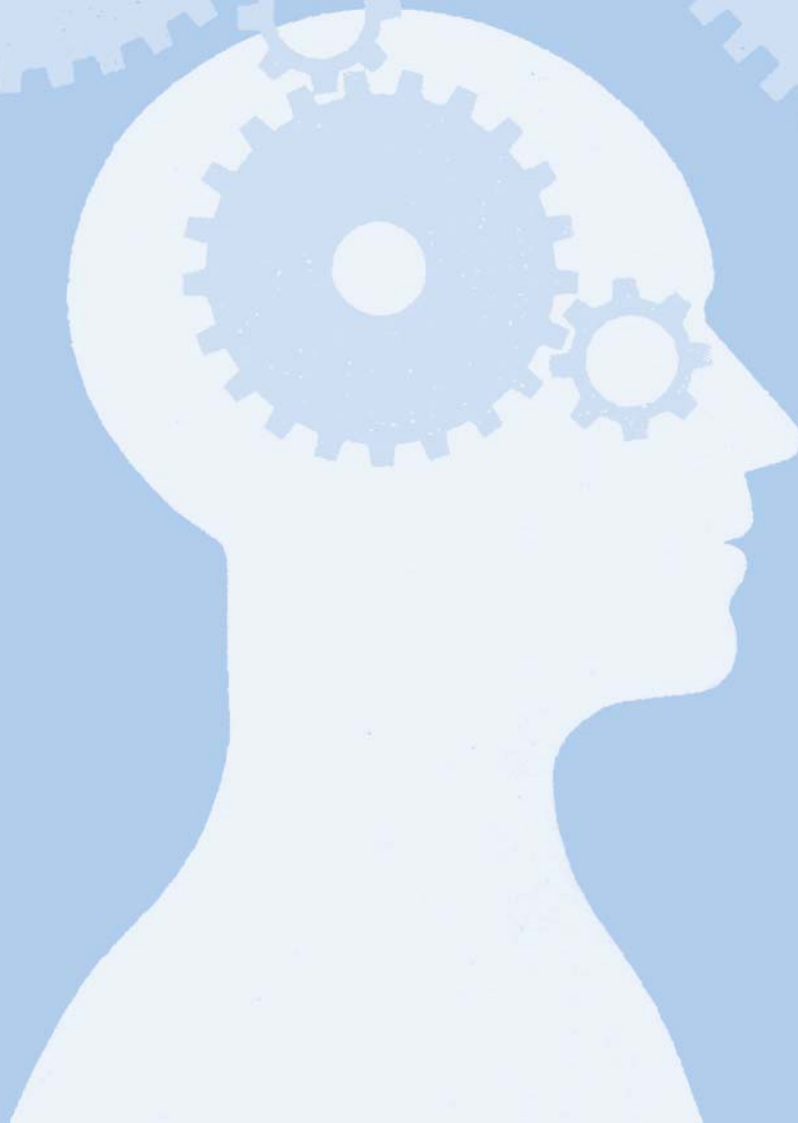


Affordability of the BBC's licence fee

Report prepared for
the BBC

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Executive summary

In the context of the current funding review for the BBC, the BBC has bid for a real increase in the licence fee of 2.3% per year from 2007/08 to 2013/14. Of this, 1.8% is for the BBC to fulfil its Public Service Broadcasting obligations, while 0.5% is to cover expenditure related to industry developments, in particular digital switchover.

An important aspect of the discussion on the level of the future licence fee is that the proposed licence fee remains affordable to viewers, without constituting a significantly growing financial burden over time. In that context, the aim of this analysis has been to examine how affordability will evolve through the next agreement period—ie, the period between 2007/08 and 2013/14.

While there are several ways to measure affordability, on the basis of past trends and once the effects of the ageing population are taken into account, the affordability of the licence fee is likely to improve over the period of the BBC's funding proposals for those for whom it is most relevant—namely those in the lower income deciles. This conclusion is not sensitive to the approach adopted for forecasting income.

On the basis of the most pessimistic analysis, for those in the higher income groups (for whom there is a slight reduction in affordability), the worst affected group will find the licence fee less affordable by the equivalent of only £1.36 per year (when their real annual disposable income will have increased by around £370 per year). As a proportion of discretionary leisure expenditure, past trends suggest that the licence fee will decline for all licence-payers.

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1 Introduction

In the context of the current funding review for the BBC, the BBC has estimated that the licence fee would need to grow at RPI + 2.3% per year from 2007/08 to 2013/14, to enable it to fulfil the major challenges it faces regarding digital infrastructure and services, quality content and new local investment. Of that 2.3% real increase, 0.5% is to cover industry costs relating to, for example, Digital UK,¹ and 1.8% relates to increased costs that are directly attributable to the BBC's core functions.

An important aspect of the discussion on the level of the licence fee is whether the proposed licence fee remains affordable to viewers, without constituting a significantly growing financial burden over time. In that context, the aim of this analysis is to look forward to determine how affordability will evolve through the next agreement period—ie, the period from 2007/08 to 2013/14, focusing on how those on lower incomes will be affected.

Affordability as a concept is not straightforward, with a variety of measures that can be used as a basis for assessment. These are explored in section 2.

To make such forward-looking assessments requires forecasts of disposable income, the distribution of income, expenditure, the number of households and the proportion of households that are and will become exempt from paying the licence fee over time. The forecasts used are explored in section 3.

Section 4 discusses the results of the analysis of the different affordability measures.

¹ Digital UK is an independent, not-for-profit organisation, established by the broadcasting industry to lead the switchover programme and communicate with the public.

2 Measures of affordability

An assessment of affordability implies a comparison of the licence fee against some measure of income or expenditure. Generally, these comparisons focus on a measure of income over which a household can exercise choice in decisions on spending. Whichever measure is examined, for any given level of the licence fee, changes in the non-discretionary elements of income (eg, tax) or spending (eg, fuel costs) may affect affordability.

One option is to consider affordability in relation to the share of disposable income that is available for households after tax (income and council tax) and national insurance payments have been deducted. For this measure, if the government tax-take were to rise, the licence fee would appear less affordable as a proportion of disposable income. In addition, there are categories of tax (eg, VAT) that are not taken into account when measuring household disposable income.

An alternative to income is to use an expenditure-based measure of affordability. The approach adopted in this report is to analyse affordability against a measure of discretionary spending, as this reflects the amount of money that households have available for non-essential items (and which could therefore be adversely affected by increases in the cost of the licence fee). The proxy for discretionary expenditure used in this analysis is the amount spent on leisure. If households were to choose to save more rather than spend, this would worsen this measure of affordability—even if exactly the same amount of money were available, post-tax.

Any analysis of affordability that looks only at the average impact will likely miss a crucial element—that affordability changes are particularly important in terms of how they affect those on lower incomes. As concerns about affordability mostly focus on the households in the lower income deciles, the effects for these households are at the centre of this analysis.

This report therefore examines affordability from a number of perspectives:

- licence fee as a proportion of disposable income per household;
- licence fee as a proportion of discretionary spending per household;
- licence fee as a proportion of disposable income by income decile, to ascertain how any affordability impact is distributed across households.

3 Forecasting

As noted above, to conduct forward-looking assessments of affordability requires forecasts of the following:

- disposable income (per household);
- the distribution of income;
- expenditure;
- the proportion of households that are and will become exempt from paying the licence fee over time.

The techniques for forecasting each of these measures are discussed below.

3.1 Disposable income

Wherever possible, government forecasts were used in the forecasting exercise. However, given the relatively long period for which forecasts are sought, there were no consistent government forecasts for the data used for the analysis.

For real household disposable income from the present day until 2008/09, Table B5 (p.238) of the 2006 Financial Statement and Budget Report (FSBR) provides a range of forecasts, from which the midpoint can be taken.² No government forecasts for disposable income are available for the subsequent period. Therefore, to construct a time series, the following proxy measures can be used:

- from 2009/10 to 2010/11, real household disposable income can be assumed to grow at the same rate reported for real GDP in Box C2 (p.258) of the 2006 FSBR.
- from 2011/12, real household disposable income can be assumed to grow at the same rate reported for long-term GDP in Table AI (p.180) of the 2006 FSBR.

These figures are included in Appendix 1, showing the annual forecasts, together with the compound annual growth rate (CAGR), which shows the constant annual growth rate that would produce equivalent outcomes to the aggregation of the different growth rates shown. The final column, controlling for a 0.7% growth in the number of households per year, provides the basis for Option 1 in the subsequent analysis.³

It should be noted that the forecasts from 2011/12 are based on an assumption of a 2.0% GDP growth rate, lower than the previous three years, even though the government notes that this is a particularly cautious approach, and does not reflect a view that the trend rate of growth will fall.⁴ If GDP and, hence, disposable income were assumed to continue to grow at the same level as at 2010/11, the licence fee as a share of disposable income would be lower—ie, more affordable—than when measured against the forecasts in Table A1. In that case the CAGR would be 1.8%, not 1.55%. Furthermore, if, in 2007/08–09/10, growth in disposable income was at the top of the range in Table 3.1, the CAGR for the period would increase from 1.55% to 1.67%.

² HM Treasury (2006), 'Financial Statement and Budget Report'.

³ The forecast of 0.7% growth per year in the number of households is consistent with the assumptions adopted by the BBC in its calculations.

⁴ HM Treasury (2006), *op.cit.*, p.180.

Rather than using a combination of forecasts for disposable income and GDP, an alternative approach is to utilise the forecasts for disposable income for the period for which they are available (2005/06–08/09), and then use the average of these forecasts for the subsequent period (2009/10 onwards). This approach has the advantage of using information solely related to disposable income. This represents Option 2 in the analysis.

An alternative forecasting technique is to extrapolate from past experience, assuming that disposable income will evolve on a similar path to the recent past. This assumes that the development of economic conditions in the recent past provides a meaningful basis for predicting future developments. Such an approach will in general be more reliable the greater the degree of macroeconomic stability. In this report, this approach is referred to as the pure extrapolation approach (Option 3). Table 3.1 presents the CAGRs using a range of start dates for the extrapolation, from 1992 to 2003. In the subsequent analysis of affordability, the results are presented based on extrapolation over a five- and a ten-year period prior to the most recent actual data—ie, from 1994 and 1999—together with analysis of the sensitivity of the results to the start dates chosen (see Figure 4.1).

A variant on this approach would be to use official forecasts of disposable income while available, and then extrapolate for the future based on the combination of recent history and these official forecasts. In this report, this is termed the hybrid extrapolation approach (Option 4).

Table 3.1 below sets out the CAGRs for the growth in disposable income, presenting the two approaches based solely on government forecasts (Options 1 and 2), together with the pure and hybrid extrapolation approaches (Options 3 and 4), presenting the figures for the different start dates for the extrapolation. As expected in the extrapolation approaches, the data exhibits greater variation when a shorter time series is used for the extrapolation.

Table 3.1 Extrapolating real disposable income per household (CAGRs, %)

	Option 1 Disposable income/ GDP amalgam	Option 2 Growth at average of forecast rates 2006–09	Option 3 Pure extrapolation	Option 4 Hybrid extrapolation
2007/08–2013/14	1.55	1.77		
Extrapolating from:				
1992			1.95	1.90
1993			2.06	1.98
1994/95			2.20	2.08
1995/96			2.53	2.32
1996/97			2.22	2.07
1997/98			2.17	2.02
1998/99			2.36	2.13
1999/2000			2.10	1.94
2000/01			2.15	1.94
2001/02			0.57	1.12
2002/03			0.95	1.39
2003/04			2.33	1.84

Note: From 1994/95, the data was published on the basis of financial years, rather than calendar years.
Source: Oxera analysis.

As shown, the methodology adopted for forecasting future income growth can have a significant impact, with a difference of 0.98 percentage points in the CAGRs between the

forecast showing the highest growth (the pure extrapolation from 1995) and that using the amalgamation of government forecasts for disposable income and GDP, adjusted for the growth in households (Option 1). This represents a maximum difference of £2,389 per year per household in disposable income in 2013/14. The CAGR for Option 2 exceeds that for Option 1 as the forecast growth rate for the period 2006–09 exceeds the government forecasts included in the FSBR for the period 2009/10–13/14. However, as noted above, the government itself has recognised that the later forecasts are particularly cautious.

The implications of these measures on affordability of the licence fee are discussed in section 4 below.

3.2 Forecasting discretionary expenditure

As discussed above, affordability can also be judged against discretionary expenditure. For the purposes of this analysis, information on leisure expenditure extracted from the Office of National Statistics Family Spending surveys has been used as a proxy for discretionary expenditure.

Table 3.2 presents the forecasts of leisure expenditure using the same techniques as applied in relation to disposable income above. The only difference is that, for Option 1, information on growth in household consumption from the FSBR (rather than household disposable income) is used. This highlights a significant difference between the forecast approaches: under forecasting Options 1 and 2 (based on government forecasts, rather than past spending patterns), the resulting CAGRs are significantly lower than when using the extrapolation techniques. This reflects the fact that growth in leisure spending has outstripped growth in disposable income—a factor which enters into the extrapolation forecasts, but not those based on government forecasts. This could reflect a variety of factors, for example, decreases in the price of food; it could also reflect changes in the pattern of savings.

Table 3.2 Extrapolating real discretionary expenditure per household (CAGRs, %)

	Option 1 Household consumption/ GDP amalgam	Option 2 Growth at average of forecast rates 2006–09	Option 3 Pure extrapolation	Option 4 Hybrid extrapolation
2007/08–2013/14	1.38	1.84		
Extrapolating from:				
1992			5.35	4.56
1993			5.50	4.62
1994			5.70	4.71
1995			6.07	4.90
1996			5.85	4.63
1997			4.90	3.86
1998			4.78	3.67
1999			5.01	3.67
2000			2.32	1.95
2001			2.50	1.98
2002			3.10	2.12
2003			5.86	2.55

Note: Option 1 forecast expenditure is calculated using the FSBR forecasts for 2005/06–2008/09; from then onwards, the calculations reported below assume that household consumption growth is 0.25 percentage points below GDP growth—consistent with the 2006 FSBR’s assumptions.

Source: Oxera analysis.

3.3 Forecasting disposable income by decile

When considering affordability, the effects on those in the lower income deciles are of particular relevance. While no official forecasts for future developments in income distribution are available, it is possible to use the extrapolation techniques adopted above to forecast future changes, on the assumption that recent developments in income distribution will continue into the future.

Analysis of income distribution undertaken by the Institute for Fiscal Studies (IFS) shows that income distribution has not changed significantly since 1992, and has in fact narrowed on some measures, in contrast to the significant widening of distribution that can be observed for the previous periods. Table 3.3 presents a number of measures of income dispersion for 1982, 1992, 1997 and 2002/03 to highlight this change.

- **Gini coefficient**—a number between 0 and 1, where 0 corresponds to perfect equality (eg, everyone has the same income) and 1 corresponds to perfect inequality (eg, one person has all the income, and everyone else has zero income). The increase in the Gini coefficient from 0.257 in 1982 to 0.339 in 1992 therefore represents a widening of income inequality.
- **Top/bottom decile-to-median ratios**—these ratios show the relationship between individuals earning at the 90th percentile point (ie, earning more than 90% of the population), the median (the midpoint in the income distribution) and the tenth percentile (ie, earning more than just 10% of the population). Increases in the ratios indicate a widening of inequality.

Table 3.3 Income distribution, 1982–2002/03

Year	Gini	90/10 ratio	50/10 ratio	90/50 ratio
1982	0.257	3.058	1.696	1.803
1992	0.339	4.197	2.035	2.062
1997–98	0.338	4.017	1.986	2.022
2002–03	0.344	4.002	1.965	2.037
Percentage change				
1982–92	31.9	37.2	20.0	14.4
1992–97/98	–0.3	–4.3	–2.4	–1.9
1997/98–2002/03	1.8	–0.4	–1.1	0.7

Source: IFS, Before Household Income, data source: Family Expenditure Survey and Family Resources Survey..

As shown in Table 3.3, all these measures of income distribution show that inequality increased significantly between 1982 and 1992; however, since 1992, the Gini coefficient has been relatively stable, while all the ratios have declined since 1992, indicating a slight narrowing of distribution.

To forecast future developments in income distribution, the pure extrapolation approach has been adopted to forecast the *share of income* for each decile. That share has then been applied to each of the forecasts of disposable income presented in Table 3.1. The results of this analysis are presented in Table 3.4, showing the CAGRs for real disposable income for each decile for the period 2007/08–2013/14.

Table 3.4 Extrapolating real disposable income by decile, 2007/08–2013/14, (CAGRs, %)

	Dec 1	Dec 2	Dec 3	Dec 4	Dec 5	Dec 6	Dec 7	Dec 8	Dec 9	Dec 10	Total
Option 1	1.86	2.80	3.06	1.71	1.39	1.24	1.17	1.48	1.44	1.41	1.55
Option 2	2.08	3.02	3.28	1.92	1.60	1.46	1.38	1.69	1.66	1.63	1.77
Option 3a (from 1994)	2.51	3.46	3.72	2.36	2.03	1.89	1.82	2.13	2.09	2.06	2.20
Option 3b (from 1999)	2.41	3.36	3.62	2.25	1.93	1.79	1.71	2.03	1.99	1.96	2.10
Option 4a (from 1994)	2.39	3.34	3.60	2.24	1.91	1.77	1.69	2.01	1.97	1.94	2.08
Option 4b (from 1999)	2.25	3.20	3.45	2.10	1.77	1.63	1.56	1.87	1.83	1.80	1.94

Note: The final column corresponds to the data presented in Table 3.1.

Source: Oxera analysis.

As this analysis shows, the anticipated growth rates in disposable income for the lower income deciles are greater than those for the higher income deciles. This suggests that the effects of licence fee growth will be proportionately less for those in the lower income deciles than those in the higher ones. This is discussed further in section 4.

A further refinement to this analysis can be made, to take into account the fact that households with an eligible person aged 75 or over do not pay the licence fee. This is discussed in section 3.4.

3.4 The implications of an ageing population

Throughout the period under analysis, an increasing proportion of households will have someone aged over 75, and will become eligible for exemption from paying the licence fee. In aggregate, government forecasts show that the number of households eligible for exemption will grow at 0.15% per annum. As households with a person aged 75 or over are concentrated in the bottom half of the income distribution, an increasing proportion of population aged over 75 will disproportionately affect those groups. Hence, the 0.15% figure has not been applied uniformly to all deciles, but in proportion to the current income distribution of households with the chief economic supporter aged 75 or over. The resulting growth rates are set out in Table 3.5.

Table 3.5 Annual growth in the number of households with over-75s, by income decile

	Dec 1	Dec 2	Dec 3	Dec 4	Dec 5	Dec 6	Dec 7	Dec 8	Dec 9	Dec 10	Total
Growth in exempt households	0.26	0.25	0.27	0.19	0.16	0.14	0.10	0.08	0.04	0.02	0.15

Source: Oxera analysis.

The implication of this ageing effect is discussed in section 4.

4 Affordability measures

4.1 Percentage differences in growth rates of income or expenditure and the licence fee

To assess affordability, the absolute difference between the anticipated increase in the licence fee and the CAGRs for disposable income and discretionary expenditure can be calculated. Figures greater than zero imply a worsening in affordability, as the anticipated growth in the measure of income or expenditure is less than the growth in the licence fee. Conversely, negative figures imply an improvement in affordability. In the tables below, improvements in affordability are highlighted in bold.

The results are presented for the changes in the aggregate measures of affordability in Table 4.1, both with and without the ageing factor. Making the adjustment for the increasing proportion of non-paying households (0.15% in aggregate, concentrated in the lower income deciles as shown in Table 3.5) means that the average licence fee paid will rise by less than the absolute increase in the licence fee. As more households qualify for non-payment over time, on average this lowers the growth in the amount that each group pays.⁵

The results of this analysis show that in aggregate, the affordability of the licence fee declines slightly when measured against disposable income and discretionary expenditure using the government forecasts in Options 1 and 2. In contrast, when assessing affordability against discretionary expenditure, forecast using the extrapolation techniques, affordability improves. These extrapolation techniques show that, if the rate of growth of leisure spending continues at the pace it has done since either 1994 or 1999, this would significantly outpace the growth in the licence fee, thereby making the licence fee more affordable.

⁵ This analysis is unable to incorporate the effects of the recently announced policy to re-establish the link between the state pension and earnings growth, rather than price inflation. This policy will improve the growth of income for pensioners on state pensions and hence the average income growth for the decile groups in which those pensioners are located. Department for Work and Pensions, (2006), 'Security in Retirement: Towards a New Pensions System', May.

Table 4.1 Summary of changes in the affordability measures, 2007/08–2013/14 (%)

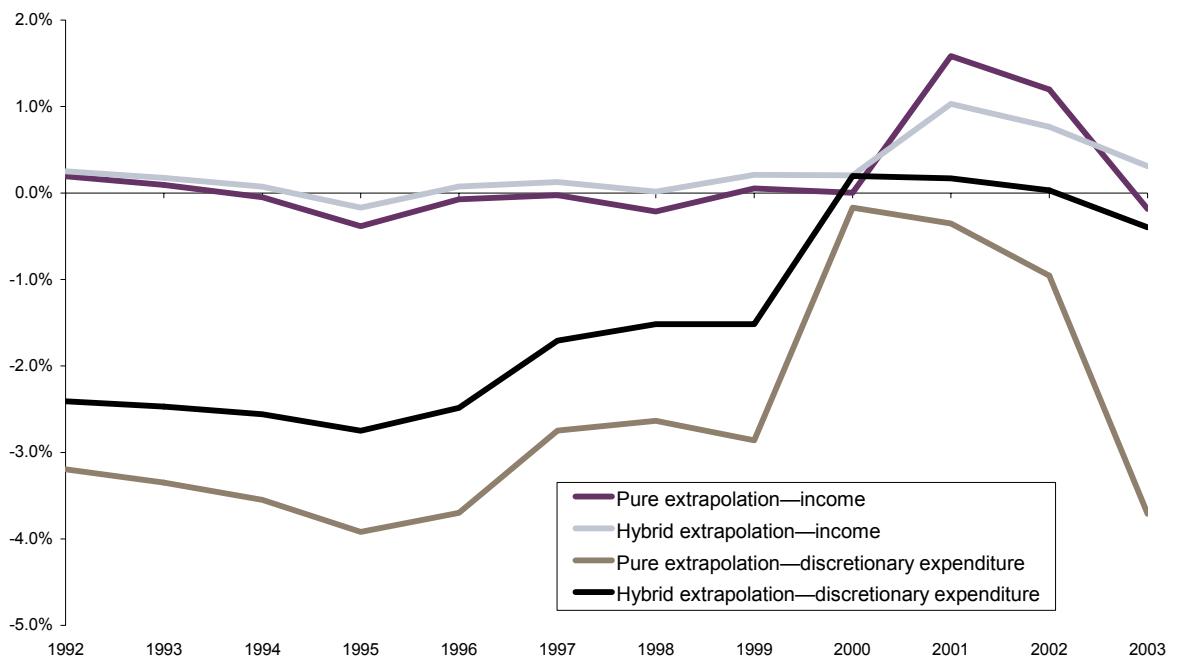
	Option 1	Option 2	Option 3a	Option 3b	Option 4a	Option 4b
	Disposable income/GDP amalgam	Growth at average of forecast rates 2006–09	Pure extrapolation		Hybrid extrapolation	
			From 1994	From 1999	From 1994	From 1999
Disposable income						
Without ageing factor	0.75	0.53	0.10	0.20	0.22	0.36
With ageing factor	0.60	0.38	-0.05	0.05	0.07	0.21
Discretionary expenditure						
Without ageing factor	0.92	0.46	-3.40	-2.71	-2.41	-1.37
With ageing factor	0.77	0.31	-3.55	-2.86	-2.56	-1.52

Source: Oxera analysis.

Figure 4.1 shows the impact of the selection of the start year for the extrapolation of income and discretionary expenditure: when a shorter period is used, the results become more variable and hence less reliable. With start dates prior to 2000, the conclusions on affordability are relatively stable.

- In relation to income, there is relatively little difference year on year, with both the pure and the hybrid extrapolation approaches predicting little change in affordability. Taking an average of the different start dates, the pure extrapolation approach indicates a slight improvement in affordability, while the hybrid approach indicates virtually no change.
- For discretionary expenditure, prior to 2000, both extrapolation techniques indicate significant improvements in affordability.

Figure 4.1 Sensitivity of the changes in the affordability measures to the start date for extrapolating in Options 3 and 4



Source: Oxera.

4.2 Absolute changes in affordability

An alternative means of presenting this same information is to show, in terms of pounds sterling, how much the absolute increase in the licence fee exceeds the increase that would leave affordability unchanged. Table 4.2 presents these results for the affordability measures based on income as set out in Table 4.1.

In real terms (measured in 2004/05 prices), between 2007/08 and 2008/09, the licence fee would increase by £3.02 from £131.29. As shown in Table 4.1, this rate of increase represents a reduction in affordability of 0.75%, when measured against income growth forecast using Option 1 (and without taking into account the ageing effect). Therefore, if growth in the licence fee were 0.75% lower, this would not represent a worsening of affordability. Translating that 0.75% into pound sterling, Table 4.2 shows that if the licence fee grew by £0.99 less (ie, by £2.03 rather than £3.02), there would be no change in affordability.

The absolute value of the reductions in affordability observed in Table 4.1 are all less than £1 per year, and most less than 50 pence per year.

Table 4.2 Absolute annual increase above the affordability-neutral level, 2007/08–2008/09 (£)

	Option 1	Option 2	Option 3a	Option 3b	Option 4a	Option 4b
	Disposable income/GDP amalgam	Growth at average of forecast rates 2006–09	Pure extrapolation		Hybrid extrapolation	
			From 1994	From 1999	From 1994	From 1999
Without ageing factor	0.99	0.70	0.13	0.27	0.29	0.47
With ageing factor	0.79	0.51	n/a	0.07	0.09	0.28

Source: Oxera analysis.

4.3 Affordability by income decile

The additional variation in the affordability analysis was by income decile. For this analysis, the dispersion across the income deciles of households eligible for non-payment set out in Table 3.5 above is incorporated. Information on expenditure by decile group is not available to a sufficient level of detail to enable this analysis to be undertaken for the expenditure measure of affordability.

Table 4.3 shows the net affordability position by income decile for each of the approaches for forecasting future disposable income, taking into account the effects of the ageing population. Table 4.4 translates these measures into pound sterling per year, showing how much the absolute increase in the licence fee exceeds the increase that would leave affordability unchanged. This is comparable with the aggregate measures presented in Table 4.2 above.

Table 4.3 Change in affordability measures by income decile, 2007/08–2013/14 (%)

	Dec 1	Dec 2	Dec 3	Dec 4	Dec 5	Dec 6	Dec 7	Dec 8	Dec 9	Dec 10	Total
Option 1	0.18	-0.75	-1.03	0.41	0.75	0.92	1.03	0.75	0.82	0.87	0.60
Option 2	-0.04	-0.97	-1.25	0.19	0.54	0.71	0.82	0.53	0.61	0.65	0.38
Option 3a (from 1994)	-0.47	-1.41	-1.69	-0.24	0.11	0.27	0.39	0.10	0.17	0.22	-0.05
Option 3b (from 1999)	-0.37	-1.31	-1.59	-0.14	0.21	0.38	0.49	0.20	0.28	0.32	0.05
Option 4a (from 1994)	-0.35	-1.29	-1.57	-0.12	0.23	0.39	0.51	0.22	0.29	0.34	0.07
Option 4b (from 1999)	-0.21	-1.15	-1.43	0.02	0.37	0.53	0.65	0.36	0.43	0.48	0.21

Source: Oxera analysis.

Table 4.4 Absolute affordability measures by income decile, 2007/08–2013/14 (£)

	Dec 1	Dec 2	Dec 3	Dec 4	Dec 5	Dec 6	Dec 7	Dec 8	Dec 9	Dec 10	Total
Option 1	0.23			0.54	0.99	1.21	1.36	0.98	1.08	1.14	0.79
Option 2				0.25	0.71	0.93	1.07	0.70	0.80	0.85	0.51
Option 3a (from 1994)					0.14	0.36	0.51	0.13	0.23	0.28	
Option 3b (from 1999)					0.27	0.49	0.64	0.26	0.36	0.42	0.07
Option 4a (from 1994)					0.30	0.52	0.66	0.29	0.39	0.44	0.09
Option 4b (from 1999)				0.02	0.48	0.70	0.85	0.47	0.57	0.63	0.28

Note: Blank spaces in this table indicate that the licence fee is becoming more affordable.
Source: Oxera analysis.

As this indicates, once the effects of the ageing population are taken into account, although in aggregate affordability worsens on several of the measures proposed in this analysis, when measured against disposable income, affordability improves for those for whom it is most relevant—ie, those in the lower income deciles. This conclusion is not sensitive to the approach adopted for forecasting income.

Furthermore, the cash effect on households on an annual basis is small, with the worst affected income decile (the seventh decile) being worse off by only £1.36 per year as a result of above-income growth increases in the licence fee.

4.4 Affordability before digital switchover costs

According to information provided by the BBC, of the 2.3% real increase in the licence fee which it requires, 0.5% is needed to cover the industry costs that the government has asked the BBC to fund. This includes, for example, the costs of Digital UK. To assess the impact on affordability, it can justifiably be argued that this element of the bid should be removed, as it is for additional expenditure related to digital switchover.

When calculating the impact on affordability on the basis of a 1.8% real increase in the licence fee, this can be seen to become more affordable over the period 2007/08–13/14 on the basis of the majority of forecasting techniques (see Table 4.5).

Table 4.5 Affordability with a 1.8% real increase against disposable income

	Option 1	Option 2	Option 3a	Option 3b	Option 4a	Option 4b
	Disposable income/GDP amalgam	Growth at average of forecast rates 2006–09	Pure extrapolation		Hybrid extrapolation	
			From 1994	From 1999	From 1994	From 1999
Percentage change						
Without ageing factor	0.25	0.03	-0.40	-0.30	-0.28	-0.14
With ageing factor	0.10	-0.12	-0.55	-0.45	-0.43	-0.29
Absolute reduction (£/year)						
Without ageing factor	0.33	0.05	n/a	n/a	n/a	n/a
With ageing factor	0.13	n/a	n/a	n/a	n/a	n/a

Source: Oxera.

5 Summary and conclusions

This report has presented the results of an analysis of affordability of the future BBC licence fee against a variety of measures. The following main points are relevant in relation to the methodology adopted.

- The BBC has bid for a real increase in the licence fee of 2.3% per year, of which 0.5% is designated to cover costs, such as the funding of Digital UK.. As these costs are to be incurred at the government's stipulation, it can be argued that they should be excluded from an analysis of future affordability. Affordability has therefore been evaluated both in relation to the full 2.3% increase, but also in relation to a 1.8% increase.
- There is the question of which benchmark measure to use to assess changes in affordability. While disposable income is one option, it is also informative to examine affordability against a measure of expenditure on the basis that this reflects changing patterns of saving versus consumption. In this analysis, both income and expenditure benchmarks have been used, with spending on leisure items adopted as the relevant measure for the expenditure benchmark.
- Various techniques can be used to forecast future changes in the benchmark measures and there are no government forecasts that cover, consistently, the period until 2013/14. Therefore, a range of options has been presented.
- The analysis takes into account the rising proportion of households that will become eligible for non-payment of the licence fee as they include a person aged 75 or over.
- The analysis also addresses the question of affordability for those on lower incomes—for whom the issue of affordability is most important.

The results of the analysis are as follows.

- When benchmarked against disposable income, there is a slight reduction in affordability in aggregate over the period (Table 4.1). This reduction equates to spending on the licence fee of less than £1 per year per household (Table 4.2), compared with an annual increase in real household disposable income of over £450.
- If the 0.5% of the bid to cover additional costs related to digital switchover is removed from the analysis (Table 4.5), affordability would improve on the majority of affordability measures presented.
- Measured against leisure expenditure, which reflects the amount of money that households have available for non-essential items, the conclusions reached depend on the forecasting techniques adopted. Using the full 2.3% bid, affordability would reduce if forecasting future expenditure using government forecasts for aggregate household consumption, but would improve (significantly) if recent patterns of increased spending on leisure spending are incorporated into the forecasting methodology through the use of an extrapolation technique.
- Finally—and significantly—if the pattern of income distribution continues to narrow slightly, as it has done since 1992, on the basis of past trends and once the effects of the ageing population are taken into account, the affordability of the licence fee is likely to improve over the period of the BBC's funding proposals for those for whom this question is most relevant, namely those in the lower income deciles (Tables 4.3 and 4.4). This conclusion is not sensitive to the approach adopted for forecasting income.

Appendix 1 Government forecasts for disposable income and GDP

Table A1.1 Government forecasts of real disposable income (%)

	Aggregate			Per household (at 0.7% pa growth in households)
	Min	Max	Midpoint	
2005–06	2.25	2.25	2.25	1.55
2006–07	2.5	2.75	2.63	1.93
2007–08	2	2.5	2.25	1.55
2008–09	2.25	2.75	2.50	1.80
2009–10	2.25	2.75	2.50	1.80
2010–11	2.25	2.75	2.50	1.80
2011–12			2.00	1.30
2012–13			2.00	1.30
2013–14			2.00	1.30
CAGR, 2007/08–2013/14 (%)			2.25	1.55

Notes: ¹ Real household disposable income growth up to 2008/09 is based on the midpoint values reported in Table B5 (p.238) of the 2006 FSR. From 2009/10 to 2010/11, real household disposable income is assumed to grow at the same rate reported for real GDP in Box C2 (p.258) of the 2006 FSR. From 2011/12, real household disposable income is assumed to grow at the same rate reported for long-term GDP in Table A.1 (p.180) of the 2006 FSR. For RPI growth, figures up to 2010/11 are based on Table C3 (p.255) of the 2006 FSR. From 2011/12, RPI growth takes the value estimated for 2010/11. ² CAGR figures are the average annual real growth rates for the nine-year period starting in 2004/05 and ending in 2013/14.

Sources: Oxera summary of HM Treasury forecasts.

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