CITIZENS FOR A SOUND ECONOMY

COMPETITIVE ENTERPRISE INSTITUTE

November 18, 2003

The Honorable John McCain
Chairman
Senate Committee on Commerce, Science, and Transportation
241 Russell Senate Office Building
Washington, DC 20510

Dear Chairman:

We write to share with you our analysis of the idea of a la carte regulation of cable television channels, in which you have shown some interest. Neither the recent GAO report on cable television rates, nor our own analysis, supports a la carte regulation of cable. It would prove disastrous for the development of new channels and for cable's still-young competitors, such as DBS.

Cable Prices and the Consumer Price Index: A Misleading Comparison

The relationship between cable television prices and the consumer price index has been controversial because the rates have risen faster than the index. Note, though, that the Bureau of Labor and Statistics (BLS) notes that the index cannot easily account for price changes that go along with changes in quality. The BLS web site notes that "One of the most difficult problems for the CPI is to accurately quantify changes in the quality of items and to factor these quality changes out of the items' price movements." The example of a hard-to-account for item that BLS explores further is a cable television tier.

Comparing cable prices to the CPI is potentially deeply misleading, given the substantial changes in the nature of cable offerings over time. The quality issue is harder to get a grip on. But it's hard to deny that there are more channels than before, and that these channels serve more diverse tastes than before. Now, more channels aren't necessarily better. But cable penetration continues to expand; by that rough measure, audiences are enjoying the greater diversity. And surely *fewer* channels aren't better.

A La Carte Would Kill New Channels. This brings us to the next problem with a la carte cable; its impact on niche channel development. New channels are expensive to start and may take years to begin to recover their costs. And new channels are a risk; entertainment industry hits and flops are notoriously hard to predict.

Under an a la carte scheme, how many people would order the fashion channel? The food channel? Or a new channel that no one has seen yet, like "Wheels TV," an automobile channel scheduled for rollout in 2004, or G4, a new channel for video game fans (G4 will cost at least $150 million over the next five years to break even). What about C-Span? We're all glad it's there, but does anyone really watch it enough to order it separately?

Maybe a few in every community would order niche channels. Enough to support the risks and costs of development? Very doubtful. What would be left at the end of the day? Mass-market fodder for the lowest common denominator. In the end, a la carte would not deliver the goods for consumers, whose tastes seem to run increasingly to diversity.

A La Carte Would Kill Fledgling Cable Competitors.

In today's changing tech markets, the whole idea that prices should follow costs in some wooden and mechanical manner is wrong. Suppose that cable companies' prices and profits did rise above costs for a period of time. This is what brings new competitors and new innovation into the market. (Remember the old-fashioned supply and demand curve, with the price point at the intersection of the two?)

A second casualty of a la carte, after new channels, is likely to be most potential competitors to cable. Could direct broadcasters cover their own costs if they had to deal with a market in which consumers could order revenue leaders like ESPN, the Discovery Channel, and nothing else? Unlikely. And what about entirely new entrants to the market? Why would they even bother to try, if regulation of cable restricts their own flexibility in bundling and pricing?

Markets Are Not Perfect, But They Work Better Than Regulation.

As the GAO report points out, cable television markets are far from perfect competition. Most markets are. But most of them, cable included, still work better with less regulation.

Sincerely,

Solveig Singleton
Senior Analyst
Competitive Enterprise Institute
1001 Conn. Ave. N.W. Ste. 1250
Washington DC 20036

Paul Beckner
President and CEO
Citizens for a Sound Economy
1900 M Street Ste. 500
Washington DC 20036