sent orig to Mike Botein 11-16-87

Read over phone to Mike

WILL U.S. PROGRAMMING DOMINATE FOREIGN CABLE SYSTEMS?

Eli M. Noam

Many observers ~~today~~ assume that imported U.S. programs -- which they generally perceive to be low quality -- have the potential ~~power~~ force to drive out domestic ~~ones~~ programs on foreign broadcasts and cable systems. The basic theory is that acquisition of existing U.S. material is so much less expensive than production of new domestic ~~material~~ films that foreign broadcasters and cable ~~operators~~ program packagers inevitably will choose the former. This widely held conclusion ~~seems~~ is questionable for a variety of reasons.

First, this approach compares the marginal cost of distributing an existing product -- where investments already have been made -- with the total cost of a new production. This is a bit like saying "it's cheaper to take a Chrysler taxi into the city rather than to buy a new Jaguar." It thus compares apples and oranges.

Second, even assuming that a broadcaster would choose an imported program due to its low cost, why would the broadcaster want a low quality U.S. program? Programs with similarly low marginal cost could be available from other countries, such as Canada or Australia in the English-speaking world, or from other countries ~~A variety of motion pictures from around the world would be available at low marginal costs.~~

Why do public broadcasters often show U.S. productions, particularly adventure/melodrama programs? Part of the reason is the audience popularity of such shows. For example, the BBC feels compelled not to slip too far below the ITV companies in overall audience ratings. U.S. dominance would seem likely if the entire world did not offer enough programs above the perceived U.S. quality level to fill one country's program requirements, even after subtracting time for news and sports. But that is widely implausible, in light of worldwide levels.

production~~s~~. For this argument to stand, it also would be necessary for there to be a simultaneous abundance of U.S. production; otherwise prices would be bid up above marginal cost by foreign broadcasters. Finally, this reasoning also implies that in all the U.S.'s large ouput, present and past, there is not enough high-quality material to satisfy the quality requirements of foreign channels.

Third, even inexpensive imports need not curtail domestic production. Demonstrating this requires only elementary economics. ~~Suppose that there are two types of programs, F (foreign) and D (domestic), and that a programmer has no preference between them. Together with the broadcaster's budget constraint, this determines the distribution of foreign programs.~~

no ¶ If foreign imports become less expensive they free up budget resources for more domestic productions. Depending on the elasticities and price involved, the <u>income</u> <u>effect</u> of the less costly import can offset the <u>substitution</u> <u>effect</u> towards the foreign programs -- leading to more domestic productions.

Fourth, the assumption of U.S. dominance is asymmetric. It considers the American product to be exportable at low marginal cost, while not recognizing that the same logic makes a foreign production equally exportable. Indeed, given the global prevalence of public broadcasting, there should be a larger international market for publicly produced than for U.S. commercial products. In the United States, cable television has created channel packagers with a voracious appetite for programs; a foreign show has a potential market in the United States. Indeed the BBC once switched some of its programs in the U.S. from PBS to The Entertainment Channel. A decision whether to produce a program domestically must consider potential earnings from exports.

This may be a double-edged sword, by leading to a greater

"Americanization" of the exporting country's products. For example, British films often cast a well-known U.S. actor, whose presence attracts U.S. audiences. ~~A~~ More extreme cases ~~was~~ were the low-budget Italian "Spaghetti Westerns" of the 1960s, which included U.S. imagery and few Italian themes. ~~There~~ Naturally there are barriers to entering the U.S. market. U.S. audiences do not like subtitles or accents; they are used to very slick production quality; and they are uncomfortable with unfamiliar situations. But these problems may improve as familiarity sets in, audience fragmentation reduces the need for mass appeal, and foreign producers pitch their programs to U.S. audiences.

Fifth, the assumption of American media dominance does not consider the potential dynamism of competition for imported video products within a foreign country. If a multichannel environment existed, an attractive U.S. program would fetch ~~no~~ far more than the marginal cost broadcasters curently pay. At present, bidding is practically non-existent; a number of cartel arrangements prevent it. In countries with several independent public channels, joint organizations buy foreign materials. In the U.K., the ITV companies buy centrally, with an elaborate allocation mechanism if several companies want the same program. ITV companies and the BBC have a tacit non-competition agreement. International buying cartels also prevent competitive bidding between countries, or a program supplier's holding out for higher prices from at least some of them -- especially where cross-border broadcasting could reach many viewers. Foremost among such organizations is the European Broadcasting Union (EBU).

Sixth, the dominance argument overlooks changes in the supply of U.S. programs. It assumes a static quality of U.S. production: low quality today, low quality tomorrow. Yet U.S. media are changing fundamentally. In America, commercial television's body-count economics aims at the peak of the bell-shaped statistical distribution, which strongly reflects popular tastes. U.S. commercial broadcasting has not lacked creativity relative to its self-defined task; it is not necessarily "easier" to create popular entertainment for a huge ~~than for a small~~ audience, than to serve an elite one. A medium's outputs are defined by its structure. Private media do not inherently produce only trash. When the number of channels increases, economic logic dictates that broadcasters disperse across the distribution of tastes. Some will specialize in programs with particular audience appeal, like publishers and movie producers. The proliferation of channels in the U.S. creates an increase production and a differentiation of U.S. television products. Higher (and lower) quality shows result from a fragmented audience. Hence, foreign broadcasters have much more quality to choose from than in the past.

Seventh, another flaw lies in assuming that American exports to not take the international program preferences into account, and that Europe is merely Hollywood's dumping ground. In making an investment decision for a series, a program producer must compare production costs with expected revenues. These include a series' probability of being ordered by a network, becoming an ongoing success, and the revenue from subsequent syndication in the United States and abroad. In recent years, most series have not broken even financially in the network runs, and have become profitable only through syndications. Anticipated purchases by foreign broadcasters directly affect the nature of the programs offered by U.S. producers. A show with no appeal beyond the United States may not be produced, and therefore not offered by a U.S. network. Foreign broadcasters thus are not passive recipients of hand-me-down program decisions by American producers, who dump them on the international market as an after-thought. In deciding on approach, script, casting, and the like, a U.S. producer takes the foreign market into account. When the revenues obtained from foreign broadcasters increase -- as they invariably will in a more varied and competitive environment -- the global feedback will impact on U.S. decisions even more than in the past. The "Americanization" of foreign television thus would be accompanied by a "universalization" of U.S. programs.

It could be argued, of course, that a program must be a super-achiever in the U.S., or not be produced at all. Even potential success in foreign markets thus would not help a program that is not a top hit with U.S. audiences. Hence, foreign audiences play no role in shaping them. This two-stage maximization probably is true at present, but only because foreign TV markets are not yet profitable enough.

Still, wouldn't a U.S. network buy only a program which maximized the domestic audience, without concern for follow-up foreign audiences -- thus skewing a producer's decisions? There are two answers. First, if this phenomenon exists, it is a by-product of the FCC's rules against networks having any financial interest in syndication -- rules strongly defended by Hollywood. If the networks cannot gain from foreign sales, they will choose programs without regard to after-markets. Second, producers can offset networks' preferences by proper substitution of budget ~~factors~~ allocations. Suppose that a network will pay a maximum of $1 million for an episode. The producer normally might decide not to use "name" stars, to ~~reduce~~ do without special effects, etc. Suppose now that foreign syndication would yield another $1 million -- but require a more "universal" approach. This mix will not be optimal for the networks's domestic audience.

Given higher revenues, however, the producer is likely to increase the overall production budget; name stars, large casts, and special effects may now be affordable. The program may become domestically attractive, and suitable for a network run.

Ninth, the theory of U.S. dominance assumes that entertainment-oriented television programs will not be produced in quantity in other countries due to the U.S. expertise. But The fact is that foreign media empires have sprung ~~up as soon as~~ where their media laws have been ~~liberated~~ liberalized. Some examples are, Berlusconi, in Italy, France, and Spain; Maxwell in Britain; Murdoch in Australia, the U.S. and U.K.; Teleglobo in Brazil; and Televisia in Mexico. All have extensive international activities that go far beyond those of the U.S. networks. Many are also active in production.

CONCLUSION

Many problems of large-scale U.S. program exports result not so much from a U.S. media offensive, but rather from the underdeveloped domestic production industries in other countries, which typically are beholden to the monopoly broadcast institutions which are ~~its~~ their clients and financiers. Another cause is inadequate media financing and the absence of profitable foreign markets. The imperfections of domestic markets -- not the ~~impact~~ cheap price of U.S. imports -- are the real problem

---

The author is a Commissioner on the New York State Public Service Commission, on leave from the Columbia University Graduate School of Business. The views expressed here are solely his own.