcast fees will ultimately have a deleterious impact on the quality of recorded music broadcast on Australian radio;
- competitive advantage for the ABC — the lower price cap on sound recordings broadcast by the ABC provides the ABC with a competitive advantage in comparison to all other broadcasters. While ABC radio is not viewed as a traditional business (because it is budget funded and does not charge for its services) the advantage provided to the ABC distorts the input market (ie, the market for the creation of sound recordings); and
- the lack of national treatment afforded to broadcasts of US sound recordings makes US music relatively more attractive to broadcasters — contrary to the Government's commitment to Australian content, this distortion increases the percentage of airtime devoted to US music and reduces the incentive for Australians to create new sound recordings.

While these impacts are difficult to quantify, standard economic theory suggests that these distortions are real.

1.3.2 *Equitability*

The current regime fails an equitability criteria in three ways.

Firstly, by placing any cap on fees for the broadcasting of sound recordings the *Copyright Act* is providing a subsidy to broadcasters (and indirectly to advertisers). As Table 1.1 shows, the PPCA estimates this net subsidy from all broadcast-related copyright distortions (ie, radio and television) to be in the vicinity of \$19 million in total,⁶ and \$12.9 million solely from radio broadcasters. Even if the Government did wish, or may still wish, to provide a subsidy to broadcasters, it is not clear why copyright owners are the mechanism to provide it: why not provide direct budget funding, reduced tariffs on broadcast equipment or reduced award wages in the broadcasting industry? It is not equitable for the subsidy to be delivered through one set of copyright owners only, and not shared with owners of other inputs.

⁵ Correspondence, 23 March 1999.

⁶ Phonographic Performance Company of Australia, *Annual Report 1998*, draft, p.9.

Table 1.1

The Financial Impact of Broadcast-Related Copyright Distortions

	1997-98 Revenue, Expenses and Distribution	Forecast Distribution if Cap Anomalies Removed
Gross revenue	\$5,960,123	\$24,914,422
Agency expenses	\$1,947,603	\$2,197,603
Amount available for distribution	\$4,012,520	\$22,716,819
Distribution to PPCA Performers' Trust	\$62,139	\$210,267
Distribution to artists and record companies	\$3,950,381	\$22,506,552

Note: Using UK Copyright Tribunal rates of two percent to five percent with an average of three percent for radio broadcasters and 0.24 percent for TV broadcasters.

Source: Phonographic Performance Company of Australia, *Annual Report 1998*, draft, p.9.

Secondly, as discussed earlier, the *Copyright Act* discriminates in favour of US sound recordings over those from other nations (including Australia). While this discrimination is permitted under the Rome Convention,⁷ such a defence is insufficient to support its retention.

Thirdly, the *Copyright Act* provides a competitive advantage to the ABC over commercial stations. While an unusual case (because the distortion is in an input market rather than an output market), the ABC's advantage discriminates against other broadcasters and should be considered as a contravention of the principle of competitive neutrality.

1.4 Recommended Policy Approach

The identification of the distortions created by the regulation of copyright broadcast fees leads naturally to the following policy recommendations:

- firstly, the *Copyright Act* should be amended to bring the treatment of broadcast fees into line with all other copyrights that fall within the jurisdiction of the Copyright Tribunal. That is, the Tribunal should be free to determine the appropriate price, taking into account all relevant matters, with no caps limiting the Tribunal's flexibility;
- secondly, consistent with the policy of competitive neutrality, the ABC should not be treated differently to any other broadcaster. Until the *Copyright Act* is amended the ABC should pay the appropriate copyright collecting society an *ex gratia* payment equivalent to the advantage that it receives because of its lower cap on broadcast copyright fees; and
- thirdly, the broadcast of US music should be brought onto an equal footing with that of Australian recorded music.

Delay in reforming the regulation of fees for the broadcast of sound recordings only adds to industry uncertainty and perpetuates current market distortions that result in significant reduction in revenue for the sound recording sector. Rather than further delay, reform of the price caps should be included in the next copyright bill (ie, the *Digital Agenda Copyright Amendments*).

⁷ Equally, the Rome Convention allows for the protection of such recordings.

1.5 Structure of the Report

Expanding upon this chapter, this report is structured in the following way:

- Chapters Two to Four analyse the three previously identified cap distortions. To aid understanding of the impact of the identified fee caps these chapters incorporate a number of stylised supply and demand examples. This market-based approach is appropriate given the acknowledged role of economic incentives underlying copyright law:

“Music is not a philanthropic or benevolent undertaking. It is essentially speculative, high risk, high return business. All participants may be involved in the industry for love but, in general terms, they are in it for reward.”

Legal and Constitutional Legislation Committee, *Copyright Amendment Bill (No.2)* 1997, 1998, para 5.11. Available at http://www.aph.gov.au/senate/committee/legcon_ctte/copyright/chap5.htm.

- Chapter Five assesses the claimed benefits of the existing arrangements; and
- Chapter Six considers the timing of any suggested reform.

2

Chapter Two

The Cap on Broadcast Licence Fees

Chapter Two

The Cap on Broadcast Licence Fees

2.1 The Legal Framework

Under sub-section 85(1) of the *Copyright Act*, the copyright in a sound recording includes the exclusive rights to:

- make a copy of the recording;
- cause the recording to be heard in public;
- broadcast the recording; and
- enter into a commercial rental arrangement in respect of the recording.

Section 109 of the *Copyright Act* takes away from the exclusive broadcast right by allowing broadcasters to broadcast any sound recording provided that they pay a fee to do so. Thus, the market power of the copyright holder — or its agent, the PPCA — is significantly diminished by way of this 'statutory licence', and further diminished by s.152.

In the absence of agreement between the parties, s.152 of the *Copyright Act* currently provides for the determination by the Copyright Tribunal of the level of royalties to be paid by broadcasters for the broadcast of sound recordings:

Subject to this section, an application may be made to the Tribunal for an order determining, or making provision for determining, the amount payable by a broadcaster to the owners of copyrights in published sound recordings in respect of the broadcasting, during a period specified in the application, of those recordings by that broadcaster.

sub-s.152(2) *Copyright Act 1968*.

The Tribunal has broad powers to investigate the application and issue orders.⁸ In particular, the Tribunal is to, "take into account all relevant matters," in reaching a decision.⁹

The Copyright Tribunal's power to set a fee is, however, constrained by sub-ss.152(8) and (11). These subsections put a cap on the maximum payable licence fees:

- sub-section 152(8) provides that the Copyright Tribunal cannot order a broadcaster to pay more than one percent of its gross earnings in royalties for the broadcasting of sound recordings; and
- sub-section 152(11) of the *Act* sets a different ceiling on the amount of royalties to be paid by the ABC for the broadcasting of sound recordings — 0.5 cents per head of the Australian population.

This chapter focuses on the impact of a broad price cap, with the special case of the ABC considered in Chapter Four.

⁸ sub-s.152(6) *Copyright Act 1968*.

⁹ sub-s.152(7) *Copyright Act 1968*.

2.2 Is a Price Cap Appropriate?

While it is generally acknowledged that unregulated markets encourage efficient production at low cost and encourage innovation, it is also known that there are occasions when markets fail to deliver optimum economic, environmental and social levels of output.

Regulatory policy since the *Hilmer Report*¹⁰ suggests that government intervention in markets should generally be restricted to situations of 'market failure'.¹¹ Market failure may arise in a number of instances related to the environment:

- *externalities* are positive or negative impacts of production methods and market transactions which are not reflected in prices, and so lead to non-optimal levels of production and consumption;
- *public goods* are those goods that the community demands but will tend to be under-produced because they are non-excludable (ie, people who have purchased the good cannot stop others using it up) and non-rivalrous (ie, the good is not diminished with use). Copyright itself is a response to public good characteristics inherent in many works (in the broadest sense) that are currently protected by copyright law;
- *information asymmetries* exist where information is not evenly distributed throughout the community; and
- *natural monopolies* are justified where the costs of establishment, resources or infrastructure are such that it is socially wasteful to have more than one supplier of a good or service. Because a natural monopoly is socially optimal but not necessarily in the interests of all players in the market, governments may decide to regulate in the public interest.

Price caps are employed/justified for a number of (often over-lapping¹²) reasons, only some of which can be defended as market failures. In many cases the reasons advanced for price capping are a mixture of the rationales listed in Table 2.1 (next page).

Given the presence of the Copyright Tribunal as a price regulator, there does not appear to be any market failure related rationale for putting an artificial (ie, non-market) price cap on copyright fees.

It appears that the justification for the price caps is to subsidise broadcasters (and indirectly the advertisers who provide revenue for broadcasters).

¹⁰ The Independent Committee of Inquiry, *National Competition Policy*, AGPS, Canberra, 1993.

¹¹ See, for example, Office of Regulation Review, *A Guide to Regulation*, second edition, 1998, p.E1; and Department of Premier and Cabinet, *Guidelines for the Review of Legislative Restrictions Competition*, Victorian Government, Melbourne, 1996.

¹² For example, price caps on pharmaceuticals are both a response to perceived (often temporary) market power caused by the patent system, and a desire to support the positive externalities associated with better community health.

Table 2.1

Rationales/Justifications for Price Caps

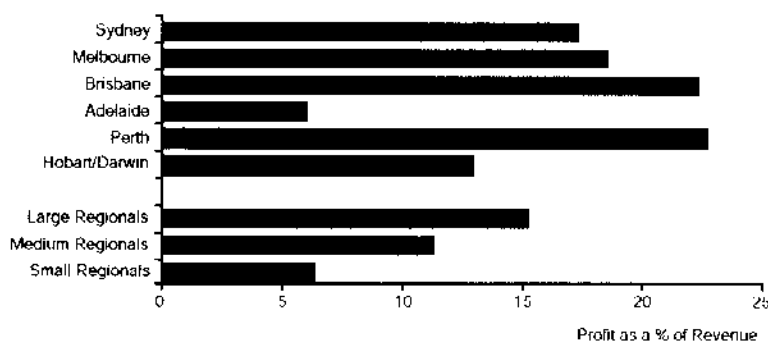
Justification	Comments	Relevance to Broadcast Fees
To control market power	<p>The strict view of the National Competition Council and the Productivity Commission is that price regulation is a means of controlling the market power of a monopolist or, at a stretch, a market where it is difficult for competitors to set up businesses</p> <p>The looser view of Ayres and Braithwaite suggests that price caps are applicable to control 'dominant firms' (ie, when a firm has market power, and particularly when it can restrict supply and fringe firms have little capability to expand output)</p>	<p>There are no significant barriers to entry to the market for sound recordings. This suggests that there is no rationale for price caps</p> <p>Furthermore, given the statutory licence and the arbitration role of the Tribunal owners of copyright in sound recordings and their agents cannot be said to have market power</p> <p>Even if it were felt that there was market power it would be standard practice to set price caps at an 'economically efficient' price, and not at an arbitrarily chosen level below the economically efficient market price</p> <p>With respect to other copyrights, the Tribunal attempts to set the price cap at the market rate, not below it</p>
To protect against exploitation associated with information asymmetries	In such a case prices would be set at or above the forecast market rate	Parties at the Tribunal tend to be large and relatively well-resourced. In this light, and particularly given a below-market-price cap, this rationale is not applicable
To encourage consumption	Usually employed where there is a positive externality (eg, where there are wider health benefits)	There is no evidence that radio stations are providing a sub-optimal level of music
To subsidise users of the capped product	This approach is almost exclusively used with respect to public organisations or where the government has provided some concession in return	This appears to be the implicit justification, and the original short-term justification advanced in 1969. It is rare for this justification to be manifest on private sector organisations

Source: The Allen Consulting Group; National Competition Council, *Review of the Australian Postal Corporations Act — Options Paper*, Melbourne, 1997, p.196; Industry Commission, *Telecommunication Economics and Policy Issues*, Staff Information Paper, AGPS, Canberra, 1997, p.55; and Ayres and Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate*, Oxford Socio-Legal Studies, Oxford University Press, New York, 1992, p.136.

Given the ABA's recent findings that the radio industry is profitable — see Figure 2.1 and increasingly so,¹³ it is difficult to suggest that the Australian radio industry needs to be subsidised (and even if it does it is not clear why the subsidy should be provided by copyright owners).

Figure 2.1

Profitability in Australian Radio Stations



Source: Australian Broadcasting Authority, "TV Profits Up 6.9 Per Cent; Radio Up 26.8 Per Cent in 1997-98" *News Release*, NR 23/1999, 23 March 1999.

¹³ The ABA has recorded profit growth in 1997-98 to be 31.7 percent in Sydney, 39.6 percent in Melbourne, 147.9 percent in Brisbane, 33.3 percent in Adelaide and 80 percent in Hobart/Darwin — Australian Broadcasting Authority, "TV Profits Up 6.9 Per Cent; Radio Up 26.8 Per Cent in 1997-98" *News Release*, NR 23/1999, 23 March 1999.

There is no precedent for copyright owners in other copyright areas subsidising the users of their copyrights. For example, educational institutions have to pay market prices (ie, at unsubsidised and uncapped rates) for the use of audio-visual material. Why is broadcasting different?

If the Government decides to subsidise radio broadcasters, it is necessary to ask if the subsidy is provided in the least cost manner. The following chapters explore some of the costs associated with subsidising broadcasters with a cap on broadcast copyright licence fees.

2.3 Consequences of a Cap on Broadcast Fees

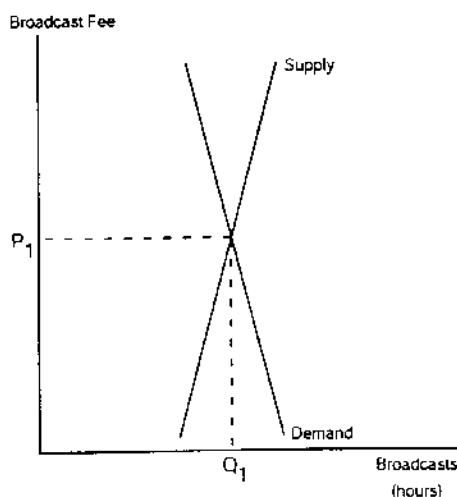
Radio stations are continually making choices about their content (eg, the relative mix of music, news, talkback, editorial, etc).

In a copyright regime without the Tribunal or a price cap the quantity of music broadcast would be determined by the participants in the market, with the level of music broadcast (Q_1), and the price of that music (P_1), determined by the intersection of the respective supply and demand curves — see Figure 2.2

In Figure 2.2 both the supply and demand curves are relatively inelastic (ie, closer to vertical rather than horizontal). That is, it will take a significant change in fees for a small change in airplay. This is a reasonable assumption given that both the supply of music, and demand for music, is significantly determined by non-economic factors (eg, taste, fashions, etc) as well as price incentives.

Figure 2.2

Supply and Demand for Sound Recordings for Broadcast



Source: The Allen Consulting Group

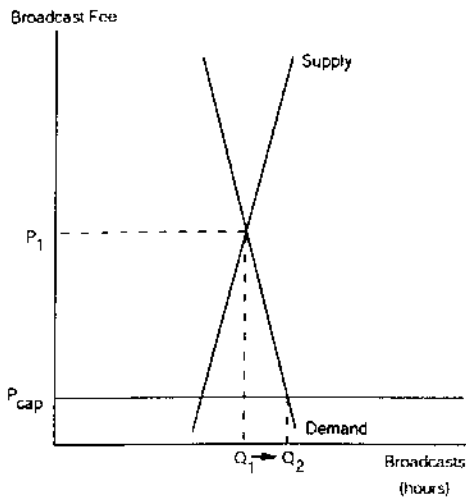
The Copyright Tribunal has a role in facilitating a reduction in transaction costs by establishing prices at which the copyright material must be made available. Normally, the Copyright Tribunal strives to set the market clearing price.¹⁴

¹⁴ Shepherd (former president of the Copyright Tribunal), *Copyright Tribunal*, unpublished, 1995, p.9.

However, in the case of sound recording music for broadcast there is a cap on the price that the Tribunal can set. The cap is set at one percent of gross revenues.¹⁵ In effect, this cap swings the supply curve from an upward slope to a horizontal line — see Figure 2.3.

Figure 2.3

Increased Broadcasting with a Licence Fee Cap



Source: The Allen Consulting Group

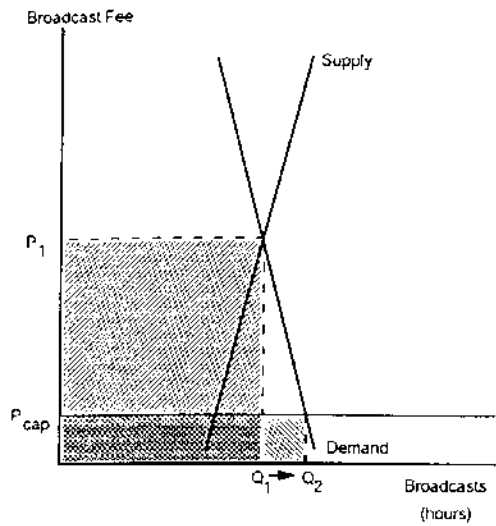
The impact of this cap is to lower the price paid by broadcasters from P_1 to P_{cap} . This has the effect of shifting the supply curve from being positively sloped to horizontal. As Figure 2.3 shows, this will increase the amount of music broadcast by Q_2 minus Q_1 .

From the perspective of copyright owners this is a negative outcome. As Figure 2.4 shows, total copyright revenue obtained from broadcasters will change from area (Q_1 multiplied to P_1) to area (Q_2 multiplied by P_{cap}). That is, total revenue will increase if the increased broadcasting offsets the decline in revenue; given the non-elastic nature of the demand curve this is extremely unlikely.

¹⁵ Based on a decision by the United Kingdom Copyright Tribunal, it is reasonable to suggest that the Australia cap is somewhere between one third and one fifth of the market-clearing price — *The Association of Independent Radio Companies v Phonographic Performance Limited & British Broadcasting Corporation*, Reference No. CT9/91, 1993.

Figure 2.4

Reduced Revenue for the Underlying Copyright Owners



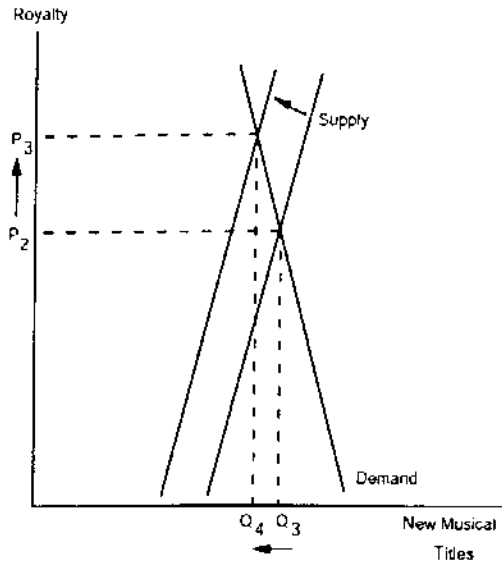
Source: The Allen Consulting Group

To this point the analysis portrays a socially beneficial outcome from the employment of a cap; the quantity of broadcast music increases but total costs to broadcasters decrease.

This conclusion is flawed, however, because it only takes a static view of the impact of the price cap.

Unfortunately, a reduction in broadcast licence fees will, over time, alter incentives for the creation of the sound recordings being broadcast. If artists/record labels expect to receive a lower level of fees from their broadcast rights they have a lower incentive to create the original sound recordings. As shown in Figure 2.5, over the longer term this reduced incentive will push the supply curve to the left resulting in fewer sound recordings at higher prices. This is a significant distortion and a reduction in social welfare.

Figure 2.5

Reduced Incentive for the Creation of Musical Works

Source: The Allen Consulting Group

While this section has focused on the output effects associated with price caps, “Another problem that is recognised as being present with price-caps is their effect on the incentive faced by the enterprise to downgrade quality.”¹⁶ Although the concept of musical quality is nebulous, experience in other regulatory environments suggests that the incentive for quality is reduced by price caps, and there is no reason to believe that such an impact would not be experienced in the creation of sound recordings.

In summary, the longer term impact of a cap on broadcast fees is therefore:

- fewer new sound recordings;
- possibly lower quality sound recordings; and
- increased broadcasting of sound recordings. When coupled with the lower creation of new recordings, increased broadcasting means greater repetition. This is worrying outcome given that, when an ABA commissioned survey asked ‘how can radio be improved to make it better for you?’ the most common answer was ‘better choice of music’.¹⁷ This may explain, at least in part, why radio broadcasters have reportedly claimed that there is not enough quality new Australian recordings to cover high local content levels.

¹⁶ Forsyth, “Price Regulation of Airports: Principles with Australian Applications” presented at the *Air Transport Research Group Conference*, Vancouver, June 1997, p.5.

¹⁷ AGB McNair, *Listening to the Listeners*, commissioned by the ABA, 1995. Summary available at <http://www.aba.gov.au/what/research/other.htm>.

3

Chapter Three

Different Treatment for the Broadcast of US Sound Recordings

Chapter Three

Differential Treatment for the Broadcast of US Sound Recordings

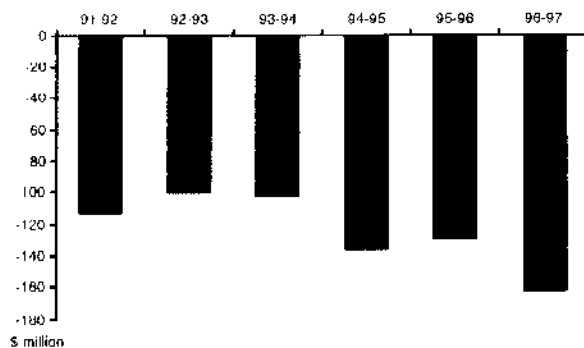
When adopting the Rome Convention Australia incorporated reservations about broadcasting rights in certain foreign recordings, most significantly for US owners of copyright in sound recordings (ie, sound recordings made in the US).¹⁸ In effect, this reservation set a price of zero on the broadcast of US sound recordings in Australia. This chapter considers the effect of this reservation as though it is a cap set at zero.

A simplistic view of the cap is that:

- it will facilitate a transfer from producers of intellectual property to consumers (radio stations and their advertisers) — see Chapter Two; and
- since Australia is a net importer of music royalties — see Figure 3.1 — any cap on royalties flowing overseas is bound to be a 'good thing' for Australia as a whole.

Figure 3.1

Net Music Royalty Flows From Australia



Note: Negative flows mean that Australia is a net importer of music rights.

Source: ABS, *Balance of Payments and International Investment Position: 1996-97 — Australia*,

Cat. No. 5363.0, pp.28&30.

Such an approach represents a static analysis and does not withstand closer scrutiny.

There is a clear Government preference, acknowledged by the broadcasting industry (see Table 3.1), for policy outcomes that foster the broadcasting of Australian musical content.

¹⁸ See footnote 3 above.

Table 3.1

Preambles to Australian Content Provisions in Industry Codes of Practice

Federation of Radio Broadcasters (FARB) — Industry's Code of Practice	Community Broadcasting Association of Australia (CBA) — Industry's Code of Practice
<p>The purpose of this code is to implement the object, set forth in the <i>Broadcasting Services Act 1992</i>, of promoting the role of broadcasting services in developing and reflecting a sense of Australian identity, character and cultural diversity, by prescribing minimum content levels of Australian music.</p>	<p>This code reinforces the community broadcasting sector's reputation as a medium committed to developing and recognising Australian composers and/or performers by providing opportunities to have their material broadcast on a regular basis.</p> <p>The <i>Broadcasting Services Act 1992</i> does not require the community radio sector to maintain minimum content levels of Australian music. However, given the nature of the community broadcasting sector and its commitment to reflecting the diversity of Australian culture and the interests of local communities, it is crucial for a significant proportion of local and Australian music, including indigenous Australian music, to continue to be broadcast by community stations.</p> <p>In selecting Australian musical items, community broadcasting stations should have regard for the make-up of the community served by the licensee.</p>

Source: <http://www.aba.gov.au/what/program/codes/farb.htm> and <http://www.aba.gov.au/what/program/codes/cbaa.htm>

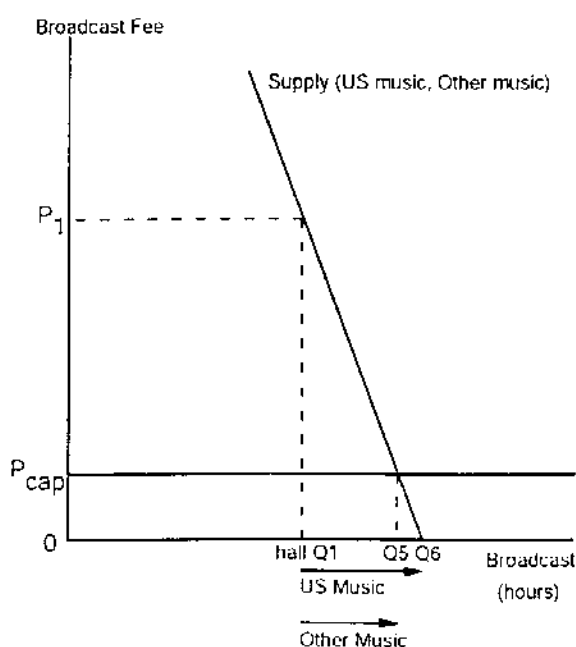
The lower US cap is inconsistent with this concern for fostering the broadcast of Australian music. This conclusion is evident from the following stylised example.

It is assumed, for lack of data, that the demand for US music is the same as the demand for non-US music.¹⁹

The non-regulated price is P_1 (derived from Figure 2.2), with US and non-US music each broadcast for half of Q_1 hours. With the introduction of a price cap (P_{cap}) non-US music broadcasts increase to Q_5 . However, given that US owners of the copyright in sound recordings cannot charge a fee the US music broadcasts increase to Q_6 hours.

Figure 3.2

An Increase in the Relative Amount of US Music



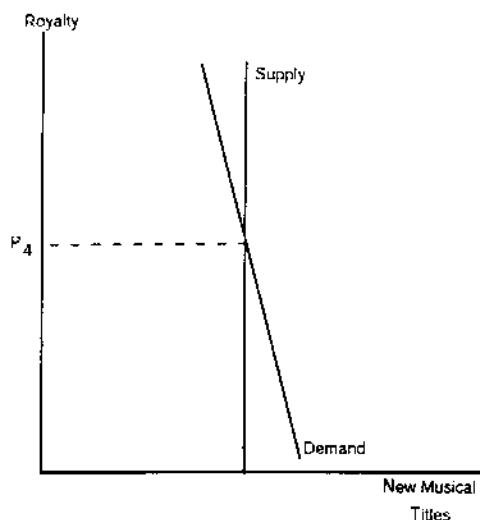
Source: The Allen Consulting Group

¹⁹ The example is not affected by altering this simplifying assumption.

As noted in section 2.3, the impact of a decline in copyright revenue from broadcasts is likely to lead to a decrease in production in Australia (akin to Figure 2.4). Given that Australia is a secondary market for US music (ie, significantly smaller than the US) it is unlikely that a decline in royalties for US music in Australia will have a significant, if any, effect on incentives for US artists to create new musical titles. As a result, the supply curve for new US musical titles in Australia is likely to be vertical — see Figure 3.3. That is, given the relaxation of parallel import prohibitions and the growth of on-line ordering, supply in Australia will be fixed at the level of US production.

Figure 3.3

Production of Music in the US is Unlikely to be Affected



Source: The Allen Consulting Group

As a result, the net impact of the lack of national treatment (ie, protection) afforded to the broadcast of US music recordings is to increase:

- the percentage of music broadcast on radio that originates from the US; and
- the percentage of new sound recordings in Australia that come from the US.

4

Chapter Four

The Differential Licence Fee Cap for the ABC

Chapter Four

The Differential Licence Fee Cap for the ABC

4.1 ABC Radio

The ABC is a significant radio broadcaster. The ABC has:

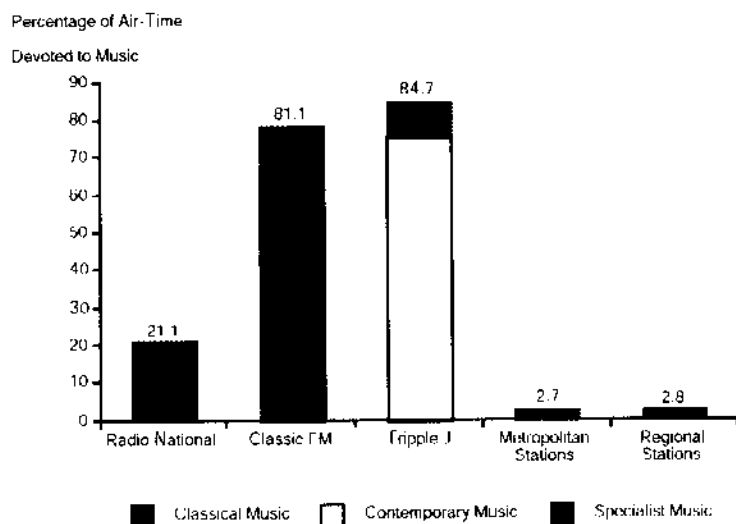
- metropolitan radio stations in nine cities; and
- 40 regional stations.²⁰

In 1997-98 the overall national weekly audience reach for the ABC's radio services was just under 6.5 million listeners (its highest result on record).²¹

Music is an important part of the ABC's radio broadcasts (see Figure 4.1), but especially for Triple J and Classic FM (with a combined weekly reach of 3.16 million people).²²

Figure 4.1

Music Broadcast On ABC Radio



Source: Australian Broadcasting Corporation, *Annual Report 1997-98*, p.94.

As noted in section 2.1, the ABC's price cap is significantly different to the cap for other broadcasters (ie, a cap based on population rather than revenue) and is acknowledged to be lower than the general cap on broadcast fees.

²⁰ Australian Broadcasting Corporation, *Annual Report 1997-98*, p.2.

²¹ Australian Broadcasting Corporation, *Annual Report 1997-98*, p.25.

²² Australian Broadcasting Corporation, *Annual Report 1997-98*, pp.25-26.

4.2 An Overview of Competitive Neutrality

Where-ever a government-owned organisation enjoys an advantage not afforded to private sector competitors the issue of 'competitive neutrality' arises. This section provides an overview of the principle of competitive neutrality.

The inaugural 1992 Council of Australian Governments (CoAG) meeting commissioned the 'Hilmer Committee' to conduct an inquiry into the development of a National Competition Policy (NCP). The *Hilmer Report*²³ was presented to CoAG in August 1993, and formed a major input to micro-economic reform discussions for subsequent CoAG meetings. At the April 1995 CoAG meeting the Commonwealth, State and Territory Governments agreed to implement a reform agenda based on the *Hilmer Report* recommendations.

One of the major features of the competition policy reforms implemented following the *Hilmer Report* was the removal of the 'Shield of the Crown' from government-owned enterprises. As a result, government businesses are subject to the *Trade Practices Act 1974* and are, unless there are intervening regulatory factors, exposed to competition from private sector providers.

If competition between public and private bodies is to be on an equitable basis, the players must operate under similar rules (ie, on a level playing field). To facilitate the creation of this level playing field the post-Hilmer NCP reforms — contained in the inter-governmental *Competition Principles Agreement (CPA)* and subsequently implemented in each jurisdiction — established the principle of 'competitive neutrality'. The principle is set out in sub-cl. 3(1) of the *CPA*:

The objective of the competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership.

Stated simply, where a substantial (ie, non-trivial) government business actually or potentially competes against private providers, the price of the goods and services made available by the government-owned business should:

- include all the costs that a private sector would bear; but
- be discounted for disadvantages that arise because of government ownership.

The Commonwealth's policy statement on competitive neutrality applies the principle to all 'significant' Commonwealth business activities. This 'significance' threshold is generally a commercial turnover exceeding \$10 million per annum.²⁴

Activities are classified as a 'business' for the purposes of competitive neutrality if they meet the following criteria:

- there must be charging for goods or services (not necessarily to the final consumer);
- there must be an actual or potential competitor (either in the private or public sector) ie purchasers are not restricted by law or policy from choosing alternative sources of supply; and
- managers of the activity have a degree of independence in relation to the production or supply of the good or service and the price at which it is provided.

²³ The Independent Committee of Inquiry, *National Competition Policy*, AGPS, Canberra, 1993.

²⁴ However, some types of business activity, such as government business enterprises and Business Units, are always considered significant regardless of turnover.

These criteria operate to exclude from competitive neutrality government functions which are budget funded service delivery activities where there is no distinction between the purchaser and provider of the service. Where there is separation between the purchaser and provider the provider activity may be regarded as subject to competitive neutrality if it is a business activity and falls above the 'significance' threshold.

4.3 Does Section 152(11) Offend Competitive Neutrality?

On the face of it, the ABC does not appear to be the type of organisation that would be subjected to competitive neutrality:

- the ABC is funded from the Commonwealth Budget;
- with the possible exception of the ABC's Radio Australia, the ABC is block funded and so there is no real purchaser-provider relationship between the Government and the ABC; and
- the ABC neither charges listeners for radio broadcasts nor advertisers (ie, other divisions within the ABC) for adverts.

These three points suggest that there is not user charging and hence ABC radio cannot be considered a business and hence should not be subject to competitive neutrality.

This analysis focuses on the output market. If, instead, the ABC is viewed as a participant in the market for material for broadcast (ie, as a purchaser rather than a supplier) it is clear that the ABC should be subject to competitive neutrality.

In an environment which only provides a fee cap for the ABC there would be a serious resource misallocation with the ABC able to secure the same music (and hence reduce the value of uniqueness/scarcity, even if the uniqueness/scarcity is only fleeting) with the impact of capturing, at a reduced cost, listeners from other broadcasters. This impact of this distortion in the input market is to make it harder for broadcasters other than the ABC to attract listeners and hence revenue from advertisers.

Indeed, the ABC certainly sees itself as a purchaser competitive input market. It is indeed ironic that the ABC makes a point of saying how important it is to develop its own inputs with the expectation that its rights will be protected and valued,²⁵ when it is provided with a competitive disadvantage for rivals.

4.4 Possible Remedies

In this case there are three options available to correct the competitive distortion:

²⁵ Australian Broadcasting Corporation, *Funding For One ABC*, March 1997, p.23.

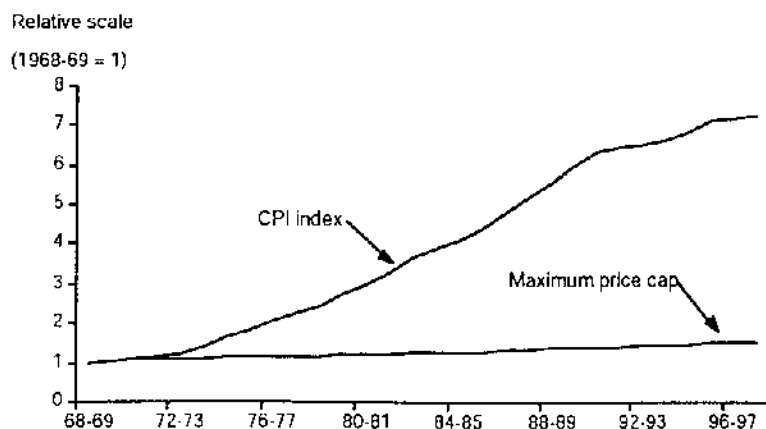
- adjust the ABC's cap to return the difference between the standard one percent cap and the ABC's cap to the same ratio as when the caps were introduced. If it can be argued that the ABC should benefit from a lower cap than other broadcasters then there is a case for adjusting the cap to restore the relative difference between the caps to the 1968 level.²⁶ For example, assuming that revenue for radio stations has grown at a rate equal to the Consumer Price Index (CPI), the maximum capped rate for non-ABC broadcasters is now eight times higher than the current ABC cap — see Figure 4.2 (next page) — and therefore the ABC cap should be increased to four cents per person in Australian;
- remove the distortion by deleting the special advantage provided to the ABC in the *Copyright Act*; or
- the ABC could be directed to pay the appropriate collecting society the identified advantage on an *ex gratia* basis. This approach has been specifically identified by the Commonwealth Treasury as a means of overcoming competitive neutrality concerns without legislating:

“As far as practicable, government businesses should operate in the same regulatory environment as private sector competitors. ... Where there are difficulties subjecting Commonwealth entities to particular regulations, such businesses should make allowance for any resultant cost advantages. For example, if a government insurance business does not have to maintain a certain level of capital securities, it should still notionally pay the capital servicing charges it has thus avoided. Similarly, if a Commonwealth business is exempt from local government charges, the business should pay these charges on an *ex gratia* basis.”

Treasury, *Commonwealth Competitive Neutrality: Guidelines for Managers*, AusInfo, Canberra, 1998, p.10.

Figure 4.2

Growing Disparity Between the ABC and Others Price Cap



Source: Derived from various ABS sources

The first option is only realistic if the Government accepts that the ABC should be provided an advantage not enjoyed by the SBS or any other broadcasters. Again, this argument is difficult to sustain given the Commonwealth's competitive neutrality obligations and since this approach singles out only one copyright sector as the mechanism for a subsidy when other input providers bear no similar burden.

²⁶ This argument is difficult to sustain given that the SBS does not receive the special treatment afforded to the ABC.

Given these concerns, the second option is clearly the 'cleanest' response. However, until the *Copyright Act* can be amended it would be appropriate for the ABC to make *ex gratia* payments to the relevant copyright collecting society.²⁷

²⁷ Given that the ABC is a substantial producer of sound recordings it would recoup some of this payment through the PCCA's distribution.

5

Chapter Five

Would Reform Leave Broadcasters Exposed?

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Would Reform Leave Broadcasters Exposed?

The previous chapters have suggested that there are likely to be difficult to significant — although difficult to quantify — long term costs associated with the current use of price caps for copyright broadcast fees, and that the *Copyright Act* should be amended to remove the caps. This chapter considers the impact on broadcasters if such a recommendation were adopted.

Broadcasters are concerned about the impact of the increased license fees upon their business. These concerns are manifested in three areas:

- the need to cover unbudgeted expenses — quite understandably, broadcasters do not wish to incur a liability which they have not made provision for in forward budgets; and
- misuse of market power by collecting societies — for example:

“The Working Group also received submissions from commercial broadcasters who opposed the removal of the limit on royalties on the basis that they were concerned that PPCA would make excessive demands for royalties if the ceilings were removed.”

Attorney-General's Department, *Copyright Reform and the Digital Agenda — Proposed Transmission Right, Right of Making Available and Enforcement Measures*, Discussion Paper, July 1997, para 4.30.

Neither of these concerns are material in the current circumstances:

- the broadcasters are protected from the market power of collecting societies by the ability of the Copyright Tribunal to set rates equal to what would have been set in a competitive market. The Copyright Tribunal's broad-ranging powers are a flexible and effective regulatory mechanism, for example, with the power, when issuing orders, to phase in new fee schedules;
- the estimated fee increase — \$12.9 million — represents only a 2.57 percent increase in operating expenses and an even smaller percentage decline in profits (from 15.9 percent of revenue to 13.8 percent).²⁹ Even with these increased expenses the industry's overall profit level remains healthy; and
- existing agreements between the relevant collecting society and the commercial broadcasting industry do not expire until 2003. This provides ample time for broadcasters to factor in a fee increase.

These observations show clearly that the concerns of broadcasters, beyond the obvious dislike of paying higher copyright fees, are accommodated by existing safeguards and market practices.

²⁹ Derived from Australian Broadcasting Authority, “TV Profits Up 6.9 Per Cent, Radio Up 26.8 Per Cent in 1997-98” *News Release*, NR 23/1999, 23 March 1999.

6

Chapter Six

Timing of
Reform

Chapter Six

Timing of Reform

A number of Commonwealth departments have been considering the issue of fee caps for a number of years in a number of fora. While there may be a temptation to again defer consideration of the issue, two factors suggest that reform should be sooner rather than later.

6.1 Online Radio is Coming (If Not Already Here)

Radio, both from a broadcaster's and listener's perspective, is in a stage of metamorphosis.

As shown in Table 6.1, the Internet is increasingly being used as a means of transmitting radio broadcasts.

Table 6.1

The Growth in Net Radio

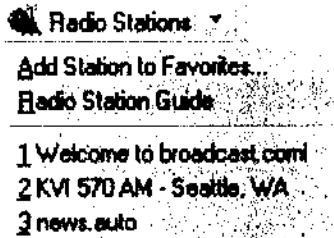
Question	Answer
How many Net radio stations exist now?	More than 2,000, including: 1,000 in the United States; 800 outside the United States; and 150 Web-only.
How many Net radio stations launch each month?	On average, 50
What percentage of US people have listened to Net radio?	The percentage doubled between June 1998 and January 1999, from six to 13 percent.
What percentage of Net users listen?	The percentage jumped from 18 percent to 27 percent between June 1998 and January 1999

Source: Verdino and Rosin, *The Arbitron Internet Listening Study II — Radio and E-commerce*, Arbitron/Edison Media Research, January 1999.

Indeed, the growth in online radio is likely to receive from the recent release of Microsoft's latest version of its market-leading Internet browser — Internet Explorer 5.0. A new feature of the browser is a 'radio' button on the toolbar: "The button will let users click directly to a page offering a customizable online radio tuner."²⁹

²⁹ Semineno, "Web Radio Tries to Tune in Advertisers" ZDNN Tech News Now, 14 March 1999, available at <http://www.zdnet.com/zdnn/stories/news/0,4586,2223877,00.html>.

Figure 6.1

Microsoft Internet Explorer 5.0's Radio Toolbar

Source: Microsoft, <http://www.microsoft.com/windows/ie/Features/Radio/default.asp?LNK=2>.

The impact of the growth of online radio could be substantial:

- firstly, the ability to broadcast music around the world, as the ABC does, further undermines the population-based criteria used in the ABC's fee cap; and
- secondly, if broadcasts of music via the Internet increase in popularity the opportunity cost of the fee caps is significantly increased to the ongoing and further detriment of artists/record labels and inevitably the Australian public.

6.2 Provide Certainty Prior to Radio Licence Sales

Over the next few years there will be a significant growth in the number of radio stations in Australia: "As at 4 August 1998, the ABA had planned for 70 new commercial radio licences, 85 new community radio licences and 188 new open narrowcasting radio services."³⁰ While there is a need to provide certainty for existing licence holders (see Chapter Five), there is also a need to provide certainty for these parties who will bid for licences; certainty will be maximised if the Commonwealth announces its intention to legislatively remove the caps.

6.3 The Digital Agenda

Given the observations in the two previous sections, and the clear case for reform highlighted in the previous chapters, the obvious step forward is to progress as rapidly as possible with the removal of the caps on fees payable for the broadcasting of sound recordings by incorporating the appropriate amendments in the Government's *Copyright Amendment (Digital Agenda) Bill 1999*.

³⁰ *Headbanging or Dancing? Youth and Music in Australia*, Monograph 8 part 2, p. 30.