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The case for
PRIVATISING the **BBC**

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Edited by
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2 PUBLIC SERVICE BROADCASTING: OWNERSHIP, FUNDING AND PROVISION

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No one has the right, and few the ability, to lure people into reading yet another analysis of PSB without a strong reason. The debate over PSB has raged for decades, and all that can be said, has been said, but it is not always clearly understood. The justification for this chapter is to reiterate an approach that has been accepted as the only coherent approach to broadcasting policy – consumer sovereignty. The Peacock Report, published in 1986, endorsed one of the core principles of economics – ‘consumer sovereignty’ – as the overriding objective of broadcasting policy (Peacock Report 1986: paragraph 592):

British broadcasting should move towards a sophisticated market system based on consumer sovereignty. That is a system which recognises that viewers and listeners are the best ultimate judges of their own interests, which they can best satisfy if they have the option of purchasing the broadcasting services they require from as many alternative sources of supply as possible.

At the time of writing, the UK government is engaged in one of its periodic reviews of the BBC’s Royal Charter and the licence fee. At such a time, the debate becomes polarised, fractious and more than usually other-worldly and emotional. Nonetheless, the PSB concept has retained its political support from successive

governments, and recent commentators and even the government's Green Paper (DCMS 2015: 14) on the renewal of the BBC's Royal Charter perpetuate myths about the rationale and reality of PSB. As a result, the UK's terrestrial TV broadcast system continues to promote PSB. This is despite the economic case for PSB being weak, and weakening, due in particular to technological change. Nonetheless, the UK Government, even before its consultations have begun (DCMS 2015: 14), has concluded that: 'Despite technological change, there is still a strong rationale for the BBC continuing to exist in the twenty-first century.' What this 'strong rationale' is is not identified.

The other purpose of this chapter is to draw attention to the unique position of the IEA in fostering the economic analysis of broadcasting. In the UK and Europe, economists ignored the subject until the late 1990s. The notable, and eventually influential, exception has been IEA authors. The IEA was the first to publish papers on the economics of broadcasting and specifically to espouse the market approach to radio and TV broadcasting (Altman et al. 1962; Roberts 1965; Caine 1968) and cable TV (Veljanovski and Bishop 1983). IEA authors and supporters – notably, the late Sir Alan Peacock and Samuel Brittan, with, among others, the author of this chapter, an adviser to the Peacock Committee – have played a prominent part in fostering an economic approach, initially through the Peacock Committee report (1986) and in subsequent writings for the IEA, and in academic and popular publications (Veljanovski 1987a,b, 1990a,b, 2000).

Background

The concept of PSB is premised on a view that there is endemic market failure in the television or electronic video sectors. Left to itself, it is argued, the market would fail to provide the right balance of quantity, quality and scheduling of programming.

Further, it is suggested that the available programmes are skewed to those that are most commercially attractive.

In the UK, the justification for PSB evolved from one of administrative convenience to a market failure *qua* paternalistic view of the role of radio and then television in society. With the invention of the radio, the then Government nationalised the British Broadcasting Company in the late 1920s in order to create a vertically integrated monopoly, offering national radio broadcasts and then, with the availability of television sets, first one TV channel (BBC1) in 1937, and then a second national channel (BBC2) in 1965. During the latter half of the twentieth century, grudging concessions were made to commercial broadcasting. A heavily regulated commercial radio sector and one commercial advertiser-supported TV channel (ITV) was permitted in 1955, though this had heavy PSB and regional obligations. A publicly owned fourth channel (Channel 4 or C4) was later created in 1982 to complement the programming of ITV and to create an independent programme production sector. A fifth commercial broadcasting channel (Channel 5) was allowed as more spectrum was released (1997).

This structure of broadcasting, and even the term broadcasting, has been under threat for several decades now from two forces – liberalisation and technological change. For most of the last century, government regulation restricted radio and TV first to a monopoly, and then to a period of rationed or managed competition, as described above. Commercial radio was partially liberalised after the hard-fought battles during the Radio Caroline era in the 1960s showed that it could deliver what listeners wanted. The launch of ITV in the mid-1950s saw the BBC's audience share fall from 100 per cent to 30 per cent, sending shockwaves throughout the BBC and revealing that it had lost touch with its viewers. This caused a rapid change in its programme schedule towards more popular entertainment.

The second and more profound change has been technology and its commercial implications. In the 1980s and 1990s, the pressure to allow cable and satellite delivery systems and content to grow intensified. The first breach came in the 1980s, when Sky TV with the cooperation of a newly privatised British Telecom enabled Direct to Home (DTH) satellite pay TV signals to dish antennas using telecom satellites (Astra), rather than dedicated low capacity direct-broadcast satellites (the latter failing because of their low channel capacity and mismanagement). The advent of pay TV, the growth of cable and, more recently, the Internet and online video streaming services to computers, laptops, iPads and smartphones, coupled with developments in digital technology (optic fibre, compression and conditional access systems), means that lack of channel capacity is no longer a barrier to entry. These technologies are also challenging the whole idea of ‘television’ broadcasting as we know it, as well as the concept of a ‘channel’, as the proliferation of outlets, viewing patterns and formats alter dramatically.

The structure of public service broadcasting

Many think that the BBC represents the whole PSB sector. That is not the case (see Table 1). The terrestrial broadcasting system is peppered with PSB constraints and objectives. According to a UK Government website:¹

The UK has 5 public service television broadcasters. These broadcasters receive benefits like the licence fee (in the case of the BBC), guaranteed access to the spectrum (or section of the airwaves) they need for broadcasting, and prominence on

1 <https://www.gov.uk/government/policies/making-it-easier-for-the-media-and-creative-industries-to-grow-while-protecting-the-interests-of-citizens/supplementing-pages/public-service-broadcasting>

Table 1 **PSB channels and channels operated by public service broadcasters**

<i>Main five PSB channels</i>	<i>BBC portfolio channels</i>	<i>ITV portfolio channels</i>	<i>Commercial PSBs' portfolio channels</i>		
			<i>Channel 4 portfolio channels</i>	<i>Channel 5 portfolio channels</i>	<i>Multichannels</i>
BBC One	BBC Three	ITV+1	Channel 4+1	Channel 5+1	All other remaining channels
BBC Two	BBC Four	ITV2	E4	5*	
ITV	BBC HD	ITV2+1	E4+1	5*+1	
Channel 4*	BBC News	ITV3	More4	5 USA	
Channel 5	BBC Parliament	ITV3+1	More4+1	5 USA+1	
	CBeebies	ITV4	Film4	Channel 5+24	
	CBBC	ITV4+1	Film4+1		
	BBC Olympics channels	CITV	4Music		
	BBC red button channels	ITV Encore	4seven		
		ITV Encore+1	Channel 4 Olympics channels		
		ITVBe			
		ITVBe+1			

Channels include HD variants where applicable.

*Channel 4 data for 2009 includes S4C viewing. Following DSO Wales in 2010, Channel 4 data from 2010 relates to viewing to Channel 4 only.

Source: Ofcom (2015a, TV Viewing Annex).

TV electronic programme guides. In return they commit to providing services that give a benefit to the public, like news, local programming or cultural content.

The public service television broadcasters are:

- the BBC, a public corporation, funded mainly by the television licence fee;

- Channel 4, a public corporation self-funded by advertising;
- S4C, a public corporation, broadcasting in Wales and funded by a combination of BBC funding, government grant and advertising;
- Channels 3 and 5, whose licences are held by commercial television companies funded by advertising (currently for Channel 3, ITV in England and Wales, STV in Scotland and UTV in Northern Ireland).

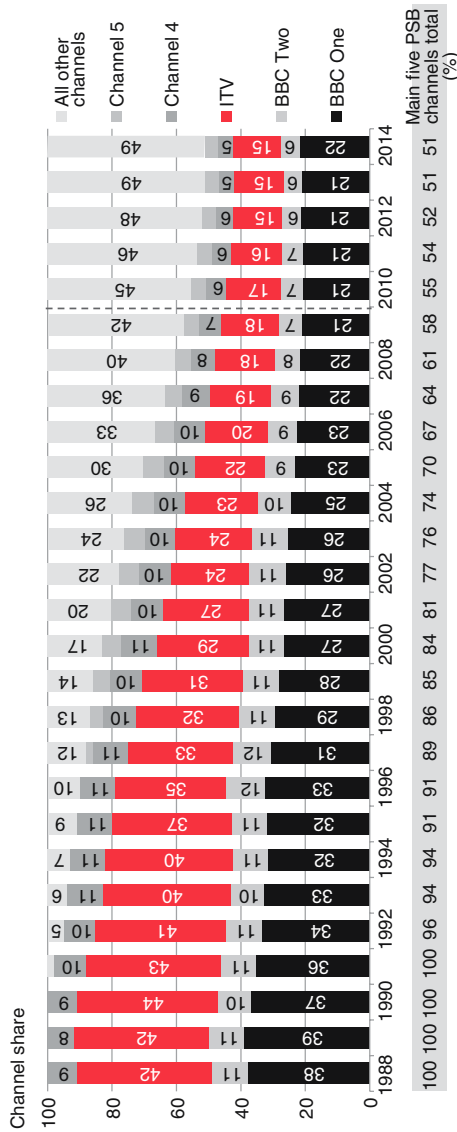
These PSB organisations have expanded into the development of so-called (by the regulator Ofcom (Office of Communication)) PSB portfolio channels, often created to meet the commercial competition and take advantage of technological developments. This has led to concerns over the BBC's and C4's 'scale and scope' of operation: that is, whether they are trying to do too much, especially of a more commercial nature, in order to protect their market shares and political support.

Figure 1 shows the audience share (in viewing time) of the PSB channels and other broadcasters, including pay TV operators from 1988 to 2014.

The main channels of public service broadcasters have lost viewers' share from 100 per cent in 1991 to just over 51 per cent in 2014. The BBC has nonetheless retained a significant market share. BBC1 has declined from around 36 per cent in 1991 to 22 per cent in 2014. ITV has declined from 43 per cent in 1991 (then well above BBC1) to about 15 per cent in 2014. If BBC2 is added in, BBC1 and BBC2 had a collective viewer share of around 28 per cent in 2014 compared with 15 per cent for ITV/C3, around 5 per cent for C4 and 4 per cent for C5. In other words, the BBC has a viewing share significantly greater than the advertiser-supported 'PSB' competitors' core channels.

When the PSB portfolio channels are taken into account, the PSB channels have nearly a 72 per cent viewer share (Figure 2). The total BBC viewer share is 33 per cent, and the commercial

Figure 1 Viewer shares by channel (aged 4+), 1988-2014



All values are given as percentages. Source: Ofcom (2015c, Data Annex, Figure 21).

PSB channels (ITV, C4 and C5), together with their respective portfolio channels, had a 39 per cent viewer share. But, if the viewing share is carved up between commercial PSBs (ITV and C5) and state-owned PSB channels (BBC and C4), then, remarkably, the state-owned channels have a viewer share of 44 per cent compared with 28 per cent for the commercial PSB channels. The continued high viewer shares of the BBC, PSBs and state-owned channels in a multichannel sector require an explanation, and raise competition and public policy issues.

What was and is public service broadcasting?

According to the BBC's first Director General, John Reith, the functions of the BBC were to 'educate, inform and entertain'. This trilogy remains part of the BBC's 'mission statement' today. Reith (1949) wrote that the responsibility of the BBC was to

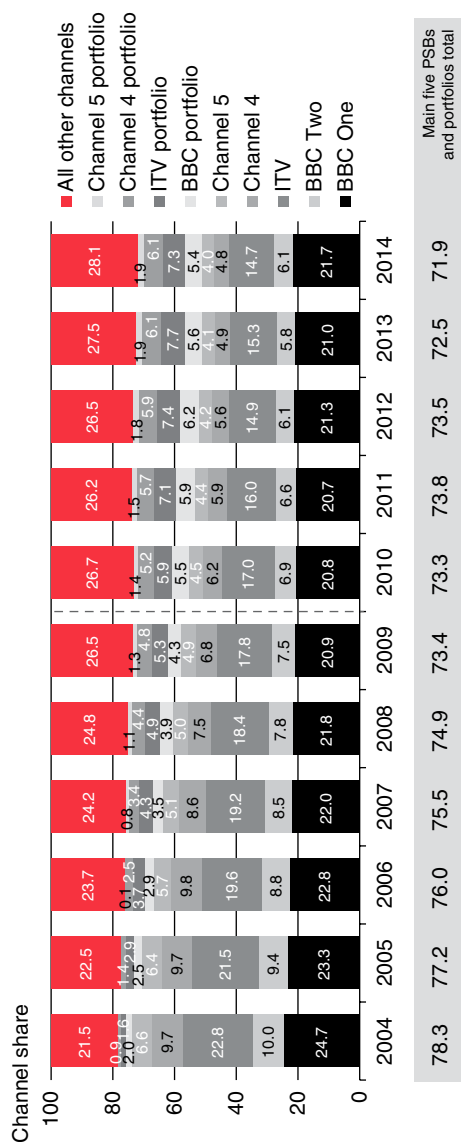
carry into the greatest number of homes everything that was best in every department of human knowledge, endeavour and achievement; and to avoid whatever was or might be hurtful.

While this contained a populist element, it was dominated by Reith's paternalistic view that only the right type of programming should be broadcast. Indeed, it was he who single-handedly turned the BBC into a 'programme monopoly' that stifled all alternative broadcasting services, including the then growing cable relay industry in the UK (Coase 1950; Veljanovski and Bishop 1983).

Obviously, given the licence fee funding of the BBC and the changing cultural and political forces in Britain, the BBC had to react and adapt its programming to accommodate these changes.

If one picks up the story of PSB in the late 1980s at the time of the Peacock Report (1986), there was a vigorous defence of

Figure 2 PSB and portfolio share of TV viewing, all individuals, by channel: 2004–14



All values are given as percentages. Source: Ofcom (2015a, Figure 8).

PSB and the BBC against the possible incursion of more off-air channels, cable and satellite TV, and the threat to its licence fee funding. The BBC got off very lightly, as the attention of the Thatcher Government turned to ITV's bloated working practices, its monopoly of advertising and the large profits (monopoly rents) earned by the then regional ITV franchise holders. It would be fair to say the Peacock Committee was misled on the possibility of a fifth channel (it was told one was not possible). It was also influenced by the evidence that the price elasticity of advertising was near unity, implying that there was a fixed advertising revenue 'pie' that would be fragmented if the BBC were forced to take advertisements (Veljanovski and Yarrow 1985). In the end, it decided to support some version of PSB with its preferred recommendation of an eventual arts council of the air (see further below).

The core tenets of PSB have never been pinned down in a convincing, operational way. The concept remains shrouded in vagueness, special pleading and *ex post* rationalisation, which mostly amounts to little more than the claim that PSB is what public service broadcasters do.

For example, in a Royal Television Society debate in Birmingham around the time of the Peacock Report, Michael Grade (then Chief Executive of Channel 4), said:

My definition of PSB is producing a wide range of programmes which is free of any commercial consideration at the point of conception of the programme.

This was, of course, camouflage, since Channel 4 was broadcasting an increasing diet of commercial programmes (e.g. *Friends*), repeats and programmes designed to appeal to advertisers, so much so that it was effectively breaching its remit (Veljanovski 1994). The plain fact was and remains that the bulk of the programmes, and certainly those that attract most of the

audiences of the five PSB channels, are programmes that could and do easily find a place in a commercially oriented television system.

In 1985, the Broadcasting Research Unit published *The Public Service Idea in British Broadcasting*, which enumerated eight principles of PSB:

1. geographic universality of reception from the four terrestrial channels;
2. catering for all interests and tastes;
3. catering for minorities;
4. concern for 'national identity and community';
5. detachment from vested interests and government;
6. one broadcasting system to be directly funded by the corpus of users;
7. competition in good programming rather than for numbers;
8. guidelines to liberate programme makers and not to restrict them.

These principles, even at the time, did not reflect the reality and trade-offs that had been made in support of PSB. For example, universal service – the requirement that everyone in the country receive the then all four channels – meant less local and regional programming, and less choice in the major urban areas.

One other principle was seen as paramount – that the BBC should be funded by the licence fee, so that it did not compete with the commercial broadcasters. The stated irrelevance of commercial considerations (at least in terms of funding) in the way the BBC programmed and scheduled its services was seen as the hallmark of PSB. Of course, today the BBC does not confine its funding to the licence fee, or its programmes to those which are purely PSB. Both conditions are violated, and the BBC has expanded and redesigned its services to meet

the competition, and embraced commercial forces where convenient, such as in setting its own executives' salaries and in launching pay TV services. But, as will be argued below, the licence fee, while the 'best of the worst' forms of funding PSB, apart from pay-as-you-view, is a double-edged sword for the BBC that encourages it to compete with commercial broadcasters.

Notwithstanding this, in the three decades since the Peacock Report the definition of PSB has remained elusive. As Gavyn Davies (1999: 9) – an economist, who subsequently served as chairman of the BBC from 2001 to 2004 – stated in (yet) another report to the government:

Some form of market failure must lie at the heart of any concept of public service broadcasting. Beyond simply using the catch-phrase that public service broadcasting must 'inform, educate and entertain', we must add 'inform, educate and entertain in a way which the private sector, left unregulated, would not do'. Otherwise, why not leave matters entirely to the private sector?

The Davies report (1999: 10) tellingly concluded: 'We decided that we may not be able to offer a tight new definition of PSB, but we nevertheless each felt that we knew it when we saw it'.

Ofcom (2004: 23), the UK communications regulator, noted:

The problem with the term 'public service broadcasting' is that it has at least four different meanings: good television; worthy television; television that would not exist without some form of public intervention; and the institutions that broadcast this type of television.

Ofcom's (2005: paragraph 1.11) PSB review in 2005 set out what it could distil as the purposes and characteristics of PSB.

PSB purposes

- To inform ourselves and others and to increase our understanding of the world through news, information and analysis of current events and ideas.
- To stimulate our interest in and knowledge of arts, science, history and other topics through content that is accessible and can encourage informal learning.
- To reflect and strengthen our cultural identity through original programming at the UK, national and regional levels, on occasion bringing audiences together for shared experiences.
- To make us aware of different cultures and alternative viewpoints, through programmes that reflect the lives of other people and other communities, both within the UK and elsewhere.

PSB characteristics

- High quality – well funded and well produced.
- Original – new UK content, rather than repeats or acquisitions.
- Innovative – breaking new ideas or reinventing exciting approaches, rather than copying old ones.
- Challenging – making viewers think.
- Engaging – remaining accessible and enjoyed by viewers.
- Widely available – if content is publicly funded, a large majority of citizens need to be given the chance to watch it.

These, however, are high ideals to which most programme makers would subscribe.

Some years later, the House of Lords' (2009: paragraph 11) Communications Committee again commented on the ill-defined nature of PSB:

Nevertheless the interpretation of public service broadcasting as content that the market does not sufficiently provide is gaining increasing support. It implies a focus on defining the core elements of public service provision that should, as a matter of public policy, continue to be supported. Such elements might include, for example, national and regional news, current affairs programmes, the arts, children's programming, programmes dealing with religion and other beliefs and UK content.

Where does the PSB concept stand today?

The BBC is self-governing through the BBC Trust and is accountable to Parliament. The BBC's Royal Charter (2007–15) defines its mission, purpose and values. It sets out six broad public purposes of the BBC:

1. sustaining citizenship and civil society;
2. promoting education and learning;
3. stimulating creativity and cultural excellence;
4. representing the UK, its nations, regions and communities;
5. bringing the UK to the world and the world to the UK;
6. delivering to the public the benefit of emerging communications technologies and services.

The *Communications Act 2003* (Section 265) sets out in general terms the PSB remits of the commercial PSB channels. Section 265(2) defines the PSB remit for Channels 3 and 5 as 'the provision of a range of high quality and diverse programming'. For Channel 4 (Section 265(3)), it is 'the provision of a broad range of high quality and diverse programming which, in particular:

- (a) demonstrates innovation, experiment and creativity in the form and content of programmes;
- (b) appeals to the tastes and interests of a culturally diverse society;
- (c) makes a significant contribution to meeting the need for the licensed public service channels to include programmes of an educational nature and other programmes of educative value; and
- (d) exhibits a distinctive character.’

All PSB channels are subject to varying degrees of oversight by the telecoms regulator, Ofcom. Under the Communications Act, it is charged with producing a periodic review of whether the public service broadcasters (the BBC, the Welsh Authority, C4, ITV and the public teletext provider), taken together, are fulfilling the purposes of PSB. In the case of C4 and ITV, Ofcom sets programme quotas as part of its licensing function.

The level of external regulation has increased, although in some cases (ITV) the PSB obligations have decreased. In 2010, parliament made substantial changes to the remit and governance arrangements of C4 through the Digital Economy Act 2010 (DEA). In particular, the DEA introduced a new remit for C4 in relation to its provision of media content, to be delivered via its portfolio channels, on-demand and Internet services as well as through Channel 4. The Act also introduced a separate reporting and governance process, under which C4 is now required to prepare an annual Statement of Media Content Policy (SMCP) on how its remit has been delivered in the last year, and will be delivered in the next year, across its services.

Overall, the definition of PSB has developed in a rather chameleon-like way to fit the political economy debates of the day. PSB is certainly alive and well as a public policy objective, as we can see from the regulatory structures now in place. The current justification for PSB normally relates back to some kind of market

failure argument that is also used to justify other interventions. The concept of market failure in broadcasting therefore needs further analysis.

Market failure

The Davies Report (1999: Annex 8) on the future funding of the BBC listed a number of what it described as ‘market failures’, which could arguably underpin PSB, and which many saw and still see as endemic in the broadcasting sector, together with those which would arise in a digital age. These were the following:

Sources of market failure

- broadcasting is a public good;
- quality broadcasting is a merit good;
- consumers are not fully informed;
- broadcasting produces externalities;
- economies of scale exist in broadcasting;
- spectrum scarcity.

Will market failure persist with new broadcasting technology?

- over-concentration in the market/risk of private monopoly;
- economies of scale will increase;
- economies of scope will increase;
- gateways bottlenecks may exist;
- increased audience fragmentation;
- negative externalities may increase.

Existing market failures

The list of existing market failures is far from convincing. Let me deal with these in a different order, reflecting their historical importance in the evolution of PSB.

Firstly, spectrum scarcity. The original reason for a nationalised BBC monopoly had nothing to do with cultural values or inadequate programme quality and diversity. It was an administrative solution to the perceived threat of radio frequency interference or congestion – or, as it was colourfully put at the time, ‘bedlam of the airwaves’ (Coase 1947, 1948, 1950, 1954). There was a growing concern that the commercial use of spectrum would lead to radio interference and congestion, thus reducing the sound quality and reception of radio services. More importantly, it would challenge the Post Office’s monopoly of wireless telegraphy. The bureaucratic solution proposed by the Post Office was to nationalise the then British Broadcasting Company, which had been set up by radio manufacturers as a way to increase sales of their wireless sets.² Commercial radio was prohibited. The idea was that, if there were a statutory monopoly service, then the technical interference problems could be dealt with by internal administrative means through government departments or other government bodies.

Of course, airwave scarcity and congestion were not market failures in themselves but the direct consequence of the refusal to establish property rights and a market in radio spectrum bandwidth. As Coase (1959, 1960) showed, and as is recognised and accepted today, the solution is to define property rights in bandwidth and allow these to be enforced as one does land, physical and intellectual property rights. While this may have been a

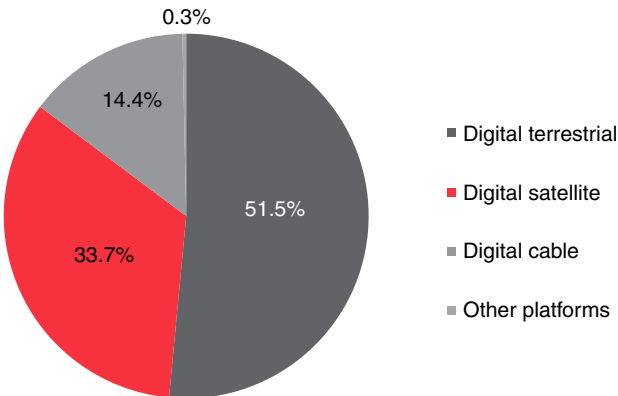
2 The original shareholders were British Thomson-Houston, General Electric, Marconi, and Metropolitan-Vickers.

bit more complicated and required some technological advances, it was not a market failure in itself.

The nationalisation of the airwaves had very adverse consequences in creating a programme monopoly, denying the entertainment and information services that many wanted. It also led to the squandering of the radio spectrum on inefficient uses, often by government departments, state monopoly entities and the civil and military defence forces – spectrum was allocated to the wrong people/entities for the wrong purposes. The auctioning of ITV/Channel 3 franchises in the late 1980s, and then 3G mobile licences in the 1990s, together with the increasing acceptance that spectrum could be sold and traded, has led to the release of more spectrum and its reassignment to more commercially valuable uses.

Notwithstanding this, today, despite the privileged position of the BBC and C4 in obtaining spectrum free of charge, these services are transmitted using a variety of platforms, including digital terrestrial, satellite, cable and the Internet (Figure 3).

Figure 3 How PSB channels are delivered to viewers, 2014



Source: Ofcom (2015a, Figure 33).

These platforms or delivery systems do not suffer from limited channel capacity.

Another argument deployed by Davies is that broadcasting is a public good. This term has a specific technical meaning in economics. It is a good or service where the consumption by one individual does not subtract or reduce the consumption of others, and where exclusion is not feasible. A television programme that has a fixed cost of production, once produced, and broadcast can be seen by an additional viewer at zero cost, could be thought of as a public good. Thus, the 'efficient' price is zero: equal to the near negligible marginal costs of transmitting a television programme to an additional viewer. Under these cost and pricing constraints, a commercial operator would not produce programmes, and, if it charged, it would lead to the 'inefficient' under-consumption of programmes.

The use of the public goods argument in television and video services, especially today, is disingenuous. Indeed, it always misrepresented the argument, because marginal cost pricing is not efficient, as it fails to take into account fixed production and distribution costs. It does not take an economic genius to appreciate that, if the price were zero, nothing would be produced. The theory, not the pricing, is wrong. In addition, a public good should not be given away free, as is often implied, but each consumer should be charged a price that reflects his or her marginal valuation. That is, there should, if possible, be a market consisting of differential pricing. The obstacle to this is allegedly the inability to get people to pay because of the absence of an encryption and payment technology. However, this technology has always existed, but it was abandoned to protect the BBC as early as the 1920s. More to the point, such payment systems exist today and are in widespread use, allowing pay TV to flourish. In technical terms, what might at one time have been a public good is now a club good – exclusion is possible and payment can be enforced. Finally, video programmes are created and sold in markets; even the BBC sells its

programmes in markets, and, after the Hollywood studios, it is the biggest distributor of television programmes in the world. Like spectrum scarcity, the public goods argument is simply an observation deployed selectively to justify a position already reached on other grounds, i.e. those of Reithian paternalism.

But, what is more to the point is that the market failure case disappears when a genuine market in programmes can be developed. Pay TV is that market. Add to this the fact that the whole concept of a channel is fast becoming redundant, as people dip in and out of different video media and have access to interactive online services, and one sees a fragmented but vibrant market in video and online services. This far outstrips that predicted by even the maddest visionary in the 1980s.

The Green Paper's (DCMS 2015: 14) only justification for the BBC is that 'high quality PSB content has generally been seen as a "merit good", which would be under-provided in a free market', continuing:

PSBs such as the BBC still deliver positive effects for society such as extending democratic knowledge through news and current affairs, helping extend the UK's influence and reputation abroad, addressing needs of audiences such as minority language groups, and serving audiences (such as children) where excessive advertising would be inappropriate. These goods would not be provided in sufficient volume by the market alone.

The argument that broadcasting is a merit good is paper thin. A merit good in economics is a vague and ill-defined concept, which has been largely discredited. It has been defined as a good whose value exceeds the valuation an individual would place upon it. This is presumably related to the value that a 'fully informed' consumer would place on it. It is hard to see how this concept differs from the externality argument, and how it has universal

appeal. The best argument is that potential viewers may under-value education and informative programming, and over-value entertainment. However, sport has been treated until recently as a crucial aspect of PSB, so much so that major international events were 'listed', meaning they had to be shown on the BBC or ITV (Veljanovski 2000). The merit good argument sheds no light on who this fully informed consumer, who makes judgements about the externalities or true value of a good programme, would be. Is it the political class or some kind of bureaucracy? Why are their views more valid than those who watch television? If the mass of consumers is incapable of judging whether a television programme is of sufficient value, are they in a position to judge who should be the politicians that are making policy about broadcasting? Might those who are making judgements about merit goods not have their own prejudices (see the chapters on bias) that are not related to some kind of objective criteria about the value of a programme?

The merit goods argument suffers from another drawback. To many people, television is a 'de-merit good' that has led to the decline of reading, conversation, manners, eating habits, family life and so on. While the economists' theory can extol the drawbacks of the market in supplying more TV, others would and do regard any supposed failure on this score as a good thing.

The existence of economies of scale in broadcasting is again not unique to broadcasting. If the suggestion is that broadcasting is, as a result, a natural monopoly or duopoly, then it is wrong, and symptomatic of the tendency to view the PSB organisations in isolation from developments elsewhere in the communications sector.

The other causes of market failure are simply variations of those already discussed. Even if they were correct, their quantitative significance has not been measured; nor do they justify the structure of PSB that has evolved, which inhibited competition and technological developments in broadcasting for decades.

Another source of market failure not mentioned is the claim that direct competition between media outlets may lead to duplication of common denominator programming. This was based on the theory, which has a good economic pedigree, that a few free-to-air (i.e. advertiser-supported) competitive channels would maximise their audience share by broadcasting the same type of programming. Like the ice cream sellers along the beach promenade described by Hotelling (1920), broadcasters would find that they could maximise their audience share by locating next to one another and producing the same mediocre programming. But the theory applied at best to advertiser-supported television (Steiner 1952; Beebe 1977; Spence and Owen 1997), and it was not applicable to a genuine market in programming with a large number of providers or to pay TV. Furthermore, this theory evaluated television and broadcasting against the consumer sovereignty objective, something PSB advocates rejected. It also ignored the very simple fact that advertiser-supported TV had an important role to play, both as entertainment and to advertise industries' wares, and generated massive consumers' surplus for viewers who received the programmes free of charge.

It is not necessary to go into the assumptions and qualifications of the programming 'inefficiencies' of duopoly channel advertiser-supported broadcasting markets. Suffice it to say that, as the number of channels increases, and if the audience is diverse, even commercial advertiser-supported channels will not slavishly broadcast the same lowest-common-denominator programming. But, more to the point, the *bête noir* of supporters of PSB – American network television – was portrayed as a cultural wasteland, which careful research showed was not the case (Gallagher 1989). This is evident from the popularity and production standards of American network television programmes and the fact that they are now shown on British PSB and commercial channels.

The paradox of PSB (see Veljanovski 1988b, 1989e) is that its past and present structure does not maximise programme diversity. It is a hybrid structure that harnesses commercial programming in order to effectively cross-subsidise the provision of what is deemed PSB. In the case of the BBC, this is done by broadcasting a large quantity of popular programmes bought from the US as well as other programming on BBC1 in order to maintain its viewer share and thereby justify the universal licence fee. This programming could easily be profitably shown on commercial television stations without any PSB remit. Moreover, it is obvious that if the BBC devoted most of its funds to programme production and scheduling different to that shown on commercial free-to-air services, much more diversity could be introduced into the terrestrial broadcast segment for the same licence fee revenues. As will be described later, such a reform is relatively easily done without too much structural change to the present terrestrial PSB system.

Taken as a whole, the market failures case for PSB is weak. One may not like what the market produces and regard the Internet as crass and demeaning, but these opinions are largely a commentary on peoples' tastes and often reflect an elitist attitude. This is not to say that the pay TV and related markets work perfectly or would necessarily replicate the programming that would be generated and broadcast by PSB. But it is not the role of the market to replicate what is arbitrarily defined by the BBC or others commissioning PSB programmes, nor is it the function of the BBC and C4 to largely duplicate programming that would otherwise find a place on unregulated commercial video-delivery systems (Veljanovski 1999a,b, 2001).

Furthermore, what is often missing from the debate, and even more serious analysis, is a recognition of the inefficiencies associated with the broadcast rationing and regulation that underpin the UK's PSB system. The Thatcher Government and the Peacock Committee were shocked by the inefficiency of ITV, and, more recently, the profligacy of the BBC has come to light.

Future market failures

There is also rather a weak case for the ‘future market failures’ that were laid out by Davies. That the new digital age will fragment audiences there is no doubt, but that is hardly a market failure. That it will lead to the emergence of new bottlenecks and gateways, and that the cost conditions of transmission and content may allow some owners of delivery networks to gain first-mover advantages and large market shares is also true. But these are concerns now dealt with by competition law and industry regulation. They are no different from those confronting the mining or mobile telephony sectors.

This is not to say that some of the issues raised by the new media are not difficult; for a time, they will seem intractable as new technologies and business models move from infancy to maturity. At first, pay TV, the Internet, mobile Internet and so on were seen as the precursors of competition, and then as threats to competition, thus attracting regulation and controls as the dynamics of the market were recognised. The relevant issues generally relate to gateways and access to key delivery systems or technologies as well as, in the formative years, the somewhat destructive winner-takes-all competition between operators (such as that which existed between Sky and BSB in the 1990s) to gain dominance of the sector. But, these are part of the process of competition that is common when there is radical technical change in any commercial sector. It is a necessary driver of innovation and a process of discovery of consumers’ needs.

The reality of the development of new media has been a struggle against entrenched interests and the retardation of competing technologies and commercial services. For example, one of the pressure groups lobbying for control of radio in the 1920s was the newspapers, who wanted to limit a threat to their news services. As commercial broadcasting and the new media

developed, existing media owners fought hard to block entry and took steps to control the media, leading to predictable concerns about cross-media ownership and 'share of voice'. These concerns have often been over-egged and are due largely to the way PSB and broadcasting regulation fostered monopoly and then oligopolistic media market structures that gave one organisation a larger 'voice' not justified on competitive and diversity grounds.

The transformation of the communications sector due to technological innovation has gathered pace in the last decade. There has been a move from analogue to digital transmission, and the development of compression technology, which has increased channel capacity, has brought down costs, reduced barriers to entry and so on. Furthermore, the development and widespread availability of encryption technology and conditional access systems enables channels and programmes to be scrambled so that payment can be required, thus leading to the growth of pay TV. While cable systems were banned to support BBC TV prior to the 1980s, they now proliferate with ample channel capacity. Online services such as YouTube, Netflix and general video streaming, taken together with the changing viewing patterns and practices of the younger generation, have meant that the role of video entertainment and information is altering dramatically. It is no longer a matter of catering for a given demand but of developing and responding to new delivery technologies and different ways of offering video entertainment. As a result, the type and range of content available from commercial providers has proliferated.

So, with regard to the possible future justifications for PSB made by Davies, these are really not justifications for PSB at all. Rather, they are largely an observation that changing technology may give rise to competition concerns, as happens in other industries when there is rapid innovation. There are already mechanisms to deal with these problems, and promoting the market

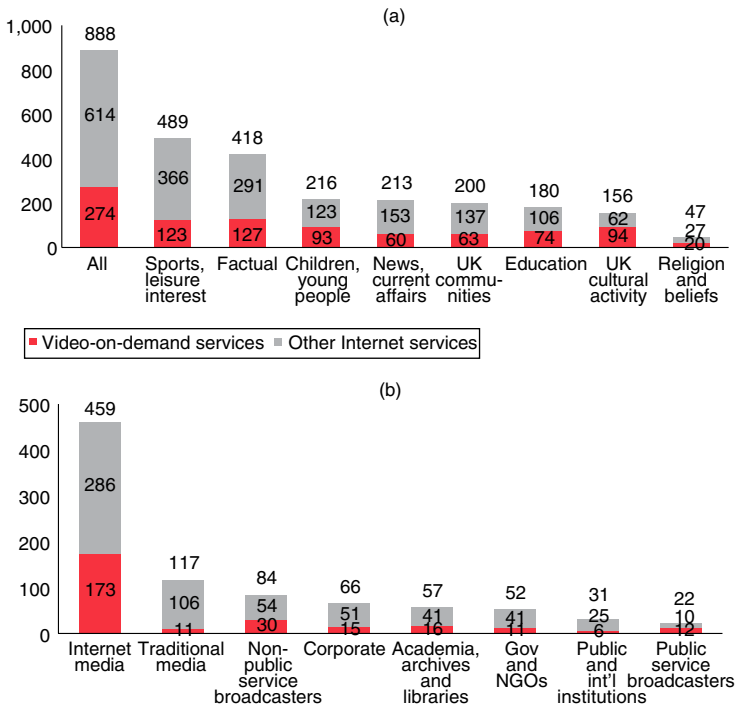
power of the incumbents in the face of competition from innovation is not an appropriate way forward.

Can a case be for public service broadcasting?

The analysis above may seem overstated. It might be argued that there is a range of programmes that may not survive in a competitive, fully commercialised communications sector. However, this does not indicate market failure, and it is far from clear what such programmes might be. The House of Lords' Communications Committee quoted above suggested that programmes under-provided by the market might be 'national and regional news, current affairs programmes, the arts, children's programming, programmes dealing with religion and other beliefs and UK content'. Most of these are produced and shown in large quantities by the market, and do not seem to me distinctively uncommercial.

Recent research for Ofcom (Enders Analysis 2014) shows that the fast-developing online media offers 'hundreds if not thousands of online media services that provide content which could be regarded as PSB content compared to the five PSBs. This content ranged from sport and leisure, actual current affairs, news. The gaps were in cultural affairs and religion' (Figure 4).

Notwithstanding this, if there is a case for PSB, it needs to be clearly identified, and the reasons why the relevant programmes would not be produced and transmitted by the market need to be fully justified. If such programming exists, then it is important that it is funded and transmitted in ways that do not distort the whole broadcasting system or require funding that is disproportionate. The cosy duopoly of the BBC and ITV/C3 prior to the 1990s resulted in significant inefficiencies. Moreover, the present structure of PSB crowds out programming that would otherwise be produced by the commercial sector, and represents unfair competition with the commercial sector. Competition issues are discussed further in Box 1.

Figure 4 Public service broadcasting by non-public-service broadcasters

(a) Online media services by public service objective, June 2014. (b) Online media services by organisation type, June 2014. Source: Enders Analysis (2014).

Funding of PSB

Suppose for a moment that a case can be made out for some form of PSB. How should it be funded?

The current funding of PSB takes or has taken a variety of forms – the licence fee, cross-subsidisation from advertising within a channel (ITV) and across channels (ITV to C4) and direct subsidy (BBC World Service, until recently, and Gaelic language programmes in Scotland). In addition, the BBC, C4 and

Box 1 Competition policy and the BBC

The BBC and other PSBs are subject to general and specific competition laws. They must comply with both EU and UK law and competition interventions administered by Ofcom as well as, in the case of the BBC, self-imposed fair trading rules.

State aid and the licence fee

The area of competition law most relevant to the licence fee debate is state aid. Over the last several decades, the competition regulators have received many complaints and undertaken investigations alleging that the funding of PSBs across Europe constitutes illegal state aid. Despite the general prohibition against state aid, in some circumstances government interventions that are necessary for a well-functioning and equitable economy can be exempt. Therefore, the European Treaty leaves room for a number of policy objectives for which state aid can be considered compatible.

In the PSB sector, the Commission has tended to exempt the BBC from state aid rules. For example, in May 2002 the European Commission investigated whether the funding of the BBC's digital television and radio stations was illegal state aid. The Commission concluded that it was not, as it gave the BBC 'no real advantage' because the 'compensation for the digital channels is not disproportionate to the net costs of the new channels, which are performed as part of the public service obligations of the BBC' (European Commission 2002). Similarly, in 1999 BSkyB complained to the European Commission that the public funding for the BBC's 24-hour television news channel was illegal state aid. This was rejected by the European Commission on the ground that EU rules allowed such aid if it was compensation for the delivery of services

of general economic interest, as entrusted to member states. The Commission found that the financial means granted to the channel did not exceed its actual costs, and so were proportionate to the public service.

A contrary view

However, this formulation of the state aid rules presupposes acceptance of the objectives of PSB and the BBC's expansion (in the case cited above), which may themselves distort competition. The premise of this chapter is that the activities of PSBs is overextended and inherently distortionary. For example, BBC Radio One is the most-listened-to radio station, and BBC News Online is the most-watched news website. These satisfy the state aid rules but at the same time clearly distort the market, as they compete with commercial broadcasters providing the same commercial content, thereby crowding-out commercial broadcasters from these areas because the competition is too intense.

Competition in production

Regulatory and competition interventions have also been prominent to foster more competition in production. At various times, the BBC (and other PSB providers) have been required to increase commissioning of programmes from external producers. For example, as part of the last licence fee settlement the BBC agreed to commission up to 50 per cent of its programmes from such external producers.

Competition in news provision

Two other areas where legitimate competition concerns could be raised are in relation to local news provision and the influence on the news agenda more generally. It has long been

argued by local newspapers that the BBC's dominant position, financed by a compulsory licence fee, involves unfair competition with local news. The BBC contests this claim. More recently, the local newspaper industry has claimed that BBC proposals to create a shared service with local newspapers to cover local courts and councils will represent unfair competition. This issue is complex. If the move is seen as a competitive threat to local newspapers, it could indeed be regarded as anti-competitive. On the other hand, the 'shared service' will involve the BBC providing local newspapers with some of their content. Given that this is financed by the licence fee, local newspapers would be receiving a subsidy from the licence fee that could be regarded as state aid under EU law.

When it comes to media ownership, there are rules that severely limit the ownership of television channels and newspapers to prevent dominance of the news sector by one provider. However, there are no equivalent rules that deal with the dominance of the BBC in news provision. Despite the relative decline of the BBC in broadcasting in general, it is dominant in news provision. In a recent Ofcom survey, five of the top eight news providers were BBC sources, with BBC One way out in front as the number one source.¹ Such market power would not be allowed if the BBC were a private organisation or in the newspaper market.

Conclusion

This is not a full analysis of competition issues. What is apparent is that the competition rules, by accommodating PSB objectives, provide only limited controls on the BBC, and

1 See http://stakeholders.ofcom.org.uk/binaries/research/tv-research/news/2015/News_consumption_in_the_UK_2015_report.pdf

leave intact the structural and behavioural abuses. These often require additional *ex ante* rules and regulation to control. The BBC should operate under the same law as applies to other broadcasters and news providers.

S4C receive a subsidy, as they do not pay for spectrum. Thus, as a practical matter, PSB can be and is funded in different ways.

The bulk of the funds for PSB comes from the licence fee paid by each viewing household, which goes to the BBC. This is a hypothecated tax levied on the ownership of television sets and other receiving devices used for live viewing of the BBC. It provided the BBC with revenue of £3.7 billion in 2014 (see Figure 5). This is supplemented from other activities, but largely from the sale of BBC programmes (£1 billion), giving the BBC Group a total income of around £5 billion. Indeed, BBC Worldwide is the largest TV programme distributor outside the large Hollywood studios.

The BBC's funding has come under pressure over the last decade. The licence fee increases have been capped to the rate of inflation and have been eroded by the so-called iPlayer loophole; more viewers receive the service using catch-up services, which do not attract a licence fee. At the same time, the government has imposed increased responsibilities and costs on the BBC. In the 2010 licence fee settlement between the government and the BBC, the BBC agreed to fund the World Services (which had hitherto been funded by the Foreign Office), BBC Monitoring, S4C, local television infrastructure and the roll-out of super-fast broadband through Broadband Delivery UK. Following the 2015 Budget, the BBC will fund the free licence given to over 75s. This squeeze on finances is symptomatic of concerns over the scale and scope of the BBC, and whether the licence fee

income is being used simply to show what could otherwise be shown on commercial services. Notwithstanding this, the issue of the extent of funding of the BBC is a critical one, raised by the lack of support for a market failure case for the BBC outlined above.

While there is considerable opposition to the licence fee as a means of funding PSB, it has several attractions over funding from general taxation revenues, which is mooted in the Green Paper on the BBC Charter Review (DCMS 2015). This is because the licence fee creates a link between the viewer, the BBC and politicians. The viewer can indirectly exert constant pressure on the politicians and the BBC by complaining about the level of the licence fee and the programming output of the BBC. If the BBC were funded from general tax revenues, this link would be broken, and the pressures and constraints on the BBC and politicians would be severed.

However, the licence fee does have a number of unattractive and perverse features.

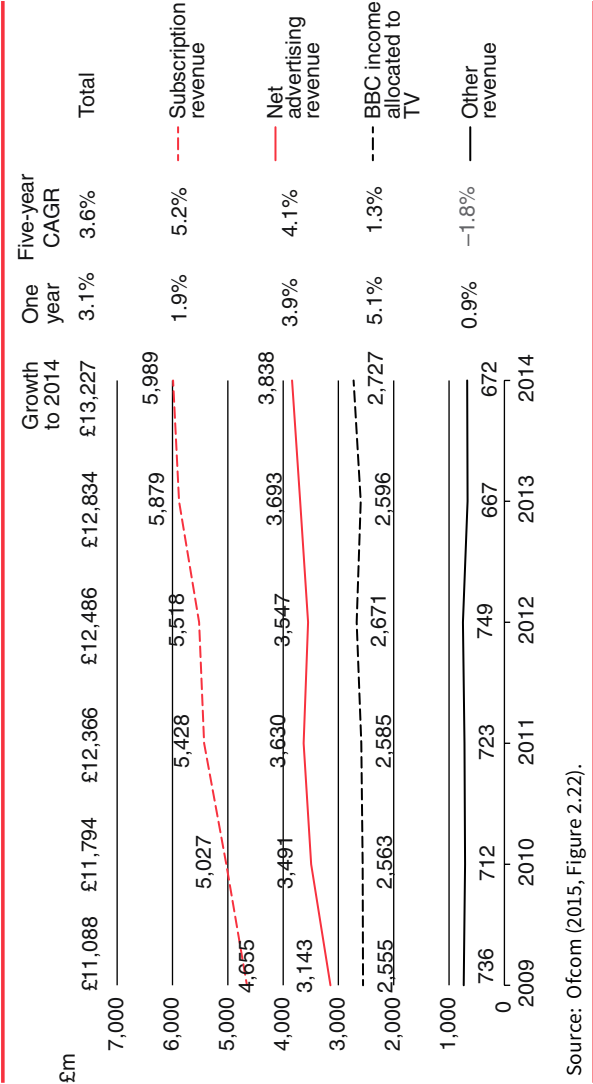
It has been described as a regressive compulsory poll tax. Its compulsory nature is widely disliked by viewers. Whether it is in fact regressive is a moot point, because its incidence has to be compared with the viewing patterns of those paying it, to see if it is disproportionately affecting low income groups who watch little BBC television and radio. The non-payment of the licence fee is a criminal offence. Indeed, almost 200,000 viewers a year have been prosecuted and liable to a fine up to £1,000 and a criminal record. There have been 50 people jailed. This represents an incredible 10 per cent of all criminal prosecutions in the UK. The present government has announced that it will decriminalise non-payment of the licence fee, but there are signs that its commitment to this proposal is wavering.

The periodic review of the licence fee is a ritualised and highly politicised affair, either extolling the virtues of the BBC or criticising the BBC's performance, political bias and poor internal governance. The compulsory nature of the licence fee means that

the BBC is not subject to the same economic constraints as the commercial broadcasters, especially the procyclical volatility of advertising revenues that fund ITV and C4 (see Figure 5). The BBC does not have to compete for revenues, and, within each licence fee period, has a guaranteed income, which has been rising in nominal terms compared with the decline in advertising revenues of the commercial broadcasters (Figure 5). This places it in a financially and competitively stronger position than ITV during cyclical downturns. This contrasts with the position of pay TV operators, who have increased their audience share and revenues significantly.

But there is a fundamental paradox at the heart of the licence fee in that its strong feature is its weakest. It has been noted above that the licence fee has the attractive feature of linking viewers to the BBC and politicians. They are annually reminded that they are paying for a 'free' service and can protest if they do not regard it as value for money. But the licence fee 'forces' the BBC to offer a broad-based service that attracts a relatively high audience/viewing share, otherwise popular and political support for the fee would drain away. This, in turn, results in the BBC broadcasting vast quantities of programming that would have been shown by commercial broadcasters. It has to satisfy the viewers and listeners with a broad mix of programming delivered in different ways, otherwise it would be marginalised as a broadcasting institution. This tendency to have broad appeal and meet the competition dilutes its PSB role. It generates an expansionist strategy, which has increased the scope and scale of the BBC's activities and thereby blurs its contribution to PSB. While for the BBC's management this makes sense – competent, ambitious managers do not want to oversee decline and be restrained – it undermines the case for the BBC. The objective of policy in relation to PSB should not be to ensure the survival of the BBC as it is now or its growth as a viable competitor to the commercial broadcasters. The BBC and PSB are not synonymous – the policy goal for those who support

Figure 5 Total TV revenues by source, 2009–14



Source: Ofcom (2015, Figure 2.22).

PSB is the efficient provision of PSB content, and not the preservation of the BBC.

Yet the real criticism of the licence fee is that, in the current broadcasting environment, it is increasingly hard to justify. Technologies now enable the viewer to be charged for their programmes, and there is a variety of devices – over-the-air TV, cable, Internet and mobile devices – which can download and be used to view live video programming.

PSB can be and is funded by advertising, as C4 and other advertiser-supported channels have shown. However, to permit the BBC to take advertising would unleash a large state-owned competitor on ITV and C5. This would severely reduce their advertising revenues and damage their viability, even if the BBC did not alter its programming. Paradoxically, advertising markets are peculiar in that the supply side is more or less fixed by the advertising exposures to viewers that can be generated. Thus, the principle effect of increased channels and advertising is simply to fragment the audience while leaving the aggregate volume of exposures constant. Indeed, channels that can supply large viewer share can charge relatively more than several channels supplying the same volume of exposures. Research for the Peacock Committee (Yarrow and Veljanovski 1988) and more recent research confirms that the price elasticity of demand for advertising is near unity, implying that the television advertising pie is more or less fixed.

Structural reforms

Unreformed sectors are an anachronism

The other big question is how the provision of core PSB programmes should be organised. Should it be the preserve of two state-owned broadcasters (the BBC and C4/S4C) and several others with specific PSB obligations? Or should core PSB

programming be dispersed over the broadcasting sector funded by an Arts Council-type organisation, with funds made available for whichever media companies bid in a competitive (more recently referred to as ‘contestable funding’) process? Or is the case for PSB so weak as to permit radical structural reform and privatisation of PSBs without any funding mechanism or other intervention being used to promote PSB?

Firstly, it should be noted that the state ownership of major broadcasters is an anachronism in a free society. As discussed above, the historical reasons for this structure were dubious even at the time they were advanced. But, as the PSB system developed, it created three state-owned entities (the BBC, C4 and S4C), which actively competed for viewers and also advertising revenue (in the case of C4) with commercial broadcasters. State ownership and the licence fee have generated major distortions together with internal governance problems at the BBC. There is a clear case in today’s communications environment for slimming down and privatising segments of the PBS system.

There has already been significant structural reform in the sector. ITV and parts of the BBC have vertically disintegrated by closing down their programme production facilities, and they are required (by regulation) to buy in all or a large proportion of their programmes. The terrestrial transmission systems once owned by the communications regulator (the then IBA for ITV and C4) and the BBC have been privatised and are now operated by a separate entity. The ITV/C3 network, which was operated by a number of regional franchise companies, has now consolidated by takeovers. Based on the Peacock Report (1986) recommendations, the original regional ITV operators were selected by competitive cash bids in 1989–90, thus paying and establishing property rights in spectrum (although spectrum cannot, as it can in the US, be freely traded other than by a takeover of ITV).

Future reforms

The most obvious first step relates to C4. There is little justification for a state-owned C4. The origin of C4 came from the intense lobbying by independent programme producers to create an independent programme production sector and increase programme diversity. This rationale has now largely disappeared. The auction franchising process inspired by the Peacock Committee resulted in the then regional ITV franchise holders divesting themselves of programme making, diminishing the case for the C4 model.

The coexistence of the BBC, and in particular BBC1 and C4, is anachronistic. BBC1 is a mass audience channel, showing a vast quantity of commercial programmes funded by the licence fee under the umbrella of PSB. C4's programme remit is to offer diverse and innovative programming, catering for tastes not well served by the other main advertiser-supported broadcaster. In fact, programme diversity and innovation could be maximised by switching the remits of BBC1 and C4. The large bulk of PSB programming would then be broadcast by the BBC, and the BBC would withdraw from acquiring, funding and broadcasting popular commercial programming.

Such proposals, first made 25 years ago (Veljanovski 1988b, 1989: 109–11), were heavily criticised at the time as having the potential to turn the BBC into a 'cultural ghetto'. However, they could turn the BBC (using a similar emotive metaphor) into a 'cultural oasis' focused on programmes that would not be broadcast in sufficient quantity in the commercial sector. This would pave the way for the privatisation of C4 (Veljanovski 1996).

A more radical proposal would be to privatise the BBC. While this has an appeal in principle, the consequence would be to unleash a large former state broadcaster to compete for advertising and subscription revenues with the existing terrestrial and commercial media companies. Any such privatisation would have to

be accompanied by slimming down the BBC, and this would pose commercial and organisational challenges. A slimmed down BBC would not be as commercially valuable, and, hence, the sale price would be reduced to the government. There would also be issues surrounding the ownership of the BBC programme library.³

An alternative proposal is the arts council for the air, as described by Peacock (2004). This requires a clear operational definition of PSB and its funding, but it would harness competitive forces in the production and delivery of PSB programming. This could operate in many ways. It could, for example, provide grants to allow broadcasters to adapt what would otherwise be popular commercial programming to include a PSB aspect (for example, providing a broader range of music in a programme series on Classic FM or news in a language such as Urdu appended to news programmes in particular regions). The main attraction of such a proposal is that the funding would be available on a competitive basis.

To a limited extent, a prototype model has been in operation for some time. My report (Veljanovski 1989) for *Comuna Gàidhlig*, funded by the Highland and Islands Board, suggested that publicly funded Gaelic language programmes should be sourced through competitive tender, and bid for by the ITV contractors and the BBC in Scotland. This was accepted by the then Conservative government when it established the Gaelic Broadcasting Committee (*Comataidh Craolaidh Gàidhlig*) in 1991. Its purpose was to manage the Gaelic Broadcasting Fund of £9.5 million a year in order to support Gaelic language programmes set up under the Broadcasting Act 1990. The Committee was charged with funding up to 200 hours of Gaelic television programmes, and with enhancing and widening the range of Gaelic sound

3 The chapter by Tim Congdon later in this book does suggest full privatisation. Indeed, Congdon argues that the size of the BBC is one of the attractions of privatisation, as it would then be able to compete with other media giants in an environment in which media companies need to operate across a range of technical platforms.

programmes, to be broadcast mainly in Scotland. In practice, funded programmes are broadcast by the BBC as well as ITV, although the former had no statutory requirement under the Broadcasting Acts to transmit Gaelic programmes funded by the Gaelic Broadcasting Committee. There were drawbacks with the operation of the Gaelic programming initiative – in the choice of programming and the fact that many were broadcast at unsociable hours.

There are major drawbacks with the arts council for the air proposal. It would interpose yet another public institution between broadcaster and viewer, charged with selecting broadcasting content that would inevitably reflect the preferences and tastes of the committee responsible for allocating funds, rather than those of the viewers. The commercial dynamics of subsidised programming may see it fund unattractive programming shown at inconvenient times. The role of the BBC would also remain unresolved. If the BBC were confined to core PSB services, the arts council for the air proposal may effectively sound its death knell. One cannot have such a body and a protected BBC (and C4).

Conclusion

The market failure framework has never and does not today provide the solid basis for PSB, even within the narrow confines of the paternalistic, programming values espoused by supporters of PSB. The present system is highly distortive and does not achieve the maximum programme diversity; and the BBC is over-reliant on popular programmes for its political support and survival. Furthermore, the ownership and funding of PSB creates an enclave of the broadcasting sector that is largely immune from commercial forces, but which adopts a commercial approach where it is convenient, thus posing unfair competition to the commercial broadcasters.

There is also what might be called the licence fee paradox. The licence fee is perhaps the best way of funding the BBC, should one want a BBC. It creates the best link between viewer and broadcaster (apart from pay-per-view or subscriber services). However, at the same time, it forces the BBC down a populist, commercial route in order to maintain political and popular support for the BBC, making it expand well beyond core PSB programming, and, as a consequence, undermining its *raison d'être*.

But the core issue today is whether, given the pace of technological change and changing viewing habits, two state-owned broadcasters are compatible with a free society and viewer choice. The short answer must be no. The easiest policy to implement would be to privatise C4. A more wide-ranging and sustainable solution policy response must avoid reforming broadcasting in such a way that defines core PSB simply as things that PSBs do. There is a range of policy options. An arts council for the air could be a viable option, but not whilst there is a protected BBC. The BBC could be fully privatised or slimmed down. These options are explored further in later chapters. The status quo is not an option.

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