



Trading Regulatory Obligations for Broadcasters

Submission to the Australian Broadcasting Authority

January 2004

1. Introduction

In this submission the Australian Film Commission (AFC) responds to the invitation of the Australian Broadcasting Authority (ABA) to comment on the work of the Allen Consulting Group on the issue of trading regulatory obligations for broadcasters. The AFC remains of the view that this is not an attractive option, although the AFC acknowledges that the Allen Group has produced a more thorough going analysis of the option than was the case with the original proponents of the idea – the commercial broadcasters.

The AFC notes that the preferred option proposed by the Allen Group is for a tradable quota obligation to be applied to the children's and documentary standards only and that to apply it to the whole standard would be counter productive to the regulatory objectives of the Australian content standard.

The AFC's submission is that we still do not believe the option is worth pursuing and that, despite the effort, the Allen Group has not demonstrated a convincing case for this to be taken further. The AFC argues that:

- Compliance costs for the broadcasters are not high;
- Content regulation costs are part of the price of owning a broadcasting licence;
- Australian content regulation provides considerable flexibility in its operation and does not limit schedule innovation;
- No evidence has been presented that audiences will be better off as a result of the scheme being introduced;
- The AFC questions whether the analysis undertaken by the Allen Group has demonstrated there are sufficient differential marginal costs of compliance, a fundamental element of the tradable obligation scheme being able to work;
- The differences in program expenditure between the networks can be explained by differences in the mix of programming scheduled, particularly differences in news, current affairs and sports coverage;
- Licensees do not currently pay the full cost of their compliance with the sub-quotas and that any trend towards monopolisation in program commissioning may lead to further compliance cost transference from the broadcasters.

2. Why tradable quotas and why now?

The first question that needs to be asked is why the ABA is considering tradable quotas as an option for future regulation.

In the introduction to the discussion paper on tradable obligations the ABA argues that there is a changing environment for both broadcasting and regulation and that digitisation is the catalyst for debate about approaches to content regulation. The ABA points to the existence of subscription television (now in its eighth year in

Australia) and of digital television, as well as to the prospect of free-to-air multi-channelling and greater specialisation in programming as being among the other factors that are influencing this debate.

The AFC does not disagree with the position that changes in the environment for broadcasting and regulation require debate on future regulatory options and has undertaken its own work on what such options might be, which it has recently published.¹

However, the current regulatory framework for Australian content on commercial television has not changed and there is as yet no indication from the Government or from the Parliament about how and when this framework will change.

While the AFC agrees that tradable quota obligations might be an option that is worth exploring in a significantly different environment, we do not believe the case has been made that it is a necessary option for content regulation in an analogue environment. The AFC is also of the view that the proposal being considered is weighted too heavily towards the needs of the broadcasters and not the audience.

The history of this issue is that it was first raised as an option to be considered in a future digital multi-channel environment by Goldsmith et. al. in their work for the ABA². They argued that in a future where an abundance of services might make uniform Australian content regulation less efficient there could be a market mechanism where quotas were traded amongst licensees and channel providers:

*The purpose of such an arrangement would be to improve the efficiency of the quota system by concentrating local or children's content broadcasting among those services best placed to provide them. In this way, for example, a Australian drama channel, or a sport and infotainment channel, would be effectively supported by a channel primarily offering US drama.*³

This is not unlike the kind of market mechanism that already operates in the subscription broadcasting sector and describes a situation where there is likely to be a multi-channel platform provider trading quota internally amongst its channel offerings.

In the analogue domain the issue was first raised during the 2001 Australian Content Review by the commercial broadcasters as an option to consider in relation to the children's drama standard. As the ABA found in its commentary on the proposed revised standard:

Submissions on this issue were uniformly negative ... Submitters considered that tradable quotas would reduce competition in the market for C drama

¹ AFC, *Future Audiovisual Services: Options for Supporting Australian Content*, November 2003 at http://www.afc.gov.au/downloads/policies/flexible%20vision_final.pdf

² Ben Goldsmith, Julian Thomas, Tom O'Regan, Stuart Cunningham, *The Future for Local Content? Options for emerging technologies*, at

http://www.aba.gov.au/tv/research/projects/pdfrtf/Future_local_Cont.pdf

³ Ibid. p.62

*programs, thereby restricting the funds available for the production of C drama programs and the program choices available to children.*⁴

The AFC was one of the submitters that took this view. In our submissions the AFC argued that a tradable quota obligation applied across the board to the whole standard was inimical to the operation of the standard. The AFC argued that the levels set by the standard were minima and not maxima, and that in the instances where the broadcasters exceeded the minimum amounts the effect of a tradable quota obligation would be to encourage broadcasters to reduce their output. The AFC also concurred with the majority of submitters that there were serious concerns about the anti-competitive behaviour if the number of broadcasters commissioning programming was reduced.

As a result of this the ABA took no further action in the context of the review and we question what has changed since the review was completed.

3. What are the forces for change?

Tradable quota obligations have only ever been supported by the broadcasters, who have never put a case that answered the criticisms of the proposed scheme. The AFC's concern is that the ABA continues to pursue this option without necessarily having demonstrated there is a significant problem with the current regulation of Australian content which this apparent solution is designed to fix. That is, other than the contention that tradable quota obligations might reduce the overall compliance costs for broadcasters.

The AFC does not believe that the compliance costs for broadcasters are necessarily high, given the continuing growth of the sector and the level of profitability. Over the last decade the trend in the commercial television sector has been for revenue to continue to rise, while program expenditure as a proportion of revenue has declined. This is set out in Table 1. On a very practical level whatever the cost of complying with the Australian content, these figures indicate that it is being easily met by the revenue generated.

Table 1: Total Program Expenditure and Australian Program Expenditure as Percentage of Revenue

	Revenue	Prog. Exp. as % Revenue	Aust. Prog. Exp. as % Revenue
1991/92	\$1858 m	34%	25%
1993/94	\$2146 m	30%	22%
1995/96	\$2459 m	28%	20%
1997/98	\$2775 m	29%	20%
1999/00	\$3271m	26%	18%

Source: ABA, AFC

In terms of recycling revenue into local program expenditure Australia is at the low end of international comparisons as Table 2 shows.

⁴ Proposed amendments: Analysis appendices, references and abbreviations, p.129

Table 2: Domestic program expenditure as a % of total TV revenue

UK	53%
USA	34%
Canada	45%
Germany	48%
France	45%
Netherlands	44%

Source: ITC⁵

All the countries in this sample, except for the United States, have some form of local content regulation for television and all of them devote a much higher proportion of their revenue to domestic programming. This suggests strongly that the costs of compliance with the Australian content standards are not high.

The Allen Group make the observation that:

The quota arrangements have come under some scrutiny because of perceptions that they:

- impose additional costs on broadcasters (which are ultimately borne by consumers); and*
- reduce opportunities for schedule innovation because the quotas restrict format choice and flexibility.⁶*

To support these observations they make reference to the literature that is critical of the current quota arrangements. However, these criticisms are not at all interrogated by the Allen Group and should not remain unchallenged.

Turning to the first observation that Australian content regulation imposes additional costs on broadcasters that they might not have to bare if the regulation was not present.

This criticism proceeds from the assumption that any intervention in the market will impose costs that would not exist if the market was left alone. However, the reality is that markets are not perfect and governments choose to intervene in markets when they do not produce socially and culturally desirable outcomes.

Television was not introduced to this country on the basis that it was just another industry that could run itself primarily upon market oriented goals with a minimum of government intervention. It was introduced on the basis that it is a medium of

⁵ Independent Television Commission,
http://www.itc.org.uk/uploads/Appendix_6__International_TV_programme_supply_market_comparisons.ppt

⁶ Discussion Paper, p.12

communication with considerable influence and an essential social and cultural role to play that comes at a cost to the providers of television services.

This has not changed and the objectives of the Broadcasting Services Act still reflect this position today. At a basic level the industry would not be regulated if the values expressed in the Act were not still deemed to be important by the government and people of Australia. As Hay points out:

*The public policy issue is not just about the concerns of the broadcasting industry. It is about the sort of society we live in, how we understand our society's past and present, and how we provide and support the institutions that allow us to discuss and decide among ourselves the direction and timing of social, political and social change in the future.*⁷

Therefore to say that Australian content quotas impose additional costs on broadcasters represents a fundamental misreading of the foundation upon which the business of commercial television is built. Providing mandated levels of Australian content is part of the essential cost of undertaking that business because that is the nature of the market which public policy has created.

There is certainly a cost to broadcasters in the existence of regulation but there is also a cultural and social value that comes from it which the kind of economic perspective that sits behind the critique offered above finds hard to deal with. As David Throsby has observed:

*cultural value, for all its ephemeral, shifting, incoherent and even irrational properties, is likely to influence peoples' decision-making in regard to cultural goods and might therefore affect desirable patterns of resource allocation in this area in ways that cannot be fully captured by standard economic analysis.*⁸

The fact that it is hard to put a dollar value on cultural resources does not mean that they are of lesser value than those things that are more susceptible to economic analysis.

Turning to the second observation that the existence of content regulation restricts schedule innovation by restricting format choice and flexibility it is hard to see the evidence for this in the behaviour of the broadcasters themselves. As we will argue below the structure of the Australian content standard provides for a considerable amount of choice and flexibility in how the broadcasters choose to comply with the standard.

Combined with this flexibility is a broadcasting market that is very open to the importation of foreign programming. It is simply not the case that Australian content rules restrict the access of broadcasters or Australian audiences to foreign

⁷ D. R. Hay, *Economic Theory and Local Content Quotas for Television*, 2000, Screen Producers and Directors Association, NZ, p.8 at http://www.spada.co.nz/documents/Rsrch_EcTheory.pdf

⁸ Throsby, D, *Determining the value of cultural goods: How much (or how little) does contingent valuation tell us*, <http://culturalpolicy.uchicago.edu/CVMpapers/Throsby.html>

programming. Recent figures from European media analysts Mediametrie reveal Australia as the most open market for television content in the world.

Table 3: Foreign programs as proportion of all new TV programs launched September 2002 to April 2003:

Australia	76%
Netherlands	42%
France	33%
Spain	32%
Italy	17%
Germany	9%
UK	9%
US	4%

Source: Eurodata TV/Mediametrie

4. What are the benefits to audiences?

The ABA is particularly interested in exploring models which would deliver benefits for audiences by maintaining, and ideally improving the outcomes of content regulation, while at the same time allowing industry more flexibility.⁹

As the ABA indicates, a fundamental objective of regulation is to deliver benefits to audiences in the form of access to programming about the life and culture of Australia. Regulation is oriented towards audiences, but takes account of the way in which the industry is obligated to meet the regulation.

In previous submissions the AFC has pointed out that tradable obligation schemes generally work best where the objective is to encourage the market place to deliver an objective that is difficult to achieve by other means, such as reducing pollution or environmental damage or encouraging better management of natural resources. In those instances the object is to either reduce the output of harmful chemicals or reduce the rate at which a natural resource is being used.

The difference with content regulation is that it is designed to encourage the production of something that might not otherwise have been produced by the market. There are fewer examples of tradable obligation systems where this is the case, but at least one is referred to in the discussion paper.¹⁰

The risk with applying a tradable quota system to such a situation is that it may result in less rather than more Australian content where broadcasters are already exceeding the minimum set by the standard. This is explicitly recognised by the Allen Group in its preferred approach when it says:

⁹ Discussion Paper p.6

¹⁰ An example of one such scheme of the New Jersey scheme that trades among local governments in obligations to provide low and medium cost housing is given in the discussion paper. This is discussed in more detail in Brent M. Haddad, Putting Markets To Work: The Design And Use Of Marketable Permits And Obligations, Public Management, Occasional Papers No. 19, OECD at www1.oecd.org/puma/regref/pubs/PUMAOP19.pdf

...in order to ensure that the total level of sub-quota content is not reduced it is suggested that trades should only be allowed for: first release C drama; first release Australian children's C programs; children's C programs; Australian preschool P programs; and documentaries;¹¹

In other words, quota trading applied to the drama sub-quota and to the transmission quota, where the minimum level is exceeded would lead to the potential for excess capacity to be traded so as to reduce the overall level of Australian content.

If the tradable quota scheme is applied to the children's and documentary standards what benefits are there to the audiences?

For example, how is the child audience to benefit from tradable quotas? Do they get better programs, because the savings made in regulatory compliance will be transferred to improvements in the quantity and quality of children's programs, rather than the saving transferred to the broadcaster's bottom line?

How do tradable quotas assist in addressing the problems identified during the 2001 Australian content review – poor promotion and inconsistent scheduling? As a result of implementing this system will children's programs be scheduled at times more convenient for them to watch than is currently the case?

If greater flexibility is to be introduced into the regulation as result of the introduction of the tradable quota system then to what use is that flexibility to be put? Is it simply to allow the broadcasters to more easily meet the requirement without any additional benefit to the audience?

5. The Nature of the Proposed Scheme

In analysing the proposed scheme, there seem to the AFC to be a number of issues that the Allen Group has not addressed which would call into question its feasibility.

Allen Group argues that:

In general, the key advantage of tradable obligation schemes is the savings in the compliance cost of regulation. The opportunity to trade an obligation provides regulated businesses with a financial incentive to find innovative low-cost strategies to comply with the obligation and therefore can reduce and allocate efficiently the cost of compliance.¹²

They then discuss a model of how this might work where there are two broadcasters each with an obligation to broadcast 500 hours of local content to meet a global requirement of 1000. The difference between them in the model is that the total cost of compliance for broadcaster A is \$100 and that for broadcaster B is \$200. That is, it is assumed that broadcaster A has a unit cost that is 50 per cent less than broadcaster B.

¹¹ Ibid p.17

¹² Discussion paper pp24-25

If these broadcasters are allowed to trade their quota obligations there is an immediate incentive for broadcaster B to come to an agreement with broadcaster A to take on an additional amount of quota hours so that broadcaster B can reduce their output of more expensive quota hours.

In the model it is assumed that broadcaster B transfers 167 hours of their quota obligation to broadcaster A, whom now broadcasts 667 hours so that for the viewer there is still a global amount of 1000 quota hours available.

The advantage for broadcaster B is that they can replace the quota hours with programming that is less costly and potentially more profitable. Even though they may have to pay broadcaster A an amount to broadcast the quota hours they have traded, if the net effect is reduced costs and increased revenue then they are better off.

Broadcaster A will have increased costs to meet the additional quota hours they have taken on, but these should be offset by the amount which they are paid by broadcaster B to take these on and in any savings that are made in not broadcasting the programs that the additional quota hours replace.

Because in the model broadcaster A can broadcast the quota hours at a lower unit cost than broadcaster B the combined compliance cost for both broadcasters is reduced from \$300 to \$266. This meets a primary objective of the scheme to introduce flexibility and to reduce the overall compliance costs.

The above sets out how the model would work in theory and the Allen Group then specifically analyses the financial incentive for commercial networks to trade finding that:

There appear to be sufficiently different marginal costs of compliance between broadcasters to create the opportunity for gains from trade.¹³

This is a key finding because without it a fundamental assumption in making the scheme work is not present. Surprisingly though, given the centrality of this finding to the argument in favour of the scheme, relatively little time is spent in the investigation of the compliance costs of the broadcasters.

The evidence advanced is firstly in Table 3 of the Discussion Paper, which shows that there are differentials in programming costs across program genre and between Australian and foreign programs. Figure 2 then provides analysis of the program costs for the three networks between 1996 and 2001. This shows that there are differences between the total cost of Australian and foreign programming, as well as between the programming costs of each network. However, the presentation of the data is somewhat unclear in that figures for network expenditure on Australian programming appear inconsistent with the data previously presented in Table 2. It is not stated whether the amounts in Figure 2 are meant to be annual averages or totals for the six years covered. In any case the amounts in Figure 2 are considerably less than those in Table 2.

¹³ Ibid p.37

The findings in these tables lead the Allen Group to the conclusion that foreign programming is almost half the cost of Australian programming, although the data presented in Table 3, on which this conclusion is partly based, suggests that foreign program costs per hour are about 65 per cent of Australian program costs per hour.

The AFC would also question the other conclusion reached by the Allen Group that they may be over-estimating foreign program costs. They reach this conclusion on the basis that not all programming purchased by the networks in output deals is actually broadcast. Our understanding is that whether broadcast or not the networks pay for all the programming they potentially have access to in these out put deals.

The discussion that follows from these conclusions by the Allen Group is somewhat confusing because it concentrates more upon the cost differential between Australian and foreign programming, rather than the key to quota trading - the differential marginal cost between the broadcasters of compliance with Australian content regulation. While it is accepted that foreign programming is generally cheaper than Australian programming, this only demonstrates that purely on a cost basis it would be more attractive to replace Australian programming with foreign, where that is possible.

The data presented in Table 2 of the discussion paper shows the Australian content expenditure for each network in the years 2001-02 and 2000-01. This indicates a differential between the Seven and Nine Networks on the one hand and the Ten Network on the other hand. These figures are only for two years and we presume the 2000-01 figures would have been affected by the cost of the Seven Network Olympic Games coverage.

Undoubtedly there are differences between the networks in the amount they spend on Australian content. The ABA itself presented evidence of this in data published in the Issues Paper for the 2001 Australian content review. At page 7 of the Appendix, Figure CX.3 shows Australian program usage and amortisation by network 1990-91 to 1999-00. This table shows that over the decade Australian program usage costs were different for each network – the Nine network’s costs steadily rose during the decade, the Seven network costs fluctuated but generally remained above those of Nine, while those of the Ten Network steadily declined to the point where they were less than half that of the other two networks in 1999-00. However, as the data in Table 2 indicates the costs for the Ten Network increased in 2001-02.

Part of the context for this is that the level of Australian content increased between 1990 and 2000. In 1990 the transmission quota was still set at 35 per cent, but the average amount of Australian content across the three networks was 46 per cent. By 2000 the average had increased to 57 per cent, just the above the mandated minimum of 55 per cent.

Analysis of ABA data (Table 4) shows that for the three networks the hours of Australian content rose by between 16 per cent and 33 per cent between 1990 and 2000.

Table 4: Comparison: Australian Content Hours per Network 1990 & 2000

	Seven	Nine	Ten
1990 Australian Content Hours	2956	3219	2825
2000 Australian Content Hours	3830	3731	3758

Source: ABA¹⁴

When compared with the ABA data on program usage and amortisation it shows that for the Seven Network hours increased by 30 per cent and program costs at 4.8 per cent per annum, for the Nine Network hours increased by 16 per cent and program costs by 3 per cent per annum and for the Ten Network there was a 33 per cent increase in hours, but program costs decreased by 6.3 per cent per annum.

This demonstrates that there are differences between the networks in the amount of Australian content broadcast and the expenditure on that content. Does this then demonstrate that there are differences in the marginal cost of compliance?

In considering this question one needs to remember that the Australian content standard provides a considerable amount of flexibility in the manner of compliance. First it is structured in two parts – transmission quota and sub-quotas for drama, documentary and children’s programs. Second, only the children’s and documentary sub-quotas require set minimum hours to be broadcast and the drama sub-quota is specifically structured to allow for significant differences in the hours required by each network to comply, based on the drama genres to which they choose to commit. This leads to the Nine Network, for example, historically needing the least hours of drama to meet its point score target for drama, because of the mix of drama genres it has chosen.

While 55 per cent of transmission time between 6.00 am and midnight has to be devoted to Australian programming the AFC estimates that the sub-quota requirements for each licensee equates to approximately 9 per cent of transmission time and within that the first release requirement to about 5-6 per cent of transmission time. This means that the remaining 46 per cent can be made up of any type of Australian program, including first release and repeat programs from the sub-quota categories.

What is more when one looks at the number of adult drama hours broadcast, while the overall amounts of Australian content have increased the hours of new Australian drama actually decreased between 1990 and 2000, as Table 5 shows. In 1990 Australian drama broadcast were 8 per cent of all Australian hours broadcast, whereas by 2000 it represented only 4 per cent of Australian hours broadcast.

¹⁴ Australian Content Issues Paper Appendix E-(i) First Release Australian drama and Australian transmission quotas – Sydney 1990-2000

Table 5: Comparison: Drama Hours per Network 1990 & 2000

	Seven	Nine	Ten
1990 Drama Hours	318	136	255
2000 Drama Hours	192	131	175

Source: ABA¹⁵

The flexibility means that there are significant differences in the way each network meets the transmission quota. For example, data published by the ABA shows that in 1998 the Nine Network broadcast the most news and current affairs, almost as much as the other two networks combined. The AFC argues this is a scheduling strategy designed to make a point of difference in the market place, rather than something primarily driven by the need to comply with the transmission quota. In the same year the Ten Network broadcast less than half the amount of sport of either Nine or Seven, which is also a product of scheduling and the highly competitive nature of the sporting rights market, rather than the regulatory imperative.¹⁶

The point of looking at news, current affairs and sport is that they represent the two largest areas of expenditure on Australian content. Data published by the AFC in *Get the Picture Online*¹⁷ shows that in 2001-02 they represented 56 per cent of all Australian program expenditure, having increased from 47 per cent in 1990-91. Spending on these program genres increased dramatically between 1990-91 and 2001-02. Expenditure on news and current affairs increased by 56 per cent between 1990-91 and 2001-02, while expenditure on sport increased by 147 per cent.

Overall the level of expenditure on Australian programs went from \$424.5 million in 1990-91 to \$706.3 million in 2000-01, an increase of 66 per cent.

In comparison expenditure, on drama, children's programming and documentary increased by only 8 per cent (most of this growth being due to the increases in the children's drama and documentary sub-quotas) over the period and as a proportion of total Australian programming expenditure declined from 29 per cent to 19 per cent. The AFC's analysis also shows that the increase in the average cost per hour for Australian drama was less than for Australian content generally. Between 1990 and 2000 there was an increase of approximately 32 per cent in the cost per hour of Australian content overall, but only a 15 per cent increase in the cost per hour of Australian drama.

In other words, in terms of both hours broadcast and expenditure the greatest increase between 1990-91 and 2001-02 appear to have been outside the sub-quota areas, where there is a higher degree of flexibility in how the networks meet their transmission quota requirements.

¹⁵ Australian Content Issues Paper Appendix E-(i) First Release Australian drama and Australian transmission quotas – Sydney 1990-2000

¹⁶ AFC, *Get the Picture*, 2001, 6th Edition, p.222

¹⁷ *Spending on programs of various types, local and imported, by commercial free-to-air services in Australia, 1990/91 to 2001/02*, <http://www.afc.gov.au/gtp/wftvprogexpenditure.html>

This leads the AFC to suggest that although there are demonstrable differences between the program expenditure of the networks, particularly between Ten and the other two networks, this does not necessarily prove that there are differences in the marginal costs of compliance are significant. If the broadcasters are using the flexibility of the standard to have different mixes of program genres outside the sub-quota areas then this makes it difficult to compare their costs of compliance.

Without access to annual program expenditure figures broken down by network and program genre the AFC also suggests that a large proportion of the difference between Ten and the other two networks could be attributed to a lesser commitment by Ten to more expensive sport and news/current affairs programming. The fact that the cost structures of Nine and Seven are closer together is further indication that this might be the case.

5.1 Drama

Within the drama sub-quotas are there differential marginal cost of compliance?

While there has in recent years been a trend towards some in-house production of drama by the networks, most drama is commissioned externally from the independent sector. There are a number of factors that could affect the cost of production, such as film versus video, studio versus location, number of episodes, the genre, cost of cast and crew etc. However, the nature of television drama production in Australia is such that the broadcaster does not, in most instances bare the total cost of production.

During the 2001 Australian content inquiry the ABA found that while the real cost per hour of producing Australian drama increased by 50 per cent between 1988 and 2001 the prices paid by the networks, in the form of licence fees and investment, have fallen in real terms. For example, the ABA data shows that in 1988 the network contribution to the cost of serial drama was 100 per cent and to series drama about 90 per cent, by 1999-2001 the network contribution was 65 per cent to both serials and series.

The reasons identified for this trend by the ABA included:

- *Cost reduction policies of the networks leading to a shift of commercial risk from the broadcasters to the production industry;*
- *Moves to in-house production;*
- *Increased government investment transferring costs from the networks; and*
- *Increased equity investment leading to future revenue offsetting licence fee costs.*¹⁸

Added to this is the fact that the level of drama being broadcast has reduced significantly since 1990, as was shown above in Table 4 above. Thus, in combination

¹⁸ Proposed amendments: Analysis appendices, references and abbreviations, pp. 13-14

with other cost reduction factors, the broadcasters have reduced their broadcast output as another contributor to restraining their costs.

The flexibility provided for in the drama sub-quota is intended to provide incentives for higher budget production, however the ABA's analysis of drama compliance shows that series and serials tend to make up the bulk of drama hours broadcast. Between 1999 and 2001 they accounted for 90 per cent of all Australian drama hours, with serial drama alone accounting for 54 per cent of Australian drama hours.¹⁹

The AFC certainly questions whether there are great differences in the cost of producing serial drama and if just over half the drama sub-quota is being met by this form of drama then what effect would this have on any difference in the marginal cost of compliance?

This is a more complex picture of the costs of compliance than is presented in the model advanced by the Allen Group and it is unclear how the various factors might affect the differences in the cost between the networks. The AFC suggests that not enough work has been undertaken to determine that the marginal costs of compliance with the drama sub-quota are sufficiently different to encourage potential trade.

5.2 Children's drama

The Allen Group analysis correctly perceives that children's drama is expensive relative to other forms of children's programming, but fails to take into account the reality that the broadcasters are not the main financing source for this programming..

In 1999-00 the total value of children's drama produced in Australia was \$85.6 million. The expenditure by the commercial broadcasters on children's drama in that year was \$11.9 million. That year was not atypical and indicates that on average the commercial broadcasters contribute less than 20 per cent of the production value of Australian children's drama. In reality this form of programming is largely financed by the contributions of the Australian government through the Film Finance Corporation and the efforts of Australian producers in securing foreign investments and pre-sales.

The costs of compliance for the broadcasters are not high. Expenditure on children's drama runs at less than 0.5 per cent of revenue, even if it may be more expensive per hour than some adult drama.

More importantly for the Allen Group analysis is the fact that the commercial broadcasters do not pay vastly different licence fees. The FFC as the main co-financer of children's drama sets minimum licence fees which the broadcasters are reluctant to meet and which they rarely, if ever, exceed.

Therefore, if the cost of compliance between the broadcasters is roughly the same then a fundamental condition of the tradable quota scheme has not been met. Without variable costs of compliance the potential for the entire cost of compliance to fall is

¹⁹ Ibid, p.9

also absent. In the model proposed by the Allen Group this should be a disincentive for trading to take place.

However, commercial broadcasters have, through their submissions to the ABA, indicated a willingness to trade their children's drama obligations. Yet the broadcasters are not on their own able to reduce the cost of producing children's drama, because they are not responsible for the entire cost of compliance. All that they can try to achieve is to reduce their own contribution to the cost of production. This could potentially be achieved by the concentration of commissioning of children's drama in fewer broadcasters through the trading of quota obligations. That is a smaller number of broadcasters use their market power to transfer more of the cost of producing children's drama to the FFC and producer sourced finance.

6. Conclusion

In our view the case for tradable quotas is doubtful and we suggest that the Allen Group has not undertaken a sufficiently rigorous analysis of the actual operation of the Australian television program supply market to establish that it could work. If the ABA is to continue examining market-based solutions to regulatory futures then it would benefit from undertaking a proper analysis of the elements of the program supply market.