

BBC CHARTER REVIEW SEMINAR – 22nd July 2004
Funding the BBC

Chair's Opening Remarks

Terry Burns: Good morning everyone and welcome to our second seminar. First of all there's some housekeeping matters for those who weren't here on Tuesday. It's likely to be quite a long and intensive morning, so please feel free to help yourself to the refreshments provided at the side of the room and outside throughout the morning. Secondly, because of the security of the building, it's a government department, if you could please keep your name badges on at all times and not go into other areas of the building without DCMS officials. And if you've got any queries on security, there are people around to help. Fire exits are clearly marked. The loos are signposted outside as well and there are officials around who will answer any other questions. We want these deliberations to be as open and transparent as possible. The BBC have kindly provided cameras in the room, which are providing a live stream of footage via a link on the Charter Review site and there will be a transcript afterwards. This has one important technical issue, which if people would please turn off their mobile phones and blackberries. That means not that they should be put onto silent but they actually have to be turned off, otherwise we get some quite heavy feedback into the microphones, which damage the quality. As I say, today is the second in the series of seminars, which we will be running throughout the autumn. As those of you who were here on Tuesday know, they are trying to provide a forum for an independent panel on the Charter Review to try to make sure that all of the arguments are heard and to provide an opportunity to draw out the key issues and to test the evidence, and the work that we're doing will help to inform and shape the government's thinking as they work towards the Green Paper in the New Year. The members of the independent panel who are here today are Tim Gardham, Alan Budd, Alice Rawsthorn, Sly Bailey and Howard Davies, who will be joining us later. And, in order to give us a full and lively debate on funding, I am delighted we have a number of distinguished guests, who have agreed to join us today – Martin Cave, Barry Cox, David Elstein, who isn't yet here, Andrew Graham and we have got the biographies in your packs, and also I'd like to welcome from the BBC Caroline Thompson and Zarin Patel, who are here today primarily to listen but also to represent the BBC's perspective and to contribute to a wider debate. And in the audience we have representatives from across the broadcasting and media industry, as well as people from a wide variety of interested organisations and we are very fortunate to have some members of the public too, who gave us their views during the consultation period. In order that we can make best use of the time, today's format I'm afraid means that the audience will primarily be in listening mode, however we would very much welcome your contribution either by written comments and questions at the end of some of the sessions today or if you contact the Panel Secretary, Kate Biggs, who is here with your reports and comments. And what I'd like you to do is to use the cards that have been provided in your packs. And if you have any questions that arise from certainly the discussion in the first session, if you would hand them in to one of the people from DCMS and at the beginning of the second session, you know, I will have a look at them and see if we can answer some of those immediately, otherwise we are proposing to have a period when we will look at them towards the end of this morning. Although I must emphasise that the questions should be about the topic today and not wide-ranging questions about the BBC. I mean today we are concentrating on funding and therefore I very much want the discussion to be about funding and not just about general issues to do with the BBC. In this seminar, as I say, we are going to look at the funding of the BBC's core public services and issues to do with the commercial services, and the World Service we will be dealing with separately in seminars in the autumn. And so today we are particularly looking at the issues about those services, which are intended for the domestic audiences. I will just give in a moment a brief summary of what the public said about the licence fee in the DCMS's recent research and consultation findings and then we're going to move on to a broad panel discussion on paying for the BBC and this, I hope, will give the panel an opportunity to draw out some of the advantages and disadvantages of the licence fee and other potential means of funding the BBC. In your packs there are a couple of short papers providing some facts and figures on the current funding arrangement, as well as some details on public service broadcasters in other parts of the world. Once the panel has had an opportunity to have its say, we'll be asking Caroline

and Zarin to respond and comment, although of course they are welcome to participate in the debate at any point. I think the other point I'd like to make at this stage is that today we are focusing on the method of funding rather than the scale of funding. It's intended that the issues about the scale of the BBC's budget should be determined much further along in the process once we have a clearer sense of the BBC's purpose and how it should be delivered and how it should be governed. After the coffee break, we're then going to, although there is not that clear a distinction between these things but we are proposing to then move the discussion on to what might be the likely implications after switchover for the licence fee and how we might support a BBC in a changed media landscape looking out into the future because of course that itself will have some implications for funding during the next period. If I could just start the discussion by offering you a brief synopsis of the key findings from the consultation and research, which are contained in, I think they're in your packs - the booklet *The Review of the BBC's Royal Charter* – what you've said about the BBC, which sets out as well as could possibly be the views that we had, both in terms of those people who wrote in but also in terms of some of the research work and consultation work, broader consultation work that went on. I think the first point I'd make is that my interpretation of this is that the view is that the licence fee was widely considered to be the best or the least worst way to pay for the BBC for the next Charter, although there is some support for other options and that's particularly the case in combination with the licence fee. The public's view seems polarised with many valuing the licence fee as a means to positively differentiate the BBC from other broadcasters and to ensure its independence but there are a vocal minority who believe that the licence is a hypothecated tax as inherently outmoded and unfair. The expectation of choice, particularly in an increasing market channel world, also raised questions about sustainable the fee was, in particular post-digital switchover. And also concerns over the implications of any other funding model such as advertising or subscription on a programme quality and the independence of the BBC also comes out very clearly from that feedback. The public's view of the value for money delivered by the BBC is equivocal, with just under half of the respondents saying it delivered fairly good or very good value for money. I should draw your attention to a typo which there is on page 31 of this report relating to value for money and there's a correction has been added to all of today's delegate packs and the online version of the report has been amended, where a figure which should have been 33% is put in as 43%. It's on page, what did I say? Page 31. In the key findings, where it says 46% saying it delivered fairly good or very good value for money compared to it should say 33% taking the opposite view, in fact it says 43% and I'm sorry for that. Perceptions of value for money do have, are strongly correlated to viewers and listeners' awareness and appreciation of individual services, for example heavy users of the BBC's TV, radio, digital and online services are of course people who are much more likely to feel that they are receiving value for money and of course there is very strong support for the BBC's independence from government and from commercial pressures. The way the licence fee is set and collected does raise issues about fairness, particularly for those on low incomes under issues of efficiency, particularly about using significant public money to chase evaders. Proposals were also put forward on different ways to distribute the licence fee to other broadcasters and production companies and I hope that we will be able to touch on that issue as well during the course of the discussion this morning. But those of you, you know, who have time can look at the section in the document that deals with funding of the BBC and I hope I've summarised it accurately, what are I think the headline points. I'm now going to hand-over to Alan Budd, who will act as the main facilitator in this session and who will outline to us how he wants to organise the next part of the discussion.

Session 1: 'Methods of Funding?' Panel discussion

Alan Budd: Fine, thank you very much indeed, Terry. Well what I hope we'll end this morning by is having a fairly clear set of views about the arguments for and against the various ways in which the BBC could be funded. As Terry said, the level of this funding is not for today an issue, although it's clearly an extremely relevant question. And what I plan to do is as follows: I am going to start immediately the discussion by asking each member of the panel – and I think I will include in that the BBC members – just to say in two minutes, and no more than two minutes, what the headline points are that they would wish to make about each of the main forms of funding, what they want to say if they only had two minutes to say it about the licence fee and alternative methods of funding the BBC. And then we'll go into a

longer series of discussions, taking the various forms of funding one by one and asking the panel to give their views and to answer the points that are usually made about each form of funding. So the licence fee, what are the arguments for and against that, direct funding, after taxation for and against, advertising, sponsorship and subscription. And also we want to move onto discussions, which answer questions including what we learn from overseas of course – that's always a question – but also does there have to be one way of funding the BBC or can there be a mixture? Can we have hybrid funding of the BBC? Now we may or may not get through all that by coffee. I don't think it's a disaster if we don't but, after coffee, what we do want to move onto is the longer term and particularly to answer the following question. People have given their views about various forms of funding but how long, how durable are their answers to those questions? Do they think that those are questions which will always be right or do they think that circumstances might change in the future to suggest that one form of funding becomes less appropriate and other forms of funding become more appropriate? Of course, at this stage one is concerned with the framework for the BBC presumably for a 10 year period. Well do these solutions last 10 years and go on to answer the question and what about after that? So that's really how we are dividing the before and after coffee break. But I'm not going to rigorously say that we don't get on to the longer term until after coffee and we must talk about nothing else after coffee. We'll see how it goes. So, if that makes sense, I'm going to start and I'm going to ask in the order in which people appear on my list. I don't know whether at this preliminary stage the BBC wishes to speak with one voice or two voices?

Caroline Thomson: One.

Alan Budd: One? Okay, that's fine. So we'll do that. So I'm going to start with Martin Cave and ask him for his two minute headline view on ways of funding the BBC.

Martin Cave: I thought the BBC was going first then. By the way, I do love this system of handing up questions. I used to hang out quite a lot in the Soviet Union and that was the standard method there. But the point was if the chair didn't like the questions, he just wouldn't read them out.

Unidentified panellist: I hope you have very difficult questions, then Terry won't read those out.

Martin Cave: Anyway, two minutes, very difficult. I guess the key point for me is that in this Charter period of 10 years we're going to see a fundamental change, which is that as a result of the analogue switch-off we're going to move to a world in which broadcasting becomes, ceases to be a public good as it is at the moment but becomes excludable. This will be available at a modest extra cost, given that we've moved over towards digital transmission. And then it seems to me sensible and natural to move out of the world of public expenditure and taxation as a basis for determining how broadcasting should be provided into the standard world of an industry producing a service where one of the key issues basically is how you recover the fixed costs. I mean we know there are substantial fixed costs in broadcasting. They represent a very high proportion of the costs, just as they do in a whole bunch of other industries such as pharmaceuticals, aircraft production, telecommunications. And so I would see the task of being how to work out a rational system for recovering those costs. Now the licence fee will also, as it seems to me, come under substantial challenge just simply as a result of the fact that in a multi-channel world the BBC's share will diminish and its justification will therefore diminish. The only way that could be avoided would be by a sort of an extension of the BBC's activity *pari passu* with broadcasting as a whole and that, I think, is probably a fairly unthinkable outcome. So what we should be looking for I think in this world is ways of funding broadcasting which have a strong element of consume sovereignty, you know, which is best achieved by people making individual decisions, as they do in the rest of the economy, and also in a way which avoids distortions of competition. And, as I think somebody said, and it isn't obviously a knockdown argument against the BBC but the BBC by its very nature and the nature of its funding does represent a distortion of competitive markets. So I would move towards market-based methods of funding over the period. That deals with, in Ofcom jargon, the consumer. We've also got the other 'c' word hanging around, by which I mean of course citizens dealing with externalities and things of that kind and there

are all sorts of ways in which those needs in my view could be dealt with. And it's also of course pretty obvious, although sometimes neglected, that private interests and public purposes often go very strongly hand in hand. I mean there's no point in putting out a programme absolutely redolent with good public messages if nobody actually bothers to watch it and that obviously means that you have to make sure that it's attractive. So the lesson which I will be drawing from this is that over this Charter period we ought to be looking at ways of winding down the licence fee - the timing of course is interesting - and introducing market instruments. By market instruments I mean alternative forms of finance, such as advertising, subscription and other things. I think there are serious problems with some of those but no doubt those will come out. But my basic message is I don't think the licence fee in the New World is a good way of organising broadcasting.

Alan Budd: Thank you very much indeed. Excellent, Barry Cox.

Barry Cox: Well I'd come from the same position as Martin essentially and I'd just want to add a few things. I mean I love the quote from the Gavyn Davies Committee on which Alan sat, which said if the broadcast market were ever to approach the condition of the book publishing market it would be much more dubious whether the BBC and the licence fee could be justified. We're there in a very crude way. We'd be in a much more sophisticated way there after the digital switchover and obviously more of that later. Therefore in these conditions public intervention has to be appropriate and the licence fee is not appropriate on several counts. Firstly, the way it's raised. We know all the arguments. As the Davies Committee said, it's a very bad form of taxation. The scale of it, the amount raised is far greater than we need, the amount of public money, than we need to service the deficiencies of the market. It's far too much. Thirdly, giving it all to the BBC. Another bad idea whose time has now passed. And finally, it is of course linked to the purchase of television sets. And, as the very interesting document the BBC wrote called Building Public Value pointed out, although it set a rather 15 year timeframe for this, there are going to be devices which deliver programme which are not television sets. So what do we do? Do we extend the licence fee to computer? Playgames? Mobile phones? I don't think so. So those are the main problems with the continuation of the licence fee in the world into which we are going. A subtext is that it's a very bad, it can have very corrupting effects on governance and I mean here actually the way the government operates because the BBC and certain departments of state can enter into a Faustian pact to use licence fee money for purposes for which it is not intended. I'm thinking here of the digital curriculum where there was a long argument overseen by the Department of Education about how this should be brought in and there are lots of commercial operations that were already in that market and wanted to do it but the BBC had £150 million, or whatever the figure was, of money, licence fee money it was prepared to use and the Department of Education cynically because it didn't want to go to the Treasury for it, used that and of course put the BBC in a very dominant position. Now it's not necessarily a bad outcome but it's a bad principle to allow departments of state and the BBC to do this and I think it relates to issues of governance for the BBC, which we aren't talking about today, where I think the governors ought to have a far greater say. They should be both more separate from the BBC and have a far greater say of how the licence fee money is used so that it couldn't be exploited frankly by departments of state that ought to be getting their money from the Treasury. So, in terms of what should replace it, like Martin I think voluntary subscription, pay television, taxation, which will still need public intervention, and advertising. I think we need to get rid of the civilest (?) that taxation is a bad way of funding the BBC. We already use it. £400 million comes directly from taxation, not for the World Service but money given for the over-75 licences, so it's a very sizeable sum of money, Channel 4 would be deeply grateful for that kind of money and it's by taxation. No one says the BBC is less independent than the government because it gets £400 million in that way. Another civilest is advertising. There has been this mantra for 20 years since Peacock that says you can't disrupt the commercial sector by allowing the BBC to take advertising. The commercial sector is totally disrupted. We're there already. The future of ITV and the BBC....sorry ITV and Channel 4, if they rely purely on advertising money they are dead in the long-term, so they need to rethink and I say this - this is a personal view, the Channel 4 Board might not agree with it - but we need to rethink that anyway and as part of that we should stop worrying if the BBC in part takes advertising because we will need free channels, genuinely free channels in the future. And I have various thoughts about how one phases this but I'll come to those later.

Alan Budd: Okay. Thanks very much. Yes, you mentioned something I should have mentioned in my introduction, which is the question of contestability, which we certainly want to talk about before and after coffee, certainly after coffee, the idea that if there is public funding, other television producers should be able to bid for it. Okay, thanks very much. David.

David Elstein: Thank you, Alan. This is maybe poor casting or maybe it's just alphabetical but whatever it is the CCE are pretty much of one mind. And perhaps the easiest thing, especially for people who have ready access on the web to beyond the Charter on www.beyondthecharter.com for free. If you want to buy it of course for £14.99, you can buy it as well but that's the great thing about the free market. The Broadcasting Policy Group came to some fairly simple conclusions. First of all, the licence fee is where we are and it broadly works and I think that's the most important thing to say about it. And abstract considerations should be viewed with proper scepticism. And if what Martin was describing, the process of digital switchover weren't already half-way there, we would probably carry on having the kind of Peacockian argument of 1986, which is in theory subscription is probably superior, in practise you can't do it until N. Well N is getting closer and it does focus the mind. And the first thing that you have to understand about the licence fee is putting aside the social inequity, you know poor and rich pay the same, the blunt instrument – you know homes with 5 TV sets pay the same as homes with 1 TV set – the impact on the court system. You know over 100,000 prosecutions; actually the last figure I saw was 400,000 threatened prosecutions. Incidentally the BBC picks up now the cost of the court process. You know the criminalisation of a very disadvantaged group of people; I suspect very few of whom are represented here today. That is kind of tucked away and it's important but I don't think it's central. The fact that the licence fee is relatively inefficient as well, inefficient to collect. you know well over £300 million a year, simply not to take the money direct from the Treasury when you already take £400 million a year from the Treasury. I mean what's all that about? Independence I am told but we'll come back to that. But I think what we really wanted to unpack was that the licence fee was doing two things. It was funding merit goods and it was funding entertainment. In other words, it was correcting very visible market failure in the shape of high quality news, information, innovative programming, etc. Quite how you measure how much you want to correct is of course an entirely other debate as Terry has said and as Alan has said but it also funds by the way much more substantially straightforward entertainment. Now it is possible in the recesses of the BBC brain to find an argument that says Eastenders is somehow morally superior to Coronation Street. It's also possible for both producers to say that making soaps is a moral act. I am less inclined to go down that route and I am more inclined to say why do we need to fund at all through this crude mechanism, entertainment, when we have already in 5 or 6 years time virtually every household will have the means of choosing whether or not to pay for entertainment. So we concluded that the licence fee was the wrong way to fund entertainment and we also thought it was the wrong way to fund public service by the way, that testable funding was a much more sophisticated instrument, more transparent, more accountable, etc. But in the final analysis what this argument is being driven by – and the Gavyn Davies panel said it themselves – if you didn't believe that there was market failure, you couldn't justify the BBC let alone the licence fee. The problem with these concepts of market failure, public goods etc., etc., is that they fail to unwrap the BBC and licence fee package. We say that broadcasting is a public good because it's non-rivalrous, etc., but broadcasting is an abstract concept. Actual broadcasts, things that people watch are quite different to ones we listen to or these days access on the web but of course the BBC spends a very large amount of money on the web. And in fact charging for those is much more economically efficient than not charging for them, unless what you are trying to do is to put merit goods into an undernourished market, which is a different argument entirely. So you know economic concepts are really only relevant in a market place where there is one provider of one piece of information or one package of goods and the licence fee pays for huge numbers of package of goods and there are virtually no products of the licence fee that are actually consumed at any point in time but they are transmitted by a majority of citizens.

Alan Budd: Thanks very much indeed. Andrew.

Andrew Graham: Very difficult to come at this complete afresh. I suspect Pigou (inaudible) said most of it in 1917. And Gavyn Davies and I wrote about it before he became Chairman of the BBC and before I went on to Channel 4, so I'm probably going to repeat some old things, but just let's touch the following key points. The fundamental reason for the licence fee is because you want an institution that has different purposes from that of the market place. That's the headline. Why do you want an institution that has different purposes from that of the market place? First, there are the market failure arguments, which we obviously need to go to in a good deal more depth. Gavyn and I set these out. Gavyn's tidied them up recently in a (inaudible) lecture and he sets out 8 tests that you would put forward to ask whether there's market failure and he finds that broadcasting comes up on all of these tests as something where you would justify doing something about it. Health and education, and all sorts of other things we typically think as being in the public sector, don't pass all the 8 tests. In addition to that, there are reasons to do with political rights and social capital, which you would add to the market failure points. All of that needs a great deal more spelling out but the critical point is the purpose and the purpose requires two things. One, that it be independent of government and independent of the market and two, that it would be free at the point of use. That then leads to the licence fee. The finding reported in the document, which the Chairman referred to, that people think the licence fee is a hypothecated tax, unfair and outmoded; I am very impressed with the rationality of the British public. They're completely correct. It's hypothecated, it's a tax, it's unfair and it's never been inmoded but that doesn't mean that there's anything else around that's better that will do the job. Taxation on a year-by-year basis from the Treasury absolutely wouldn't deal with the independence point and subscription wouldn't deal with free at the point of use and advertising wouldn't deal with maximising the area under the social demand curve, which is what you're trying to do when you're producing public goods. So no other form of funding meets the criteria. The licence fee is a complete disaster but it's better than anything else.

Alan Budd: Okay, thanks very much indeed. I think James, can we go to you now. Thank you very much.

James Sandbach: Well I'm not going to comment on the principle of the licence fee itself but I think just part of the due process it's fundamental that the consumer issues are addressed – how the licence fees works in interacting with the consumer and some of the issues that haven't been addressed for many, many years now really must be taken on. And I think the first is, I mean I think Michael Grade's entirely right that the BBC should actually lose control of the licence fee setting and collection and have that entire function pass over to an entirely independent body. At the moment there's really I think still too much of a close relationship with the licensing authority and the BBC itself, so. The second really most important point though is that it's simply no longer tenable to have non-payment of the TV licence fee as a criminal offence. The criminal law is really there for things which, acts which either cause other people harm, physical, psychological, emotional harm, or they offend society's values in a very deep and disturbing way. Now I can't see how watching television without a licence fee qualifies on either of those two counts. The argument is that this is the most effective mechanism, it is the most effective mechanism of enforcement is for a crime, a crime to be a criminal kind but that really means it has to be a criminal offence and this is not, this does not stand up as a criminal activity except that it's the state myth (inaudible) of criminal activity and it really must now be a time to look at this issue again so actually the licence is a civil contract. It's got to be treated as a civil contract and enforced as a civil contract and there are mechanisms within the court system to do that. The magistrates don't want to enforce it but there are still, 10 years ago there were 400 women in jail for not paying their TV licence fees and I mean that's just a travesty of justice. Now the sentencing policy has changed but it is still possible in some circumstances and you ask well how do people get themselves into that position? Well if you're on an income of £50 a week or less, it's very easy to get yourself into that position and the CABs, the Citizens Advice Bureaus around the country keep on reporting cases where the TV Licensing Authority are quite simply harassing people. And if the fine is say more than 10% of a client's income that causes problems. And although we have this easy cash entry scheme, that actually only applies to colour TVs. None of those systems apply to black and white TVs. And an awful lot of very low income people have an old black and white set which they use and yet they're still being required to pay over £100 every year to be able to access them. So I mean these kind of issues, yes this is what is

happening. I mean we have several cases where the authorities are saying that the scheme is simply too costly to operate for a few black and white television owners and that was a TV Licensing Authority officer who said that to one of the CABs, to one of our clients. So, you know, these issues are coming up all the time and they do need to be addressed. Obviously the analogue switch-off is one way of moving forward but I think we have to look at really whether the time is right for sort of moving away from an entirely flat rate and possibly looking at introducing specific exemptions for people on specific benefits because I mean there are these different schemes I know but our experience of them, the CABs' experience of them is they don't necessarily work. Analogue switch-off, well I think again there is this problem of guaranteed access for all on low incomes and I think when you look at analogue switch-off those sort of issues need to be addressed as well. So I just really want to put those thoughts forward.

Alan Budd: Okay, thanks very much indeed. And Caroline, are you going to...(inaudible)

Caroline Thomson: Yes, I am. Thanks very much and it's obviously going to be the start of an interesting debate this morning. I think from the BBC's point of view actually we could echo some of what Andrew was saying in that the BBC is the, the BBC believes that the licence fee is in a sense the least worst form of funding. No one is ever going to argue it's perfect for all the reasons that everyone has outlined just now, particularly some of its regressive nature and so on. However, it is a system that has stood the test of time and we think that, if there's to be a debate about alternative systems of funding for the BBC which we welcome and I mean obviously is appropriate and right and proper at the time of Charter Review, then you have to keep the three key principles in mind in determining what other systems of funding would work. And actually Andrew largely enumerated them. We think that a system of funding ought to be universal and ought to allow people to consume the services free at the point of use, that it ought to give us, I think one of the arguments for having a public funding stream for broadcasting is to give a sort of level of stability and long-term commitment against the other systems of funding for broadcasters which vary an awful lot with market conditions. So we think it should have a longevity and provide some long-term security to allow investment if you like against market trends, counter cyclical investment where necessary, and that it ought to be a system that is independent of the market, that allows us to pursue different objectives, put audience needs first rather than commercial revenue or shareholders' interests first, not that either of those are wrong things for other people to do but if we're going to exist, we ought to be existing with different purposes and delivering something else for the nation and obviously as independent as possible of government. And I would add another benefit of the licence fee, which I was quite struck, came out very strongly I thought from the survey that was done, that the licence fee does give the BBC a direct link and an obligation to serve individuals throughout the United Kingdom. Because everyone has to pay it, we feel that we have to serve everyone and it's interesting that that comes out, that sense comes out strongly from the consultation, that we try to do that and that to a certain extent we succeed. We could obviously do better but it is the case that in any one week 93% of the population consumes at least 15 minutes of a BBC service, whether it be radio, television or online, so we're sort of getting there. And the interesting thing I thought from the survey results is also that one of the most common reasons cited for continuation of the licence fee was the sense that the public do understand that this gives them in a sense the right to be shareholders in the BBC. The sentence quoted in here was that the licence fee "gives every household an equal stake in the BBC's future and pride in its success." Now personally I think one of the things for Charter Review is that the BBC has not always been good enough at being accountable to licence fee payers. We ought to be a lot better at it and we ought to develop perhaps more of this concept of shareholders, of membership and so on. But I think it's interesting and important that it's there as an idea and I think it's one of the really valuable things about the licence fee. It is interesting, of course, that the survey also shows that, while 34% support the licence fee, only 10% would support a move to subscription for the BBC in the survey here. So I think that, while there's not overwhelming support for the licence fee, as I would argue there never is for any tax, it's not regarded as being worse than people paying for it themselves, exactly the reverse in fact. There are disadvantages to the licence fee, some of them James has just been talking about. I would simply say on those things that, just to make sure we get the record straight, the black and white licence fee is actually about £40 a year not over £100 but there are currently 3 women in prison for not – and no one is in prison for not paying the

licence fee. People are in prison for not paying the fine and the criminal activity if you like or the point that society feels it needs to make a gesture is about the importance of fines that are imposed by the court being paid. Now, you know, the BBC is really up for discussion about how we can make the licence fee fairer to people, how we can administer it in ways that, I mean anyone who goes to prison is a regret for us and obviously what we want is people to pay the licence fee and we've got rather better at getting that done. But in the end, if you're going to fund a broadcasting system from a source of public funding, there's got to be some sanction in the end, however regrettable it is. So just to summarise, I think that we would support the licence fee but welcome a debate on it and clearly there are, it would be foolish to say – just in answer to Barry and David's points – there are obviously long-term issues about sustainability and so on, which we'll obviously get on to later on.

Alan Budd: Okay, thank you very much indeed. It's always open to other members of the panel to talk at this stage if they want to do so. I think they'll just wave their hands. Yes, Alice is doing so.

Alice Rawsthorn: I have waved. Picking up on the point of purpose of the BBC and Andrew's point that it has a different purpose from the market place, and it strikes me that this really is the central theme in this debate. And if I pick up on what both the Cs said, if I'm understanding you correctly, and do argue otherwise, you were actually arguing from a funding perspective, the BBC needn't necessarily have a different purpose from the market-place because the funding mechanisms that you were advocating – subscription and a hybrid combination of subscription, advertising and sponsorship, would imply that the BBC becomes part of market choice. And then moving back both to Andrew and Caroline, if you do accept that the BBC should have a different purpose from the market-place, I am slightly puzzled by Andrew saying that the only other option in terms of public funding, direct public funding rather than market funding would be funding on an annual basis from government. Isn't there another possibility there that the BBC could be funded directly from taxation and therefore avoiding all the anomalies that are inherent in the licence fee that people have already pointed out but that proper safeguards were put in place to ensure that it wasn't open to annual review or even the usual biannuals' Treasury spending review?

Alan Budd: Can we deal with this – thank you very much indeed, Alice – rather than maybe ask people to answer your questions now, which they clearly want to do, is to make sure that these points are covered in the course of our discussion and, if they're not, wave again. But they are of course extremely important questions. Tim thanks very much.

Tim Gardam: Just picking up on some of the things, which have been said. Although obviously putting the consumer and citizen's point of view first is where I want to start, I don't think it's a total (inaudible) for making these decisions. I think, talking as somebody who has been involved in making broadcasting decisions and making programmes, I think one has to look hard at the influence on the motivation of the programme maker and the programme commissioner. The first division I think in broadcasting is between for-profit and not-for-profit and I think as we move towards a world of limitless channels where the advantage of having a public service licence and right to air, the advantage of analogue spectrum diminishes. So you will see in the commercial world a move from an obsession in ratings, which there is at the moment, to an obsession with margins and I think that's going to be a fundamental shift in commercial television. And so I think the not-for-profit issue is fundamental but beyond that normally I would agree with Barry but when it comes to the idea of the BBC taking advertising, I do worry about that because my experience of Channel 4, where we had that freedom of being not-for-profit was nonetheless that the ratchet of the advertising market towards youth led to the development of a brand which certainly limited the universality of its public service offering. Now it didn't have the same obligation to do that but I think your behaviour as a broadcaster does change if you are calibrating your decisions to advertising revenue and however much you try and insulate institutionally what only in my experience of going through the 2001/2002 recession, you were most certainly aware of what was going on, what was going to maximise the advertising revenue and it I think did make a difference. And similarly, I think the sponsorship, if you look at the rather pathetic version of public service television in America, PBS, their worries about offending sponsors for some of their programmes does lead them to all sorts of neurosis particularly in their current affairs. I think one question that

concerns me most though is this issue of universality and subscription because I think it's very important that the BBC can offer a view of individuals in society, which is beyond a marketised view of the world. I think practically everything you do in any television which is related to getting its funding the market, marketises - if there's such a word - its consumers. You think of them in terms of markets. The BBC doesn't do that and I think any change to that does compromise that sense of civil rights and an individual in the society. And one of the worries I have about subscription is that were the subscription were to be structured in such a way that there were no longer any free-to-air offers in the BBC, particularly in news and current affairs, I feel that that needs to be always there for people to have access to. I think the really big issue that comes out about those are whether these ethics which, these motivations which I'm talking about can survive outside an institution and whether we're saying that there is only one institution that will ever deliver them. And that's where I hope we will get to, is a sense that if you need to have these principles of funding to deliver a certain type of programming, are we in the end saying in the sort of world we're going into there will just be one rate institution for building really out of where all these ideas come and is that a good idea?

Alan Budd: Okay, thanks very much, Tim. Howard, do you want to say anything at this point?

Howard Davies: No, that's fine.

Alan Budd: Okay, well that's all very, very helpful and despite those being slightly more than two minute presentations but I've actually, the first deadline was that this part should be finished by 10 o'clock. Terry very kindly was very brief. Alright, well let's then move on to try to look through some of the points that have been raised? I think we want to look at each form of funding. We have to try to avoid duplication because arguments against one form tend to be arguments in favour of another but we'll try to make sure that we don't keep having the argument time and time again as we go through the forms of funding. But I do want to start with the licence fee and a way in which I would perhaps present Andrew's point, and it was also questioned by Tim, which is as follows: The economists tend to talk about this issue in terms of market failure and so there's going to be some economics for a time, and I apologise to those of you who feel that there shouldn't be any such sort of discussion but I think inevitably there is going to be some and it's particularly useful to have Martin here, who's very much an expert on this matter. But normally economists do recognise in this area two relevant forms of market failure. David referred to them also. One is what's known as the merit good argument, that there are certain things that somebody or other believes there ought to be which the market won't provide. And these are things that again I'm not in any sense intending to mock these, these are things that are good for you. And it's perfectly reasonable in a democracy to provide these things, as I say, even though the public would not pay for them and there are all sorts of examples of merit goods and, as I say, that's a perfectly valid way of using normally taxpayers' money to provide these merit goods. So the BBC is good for you and what the BBC provides is good for you. It's good for us all. The second is the issue of what's known as public goods, which is a good which where the cost of the marginal user is zero. So that if I watch a television programme, this imposes no costs on the producer of that programme or on any other part of society. And therefore, since there is no cost to my activity of watching a television programme, there should be no charge for my activity of watching television programme because, if there is a charge, then I may be discouraged from watching it, whereas if it were free, I would watch it. So there's some loss of consumer utility through this particular nature of products, which have zero marginal cost, and I think that's another argument on which Andrew and indeed Gavyn Davies have tended to rely. But let's say that both those features are correct. Do they imply a) that there should be a single institution called the BBC or something like it which does this, that it's the one that solves these two problems of market failure. Incidentally of course advertiser-financed programmes are free to the users. They don't meet that problem. It does cost me nothing to watch an advertiser-funded television programme, so that that particular problem doesn't arise.

Unidentified panellist: (INAUDIBLE)

Alan Budd: That of course is true but what, no the marginal cost am I watching is zero, which is what matters to economists. So first of all does this require that we do need a

separate institution to solve this problem of market failure? But that's too big a question for us to answer. We're not here to discuss whether or not there should be a BBC but the fact that this is the BBC's role is an important one. And the second is does it imply that the only way to fund it, the least bad way of funding it is the licence fee? Any other way of trying to fund this activity runs up against problems which produce a less desirable outcome. So those are the sorts of questions that I'm interested hearing discussed at this stage of the process and....

Unidentified panellist: (INAUDIBLE)

Alan Budd: I'm going to ask this about the licence fee and the licence fee and market failure. Is the licence fee the solution to the problem of market failure? Then we're going to go on to government funding and then on to advertising and everything else. So actually I'm going to ask Martin to speak first because he's the real expert here.

Martin Cave: No, no, I've been deskilled here a long time ago, as David Kaye said in his interview in the Guardian. Well, I guess the first point to make is that, as I tried to make in my opening remarks, is that there are two conditions for something being a public good. The first is that it has a zero marginal cost for extra consumption. The second is it's non-excludable. Now you know this seems to me absolutely fundamental. Before we get to the analogue switch-off, we've got a very large number of people who are basically unexcludable because the technology doesn't envisage it. Once we get to analogue switch-off, however, we're going to be within easy reach of a system in which everybody will be excludable, that's to say everybody can comparatively easily get access to an additional access system. That doesn't mean that there won't be any free-to-air broadcasting because, as we'll discuss, there's going to be an awful lot of free-to-air broadcasting but, you know, as now there will be some pay broadcasting and that will be excludable. So this introduces, together with advertising, an additional market based method of driving revenue to recover the fixed costs. So I think you know this may be sort of a definitional point primarily but we should abandon the discussion of fixed goods, of public goods, once we're in a digital age. So the question then becomes, as I've suggested, what do you do when you want simultaneously to have efficient pricing and you need to recover a lot of costs? You know this isn't an unusual problem. Let's take magazines, for example. They have a lot of fixed costs and they have marginal costs. They have to break even. Let's take, as I said, people who manufacture aeroplanes. They've got huge first copy costs making the first Air Bus 600 or something. Then you can roll them off the production line at a marginal cost, which might be half the average cost. Or take another industry I know quite well – telecommunications. I mean the marginal cost of a phone call is probably, depending on the time of day, somewhere between zero and 10%, well the average cost of it is. So the issue then becomes it seems to me how in those circumstances do you have a pricing system which manages to combine as far as possible the ability to recover the costs, so you can keep the operation going, and at the same time minimises the exclusion of consumers from it? Now people have been wrestling with this problem for ages. I think what happens in competitive markets is that you devise probably fairly complicated pricing systems, which include bundling and price discrimination. I mean you only have to look at the Sky pricelist to see how you can produce a regime of selling television programmes, which offers an awful lot of services at marginal very low costs but simultaneously manages to capture a very substantial amount of willingness to pay. I'm not, I hasten to say, recommending that as a particularly efficient form of cost recovery because I think it's probably based upon a degree of market dominance, which enables over-recovery of costs, but let's put that to one side. It just illustrates how you can actually set up a system for something like broadcasting which enables you to combine to a reasonable extent efficient pricing and cost recovery because let's consider the alternative. I mean if we propose to public policy that all goods should be sold as marginal cost, then there wouldn't just be a broadcast licence, there would be a telecoms licence and you'd all have to put money into a pot to pay for BT's fixed costs and it would probably be a very large sum. There would be an air travel licence and we'd all have to put money into a pot so that we could charge air travel at marginal cost, which as we know in many cases is very low. So it seems to me to be entirely the wrong question. We're really talking about broadcasting as a taxation problem, a Pigoudian one to revert to the name of the now rather obscure Cambridge economist who wrote about taxes and public goods, whereas what we should be looking at, as it seems to me, is a pricing problem. How can we maintain competition within the industry, meet thereby

consumers' needs, plus a bit of citizenship wallop if you're interested in that as many people are, but do so in a way, which doesn't distil competition. So I think quite honestly that the argument that broadcasting exhibits more market failures than any other thing that you can think of, which has been attributed to Gavyn Davies, you know flounders upon the fact that realistically everything exhibits market failures in the sense that there are very few bits in the economy where all products are sold at marginal cost. You know, the world doesn't work like that. Physics are against it.

Alan Budd: Okay, I'm going to come on to, can I just make a point here, which I think there's a background to a lot of comments here which Tim almost got to it with profit, not-for-profit, but it's not really that. It is consumer sovereignty, not consumer sovereignty. I think Martin, and perhaps others around this table, are naturally assuming that unless there are very good reasons not to do so, you let the consumer decide what he or she wants to watch and the purpose of this exercise is to make sure that this is done in the most efficient way possible and there are only rare exceptions to that general approach. And this is contrasted by a view that, particularly in broadcasting, you don't really want consumer sovereignty. You want a lot of other things instead. Let's call them citizenship. There's something else going on there. I remember at a debate after, at the time of the Peacock Report in which I took part, I think it must have been perhaps at Cambridge, and Hugh Weldon standing up and saying "How we understand broadcasting is that the independent companies give the public what they want and the BBC gives the public what they ought to see." And that was in those days a very clear distinction, and we all understand the historical origins of this distinction. And I would be very interested when people are making their comments to what extent that really is an important part of what they are saying about the BBC and how it should be funded because, you know, it really is saying we don't want consumer sovereignty in this area. Okay, so Andrew, you were jumping up and down in Martin's...

Andrew Graham: Yes. Martin's argument works by focusing on the pure marginal cost point. I mentioned 8 tests that Gavyn and I had suggested, so there are another 7 - positive externalities, increasing returns, information asymmetry, distribution or concerns. Then I mentioned political rights, which he just threw out, didn't even touch at all, and then I mentioned social capital. So there are quite a number of other reasons and I suspect they do, to be quite honest, jump across to exactly what Alan said, that there is a difference. And Alice put her finger on it precisely. She said "Isn't it the case that the two C's - Cox and Cave - are really saying that we don't need a licence fee because we don't want a BBC which is provided in some way other than through the market. That's the core point. So we'd better go back to some of these core questions. Now, as to whether you know this Cambridge remark, you know the BBC gives you what you ought to have, it sounds mindbogglingly paternalistic and very unmodern and we've got to get rid of it. That's all done and dealt with. Well let's pause a minute because the rather nice little phrase that I think it was Alan or Terry who said this, talking about, Alan said. There are these things called merit goods and he then said "It's a perfectly good idea that you might want to have some things that are good for you in a democracy", just in a democracy, on the side. Now you might think that part of in a democratic system things are allocated in two fundamentally different ways. They are allocated through the market place, in which one person's pound is as good as everybody else's pound, assuming perfect competition and all those incredibly horrendous assumptions, which Martin and Barry are implicitly assuming, and there's another part of the process in which one person's vote is as good as any other person's vote. And these are two very different principles of allocation and the democratic system ought to accommodate both of them. And if we have our broadcasting only provided by through the market place, we're missing something. And I want to hear if I can - a bit of a deviation, I think it's an extremely important deviation - there's a tendency these days to think that the only ways that we can find out whether anything is valuable is by asking people and then adding up what they say and this is what Ofcom has just recently done, sent out a big questionnaire to everybody saying 'Did you value the BBC?' Now I have an enormous trust in people to get the answers to questions right but after they've thought about it for a bit and after they've debated it for a bit and I'm not at all sure that it makes sense to ask people whether they value the BBC without them thinking well hold on a minute, do we realise the BBC is part of the democratic system? Do we care about democracy? I don't know. What's democracy worth? There is an economist, Albert Hirshman, in a book called Shifting Involvements, who pointed out the things we least

know how to value are the things we take for granted. He gave us an example – glass in windows. Most of us haven't lived through a winter without it. I bet that almost nobody in this room has lived in a world that doesn't provide a democracy. We don't know how to value it and indeed we don't know how much it's valued to each other. We couldn't buy democracy in the supermarket. We need something that's separate from that and this is a little bit bigger than just telling you what you ought to have if it's not a least bit paternalistic.

Terry Burns: Andrew, although today you know I don't want to get into...

Andrew Graham: Sure, okay, but you can't quite avoid it.

Terry Burns: It is of scale though and about the BBC but do your, do these arguments about the licence fee, do they apply to the whole of the kind of output that we have from the BBC today or do they particularly apply to certain parts of it and does your approach, I mean I don't want to get us into an issue of scale but it seems to me that one inevitably gets drawn into this if you're presenting arguments to do with democracy and some of these wider cases as to whether you want to stretch these arguments to cover the whole of the output that we've seen today from the BBC or whether it applies to some specific subset..

Alan Budd: Howard's trying to get in.

Howard: Sorry, I'm quite happy to have your answer to that question and I'd like to follow up on it.

Alan Budd: Okay.

Andrew Graham: Well I don't think these arguments are very genre specific. I think that we understand the society we live in through comedy, through entertainment, through soaps. It isn't just a question of impartial news and it isn't just a question of Question Time. The democratic process is filled out in all sorts of ways and the social capital within which we exist, the kind of company you keep, as a phrase that I used, is embedded in all sorts of programmes. So I don't think there's anything wrong with the BBC in putting out programmes that people watch. You know as an economist I don't want to give lectures in Oxford that nobody comes to but I'm not driven in giving the lecture by trying to maximise the number of people who come and I wouldn't put on a programme, a seminar series in my university, which was so to speak promoting the values of creationism. I wouldn't stop a junior common room from inviting somebody to talk about it. That's free speech. But I wouldn't take equally seriously a view that I thought for which there was no evidence. I have a set of other values but I also want to reach people.

Sly Bailey: And does your argument apply to other forms of media then? Why is it just, or is it just broadcasting?

Andrew Graham: I think broadcasting is extraordinarily pervasive and we have somehow managed to create a system of broadcasting in this country which, having got it, having generated this ecology we would be foolish to throw it away. It would be incredibly difficult now to generate the same kind of situation in the news media and the economics of the news media are rather different, less pervasive, pretty pervasive but not as pervasive and in some sense, given that we've got a broadcasting and radio and television world which sits alongside our news world, we don't have to worry quite so much about the news world, the printed news world.

Alan Budd: Howard wants to make a point.

Howard Davies: Yes, it's building on what you said. Chairman, you said we weren't allowed to talk about the size of the licence fee. I think that's probably your Treasury ancestry here. I don't see why we shouldn't actually because I think it is relevant because I think that some of Martin's arguments are – and economists like to think about this in matters of principle – but the poll tax exercise did show us that there was a point beyond which a regressive tax, even if you had some other arguments for it, just became unacceptable, whereas below a certain

point it was just about tolerable if you like. Now the question of how far this applies in the BBC though I think is not just a question of the number of the licence fee but it is a question of this scale and scope of what you're funding with it. Now if we go back to the seminar on Tuesday, the BBC has in a sense presented us helpfully with an answer to that question because it has set out a public value definition and indeed has set out a procedure which is going to operate in future in a transparent way, which will involve licences given, and they will have to meet some version I suppose of Andrew's tests and Gavyn's test or constructed in a slightly different way. And it is envisaged within that system that a proposal for a service licence from a channel, or whatever it might be, might fail. It's explicitly said it might fail and the governors would say no, that doesn't meet our tests. It seems to me in principle that should then mean that that money or that bid should not be, that money should not be spent and therefore I wonder if it's implied in this by the governors that that means you'd in some sense give that back, that the licence fee would then fall by that amount because BBC 1 or Radio 1 or whatever had failed a public value test. And it seems to me there's then an important linkage between what we're talking about today and that because if the system is simply oh well we'll have another go and see if we can find another way of spending this 200 million quid, you know that doesn't seem to me to be a very good process. So there must be it seems to me some linkage between the public value definition and the licence fee if you're having a, well but I think that actually this would apply even if you had some other form of quasi hypothecated direct taxation, the same arguments would apply, there must be a linkage. And it's not clear to me from the BBC's current formulation whether they have really thought that through or how they envisage that linkage between meeting public value tests and funding would operate.

Alan Budd: Do you a quick answer to that question, Caroline?

Caroline Thomson: To be absolutely honest I'm not sure I do have a quick answer and I think Howard may be right to put his finger on a very interesting issue about, I mean I would say that the public value test is intended to be applied to news services and then to reviews of existing services, so were BBC 1 to fail it you would, I mean my supposition is the answer would be you would reform BBC 1, not hand the money back. I think there's a very issue you made about news services and to be honest we haven't thought that through, no.

Alan Budd: Okay.

Caroline Thomson: And we will take it away.

Alan Budd: Right. I am very conscious that we mustn't slip back into Tuesday's discussion, which I wasn't at, about the, and whatever we do we're going to sit here and discuss the licence fee until you're sick and tired of hearing about it and we're going to do our job. Barry?

Barry Cox: I mean it has focused quite rightly, I think the heart of it is the institutional value of the BBC as such and the job therefore and justification of the licence fee on the current scale to do that. There are various points. David's right, most of what the BBC produces, it's very good or it's good anyway. A better market would do it. And Tim's argument, his *cri de Coeur* about what happened at Channel 4 is of course correct. That is what happened but it's happening at the BBC even though it's got the licence fee. Greg Dyke was right. If you are in the business of reaching a large number of people, you behave as the market dictates. You make the programmes that the market wants even though you aren't funded by it and that is what is happening. Why are there all the complaints about the quality of the BBC? Because a considerable section of the population sees that and doesn't like it. Well I sympathise but that is inevitable in a system as we have and it goes to the heart of what is, you know if there is going to be public funding for the BBC, what should it do? And regrettably – I don't have the (inaudible) by the way – you end up with the ghetto BBC doing purely merit good arguments. I wouldn't want that because actually I think the BBC is a wonderful maker of programmes and a broadcaster. I love what it does but I want to pay for it directly. That way I think I've got long term guarantee, your durability point, that it will still be there doing all these things, many of which other people wouldn't dare do for commercial or other reasons. But what I loved about Building Public Value was the way the BBC said it regretted the fact that something like two-thirds of us would pay more than we do already to get 90% of its services. Bloody wonderful

result. You know that is a great result for voluntary subscription. And it's this concern that somehow there is this mystical merit in the licence fee and frankly it doesn't help the democratic arguments. There are other ways of dealing with those which we will doubtless come to. The other one is universality, which Caroline raised and is also part of this mantra. Universality is very important in one respect that the remote parts of the country get the broadcasting infrastructure and the universal service obligation, which is going to be met in digital. They're going to build the 1150 transmitters. The BBC will bear two-thirds of the cost of that and ITN and Channel 4 between them one-third. That is a public service obligation of a very important kind because there is no commercial reason for building out that infrastructure but importantly it delivers not only broadcasting, which could arguably be delivered in a cheaper and more efficient way by satellite, but it delivers an infrastructure of lasting towers which do other things, which keep the emergency services going and which in future would probably deliver a whole load of government public service, e-government services. And that's a very narrow and particular justification, rather similar to rural broadband, and there is no doubt at all in my mind that some kind of taxation should do that. That is a proper social policy objective and the BBC quite rightly wants to do that but that is it. It is then available to people. It doesn't mean that you as it were get the programmes for free after that unless they are advertised and funded as we have pointed out. So the universality point needs to be focused down on the real point of universality, of overcoming geographic disadvantage and that is a real one.

Alan Budd: David? He's been waiting and then to Caroline.

David Elstein: I just wanted to reinforce that point. Universality of provision is true of nearly all broadcast services. Universality of consumption is not true of any of them and universality of payment is only true of the BBC because it's a forced payment not a voluntary payment but actually the principle is the same. Everything that you buy off a subscription is free at the point of use once you pay the subscription. Everything you view on television is free at the point of use but only after you have paid your licence fee. If you don't pay your licence fee, you're stealing. So it may be free but it's theft. The fact that it's an annual involuntary payment and that indeed in paying it you not only get access to BBC programmes but loads of things the BBC doesn't do, which you are not allowed legally to access without paying it. It doesn't differentiate it in principle from a voluntary subscription. The involuntariness of it is for me not a moral virtue. The issue of consumer choice is terribly important. What the licence fee pre-empts is any ability to differentiate between the multiple offerings of the BBC by the consumer. It's an extremely crude mechanism to wrap up 6 TV channels, 7 – well half a dozen, 8 TV channels if we include Parliament, sorry – a lot of national radio stations, etc., etc. In any sensibly organised consumer-driven process, people would be allowed to choose between how many of those BBC services they wanted to watch. And indeed the illustrious Gavyn Davies Panel came to exactly this conclusion in 1999 when they recommended that the BBC's new digital channel, what we now call BBC 3, BBC 4, etc. should be paid for separately by those who wanted them not by the generality of licence fee payers and that seems so overwhelmingly right and just that not only did the Davies Panel accept it but the BBC accepted it as right and proper. I still treasure the article that Will Wyatt, then Chief Executive of BBC Broadcast, wrote in support of this principle, which is those who get it should be the ones who pay for it. And you know to this day 45% of the population are paying for digital TV services they cannot receive. There's a substantial net transfer, given that these services cost £300 million a year, effectively there's a bunch of people, the have-nots, who are subsidising to the tune of 140-something million pounds a year the haves. That can't be right. And this portmanteau version of BBC is thoroughly anti-consumer. It's anti-choice and it's anti-accountability. It's a way of avoiding the issue of actually what should I be providing? And what Howard has raised, which is you know surrogate methods of deciding what we should do and how we should do it, it's dead easy to do in the Martin Cave version of consumer choice when you've got a digital box, and you can't have analogue switch-off without everyone having the digital connection, and you just do it. Why we continue to wrack our brains to find justifications to something invented in 1922 because there was no alternative absolutely defeats me. It seems not just good for the consumer and good for society, good for the BBC as well. As Barry just said, the fact that two-thirds of people would willingly pay much more for the BBC than they do, something by the way we've known since 1988 when viewers' willingness to pay – sorry, 1990, the research was done in 1988 and

1989 at the London Business School – you know exactly the same outcomes. The only people who benefited from that were Rupert Murdoch and Sky, who worked out that there was massive willingness to pay for broadcast products over and above what people pay for the licence fee and out they went and made their billions. And the fact that 6 million people, according to Gavyn Davies, or 6 million households feel that their licence fee is poor value and would rather not pay it somehow is lost in the wash. We seem to think that in a democratic society it's right to make those 6 million people pay for what they don't want in order to subsidise the 18 million households who think it's worth more than they actually pay. I mean it's weird that we're doing this.

Alan Budd: Okay, but we have to, because we're going to have to move on to other methods of funding. Let me just make sure that I've ticked the homework we should have done. We've probably had enough argument or discussion for the moment about the public market failure type of defence for the licence. What about the argument that this is the way of preserving the BBC's independence? Does anyone want to speak, the important thing about the licence is it comes in and compared with for example taxation or other means of funding, which we are coming onto. This is the licence fee that gives the BBC its independence. Does anyone want to talk briefly on this? Andrew.

Andrew Graham: I'll be sort of brief and calm about that. It was the question that Alice asked. I think it was a very good question, the variety of possibilities. It could be funded annually and I think one can probably see that at that end of the spectrum then it would really be in the political market place all the time. It's very difficult to see the BBC being independent of government in that sort of process. Maybe there could be some longer term settlement, a two or three year time horizon, a four year time horizon. I mean there are people here with intense experience of the Treasury. I wouldn't wish to challenge them but I would guess governments find it incredibly difficult in the Comprehensive Spending Review to commit themselves to particular items of expenditure three or four or five years ahead. They normally only commit them – I'm not up-to-date on these things but they normally only commit themselves to the actual spending plans about a year or so ahead, although the broad magnitude – Terry and Alan can fill this all in for us and update us but I would guess that the Treasury would be pretty reluctant to give the BBC any cast iron fixed sum over a four or five year period and we'll hear that one way or the other. But even if that, even if the Treasury would do that, I think there's a slightly different problem which is that we said at the beginning that the licence fee was a hypothecated tax. Now in general economists are extremely opposed to hypothecated tax because you don't normally slosh money around and we're all fudging, but actually the fact that it's hypothecated persuades people most of the time it's not unreasonable to pay it. They think it's quite good value. The moment it was just being funded out of general television, general taxation, it's very hard to see – and I think in a way this is funny style, I mean I'm speaking in David Elstein's style on this side – but it's very hard to see, you know you can fund another hospital or some nurses or a few more programmes on a soap? You know the nurses are going to get it aren't they? But that's not what people are paying the licence fee and getting a very good value for their licence fee and they know when they pay their licence fee they get their soaps and all these other things as well. It's incredibly cheap. So, on balance, I think the licence fee is better than anything coming from the Treasury over one year. For sure...(inaudible)

Alan Budd: Can I just say, I (inaudible) the issue when people are talking about independence, they mean independence from political pressures, that what we want is an independent broadcaster and that's what the licence fee gives you. I think you're making a rather different point.

Andrew Graham: Well if I'm going to go cap in hand to the Treasury once a year, that's what I understood by independence from political pressures. Am I missing something?

David Elstein: I think most people would conceive that all other things being equal, the licence fee is the best version of delivering political independence for the BBC, better than any other, but all things unfortunately aren't equal. Clearly if the licence fee were 50 quid and the cost of collection were 30% of that, you would say well why are we doing this? Indeed that's why the radio licence fee disappeared. It was no longer economic to separate it or keep

it separate. If the price of the BBC's independence is that the licence fee has to be 350 quid, then a lot of people would say "Hang on a minute, I'd rather have a less independent BBC." So you do have to apply an economic test to the worst of the mechanism as against the relative independence that goes with it. And I think it's important to recognise that, you know, you can put substitutes and surrogates in which are economically more efficient. The question is would they stand the test of time the way the licence fee on the whole has, although the BBC has often been subject to all kinds of political pressures, which it has to come to because of the licence fee. You know I've been in the room where the Secretary of State has threatened the BBC governors you will never get another increase in the licence fee until you change your reporting of Northern Ireland. Roy Mason, you know (inaudible).

Caroline Thomson: But we didn't change it. But we didn't change.

David Elstein: Okay, alright.

Caroline Thomson: Politicians threaten. The question is not that. The question is what action you take as a result.

Alan Budd: I do think that it can't be the only criteria. It's important. It's something we have to...

David Elstein: No, we're just dealing there with this issue.

Alan Budd: We're trying to deal with the arguments that are put forward.

Howard Davies: I just think that this independence point to my mind can't be an absolute question. There are all kinds of different structures in the public sector of maintaining independence. The BBC has in a way an unusual one. It has its own independent source of funding but of course the governors are all appointed directly by politicians without any intermediate appointment mechanism, which is also an interesting question. In the case of the judicial system, the judicial system is paid for out of general taxation. Now after Hutton, the BBC may be slightly ambiguous about whether it believes in a judicial system is wholly independent of government but let's assume for the sake of argument that in the normal way it is and yet it is funded directly out of central taxation. So I don't find this to be a black and white yes/no question.

Alan Budd: Okay.

Barry Cox: And just what's relevant, all the cultural museums, galleries, they're all...

Alan Budd: Absolutely. Caroline and then Alice.

Caroline Thomson: Actually perhaps this may be somewhat to your surprise but I mean I think Howard's right. I think the licence fee is preferable to direct government funding because direct government funding would be perceived as being considerably closer, a considerably closer relationship. But I mean I used to be the Deputy Managing Director of the World Service for some time, which is of course directly funded, and you cannot argue that it's affected actually the news coverage. And of course our job is to resist pressures however we're funded. But what I did experience at the World Service, what I would say about the World Service as a parallel is that firstly of course it's not principally reporting domestic politics and therefore the likelihood of pressure is less because you haven't got the Today programme every morning hauling government ministers over the coals, as is its proper job. But also my experience was that, however much you were supposed to have a 3-year funding settlement, this was vulnerable and indeed in my period there the Conservative government did break into that funding and cut our funding significantly and substantially because of other pressures on public spending. So I would be sceptical about promises that somehow we could uniquely amongst all public service institutions get a 5-year guarantee out of (inaudible).

Alan Budd: Fine. Alice?

Alice Rawsthorn: I'd like to ask Caroline about her point about the emotional bond that the BBC feels the licence fee forges between the public and the BBC. Personally, and this may make me sound very skinflintish, I generally feel cheerful about the BBC, I feel pretty grumpy about it when the direct debit comes in for my licence fee and I suspect this is a common feeling and that's certainly borne out in the research. So I was slightly puzzled that you felt that payment of the licence fee made people feel more positive towards the BBC and I wondered whether you'd done any research to study whether actually a shift to payment by general taxation would change that? And secondly, why wouldn't a shift to payment or funding by general taxation or why would it affect the notion of the public ownership of the BBC? The public generally feels that they do own the judicial system; they own museums in the cultural world, street lighting, parks, all these other areas of public provision. Why does paying the licence fee forge a different kind of emotional relationship with the public?

Caroline Thomson: Yes, I didn't mean to imply that paying the licence fee meant everyone felt sort of warm and cuddly about everything we did. I think actually probably rather the reverse. I think, and indeed I would hope, that a sense of ownership makes people more critical and would make them question us more and want to be sure that they get value for money and so on and, if they feel a bit grumpy, to let us know. And I think we've not been very good at that up till now and was one of the things we need to get better. I was quoting the research here which actually to be honest, I mean I've always thought that paying the licence fee, it works very, very powerfully as a mechanism and just to pick up the one point I was going to pick up from Barry earlier where he said we had to respond to the market as much as anyone else, I just don't think that's true. I think the point Tim is making is when you're a commercial broadcaster, when you're funded – not that Channel 4 is a commercial broadcaster – but when you're funded by commercial, by advertising revenues, actually the market drives you to certain sectors of the audience because they are the valuable ones. And actually the thing about the BBC is the funding mechanism does have an impact but it drives us to serve everyone and that's a very important principle and indeed we, you know, by and large succeed. As I say, 95% of the population consumes us every week. And so I think there's that point but I think that the research that was in here, I did imply that people who support the licence fee do it partly because it gives them a sense of ownership to it and I think you're bound to get a much stronger link in that with the payment of a direct tax and you're bound to get the stronger pluses and the negatives actually from that. If they think we're doing badly, then you are through some source of direct government grant. I mean I don't, as I say, you know I think the arguments against direct government grant, you know, there are arguments on both sides. Clearly it's more efficient in terms of collection cost. There's no doubt about that. Clearly it's less regressive. I mean you're funding it from something which is means tested. Those would be significant benefits. I just think there are costs associated with it as well.

Terry Burns: Obviously the benefits of the cost of collection, there are benefits in terms of it being progressive rather than in a sense regressive and, you know, many of the issues that have been raised about people cross-subsidising may be less severe under that means but the normal method of funding programmes – and indeed government does fund programmes, museums, parks, etc. – but the issue of political independence surely at this point does become quite a big issue. I mean a 3-year, even if it is a 3-year rolling programme, dealing with something as huge as the domestic television market would be very difficult to take out of the political framework, particularly when we do have the inevitable tensions with government. You know one government can't commit the next government to any level of spending and the Treasury is enormously unwilling to give anybody a top slice of taxation because there are lots of other people who will make similar demands to have their guaranteed level of (inaudible)

David Elstein: But one of the reasons why that's a problem is because we're trying to fund two different things from the same mechanism. If all we were funding was merit goods, it would be a lot easier and simpler argument and the point that Andrew is making about choosing between nurses and Eastenders would be that much harder if you were choosing between nurses and Panorama and you'd get a more balanced argument. Because the BBC insists on wrapping entertainment along with merit goods, it then forces you into a situation where you end up saying "Well actually it's £3 million a year. We can't leave that to the

vagaries of the economic cycle or indeed the political party in power.” So you know the argument is being driven by a non (inaudible)

Terry Burns: Okay but my worry about independence would be, in news and current affairs would actually be the point at which this tension was at its greatest. I mean it is in terms of news and current affairs that there is the strongest case for public funding and yet this is the point at which the issue of independence from government becomes most striking. And one of the interesting things of a lot of this research that is being done is how concerned the public are about political involvement in things to do, decisions to do with the BBC.

Barry Cox: There are other mechanisms than taxation for doing that particular job. I mean Martin....

Terry Burns: I'm just referring, relating you to this issue about independence.

Barry Cox: No, no. Yes but I'm trying to answer that point. Martin, to his shame or credit, invented spectrum charging. Now it is perfectly possible to give a not-for-profit organisation, Channel 4 and the BBC, the benefit, a negative one, of not being charged for spectrum. The kinds of prices that are being quoted for analogue spectrum would pay for the infrastructure and the news and current affairs. So you don't have to have a direct (inaudible). The regulator can simply say "We are not charging you. It's a long-term guarantee. You are not going to be spending £90 million in the case of the BBC, possibly £180 million that your competitors are having to pay for the equivalent use of spectrum. So you get round it that way.

Alan Budd: Okay. I think we're going to have to move on but I was going to say specifically that we mustn't move on from the licence before we feel that we have dealt with the points, source points that James was making about the licence fee and criminalisation and all that. Do you want to say anything or shall I ask (inaudible).

James Sandbach: Well there's a couple of things really. I think one of the issues with independence is that as long as some enforcement arrangements are located within the criminal law sphere and the criminal justice system, that doesn't actually from the consumer's point of view and how they see public power and authority give a very, very good perception of the BBC's independence. I think a second element to independence is that, you know the BBC has done a fantastic job in the sense of using its programme making to advance certain social justice type of issues and yet you have this paradox that the funding system itself has this regressive element to it. And so that regressive element again appears to undermine the independence of taking, of looking at public broadcasting within its social context because if you look at broadcasting within a social context, I think what you have is in deprived communities there is no other affordable form often of entertainment, particularly in deprived council estates where you have single parents bringing up large numbers of children. Obviously, how do you control the children? Well television is one way. And there's a whole social context there that the funding policy needs to be sensitive to.

Alan Budd: Okay, thank you very much. Do you want to make a quick answer to the question of the sort of points that James was making in his introduction?

Zarin Patel: I would make a couple of points if I may. Can I just explode the myth that you get a criminal record for evasion. You don't. It is not a reportable offence. That needs to be quite clearly stated and there are only 20 custodial sentences in the last year for which we have figures, which has come down substantially. Any system of collection, wherever it is, I think needs a credible deterrent, a sanction if you like. In countries, for example Japan, Italy and Ireland, where there is no prosecution or very little, evasion rates run at something between 18 and 24% and collection costs somewhere between 20 and 25%. That's high. In countries where there is a credible sanction, for example the UK, Germany, Denmark, evasion rates are low. So in a way it's one thing to say. Lord Justice Old in 2000 looked at various different ways of applying a deterrent and some of the things that were working on the Home Office with for example a fixed penalty notice like driving offences or a conditional caution so you don't have to appear in court, are things that we want to work with government on. I think the thing is worth exploring now. The time is right. Other issues – people have this

perception that the courts are absolutely clogged up with TV licensing cases, well work was done very recently with the Home Office which shows that whilst our cases account for 12% (inaudible) they account for about 1 to 3% of time taken. So I think that's something that we should bare in mind. Whatever we come up with, we need a credible deterrent that is cost effective to operate and that isn't unduly draconian for people.

Alan Budd: Right okay. Thank you very much. Now I'm going to define us as having discussed the licence fee and direct funding because we talked quite a lot about that. And I think my ambition is at least before coffee we should discuss advertising as a source of funding and that's not a bad thing to do because it means that the discussion about subscription can be wrapped in to the discussion about the future and technical change and the analogue switch-off and all that. So let's have a bit of discussion about whether or not advertising is a suitable means of funding all or part of the BBC's output and of course it's common ground that the sort of programme you make, if yourself the question how shall we pay for this programme through the advertising revenue that we will get from selling it to advertisers because of the consumers, is different from the sort of programme you will make if that's not your consideration. That of course is common ground. The question is how serious an issue is this and to what extent is it a problem as far as the mix of programmes is concerned? Now maybe I'll go back to David on advertising, start with you.

David Elstein: Well the first thing to remember is that the BBC has been in receipt of advertising revenue for a very long time, almost from its inception. The Radio Times was a major source of BBC revenue, partly cover price, partly advertising. For 30 years it was at the roughly 10% total value. UK TV, which is half owned by the BBC, is funded by a mixture of subscription or advertising. The BBC has not descended into purgatory, let alone hell, as a result of receiving that income. So I don't think there's anything that is morally worrying about the BBC in due course taking advertising beyond the pay services in the UK TV market place. I don't think it's actually necessary and you see an interesting version of this debate in the radio industry. There are some commercial radio operators – hands up, I'm Chairman of the Commercial Radio Company Association – there are some commercial radio operators who would welcome Radios 1 and 2 being funded by advertising because they think it would expand the radio advertising market against the rest of display advertising and would be good for everyone because advertisers would get more used to using radio and they, the commercial operators, would be no worse off in terms of audience share but they might be better off in terms of prevalence of the media. Others say this would be a disaster for us because the BBC would swamp us. There's a limited advertising pool and that was certainly the conclusion that Peacock came to in terms of TV, advised by Professor Alan Budd amongst others, that the elasticity of demand was not directly a function of supply. In other words you could double the supply of advertising, you wouldn't double the supply of revenue. Now, although that's true, I've not seen any economic side to really challenge that, I think it's had a semi-challenge to it at one point but broadly that's the case. I'm not sure we should worry that much about that. I mean, so what, in a sense? So ITV would have to work harder and become efficient. Golly gosh, that would really shake them up. So the £200 million a year of wasted money inside ITV would actually have to be squeezed out because its revenues had gone down under competition. What are the benefits for manufacturing as a whole of having realistic advertising rates but of course at long last they have access to the whole of the consumer market place in terms of radio and television and not just half of it? So, we shouldn't be utterly purists and say "Oh gosh, we wouldn't have Wife Swap on Channel 4 if the BBC could take advertising and society would, you know, disappear down the plug-hole in the process." These are relative issues. Equally, it's perfectly possible to imagine a commercially-funded BBC, i.e. subscription-funded, which chooses not to take ads. HBO takes no ads. The Disney Channel takes no ads, on principle because they don't want to be driven by an advertiser agenda. If that's what the BBC wants to do in the digital future, fine, no problem.

Alan Budd: Okay, yes. Can I make sure that we are distinguishing here, as David has, between two arguments that are normally used about advertising and the BBC. One is the effects it would have on BBC content and the sort of programmes it makes and the second is the effect it would have on the revenues of the other independent, on ITV.

Barry Cox: To do the first one, I mean I think the way that, I think a) it is important that the BBC does have an advertising funded service of some kind in the future because that is the only way a lot of people will get programmes, you know a significant minority may never get the programmes if they either don't want or are unable to pay. And there is a value in that but you have to take the commissioning and motivation process because those programmes will be ones that a lot of them, that other people had already paid for to see first. So the motivation for making a programme that Tim was going on about will be more complicated. It would not just be to meet the demands of the advertiser because one would not want to see a BBC, and were I running the BBC now, that would not be a strategic aim. Advertising would have a secondary value to me and therefore it would not affect the programme commissioning in the way that Tim is talking about.

Terry Burns: When you say affecting, it's not because it's being done for the benefit of the advertiser, it's because you want a particular type of audience that the advertiser will value.

Barry Cox: It's extracting maximum value for the product. You've spent all this money on a programme. You know there are various ways of getting the revenue out of it and one of them is putting it on an advertising channel which indeed they do through Discovery and, you know, the UK TV operation now. So it is, the motivation for making it is not contaminated by the fact it will end up on an advertising channel.

Alan Budd: Well one wouldn't use the word contaminated but I mean to me...

Barry Cox: Well the suggestion is.

Alan Budd: Advertisers want a large audience who are watching. That is the perfect audience. What matters is they're watching. How much they're enjoying what they're watching is not an advertiser's consideration as long as they're watching. This to me has always been the interesting aspect of advertising, that they're watching. And what is excluded is programmes with a smaller audience who really want to watch that programme and advertising doesn't normally meet that particular need that Martin has...

Martin Cave: Well I agree with you entirely. You know it's a question of horses for courses. If you are in the market place, as we see in existing media, there are some free titles and then there are some where you have to pay and you know part of the art of being a successful business executive in that area is to figure out what the proportions are in which you are going to generate the revenue to meet my famous fixed costs. But in just going back to advertising as a procedure for generating revenue, you said earlier that it was zero marginal cost. I must confess I have to depart from that because I think watching advertising is really a pain. How much of a pain it is depends upon whether it's 6 minutes or 7 minutes, as in the UK, or 15 minutes as it is on some US channels. So you know it's not a costless, it's not a deus ex machina that's going to rescue the BBC because there is that quite serious problem. And it also, as you've been suggesting, does have some distorted elements in terms of programme selection, you know the commissioning decisions that Tim's been talking about. My belief is that in the brave new world advertising channels are going to be of two kinds. There are going to be sort of general entertainment channels, my brave new world and the digital world, there are going to be live audience general entertainment channels – a bit like Channel 3 or ITV – and there are going to be specialised channels which are run on a shoestring for people who are interested in fishing, you know, and stuff like that. So those two things will coexist. But yes, the key point is that the general entertainment channels, even though in an ideal world they would only be watched by yuppies in the south of England, they will in fact be available to older folk like myself in the West Midlands and so we will get the benefit of them as well.

Martin Cave: Can I just make a point, can I just make a firm point about the capacity of the advertising market because I think that's absolutely fundamental. You referred to the results that came out at the time of Peacock, which suggested that if you have a lot of advertising on the BBC then total revenue would actually go down, so there would be a smaller pot to divide between the existing advertisers, channels and the BBC. Well recently, well 10 years ago and more recently as well, the data had been re-Hendryfied, which is a way of saying they'd been

subject to minute analysis by Professor David Hendry, one of Alan's colleagues at Oxford University, and he has come up with rather different and more encouraging results. And indeed the BBC Paper quotes some estimates by Steve Davis of the University of East Anglia that the price of advertising demand is actually in the range of two, which means basically that if you increase advertising by say 20%, you will increase revenue by something like 10%. So there will be the possibility of expanding the advertising pot. So I think that's an important point. And the other important point is how much extra advertising dough is going to emerge over the next 10 years? The estimates which I've seen suggest that it might be between now and 2014 something of the order of £1 billion or more of extra money which would be available and that obviously creates a very substantial pot for new advertisers supporting channels. So I am generally fairly optimistic about this.

Alan Budd: Okay, alright, fine.

Sly Bailey: Can I say a point here and I don't know the answer to this question. I'd be interested what the economists think but I think we do have to consider, you know, the advertiser-funded model that we know and love or know and don't love across the commercial sector as well and the impact of things like Tivo and Sky Plus, which quite frankly nobody quite understands at the moment in terms of consumer response and what that will mean to, you know, the typical mass market audience and what that means to advertising in terms of efficiency and effectiveness in the way that television has been planned in the past because fragmentation and technology means that audiences are going to continue to go south and I think therefore the BBC putting themselves in that environment from a funding perspective, none of us quite know where that's going to be, even though we might see the total expenditure on advertising expanding. And I genuinely don't know the answer to that but I just put it forward that it is something that we have to consider because no one knows how consumers, when we've all got those, are going to start behaving and what that means to eyeballs watching advertising.

Martin Cave: I agree but nobody knows but these things have been available on the market for 5 years now and in fact their take-up rate has not been humungous.

Alan Budd: Alright. Can I just go past my own particular history to do with the Peacock Report. The only prediction I was able to make competently, not necessarily correctly, about the BBC being funded by advertising was that this would increase the supply of television advertising and an increase in supply would mean a fall in the price of television advertising. And since the independent companies couldn't all they could do is sell an existing amount under regulation of advertising, therefore the price at which they sold it would fall, therefore their revenue would fall, therefore they would have less money with which to make programmes. That was the point I made at the time. We don't need to know what the elasticity is.

Terry Burns: And which no doubt explains...

Alan Budd: That's if there is growth in the pot.

David Elstein: No, that's independent of growth but..

Terry Burns: If one of your predictions was entirely correct, which of course is in the submissions to BBC Charter Review, all I think of the commercial companies have recommended that the licence fee should be retained and that the BBC should not have advertisers.

Alan Budd: Indeed. So to David's very credit he says so what?

David Elstein: One extra point, Alan, on this but of course it goes to Tim's earlier question about motivation. The assumption is generally made that the licence fee immunises the BBC against commercial or quasi-commercial commissioning decisions. Of course the BBC can't be immune because it lives in a competitive market place, a market place (INAUDIBLE). But not only that, we actually, those of us who went through an Ofcom consultation a couple of

months ago were treated to a description by a BBC producer of the process of trying to get an idea through a BBC commissioning editor and he had gone through the exact same process as any ITV or Channel 4 or Channel 5 producer, which was: "these are our target audiences, this is the target demographic, this is the size of audience you've got to deliver at this time of night." Now there was no physical outcome as a result of this other than maintaining audience share and audience profile, so there was no cash generation, but the process of decision making was remarkably similar.

Alan Budd: Tim, alright. Tim first, then Caroline. No Tim, then Andrew, then Caroline.

Tim Gardam: I very much agree with what David just said. There is a mimic effect that takes place and certainly has done in recent years. I think though I'm going to move away from the pure economics to talk about programmes at the moment. It may not be a bad thing. The issue it seems to me is whether this notion of the public funding of these programmes is there essentially to top up the merit-good fund or whether it is the principles that underpins the motivation of an institution producing a certain sort of programme. And this sort of relates to the what the public wants, what the public ought to have argument. And I'd refine that a bit by saying there is an issue here which is about, it's essentially about a level of risk and a level of range which allows you to try out on the public something they may not know that they want. And I'm just going to give an example here of something which I think has happened as digital television has taken hold, as fragmentation has taken hold. The traditional documentary if you like, the documentaries which have a great cultural root in this country going back to the 1940s, have been essentially narratives where the producer in real time has explored a subject with the participants, got very close to them, filmed it often over months, even years, taken it back to the cutting room, compressed it, distanced themselves from the subject and produced something, an artefact, which has a certain quality to it which comes out in that process. Now that process is essentially an open-ended one that when you start you don't know what the story is going to be. When you start you don't even know if you're going to have a story, you don't know whether you're going to be able to maintain access, whether you're going to fall out with the person or the institution you're working with and where the process of exploration of the programme maker leads to a certain type of thing at the end. And this is well away from the sort of thing that Martin's been talking about but you then look at the sort of programme that has come in recently and you'll see a difference. The programmes I've just been talking about are two classic examples on Channel 4 on the time I was there were 'Shanghai Vice', which took 4 years to make in China, I think it was 6 programmes all about the industrialisation of modern China. There was another programme called 'The Last Peasants of Europe', which was essentially a programme which turned out to be about migration but started with the motivation we'll go to Transylvania and record the last years of essentially peasant culture in Europe. And the producers who went to make those programmes did not know what they were going to get. Those programmes were very expensive. They were I think a bit like £200,000-300,000 an hour and they were very good and they were not badly watched, you know over a million people watched each programme. You then take two programmes that I think are also very good like Wife Swap and Faking It, two programmes which are modern documentaries. And what's interesting about those programmes is that they have been devised in the new market that we're in to ensure that there is going to be a guaranteed end, that by formatting in the way they have been formatted the risk of investment, the risk of commitment to the producer to go and work with people over a non end-stop period to see what happens is obviated. What you have is you have a game whereby something happens. You reverse roles and something happens out of that. So you know you can make those programmes in a series of x weeks at a time. You can produce one, you can produce six, you can produce twelve and they are very good. They are fundamentally different sorts of programmes based on fundamentally different sorts of economic decision and what is happening in television, as happened with Channel 4, is that initially there were three 'Wife Swaps' and there were four 'Faking It's. There are now twelve of each. The 'Shanghai Vices' and the 'Last Peasants' programmes - there were I think six of 'Shanghai Vice', three of 'Last Peasants' but there are none being commissioned at all at the moment, there are none on the books that I know of - because essentially economic logic of the latter is one that is controllable. The economic logic of the former is one that is increasingly uncontrollable and that's what's happening in the television market at the moment. Now the question is whether public funding will enable a range of programming still

to be made so that the next programme, which is a long-term narrative documentary, may suddenly hit upon something which, you know, absolutely catches the public imagination and that's the danger I think of just leaving the consumer sovereignty argument to be the one that dominates.

Alan Budd: Okay. Alright. Andrew.

Andrew Graham: I'll try to be very quick. One, completely in agreement with what Tim's just said and he's saying, in economics terms he's saying that there's this demand curve and what you want is people, public servants, willing to take risks which are not really dictated by them. We don't know where the demand curve is. That's point one. Then there's the points being made by both Alan and Martin saying that, when you're trying to be a public service broadcaster, you're trying to maximise the value underneath that demand curve, which is different from trying to maximise the audience add along here and it produces different results. And, if you're interested in welfare or public value, you ought to be interested in the area under the demand curve. And I think even Martin Cave would agree with that.

Martin Cave: That's private value. That's not public value.

Andrew Graham: Yes, it is. Yes, it is.

Martin Cave: No, it's private value because it's the willingness to pay..

Andrew Graham: Okay, but it's the only way of getting it under, under...

David Elstein: You can't get it on advertising but I can get it by being asked to pay for it.

Andrew: Exactly. Exactly. Okay. You can get it if you can perfectly price discriminate. Yes? And the next point is that because there's a difference between these things – the advertising model just gets the maximum audience, the other one gets the maximum value – neither Barry nor David Elstein were really saying the BBC should do advertising large. They don't mind doing a bit of it but they don't mind doing a bit of it because it doesn't change anything fundamental.

Alan Budd: Thank you. Caroline.

Caroline Thomson: Well I just, I won't take more than a minute actually but it's, I mean I think you know you could have an advertising funded BBC. It wouldn't be the same BBC and I mean perhaps some people would regard that as being a good thing but I think you would lose quite a lot in the process. I just also wanted to pick up quickly David's point about our commissioning mimicking ITV's because I don't think we should be apologetic about the fact that we do compete for audiences. Actually I think the genius of the British broadcasting system so far, and I do completely accept that in a digital world it's different and we have to look at it again, but up to now in an analogue world it has been that you've had institutions that have competed for audiences but not for revenue. And that has meant that almost uniquely amongst public services the BBC enjoys a level of support and a level of usage by the public compared with, you know, education systems and health systems and so on. We have a level of trust and satisfaction which is really pretty high because we've had to be conscious of audiences. Now clearly if we go down a route of maximising audience share all the time that is wrong and where we've done that people are right to criticise us but the idea that we take commissioning decisions thinking about are people going to watch it, are the right people that it's aimed for going to watch it, is not something I think we should be apologetic for.

Terry Burns: Okay. Well we haven't touch on the issue of the BBC advertising itself. There are quite a lot of people in the consultation who ...

David Elstein: Well it would be the way account for why there's 34% nominal support for the licence fee and only 10% for subscription. If I had as much money to spend on BBC services trumpeting the merits of subscription, I think I could change those round.

Alan Budd: Well I'm not going to attempt to summarise this because we are still in the middle, we'll move on, but I'm going to tell a story which is slightly relevant to what Terry said. When I was a member of the Davies Committee on the future of funding of the BBC, the BBC had a poster campaign, which went roughly as follows, that the BBC provides wonderful programmes because it does not have to worry about shareholders. And it so happens that one of these posters was exactly opposite the place where I used to wait for the train when going to take part in the Davies Committee discussions. And knowing the BBC, that probably wasn't an accident. But what I will comment on is every time I saw that poster I mentally reduced by several million pounds...

Terry Burns: Before we go to coffee, could I encourage people if they have any points to make or questions relating to the discussion that we have had so far, not relating to the discussion that we might have later but relating to the discussion that we've had so far, if you could please put them on your cards. I take to heart the strictures about the Soviet style that Martin mentioned to me and let us see how many questions we get out of that and we'll just have to feel our way along and see how many we can deal with at this stage in the day and how many at the end of the day. But we'll now have our coffee break. Thank you all very much.

Short Refreshment Break

'Mixed Funding and subscription' Panel discussion

Terry Burns: I'll just mention some of the questions at this point which we have had and I'll go through some of them and people may wish to respond to them, so if you would be monitoring them as I go along. The first one says: "It seems to me that a great deal of questions on the BBC's future presupposes that the multi-channel market will invite and support a huge number of high quality, high public value channels. Does the panel think this is happening so far and what guarantees have we that we won't have simply cheap music repeats without the BBC?" Someone says: "Please define a merit good. Generalising, only the BBC produces situation comedy. Without the BBC, the drama would disappear. A merit good but is it entertainment?" "Is illegal downloading a criminal activity and surely the elderly would suffer from an advertising-led medium? Is there anyway round this?" "Has any research been done on the effect of time shift on viewing advertising." "Some programmes are merit goods, is there a case for imposing a tax on producers, broadcasters who profit but not produce merit goods to fund the production of merit goods elsewhere?" "Andrew Graham's arguments are stated with such conviction that they would appear to support a licence fee of 5 billion, 20 billion, perhaps more. Perhaps even the abolition of ITV and Sky. Does he believe this? If not, if he accepts some concepts of finite limits and diminishing returns, does he believe that the current level of licence fee is by some amazing coincidence optimal always?"

Andrew Cave: How could you answer that?

Terry Burns: "Will future developments in delivery methods – broadband, mobile phones, etc. – make the TV licensing system impossible to enforce in the foreseeable future?" Oh yes, and this is from someone who's been a JP (justice of the peace) for a long time. "Licence cases are one of the most demoralising duties and causes us difficulties of upholding our magisterial oath of administering justice according to law. The other alternative to a fine is probation or a curfew order, both entirely inappropriate. By having regard to the fee loss, we have composed fines largely in relation to means than we would for any other offence of a similar seriousness and this is often uncollectible, especially for those with multiple licence prosecution. It involves further summonses, arrests eventually, remission, etc. in order to collect a small sum of money. This system is wasteful, in addition to the BBC's collection costs. There are further costs to the taxpayer of the courts. My personal feel is for a direct grant from general taxation with BBC independence guaranteed by statute as is the judiciary." And the same person says: "My postbag has revealed many cases of unacceptable harassment of people with no TV. British justice operates an innocence until proved guilty principle. TV licences are the one case where people must constantly prove

their innocence, submit to demands for entry and inspection of their property and receive numerous threatening letters. Although only a small percentage of the population is affected, it is unacceptable for a funding system to be able to harass people in this way.” “Should not funding mechanisms of the BBC reflect its two different purposes, i.e. why should not the BBC supply say a couple of TV channels and a couple of radio channels reflecting public value and funded by a licence fee and provide whatever number of other TV and radio channels consumers want to pay for through subscriptions?” (inaudible) “Were those jailed for non-payment of fines re: licence fee, also Sky subscribers and were those people jailed allowed to watch TV during their...” “The BBC has effectively banned me from complaining about pro-EU bias, particularly about their censorship of bad news about the EU and the euro. My only way of expressing my dissatisfaction of the BBC’s policy is to refuse to pay my licence fee. Is the panel and those who advocate the licence fee happy that this will result in my being fined £1,000, my home being stripped by bailiffs and a jail sentence on what I regard as a matter of principle?” “Barry Cox and Martin Cave both appear to advocate voluntary subscription, citing evidence that some members of the public state a willingness to pay more to the BBC than the cost of the licence fee. And then there’s problems it says about the argument against is about the unpredictability of this if it was subscription and therefore isn’t the answer to maintain the licence fee but with voluntary” ...sorry this writing is not as good as it should be...”but with voluntary subscriptions above this level and wouldn’t this also help to address the issue of regressiveness to some degree?” So there are a number of issues here about, I mean a number of questions about criminalisation, a number about just what it is that public value is, a number to do with mixed funding of one kind or another. I have some others, which maybe we’ll take later but is there anything in those groups of questions, which anyone wishes to respond to? Andrew.

Andrew Graham: Mixed funding we are coming onto?

Terry Burns: We are. We’re coming onto mixed funding and we’re coming onto subscription, which some of the other questions do address.

Andrew Graham: Let me have a quick go at merit goods and how large the BBC. Merit goods? What economists mean by merit goods are things that people wouldn’t choose to buy now, despite all the information that they have now, but would regret it if they hadn’t bought them several years later or several months or maybe a long time later. And you can think of, here are some examples. Most kids don’t like going to the dentist. They know perfectly well their teeth are going to rot later on if they don’t go. By the time they get to their 30s, their 40s, their 50s, they might be quite glad that they’d gone to the dentist. It takes a long time for them to find that out. It looks rather small-scale. What on earth’s that got to do with broadcasting? Well, here are some other kinds of examples of merit goods. A great deal of education is a merit good. We, most of us don’t much enjoy doing GCSE maths or English GCSE but in fact later on in life we find that an ability to communicate, add up turns out to be quite important. It adds a great deal to the kind of society in which we can operate and I think that institutions can be places in which people gradually come to understand merit goods that they didn’t sort of understand before. I mean if you live in a community, which can stretch you, expand you, allow disagreement without argument, I mean without fights, you begin to understand that things are possible which might not otherwise have been the case. So I think that broadcasting has an extraordinary capacity to be, as I’ve said, part of the company you keep and if what it depicts all the time is people engaging in violent acts towards one another, no matter that they think they’re just portraying the society which is around them, but if that’s all that they show because that’s what sells or, as one American radio producer says, “We’re quite willing to broadcast programmes that verge on racism because we know that sells” that’s one kind of thing but it’s not public service broadcasting. So I think merit goods are rather quite important, quite extensive. We just don’t like to talk about them because we become a society that’s very uneasy about having values about things. We think it’s paternalistic. I don’t think it’s at all paternalistic to, it’s the exact opposite of paternalism to say that I want a society in which people have the opportunity to reach their potential and we need to build the institutions in which that’s possible. It’s like saying you want people to be part of a good football team rather than a bad football team or a good orchestra rather than a bad orchestra. You want the capacity to expend themselves and I think we’re just terribly, terribly nervous. We also think, you know, the BBC is auntie, paternalism. We think that’s all wrong

somehow. We're just terribly scared of saying something's right and something's wrong. How large should the BBC be? Put this in context in two very important ways and first of all remember that we could have these debates, perhaps we even did have these debates when we were wondering whether the BBC should go into television - it looks like quite a good idea now to me - or should go into colour television. It looks like quite a good idea now to me. Should go into digital? Probably going to be a good idea. I happen to agree it should have been paid for in exactly the same way as the colour licence was by the people who took up digital TV. I agree with David Elstein completely but that's not an argument saying the BBC shouldn't do it. It was just an argument about the transition. And the very important point to realise is that over the long time these sorts of things, entertainment, tend to have what economists describe as income elasticity. They rise with people's income. The licence fee pegged to the retail price index declines in real terms relative to people's incomes. Why shouldn't it go up in line with incomes at least, maybe slightly more, if that's what people want to spend their money on over time? How big should it be? Remember that it's been getting smaller. The BBC, I mean I'm pretty staggered by some numbers the BBC showed, which showed roughly speaking the same size as '56 through to 2004. I couldn't believe that actually. There is something really bizarre about those BBC figures which showed it having dropped to 38% the moment ITV came on but I don't understand that. But in general the BBC has been edging downwards a little bit as other things have been coming along, so there's no prediction in my mind that I want the BBC to get bigger and bigger and bigger. My argument is much, much more that the summary of my version is it's the ecology, stupid, right? And the ecology of British broadcasting has depended upon both the BBC and Channel 4 and ITV having public service broadcasting obligations. As the ITV companies want to get more and more out of public service obligations and, as Tim Gardham was describing, as Channel 4 has felt it more under a squeeze, less able to do the risky kind of programmes, so the obligations on the BBC are probably going to get larger. And how big do you need to be for the ecology to work? The numbers that Gavyn and I looked at suggested if it got below maybe 25%, it probably wouldn't work and there's probably an asymmetry once it drops below, we don't know, 25, 30. I mean these are very, very broad brush numbers.

Terry Burns: Is that sort of audience share?

Andrew Graham: Audience share. Between 20 and 30%. It's very difficult to think people are going to notice the BBC in their viewing as a matter of course and if other broadcasters are going to care about it when it's down to 10%. When it's a quarter, people are going to notice it and care about it. It's going to influence the system. That doesn't mean it has to be 100%. I don't want state broadcasting and it's not the state, it's public service broadcasting.

Terry Burns: Okay. Thanks very much Andrew. Some of the questions on the criminalisation.

Zarin Patel: Yes. Can I start with people who claim not to have a television set first of all? There are about 500,000 on our records of whom about 125,000, we verified their claim and we tend to leave them alone. We check once every 4-6 years, just to check that they haven't moved home and that they haven't actually gone out and bought a television. Of the other 360,000 who claim not to have a television and whom we visit, we find that when we visit half of those who claim no television indeed are actually using a television. So that is lost income. So I think we have a duty to the honest majority who pay to check on that. But once we've confirmed it, it's a simple straightforward visit. We've no automatic right of access. We rely on licence fee payers being cooperative but once we do do that we can leave you alone for about 4-6 years, as I said before. So it's a simple straightforward system and I think there was a letter in the FT a couple of weeks ago where someone suggested that was no more onerous than having to show Customs your bags when you're at the airport. That's the first point. The second point, I understand how demoralising it can be when the same people come to court over and over again and that is an issue. As I said before, we have to think really hard about some of the alternatives to prosecution that Lord Justice Old enabled us to think about. But some things I'd say - we make it very easy to pay. There are now 17 different ways to pay. The cheapest way to pay a colour licence is £2.30 a week on stamps. Prosecution is a last resort. We give people every chance to pay right up to the doorstep of the court. It is not in our interest to prosecute. We would rather people paid. And lastly,

someone asked how many of the people we prosecute are Sky subscribers? I did check, 10%. What I think you might find amusing is that, when you do go to jail, people in jail are exempt from paying their licence fee but prison officers aren't, which causes prison officers some angst as you can imagine.

Martin Cave: It sounds to me that you're not worried about any of the points this has brought up.

Zarin Patel: No, I am worried. I am worried because I think, certainly on the demoralising point and putting people through courts, of the people we catch at the doorstep of some 400,000, 78-90%..sorry 78-80% pay when we catch them. The people who can't pay are those in genuine financial hardship or, you know, people who have a strong anti-licence fee view and will not pay. But for those people are fines and courts effective? We've got to find different ways. I think the time has come to look at it properly.

Caroline Thomson: We would prefer a different system but this is the system we've got and we've got to make it work effectively.

Zarin Patel: And there are a number of alternatives. One, which is conditional court and which is being piloted by the Home Office in other areas, is a simple one – pay the licence, a very small penalty and you don't get to appear in court. Now there are issues around cost and how you make that work but I think that is something worth thinking through really hard.

David Elstein: I mean there is a very simple way in the digital world to do this, which is you cut off supply like you do with electricity, gas, water, telephones, etc.

Terry Burns: You can't cut off water.

Unidentified panellist: You can't cut off water.

Unidentified panellist: Ah, you don't have to cut off water.

David Elstein: Incidentally I notice that....

Terry Burns: I know to my cost.

David Elstein: ...one prisoner has been suing the government under the Human Rights Act because, although he was provided with television in his cell, he wasn't provided with Channel 5 in his cell and I'm not sure how far he's getting with his case. But the one question I would simply ask, you know given that in the digital future we'll be able to solve the problem with the flick of a smart card...

Terry Burns: We're about to come onto this.

David Elstein: ..which we're about to come to, is you know why is the BBC itself so coy about sharing what has just described to us with the general public? Why has there never been a single documentary about life in Windsor Magistrates Court? Why don't we ever..

Tim Gardam: I made one. I made one for the BBC.

David Elstein: On the licence fee?

Tim Gardam: Yes, about licence fee evasion. I left about 3 months later.

Caroline Thomson: There was a whole discussion on Radio 4 about 4 weeks ago chaired by Sheena McDonald about licence fee evasion as well. It does happen.

Terry Burns: I think most, in fact many of these which are put as questions are actually statements.

David Elstein: Can I just say one thing in terms of what Andrew was saying, which is merit goods. I don't think there's any serious debate that governments are entirely justified in generating in the broadcasting arena as well as in all kinds of other public service areas additional merit goods however defined and of a yet to be agreed volume. That's never been an issue between critics of the licence fee and supporters of the licence fee. Nobody denies that merit goods exist and that broadcasting can generate merit goods. Much more of an issue is why would you do it in this way? You know the argument for merit goods doesn't automatically be due to either the BBC or the licence fee and, to go back to the point we were discussing just before the break, one of the reasons why the Broadcasting Policy Group recommended a Public Broadcasting Authority as the dispenser of public funds in connection with merit goods was to insulate the BBC from direct political interference. In other words, if the government didn't like a BBC broadcast, there was nothing it could do about it because if it reduced the funding of the PBA it wouldn't necessarily have any impact on the BBC at all. So structures and funding mechanisms to deliver merit goods is an entirely other debate. It doesn't pivot around either the BBC or the licence fee.

Terry Burns: Could I hand back to you, Alan?

Alan Budd: Yes, alright. So we're going to move on. What we're omitting, but I think this is probably reasonable, is a discussion on sponsorship. I think probably the arguments on sponsorship are....

Terry Burns: Marginal.

Alan Budd: ..yes, it's a marginal source of funding and I think you fully understand the pros and cons. So we're going to move onto subscription and this obviously ties in with technological developments because, as we move to the analogue switch-off, then subscription certainly becomes feasible as a means of funding the BBC as anticipated in the Peacock Report and one therefore asks the question is it desirable? One has the opportunity. Is this a better way of funding the BBC? This also mixes in with the question, which we certainly want to come onto, is it sensible to have a mixture of ways of funding the BBC? Do we have to think in a unique way, only one way, all the licence fee or is it reasonable to think of a combination of perhaps some sort of fee, either the licence fee or some form of government grant, plus some channels, some sorts of programmes, some activities funded by advertising? Again the Davies Committee thought that one should consider seriously the idea that the internet services provided by the BBC should be funded by advertising and some programmes provided by subscription. Does it have to be all of one or can we have a mixture? And then I also want to make sure that we do consider the question which comes up and then goes down again of: if there is public funding because there are merit goods, should this funding be contestable? Should other deliverers of television programmes be able to bid for this money? And another point I would make, if it is possible, we have been focusing of course on the United Kingdom because this is what we're being asked to discuss but what can we learn from what goes on in the rest of the world? Are there any lessons to be learnt from what goes on in the rest of the world? I, usually in these discussions though I suspect not here, find myself unique in two ways. One is that I actually watch television. I'm a confessed television watcher. Most of the people about whom I discuss television don't actually watch it. The second thing is that my watching is predominantly of programmes made in the United States of America, which I think are absolutely superb, but I just throw that in to this discussion just in the hope that we might think about what happens elsewhere in the world and what lessons there might be. So we're going to start on subscription. I think again I'll perhaps start with Martin, who of course talked about this from the point of why one should move onto subscription, particularly if one's interested in consumer sovereignty. Martin.

Martin Cave: Yes, well I've already suggested what I think is one of the fundamental arguments about subscription, which is that you don't necessarily produce a situation in which there is a high marginal cost price to consumers for viewing particular services because what sellers of subscription services tend to do is bundle them in ways that you extract a lot of the willingness to pay, for example of people who want to watch sports channels, and then you offer them a second movie channel at a much lower rate. Conversely, if your first interest is in movies, then you will be required to pay an awful lot to subscribe to a movie channel but then

a sports channel will be available at a much lower rate. So in other words what people are able to do by setting prices in this way is to achieve a kind of price discrimination which takes levels of consumption much nearer the end of the demand curve. You know so you're getting people on whose willingness to pay is much less than would be the case if you just simply confronted them with an all or nothing choice. You can have these 15 services at £250 a year or you have nothing? I mean that's a really dumb way of doing it. I mean it's dumb from a public policy point of view but even worse or perhaps not quite so worse, so badly, it's dumb from a commercial point of view as well. That's just not the way business operates. So I think, I think that's a point that's got to be taken into account but can I just suggest another point, which really is slightly in anticipation of what we're going to come to. If I'm the holder of a programming, the owner of a programming, a programme, and I'm deciding how best I can get it into the market place and gain revenue from it in order to recover its costs, then basically, if in a purely market world, I have the choice of either putting it on a subscription channel or putting it on an advertisers supported channel. And it would be quite clear what will determine that choice. If it's a channel, a programme, which lots of people are willing to pay quite a lot to watch and then it tails off fairly quickly, it's not like a mass interest thing, you know, like Sky Sports would be a good example, you know that's clearly going to be a subscription material. Equally, if it's sort of general entertainment programming, where you can get in a big audience but they aren't desperately anxious to watch all bits of it and they're quite willing to switch, that's a sort of bums on seats type arena in which the ordinary commercial logic suggests that it goes down the advertiser supported route. And in fact it turns out, not in fact contingently but perhaps not obviously, that that's the best way of actually delivering programmes to people. That kind of segmentation between pay TV and advertisers supported TV actually enables a large number of programmes of varied type to be made available in a way which ultimately benefits consumers. So I think that's quite an important point to make about this. So for that reason it's slightly unrealistic to think about subscription on its own because in any realistic world we're going to have both running simultaneously.

Terry Burns: Can I, Alan, just take this point? I mean I did have a question which was directed at Martin on this issue because I mean first of all one of the things that presumably happens with subscription, if some people will choose not to pay it means that, to provide the same amount of money, those people who do pay it are going to have to pay more than their present licence fee. And the question is that if you are excluding people in this way, doesn't this actually attack most of all the very people who live on low incomes in deprived communities to whom television is a very important part of the entertainment to them and you are actually producing a mechanism which makes it less affordable for them?

Martin Cave: Well that's, you know, that's undeniably true. You know it's sort of anybody can dine at the Ritz kind of argument. Equally, anybody could be a Sky subscriber but to get all the programmes you have to have £575 a year or whatever it is. I mean the real issue I think is what the underlying balance is and my conjecture is that the underlying balance of programmes in a competitive digital market place will contain basically general entertainment programmes as part of the advertiser supported block. And for that reason I have my doubts about the feasibility of turning the BBC into a subscription service because, even though people are happy to come forward and say "I value it at more than £121," I think that when confronted with a choice and I'm paying the £121 or alternatively watching very similar kind of programming at the cost merely of watching the advertisements, there's going to be a considerable backing away from that. I can't think of any country in the world where general entertainment channels are available as subscriber financed channels rather than as advertiser financed channels. So I would be very interested to hear what David has to say about that because he knows much more about the industry than I do.

Alan Budd: Okay, let's ask. Yes.

David Elstein: Well there are scores of general entertainment channels available on basically pay TV, which are also generating advertising revenue. On the whole it tends to be a 50/50 split. Some of them choose to tilt much more towards subscription and much less towards advertising but that's the normal outcome. But I do think Terry's question is a very strange question because..

Alan Budd: My question.

David Elstein: Oh well as read out, as read out. It's a very strange question because it seems that we're quite relaxed about forcing people under penalty of criminal law to pay for something they may not want in order to view something they do want, i.e. free-to-air television, genuine free-to-air television, advertised funded television. That we're happy about however poor those people are and however many hundreds of thousands a year are dragged through the courts. That's fine. But when we give them the choice not to pay for it, which is what subscription does, that's bad, bad for *them* apparently. So it's good for them that we force them to pay for something inequitably which, if we really believed it was good for them, we should pay for out of taxation but it's bad for them when we give them a choice not to pay. Now I do struggle with that one. The other key thing to remember about subscription is three things fall out from the argument for subscription. The first, as Martin has said, is you get differential supply of content. Instead of one price fits all, you are going to be able to generate different menus of BBC content and some of them in my view will definitely be lower than the current licence fee, even with the added cost of VAT, which is going to be a new element in the package, and even with the higher marginal cost of generation because you can't assume 24 million households consuming, which the BBC currently have. So there will be variation and some people will be able to choose to pay less to receive less. The second....

Tim Gardam: Will any of it be free-to-air?

David Elstein: I'll get to that in a moment because that's the third point. The second thing is, if you are serious about a subscription-funded system, almost inevitably it's going to be a per set not a per home system. That is the only way in which you can generate the revenue. It's coming effectively through a smart card in your set. Now you may have one smart card enabled and you may move from room to room and move it around but on the whole homes with more sets will pay more for any given subscriber-driven service than homes with less sets. Now that for me looks to be fair and reasonable. I have 5 TV sets at home, or is it 6? The people next door have 2. At the moment we pay exactly the same amount. Maybe that should change. The third point is, as Tim has picked up and as Barry has already said, there is nothing to stop you packaging up subscription-funded BBC content of value and making it available in second window either on a free-to-air basis completely free, i.e. funded by government grant or PBA grant; or advertiser supported. So if you actually look at it from the consumer's point of view, they should miss out on no merit-good content, they should be getting it more cheaply and everyone paying for BBC content in the future will have more choice of packages and will be paying on a more equitable and choice-driven fashion. Now all of those benefits seem to me pretty substantial relative to the inflexibility of a licence fee funded system. Now there are things that you do lose and you've got to think of how you substitute for the losses. So we've talked about independence. There are I think ways of dealing with that. There are, you know, the direct connection that people feel with the BBC. Well, actually I think they'll probably feel a stronger connection if they've chosen to pay the licence fee as an act of deliberate decision because they want to see the BBC's content than if they're forced to pay for it. One of the oddest things in this report is I think it's 54% of people who think it's unfair in a subscription system that those who can't afford it will be forced to pay. Of course they're not forced to pay at all. The unfair bit is when you are forced to pay for something that you either don't want or can't afford. So, you know, there are different ways of dealing with all these issues. The one thing that drops out of the bottom is radio. Radio, although there are examples in the US of subscription-funded radio which are quite interesting and digital radio is going to take off in due course in the way that digital television has, it doesn't feel as if we are going to be able to solve the problem of funding merit goods in radio as quickly as we can solve it in TV and therefore the chances are that if we go down this route, we will have to put into the Public Broadcasting Authority concept, if that's where we go, a significant allocation for public radio or public service radio, by the way not necessarily only supplied by the BBC.

Alan Budd: Okay, I think I'm going to take Barry. I'm going to build up the case for subscription maybe and then hear some other views.

Barry Cox: As the others have said, I'd just add a few points. Quite obviously the voluntary thing eliminates the evasion problem, the criminality thing and I think that is a big gain. It also, which we've not mentioned at all to my mind, eliminates the fair trading problem that exists because once the BBC is funded as it were commercially by voluntary assent of the people subscribing to it, then you know what it chooses to do is safe from a fair trading point of view. I think it enhances the independence of the BBC because it takes away, you know the legitimacy of the BBC comes then from the fact that a large number of population are paying for it directly of their own choice. The government has no say in that respect over it. And there are just two bits of the points that David and Martin made that I want to just challenge a bit. One is Martin's description. I actually think the compulsory bundling of services that you get in Sky is appalling and there is absolutely no wish to see the BBC reproduce that with its services. Of course it's entirely legitimate to say if you take a package of services you're going to get some benefits from doing it but you should be able to say "I don't care about that. I just want to pay the premium price for this particular service and the fact that I don't, you know, don't throw in all these other things. I don't want them very much." And that we need in the pay world and certainly in a world in which the BBC was operating like that. And the other thing that is very important here is that I do think the licence fee is not, you know, Andrew's point about increasing more than inflation. Hopeless. It's never going to be possible to do that. And quite obviously the price of certain high quality goods in the electronic audio/visual world is going to go up and the only way of securing the continuation of the kind of thing that Tim was talking about – high end documentary, and I would include there very expensive drama, very expensive comedy – in the medium to long-term is to get us to pay for these things directly as part of the cost of them, not to solve it, not to solve it, otherwise they will disappear. And actually there are some, you know the sitcom thing is quite an interesting one. We got through life without having situation comedy for many centuries. Suppose it disappears? Does it matter? I don't know the answer to that but we need mechanisms, which we don't currently have, to make it at least possible for us as consumers to say we do want this to continue, I'm willing to pay directly for it. So I think that's another crucial one. The per set thing I think is a problem. David think it's an advantage. I don't think it is. Anyway the technology is going to make it, there are going to be in the future servers sitting in your home which will wirelessly directly everything you receive round the house to every set you've got. I don't see it being a question of carrying smart card around and sticking them in slots. So I don't think that's an aspect that I would support as part of the purpose of subscription but everything else they've said I agree with and it seems to me it's self-evident.

David Elstein: There's one thing we haven't mentioned at all, which mainly is because it's blindingly obvious, but the reason we have the broadcasting system we have is because of spectrum scarcity. It was entirely understandable that when you only have 1, 2, 3 or 4 channels available you would manage it centrally. You would try and reinvent a rational outcome which, because the market couldn't intervene. What is available to us now because spectrum scarcity is effectively dead, certainly in the cable and satellite world, slightly less so in the terrestrial world, is you can actually take the allocator, the rationer out of the system and have a much more direct consumer/supplier relationship. Now the advantage of that is that at the margin you're going to generate more supply because you're going to be able to capture demand for more supply more accurately. So types of programmes will enter the viewer's choice that can't enter at the moment because of the pressures on the institutions in a fragmenting market to deliver certain types of product but not others. And we find it harder to introduce that. And in many ways the IP based, intellectual property based version of broadcasting has many, many attractions for the creative economy, for the creators themselves as well as for the consumers. It sadly bypasses the historic controllers of our broadcasting system. Whether that's a good or a bad thing is another matter. It makes it that much harder to manufacture outcomes but it may concentrate our minds more on what actually what do we really need to intervene to do, how much should we spend and how should we manage that spend? How do we make sure it's transparent, accountable, real value for money? Now all of those decisions at the moment we just dump with broadcasters who tell the regulator this is what we're doing and the regulator struggles to measure and that's why we're going round having public purposes and, you know, value measurement and building public value and, as Howard just pointed out, nothing will ever close because that's the nature of things. The BBC has in its entire life never had a reduction in its income and

never had a difficulty in predicting what its income would be in any given year and that's a very unusual situation to be in.

Terry Burns: Now you've had two shots, David. Yes, Tim.

Tim Gardam: I just want to ask a question of Barry and David, which is whether they accept news or even news and current affairs from this subscription model and do they think that the BBC's news has got a status and a value which means that that ought to be universally available and differentiated from everything else?

Barry Cox: Well it, news is the most interesting question and where I think I've got to on that is it is, you could fund news services directly or indirectly by public money. You could do it with contestable funding, you could do it with a block grant to not-for-profit institutions like the BBC or Channel 4 as saying: "And we intend this to help you provide news" and they may be fine. You could obviously have free-to-air advertising funded news but the likelihood with that is that it is going to become opinionated news and I don't think, certainly purely commercial broadcasters will in the long-term be required to do their accuracy and impartiality, high quality stuff that you can reasonably expect of not-for-profit corporations, such as I hope the BBC and Channel 4 will remain. So what can you give them to fund their news that is kind of indirect? And I'd go back to, there are two things I think. One, I've already mentioned, which is relief from spectrum charging, which will be a real asset if the Ofcom chooses to do this, which ought to fund news services. It's more than enough on the economics that I've seen to fund news services. The BBC probably spends too much on news but that's another matter. The other of real value is you could designate them more than we do now, like the 24-hour news channels ought to be this, public service and therefore get due prominence on the EPG, another very valuable gain. So I think there are ways in which of keeping what we have, the stuff we really get from news, keeping it independent of some of the problems with taxation by these other mechanisms.

Tim Gardam: But it is, under both your visions, anyone in the country when they're in front of a television set can get BBC news?

Barry Cox: Yes. Yes, absolutely. I mean I have to say I don't think....

Tim Gardam: Regardless of whether they've paid their subscription or not, they get BBC news?

Barry Cox: Yes. They can get BBC news. Yes, absolutely.

Alan Budd: Howard wants to make a point and then Alice.

Howard Davies: I'm certainly nervous about making a point because I was one of the people Alan was attacking earlier on by saying the people he discussed the BBC with don't watch television. But I guess once you've sort of retired to Oxford, you don't have much else to do. So I'll nonetheless comment just on one dimension of it, which is this issue which both for Barry and David raised about sort of independence and regulation. I'm not quite sure, I think one thing is true that, if you had a diverse set of funding sources, including some that had an element of choice, it's quite clear that the regulatory context would change. However, all kinds of new issues would arise, for example people would be extremely interested in transfer pricing within the BBC to ensure that you weren't actually cross-subsidising bits that might be funded through some reduced licence fee for bits that are in the purely commercial market. People would be very interested in cross-subsidies; they would be extremely interested in the possibility of predatory pricing, which of course we don't really currently have to issue. You can argue the licence fee is one huge predatory price if you like but it nonetheless isn't targeted in a way, which could affect other services. So I just wanted to enter the point, although we're not discussing regulation, if you did move to a more pluralistic funding model, you'd have to think very, very carefully about the different regulatory environment in order to maintain the same degree of independence and I don't think I'd quite agree with Barry that you would immediately necessarily create more independence for the BBC because it could raise all kinds of other issues.

Alan Budd: Okay, can I just, I think the word 'independence' is being used in two different ways, one of which is independence from political pressure and the other is independence from market pressure and some people feel more strongly about the former than about the latter. And I think perhaps when you were talking about independence, you perhaps meant from market pressures did you?

David Elstein: No, no. I meant absolutely from political pressure for the very reason that Barry gave, which is suddenly the government doesn't control the BBC's income and therefore can't run organisations in processes like this.

Alan Budd: Oh so it's a benefit? Okay, I see.

David Elstein: No, it does work that way but just to pick up on Howard's point...

Alan Budd: Alright, no, Alice.

Alice Rawsthorn: Well actually I want him to thank me for that because my point was about market pressure. So far you've dealt on the financial and technical possibilities of subscription but not its cultural implications and specifically its implications for programming. Would subscription mean that we'd have an acceleration or an aggravation of a system that Tim was alluding to earlier, where you know the tyranny of the consumer focus group would distort the kind of programming that we're given? Do you find that worrying or do you perhaps think it's a good thing? And also what would the implications for the BBC be of, Caroline spoke earlier about the importance of having the ability to plan in the long-term and invest in the long-term for the BBC, wouldn't subscription and the appearance of market pressure detract from that and would that be damaging?

Barry Cox: Well the answer to the first one is that the subscription actually liberates you from the advertiser problem. You know I mean in print you could have magazines like Prospect which are virtually only paid for by subscription. Indeed they don't make a profit but, because the advertisers aren't interested, but it enables them to do all kinds of other things that the advertiser-funded magazines wouldn't do and this is...

Alice Rawsthorn: But the capital base of a periodical like Prospect is so dramatically different from a broadcaster...

Barry Cox: No, I'm not going to really answer the point that the, many industries have the problems of how they fund high fixed cost operations and I think he's right about that. I really wish the prohibition on ITV and Channel 4 from running first run original programming and obliging it to be free was lifted. It would enormously help us because that way we could start varying the advertiser pressure that Tim has described with something else, which is the people's willingness to pay for stuff. And I absolutely believe the amount of money that is spent on DVDs, video games – what's the other thing, there's three of them, I can't remember it now – anyway we use the TV set for many other things than watching terrestrial television. That's the great change in the last 10 or 15 years. Willingness to pay is enormous. There's nearly as much spent on that as there is on pay television and you take them together, it outspends the advertiser. So we're already in a mixed economy of consumers using TV sets, putting money in their pockets and paying lots of money for things that cost a lot of money to make. You know the video games are a big investment. So we're in that world and I just think we need to extend it to what we would regard as conventional broadcasting because if we don't, we are going to see the range of programming shrink because advertising funded programming, partly because of the amount of advertising that would be around, I don't think Martin, I share the other view of the way advertising is going, they will not be capable of delivering that rate and partly because the licence fee will not keep pace with the cost of those things. So in both cases we will see a shrinkage. We need to tap into the consumer's willingness to pay, which is absolutely there as we see it, to extend it to some of these threatened species that actually I regard as very valuable. As for the unpredictability, of course it's unpredictable, yes, but everybody else except for the BBC has to live with that and we get by.

Alan Budd: Okay, I'm going to ask Andrew to respond to some of the points that have been made about subscription television.

Andrew Graham: Okay, let's deal with the sort of bit that I think probably economists can agree on to begin with. It's perfectly true that with the price discrimination you can get under subscription, you could capture that area under the demand curve better than you could under advertising. I think we probably all agree about that. That's fairly easy. But that doesn't deal with the other question, which is whether the demand curve, being privately revealed by private consumers, i.e. a market-driven system, gives you all you want from broadcasting and I don't want to go back over all the other stuff we've had earlier this morning but I mean we keep sort of saying it gets bundled into, well either it's just public goods or it's just merit goods. But there's a whole range of problems, which is why we've had the BBC in existence, and I think that David Elstein tempts us into what I see as the sort of deep fallacy, where he says that we had the BBC because we had spectrum scarcity and so there was a natural monopoly. Now that spectrum scarcity has gone, we don't need the BBC. If you think the points about market failure exist, then actually the end of spectrum scarcity and having something influencing the market gets more important not less important. Second point, the point that Howard Davies made is absolutely right. As you shift one way of influencing the broadcasting ecology out of the window of the BBC, you bring in the regulators. You suddenly have got everybody wondering about can their package with Sky be unbundled or not? Martin I think has been on the, in the firing line about trying to unpackage Sky bundles. It's extremely difficult.

Unidentified panellist: Barry.

Andrew Graham: I think he had a go at one point too but anyway it's extremely difficult. I mean there's nothing wrong with people trying to want to make money but it doesn't mean that they necessarily want to help you. You know that's not their purpose. They want to put together a package that you might buy and pay the most possible for. It's a different kind of game. I mean Howard Davies I think had a little bit of problem with the pensions industry. We had to establish the Financial Services Authority precisely because we had all the mis-selling of pensions. There's a long time between buying a pension and consuming it, so consumers tend to get it wrong. You know there are very substantial market failures. Broadcasting is extremely powerful. The fact that subscription would solve the advertising problem is really a rather small part of it. The next thing is I don't yet see any television system in the world where the economist's idealistic model of perfect competition, lots and lots of tiny channels, has come about, not even true in the US. It's still the case that the big channels get the big chunk of the market place. They're still very influential. And that brings me to Tim Gardham's absolutely critical question about news. A very interesting survey done by the University of Maryland last autumn about the coverage of the US channels of what people in the US thought about the war. They tracked attitudes all the way through last year and in the autumn, well after the war was over, well after on the whole we thought they had had a little bit of problem in finding weapons of mass destruction, they found that 60% of the American watchers of television believed one of the following three propositions: They either believed that weapons of mass destruction had been found, or they believed that al-Qua'eda and Saddam Hussein had been shown to be inextricably linked, or they believed that world opinion was on the side of the US in going into this war. Now that's pretty surprising that 60% of the US would believe one of those propositions but what's more dramatic is the University of Maryland then unpacked it by which television channel people were watching and the number of people believing one of those propositions grew to more than 80% when they were watching Fox and it was only down to 23% when they were watching PBS. What's more, they checked this out, whether the people watching Fox were all naturally members of the Republican Party. No. They found that the chances of people being mis-led the more closely they paid attention to the channel they were watching. I think that that gives you something to be afraid of in kind of the way that broadcasting might go if you didn't have a BBC and I don't see the pub subscription being the solution to the BBC, though in the long-term, well, we'll talk about that.

Alan Budd: Well we will talk about it. Would you like to talk at this stage, Caroline, about the BBC and its view of subscription?

Caroline Thomson: Yes, can I just, I'll just pick up a couple of points. I think just to unpack Andrew's really interesting point, and I hadn't heard the statistics before, but of course one of the problems – and I think actually this has been implicitly recognised by David and Barry saying they would take news out of a subscription service – one of the problems that if you have news in a subscription service is you have to then maximise the subscriptions to cover the costs and actually the way you do that is you go down the route and, if Sly will forgive me, of you know what's happened to a lot of our newspapers. I mean you quite rightly have to sell them and in order to sell them you have to appeal to a certain demographic who will take out a subscription. And I do think David, if you'll forgive me David, is trying to have his cake and eat it on this. He's simultaneously saying subscription would make us more independent but at the same time saying that nonetheless news will have to be taken out of this and publicly funded. Well I don't know how else you're going to fund it. You said news would be taken out of it. I don't know how else you'd fund it if it wasn't publicly funded.

David Elstein: It would come through a PBA which is independent of politicians. In other words you put layers in between so...

Caroline Thomson: So you'd still have, but it still would be publicly funded. So the argument that somehow we're somehow miraculously independent, and I think David's argument on subscription is basically what you're arguing for is a smaller BBC. Now it's a perfectly sensible thing to argue for. I mean I wouldn't agree with it obviously but I think we ought to be clear that's what it is because what you're saying is...

David Elstein: That's completely untrue.

Caroline Thomson: ...because – I listened very quietly to you David – because what you're saying is that you'd have two or three publicly funded channels, funded through this PBA or whatever it is, and then the rest would be subscription and, as Barry says, they would be commercially funded. Subscription is not some other sort of nice system of the licence fee that's voluntary. Subscription is commercial funding and it will inevitably change the behaviour of the subscription funded channels if you do that. Now that may be a behaviour that you want to get the BBC to do, and I would perfectly, you know that's again an argument you can run, but what I don't think you can argue is somehow, or imply to people, is somehow you can take the existing BBC, put it all on subscription with the exception of News 24 and somehow expect to get the same thing at the end. And some of the work we've done does show that in order to get a similar level of funding for the BBC on subscription, you'd have to probably put the subscription level up about 30% if you're going to maximise. That doesn't get you exactly what you'd get now in terms of revenue. Indeed you'd get about 90% of the revenue. But at that level a third of the people who currently get the BBC would not subscribe.

Tim Gardam: How many would drop out do you think? If you've just got to go up 30%, how many people are you assuming drop out originally?

Caroline Thomson: Sorry, drop out?

Tim Gardam: Well if you say, if subscription requires you putting up the licence fee by 33% that must be on the basis of the take-up for subscription...

Caroline Thomson: Yes because you have a sort of ratchet effect, that you know you set the subscription initially at £120 so some drop out, so you have to put it up to get the revenue up.

Tim Gardam: You must have done research showing how many people would be happy to drop out of the licence fee as it stands at the moment?

Caroline Thomson: As it stands at the moment there are about 19% who do not want to pay the existing level of the licence fee. About half of those would be prepared to pay, still pay a licence fee but at a lower level.

Alice Rawsthorn: A question for you. I'm not getting why subscription would, you seem to be saying, substantially change the content, that it would drive that? Why would it do that?

Caroline Thomson: What I'm saying is that you basically put the BBC in competition for revenues with other subscription channels and you can't be sure that once you do that that you end up with the same BBC because what you have to do then is adjust your programming to maximise revenue and that will inevitably affect your programming decisions.

Barry Cox: It might improve it.

Caroline Thomson: Sorry?

Barry Cox: It might improve it. That's the point.

Caroline Thomson: No, Barry, it might improve it but it will change it is my point. I mean I did say, to be fair, I did say you know you might think it would make it better but it's different. And you yourself described this as this is commercial funding. I mean you said it's commercial funding.

Barry Cox: Absolutely.

Caroline Thomson: And I think, I just think people should understand that what you're saying is you're wanting to take, you're wanting to have a couple of core channels which are publicly funded, including news. You're basically arguing I think for a smaller BBC because you're then taking the rest of the channels and putting them into the commercial market place and so that, you then have a different animal.

Barry Cox: But I go back, your figures can be taken the other way. You know I think it is wonderful news that 60% of the population would pay £13 a month...

Caroline Thomson: It may surprise you, Barry, but our object in life is not to maximise our revenue. Our object is to serve most of the populations with programmes and services which we think will build public value. I mean that is the difference being a public service and a commercial operator.

Barry Cox: it's showing a willingness to pay for the value the BBC represents. That's terrific. They'll do it voluntarily. Wonderful.

Caroline Thomson: But they do it at the expense of excluding 40% of our current audience from being able to receive the service and we would prefer to have a lower revenue and have everyone receiving it because we think what we do, particularly in areas like news and current affairs and the educational stuff and so on but across a whole range of other things as well, really builds public value for the majority of the population and we're proud of the fact that 95% of the population uses us in some form every week. Our aim is to maximise usage not to maximise revenue and that's the crucial difference.

Alan Budd: Tim and then I want to make a general point.

Tim Gardam: Just to tease this out and ask Caroline a bit more so I get it clear. The Secretary of State has said a strong and independent BBC comes out of this. You say a universal BBC is essential but you seem to be saying that all that has to be predicated on the BBC being at least as big as it is now because a smaller BBC won't do this as well. How can you be sure that everything that the BBC does now contributes to its being strong, independent and universal? I mean it seems to me there's a danger that it's, you're saying the BBC has to be what it is and, since the BBC has always been genetically programmed to

grow, there will be those who will say that what essentially this is about is just maintaining the BBC...

Caroline Thomson: I haven't in this argument argued at all that the BBC has to be as big as it is and bigger still. I've been simply arguing that we shouldn't be funded by subscription. I mean we could grow even bigger in some ways perhaps if we were funded by subscription. We'd probably spawn all sorts of sports channels and Top of the Pops channels.

Tom Gardam: But you said David was arguing for a smaller BBC. That may be right and something you think, obviously you would not expect us to agree with that, so it sounded to me as if you thought the BBC should become...

Caroline Thomson: Yes, yes. Well that is because I believed that the current range of services – and I would believe this wouldn't I? – not to argue every programme in every single service is perfect, but the current range of services we run do genuinely build public value and bring a benefit and I do think there is a benefit in size. And I think you can obviously take a decision, as America has done, that you want a public broadcasting service that is very small, that only deals with market failure and you know it reaches a small percentage of the population. And that's a perfectly rational decision to make but you have to realise that in making that decision you are losing some of the benefits that I would argue you can't regain from having a large-scale intervention of the way we have in Britain.

Alan Budd: Andrew wants to make a, a question and then I think Terry's going to start.

Andrew Graham: I mean it does seem to me we're in a certain sense making a bit of progress because I think at least Caroline and I are taking the view, which I think we're getting very clear that David and Barry dispute, that we think that the sources of your funding inextricably affect your purposes and your values. That's the key point. And Barry thinks that subscription, and David thinks that subscription take is an improvement because it takes you closer to the consumer. But we are arguing that's not what public service broadcasting is designed to be. So at least we're getting clear what the nature of the dispute is. You might have a bigger BBC but Caroline's saying it's not, wouldn't be a bigger public service broadcaster.

Terry Burns: I think we've probably covered most of the ground. What I'd like to do as the sort of final stage in this is to put two questions to each of you. One is what, in terms of funding the BBC, I mean how would you see over time the balance of the licence fee, advertising and subscription and how quickly would you anticipate moving to this over the next 10 years or so or even, you know, looking beyond the 10-year period? I mean much of the discussion we've had has had a sort of slightly timeless element to it because some of the things, you know, about subscription, it has to wait for digital switchover in any case and sort of two supplementaries in that. I mean do people think that it's completely impossible you know to have mixed funding or is mixed funding possible? I mean is it such a dramatic transformation that it couldn't happen or could you envisage a situation where there were some channels that were funded by a licence fee and there actually were some channels which had advertising and some channels which had subscription and would you move to these gradually or would you wait for...?

Barry Cox: You're looking at me to start. Yes to the mixture. I hope subscription will be the dominant form.

Terry Burns: By when?

David Cox: Well I'll come to that. No, no, this is absolutely critical from my point that, you know, if 60% is what the BBC then get, that would be wonderful and then they could, the rest of it can come from other means. How you get there – and I would formally like to recommend this to the panel for its serious consideration – is that the licence fee should be renewed for 5 years but within that the BBC should be tasked for the BBC to produce, not some other committee or anything else, the BBC should take the responsibility for saying what your best mix of alternatives would be going forward in the second half of the Charter, so with an

implicit assumption that the licence fee would be reduced, possibly eliminated but certainly reduced, in that period. And they should come forward with this by 2009 because at that point that's 2 years in and it gives 3 years for this to be debated in public and gives due notice to the rest of the market that this could happen because I do think it is, this is happening now but it's going to be far, far more intensive and in all the ways that we kind of briefly alluded to by the second half of the Charter... You can't stop the licence fee overnight. That would be crazy. It has to be phased. Give it 5 years but get the BBC to think honestly, seriously and fundamentally about what is the best mix in the New World that they know as well as any of us is coming and ask them to do that, you know produce that as a phase for the second half.

David Elstein: We covered a lot of this territory in the Broadcasting Policy Group before but essentially we said two things. First of all, if analogue switch-off were contemplated for 2012 or whenever it might be, it didn't seem to us either likely or desirable that in that environment you would carry on with a compulsory licence fee in order to watch television at all. It just didn't fit with the availability of technology and you would be really hard-pressed to justify spending very large sums of money physically pursuing people when you could so easily just cut them off if they didn't want to pay and if you had the opportunity to moderate payments and indeed have the opportunity to fund a certain amount of content so it's completely free. The second thing that we said was you start right away in 2007 with implementing the Davies Panel recommendation on digital channels. In other words, the BBC's digital channels should be paid for by those who choose to pay for them rather than funded out of the general pot. And the reason why we thought this was important was that it would force a shift in perception and in the end this is one of those things that is binary. At the moment we have a very odd model of broadcasting, which is that primarily money is spent on first run programming which is free- to- air and it's then exploited secondarily in the pay-TV market. That's pretty counter-intuitive and it's the point that Barry's been going on about. If BBC 3 and BBC 4 were subscription funded, our view was that the BBC couldn't afford to let those channels die. So instead of being very marginalised channels with bits and pieces of content with BBC 1 and BBC 2 having all the first runs or nearly all the first runs of all the best product, inevitably first runs would start to shift across to BBC 3 and BBC 4 in order to keep them buoyant and we thought this was probably beneficial in terms of a rational way of funding broadcasting generally, good for the creative economy and progressive in terms of getting people used to the post analogue switch-off world. So, if you can work out what your end point is and you've got a start point, then you can do some of your transfers in-between. As it happens, our recommendation, because we haven't even mentioned top slicing yet, was that all of the licence fee as it reduces should go into Treasury PBA and then be redistributed such that the BBC's core merit-good public service content would absolutely get funded but on a reducing cost to the consumer basis and probably made available freely without any compulsion at all. Our biggest struggle was that, as the licence fee reduced over this 8-year period or 6-year period 2007-2012, it become increasingly inefficient to collect because the percentage of the licence fee spent on collection and evasion at the moment at £121 is, you know, is whatever it is, 10-11%, 12 if you combine the two. If the licence fee comes down to £50, you can't physically reduce the cost of collection. You might reduce the cost of evasion and therefore it becomes an increasingly awkward phenomenon. We haven't solved that problem. We'll leave that to you.

Alan Budd: Thank you very much.

James Sandbach: Well I think one of the issues in terms of the balance of funding streams is that there's going to be actually a whole new set of legal relationships that underpins new funding arrangements and given that it took until last year in the Communications Bill to actually get some sort of modern legal framework in place for the broadcasting industry and that, I mean, many groups have been asking for a long time to review the Wireless Telegraphy Act with ministers, a pretty old-fashioned piece of legislation on which the licence fee was based, that if you had a device in your home that received this wireless telegraphy, i.e. one of those sort of funny 1940s boxes, and the law was really quite hopelessly outdated. It took a very, very long time to get some sort of proper legal framework into place and even then the Communications Bill only kind of squeaked through in parliament at the end of the last session with all sorts of politics and complications accompanying it. And I think you know one of the key issues that will need to be addressed is how would you then move from the

principles of say a mixed subscription and licence fee funding, advertising fee funding, how would you actually then move from that to a legislative framework that actually works, that actually works in a practical way in terms of implementation and enforcement, etc.

Martin Cave: I think we should be looking in terms of achieving by the end of the Charter period what would in effect be the euthanasia of the licence fee. Exactly how you'd phase it depends upon the issue which David has raised about the ratio of collecting cost to the revenue that's generated, leaving it to the BBC to decide how to generate revenue on the basis of its portfolio programmes. So it would have three sources. It would have some kind of public funding, either from the licence fee or by other means, and it would have a subscription revenue and it would have advertising revenue. I mean it's obviously going to be quite a painful process. One of the issues that comes in is whether starting from almost straightaway, the beginning of the Charter period, some kind of advertising should be inserted on the BBC, so the BBC would be deemed for the purposes of setting the licence fee to be generating some kind of advertising revenue. I mean, if you think as I do that that's the way in which BBC funding is probably going to go in the long term to a considerable degree, in a sense the sooner you start the better. And it may be possible to devise ways to start. I mean radio is obviously a start. It would be difficult if the proposal about turning the digital channels into subscription channels, that would obviously preclude them from being advertising financed as well and BBC 1 and BBC 2 might be a step too far in 2007 but maybe possibilities with radio.

Alan Budd: Andrew.

Andrew Graham: Two quick, well one quick point and then one slightly longer point. Maybe I'm missing something. I still can't quite see why one, in terms of the licence fee, can't go back to a higher licence fee for digital TV sets in exactly the same way as a higher licence fee for colour TV. That gives you the buoyancy, gets the people who are consuming digital services to pay more for it. I don't see any great problem with that. Float the BBC on for quite a long time. The longer point, it's something we just haven't touched on except that Tim mentioned it in talking about the style of two different programmes that Channel 4 struggled with, and I still think it, although it's sort of deep down in the interstices of television, I think it's incredibly important. We're talking about this variation in funding because I think it alters the purposes and values of the institution. And you've got two different models you can run with. You can either run with the way that we do various other industries and regulate them and then you have regulators who have very specific performance targets, etc., etc. Now we already know that those performance targets are quite problematic, even in the broadcasting world it's extraordinarily difficult to measure. Is this programme making people feel stretched, more imaginative, using a language in a richer sort of way, seeing people in non-stereotypical forms, portraying other cultures in a way that is sympathetic rather than derogatory, non-racist, all sorts. These are not very easily measurable things. And the way that they're done at the moment in the BBC and Channel 4 is by the commissioning editors and we have a very delegated system of regulation because we don't have to formally regulate them all the time because the ethos of the institutions is they're trying to do broadly speaking public service broadcasting programmes. Take that away and you either take away all those kind of programmes or you're suddenly driven into really very complicated regulation in a way that some of us in universities are already beginning to see what a headache it is in another form. And it isn't the case that you can just say this problem will go away and the market will solve it. It won't, or you'll get absolutely dreadful television as a result. And I would come in with a story: David talked about the extent to which, when he'd been hearing people in the BBC and ITV, they told exactly the same stories about getting ratings. Tim has partly replied to that by saying of course, people don't want to put out programmes that nobody watches. But the equivalent story to David's is that when the ITC were talking to Channel 4, they said they'd had Sky in the week before and Sky, they said, had spent all of the time talking about the bottom line, Channel 4 people spent all the time talking about the programmes. I know which I prefer.

Terry Burns: Could I put something to you there, Andrew. I mean would you rule it out that the BBC should have some subscription channels that say were carrying things that there might be small audiences for or which were specialised audiences in some way and which otherwise wouldn't get on? I mean in some way would you rule it out on principle any

advertising to be carried on them because this was a border that you couldn't, you know, that it has to be all or nothing because the consultation does point towards quite a lot of sympathy of people for some kind of mixed funding and....

Andrew Graham: In principle, I would prefer the clean version because I think it's very difficult to serve two masters. You get very confused. If one of the masters is smaller and you still know which is the dominant one and you're clear about your values, then it's alright, you can probably live with it. I mean I struggle with this all of the time in the university world where, you know, we think we're about education and there are people who have wanted to give us money on certain conditions. And every so often you have to say "No, I won't take it." But if the people who are giving you the money are the only people who give you the money, my goodness it's very difficult. So the crunch point is what would undermine the values of the institution?

Tim Gardam: Isn't there an issue about mixed funding, which, you know you should be quite clear to differentiate advertising from subscription. David will know more about it than I do but I think it's fair to say that the mixed funded public service broadcasters, which have been funded by a mixture of the old-fashioned licence fee and by advertising have all come to a pretty sorry past in terms of what they do. I'm thinking of in Canada and in Australia in particular. And it would seem to me that there has been a very good case to be proven that once you bring advertising into the mix you don't change things fundamentally because advertisers are essentially not a direct transaction with you the individual, choosing to watch a programme. Advertising, as we know, is about selling audiences to advertisers. Subscription it does seem to me is different because subscription is giving this voluntary principle to what is still an individual relationship between the broadcaster and the viewer and that seems to be closer to the public service principles than advertising.

Terry Burns: Caroline, I mean given your pulse document you're unlikely to be advocating here mixed funding but are there any other comments that you want to make about the points that other people have made?

Caroline Thomson: Well I think Andrew made the point about the difficulty with mixed funding and I think that's fine, and Tim's made it as well. I won't take up more time.

Terry Burns: Most of the questions which I had in the interval I do think have emerged during the course of this discussion, even including Tim's very brief comment that he made about experience in Canada and Australia, which one or two people raised. I think the one area that we haven't touched on is sponsorship and the impact of that and there are some questions too as to whether or not the licence fee could be made so as to distinguish between different groups of people who would pay different amounts. But, as I say, apart from that, with the exception of the issue of contestable funding, which we had on our agenda, which we haven't yet been able to get to, I think we have probably covered those. Are there any questions which anyone feels, in the last 10 minutes, we have 10 minutes left, that have not been, I mean what I'm looking here in a sense is not more argumentation about the issues that have been raised but is there anybody with a burning desire to say that there are some subjects which should have been covered which haven't been covered?

Audience member: Yes, there is one area that I think hasn't been covered and that's the mixed funding that already exists, which is the commercial revenue the BBC generates from particularly overseas programmes, and it now has the opportunity to do that with the online services, particularly again with the overseas users. That's already £700 million. Why could that not be substantially more and therefore get a better return on the public investors?

Terry Burns: We are having a seminar on commercial activities in the autumn and I think this is one of the issues we are obviously going to spend quite some time on because there are two aspects of this. One is the amount of money it raises but there are also some important questions about the competitive nature of this and the impact of it upon the private sector. And what you're quite right to point out of course is that we talk about the BBC being funded by the licence fee. In fact, as we know, only 75% of the BBC is funded by the licence

fee. There is already a substantial commercial income as well as the grant-in-aid from the Foreign Office. At the moment it's clearly 75/25 isn't it?

Caroline Thomson: Could I just correct that because I think actually that's one of the things in the packs that is a bit misleading. I mean you're quite right that we have commercial, you know, revenue streams but actually the figures in the pack relate to our turnover...

Terry Burns: Gross are they?

Caroline Thomson: Gross.

Terry Burns: Right.

Caroline Thomson: They're not the, actually the contribution from the commercial subsidiaries is less. It's around 10%. Actually less than 10%.

Terry Burns: Plus the World Service?

Caroline Thomson: World Service is about £200 million.

Second audience member: I have a question for the whole panel, particularly David. It's been mentioned a couple of times that digital switchover can be in advance of subscription and even the date of 2007 was mentioned for BBC 3 and 4 to become subscription channels. Just for my own information and something I don't know the answer to is my own preview box at home doesn't have a slot for a card and it doesn't have a back channel that I'm aware of and there's a big push to sell preview boxes and others I have seen also don't have a smart card, so if you say given a charge in 2010....

David Elstein: Well it is of course technically possible but you don't have to roll back a bit of BBC log-rolling that's been going on for the last three years, which is to try and make sure there are as many digital boxes out there that don't have conditional access as possible. Our view...

Caroline Thomson: Helping digital switchover. Barry loves it.

David Elstein: If we want to delve down deep into the BBC's political manoeuvres here we could do but there's a very simple answer to this. Upgrading a Freeview box to include Conditional Access costs £10 at the manufacture level, probably £20 at the retail level. It's a very simple thing to do and if people want to have subscription funded BBC services, they would just take their non-CA boxes along to a supplier of CA enabled Freeview boxes and for a 20 quid one-off payment they would then have access forever to BBC digital services. And if you read the report I mentioned to you, you will find that one of the key recommendations...

Terry Burns: There is obviously no ban on advertising.

David Elstein: I didn't say buy it, I just said read it. The great thing is that it's not just free at the point of use, it's free because it's all been paid for by the people who wrote the report. One of our key recommendations was that a conditional access module should be mandatory in all future digital set top boxes because doing it is such a low cost and has such a huge consumer benefit that we should not allow a situation to arise where it's deemed to be impossible to introduce the most rational way of funding the BBC because that log has been rolled for so long.

Barry Cox: Well I mean I disagree with David on the 2/7 point because digital switchover, if it starts then and it probably will, will be done region by region and it seems to be very unfair that either the only people who could get BBC 3 and 4 under these proposals are people who live in border, or that the, and then the rest of us can as it were because suddenly, though we've been getting it, we can no longer get it. I think it is only realistic to assume that subscription when switchover is finished, which at the BBC's view should be around 2012, and I tend to agree with them.

David Elstein: Sorry, Barry, I don't understand that at all. If the BBC's digital channels are only available to people who pay for them, you can get them wherever you have cable, wherever you have satellite and wherever you have DTT. You just have to have a conditional access module in your box. It doesn't change the transferring format.

Barry Cox: No but linking it to switchover implies that, since the whole point is to maximise people's choice, that it would only become available to everybody in that form when they've been switched over.

David Elstein: No, we've separated out those issues. They are two quite distinct points.

Terry Burns: Anymore points?

Third audience member: Well I've got two points to make. Firstly, I don't see how – it is points, they're not questions.

Terry Burns: But are they points we've missed?

Third audience member: Well how (INAUDIBLE) .the advantage we get from the BBC as a whole, as a service as a whole, for example, as a sponsor of the arts, and I'm not happy secondly about the fact that radio will soon be identified as a problem. (INAUDIBLE) and therefore radio services are hit under that umbrella and I think there are lots of the things that the BBC offers as a service as a whole and an ethos that the BBC offers as a service as a whole that I don't think the commercial alternatives provide at all. They just seem to me piecemeal opportunities for funding for elements of the BBC but not for the service as a whole.

Terry Burns: I think your strictures about radio are well taken because there is a tendency in all of these discussions for it to be completely dominated by television and so there may be a radio programme and we'll deal with that separately. We are going to have two seminars on radio issues and we will...

Third audience member: Don't you think you should have had the funding session at the end of the...

Terry Burns: There is no way of easily breaking into this I'm afraid. It is the issue of where you start and where you finish is one that I've wrestled with for some time. That doesn't stop issues of funding returning and I think they will in some of the issues. I think particularly in the issue of radio we will come back to that. Howard?

Howard Davies: Just one briefly on the point you asked about points not covered and I was quite surprised by both Martin and Barry in their recommendations for the future. Both of them included the notion that the BBC should be responsible for working out a new funding mechanism, which seems odd to me on the basis that...

Terry Burns: (INAUDIBLE)

Howard: Yes, on the basis that the BBC's view is clear and their interest is very clear and that seems to me to be odd to ask someone to work out how they should be paid. In most walks of life we don't do that and so I think the question of who should be responsible is one that we haven't really determined, if there is to be any change in the next phase if you like outside the Charter Review. And my own prejudice would be to think that they're wrong to suggest it should be the BBC.

Terry Burns: Well we can pick this up on the government's regulation.

Martin Cave: I'd envisaged that the BBC would be like most other organisations, which was that they were put in a position where they had to meet the payroll and they had various ways

in which they might do it and then they would choose, like other broadcasters, to decide how to do it.

Barry Cox: My point is the statement of Howard. You're absolutely right. Of course it couldn't be left to the BBC. Either the regulator and the government would have to decide, but they should take responsibly initiating figures. I really do think that it is not helpful now to as it were let the BBC continually say the status quo, the status quo, the status quo. Make them think about something differently.

Fourth audience member: It seems to me that the argument is that the BBC should be driving digital switchover funded by the licence payer so that then we can change the form of funding. It seems to me to be a contradictory point.

Barry Cox: No, that is the government's policy. The fact that the government chooses to make this, as I call it, Faustian pact with the BBC is entirely of their volition. They could have been done differently.

Terry Burns: Okay, well thank you all very much. I think it has been a very useful discussion and I think it has helped to clarify a number of the areas of the different points of view about the different sources of funding and I am very grateful to everyone here who have been participating in that and thank you everyone else for coming. Thank you very much.