7-2004

Media Economics and Media Policy: The Good and the Bad

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THE

DONALD MCGANNON

COMMUNICATION RESEARCH CENTER

WORKING PAPER

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Presented at the Latin American Meeting of the Econometric Society, Santiago, Chile, July, 2004

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Abstract

This paper explores the role and function of economics in media policymaking and policy analysis. This paper begins with an overview of the distinctive economics of media industries in an effort to demonstrate the importance of focused and specialized economic analysis of these industries. The paper then chronicles the growing role of economics in U.S. media policymaking and examines both the positive and the negative implications of this transition for media policy.

Media Economics and Media Policy: The Good and the Bad

Economists traditionally have devoted relatively little attention to media industries, though the level of attention has increased in recent years. This increase in attention is likely due in large part to the wide range of economic questions raised by both the changing media technology environment (see Mitra, 2000/2001), the adoption of new regulatory philosophies in many nations around the world, and the consequent efforts to effectively impose these new philosophies.[1] Overall, however, media economics remains a very small – and even somewhat obscure – specialization within the economics field, with relatively few media-oriented research articles being published annually in traditional economics journals and the only journal devoted specifically to media economics (the Journal of Media Economics) publishing more work by communications scholars than by economists.

What can explain this general pattern of neglect of this increasingly significant component of the global economy? The neglect may be due in part to, as one economist has studied media industries has noted, the belief within the economics community that "frivolous activities can hardly exert the intellectual pull of serious industries such as steel, pharmaceuticals, and computer chips" (Caves, 2000, p. vii). This assessment is somewhat troubling, as it seems particularly narrow-minded – and even dangerous – to consider those industries and institutions engaged in the process of influencing cultural and political attitudes, beliefs, values, and behaviors as engaged in "frivolous activities,"[2] even through the somewhat narrow lens of economics. Research has demonstrated the important role that media institutions play in the political and cultural life of nations, impacting social trends, electoral outcomes, and consumer purchasing behaviors (e.g., Stromberg, 2001, 2004). On what grounds can such activities be considered frivolous, even to an economist?

Fortunately, there is a growing recognition within the economics community of the importance and influence of media industries in the political, cultural, and economic life of nations – and, consequently, a growing recognition of the importance of concerted economic analysis of these industries (e.g., Hamilton, 2004; Owen & Wildman, 1992). This recognition has grown particularly strong in regards to those economic questions that bear directly – or indirectly – on media regulation and policy issues. Particularly within the United States, media economics has become very important as a tool to guide a wide array of regulation and policy decisions – so much so that some would argue that, today, U.S. media policymakers rely too heavily on economic analysis, to the neglect of other relevant analytical tools and perspectives and, consequently, to the detriment of effective policymaing (Adelman, 1996; Cavanagh, 2003; Simon, 2002; Stucke & Grunes, 2001).

It is this question of the appropriate scope and influence of economic analysis in media policymaking that forms the crux of this paper. In addressing this question, this paper begins with an overview of some of the defining economic characteristics of the media marketplace. In particular, this first section explicates the dual-product nature of most media markets, as well as the distinctive characteristics of these two products (audiences and content). This section also will highlight some of the distinctive externalities associated with the output of media industries. The goal of this overview is to illustrate the importance of media economics as a distinct subfield within the broader economics field, but also to illustrate the non-economic concerns that must inevitably be brought to bear on media policy decisions. This paper will then provide an historical overview of the place of economics in U.S. media policymaking, in an effort to illustrate how the role and function of economics in media policymaking has evolved over time, particularly in terms of how economics has become increasingly central to media policymaking. The next section will examine both the positives and the negatives that have been associated with the increased role of economics in media policymaking. A particular goal of this section is to develop some clear thoughts as to what economics can – and can not – bring to the table in terms of formulating and analyzing media policy. The concluding section offers some final thoughts on the appropriate role and function of economics in media policymaking, as well as some thoughts on the issue areas particularly in need of more analysis.

The Complex and Distinctive Economics of Media Industries

At the most basic level, it is widely recognized that media industries are somewhat distinct from other industries due to the fact that they typically operate in what is best described as a dual product marketplace (see Owen & Wildman, 1992; Napoli, 2003). That is, media firms often simultaneously market one product (content) to one set of consumers (audiences) and another product (audiences – or, more specifically, audience attention) to a different set of consumers (advertisers) (see Napoli, 2003). That these two product markets are inter-related should be quite clear from the fact that the consumers in one product market (audiences) are essentially the product in the other product market.[3]

On the basis of this brief description, it also should be clear that there are some unique complexities associated with the media marketplace. In fact, the situation is actually much more complex than this description suggests. Figure 1 provides an overview of the variety of distinct media markets, categorized by product market and geographic market criteria.[4] This figure illustrates the fact that not only do media firms operate in two distinct product markets (the content and audience markets), but also that these markets operate at different geographic levels (local and national), and that the content market is further differentiated into upstream and down stream components. The upstream component involves the sale of content from producers to distributors, while the downstream component involves the sale (or, in the case of pure advertiser-supported media, giving away) of content to audiences.

Greater complications arise when we examine the distinctive attributes of the two primary products in the media marketplace – content and audiences. As many economists have noted, media content is a fairly distinctive product, with a number of important distinguishing characteristics. For instance, the "public good" nature of media content has been the subject of extensive analysis (e.g., Waterman 1987; Owen & Wildman 1992). As a public good, media content is not "used up" in consumption. Consequently, the same media product can be sold and resold indefinitely without incurring additional production costs. As many analyses have demonstrated, the economic implications of the public good nature of media content are far reaching, affecting budgeting decisions, distribution strategies, and pricing policies (Owen & Wildman 1992; Waterman 1987; Werbach 2000), all of which have implications for effective media policymaking (see Wildman, 1998).

Audiences are perhaps an even more unusual product than content. In selling audiences to advertisers, media firms essentially deal in human attention, and human attention represents a much more abstract, elusive, and intangible product than, say, steel, insurance, or legal services. Human attention resists the type of exact verification and quantification that typify the transactions that take place in most other industries. The economic implications of this attribute currently are being played out in a very public way in the U.S., where Nielsen Media Research is attempting to introduce a new local television audience measurement system (the local peoplemeter), to much resistance from certain industry stakeholders who anticipate that the new system will provide smaller and/or less demographically desirable audience estimates for their channels and/or programs.[5] Recent hearings held before Congress illustrated a wide array of potential policy ramifications arising from systems of audience measurement, from the standpoint of both competition policy and broader public interest concerns (U.S. Senate, 2004) – with the key underlying point being that changes in audience measurement systems can dramatically affect the competitive landscape within and across media industry sectors (see Napoli, 2003).

Another defining characteristic of audiences is that the production process is highly unpredictable. This is due in large part to the fact that the audience product is produced from raw materials that the producers can not effectively control. As Berry and Waldfogel (1999) noted within the context of radio broadcasting, “The production process . . . is unusual in that the primary inputs, listeners, are not purchased by the firm but rather make a free choice about listening to radio” (p. 399). Thus, when considering the audience product, “output is determined by listener behavior rather than a traditional production function” (Berry & Waldfogel 1999, p. 399). The challenges posed by this unpredictability of audience behavior are compounded when we consider the inherent perishability of media audiences. Unlike media content, which can be sold and resold indefinitely (Owen & Wildman 1992), the shelf life for media audiences is exceptionally short, lasting only for the duration of time that a media product is consumed (see Napoli, 2003). Thus, audiences have been described as “very fleeting products: they become obsolete almost instantly” (Ang 1991, p. 61). This attribute requires, then, that audiences be purchased in advance of their production and, consequently, that these transactions be based upon predictions as to the size and composition of audiences whose appearance before different content options is inherently highly difficult to control and, thus, to predict.

This brief overview of the key market and product characteristics of the media marketplace is meant to convey the importance of understanding the distinctive economic characteristics of media industries and media products and, consequently, why media economics needs to play a central role in media policymaking. Policymaking needs to be informed by economic analysis that effectively accounts for these distinctive characteristics of media industries. Conventional analytical templates will not necessarily apply, and will not necessarily produce optimal decision outcomes (see Hamitlon, 2004 and Wildman, 1998, for thorough treatments of this subject).

There are also, however, significant limits to what economic analysis can bring to bear on media policy issues. This is because media industries are quite distinct from other industries in terms of the unique positive and negative externalities that often are associated with their output – as well as with these policy decisions affecting these industries. These externalities extend into areas that most policy analysts may seldom take into consideration, or may not know how to identify and measure (see Entman & Wildman, 1992; Hamilton, 1996; Sullivan, 1995), including areas such as citizen knowledge, public opinion, and voting behavior; or the diversity or local orientation of media content. Content regulations, for instance, often are imposed with the intention of exerting a positive effect on citizen knowledge or behavior (for example, in the case of access regulations for political candidates, or educational children's programming regulations) or with the intention of protecting audiences from certain psychological harms that can arise from exposure to certain forms of content (for example, indecency regulations). Even structural regulations (i.e., ownership regulations) often are motivated in part by the desire to create a robust "marketplace ideas" that facilitates the free flow of diverse opinions and thus, the intellectual and political well-being of the citizenry.

Due to the potential for media policy decisions to indirectly affect the political and social disposition of the public, media policy analysts face an analytical burden more far-reaching than analysts in most other policy areas (see Hamilton, 1996; Sullivan, 1995). The range of variables and methods that must be considered extends into areas seldom encountered within other regulatory contexts. As has been argued elsewhere (see Napoli, 1999), media policy is unique in the extent to which it straddles the economic and social policy realms – a characteristic that policymakers and policy analysts must consistently recognize and address in their work.

Thus, as should be clear at this point, media policymaking and policy analysis inherently stretch the capacities of traditional policy analysis tools. From a purely economic standpoint, media industries require specialized attention and analysis. Moreover, given the range of concerns and potential impacts associated with media policy decisions, there is a fairly obvious limit to the extent to which economic analysis alone can effectively guide media policymaking.

The Changing Role of Economics in U.S. Media Policymaking

It is important to note that there was an extended period of time during which economics played a rather minor, even marginalized, role in U.S. media policymaking. Historically, the Federal Communications Commission relied on what Robert Corn-Revere (1993) has described as an "intuitive model" for making judgments. Corn-Revere's observation corresponds with broader analyses of traditional regulatory decision making. According to McGarity (1991), traditional regulatory decision making relied heavily upon intuition and experience. Also, "the primary institutional goal [was] to produce rules that [had] a reasonable chance of surviving...legal attacks...it [was] a matter of secondary importance that the benefits of the rule [could] somehow be shown to exceed its costs" (McGarity, 1991, p. 7). The traditional prominence of lawyers among the decision making personnel may help explain this institutional perspective, within the FCC as well as other regulatory agencies (Krasnow, Longley, & Terry, 1982; McGarity, 1991; Williams, 1993). The courts frequently have validated these intuitive predictive judgments, granting the Commission "necessarily wide latitude to make policy based upon predictive judgments deriving from its general expertise" (Bechtel v. Federal Communications Commission, 1992, p. 881). This permissiveness on the part of the courts no doubt further entrenched the "intuitive model" within the Commission.

It was not until the 1970s that economics began to make significant inroads into media policymaking. It was during this time that an important analytical shift took place within the FCC, reflecting a broader analytical shift taking place throughout government (McGarity, 1991). Specifically, economic thinking and analysis became increasingly central to FCC decision making (Corn-Revere, 1993). The FCC's personnel make-up shifted accordingly, with a major influx of economists joining the Commission during the 1970s (Williams, 1993). The Office of Plans and Policy was created in 1973 to provide the Commission with the capacity for independent economic analysis and planning that it had frequently been criticized for lacking (Napoli, 1998).[6]

As a result of this shift, the 1980s saw an unprecedented use of economic analysis in assessing proposed and existing media policies. The general pattern was one of such analyses contributing to the elimination of a wide array of regulations that were seen as either impeding economic efficiency or as unnecessary in light of the effects of competition on producing similar results (see, for example, Besen, et al., 1984). A broad array of what have been labeled “public interest obligations,” were eliminated, such as obligations for broadcasters to provide specific quantities of local programming, as well as specific quantities of news and public affairs programming. Requirements that broadcasters ascertain the needs and interests of their local communities via surveys of community members and meetings with community leaders similarly were eliminated. And perhaps most well-known was the elimination of the infamous Fairness Doctrine, which required broadcasters to provide balanced coverage of controversial issues of public importance (see Napoli, 2001). Such regulations were eliminated in large part due to increased recognition of the costs such regulations imposed on broadcasters as well as an increased faith that the pro-social benefits of such regulations would be achieved as well or better by market forces (see Napoli, 2001) – points that clearly demonstrate the increasingly influential role that economic analysis had begun to play in FCC decision-making.

Assessment

Given the passage of time, and the increasing visibility and politicization that have characterized media policy issues in the United States in recent years, it seems appropriate to begin to undertake an assessment of the role and function of economics in media policymaking, in terms of both the pros and the cons. It is this issue that is the focus of this section.

Looking first at the positives, perhaps what has been most valuable about this shift in analytical orientation in the media policy sector has been the extent to which it has enabled the FCC to recognize a variety of instances in which, at least from an economic standpoint, certain policies not only were not having their intended effect, but were, in some cases, having an effect that was the opposite of what was intended. So, for example, it became clear in the 1980s that the Commission’s policy of slowing the growth of cable television did not, as was intended, protect the financial viability of struggling UHF television stations, but actually hurt these stations, for whom the diffusion of cable television ultimately proved instrumental in placing them on closer to equal reception footing and, consequently, closer to equal financial footing, with the more powerful VHF stations (see Besen, et al., 1984).

Another key benefit of the integration of economics into media policymaking is the stronger overall empirical orientation that has resulted. Both the FCC and the courts frequently demand empirical evidence in support of policy decisions – something that was less common in an environment in which legal principles and arguments alone could more easily be used to justify or eliminate a policy option. Predictive judgments carry less weight now than they did in the past – and perhaps more important – they must at some point be supported by evidence (see Napoli, 1999). Recent FCC behavior illustrates this point. For instance, in conjunction with its 2003 media ownership review (Federal Communications Commission, 2003), the FCC conducted 12 detailed studies of a variety of issues relevant to the media ownership proceeding. These studies – and their underlying data – where then made available for public comment, critique, and even reanalysis (see, for example, Napoli, 2004). One of the key benefits of this transition is the extent to which it can help to liberate policymakers from relying heavily on the research and data conducted and compiled by interested stakeholders – work that inevitably can only be described as self-serving and of questionable reliability.

All of this being said, there also have been drawbacks associated with this transition. The most important of these, perhaps, has been the increasing tendency to express and approach every policy question, regardless of its complexity, in purely economic terms. This propensity exhibited itself fairly quickly, for instance when, in the early 1980s, then-FCC Chairman Mark Fowler (a key actor in increasing the role of economic analysis in media policymaking) declared that television was nothing more than a “toaster with pictures” (see Napoli, 2001), a statement that suggests that media markets can be analyzed in a manner similar to any other product market.[7] As was hopefully illustrated above, this is not the case.

More recently, we saw this tendency perhaps most clearly in the FCC's recent efforts to analyze diversity within media markets via the creation of a diversity index that was little more than a slightly modified version of the Herfindahl-Hirschman Index (HHI) traditionally used in anti-trust analysis. Such an approach barely scratches the surface of what diversity means from a media policy standpoint (see Napoli, 2001) – and many would question whether an economic foundation for such an analytical tool is even the appropriate starting point.

As is suggested by this latter example, the issue of ownership regulation has served as a focal point around which the question of the appropriate role and function of economic analysis has revolved. Although there have been arguments from some sectors that antitrust laws and the economic mechanisms of antitrust analysis are sufficient regulatory tools for dealing with media markets (e.g., Gasman, 1994; Huber, 1997), in fact the more compelling case is that such an approach is not only insufficient, but potentially dangerous as well (see Stucke & Grunes, 2001). As one critic has argued, "Antitrust analysis has not encompassed other important goals . . . including content diversity and the need for local stations to address local concerns" (Cavanagh, 2003, p. 67; see also Simon, 2002). This point raises the issue of the other public policy goals that can often (intentionally or unintentionally) get stripped away, or, become marginalized, in an environment in which economic analysis predominates (see Stucke & Grunes, 2001).

Another drawback to the increasing role of economics in media policymaking has been the willingness among policymakers to assume a wide array of positive benefits that would arise as a result of unrestrained market forces. No intellectual discipline is completely value-neutral, and in the case of economics, competition, efficiency, and the primacy of market forces exist on a normative plane that can, on occasion, lead to a willingness to assume that market forces will produce a wide range of beneficial outcomes without demanding the empirical evidence that this is in fact the case. Such assumptions are particularly dangerous when we consider the unique economics of media markets, where the value of certain types of content can not be fully captured by traditional economic models (Hamilton, 2004). It is in instances such as this that economic analysis can become more ideological than social scientific. Consequently, one common characteristic of media policymaking over the past decades has been the willingness to eliminate regulations on the basis of the failure to find strong evidence of their effectiveness, while at the same time neglecting to investigate whether the reliance on market forces produces similar or better results (see Napoli, 2001).

Finally, there is the issue of whether the stronger empirical orientation that has been brought to media policymaking as a result of the integration of economics has undermined the prominence of long-standing policy principles such as diversity and localism – principles that may not be as amenable to empirical analysis as economic principles such as competition and efficiency – or, at the very least, not amenable to empirical analysis via the same methodological tools employed in economic analysis. In recent years, much progress has been made in terms of strengthening the underlying empirical basis of these normative policy principles (see Donald McGannon Communication Research Center, 2004); however, the empirical record on these subjects still pales alongside that of traditional economic issues and concerns. Thus, the question is, if diversity or localism can not be measured as rigorously and reliably as competition – or at least not measured in ways familiar to economically oriented policy analysts and decision-makers – should that undermine their influence and prominence in a policy decision-making environment (and legal decision-making environment) that increasingly applies the standards of economic analysis to the full range of policy issues and concerns? Decisions by the FCC and the courts over the past two years suggest that they believe (incorrectly) that the answer to this question is yes (see Napoli, 2001), a pattern that raises questions about whether thorough and well-rounded policy analysis and decision-making are taking place.

Certainly, the greater integration of economic analysis over the past two decades has coincided with a greater emphasis on deregulation of the media industries in the United States. However, this was not simply because the competitive contours of the media environment became more clear to policymakers (though this was an important factor), but also because many of the regulations that were in place were motivated at least in part by policy principles of a distinctly non-economic character (e.g., diversity, localism, the public interest). When examined through a primarily economic lens, the logic of these regulations proved difficult to understand or justify

Conclusion

This paper represents a first step in what should be a continued exploration of the implications of the increased role of economics in media policymaking. While much more work needs to be done, a number of points can be articulated at this stage that can hopefully be useful in guiding future policymaking and policy analysis.

First, it is important to recognize that inefficiency can be good for media markets. Indeed, inefficiency may very well be <u>essential</u> to media markets. To the extent that media markets serve the political and cultural needs of consumers best when they have access to a diverse array of content and sources, certain redundancies in content provision (assuming that these redundancies emanate from different sources) should be thought of as desirable mechanisms for maximizing the positive externalities that can be generated by media markets – externalities such as a better informed and/or a more culturally sensitive and aware citizenry. Similarly, structuring media markets in ways that fully capitalize on economies of scale also may need to be avoided in some contexts. To the extent, for example, that requiring content to emanate from locally based owners facilitates a media environment more sensitive to local interests and concerns and more conducive to the flow of locally-based political and cultural discourse, then such structures may need to be preserved regardless of the economic benefits of regionally or nationally based ownership structures, or of networking relationships.

Second, there is much we still need to know about the dynamics of media consumption and the appropriate contours of media markets. These issues should be a focal point of future economic analyses. The U.S. Federal Communications Commission in many ways demonstrated its lack of knowledge and expertise in this area in its (up to this point) failed effort[8] to develop an economics-based diversity index that relied, in part, on audience consumption patterns in its calculus.[9] However, what the Commission did do is open the door for such work to become a deservedly more central component of the analytical processes associated with formulating and assessing media regulations and policies. Much more work needs to be done in terms of accurately delineating the parameters of media product markets in ways that account for not only different media technologies, but also different types of content. Economic analysis can make vital contributions in this area.

In sum, there remains more that economics can do to effectively guide media policymaking; however, at the same time we must also recognize the limits of the contributions that economic analysis can make to media policymaking. Ultimately, if we make the mistake of treating and analyzing media markets like other markets, we will suffer from a market failure far more profound and far more damaging than economic tools can effectively capture or correct.

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Figure 1: Product and Geographic Markets for Media Industries.

	PRODUCT MARKET		
	CONTENT		AUDIENCE
GEOGRAPHIC MARKET	UPSTREAM	DOWNSTREAM	
LOCAL	BUYERS: NA	BUYERS: LOCAL AUDIENCES	BUYERS: LOCAL ADVERTISERS
	SELLERS: NA	SELLERS: LOCAL PROGRAMMERS	SELLERS: LOCAL PROGRAMMERS
NATIONAL	BUYERS: LOCAL/ NATIONAL PROGRAMMERS	BUYERS: NATIONAL AUDIENCES	BUYERS: NATIONAL ADVERTISERS
	SELLERS: PROGRAM PRODUCERS	SELLERS: NATIONAL PROGRAMMERS	SELLERS: NATIONAL PROGRAMMERS

Source: Napoli (2001).

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Endnotes

[1] It is important to note that the changing technological environment and the changing of regulatory philosophies are related trends, with the reduction of barriers to entry and the perceived relaxation of traditional "bottlenecks" between content producers and audiences characteristic of the changing technological environment (via developments such as digital transmission, the Internet, etc.) fueling changes in regulatory philosophy that typically emphasize the reduction or elimination of line-of-business restrictions and/or the permission of more inter- and intra-industry mergers and acquisitions.

[2] For an economist who studies creative industries (television, film, music etc.) to himself describe the very industries that he is studying as frivolous (see Caves, 2000) to a certain degree helps explain the criticisms that frequently are leveled against economic analyses of media industries – that such analyses fail to grasp – and account for – the multiple characteristics that make media industries unique and worthy of specialized study and analysis (see Napoli, 1999).

[3] For further discussion of the interaction between the audience and content markets, see Napoli (2003).

[4] It should be noted, virtually of these media markets are relevant, to varying degrees, to media policymakers (see Napoli, 2001).

[5] The new measurement system is also raising diversity concerns, due to possible under-representation of minority viewership. Not surprisingly, industry stakeholders opposed to the local people meter have seized upon the diversity issue and made it a focal point of their objections, in order to better clothe their financial self-interest – and their calls for government regulation – in "public interest" rhetoric (see Napoli, forthcoming).

[6] This office recently was expanded, restructured, and renamed the Office of Strategic Planning and Policy Analysis.

[7] Fowler's perspective is extensively developed in his well-known "marketplace approach" to broadcast regulation (see Fowler & Brenner, 1982).

[8] This effort is described as “failed” only because of the recent rebuke by the U.S. Court of Appeals for the Third Circuit (Prometheus Radio Project v. Federal Communications Commission, 2004). Ideally, the Commission will continue working in this vein to develop an index (or multiple indices) that draws not only upon economics, but upon other relevant disciplines, such as political science, sociology, and communications in order to assess ownership concentration and its consequences, not only for the economic marketplace, but also for the marketplace of ideas.

[9] The FCC’s diversity index modified HHI scores for individual media owners and outlets on the basis of survey data indicating the relative importance of different media outlets as sources of information for audiences (see Federal Communications Commission, 2003).