Comment: Welfare Analysis and the Video Marketplace

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Wildman and Owen present four conundrums: Will competition produce enough access diversity? Will competition between ad-supported and viewer-supported services result in a welfare maximum? What is the effect of channel-packaging on welfare and diversity? What will determine the number of multichannel competitors? Equally important is a question implied throughout: What can economic analysis say about the appropriate role for public policy in this brand new video world?

In assessing the welfare implications of video competition, economists are perhaps handicapped by second- (or nth-) best considerations to a greater extent than in, for example, the textile or automobile industries. First, programming is distinct by virtue of its heavy dose of public-good characteristics. Unlike the purchase of a sweater or a car, one person's viewing of a particular program in no way limits any other consumer from viewing exactly the same program. Economic theory advises that the optimal production of programs will occur if the marginal cost of program production is equated to the sum of prices individual consumers are willing to pay for programs. Those consumers who value the programs at less than the marginal production costs should nonetheless be allowed to view the programs at a zero price. This is true because once a program is produced, the same program can be distributed at near zero marginal cost to all viewers.

Such a scheme would require that some entity (e.g., the government) determine the demand for programs by each consumer, extract the necessary payment from those consumers, and then distribute those funds to program producers. I doubt that any economist believes that the tremendous costs of implementing such a scheme would be worth the benefits. Nonetheless, the ideal production-distribution system provides us with a benchmark for assessing the private supply of these public goods. Advertiser-supported over-the-air broadcast services approximates program distribution at zero marginal cost, but program production depends not on intensity of preferences but rather the number of viewers. Viewer-supported services take into account intensity of preferences, but do not distribute programming at zero marginal cost.

In addition to the public-good aspects of programming, welfare analysis is complicated by the nature of the FCC's spectrum allocation scheme. The Commission does not rely on any market test to allocate spectrum, but rather makes its decisions administratively on the basis of some vague "public interest" standard. Thus there is no guarantee that the spectrum allocated to, e.g., over-the-air broadcasting versus LPTV versus MDS versus satellites is "just right" or even in the right ball park. Moreover, as Botein and Geller point out in papers 9 and 10 of this book, the crazy quilt of regulations regarding the ownership and operation of the various video delivery systems has and will continue to bias the development of these systems in ways that the Commission could not have foreseen.

Wildman and Owen are understandably reluctant to draw any policy conclusions from this result. The assumption of asymmetrical demands for pay- and ad-supported programs, the authors note, preclude proonly ad-supported services, the latter deals with both types individually but not simultaneously. Wildman and Owen extend the Spence-Owen model to encompass patronage of more than one channel simultaneously by viewers and competition between ad-supported and viewer-supported channels. Unable to derive analytically the comparative static results, Wildman and Owen rely on simulations. Over a wide range of parameters, the authors conclude that competition will produce too few ad-supported services.

Wildman and Owen are understandably reluctant to draw any policy conclusions from this result. The assumption of asymmetrical demands for pay- and ad-supported programs, the authors note, preclude programming for minority tastes. Even if one were to ignore this aspect of the model, the proliferation of ad-supported service on cable make it less than obvious what appropriate public policy ought to be.

The Wildman and Owen type of effort can, over the long term, prove productive in understanding the welfare consequences of the expanded video environment. Aside from relaxing the assumption of symmetrical demands, useful extensions of the model would include permitting programming services to be supported by a mix of advertising and viewer payments. In any event, it is clear that economists are now able to say very little about the welfare consequences of the new competition.

Wildman and Owen assess the effects of a monopolist offering to consumers channels tied together in a bundle or a package. As in cases of third-degree price discrimination, and compared to pricing each channel individually, channel packaging may permit the monopolist to more finely price discriminate and possibly improve welfare. Programs or channels of programming that might not be produced under a single price-per-channel scheme may be produced with channel packages.

Of course, price discrimination is not the only possible explanation for "all-or-nothing" channel offers. For example, Wildman and Owen characterize basic cable service as a typical "all-or-nothing" offer. You either subscribe to basic cable with all channels on basic or you do not subscribe to cable. An alternative explanation for basic cable packaging is cost minimization rather than monopolistic price discrimination. For many so-called basic services (Cable News Network, WTBS, Christian Broadcasting Network, for example), the price per subscriber would be so small that a requirement that these channels be priced individually might result in their disappearance from the market. This is because the monitoring and billing costs on a per-channel, per-subscriber basis may be considerably more than any revenues obtained from subscribers. Addressable converters, however, may lower these costs substantially. While they still may not permit per-channel, per-subscriber monitoring and billing for all individual channels, addressable converters may make it profitable to offer small bundles and more channel combinations. Interestingly, some addressable cable systems have begun "unbundling" basic services, charging a fee for "good reception" services and then additional fees for smaller basic channel bundles.

Even if finer price discrimination were the motive for packaging channels, once again there are no hard and fast policy conclusions that can be drawn. In some circumstances, monopolistic bundling may improve consumer welfare; in other instances, bundling may generate a welfare loss.

If the monopolist in the previous analysis is replaced by a number of multichannel competitors, Wildman and Owen conclude that bundling may or may not occur and single-channel firms may or may not be driven out of the market by multichannel firms. Importantly, Wildman and Owen are able to point to factors affecting the extent of multichannel competition, such as the degree of specialized tastes on the demand side and scale economies in channel provision on the cost side. They conclude that "empirical knowledge of these factors is very limited; there is no reason to suppose for example that they will not work out to be the same or similar to those in the print media." Wildman and Owen could have added that there is also no reason to believe that they will.

In addition to these caveats regarding the difficulty of welfare assessments of video competition, economic analysis is further complicated by "First Amendment" concerns, usually addressed in terms of diversity. Wildman and Owen discuss whether competition is sufficient to insure diversity of access (or voices) to the new video media, and conclude that access diversity depends upon ownership diversity. With respect to the latter, the authors assert that "it would be hard to argue for [ownership] standards stricter than those already applied in evaluating the economic consequences of mergers [as described in the Justice Department's merger guidelines]." Yet, if a range of competitive ownership configurations yielded the same level of consumer welfare conventionally calculated, I suspect that advocates of First Amendment concerns might not be indifferent as to which ownership configuration prevailed.

Wildman and Owen have absolutely no analytical basis for their conclusion, but "faith" in competition, a faith that I share. The fundamental difficulty economists have in dealing with diversity issues is our inability to incorporate those concerns into our welfare calculus. The problem, as Besen and Johnson point out in discussing the FCC's ownership policies, is that those who are concerned about diversity in the new environment will not provide anything remotely resembling a quantifiable performance standard against which different ownership configurations can be appraised. With the only standard being "I'll know it when I see it," economists will continue to have problems in determining the compatability of competition and diversity.

This discourse is not meant to be a counsel of despair, but rather a more realistic assessment of what economists can and cannot say about the welfare consequences of emerging video rivalry. But economists are clearly limited in what they can say based upon sound analysis. For example, I share Wildman and Owen's concluding sentiment that it is difficult to see how consumer welfare could be improved by a new array of FCC or legislative regulations imposed on the new video systems. As should be apparent by now, that sentiment cannot be derived from careful analysis of the emerging rivalry, but in my case, it is based on the failure of past regulatory efforts to rectify perceived ills, ills which in many cases were not even present. Moreover, in an industry undergoing as much flux as video, regulation's inflexibility may do irreparable harm to consumers. Put simply, the costs of past video regulation appear to have outweighed any benefits gained, and I have no reason to believe that any new regulations will achieve a more favorable cost-benefit ratio. But that is faith, not analysis.

Economists, however, can contribute hard analysis to the current debate. For example, Wildman and Owen suggest that economic analysis can indicate the costs of seeking more ownership diversity than might be compatible with competition. While there is no way economists can currently judge the additional benefits, policymakers will at least be aware of the costs of their actions. In a similar vein, the FCC's Network Inquiry Special Staff (FCC 1980f) defined three types of diversity (content, access, and the number of options confronting viewers at any one time) and advised the FCC that reducing artificial constraints on the number of options is likely to advance all three forms of diversity.

At the National Cable Television Association, we commissioned the National Economic Research Associates (NERA) (Shew 1984) to assess the welfare loss (conventionally calculated) of various franchising requirements imposed on cable systems. While NERA could not estimate the benefits of, e.g., public access channels (for reasons that should by now be clear), the study did indicate the likely consumer cost of those requirements. Occasionally, one can find a study that is more conclusive. For example at NCTA, the Research and Policy Analysis Department estimated that the deregulation of basic cable prices and the elimination of the delay in awarding cable franchises would result in nine to fourteen new programming services comparable in cost to Nickelodeon. In this instance, deregulation would foster all three forms of diversity.

Given the First Amendment concerns and the second-best considerations surrounding video competition, economists will not have all the answers to pressing regulatory questions. Economics can reduce the degree of guesswork in rendering policy judgments such as the apparently almost wholly arbitrary judgment by the Justice Department's Antitrust Division regarding the Showtime–Movie Channel merger (see

White in paper 11 of this book). Put simply, solid economic analysis can help reduce the extent of future policy failures.

Note

The views of the author do not necessarily reflect those of the National Cable Television Association or any of its members.