

## 4 Funding

### What people think

- The licence fee is 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, particularly in combination with the licence fee.
- The public’s view of the value for money delivered by the BBC is equivocal – with 46% saying it delivered fairly good or very good value for money, compared to 33% taking the opposite view.
- There is strong support for the BBC’s independence from Government and from commercial pressures.
- The way the licence fee is set and collected raised issues about fairness (particularly for those on low incomes) and efficiency (using significant public money to chase evaders).
- Some proposals were put forward for different ways to distribute the licence fee to other broadcasters and production companies.

#### Our policy

The licence fee remains the best way to fund the BBC. All other funding models have more significant drawbacks while the principle of collective payment through the licence fee retains general public support. The licence fee should continue to fund the BBC throughout the next ten years.

In the next phase of Charter Review, we want to look further at the operation of the licence fee including its level and the way it is collected and enforced. To set the level of the licence fee we will have to consider the costs of any new obligations or proposals, many of which are still uncertain, against their potential benefits. We will take independent advice on a range of issues including the value for money of the BBC’s existing services and will take account of the public’s views.

Changes in technology will in future allow audiences to watch television programmes in a variety of different ways without needing a television set – for example over the internet or via mobile phones. The collection of a fixed charge based on television ownership may therefore become difficult to sustain in the longer term. Planning should start ahead of time to establish whether any alternative funding models, particularly subscription, may need to be reconsidered after 2016. This should be an issue for further review as the process of digital switchover nears completion.

### The licence fee and the arguments made against it

- 4.1 At present, the BBC receives most of its funding from the TV licence fee (currently £121.00 per household per year). Licence fee income in 2003/4 was around £2.8 billion (£408 million of which came from the Department for Work and Pensions to compensate the BBC for free TV licences given to over-75s). It supplements that income with the contribution made to its

public services by its commercial services (which contributed profits of around £38.5 million in 2003/4)<sup>21</sup> and some direct Government funding – around £220 million from the Foreign and Commonwealth Office – that pays for the World Service.

4.2 A significant minority of respondents to our public consultation argued for the abolition of the licence fee, and there are a number of arguments made against the principle of the licence fee as it exists today:

- It is a regressive form of taxation – everyone pays the same flat charge, regardless of their income, the number of televisions they own or the extent to which they watch television in general and BBC services in particular.
- The unfairness of the flat rate charge is intensifying as the number of TV channels increases and the BBC's overall audience share decreases.
- The BBC uses the income it receives from TV viewers to pay for its other services, in radio and new media, and its non-programming activities.
- The costs of collection and evasion are high (£300 million annually – £150 million for collection, £150 million for evasion) and enforcement is often perceived to be draconian especially where evaders are criminalised and those who fail to pay their fines are occasionally imprisoned.

4.3 It is also argued in some quarters that the licence fee will become more difficult to sustain in future as technology develops, for three main reasons:

- As digital take-up increases, audiences for BBC services may fall significantly, reducing public support for a universal charge.
- Subscription and on-demand payment systems will be developed for use across all forms of television, making it possible for viewers to be charged only for those programmes or services they want to watch.
- TV viewing may no longer be confined to TV sets, but could take place via computer terminals or mobile phones. A licence fee based on TV ownership could therefore become redundant.

### Alternatives to the licence fee

4.4 The Independent Panel discussed three main alternatives to the licence fee, all of which merit consideration:

- direct funding from Government.
- commercial funding for a free-to-air service – through advertising and sponsorship.
- commercial funding for a pay-TV service – through subscription (although this would not be possible for radio services).

However each of these options carries significant drawbacks.

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<sup>21</sup> See Chapter 6 for a detailed breakdown of the BBC's commercial services.

## Government funding

- 4.5 Government funding could be considered fairer than the licence fee in that it would be progressive – each individual would in effect only contribute according to his or her income. This would make the BBC an area of Government spending like any other public service. The objections to this arrangement are made on the grounds that the BBC is a public service like no other, and it is feared that direct Government funding might threaten both:
- the BBC's independence – if the Government held the purse strings; and
  - its stability and security – were the BBC to be subject to reviews of its funding through the biennial Government Spending Review process.
- 4.6 These objections appear to be supported by public opinion. The public told us they wanted less scope for Government interference in the running of the BBC and nearly two thirds of them support the licence fee in its current form as the best method of funding. Ofcom's audience research found there was significant opposition to Government funding – partly because people wanted the Government kept out of television and partly because they saw a distinct difference between the 'luxury' of public service television and the 'right' to other forms of universal public service such as the NHS.<sup>22</sup>

"I think they would lose their impartiality, and you might see, as a change in government came along, a change in slant. I don't want to see that."  
*(C1, 46-60, light TV watcher, Scotland)*<sup>23</sup>

## Advertising and sponsorship

- 4.7 The case for allowing advertising on the BBC is a difficult one to make. There was quite vehement opposition expressed to the idea of advertising on the BBC in the course of our public consultation and research. 60% say it interferes with their enjoyment of programmes (31% disagree). The lack of advertising is therefore felt to be a key distinguishing characteristic of the BBC – it was the third most frequent value spontaneously attributed to the BBC by contributors to our quantitative research.<sup>24</sup>
- 4.8 The BBC would certainly attract advertisers if it were allowed to, particularly to its mainstream services. However, modelling of the advertising market suggests that the effect of such a move would be to push down prices (since the total amount of money spent on advertising would not rise significantly but many more ad 'spots' would become available)<sup>25</sup>. This would almost certainly reduce the income of both the BBC and the existing ad-funded broadcasters (including other public service broadcasters, such as ITV and Channel 4).
- 4.9 Advertising would also create conflicting incentives for the BBC – the requirement to fulfil public purposes would have to be weighed against the need to generate revenue. The character of programming might drift towards the middle ground of taste as a result. Ofcom has

<sup>22</sup> MORI/Ofcom, *Valuing PSB: the view from the audience*, pp. 27-30

<sup>23</sup> Cragg Ross Dawson, *Qualitative research to Inform the BBC Review*, 2004

<sup>24</sup> MORI, *Quantitative research to inform the preparation of the BBC Charter Review*, 2004

<sup>25</sup> Ofcom review of public service television broadcasting, *Phase 2 – Meeting the digital challenge*, p. 69

pointed out that such a conflict of incentives already exists for ITV1, Channel 4 and Five, and that it will be increasingly difficult to regulate in future as commercial competition intensifies. 52% of those we surveyed said they thought the BBC would lose its independence if it relied on advertising or sponsorship.

- 4.10 The long-term trends in the TV advertising market are anyway uncertain. New digital technology – particularly PVRs – increasingly allows audiences to skip through advertising breaks. It may be unwise to increase the dependency of public service broadcasting on advertising revenue at a time of such uncertainty.
- 4.11 There are probably fewer concerns about allowing the BBC to take sponsorship for some programmes. There would still be some questions to answer, however, about a potential conflict of incentives and the commercial impact of such a move. Viewers and listeners may feel it detracted from their experience of the BBC if commercial messages were attached to their favourite programmes – although our research suggests they would prefer it to advertising. And sponsorship alone would never deliver sufficient income to sustain the BBC without some additional source of funding.

### Subscription

- 4.12 The BBC's own 'willingness to pay' research suggests that some people are willing to pay significant amounts for access to BBC services – 42% say £20 per month and 19% say £30 per month<sup>26</sup>. If services were put together in differently priced packages, with premium programmes available at different prices depending, for example, on their newness or exclusivity, audiences would have more freedom of choice and some argue that the BBC might retain a sustainable level of funding.
- 4.13 This sort of model would raise significant issues of principle. The chief argument against subscription as a funding method is that it would undermine the principle of universal access – BBC content would no longer be free at the point of use. It can be argued in response that the existing licence fee is anyway a form of 'compulsory subscription'. Services are only 'free' once a bulk licence fee has been paid. But if people could choose not to subscribe then prices might have to rise for those who carried on paying, and some low-income viewers and listeners who did want to subscribe might well be priced out of the market for BBC content. If that content were not universally available, its potential benefit to society would be reduced.
- 4.14 In the short term, there are also significant practical problems. In mainstream radio, no subscription facility exists, nor does one look likely to be widely available for some time. While a TV subscription service could function in satellite and cable homes, for most terrestrial viewers (including most digital terrestrial or Freeview homes) there is presently no way of controlling access to individual channels. New subscription technology (code-protected cards for 'conditional access') of the sort used in satellite and cable homes would need to be included in most, if not all, digital terrestrial equipment before any subscription system could function for the BBC.

<sup>26</sup> BBC/Human Capital, *Measuring the value of the BBC*, October 2004

## Why the licence fee should continue for the time being

- 4.15 When compared to the alternatives, we feel the licence fee continues to be the best funding mechanism for the foreseeable future. That is a conclusion endorsed by Ofcom and the Culture, Media and Sport Select Committee, as well as by licence fee payers. While some people show interest in the alternatives, in all strands of our research work there was more support for the licence fee than for any other mechanism. 63% of those who mentioned funding in responding to our consultation accepted the principle of the licence fee. Many respondents argued that the licence fee provided unparalleled value for money, and one of the most common arguments made in its support was that it binds all households together as equal stakeholders in the BBC.
- 4.16 Audiences want the BBC to remain a universal service. They also see that the value of the licence fee is that it should keep the BBC at arm's length from Government but should bring it closer to the public who are footing the bill. Systems of accountability need to be devised to reflect this, and these are discussed in Chapter 5.
- 4.17 Two significant issues remain about the future operation of the licence fee, however:
- The licence fee remains a regressive tax. There is some evidence that audiences accept and even value this, since they consider the BBC to be a different sort of public service to that provided by the NHS or the education system. Nevertheless, we need to consider whether or not there are anomalies that need addressing in the existing concessions policy that applies to the licence fee, as well as whether collection could be made more efficient or enforcement less draconian.
  - Technological change may in future open up the possibility of new electronic means of payment, and digital take-up may affect the level of public support for the licence fee. This should be one issue for review during the course of the next Charter period, as we go through digital switchover.

These issues are discussed in more detail in the sections that follow.

## The operation of the licence fee

- 4.18 The next phase of the Charter Review process will involve a review of the BBC's funding needs – to allow the Government to calculate the necessary level of the licence fee, to apply from April 2007. Since 2000, the BBC has benefited from an annual increase of 1.5% above inflation, to pay for its expansion into new digital services. At the same time, it has continued to benefit from the increasing number of UK households, which is adding 0.75% a year to the value of licence fee income.<sup>27</sup> If the number of UK households continues to rise at the projected rate, after ten years the BBC could expect to receive an extra £230m every year. To decide what future settlement is appropriate, in the next phase of Charter Review the Government will conduct a funding review – to weigh up very carefully the overall costs to licence fee payers of the BBC's existing services and any proposals for new obligations or services. Decisions will need to balance these costs against the benefits to be gained. The funding review will be run by Government. It will take independent advice on a range of issues including the value for money of the BBC's existing services and will take account of the public's views.

<sup>27</sup> Ofcom review of public service television broadcasting, *Phase 2 – Meeting the digital challenge*, p. 79

- 4.19 We believe the current scope of licence fee concessions is about right. However, we will re-examine any anomalies in the existing licence fee concessions policy, particularly in the accommodation for residential care (ARC) scheme that applies to residents of sheltered housing.
- 4.20 We will review the existing licence fee collection policy. Collection currently costs around £150 million each year and the Independent Panel noted the ‘clumsiness’ of the current arrangements. We will consider whether new technology allows collection to be conducted in a more cost-effective way, and whether, for example, increased use could be made of direct debit and internet payment schemes.

### Providing flexibility for the future

- 4.21 At present, to achieve universal availability the BBC needs to operate as a publicly-funded, free-to-air service. To this end, the licence fee is the best funding method available. But the combined costs of evasion and collecting and enforcing the licence fee are roughly 11% of licence fee income, or £300 million per year, before any money is spent on programmes<sup>28</sup>.
- 4.22 In future, if a large number of people are downloading audio-visual content from the internet, and watching it on their computers or mobile phones, rather than using traditional TV and radio services, it may be difficult to collect and enforce a licence fee based on television ownership.
- 4.23 In that world, different funding models may have to be considered. If the licence fee was to be retained, the means of collecting it might have to be changed – so that it became, for example, either a compulsory levy on all households or even on ownership of PCs as well as TVs.
- 4.24 Some argue that if the BBC’s audience share continues to drop, public support for the licence fee will drop with it. We are not by any means certain that this will happen. However, if it turns out to be true, subscription alternatives may need to be considered – either charging a one-off payment for access to the whole range of BBC (or PSB) services or, more likely, creating different BBC packages, with different prices, available across a range of different digital platforms.
- 4.25 There are potential problems with all these options. A compulsory levy might be unsustainable if the BBC’s audience share continues to fall. Subscription options would compromise universal access and might pose technological complications if they were applied to BBC radio programmes and new media services, even if all televisions were fitted with conditional access technology. Our quantitative research suggested that only 10% of people currently think that subscription would be the best way to fund the BBC.
- 4.26 The Independent Panel has suggested that a ‘mixed funding’ model, combining elements of licence fee, advertising, sponsorship and subscription, may be workable beyond the next ten years. There may be some serious questions about the efficiency of such an arrangement. But we agree there should be a further review of the practical implications of the different options during the course of the next Charter, before the end of digital switchover, so that the necessary planning could be carried out for any change after 2016. One issue for that review to consider would be the feasibility of rolling-out conditional access systems to the point where subscription options were viable in some form.

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<sup>28</sup> BBC Annual Report and Accounts, 2003-2004, p. 97