DOCUMENT RESUME

ED 318 406 IR 014 310

AUTHOR Brennan, Timothy J.
TITLE Vertical Integration, Monopoly, and the First Amendment.
PUB DATE Oct 89
NOTE 21p.; Paper presented at the Annual Telecommunications Policy Research Conference (17th, Airlie House, Warrenton, VA, October 1-3, 1989). For other papers of this conference, see IR 014 305-322.
PUB TYPE Information Analyses (070) -- Viewpoints (120) -- Speeches/Conference Papers (150)

EDRS PRICE MF01/PC01 Plus Postage.
DESCRIPTORS Broadcast Industry; *Federal Regulation; *Policy Formation; *Telecommunications
IDENTIFIERS *First Amendment; *Vertical Integration

ABSTRACT

This paper addresses the relationship between the First Amendment, monopoly of transmission media, and vertical integration of transmission and content provision. A survey of some of the incentives a profit-maximizing transmission monopolist may have with respect to content is followed by a discussion of how vertical integration affects those incentives. A review is presented of some ways in which these incentives may be changed by goals other than profit-maximization, and of economic regulation of the transmission medium. The paper concludes with a summary and suggestions as to how these considerations might contribute to first Amendment Policy debate. (31 references) (GL)

Vertical Integration, Monopoly, and the First Amendment

Timothy J. Brennan

George Washington University

Telecommunications Policy Research Conference, 1989





There is a tension between the methods of meeting the goals of the First Amendment and the underlying economics of the technology and institutions used to meet those goals. The conventional way to ensure individual autonomy (Lichtenberg, 1987), political expression (Scanlon, 1979), and effective competition in the marketplace of ideas, (Mill, 1956; Rawls, 1970) has been to minimize government regulation in content of speech. As a consequence, those who own *media* for the transmission of information are allowed, under First Amendment tradition, to determine the *content* of what is transmitted over their media.

Using the model of the pamphleteer or publisher, minimization of legal restrictions on the ability of media owners to do as they see fit with their media is a virtually unquestionable good. With plenty of media outlets, those with things they wish to convey can do so at competitive, marginal costs. Some take this ability to be the economic definition of freedom of expression (Owen, 1975). Additionally, abundance of media outlets, especially if entry is easy, makes less likely domination by those with a particular point of view.[1]

When media outlets appropriate for a particular form of expression are not numerous, though, the pamphleteer model need not hold. The extreme case is when there is but one owner of a medium available in a particular area. This is not rare in the communications industry. In most cities, there is but one telephone company, cable television company, and newspaper. In many cities there but three or fewer television stations. There is no assurance either that media access will be available at reasonable cost or that the views of many will be represented in the "marketplace of ideas."

[1]See Brennan (1987b) for a model in which systematic ownership of media by the "rich" could lead to an underprovision of points of view advocating egalitarian or redistributive policies.

A key concept, usually only implicit in first amendment policy, is that these media are typically *vertically integrated*, i.e., the same firm provides both the transmission medium and the content transmitted. Making this concept explicit helps us see that it need not be a necessary feature of a communications medium. The most obvious example of a non-integrated medium is standard voice telephone service. There, transmission capacity is leased on a monthly basis (local service, private lines) or by minutes-of use (long distance) by an independent supplier of content. A less familiar separation of transmission from publication is the leasing of satellite transponder capacity for delivery of signals from an originator to a retransmitting facility, such as a local television station or cable system.

The theoretical potential for separating transmission from publication is not limited to point-to-point communications or to those between firms on the way to eventual delivery to viewers. Despite the FCC's stated policies regarding localism and putting ultimate responsibility for content on the licensee, commercial broadcasters essentially rent their transmission capacity to independent content suppliers—the commercial networks. Part of the "rent" comes from clearance payments from the networks; the remainder comes from sales of commercial time within network programming.

Contracts between cable systems and premium services such as HBO could be interpreted the same way. On paper, the cable system bills the consumer and splits the receipts with the premium service. However, the transaction could be equivalently viewed as one in which the cable system is paid a fee for channel rental, marketing services and billing, where the "fee" is the difference between what subscribers pay for the premium service and what the premium service supplier actually receives.

The medium in which vertical integration is the most obvious is print. The notion of an editor often seems forced when applied to operating a television station or cable system, but the notion that the distributor of information through print controls the content is so obvious that the possibility of the reverse is rarely discussed. The prominence of this association in first amendment policy debate is paramount; often analogies to editorial control in print media are thought to be debate stoppers. Even here, though, it is at least possible—not necessarily desirable, but possible—to separate transmission or distribution from content. Classified advertising is an example of this separation. More radically, one could imagine reporters, writers, or entire editorial staffs renting space in an independently distributed newspaper.

The possibility of vertical separation raises many questions. Why is it that some media are integrated while others are not? If there are concerns about diversity or access, can or should media be treated as non-vertically integrated entities, with policies directed at the transmission function that do not inappropriately favor content? If the economics of a transmitting medium lead to "natural monopoly" and invite monopoly regulation, how should the content-related operations of the owners of that medium be controlled?[2]

These questions are being brought out currently in two legal settings. In cable television, a series of cases involving obligations to carry local television stations and local franchising policy have been contested on first amendment grounds. In *Preferred*,[3] the city of Los Angeles was accused of violating the first amendment rights of a company who wanted to build a cable system without conforming to the franchising procedures. In *Quincy*,[4] the FCC's rules requiring cable operators to carry local over-the-air television signals were found to be an unwarranted restriction on a cable company's freedom to program channels.[5]

The second legal setting involves the regional local telephone companies, created in the 1982 settlement of the government's antitrust case against AT&T.[6] As part of that settlement, these Bell operating companies ("BOCs") are not allowed to provide "information services," defined roughly as services that involve generation or processing of informati ,
as opposed to the transmission of that information. This prohibition has proven contro-

---

[2]Nadel (1982) recognizes the tension between media regulation and content effects. He proposes that first amendment protection be given to those making editorial rather than business decisions, signified in part by who would get a copyright. However, a distinction between being a medium for hire and selecting message is both artificial and, at least in part, is up the the medium owner. Moreover, as the current information services controversy in telephony shows, effective "business" regulation has "editorial" consequences.

[3]*Preferred Communications, Inc. v. Los Angeles* 476 U.S. 488 (1986).

[4]*Quincy Cable TV, Inc. v. Federal Communications Commission* 768 F. 2d. 1434 (1985); *cert. denied* 106 S. Ct. 2889 (1986).

[5]Nadel (1987) finds that franchising and carriage restrictions would violate the first amendment, as unreasonable restrictions on a cable operator's editorial control. However, he finds unobjectionable requirements that cable systems lease some of their channels on a common carrier basis, which effectively preempts the operators right to program those channels. Brenner (1988a, 1988b) disagrees in part, finding that cable's "speech interests are relatively lightweight" and, thus, that local franchising and access rules would not be unconstitutional.

[6]*United States v. American Telephone and Telegraph* 552 F. Supp. 131 (1982).

versial. An argument employed with increasing frequency by the BOCs is that the information services prohibition infringes on their rights of free speech.

Critical to these cases is that policies directed toward a transmission monopoly have effects on speech. To understand the relations between the first amendment, monopoly of transmission media, and vertical integration of transmission and content provision, we first survey some of the incentives a profit-maximizing transmission monopolist may have with respect to content, and how vertical integration affects these incentives. We then review some ways in which these incentives may be changed by goals other than profit maximization and, of particular importance today, economic regulation of the transmission medium. We conclude with a summary and suggestions how these considerations might contribute to first amendment policy debate.

## MONOPOLIES AND CONTENT

### *Unregulated Profit Maximizing Monopoly*

In a competitive environment, a firm must take the market price as approximately given. It would be unprofitable to charge less than the going price and impossible to charge more, as it would lose sales to its competitors.[7] When a firm takes the price it can get for its goods as given, it will supply them up to the point where this price just equals the marginal cost of producing the good. For a supplier of transmission media, competition would mean that each "receiver" or viewer pays just what it costs to add the capacity to serve another viewer, and each "sender" or user of a "channel," broadly defined, pays just what it costs to make an additional channel available.

Without the discipline of competition, a media monopolist would be expected to withhold channels or capacity to raise the prices paid by "senders" and "receivers." This withholding of output makes prevention or control of monopoly a goal of economic policy, primarily through antitrust laws or government regulation of pricing and output. These policies generally conform to first amendment-related goals, in that decreasing the price of

[7] This concept of resistance to price is used to define markets for purposes of evaluating the competitive effects of mergers under the antitrust laws (U.S. Department of Justice, 1984).

speaking and hearing would increase the quantity and variety of information available and the opportunity to express oneself and to become a well-informed citizen.

Media monopoly, however, may not lead to reduced diversity in content. A medium monopolist has an incentive to make its product attractive to purchasers, and doing so in part requires such diversity. Consider, for example, a firm with monopoly control over access to electronic data bases.[8] Suppose that all data base suppliers would be willing to pay the same fee of $F to be carried by this monopolist. If so, the monopolist has no reason to reduce the number of data bases carried; it would not raise price above $F by doing so. Consequently, the monopolist's decision whether or not to carry an additional data base would be based upon a comparison of (a) the cost of adding the new data base, net of the $F fee collected, and (b) the increase in revenues consumers would pay for access to the new data base.

Because of the effect on consumers, the medium monopolist need not have an incentive to reduce the variety of expression available.[9] In this case, the "expression" is in the form of data bases, but similar arguments could be made regarding the types of events covered in a newspaper or channels carried by a cable system. In fact, in some situations a monopolist might find it profitable to produce more different kinds of programs at a faster rate than would its competitors, to deter entry and protect its monopoly profit. (Gilbert and Newberry, 1982; Schmalensee, 1978).

Besen and Johnson (1982) provide a second reason why monopoly need not lead to a reduction in media content. They discuss how a monopoly medium, cable specifically, would have the incentive to provide channel space to all who desire it if it can "price discriminate," i.e., charge different prices to different program suppliers. The incentive a monopolist has to reduce the supply of channels or spaces to "senders" follows from the fact that, ordinarily, it must lower price to all in order to sell more channels to some. If it can sell more channels to those unwilling to pay a high price, without having to cut price to those willing to pay the high price, this incentive to reduce supply is eliminated.

---

[8]This might result if local telephone companies are permitted to provide such access (Brennan, 1989a).

[9]White (1977) and Besanko, Donnenfeld, and White (1987) provide models in which a monopolist offers a lower range of quality choices than is optimal. Their results follow from the consideration that offering the optimal product variety for one set of consumers may prevent the firm from charging the profit maximizing price for a different product mix to a different set of consumers.

Besen and Johnson use this theory to argue against rules requiring cable systems to offer leased access at a fixed rate that, because of the natural monopoly properties of cable systems, would have to be above the marginal cost of supplying channels. A cable system that could price discriminate would, in their view, increase supply to allow those who would be willing to pay the marginal cost of a channel, but not willing to pay the prescribed leased access fee. However, Besen and Johnson's argument holds only if the a programmer's willingness to pay for a channel is independent of the number of other channels carried. However, since programmers compete among each other for subscribers or advertisers, a programmer's willingness to pay for a channel is likely to fall as more competitors purchase channels over the cable. If so, a medium monopolist will still have an incentive to keep the number of channels available to a group of competing programmers down, to raise the price those programmers are willing to pay. The argument holds whether the "channels" are cable channels, newspaper column-inches, or any other monopolized medium.

In the context of broadcasting, Owen (1979) offers an additional argument regarding the incentive of a medium monopolist to provide more diverse content than would competitive providers. Independent broadcasters may an incentive to imitate each other's broadcasts, finding it more profitable to take a share of a large audience rather than to attract a new set of viewers. A broadcaster with monopoly control over the spectrum at any given time, however, would be more likely to find it profitable to offer a diverse array of programs, since it would take into account the losses it would bear on one channel incurred by offering closely similar programs on another channel.

There are two keys to this argument. The first is that copyright protection does not extend to program concepts, so general ideas (e.g., western, science fiction, working class sitcom) can be easily imitated without violating copyright laws that protect against unauthorized reproduction of specific expressions (e.g., *Bonanza, Star Trek, Roseanne*). The second key to Owen's argument is that viewers do not pay directly for programs. The lack of a direct viewer payment mechanism has a number of policy implications (Brennan, 1983), but its pertinence here is that there is no price to viewers to fall in response to competition or in virtue of the efficiencies that enable a broadcaster to attract a large audience with a single type of program. With no such price to fall, it is more difficult for "the market" to discourage broadcasters from imitating each other or protecting themselves against imitators. This implies that Owen's argument holds best for media where viewers do not directly pay; it is less likely to support monopoly in media such as print or cable television.

*Vertical integration*

Monopoly of a medium in and of itself presents little reason to suspect bias in the range of content transmitted, and in theory there is some reason to think the variety of content will be no less, and possibly more, than under competition. These results, however, may seem to depend upon the absence of content production or editorial control by the medium monopolist, i.e., that the medium monopolist is not vertically integrated into content. One might think that a medium monopolist will surely bias content, favoring that which it provides.

If an integrated monopolist has the goal of maximizing profits, it will generally act with no more distortion or bias than will a monopolist with no direct economic interest in content production. Conceptually, the profits a medium monopolist can make depend upon the costs of producing and transmitting the content and consumers' willingness to pay for that content. Therefore, a profit maximizing medium monopolist will use its self-generated expression over that available from independent providers only if its expressions can be produced at lower cost, or induce greater demand from consumers, than the expressions available from other speakers. To make the example more concrete, the chairman of the board of a profit-maximizing newspaper will hire her son as a reporter, or publish her mother's opinions as editorials, if they would score more highly on the same "cost-benefit" applied to any journalist or columnist.

This argument is nothing more than the specific application of a general principle that any profit-maximizing firm cares only about costs and revenues when making its input decisions. If General Motors could get better engines—"better" as measured by the prices drivers will pay—for its money from Toyota than it can produce itself, it would be expected to buy them rather than make them. Unless there is a reason why production of both inputs and outputs by the same firm changes cost or demand factors, vertical integration will not result in decisions different from those reached by unintegrated firms.[10]

This radical indifference between using one's own products and using others, however, would seem to be belied by the extent to which communications firms are vertically integrated. If vertical integration makes no difference, why do so many bother?

---

[10]Evans and Grossman (1983) use this reasoning in detail to discuss why AT&T's claims regarding the merits of vertical integration were insufficient to argue against divestiture.

The main justification for vertical integration is to "internalize externalities," i.e., to maximize benefits or minimize costs imposed on one level of a business from those generated at another level (Tirole, 1989, p. 170). On the "supply side," these are usually manifested as "economies of scope," where one firm finds it less expensive to produce two products together than to have the products produced separately by different firms. Economies of joint production may seem ubiquitous, but much communications policy assumes at least implicitly that they are not significant. While there are reasons to think that preventing television networks from producing programs or owning all their affiliates may lead to inefficiencies, there is not to my knowledge much evidence to support these claims.[11] More strikingly, the performance of the telephone industry subsequent to the breakup of the Bell System contradicts what might have been viewed as the model for single-company end-to-end control of an industry. Nevertheless, initiatives to lift restrictions on local telephone company provision of information services presuppose that there are economies of scope which make the telephone companies low-cost providers, and possibly the only economical providers, of these services.

A second "supply side" rationale for vertical integration is that firms may be able to operate more efficiently when they do not have to go through a market to deal with one another. One type of saving is that markets are not free to use—a buyer often must search and, in some cases, verify that the seller offers a quality product. A second type of saving results when, absent vertical integration, the seller will sell to the buyer at a price above marginal cost. Integration may permit efficient internal marginal cost pricing.[12]

The standard example of efficient transfer pricing through integration is when the seller is a monopolist; merger eliminates the incentive to sell to oneself at a monopoly price.[13] A more common incentive for integration in electronic media springs from the economics of program distribution. Once a program is produced and made available, the marginal cost of

[11]That's not to say that there is much evidence supporting the claim that these restrictions serve a useful economic or social purpose.

[12]Integration may not be necessary to achieve efficient pricing. A separate seller may be able to sell its products at marginal cost, but also charging a "lump sum" payment reflecting whatever premium it is able to charge above marginal cost (Tirole, 1989,p. 174-81).

[13]The benefits of merger, though, are not necessarily positive, since merger may confer power in the buyer's output market that did not exist before.

providing it to another outlet is virtually zero. Consider distribution of video programming to cable systems. It does not cost any more to serve more subscribers within a cable system, or more systems within a multiple system company. If a cable operator contracts for a service on the open market, though, its fees are usually based on the number of subscribers and the number of systems supplied. If the cable system and the program service merge, though, the inefficiency can be avoided by letting the systems use the service for free, covering its cost directly through charges to subscribers.[14]

A final rationale for vertical integration is on the "demand side." Consumers may want to purchase a number of potentially different products from the same company, making it efficient for one company at least to supply the entire product line. This is well illustrated by the newspaper and cable businesses. As pointed out above, newspapers and cable systems could act as common carriers, charging content suppliers and receivers a fee for using the medium, but not supplying the content itself. While this has not been seriously considered for newspapers, the idea of "common carrier cable" has been proposed, although it is not currently regarded seriously (Brenner, 1988b). If, as it appears, readers or viewers regard newspapers and cable not as media *per se* but as content that happens to be delivered in a particular way, common carrier operations may not work. Readers do not buy a print delivery system, but a specific package of editorial structure and substance. Viewers do not buy cable *qua* cable, but a collection of video channels that happen to come into the house in a particular way. In neither case could the medium be economically divorced from the message.

Economies of scope, efficient pricing, and consumer linkage of medium and content imply that a medium owner may favor some content, content it produces, over content supplied by others. Where there is competition within a medium or across media, this favoritism in and of itself presents no problem. Moreover, there is no predictable lack of content diversity associated with such favoritism. For example, a newspaper operating as a monopoly and exercising strict control over access to its pages still has an economic incentive to produce the content its readers wish to see. A similar argument applies to integrated

[14]This oversimplifies the market situation somewhat. Program suppliers, particularly feature film producers, may regard viewing on cable as a substitute for a video cassette rental or purchase, second-run theater ticket purchase, or later viewing on over-the-air television where broadcast license fees are based on the size of the audience delivered to advertisers. If so, there is a positive "opportunity cost" to film producers from making their films available to a larger cable audience. Cable license fees charged to cable program services will reflect this opportunity cost; the services will pass this cost on to cable systems. Thus, even if the cable market operated perfectly, there would still be a per-viewer element in cable program fees.

cable systems and program services. Finally, policies to limit content control by media owners will impede the cost savings or responses to consumer preference motivating the vertical integration in the first place.

## NON-PROFIT MAXIMIZATION AND CONTENT

Money may be thought of as the root of all evil, but the quest for money has some benign properties that limit the harm greed can do to information provision. One of the virtues of profit maximization is that no firm can maximize profits without giving its buyers what they want. The price may be excessive, to be sure, but in simple terms, a firm only loses money when it gives consumers something less than what they would most prefer. For this reason, profit maximization, even under monopoly, limits the divergence between the content a monopolist provides and the content most desired by readers, listeners, or viewers.

This very much pertains to media operations. One hears complaints that cable service is too costly; one rarely hears complaints about its programming choices—except possibly from those it elects not to carry, e.g., some independent commercial or public television stations. The relatively benign consequences of profit maximization may not hold, though, when a profits are not a medium owner's direct objective. Two such contexts can be identified—when profits are controlled through economic regulation, and when the owner of the firm has interests other than making money.

### *Non-profit related motivations*

Monopolists may be willing to sacrifice profit to use their transmission monopoly to control content in ways they prefer, and in ways unrelated or opposed to monetary considerations. Imagine, for example, a city with a monopolist in film developing. This monopolist has strong views opposing legalized abortions. A photographer takes a roll of negatives taken at a women's rights march to this developer. The developer sees the prints, and refuses to turn them over to the photographer, claiming instead that the original negatives were lost or destroyed, and refunding the cost of the blank film.

Other examples along these lines can be imagined. A monopoly Democratic newspaper refuses to carry stories about Republican administration accomplishments or Democrat sex scandals. A teetotalist cable television system operator refuses to accept beer advertisements. A video rental monopoly refuses to carry movies depicting homosexual or interracial relationships. The sole radio station in a small town features racist editorials and "news." An anti-Semetic telephone company operator refuses to lay lines in Jewish neighborhoods.

These hypothetical situations illustrate the possibility that a transmission monopolist willing to sacrifice profits may use its monopoly in ways contrary to the goals of liberal policies toward freedom of speech. Interpreting these goals economically, the monopolist is not transmitting the content its consumers want to send or receive. More broadly interpreted "diversity" related goals are also not served. We should doubtless be grateful to the profit motive that makes it costly for firms to limit communication in this way. Competition, in many cases, and the desire for evenhanded and respectable programming by consumers and producers alike also limits the incidence of these problems.

Nevertheless, these hypothetical situations illustrate the harm that can be done when media are monopolized. A good contrast is provided by reviewing Owen's (1979) argument for monopolization of broadcast channels, at least at any given time. His conclusion, that such a monopoly would lead to more diverse and less imitative programming better meeting the preferences of viewers, depends upon the interest of this monopolist in making money. If the monopolist cares primarily about advocating a specific aesthetic, cultural, or political position, programming may become less diverse, not more, if it were to control all broadcast channels.

The potential for harm arising from non-profit oriented behavior can be characterized in economic terms. Normal definitions of market power are based upon what a profit maximizing monopolist could accomplish.[15] This, in turn, depends as noted above on the price the monopolist can charge for his product. The effects of monopoly in these circumstances is a redistribution of wealth from consumers to producers and an inefficiency resulting from the reduction in output needed to raise price to the monopoly level. These effects will depend upon the market or "exchange" value of the monopolist's output, information in our example. However, the injury to consumers that can be created by a monopolist uninterested in profit can run much higher, equivalent in the limit to the the reduction in consumer welfare when *none* of the output is made available. This effect is proportional to the "use

[15] See, for example, U.S. Department of Justice (1984).

value" of the output, information here, which in general will be greater, and often much greater, than the exchange value.[16]

Neither corporate integration of content and medium nor non-profit maximizing behavior is necessary for this large harm to take place. With regard to the former, a separate person or group interested in restricting dissemination of particular information could pay media owners not to carry certain messages. For example, the National Rifle Association could pay stations not to carry advertisements from political candidates supporting firearm control. With regard to the latter, if a profit-maximizing media monopolist can perfectly "price discriminate," it can charge consumers what they would pay to be able to get any information at all. Getting the information needed to determine these charges, and then figuring out a way to charge different prices to different persons for the same product, is notoriously difficult. Looking at these exceptions only illustrates how vertical media integration and non-profit maximizing behavior may interact to cause the potential limitations on information content that may be behind the concern they engender.

In many respects, the first amendment policy debate may center on just the issue of whether content-producing media monopolists are profit maximizers. If they are, one would predict diverse, responsive content, albeit delivered at somewhat higher prices; if not, though, the control over content may be exercised in ways that violate one's senses of distributive equity or the proper breadth of information availability in a democratic polity and modern culture.[17] To the extent these are real concerns, then there may be a conflict between the goals of informational freedom and the current policy disposition to permit media owners to control the content they transmit. The conflict may seem esoteric, but it strikes at the core of fundamental communications policies. If the very notion of "common carrier" regulation itself preempts any editorial control, a serious first amendment related argument would suggest that as a matter of policy, the government has no policy right to prevent a telephone company from refusing to provide telephone service on the basis of the subscriber's beliefs.

---

[16]Repo (1989) discusses the difference between "exchange value" and "use value" in information settings.

[17]Even within more market-oriented antitrust contexts, there has been a long-running debate about the role efficiency should play. That debate might similarly be construed in part as a debate over whether the concern is that a monopolist might maximize profits, or that it might pursue other ends to the greater detriment of society.

*Regulation*

Monopoly can be the consequence of scale economies that prevent firms from surviving long enough to make pricing competitive, or where government franchising practices restrict entry. A traditional remedy in such situations is regulation of prices, to prevent the attendant inefficiency and wealth redistribution. For the most part, media have not been subject to such regulation, largely because the media industries have been regarded as sufficiently competitive (radio, television to some extent, and print). Basic cable rates were regulated prior to implementation of the 1984 Cable Act, however; as this is written, dissatisfaction with increases in cable prices subsequent to that act have stimulated calls for cable reregulation. Of growing relevance to the content issue, moreover, is the continuing regulation of local telephone service.

The direct effect of economic regulation of a monopoly transmission medium, if it works well,[18] is that it reduces the prices and increase the supply of channels, routes, or pathways through the medium. Regulation should make communications more plentiful, by increasing the number of senders, receivers, or both. It may enable more efficient speech, mitigating the effect of monopoly to hold price substantially above cost. In general, lowering price will induce more "discretionary" use of the medium. If demand to send or receive information through the medium is generally more price-sensitive for households with lower incomes, such regulation will increase the relative role poorer households have in how the medium gets used. Effects on the nature of content, however, as opposed to effects on the volume of content, are difficult to predict *a priori*.

The predictable distortions of economic regulation on content are less direct. They spring from incentives regulated monopolies have to get around the profit-reducing regulation. One of the effects of these incentives is that the regulated firm will want to enter unregulated markets. Doing so may enable it to evade profit limits, if it can use its regulated monopoly to favor its unregulated operations over those of its competitors. A second possibility is that the regulated firm may be able to misallocate costs of its unregulated operations to the regulated sector, increasing its profits in the unregulated markets at the ratepayers' expense. These concerns are familiar in telephone policy, respectively known as "discrimination" and "cross-subsidization" (Brennan, 1987a).

[18]It need not work well, as many have pointed out (Stigler, 1971).

The effect of these on media content may be illustrated by some hypothetical examples. Suppose, as was the case before the Cable Act, that basic cable rates are regulated.[19] This regulation creates the following incentive. A cable system could vertically integrate with a supplier of programming shown on basic service, e.g., a television network. It then would have an incentive to discriminate against services that with the network for subscribers or advertisers. One such way would be to deny access to these competitors; another might be to increase their costs of operations by placing them in unfavorable channel positions or in positions different from their "over-the-air" channels. This tactic would lead to a reduction in the supply of programs with content close to that provided by the network, and possibly leading to a substitution of programming that attracts a different audience or different advertisers.[20]

An example of cross-subsidization might run as follows. Consider a local telephone company, regulated so that its prices are based on its reported costs.[21] Suppose that the local telephone company is able to allocate costs associated with generating or marketing content to its regulated rate base. For example, sales agents assigned to market a teletex service could be charged as a cost of providing the regulated telephone service. The distortion here is that the motive for the telephone company to provide the information service is the opportunity to cross-subsidize; without the profits achievable by misallocating costs, it would not enter the market. Such entry, however, may discourage or diminish operations by other providers who might be more responsive to the interests of senders and receivers.[22]

These examples illustrate the possibility that regulation directed to expand the output of a transmission monopoly may have distorting effects on content if that monopolist is al-

---

[19]Regulation of rates for premium services had been preempted by the FCC for "two decades" prior to 1983 (Ross and Brick, 1987).

[20]This argument was set out by the U.S. Department of Justice (1981). Note that on some accounts this distortion might enhance "diversity." It would, for example, be consistent with substituting minority-oriented or foreign language programming for programming more akin to network fare.

[21]If regulated prices are not tied to costs, the incentive to cross-subsidize disappears as regulated rates cannot rise to cover misallocated costs (Brennan, 1989b).

[22]A more detailed analysis of possible effects of vertical integration by regulated telephone companies on information services provision is provided in Brennan (1989a).

lov ed to integrate into information production. The remedies for that distortion are primarily either to regulate the operations of the firm to prevent discrimination and cross-subsidization, or to keep them out of information markets altogether (Brennan, 1989b). But either remedy, especially the latter, impedes the ability of a corporation—the transmission monopoly—to communicate as it pleases through the assets it owns. Integration by transmission companies into content provision may lead to a contraction, rather than an expansion, in the number and diversity of speakers. Conversely, however, making effective the policy of regulating transmission prices, which should facilitate speech by reducing media costs, limits the ability of one group of individuals, represented by the transmission firm, to speak.

This argument is beginning to be used by cable systems and telephone companies who wish to be freed from legal restrictions on their content provision, which spring from of their apparent transmission monopolies. Cable television companies have employed first amendment arguments to have the FCC's "must carry" rules lifted (*Quincy*) and to call into question local franchising restrictions (*Preferred*). It may be more surprising to find the argument used by telephone companies, which traditionally have operated as common carriers without editorial responsibility. To gain the opportunity to diversify into other lines of business, they are now asserting first amendment arguments to get lifted the post-divestiture restrictions on information service and cable television provision.[23]

## POINTS FOR FURTHER DISCUSSION

Reviewing the relationships between vertical integration, monopoly, and regulation suggests the following:

- Profit maximization may not be the culprit in information policy. More severe first amendment related concerns arise when regulation is imposed to control the profits of me-

[23]"Court Asked to Rule on Constitutionality of Cable/Telco Cross-Ownership Ban in 'NITCO' Case; Argument Focuses on Whether First Amendment Issue Should Be Reached At This Time," *Telecommunications Reports*, March 13, 1989: 7-8; "Supreme Court Commercial Speech Decision May Affect RHCs-Information Services Issue," *Telecommunications Reports*, July 10, 1989: 19-20.

It is ironic that cable television, a staunch supporter of corporate first amendment rights as far as its own content control is concerned, is not so enthusiastic a supporter of those rights when it comes to telephone company provision of video services.

dia monopolists or when those monopolists have non-monetary interests in promoting particular views and values.

• The liberal view of freedom of speech tends to regard that freedom as without conflict, in that one person's rights need not conflict with anothers. However, in the regulatory contexts now before the courts, there is a conflict. While the "game" may not be "zero sum," conflict is predictable if not unavoidable. Allowing the telephone company to provide information services may prevent or limit the ability of others to supply those services. Allowing newspapers to refuse to print corrections or opposing viewpoints limits the ability of others to speak their piece.

• Another side of the debate involves the role of efficiency analysis. One argument for limiting policy intervention in information provision is that information is but a commodity—television as a "toaster with pictures"—and that efficiency is best served by letting information markets operate without public encumbrance. However, arguments that apply as well to toast as to public affairs coverage imply that there is no special policy served by the first amendment. In particular, where there is a market failure, e.g., media monopoly, an efficiency approach not only permits corrective intervention, it mandates such intervention. One cannot have the first amendment cake and eat it, too.

• Markets themselves may be viewed as information transmission mechanisms. As such, many of the purported flaws in the media—narrowness of the political spectrum, superficiality of news coverage, lowbrow aesthetics, a lack of edification—are because that is how the viewers want it. Understanding these policy debates requires clarification as to how much of the argument is paternalistic or normative. It may help to focus on paradigm cases where monopoly or market failure is not present, e.g., when, if ever, should society intervene to prevent operation of a Nazi radio station when that is what a substantial fraction of the listening would choose to hear.

• Potential for conflict, non-efficiency considerations, and paternalistic or normative influences in the debate imply that information policy is not a simple matter. A dogmatic approach to the first amendment begs these questions and may prevent a reasoned discussion of the guiding principles and tradeoffs that need to be considered in understanding how society should or should not regulate vertically integrated media monopolies. This, I think, is why invoking the first amendment to thwart non-content directed regulation of medium monopoly, such as the telephone line of business restrictions, seems inappropriate.

• Clarification of the philosophical foundations and empirical conditions for such regulation also need to be clarified to understand when policies toward one medium are appropriate for another. Advocating the "print model" for broadcasters itself says nothing. There may be differences warranting different treatment, or there may be reason to impose the "broadcast model" on print. Until reasons are substituted for metaphor in the debate, these questions remain open and ought to be regarded as open (Brenner, 1988b)

• It may be worth noting that policy questions should not be settled by appealing to legal or constitutional doctrine. While it can be argued that the development of these doctrines reflects a certain kind of moral consideration (Dworkin, 1986), the questions of what the law should be are in principle different from what the law is. It may be valuable to know whether or not the courts are likely to find a particular regulation or statute constitutional, but that in and of itself does not tell us whether that regulation or statute is desirable.

• Finally, the monopoly considerations discussed here focused entirely on monopoly in media. The "public good" aspect of information, however, implies that there will frequently be "natural monopoly" aspects to the production of content, apart from the economics of transmission. Intellectual property and information inherently can be "consumed" by additional persons without reducing its availability to others, implying that only one provider of that information may be needed. For example, satellite transmission seems a competitive industry, but there is only one company using satellites to provide news services to cable (CNN), there is only one music service (MTV), and one major sports service (ESPN). These raise the question of when a program service becomes something like a "medium" itself, in which the questions of vertical integration, monopoly, and possible regulation pertain.

REFERENCES

Besanko, D., Donnenfeld, S., and White, L. (1987). "Monopoly and Quality Distortion: Effects and Remedies," *Quarterly Journal of Economics* 102: 743-67.

Besen, S. and Johnson, L. (1982). *An Economic Analysis of Mandatory Leased Access for Cable Television* (Santa Monica: Rand Corporation).

Brennan, T. (1983). "Economic Efficiency and Broadcast Content Regulation," *Federal Communications Law Journal* 35: 117-38.

Brennan, T. (1987a). "Why Regulated Firms Should Be Kept Out of Unregulated Markets: Understanding the Divestiture in *U.S. v. AT&T*," *Antitrust Bulletin* 32: 741-93.

Brennan, T. (1987b). "The Fairness Doctrine in Broadcasting: Economic and Philosophical Perspectives," Department of Economics, George Washington University.

Brennan, T. (1989a). "Divestiture Policy Considerations in an Information Services World, *Telecommunications Policy* (forthcoming).

Brennan, T. (1989b). "Regulating by Capping Prices," *Journal of Regulatory Economics* 1: 133-47.

Brenner, D. (1988a). "Cable Franchising and the First Amendment: *Preferred* Problems, Undesirable Solutions," *Comm/Ent* 10: 999-1032.

Brenner, D. (1988b). "Cable Television and Freedom of Expression," *Duke Law Journal* 1988: 329-88.

Dworkin, R. (1986). *Law's Empire* (Cambridge, MA: Harvard University Press).

Evans, D. and Grossman, S. (1983). "Integration," in D. Evans (ed.), *Breaking Up Bell* (New York: North-Holland): 95-126.

Gilbert, R. and Newberry, D. (1982). "Preemptive Patenting and the Persistence of Monopoly," *American Economic Review* 72: 514-26.

Lichtenberg, J. (1987). "Foundations and Limits of Freedom of the Press," *Philosophy and Public Affairs* 16: 329-55.

Mill, J. S. (1956). *On Liberty* (New York: The Liberal Arts Press).

Nadel, M. (1982). "A Unified Theory of the First Amendment: Divorcing the Medium From the Message," *Fordham Urban Law Journal* 11: 163-224.

Nadel, M. (1987). "Editorial Freedom: Editors, Retailers, and Access to the Mass Media," *Comm/Ent* 9: 213-53.

Owen, B. (1975). *Economics and Freedom of Expression: Media Structure and the First Amendment* (Cambridge, MA: Ballinger).

Owen, B. (1979). "Structural Approaches to the Problem of Television Network Economic Dominance," *Duke Law Journal* 1979: 192-244.

*Preferred Communications, Inc. v. Los Angeles* 476 U.S. 488 (1986).

*Quincy Cable TV, Inc. v. Federal Communications Commission* 768 F. 2d. 1434 (1985); *cert. denied* 106 S. Ct. 2889 (1986).

Rawls, J. (1970). *A Theory of Justice* (Cambridge, MA: Harvard University Press).

Repo, A. (1989). "The Value of Information: Approaches in Economics, Accounting, and Management Science," *Journal of the American Society for Information Science* 40: 68-85.

Ross, S. and Brick, B. (1987). "The Cable Act of 1984: How Did We Get There and Where Are We Going?" *Federal Communications Law Journal* 39: 27-52.

Scanlon, T. (1979). "A Theory of Freedom of Expression," in R. Dworkin (ed.), *The Philosophy of Law* (Oxford: Oxford University Press): 153-71.

Schmalensee, R. (1978). "Entry Deterrence in the Ready-to-Eat Breakfast Cereal Industry," *Bell Journal of Economics* 9: 305-27.

Stigler, G. (1971). "The Theory of Economic Regulation," *Bell Journal of Economics and Management Science* 2: 3-21.

Tirole, J. (1989). *The Theory of Industrial Organization* (Cambridge, MA: MIT Press).

U. S. Department of Justice. (1984). *Merger Guidelines* (Washington: Antitrust Division).

U.S. Department of Justice. (1981). Comments Before the FCC in the matter of CBS., Inc., Petition for Waiver of Section 76.501 of the Commission's Rules, Docket No. CSR-1847 (X).

*United States v. American Telephone and Telegraph* 552 F. Supp. 131 (1982).

White, L. (1977). "Market Structure and Product Varieties," *American Economic Review* 67: 179-82.