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The Economics of the NAB Case

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Federal District Court Judge Harold Greene is best known for having presided over the Justice Department antitrust case against AT&T. At the same time he was hearing arguments in the AT&T case, however, Greene was judging a case given less media attention, but of no less importance to those involved. The U.S. Justice Department filed suit against the National Association of Broadcasters in 1979, charging that the NAB Television Code restricted the supply of television advertising. Judge Greene issued a consent decree in 1982, under which provisions the NAB eliminated Television Code sections regulating the number of commercials code subscribers could broadcast.

AT&T and NAB Cases are Similar

The AT&T and NAB cases share several interesting similarities besides having been adjudicated by Judge Greene. Both cases were brought against a pervasive communications industry heavily regulated by the FCC. The cases both extended over a number of years and were settled by consent decree. In both, industry structure was changing dramatically during the period of the case in response to changes in technology and the overall legal and regulatory environment. Perhaps most important, in both cases the benefits of the consent degree to consumers were not entirely clear and are still a subject of controversy. It is this last issue that forms the heart of the following discussion.

History and Function of the NAB

The National Association of Broadcasters was organized in 1923 by radio stations responding to a variety of pressures, the most important being demands by the American Society of Composers, Authors and Publishers for royalty payments from radio stations broadcasting copyrighted music. The NAB's role and jurisdiction soon expanded. Television stations were included beginning in the early 1950s. The NAB began to provide technical assistance, managerial consulting, and industry lobbying, and to promote industry self-regulation. To encourage industry self-regulation, the NAB issued voluntary radio and television "codes" whose provisions included programming ethics and advertising standards. The first NAB radio code was ratified in 1929 and the first television code in 1952.

The Television Code

The Television Code of the NAB, administered by the Code Authority, contained both ethical and advertising restrictions. The ethical provisions included prohibitions on advertising alcohol, guns, and some other products, and provided standards for a variety of activities including payments by advertisers for displaying products within programs. The advertising rules set maximum limits for minutes of commercials, number of commercials, and number of commercial interruptions. Separate limits applied to prime-time programs, to children's programs, to some other types of programs, and for network affiliates. The stated purpose of the code was "to maintain the highest possible programming and advertising standards." This is a reasonable goal for an industry hoping to maintain the goodwill of a vast viewing and voting audience. The code also might reasonably serve to forestall more restrictive regulations imposed by the FCC and to counter lobbying efforts by consumer groups seeking stricter FCC regulation of advertising. Another possible (and unstated) purpose of the code is to restrict output of advertising in the same way cartels restrict output in an effort to increase joint industry profit. It is this issue which motivated the Justice department to bring the case.

Could a Television Station Cartel Succeed?

Provisions of the television code clearly aim to limit output of television commercials. As mentioned, one possible reason to limit commercials is to increase joint profit as would a cartel. In the usual industry examples, the potential gains from colluding are clear. Colluding firms increase joint profit by reducing output and raising price. The relationship between output and price for commercial television stations is less clear, however. Television stations do not earn revenue from selling commercials so much as they earn revenue from selling viewers to advertisers. Commercial sales only earn revenue as they are sold on programs which attract viewers and the price for commercial time is directly related to number (and type) of viewer. The implication of this difference between television and the usual industries is that a change in the number of commercials only indirectly affects the price of commercials since changing the number of commercials also affects the number of viewers of a program and thus the price of a commercial. Nor does reducing the number of commercials immediately reduce television station production cost as occurs in the usual industries. These effects make alterations in number of commercials relatively less useful as a tool for changing the price of commercials and station profit.

The Code Was Largely Unenforceable

The foregoing argues that television stations have the potential for earning monopoly profit by colluding and reducing the number of commercial messages. However, a number of compelling reasons argue that television stations in fact could not or did not succeed, and argue that Greene's consent decree, even the original Justice Department suit, was ill advised. First, code subscription was voluntary and violation of code provisions was at worst (and rarely) punished by prohibiting a station from displaying its code membership medallion on station advertising or on the air. Commonly, the Code Authority used only verbal persuasion to discourage misbehavior. That the code was widely ignored is beyond dispute. A 1963 FCC staff study calculated that forty percent of stations exceeded code standards. Actually, it is not at all surprising that eleven hundred stations in the two hundred or so separate market areas were unable to coordinate their efforts and behave like a cartel, even with the assistance of the code.

Stations Compete on Uncontrolled Dimensions

As shown, code enforcement and compliance were problematic. However, even if code standards had been followed universally, supranormal profit to stations was not assured. Television programming is a multidimensional product and code advertising limits do not prevent, and probably encourage, competition on uncontrolled dimensions. Each individual station gains by attracting viewers and is tempted to do so in spite of the potential gains from collusion. Intensifying this temptation is the fact that uncontrolled dimensions are not enforced by the NAB and are in any case nearly impossible to measure meaningfully. In particular, stations have incentive to attract more viewers by increasing all of the dimensions of program quality, dimensions like signal strength, signal clarity, programming quality, and hours of operation. The effects of such a decision are obvious. The number of viewers increases, overall market price of commercials falls, costs increase, and potential monopoly profit is dissipated in whole or in part. The difficulty faced by all cartels in monitoring and controlling output is exacerbated in the television industry by the multidimensional nature of television programming.

Industry Structure Was Changing Anyway

The potential ability of the television code to increase station profit is reduced not just by the complex nature of television programming. Dramatic changes in the broadcasting industry were (and are) taking place, changes which further erode the ability of stations to coordinate their efforts in an anticompetitive way. In particular, every television program market has been facing increasing competition from alternatives to standard commercial broadcast television. For one, the FCC has changed its regulations to allow entry by 160 new low-power broadcast stations in the continental U.S. alone and has permitted 50 new stations to broadcast to viewers by subscription. FCC regulation is also permitting public television stations to come very close to competing with commercial stations for broadcast advertising. Television viewers are also responding to changes in prices and technology by purchasing an increasing number of videocasette recorders which compete with broadcast advertising when consumers watch movies at home. Perhaps most dramatically, however, is the growth of cable television. Although local stations are carried by cable systems, the benefit to a local station due to better signal reception is usually more than offset by the loss of viewers to the additional programs offered on cable. Nationwide cable penetration increased from 19% to 46% in the years the NAB case was being argued. Even if it was a useful tool in the years before the case was brought, the code's ability to monopolize broadcast markets has been disappearing since. As in United States v Aluminum Company of America (148 F. 2d 416, 2d Cir. 1945), industry structure had changed enough that no legal remedy was necessary.

There is No Evidence of Code Success

As mentioned, a television code can serve a number of valuable functions, one of which is to create monopoly profit for member stations. Although foregoing arguments show that this function is a difficult one to achieve, had it succeeded, station profits would reflect the code's influence. Available empirical evidence shows no relationship between monopoly profit and the code. Statistical analysis by the authors of station sale price before and shortly after the consent decree shows that station profit is affected by factors like number of station program viewers, network affiliation, possession of a VHF channel (better signal), number of competing stations, and cable penetration. Station profit is not enhanced by code cartel enforcement. The statistical methods employed include classical, probit, and limited-dependent variable simultaneous-equations regression analysis. While the data certainly allow the possibility of collusion by stations in local markets, it is clear that the television code was not the tool used to enforce desired behavior.

Consent Decree Ignored Viewers

Evidence shows that the television code had little chance of enforcing a cartel and shows that stations received no monopoly profit from code subscription. Even if it had been successful, however, a decision against the code might have been ill advised. True, a successful code increases the price paid by advertisers and so provides them a cause of action. But, as has been argued in the AT&T case, Greene's consent degree very possibly made the average consumer worse off. An effective code reduces the number of commercials while encouraging stations to compete by improving the various dimensions of program quality. Surely television viewers gain from these two effects. In fact, television viewer lobbying groups like Action for Children's Television recognized the potential disadvantages of the consent decree and filed briefs opposing elimination of code commercial restrictions. Economic theory generally favors competitive markets but also recognizes that competitive markets may fail, especially in the case of products characterized by joint consumption. Television signals have this characteristic, and encouraging their optimal production may imply allowing some monopoly power. Judge Greene's decision seems to have made the not uncommon error of considering damage to some industry participants and ignoring damage to consumers.

Conclusion

Commonly in antitrust cases against trade associations, the courts have made decisions based on a rule of reason, evaluating the harm caused by the association rather than proscribing *per se* a given activity. Had Judge Greene evaluated the harm caused by the NAB Television Code, only one decision was possible: the code was not evil. Although restricting the number of commercials does (indirectly) increase price of commercials, the code was widely ignored. Nor could it be expected to succeed in the large and diverse number of broadcast markets. In any case, the broadcast market was changing significantly during and since the case in a way that makes code enforcement even more problematic. The introduction of low-power "drop-in" stations and subscription stations combined with the tremendous increase in cable television penetration combine to severely limit the ability of ordinary broadcast stations to protect their positions. Statistical evidence confirms these market characteristics. The code has no positive effect on station profit. Finally, an effective code likely benefits consumers by reducing the number of commercials and by encouraging stations to compete by raising program quality.