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THE MYTH OF 'FREE' TV

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Beginning in the 1950s, local TV broadcasters have argued that because they provide a "free" (i.e., ad-supported) product to the American people, the government should treat them more favorably than other commercial businesses that charge consumers for their products. In the name of preserving free TV, the government has transferred from the public to broadcasters control over assets worth at least $100 billion in the last decade alone. Today, thanks to this special treatment, local TV broadcasters routinely earn profit margins from 40 percent to 60 percent on this "free" service—a remarkable feat for any business.

This paper calls into question the vast subsidies given to broadcasters in the name of free TV. By subsidy I mean any government policy that increases the profitability and asset value of local TV broadcasters. By "free TV" I mean advertising-supported programming. By "pay TV" I mean audience-supported programming, usually in the form of a monthly subscriber fee paid to cable or satellite multi-channel services.

THE ECONOMIC ORIGINS OF "FREE" TV

The history of the free TV argument illustrates that broadcasters' and their allies' support for free TV has been a function of economic necessity and political expediency, not concern for the public weal. In its early days, free TV was a technological and economic necessity for broadcasters. There was no profitable way for broadcasters to charge audiences for programming. When competitors invented technologies that changed these economics, broadcasters turned this economic necessity into a political virtue. But as new technologies have allowed broadcasters themselves to charge audiences for content, the broadcasters have sought every opportunity to do so and have redefined the meaning of free TV to include only those services where it is uneconomical to charge.

In the United States, radio broadcasting took off as a commercial enterprise in the 1920s. A generation later—in the late 1940s—TV broadcasting was introduced to supplement radio broadcasting. About the same time, TV manufacturers began to seriously tinker with technology to allow audience payment for broadcast content.

In comparison to radio, TV was well suited for direct audience payments because mobility was less important. It was an ideal medium for the new wire-based cable TV technology, which promised better reception and more channel offerings than existing broadcast television. And unlike broadcasting, cable TV was wire-based. This made it relatively easy to charge viewers on a subscription basis. Consumers who hadn't paid for cable TV service could simply be disconnected from the cable TV wire.

During the earlier days of television, however, it was thought that over-the-air TV broadcasting (wireless) would be the medium to charge audiences for TV. UHF broadcasters, in particular, hoped that technology allowing them to charge audiences as well as advertisers could give them a competitive advantage over VHF broadcasters.

In 1945, the FCC began licensing VHF channels. By the time UHF channels were allocated, the VHF channels, dominated by affiliates of the major TV networks, were already entrenched. VHF dominated in part because VHF receivers offered better reception and in part because only a tiny fraction of U.S. households initially had UHF receivers.

At the same time, UHF entrepreneurs saw that new technology might allow them to charge over-the-air audiences for UHF channels. But no cheap and simple technology evolved to allow UHF broadcasters to discriminate between free riding and paying customers. By the mid-1960s, it became clear that audience-financed programming would be the most profitable business model for cable TV; and advertiser-financed programming would remain the most profitable business model for over-the-air TV.

THE POLITICAL USE OF FREE TV

As the economics of broadcasting changed, so did the lines of political battle. The early political battles tended to center on whether the government should encourage a non-profit or for-profit business model for the broadcasting industry.[1] By the 1950s, this battle was won by the for-profit broadcasters: They would get the lion's share of the public airwaves as well as a panoply of other government subsidies. But now a new battle opened up within the ranks of the for-profit television broadcasters.

The incumbent TV broadcasters, who were entrenched on the VHF channels (channels 2 to 13), strongly opposed audience-

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supported TV on both cable (wired) and UHF (over-the-air) channels. Audience-supported TV promised to both break up their highly profitable monopoly on TV programming as well as introduce a new stream of revenue that could finance both niche channels and high quality productions. Accordingly, with the support of theater owners, the incumbent broadcasters launched a lobbying campaign to cripple audience-supported TV.

As part of this lobbying campaign, economic expediency was transformed into political virtue, and the distinction between "free TV" and "pay TV" was invented. Now advertiser-supported TV was to be labeled "free TV" and subscriber-supported TV "pay TV." Where both advertiser- and audience-supported TV had previously been lumped together as commercial TV, now they would be portrayed as different as night and day.

From this period on, politicians and broadcasters would use the idea that "free TV" is a public good as one of the justifications to support a U.S. industrial policy favoring ad-supported local TV broadcasters over all of their competitors. That expensive industrial policy remains in place today, despite the fact that 87 percent of U.S. households have voted with their wallets to receive their primary TV signal by subscription cable or satellite service.

POLITICAL FIGHTS OVER FREE TV

On February 25, 1952, Zenith Corporation filed a petition with the FCC to establish a wireless service that could charge viewers for broadcast programming. The established advertiser-supported broadcasters were strenuously opposed to any test of this new service. They felt that once this type of service got a foothold, it would be impossible to stop. So when the broadcasters didn't get what they wanted from the FCC, they began an intense lobbying campaign to get Congress to reverse the FCC's decision. The broadcasters backed up their position with three arguments centering on efficiency (advertiser-supported, "free" TV enhances consumer welfare more than would audience-supported "pay" TV, equity (pay TV would favor wealthy elites at the expense of the general public as only the wealthy would be able to watch the new pay TV), and politics (pay TV was politically unpopular).

Over the years, the broadcasters' efficiency, equity, and political arguments in favor of free TV would evolve as pay TV got a foothold and earlier arguments became implausible. As broadcasters came to rely on satellite and cable TV to distribute their programming, and as digital TV technology opened up new avenues to charge audiences for watching their programming, the percentage of broadcasters' revenues derived from advertising would be reduced.

The Cable TV Threat and the Battle for Must-Carry

By the mid-1960s, at the broadcasters' prodding, the federal government turned its attention to wired forms of pay TV. On April 23, 1965, the FCC issued a report and order mandating that cable TV systems carry local broadcast stations ("must-carry") and not duplicate any program offered by a local broadcaster ("non-duplication"). On March 8, 1966, the FCC issued a report and order essentially banning pay TV from the top 100 TV markets—the largest metropolitan areas in the United States.[2] This was a devastating blow to the cable TV industry because it would mean that it was not only illegal to provide service to the vast majority of U.S. households, but also to the households that were most densely concentrated and therefore affordable to wire.

In December 1987, the U.S. Appeals Court in Washington DC ruled that the FCC's must-carry rules requiring cable TV systems to carry local broadcasters' TV signals were unconstitutional, a violation of the First Amendment. The broadcasters' response was to launch a massive lobbying campaign to get Congress to past must-carry legislation. By having Congress pass must-carry rules rather than the FCC, the broadcasters felt they could check the courts; courts are typically much more deferential to legislative branch laws than to those of an independent agency.[3] The growing market power of the cable industry would also give broadcasters new grounds to argue their case.

Must-carry was important to the financial success of all broadcasters but especially to UHF broadcasters, who usually lacked network affiliations. Without must-carry, a cable TV company could potentially kick a broadcaster off a local cable system—thus depriving them of a large fraction of their advertising base—or charge the broadcaster for cable carriage. In such a situation, the value of a TV station would plunge.

In 1992, Congress granted local TV broadcasters must-carry, retransmission consent, and preferred channel positioning. ***Must-carry*** required that cable operators carry the programming of all local TV broadcasters. ***Retransmission consent*** gave broadcasters the option of not accepting cable carriage if cable operators didn't pay them enough for this privilege. ***Preferred channel positioning*** made it illegal for cable operators to move broadcasters to a less desirable channel number. In 1996 Congress extended these basic broadcaster carriage rights to telephone video services and in 1999 to satellite TV systems, effective January 1, 2002.

The Battle for Digital Spectrum

The free TV argument was also central to the broadcasters' lobbying effort to acquire spectrum for digital TV. In 1986, the FCC was petitioned to allocate for wireless telephone service the unused spectrum allocated to the broadcasting industry. Of the 67 channels allocated for broadcasting, only about 13 were actually used to broadcast TV programming in any given market. The broadcasters countered that they needed the spectrum so that free TV could be preserved in the coming age of high definition TV. Accordingly, the FCC prevented any other industry from securing rights to this unused spectrum. In 1992 the FCC took the next step of formally reserving the spectrum so that broadcasters could eventually simulcast their standard definition TV channel programs on their new high definition channel.

In 1993 Congress exempted all spectrum reserved for local broadcast service, including the newly reserved spectrum for HDTV, from ever being allocated via spectrum auctions. And in 1996, Congress, via the Telecommunications Act, granted incumbent broadcasters twice their existing spectrum so that free TV would be preserved in the new digital TV era. Congress argued that the grant of spectrum was a "loan" to help the broadcasters transition from free analog to free digital TV. But the loan required no interest payments and no definitive payback date, so, by conventional banking criteria, it was functionally identical to a gift.

In 1996, the FCC estimated the value of this new spectrum, if sold to wireless telephone operators, at up to $70 billion. The estimate was derived from recent sales of comparable spectrum for wireless telephone service. A wide variety of commentators and senior government officials, including the FCC Chairman Reed Hundt and Senate Majority Leader Robert Dole, called this one of the great corporate giveaways of the twentieth century.

THE DECLINE OF FREE TV

Despite all this rhetoric about saving free TV, broadcasters and their government allies have for the last 15 years taken every opportunity they could to kill free TV in the name of saving it. Saving free TV was a major rationale behind the Cable Act of 1992, which gave broadcasters must-carry and retransmission rights on cable TV.

Today, the vast majority of Americans get their so-called free TV not over the airwaves but over subscription TV services such as satellite and cable TV. And in order for these satellite and cable TV companies to get carriage of this TV—thanks to the double whammy of must-carry and retransmission consent—they must pay for it. These costs are then passed on to consumers. But whether compensation is direct or indirect, in cash or in kind, the subscription TV consumer ultimately pays—and still must watch the same volume of advertising as the shrinking minority of homes that still rely on over-the-air signals.

The free spectrum granted to broadcasters in the Telecom Act, as we have seen, was also done in the name of preserving free TV. But the fine print of the Telecom Act allowed broadcasters to use 90 percent of their spectrum for any type of fee-based data service, including pay TV. The rationale here was that broadcasters needed these extra revenues to subsidize their free TV services. But there is no requirement that such subsidies actually occur, nor any economic incentive why they should occur. So now we have broadcasters planning to use that "pay" spectrum for phone service, last-mile broadband Internet service, and a dizzying array of other fee-based data services.

THE COST OF FREE TV

Obviously, advertising-supported TV programming provides a valuable consumer service; otherwise, consumers would not watch it. But that doesn't make it free or imply that it should be free. Factors that play into the consumer cost to watch ad-supported ("free") TV include equipment (fixed) costs, time watching ads, program quality, and product costs. Government subsidies to local TV station owners to enhance the profitability of this type of programming is another significant aspect of the cost of Free TV. Over the years, the government has enacted a large number of policies to enhance the profitability and market value of local TV stations. I call these policies "subsidies," whether they come from the pockets of the general public or broadcaster competitors and suppliers.

Broadcasters lobby to build a telecommunications network at public expense. Unlike wire line telecommunications providers, which seek preferential access to public roads and byways, broadcasters seek preferential access to spectrum, colloquially called the "public airwaves." Broadcasters are currently allocated 402 MHz for retail uses and hundreds of additional MHz for wholesale use. The current market value of this spectrum is in the vicinity of $367 billion. Broadcasters pay no monetary compensation to the government for use of this asset.

Additionally, broadcasters lobby for free or discounted rights to build broadcast towers on public property.[4] Broadcasters transmit their signals from towers. To build a several thousand foot tower from ground level can cost as much as $2 million.[5] Broadcasters also lobby to build broadcast towers in communities that don't generally allow 2,000-foot-high structures. This requires federally mandated zoning exemptions for broadcasters. The resulting broadcast towers can be extremely profitable.[6]

Broadcasters also seek to buy from suppliers at the lowest possible cost. This applies to both upstream and downstream suppliers. Perhaps the most important upstream supplier for a broadcaster is its audience. Broadcasters buy audience attention ("eyeballs"), which they then sell to advertisers. It is in the broadcaster's interest to ensure that these eyeballs watch the maximum endurable amount of advertising per hour and cannot filter out ads. In prior lobbying campaigns, broadcasters won elimination of any limits on the amount of ads per hour that they could show.

Program suppliers are also another upstream supplier. It is remarkable that radio stations pay only a trivial percentage of their revenue for the rights to use the songs they broadcast. By law, the record companies must allow broadcasters to use their product for free. It is also remarkable that local TV broadcasters get national network programming for "free." All they give the networks for their programming is some of the advertising time within their programs. When a broadcaster acquires a program, he also automatically acquires so-called moral rights. These moral rights allow broadcasters to edit, crop, and otherwise change purchased programming without permission from the author of the programming.

Broadcasters seek to get distribution of their programming at the lowest possible cost. With cable TV must-carry rules, they are guaranteed free distribution on local cable TV, even if the area of the cable TV system is larger than the area of the over-the-air broadcast signal. Broadcasters are also guaranteed minimum technical quality of carriage, so even if an over-the-air UHF channel has a snowy image or is impossible to receive behind a dense object such as a tall building, the cable TV version of the channel must be as good as the UHF signal at the transmitter. In the late 1990s, must-carry rights for a TV channel without a major network affiliation were worth as much as $13.88 per subscriber.[7] Broadcasters have a similar set of must-carry rights with satellite TV providers. The big difference is that if a satellite provider wants to carry one local broadcast channel from a local market, it either must carry all the local broadcast TV channel from that market or carry none at all.

Broadcasters have lobbied against allowing downstream suppliers from having any control over the broadcast content they carry. Thus, they oppose allowing cable TV companies to modify broadcast programming in any way, including providing localized emergency information when broadcasters are unable to provide this information because of the large geographic area of their signals.

Conclusion

Free TV started as an economic necessity for broadcasters and evolved into a lobbying rationale to keep down competitors. Now, as the technology of broadcasting is changing, broadcasters are moving into fee-based services. But while they are abandoning free TV whenever it is profitable to do so, they don't want to sacrifice the subsidies they are getting in its name. The clever political solution that broadcasters and their congressional and FCC allies have worked out is to advocate saving free TV by allowing broadcasters to generate revenues from fee-based services, including pay TV. But if this pattern continues, the end result will be the death of TV at the hands of the very people who claim to be supporting it.

Under such circumstances, it is vital that broadcasters and their allies provide verifiable evidence that subsidies given in the name of preserving free TV not only go to free TV but also don't actually serve to undermine free TV. However, it is not even clear that free TV is worthy of government subsidy.

Even if "free" TV is determined to be a vital national interest, it is possible that there are far more efficient ways of delivering it and of accelerating the conversion to digital TV.[8] Let's assume that every American has a sacred right to continue receiving local ad-supported TV from the current crop of incumbent broadcasters. Currently, these broadcasters use the most valuable airwaves available on earth to distribute their programming. But the programming could also be delivered over the much less valuable spectrum that can be used with satellite TV delivery. Satellite dishes and digital set-top converters can be used to translate satellite TV for those who still rely on over-the-air analog signals. The set-top converters could be subsidized by the government for a fraction of the revenue that would flow from freeing up and auctioning prime broadcast spectrum. Consumers preferring "lifeline" cable TV hook-ups could be offered the same level of subsidy to purchase a set-top converter, probably as a tax credit.

Every American could be guaranteed their current free TV fare, just not over the same airwaves. This would appear to be a creative win-win because free TV is preserved while resources are used more efficiently. Yet broadcasters would be sure to oppose it because the current regulatory regime is even more favorable to themselves.

The myth of free TV is that it is free. Free TV is the most profitable business in the United States, but only because it has been subject to vast subsidies. The time has come to carefully evaluate the costs of free TV and try to minimize them. It is also time to drop the phrase "free TV" from political usage. Perhaps a more apropos phrase would be "government-subsidized TV."

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[1] Robert W. McChesney, *Telecommunications, Mass Media, and Democracy: The Battle for the Control of U.S. Broadcasting, 1928-1935*, 1995.
[2] This ranged all the way from New York City with 5.8 million TV households down to Augusta, Maine, with 138,000 TV households.
[3] Turner Broadcasting System v. FCC 520 U.S. 180.
[4] Petition of the NAB Regarding Rental Schedule for Communication Uses, before the Office of the Secretary, U.S. Department of Interior, December 13, 1995. See also Statement of the NAB, Submitted to the House Subcommittee on National Parks, Forests, and Public Lands, and The House Subcommittee on Environment Energy and Natural Resources on the Issue of Oversight of Federal Communication Sites, July 12, 1994.
[5] Broadcasters' estimate for members of Congress. See NAB, Spectrum Auction Action Tool Kit, Feb. 1996.
[6] NAB, "Broadcast Towers: Managing Your Vertical Real Estate," Panel discussion at NAB 1998, April 6, 1998. At this panel broadcasters were advised: "You have two key assets: a tower and a license," and "If you're going to build a tower, why not build it big enough to be a profit center." A number of towers in recent years have been so overloaded with revenue producing transmitters that they have collapsed. One presenter promised that a very popular tower can bring in revenues of a "couple million dollars a year."
[7] John Higgins, "Paxson Renders Unto TCI," *Broadcasting & Cable*, May 4, 1998, p. 6. One public broadcaster leased just its must-carry rights to a commercial broadcaster for $4.25 million over an 8-year term. Wayne Walley, "Public Broadcaster Sells Must-Carry Rights," *Multichannel News*, October 14, 1996, p. 95.
[8] See e.g., Larry Irving, "Testimony to the Senate Budget Committee Hearing on Spectrum Auctions, March 14, 1996; Thomas W. Hazlett, "The U.S. Digital TV Transition: Time to Toss the Negroponte Switch," AEI-Brookings Joint Center for Regulatory Studies, Working Paper 01-15, November 2001.