PART I

Serving Audiences

Economics-minded critics of government intervention in the media realm raise a constant refrain: interventions are paternalistic and treat viewers as "helpless or obstinate."[1] Interventions assume that viewers are "incapable of wise choice."[2] A free society must treat audiences as perfectly able to know and choose what they want to read, watch, and listen to. Market incentives lead media producers to provide audiences with what they want.

In his classic article arguing for deregulation of broadcasting, former FCC chairman Mark Fowler explained that the government "should rely on the broadcasters' ability to determine the wants of their audiences through the normal mechanisms of the marketplace."[3] As with any other product, "[i]n the fully deregulated marketplace, the highest bidder would make the best and highest use of the resource."[4] Fowler summed up this view of the media with his famous remark that "television is just another applianc . . . a toaster with pictures."[5] Fowler's deregulatory perspective swept through policy-making circles in the United States. It became received wisdom in executive, legislative, and judicial branch thinking about media policy.[6] In the last decades of the twentieth century, deregulation of the media (and much else) became a global phenomenon. I argue here that this approach is fundamentally wrong.

My primary concern is with the creation and provision of media content. The pervasive antiregulatory refrain, however, has recently been equally loud in the related context of the infrastructure for delivering communication content.[7] It was overwhelmingly evident in the passage of the Telecommunications Act of 1996, adopted as an act "to promote competition and reduce regulation."[8] A virtually unquestioned market orientation was conspicuous. For example, the initial Senate report described the bill's purpose as "to provide a pro-competitive, deregulatory national policy framework."[9] Senator Hollings' additional views emphasized that "competition is the best regulator of the marketplace." The only two dissenting senators did not disagree on this point. They observed that "[d]eregulation has a clear and consistent track record" but complained that, as reported out of committee, the deregulatory bill did "not go far enough" and did "not guarantee free and open markets."[10]

The chorus favoring deregulation within the media realm often repeats standard conservative defenses of free markets. Yet, in the context of the media, this view has added rhetorical appeal. First Amendment values lead even some interventionist liberals to reject government paternalism in respect to speech. Nevertheless, despite the lure of equating freedom of the press with free markets, constitutional law does not mandate such an equation.[11] Although the First Amendment ought to restrict purposeful suppression of speech, it should not and has not restricted structural interventions designed to improve the quality of the press.

Still, maybe critics of intervention are right to emphasize the strong antipaternalism aspect of the First Amendment. If interventions are paternalistic, if they attempt to displace readers', listeners', and viewers' own choices, then maybe interventions are contrary to basic First Amendment values. The critics argue that, in respect to media content, surely the government ought to let the public get what it wants – and this, the critics assert, means leaving the issue to the market.[12] An advocate of intervention might plausibly argue that people often do not know what they want or that they should receive what (someone else thinks) they need – government does this for children in the schools. Both positions have nuanced versions, but I put this debate aside. Rather, in Part I of this book I assume that people's choices ought to prevail but argue that this will not occur in an unregulated market. Thus, Part I critiques the underlying assumption of the market advocates' argument, namely, their claim that the market gives people the media they want.

Before beginning, however, I must make a confession. The first three chapters apply the most conventional of economic analyses. This is problematic on a number of grounds. For example, the key concept of the conventional analysis, "efficiency," is *inherently* indeterminate in the policy context of choosing legal rules.[13] In a conventional analysis, determining the efficient rule or policy depends on assuming some distribution of wealth and some set of preferences. The economist's normal approach of assuming the existing distribution of wealth is conceptually unavailable when the content of the existing distribution is precisely what the choice of a legal rule or policy places at issue. The choice of a rule (or a disposition of a legal dispute) affects the parties' wealth and, often, influences people's preferences toward favored or approved options. Thus, as a positivist analysis, typical versions of law and economic methodologies are systematically incomplete; the efficiency criterion is often indeterminate. In contrast to the overt inadequacy of this law and economics analysis as positivist theory, a positivist class-based theoretical addition makes for potential descriptive completeness. When alternative results would both be "efficient," the class-based theory could predict that the law will choose the solution that adds to the ruling economic class's wealth or power. Likewise, a normative egalitarian theory would also be determinant, but would recommend the opposite. Analytically, however, law and economic analysts effectively adopt the ruling-class orientation when they assume, as a starting point of analysis, that value is determined by a person's "willingness to pay" with the wealth she has available absent the contested rule. In contrast, the poor would be comparatively favored if the analysis adopted as its criterion of value the amount a person would require before selling a benefit if it were supposed that she initially held it. This second starting point would proportionately increase the wealth of the poor more than the rich, making it possible for her to value the item more. For example, a poor person might be able to pay only $500 for a potentially life-saving operation for which a rich person would, if necessary, pay a million dollars. If, however, both had an initial right to these medical services, the amount they would require before giving up the right might be virtually the same. That is, given an efficiency goal of trying to locate a right or benefit in the hands of the person who values it the most, the first criterion favors the rich by making it seem that she values the matter at issue the most while the second comparatively favors the poor (but not as much as would an egalitarian standard).

None of the foregoing denies, and this book implicitly assumes, that welfare economics can be extraordinarily useful in examining relevant aspects of the legal order. On the other hand, this economic analysis can be equally dangerous to the extent it dominates consideration of legal issues. The analysis's linguistic commodification of all valued elements of human existence may contribute to making such commodification intellectually and socially acceptable. As Chapter 4 observes, human flourishing requires many elements of life to remain uncommodified.[14] The analysis's reductionist orientation regularly treats as assumptions particular answers to precisely the issues most in dispute.

Different methodologies are essentially different languages. Although the same question can be approached and the same "best" answer can often be reached using different languages, the different languages vary in their ability to shed light. No single language can do all that others do even if a given insight is seldom (if ever) available in only one language. A particular language may be out of place in a particular context. Each is a tool and should be used to the extent it is useful; while it makes some things clearer, it is likely to obscure other important matters. The danger of hegemony arises when a particular language either implicitly or explicitly claims to be the only way to reach insight.

Probably the most important issues the legal order faces today are normative; they relate to proper distributions of wealth and power and to what preferences or values should prevail in various contexts. These issues are inevitably seriously contested and the perspectives that different groups bring to bear on them differ, often profoundly. The methodologies that are often most important for responding to these contested issues – and hence methodologies that should be at the core of any policy-oriented education – are ones that aid in seeing different perspectives and that aid in the self-reflective development of these perspectives. If the reductive allure of economic problem solving causes neglect of these more difficult methodologies, we are all losers.

Despite these reservations, Part I is relentlessly economic in analyzing the capacity of markets to give people the media they want. In part, this emphasis is valuable because of the clarity it casts on numerous important issues of media policy. Because my conclusions diverge from those that many free-market advocates believe economics recommends, I hope this approach is also useful in speaking directly to defenders of the market on their own turf.

CHAPTER 1

Not Toasters: The Special Nature of Media Products

Economics-oriented critics of government intervention in the media realm typically rely on oversimplified economics. Under certain purportedly normal circumstances, the market provides firms with an incentive to produce and sell the product as long as the product's cost (e.g., its cost of production and distribution) is less than the purchaser will pay, that is, as long as marginal costs are less than marginal price. The market thereby leads to a preference-maximizing production and distribution. This I call the "standard model."

The standard model is subject to a host of general critiques mostly related to why the market will fail or will be dysfunctional.[1] As one example of the latter, note that market competition creates an incentive for a market enterprise (e.g., capital holders) *to gain power* in relation to other resource owners (e.g., labor or other competitors) as much as it creates an incentive *to produce goods efficiently*. The power struggles between stakeholders, however, are primarily over distribution and do not produce any goods. As such, they waste resources as well as often generating unjust distributions.[2]

Of course, no one ever claims that the market works perfectly. Still, despite its problems, many find the standard model relatively adequate, at least enough so that it provides a presumptive reason to rely on "free" markets. For present purposes, I assume that the market *generally* works relatively well – for example, it effectively and efficiently leads to roughly the right production and distribution of cars or can openers. My claim is that, whatever the validity of general critiques of the market, the standard model applies especially badly to media products.

The standard model's persuasiveness depends on the following assumptions. (1) Products are sold in competitive markets and are sold at their marginal cost. (This will mean that their market price will equal their marginal cost, which will equal their average cost, which implicitly requires that at this point their marginal cost is rising.) (2) Product's production and normal use create relatively few serious externalities (i.e., relatively few major benefits not captured by or costs not imposed on the seller-producer). (3) The most significant policy concern is satisfying market-expressed preferences.

Even if these assumptions are true enough in general, my claim is that they do not apply so well to certain categories of products of which the media are an example. Media products are unlike the hypothesized "typical" product, such as a car or can opener, in four ways that are relevant here. Each difference complicates any economic claim concerning the wisdom of reliance on markets.

FOUR FEATURES OF COMMUNICATION PRODUCTS

First, media products have significant "public good" aspects. A public good is an item for which one person's use of or benefit from the product does not affect its use by or benefit to another person. National defense or public parks are goods that, once provided, many can use without interfering with others' use.[3] Similarly, many can watch the same broadcast or read the same poem once it is created. Economic definitions of "public good" usually emphasize two aspects: "nonrivalrous use," which is the aspect that I am primarily concerned with here, and "nonexcludability."[4] Typically, utilities or other "natural" monopolies exhibit this "nonrivalrous use" public-good quality in their infrastructure, for example, in the gas lines, water mains, or telephone lines (other than the final connection to the house). Multiple consumers can use this infrastructure with no or very modest extra expense. To the extent that adding an additional customer does not increase the cost of this infrastructure, which is usually true until crowding requires larger lines or mains, the infrastructure exists as a public good. If this infrastructure is a major part of the delivered product's cost, the marginal cost of serving that additional consumer will predictably be substantially less than the average cost. That is, the marginal cost of supplying the new user could approach zero while the average cost of the infrastructure to each user, that is, its total cost divided by the number of users, stays much higher.

This situation creates a problem. If the product is priced at its average cost (or priced higher if a seller exercises monopoly power), some consumers will be unwilling (or unable) to pay that price, even though they want the products and would be willing to pay the added cost created by their usage. Charging the average cost results in underproduction. On the other hand, charging the marginal cost, as efficiency considerations normally recommend, fails to produce enough revenue (selling price times the number of purchasers) to cover the product's cost. The market will not support production if the seller must provide the product or service to all customers at the marginal cost of supplying the last customer. At that price, the seller would not recover the cost of the required infrastructure.

To gather, write, and edit news or to create and produce video entertainment, the media incur huge "first-copy costs." This economically significant element of media products' cost is like the utility's infrastructure or, better, is like national defense. There is no limit to how many can benefit from the producer's expenditure on first-copy costs or analogous costs, such as the expense of broadcasting.* Writing the story or sending out the broadcast signal costs the same no matter how many people "tune in." Adding a marginal consumer does not affect these costs. As long as these public-good costs are a large enough part of the media's total cost,[5] charging potential audience members the average cost leads to inefficient exclusions. Charging the average cost excludes people who would pay more for the story or broadcast than it actually costs to include them among the recipients. Alternatively, setting the price at the marginal cost, that is, the cost of supplying it to

* Economists often identify this factor as the cause of the current dominance of one-newspaper towns. A monopoly newspaper pays only one set of first-copy costs (and requires a single infrastructure) in serving the whole city. By adding customers, it constantly reduces its average cost. See James N. Rosse & James N. Dertouzos, *Economic Issues in Mass Communication Industries* (Stanford: Department of Economics, Stanford U., 1978), 55–78. Any competitive equilibrium would be unstable, usually requiring two papers roughly equal in circulation. See Randolph E. Bucklin et al., "Games of Survival in the US Newspaper Industry," *Applied Economics* 21 (1989): 631, 636. Despite this theoretical account, until a long-term decline began just before the end of the nineteenth century, competition generally prevailed among local daily newspapers. Thus, Rosse more precisely suggests that the "fundamental long-run cause of newspaper failure is loss of effective market segmentation." James E. Rosse, "The Decline of Direct Newspaper Competition," *Journal of Communications* 30 (1980): 65, 67. Although Rosse does not explain this loss, the decline in effective segmentation could result from the changed incentives that occur when advertisers become the primary purchaser of newspapers' efforts – that is, as they become the paper's primary source of revenue and profit. To the extent that daily newspapers' primary product becomes readers sold to advertisers rather than product sold to readers, the main product differentiation for daily newspapers selling to mostly local advertisers will be geographically rather than content based. See C. Edwin Baker, *Advertising and a Democratic Press* (Princeton: Princeton U. Press, 1994), ch. 1.

the last purchaser, creates insufficient incentives to produce the media product.

Firms sometimes avoid these consequences by engaging in "price discrimination" – charging different purchasers different prices and thereby tapping the "consumer surplus" that some consumers would receive if they were charged only the marginal costs. Whether there are sufficient opportunities for price discrimination to lead to a value-maximizing level of production (hopefully without producing monopoly profits) is an empirical matter that will vary with the product and market in question. I assume in much of the discussion that follows that providers of media products cannot uniformly engage in sufficient price discrimination to eliminate this problem. Moreover, even when reasonably adequate levels of production could be achieved because of the availability of relatively costless price discrimination, price discrimination introduces an additional policy-based fairness issue. When and why should some consumers have to pay more than others for the same good, thereby reducing or eliminating their potential "consumer surplus," in order to achieve distribution to others who willingly pay the marginal cost but would not pay the higher price necessary to cover infrastructure or first-copy costs? This is a central issue in many rate-setting disputes. It can obviously also raise controversial issues in the media context – for example, was it fair for an early Congress to charge some mail users a price higher than the cost of serving them in order to subsidize the cost of communication for other users, namely newspapers?

Second, media products often produce extraordinarily significant positive and negative externalities. Externalities typically refer to the value some item has to someone who does not participate in the transaction. If one or more persons, often numerous unorganized people, would potentially pay to have the transaction occur, then the externality is positive; it is negative if they would potentially pay to have it not occur. For example, people care whether their reputation is ruined or advanced, whether people they meet are boring or cultured, and whether they are murdered or aided by the person they pass on the street – and these are among the phenomena whose occurrence can be significantly influenced by *other people's* media consumption. Likewise, many people value a well-functioning democracy. They are affected by whether the country goes to war, establishes parks, or provides for retirement and medical care – and hence can be greatly benefited by other people's consumption of quality media or harmed by others' ignorance or apathy produced by inadequate consumption or consumption of misleading, distortive, and demobilizing media. Furthermore, the political or corporate corruption that the threat of media exposure deters is a benefit that the press cannot effectively capture – there is no story – to sell to consumers. In each case, people other than the direct media consumers would pay if necessary to have the beneficial effect occur or to avoid the harmful effects. Later I suggest that many media policies, ranging from libel laws to reporters' privileges or postal subsidies given to newspapers or direct grants for public broadcasting – and much, much more – can be understood as in part designed to increase positive or to reduce negative externalities.

Third, media products are unusual in that often two very different purchasers pay for the transfer of media content to its audience. The media enterprise commonly sells media products to audiences and sells audiences to advertisers. Of course, multiple parties being "affected" by a transaction, each thus being a potential but often not an actual payee or purchaser, is not an unusual phenomenon – that basically defines an "externality." However, in the media context this multiple set of purchasers represents not merely potential purchasers; and the payment from advertisers in return for what is sold or delivered to audiences plays an unusually large and relatively routinized role. Selling to both audiences and advertisers has especially significant consequences and adds special complexities. For example, what is the right level of production of television programming? The "value" of a television broadcast is its combined value for the audience and the advertiser – in economic terms, the amount they would be willing to pay. To the extent that the broadcaster only collects from the advertiser, the broadcaster apparently receives an inadequate incentive to spend money on programming. From this observation, some economists conclude that our society drastically underinvests in television broadcasting.[6]

Having multiple purchasers creates other issues. For example, advertisers in effect pay the media firm to gain an audience by providing the audience with something the audience wants, although not necessarily what the audience most wants. A portion of the advertisers' payment often goes to having the editorial content better reflect the advertisers' interests. There is a potential conflict between advertisers' and audiences' interests in the media content.[7] A century ago many papers routinely accepted "reading matter," material prepared by advertisers that