Secretary:..............................
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HOUSE OF REPRESENTATIVES
STANDING COMMITTEE ON
COMMUNICATIONS, TRANSPORT AND
THE ARTS

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6 June, 2001

The Committee Secretary
House of Representatives Standing Committee on
Communications, Transport and the Arts
Parliament House
CANBERRA ACT 2600

House of Representatives Standing
Committee on Communications
Transport and the Arts
Submission No: 273 . 01
Date Received: 6/June/01
Secretary: Janet Holmes

Dear Sir,

Further to my appearance before the Committee on May 28, 2001, I have been concerned that I did not deal adequately with the issues that were raised. Put this down to the fact that I had not focussed on what might be expected of me and that as a private citizen I can only avail myself of my own counsel and resources. Perhaps this letter will be of help and go some way toward rectifying my inadequacy on the day.

The first issue of concern is how to mount an argument for the regulation of commercial broadcasters that counters the prevailing belief in the efficacy of *laissez-faire* economics:-

1. Commercial broadcasters are the product of a desire to provide a public service at no cost to the public purse. A three way relationship between broadcasters, audiences and advertisers ensures the public need not pay for the service provided.

2. Commercial broadcasters use a tangible finite resource (the Radio Frequency spectrum) which is the property of the people and administered on their behalf by government. This places an unequivocal obligation on government to ensure the resource is used in a way that produces the highest qualitative benefit to the public.

3. This obligation can be met by the free play of market forces where market size allows a substantial number of services - provided always that ownership limits are in place that preclude one operator monopolising the market and reducing the number and range of services to an unacceptable level. Immediately we see that regulation is necessary to prevent market forces defeating the policy objective, even in the largest markets.

4. A situation of many players operating in a large market with minimal regulation produces a direct nexus between the public good and commercial success.

5. Why is this so? Because in this environment maximising audience size is the key to advertising sales but creating programmes that will attract the largest possible audience is expensive. Consequently the commercial objective is to maximise revenues in order to provide the resources for programme content that will in turn maximise the individual station's audience and thence its potential to make profits.

6. The circle is complete and the public need met. Where a station is well operated the process produces large revenues and profits. A station failing to meet audience needs becomes marginalised, falling into a poverty trap of minuscule audience numbers, low revenues and high costs. If a station in this plight closes down there is no cost to the community, it having already failed in its primary function of providing a service to the public.

7. The free market model requires population sizes such that there may only be two markets in Australia where it actually works.

8. The free market demonstrably fails when market size (and hence revenue potential) caps the resources available to broadcasters, limiting their number and capability. Success now depends on factors other than providing the most sought after programme content; the direct relationship between public need and commercial success breaks down.

9. Whereas in the very large markets competition for audience is ever-present and there are effectively no limits to the revenues available to any one station, in smaller markets audiences and revenues are finite.

10. This is an important change. Success is no longer tied directly to meeting the public need; success now flows from optimising the balance between costs and revenue to optimise profits.

11. Small markets today operate without regulation. There is not even a limit on the number that can be served by one operator. Given this, it is no surprise that network operators have found the revenue penalty incurred by reducing programme standards is not proportional to the profit gained by minimising costs. Networking the greatest number of markets yields the highest profit.

12. This outcome is quite the reverse of what was intended, yet there is no commercial penalty - contrarily, the network broadcaster is rewarded for downgrading the service provided.

13. The effect of this misapplication of free market principles is what is now observable - a commercial radio broadcasting service comprising stations networked at minimal cost across large geographic areas, with little or no regard for community of interest, from originating points that are totally removed from the communities they are intended to serve, and incapable of meeting their needs.

14. Without effective regulation these broadcasters are at liberty to direct their attention to the task of exploiting the profit potential of the markets they hold captive. With no ownership restraints more and more small markets have fallen into the hands of fewer and fewer operators, leading to ever increasing areas of Australia falling victim to the downgrading of services, to the point where there is sufficient disquiet among the public that should be served to bring about the present inquiry.

15. Contemplating all this, it cannot be argued that the free market has not produced a logical outcome; the limited free market objective of maximising the return on capital employed, building shareholder wealth, and all the rest of it, has certainly been met.

16. The point is that this is not what the policy was intended to do - it was supposed to provide the best possible service to the community at the least cost to the public purse. It is in this that the free market has failed.

The free market has failed because the pre-conditions for its success have not been met. The nature of the RF spectrum is such that individual transmissions are geographically restricted. Hence, audiences in small markets have no choice regarding service providers and are thus captive and unable to punish a broadcaster by moving on to a more attractive alternative. For these consumers the free market option is not available. Small markets dominate Australian broadcasting both geographically and numerically, so to achieve the policy objective it is necessary to introduce new tensions that will tilt commercial broadcasters toward providing the best service possible within the constraints of the markets in which they operate.

This brings us to the second issue, which has to do with how the position can be rectified once it is acknowledged that the service to the public has been debilitated and consumers disenfranchised by the free play of market forces. My first submission illustrated how the commercial radio service in small markets had been good but was destroyed; by an ideological movement unable to tolerate the presence of a commercial service that operated in a 'protected' environment.

Those who destroyed the service were blinded by ideology and unable to comprehend the policy objective and what it was intended to (and in fact did) do. This submission is to the effect that, nonetheless, a regulatory environment that produces a commercial broadcasting service focussed on public needs in small markets, is still attainable.

The problem is to establish a platform to support the changes needed to fulfill the obligation of government, ensuring the operation of the public resource in a way that benefits the public in country communities. Area based licensing is put forward as the most appropriate platform to attain this end. It is a concept that is sympathetic to the composition and distribution of the Australian population and concomitantly in harmony with the way in which the broadcast spectrum is deployed. On this base a regulatory environment can be erected that will produce the tensions necessary to re-establish a healthy and focussed commercial broadcasting industry, well able to meet the needs of the communities it serves.

The goal of area based licensing is to support graduated regulation to achieve the policy objective of providing the service to the community utilising the public resource to the best effect without cost to the public purse. The implementation of area based licensing should not be a 'winding back in time' (things must always move forward) but the creation of an environment that will fulfill the policy objective. In my view the way forward is as follows:-

1. Take the whole of Australia and break it up into its natural geographic areas. Use the existing commercial radio service areas as a starting point. This entails no more than establishing where the populations are and the extent of their community of interest.

2. This first step will reveal large populations in Sydney and Melbourne; second ranking cities such as Brisbane, Perth, Adelaide, &c; another tier of lesser major population centres; and so on down to small country markets comprising districts of 25-30,000 people.

3. This process will, in turn, reveal the distinct steps that characterise the distribution of Australia's population. They will look something like:

    Over 1,500,000
    750,000 to 1,500,000
    200,000 to 750,000
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4. The real numbers may not work out quite as neatly but they will be something like. I lack the time and resources to work out exactly where the breaks should come but it is the concept of classifying areas into population categories that is important.

5. What will be found by classifying markets in this way is that very few markets will fall into the over 1,500,000 category and not many more in each of the 750,000 to 1,500,000 and 200,000 to 750,000 class. A significant number will fall into the 50,000 to 200,000 grouping and, I suspect, the greatest number will come in with populations of less than 50,000.

6. This process should be carried out for the whole of Australia because of the serious deficiency in services to remote parts of the country.

Once the market classes and their location have been determined each class can be examined separately with a view to creating an environment that will bring about the best possible radio service. Appropriate regulations with regard to the commercial sector would be along the lines of:-

Class 1 Markets - Population over 1,500,000

i. Number of licensed services unrestricted beyond the limits imposed by available frequencies.

ii. Limit of two services by any one operator in any one market.

iii. Unrestricted access to Class 1 & Class 2 markets.

iv. Excluded from markets lower than Class 2.

Class 2 Markets - Population between 750,000 and 1,500,000

i. Number of licensed services capped at (probably) eight.

ii. Limit of two services by any one operator in any one market.

iii. Unrestricted access to Class 2 Markets.

iv. Excluded from markets lower than Class 3.

v. Restricted to not more than 25% of markets in Class 3.

Class 3 Markets - Population 200,000 to 750,000

i. Number of licensed services capped at (probably) six.

ii. Maximum of three operators in any one market.

iii. Limit of three services by any one operator in any one market.

iv. Unrestricted access to Class 3 Markets.

v. Excluded from markets lower than Class 4.

vi. Restricted to not more than 10% of markets in Class 4.

Class 4 Markets - Population 50,000 to 200,000

i. Number of licensed services uncapped.

ii. Not more than two operators in any one market with one preferred.

iii. Closed to licensees from Class 3 except as a second operator in the market.

iv. Restricted to not more than 20% of markets in Class 4.

v. Restricted to not more than 10% of markets in Class 5.

vi. Service obligations imposed - such as minimum manned local broadcast hours - say eighteen per day on first service, twelve hours on second service, eight hours on third and subsequent services plus community service obligations, provision of local news &c.

Class 5 Markets - Population under 50,000.

i. Number of licensed services uncapped.

ii. Not more than one operator per market.

iii. Restricted to not more than 20% of markets in Class 5.

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The last issue that has to be addressed in conjunction with the use of regulation to compensate for the failure of the market is the position of existing operators. These operators must be allowed to maintain their existing ownership positions but be restrained from further expansion if this conflicts with new ownership and control regulations; beyond this no more should be required of them than that they conform to the new behavioural requirements of the various market classes.

Asset value is an important issue for the present network operators. Under the proposals canvassed here asset value will be maintained by the restricted entry opportunities into controlled markets. A market for these assets will develop as a new style of specialist local and regional operator becomes established.

There is also a social argument that supports restricted ownership, which need not be canvassed here, beyond saying that the 'absentee landlord' syndrome is highly relevant. Local broadcasters are sensitive to their role in the community and will always strive to maximise revenue so as to provide a better service, whereas the large owner remote from the community lacks the motivation to do this. So there are really two strikes against the present untrammelled free market approach and each contributes to produce a result directly counter to what was intended.

All of the above argument, beyond the virtue of its logical explanation of how commercial broadcasters behave in varying circumstances, is supported by the empirical evidence, available to any interested observer. The existence of the inquiry is confirmation the current approach has failed.

For the sake of the communities affected it is to be hoped I have shown what has happened, demonstrated the inevitability of what has come to pass, and provided some ideas that will start things moving forward.

Yours faithfully,

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FACSIMILE

Date: 6 June, 2001

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From: W Higginbotham

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