The original documents are located in Box 8, folder "Communications (2)" of the James M. Cannon Files at the Gerald R. Ford Presidential Library.

THE WHITE HOUSE

WASHINGTON

May 7, 1975

MEMORANDUM TO THE WHITE HOUSE STAFF

FROM: Ron Nessen
Press Secretary to the President

SUBJECT: "Ground Rules" Regarding Interviews with Newsmen

Most White House officials have occasion to be interviewed by the news media concerning matters pending before them or to discuss general Administration policy. The President supports and encourages increased accessibility to the media, balanced, of course, with the need to insure a proper and timely flow of information to the public.

There are certain ground rules to be observed when talking to a reporter. The most important rule -- and the one most often misused or misunderstood -- concerns the attribution of information given to a newsman by someone on the White House staff.

It is the responsibility of the person releasing the information to set the level of attribution -- on the record, on background, on deep background, off the record, or for guidance.

It is the reporter's job to seek the highest level of attribution for his story. If no discussion of attribution occurs, the reporter is correct to assume the information is on the record.

The five types of attribution under which the Press Office operates are as follows:

ON THE RECORD: All statements are directly quotable and attributable, by name and title, to the person who is making the statement.

ON BACKGROUND: All statements are directly quotable, but they cannot be attributed by name or specific title to the person commenting. The type of attribution to be used should be spelled out in advance: A White House official, an Administration spokesman, a government lawyer, or whatever.

ON DEEP BACKGROUND: Anything that is said in the interview is usable but not in direct quotation and not for attribution. The reporter writes it on his own, without saying it comes from any government department or official.

> NOTE: Reporters generally dislike this form of attribution and it should be used only in the most delicate circumstances and urgent news. Too often, government officials use "deep background" to plant or leak stories or to get the reporter to stick his neck out when the official has only part of the information.

OFF THE RECORD: Information given "off the record" is for the reporters' knowledge only and is not to be printed or made public in any way. The information also is not to be taken to another source in hopes of getting official confirmation. This form is mainly used to prevent reporters from speculating along inaccurate lines.

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GUIDANCE: Reporters often will ask for "guidance" on the particular timing or status of an event. In this case, they believe they are receiving the information on a "background" basis, and not "off the record," and the information will be used in stories which say "White House sources predicted that the appointment would be made this week." It must be made clear when giving a reporter "guidance" whether he can use the information in a story.

It is important to understand that the terms "off the record," "background," "deep background," and "guidance" are much misused, even by reporters themselves. To avoid confusion which might have serious consequences, make sure you and the reporter know exactly how he is receiving his information and to whom he can attribute it before the interview begins.

You should both understand not only which of the categories you are speaking under, but exactly what that category means to the other person.

One of the most commonly misunderstood uses of attribution is by the government official who says to a reporter that he is supplying the information off the record and not to quote him. By saying, "Don't quote me," the source is really talking "on background" and not "off the record," so the reporter feels he is entitled to use the information as long as he doesn't attribute it to a specific source.

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Finally, the Press Office strongly recommends that White House officials speak "on the record." It is by far the safest policy.

We also encourage you to speak to reporters openly and fully about matters within your area of responsibility and personal knowledge -- but you should be aware of the dangers of uninformed speculation or talking about something not within your field of expertise.

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THE WHITE HOUSE

WASHINGTON

INFORMATION

December 12, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: JIM CANNON

SUBJECT: Domestic Council Review of the Organization of Telecommunications Functions within the Executive Branch

In a recent budget meeting concerning the Office of Telecommunications Policy, Jim Lynn and I discussed with you the need for a review of the organization of telecommunications functions within the Executive Branch and you indicated your approval of it. The following is a description of the review we are undertaking:

OBJECTIVES

The objectives of the study would be twofold: the first stage would be the development of a paper to assess the effectiveness and appropriateness of the current operational functions of OTP. This will be used to develop options for short-term organizational changes, which will then be discussed with directly affected Federal agencies (like DOD) and Congressional Committees, prior to submission to you for final approval.

The second phase of the study would be the assessment of the long-range needs of a communications policy apparatus within the Executive Branch and the submission of the recommendations for your approval.

ORGANIZATION

The review would be conducted by a working group, chaired by the Executive Director of the Domestic Council, consisting of the following agencies of the Executive Office of the President:

OTP	NSC
OMB	The Counsel to the President

I feel that the preliminary stage of the study should be an in-house, Executive Office activity, undertaken without a public announcement, because of the extreme sensitivity of the Congress on this issue and because of the parochial interests of the Federal agencies involved. I intend, however, to brief Senator Baker and other interested members of Congress about this at the earliest opportunity.

TIMETABLE

The study would begin immediately. The first stage dealing with OTP's operational functions should be completed by February 1, 1976. The second stage, reviewing the Administration's long-range organizational requirements for communications policy should be completed by June 1, 1976.

Paul W. MacAvoy

Jim -

This is the backup memo on the case for indefinitely postponing broadcast deregulation.

COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

ALAN GREENSPAN, CHAIRMAN
PAUL W. MACAVOY
BURTON G. MALKIEL

April 2, 1976

MEMORANDUM TO: DOMESTIC COUNCIL REVIEW GROUP ON REGULATORY REFORM

FROM: Paul W. MacAvoy Paul MacAvoy

SUBJECT: Status Report on Proposals for Regulatory Reform in Broadcasting

For the last six months a DCRG Working Group has reviewed Federal Communications Commission regulations of television broadcasting. Attention has centered on restrictions on the use by cable television companies of broadcast signals, by nature the most restrictive of FCC procedures. These restrictions were examined as part of the reform initiative to remove "anticompetitive regulations."

Cable television is a relatively "new" communications medium compared to over-the-air broadcasting. Cable currently makes extensive use of television signals originated by broadcasters. The FCC, however, limits the number of non-locally produced signals that cable operators may use. The introduction of a new technology invariably erodes the position of established firms, but this effect generally benefits the public in terms of new products and competitive prices. This phenomenon would argue for eliminating FCC rules against signal usage. However, a number of significant objections have been raised about the free use of imported signals by cable. First, since copyright payments are not yet required for imported signals, program producers are denied full value of their product. Second, the imported signals could so fragment the markets of local over-the-air broadcasters that local service would be eliminated or radically reduced in quality. This could result in reduced total service to non-cable viewers. Third, unrestricted pay cable might "siphon" programs now available free on over-the-air TV. Finally, the FCC's policy of localism may be significantly eroded, with consequent adverse affects on the full dissemination of information at the local level.

The DCRG Working Group has examined and extended the research literature on cable and pay TV and has solicited further analyses of these issues from the cable and broadcast industries. In our judgment this literature does not fully address the issues, nor has further work on our part or the industries part been able to produce definitive forecasts of the effects of cable deregulation on (a) the cable industry (b) the broadcasters, or (c) consumers.

Some preliminary conclusions have been established. The threat to some existing broadcasters could be excessive -- in terms of producing adverse effects on non-cable viewers -- but the evidence on that is extremely slim. The copyright problem may be dealt with by proposed legislation this term, so that the effects of deregulation without copyright are obscure and perhaps irrelevant. The FCC policy of localism could be eroded in mid-sized markets by cable deregulation. But it is now impossible to place any estimate of the real value on local service for consumers. Further signal importation by pay TV could produce more and different programs, although this is more likely with entertainment than with sports programs.

However, more research is necessary before burden of proof for regulatory changes can be borne by these preliminary conclusions. For example, even if mid-sized markets will be most affected by relaxed rules on distant signal importation, we have not been able to estimate how many markets are involved or how great the impact will be on local broadcasting. The research necessary for policy evaluation is outlined in the following sections of this report. Some of the work is extensive, and both procedures and results are uncertain. No time schedule can be set at this time for completing the work. It is to be hoped that interested public service institutions, the industries involved and the FCC might undertake some of this research.

For each issue we review the existing research results, present preliminary conclusions and suggest the additional work necessary to extend these conclusions. The review starts by discussing the development of FCC policy. Next is analyses of the effects of the reform on cable systems, broadcasters, and consumers. Last of all there are discussions of pay TV and educational TV.

1. FCC Broadcast and Cable Regulation 1/

During the 1950's and 1960's, the FCC issued television broadcasting licenses so as to spread stations geographically across the country. With the goal of putting in place 2,000 stations to serve 1,300 communities, the Commission attempted to provide more of the smaller communities with their own sources of news and feature programming.

However, it soon became clear that, for technological and economic reasons, VHF broadcasting stations could not be located in many smaller markets, and that only five or six channels could operate in the largest markets. The FCC, particularly concerned about the lack of local service in small communities, proposed to strike at this problem of limited localism by licensing a large number of UHF stations. Thus, the 1952 allocation plan foresaw the operation of at least one or two stations in each community, and most of these on the UHF band.

The FCC's objective was not simply availability of TV throughout the Nation; that could have been accomplished using only the VHF range.2/ In fact, alternative frequency allocations could increase the number of homes receiving TV.3/ The FCC saw local TV stations as "...instruments for community enlightenment and cohesion, much like the hometown newspaper of an earlier era." 4/

1/ The most recent and comprehensive treatments of TV regulations are R. Noll, M. Peck and J. McGowan, Economic Aspects of Television Regulation (Washington, Brookings, 1973), and B. Owen, J. Beebe and W. Manning, Jr., Television Economics (Lexington, Massachusetts, Lexington Book, 1974).

2/ Or, in fact, with a single channel, as was done in the United Kingdom.

3/ Noll, Peck, McGowan, op. cit. pp. 58-93.

4/ Ibid., p. 100.

The 1952 allocation plan has not been successful on its own terms. Television has not become something "like" a community newspaper. Furthermore, because of the relatively low population densities found in much of the country, fewer than half of the planned stations are now broadcasting. Those in population centers enjoy access to fewer channels than they would have had in the absence of the allocation plan, while many of those in outlying areas still have few options and relatively poor quality service.

Cable television was drawn by consumer demand into gaps in the market left by the "visible hand" 5/ of these policies of the FCC. CATV first appeared in smaller towns and suburban fringes of cities, where off-the-air reception was either impossible or of low quality. The role of CATV in these areas was to provide better TV or simply some TV. Somewhat later CATV began to appear in core cities, where several high quality free channels were available over-the-air. Improved quality, especially quality for UHF channels, was an important consideration in some large markets -- especially New York and Los Angeles. But in some cases cable was able to enter these markets because many consumers were willing to pay for the added diversity that it could provide through imported signals. 6/

CATV in the mid-1960's still served only a very small fraction of the television homes in the United States. Nevertheless, the very rapid growth of cable suggested that it would shortly upset the FCC's 1952 allocation plan. In particular, the growth of cable seemed to threaten the viability of UHF stations, most of which were at best marginally profitable, and to severely limit the possibilities for creating more local stations.7/

5/ Leonard Chazen and Leonard Ross, "Federal Regulation of CATV: The Visible Hand," Harvard Law Review, Vol. 83, June 1970.

6/ The relative important of these two factors cannot be assessed city-by-city at this time without significant additional documentation not yet available.

7/ Such, in essence, was the conclusion of F. M. Fisher and F. E. Ferrall, Jr., et. al., "Community Antenna Television Systems and Local Television Station Audience," Quarterly Journal of Economics, Vol. 60, No. s (May 1966), pp. 227-251. This study was the first important econometric work on CATV and is criticized in this paper.

The FCC responded to this situation in 1966 by freezing cable in the largest 100 TV markets. 8/ Importation of additional distant signals by existing systems and the creation of new systems were prohibited in these markets pending further consideration by the Commission.

The freeze was lifted in 1972, but neither regulation of CATV, nor the policy of localism, was abandoned. In place of the freeze, the FCC imposed three important restrictions. First, the number of distant signals that could be imported was sharply limited. 9/ At most, three non-network signals can be imported in the top 50 markets, at most two in the next 50, and, if there is a local independent, no non-network signals can be imported into the remaining "smaller markets." Second, the FCC imposed exclusivity rules that require blacking out specific programs in imported signals. 10/ The restrictions are strongest in the top 50 markets, where most movies and serials of the networks are blacked out of a distant signal in favor of the local signal. As a result, the distant signal is typically blank half the time. Third, pay cable services are limited to providing sports events that are not generally televised over-the-air. 11/ FCC rules also

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8 / Cable has made its greatest inroads into smaller and fringe markets, and it is in these markets that local stations are least profitable. Consequently, given the value accorded to localism by the FCC, it is anomalous that the freeze was applied to only the top 100 markets. This point, which is discussed further in the paper, has never been adequately explained by the FCC.

9/ Until recently, the "leapfrogging rule" required that signals be imported from the closest market. The FCC recently rescinded some of these restrictions. See FCC Report and Order 75-1409, 38342, December 19, 1975.

10/ Syndicated programs as well as those under contract to local stations in general, cannot be imported, at least for an appreciable period of time, in the top 100 markets. FCC Report and Order, February 3, 1972, and June 26, 1972. Some relatively minor changes in the exclusivity rules have since been made. The restrictions are less stringent in the second 50 markets, and the exclusivity rules do not apply to smaller markets.

11/ The FCC pay TV rules effectively eliminate sportscasts on a pay basis for sporting events shown in the market within the past five years. The "market" is defined to include the market served by any of the TV stations whose signals the FCC requires the CATV system to carry. Under the rules, the FCC requires that certain "fringe area" stations be carried, so the "market for the purpose of these rules is very broad.

essentially exclude from pay cable current motion pictures, and in some instances, even movies over ten years old if they have been televised in the community within the past three years.

Individually, and collectively, these restrictions could have a significant impact on CATV. The FCC's restrictions could well retard the rate of growth of cable and limit the value of CATV to subscribers. If the FCC's restrictions were relaxed, the cable company could disseminate the local stations and perhaps as many as half a dozen additional signals. Furthermore, pay cable would likely offer programming tailored to small audiences. The restrictions effects and the effects of their removal have been the subject of a lengthy debate which is discussed below.

Thus, the change in regulation to be examined center on removing these restrictions, as follows:

(a) Distant signals. The restrictions on use of distant signals would be eliminated altogether, subject to the payment of copyright fees on program use as set out in the bill now before Congress. A possible variant would require cable systems to "affiliate" themselves with a major independent station, bargaining for the right to retransmit its signal. Copyright owners would then receive their compensation by charging the station more.

(b) Pay programming. Two types of pay legislation have been circulated, the first proposing to eliminate the restrictions outright, subject to an "impact" finding, and the second proposing to include language guaranteeing the public the right to see certain programs on "free" TV. In the second, a distinction is made between movies and sports, with the limits placed on sports. Distinguishing between movies and sports programs in the long run might be justified on the grounds that the supply of the first, in theory, is expandable while the supply of the second is not. 12/

12/ The FCC recently issued new pay cable regulations but their likely effect is not yet clear. Federal Register, April 7, 1975, Vol. 40 NO. 57, Part III, page 15546-15578 also Dockets of March 28, 1975, 1975, and Government 31, 1976

2. Impact on Cable TV

In this section the effect on CATV of removing regulatory restrictions is analyzed. First, the effect of removing the restrictions on imported distant signals is discussed. Because of a number of problems with presently available research results it is only possible to qualitatively conclude that CATV would experience faster growth, and only particularly in mid-sized markets. Then the effect of changes in the exclusivity rules and copyright arrangements is analyzed. It is found that CATV systems can pay copyright fees of 3 percent to 5 percent and still experience modest growth particularly if the exclusivity rules are ended as part of the copyright solution. Finally, the effect of these changes on the programming originated by CATV is discussed. In each section it is concluded that the existing literature is deficient and suggestions are made for further research.

There are currently about 3400 cable TV systems in the country. Approximately 85 percent of these systems have less than two thousand subscribers and just more than 1 percent 20,000 or more subscribers. There are about 10.5 million cable subscribers or about 16 percent of the television homes in the United States. Most of the systems are in smaller markets. The main source of programming at present is network and independent stations.

However, some systems, particularly large ones, originate some of their own programming. These originations are described here because they will be important in the discussion of localism later in the paper, and because they need to be considered in assessing the effect of regulatory change in large markets, and because more research is needed on the relation of origination to regulatory changes. There are about 500 systems providing local origination to about 7 percent of all TV households. Originations are made from systems as small as 180 subscribers to the largest systems and from a few hours a day to very extensive schedules. The programming is a mix of syndicated shows, movies, and local programs. The local programs include city council meetings (27 percent of the originating systems presented these), the "police blotter," local elections and local sports. In addition, "local access" programs which are made by people in the community and shown as is uncensored by the system are carried on a number of stations. 13/

13/ All information from 1975 Local Organization Director, NCTA.

There is some cooperation among stations in obtaining programs and although no systematic data are collected on the number of CATV networks, at least two exist. The largest operates in six midwestern states, supplying programming to 100 cable systems with over 340,000 subscribers. It provides very specialized programs such as how to cook, how to fix farm equipment, cars and the like. It is supported mainly by sponsors looking for very specific markets.14/

The effect of unlimited distant signal importation on cable penetration and profitability has been debated extensively. But the only study to estimate the effect of additional distant signals on cable penetration is Park's 1971 study of "The Prospects for CATV in the Top 100 Markets." 15/ Unfortunately, his estimates were for additional signals under the then existing FCC rules. This creates several problems. First, the FCC constraints on the number of distant signals were binding so that there was little variation in the number of imported signals. As a result most of the variance occurs in variables not controlled by the FCC, such as price, income, and especially reception. Thus, in Park's study, improved network reception was very significant while the coefficient on imported independents was small and insignificant. Since independent signals will be the only additional signals imported if the current rules are removed, Park's results cannot predict the effect of the change. Second, at the time Park's study was done the FCC rules required that the nearest signal be imported. Thus, the signals in many markets were not particularly attractive and so give a poor indication of the effect of removing all restrictions on distant signals. It is apparent that Park has many unattractive imported independents in his sample, since he obtained the implausible result that an additional ETV station and an additional independent station were valued equally.

14/ "Monday Memo" - Broadcasting Magazine.

15/ See R. E. Park, "Prospects for Cable in the 100 Largest Television Markets," Bell Journal of Economics, Vol. 3, No. 1 (spring 1972), pp. 130-150.

Park should have used dummy variables to separate imported signals into several categories according to quality. In this case the FCC rules guarantee substantial variance since some systems are close to large markets with strong independents while others are close to weak UHF stations. This change would give information on the value of strong vs. weak signals. The rules also result in some signals being imported only a few miles while others are microwaved over long distances. Adjusting for this would show the value of distant signals relative to close ones of a lesser quality. Not only would these modifications make the study more useful in determining the effect of uncontrolled distant signal importation but it would be especially valuable in determining the effects of the FCC's recent removal of the anti-leapfrogging rule.

Although Park's results are not very helpful, qualitative estimates can be made by combining the results of several other studies. Crandall and Frey's study on the "Prophecies of Doom for CATV," discussed in more detail below, found that the profitability of CATV systems was very sensitive to increased demand, 16/ whether reflected in a higher subscription price or higher penetration. For example, a 2 percent increase in price per year would strongly increase profits. Thus, if additional imported signals increase price or penetration, CATV growth will be stimulated. A study by Noll, Peck, and McGowan found that viewers value additional signals highly though at a fairly strong diminishing rate. 17/ Thus, it is likely that importing additional signals would make cable profitable in some markets where it is not at present and would increase penetration in existing markets.

16/ R. Crandall and Frey, "A Reexamination of the Prophesy of Doom for CATV." Bell Journal of Economics, spring 1974,

17/ Noll, Peck and McGowan, Appendix A.

The cost per subscriber will determine whether distant signals are imported. A recent FCC staff study estimates the cost of importing signals and the increased penetration necessary to make it profitable in different sized CATV systems. 18/ The results show that importation would likely occur in larger systems. For example, for a 10,000 subscriber system penetration would have to increase by 3 percent to 13 percent, depending on distance, to make importation of one station profitable. Since penetration is now fairly low in most larger systems an increase of this size appears reasonable. If the signal is imported over a commercial microwave network only one to two signals are likely to be imported in each market. However, many CATV operators operate their own microwave systems. Currently there are about 350 such private microwave systems averaging about 40 to 50 miles in length. In these cases the cost of importing additional signals is low and signals would be imported in bundles, increasing the probability that distant signal importation would be profitable. In major markets the importation of programming from other major markets would significantly increase the attractiveness of cable. For example, cities such as Philadelphia, which is without a VHF independent, could import a number of signals from New York.

The FCC report finds that growth in smaller markets is not likely to result from relaxed distant signal importation rules. CATV systems with under 3500 subscribers at a fixed fee of $6.00 would need increased penetration ranging from 10 to 40 percent, depending on distance, to profitably import distant signals. Most small systems already have quite high penetration rates so that further increases of this magnitude are not likely. However, these figures are sensitive to increases in the monthly fee. But without

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18/ An FCC staff estimates that microwave transmission is profitable for systems of over 3500 subscribers. See FCC "An Economic Evaluation of the Leapfrogging Rules for Independent Stations," (memo, no date). It should, however, be noted that relaxation of the rules would tend to make investment in CATV more attractive and tend to strengthen the many CATV systems that are now weak financially.

reliable information on the elasticity of demand for distant independent signals, no estimate can be made of the increased revenue from higher monthly fees or per channel fees for the imported station.

The resolution of the copyright issue and the ending of the exclusivity rules are important factors in predicting CATV growth. Naturally, if the exclusivity rules are eliminated, imported signals will be more attractive, cable revenue will rise, and cable will grow. However, this influence will be offset to some extent by the copyright liability newly imposed on the CATV operator. The worst possible case for CATV growth would be the imposition of copyright liability with no relaxation of the exclusivity rules. The result of this case was estimated by Mitchell.19/ He found that even modest copyright fees would significantly reduce the profitability of CATV but he was probably too pessimistic. Since such a large part of a CATV system's costs are fixed, small differences in assumptions about cost and demand can make a great difference in profit projections. Crandall and Frey have effectively criticized many of Mitchell's assumptions.20/ They found that Mitcehll projected no increase in the subscription fee for fifteen years, overestimated the costs of cable installation significantly, and underestimated ultimate penetration. In addition, Mitchell assumed no future revenues from pay TV but in 1975 at least 60 systems were operating pay cable. Finally, Mitchell overestimates the economies of scale in cable systems resulting in especially pessimistic predictions for smaller systems. Correcting for all but the pay cable omission, Crandall and Frey find that cable will do fairly well even with no regulatory change. It does not appear that copyright liability will significantly reduce CATV growth.

19/ B. M. Mitchell with R. H. Smiley, "Cable Cities, and Copyrights," Bell Journal of Economics and Management Science, spring 1974, p. 235.

20/ Crandall and Frey.

If the exclusivity rules are relaxed or removed cable growth will be stimulated, but we do not know by how much. Park has provided a base to work from by estimating how much of the time the distant signal must be blacked out. 21/ He found that the rules could leave distant signals in the top 50 markets blank up to half the time but that the rules did not block out more than 15 percent of the programs in the second 50 markets. His estimates are low because he assumes that some substitution will take place but to date the technical arrangements for this have not proved economical. The amount of blocking out with no substitution should be calculated.

Given that we know the increase in available programming caused by ending the exclusivity rule we still don't know the marginal value attached to the increase. Reestimation of Park's study of the top 100 markets along the lines suggested would give quantitative results on this. The fact that CATV systems are sensitive to increases in demand does make possible the qualitative prediction that removal of the rules would help the industry.

If the restrictions on cable are relaxed and it starts to grow in mid-size and large markets, what will happen to local origination? There has been virtually no research on this topic. Origination will tend to increase because larger systems can better exploit the economies of scale in programming. This is important because growth would probably promote the FCC policy of localism more effectively than is possible on over-the-air TV. There would also be an incentive to reduce local origination because more attractive distant signals would be available. It is probable that there would be a net increase in origination but more study is needed. To date no estimates have been made of the effect of origination on penetration and the possibilities for its growth given its cost. The data for this very useful study is available.

21/ Rolla Edward Park, "The Exclusivity Provisions of the FCC's Cable Television Regulations," June 1972, funded by Ford Foundation and the John and Mary R. Markle Foundation.

In conclusion, more studies are needed to predict the growth of CATV in the event various restrictions are removed. Most useful would be a study similar to Park's study of the "Prospects for CATV in the 100 Largest Markets" which exploits the information supplied by the variance in the quality of imported signals. The studies need to pay more attention to the cost of importing distant signals than most previous studies have. The relation between market size and CATV system size needs to be established and the economics of importing distant signals relative to system size and thus to market size has to be investigated in more detail. This work should produce the information necessary to estimate the effect of removing the exclusivity rules. Finally, the relationship between local origination, penetration, and distant signals needs to be studied.

3. The Economic Effects on Broadcasters

Signal importation by cable makes available more channels for viewing by cable subscribers. This fragments audiences of local broadcasting stations, and hence, reduces their advertising revenues. The reduction in advertising revenues may threaten the quality of local broadcasts or even the viability of some local broadcasting stations.

Perhaps the first question to ask is why adverse effects on local broadcasting stations are relevant. No one holds that the growth of CATV, or any other new technology, should be restricted simply because it endangers net revenues of established companies.22/ However, the FCC has adopted the position that unfettered growth of CATV could be contrary to the public interest in two respects. First, the possible decline in the number of broadcasting stations would be counter to the longstanding FCC policy of localism. Second, financial difficulties for local broadcasters might result in a reduction in their ability to support local public service broadcasting. The importance of these considerations turns on the magnitude of the effects of CATV deregulation on the number and economic health of local broadcasters.

22/ This point is at least implicitly accepted by broadcasters. For example, in a letter dated October 24, 1975, to F. Lynn May, Executive Director of the Domestic Council, Mr. Lester W. Lindow, Executive Director of MST, describes the adverse consequences of cable in terms of a reduction in the quantity and quality of over-the-air broadcasts.

Unlimited signal importation and elimination of the exclusivity rules would tend to reduce the revenues of local stations in all markets. However, it is not this fact as such, but rather its implications for the availability and quality of over-the-air broadcasts that is relevant. The effects on the availability and quality of over-the-air broadcasts in larger markets are not likely to be substantial. This is true for three reasons: (1) the number of channels in these markets is sufficiently large now that the effect of introducing new channels is fairly small; (2) cable penetration is less in larger than in smaller markets, 23/ and (3) the profit rates of the broadcasting companies are sufficiently large in larger markets to prevent failure as a result of these changes.24/ 25/ The revenues of stations in larger markets presumably would decrease somewhat, or grow less rapidly. However, with

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23/ See R. Noll, M. Peck, and J. McGowan, Economic Aspects, *op. cit.*, pp. 153-62, and R. Park, "Prospects," *op. cit.* pp. 130-150.

24/ Neither original cost nor book value includes the purchase price of the franchise. When the price of the franchise is included, realized rates of return are lower. However, it is figures such as those in Table 1, rather than realized rates, that are relevant to questions about the industry's ability to hold and attract capital. This is so because the cost of a franchise is entirely a pure rent; franchises would still be available even if their price fell to zero.

25/ Also, UHF Independents may be helped by better reception. See: R. Park, "Cable Television, UHF Broadcasting and FCC Regulatory Policy," *Journal of Law and Economics*, Vol. 15, No. 1 (April 1972), pp. 201-232.

profit rates on tangible equipment greater than 100 percent per year (as shown in Table 1), cable deregulation would not lead to either a decrease in broadcast quality or a significant decrease in the number of stations.26/

26/ The statement is in rough agreement with a judgment, based on the available evidence, of a group of economists who are knowledgeable about the industry. See: Bruce N. Owen, "Memorandum on Deregulation of Cable Television," December 4, 1975. The FCC Report referred to in footnote 18 predicts little effect on small stations. Members of the industry have expressed a contrary opinion. For example, a statement by Paul E. Sonkin, Vice President, Affiliate Research, ABC Television, dated November 6, 1975, contains the following (p. 8):

> The foregoing evaluation has focused on smaller television markets. At this point in time, CATV growth and its level of penetration has been greatest in these markets. However, the economic principles arising from the advertising practices in the television industry, are equally applicable to all television markets. It is simply a question of time and the extent of CATA growth in particular areas before similar effects will be seen in the larger markets as well.

The letter from Mr. Lester W. Lindow (Footnote 22), refers to "several instances in the 100 largest television markets" where entry by a new broadcasting station was deterred by "existing" or reasonably anticipated CATV importation of distant signals." Since, however, it is possible to deal here only with aggregates, the dominant consideration is the extremely high rate of groups of firms. These show that it is unlikely that firms on average will stop broadcasting if profit rates fall.

The point to recognize is that any predictions of harm to broadcasting from increased cable activity must be tempered by an understanding that in the larger markets the level of broadcast service (and profits) is higher, and the appeal of cable services is lowest. Predictions that an increase in cable activities will harm local broadcasters in smaller markets must take into account the fact that it is in precisely these markets that most cable growth has occurred to date (and, below the top 100 markets, the "protection" afforded under the FCC rules, are less significant).

Table 1

—PROFITABILITY OF TELEVISION STATIONS

Commercial TV stations	Number of stations	Income before Federal tax (thousands) (1)	Original cost of tangible property less depreciation (thousands) (2)	Percent (1) of (2) (3)
Small market (below 100):				
Network:				
UHF	59	(—$900)	$26,584	([1])
VHF	219	33,460	127,954	26.2
Independent:				
UHF	8	(—1,927)	1,847	([1])
VHF	11	(—3,330)	8,503	([1])
Total, small market	297	27,303	164,888	16.6
Large market (top 100):				
Network:				
UHF	58	7,200	45,595	15.8
VHF	244	474,951	379,676	125.1
Independent:				
UHF	52	(—10,345)	42,655	([1])
VHF	20	11,677	46,165	25.3
Total, large market	374	483,483	514,091	94.0
All stations:				
Network:				
UHF	117	6,300	72,179	8.7
VHF	463	508,411	507,630	100.2
Independent:				
UHF	60	(—12,272)	44,502	([1])
VHF	31	8,347	54,668	15.3
Total, all stations	671	510,786	678,979	75.2

[1] Loss.

Source: FCC.

Unlimited signal importation might actually help some independent stations in larger markets, especially those few very high quality independent stations that have been said to have "super station" potential. A station whose signals are carried by cable systems into distant markets will market time to advertisers in a way that capitalizes on its larger regional audiences. 27/ Also, the station might "sell" its signals to cable systems directly; this will provide an additional source of revenue, at least until regional advertising becomes more widely established. As such stations reach out for a regional market, local advertisers would switch to stations which lack regional aspirations and whose signals were not carried outside their markets. This reassignment of customers would follow the pattern earlier established in network broadcasting whereby the network sells time to national and regional advertisers.

The available evidence does not show which stations will be most strongly effected by unlimited distant signal importation. The FCC report implies that stations in smaller markets will generally not face competition from strong imported independents. 28/ As discussed above, the largest markets will probably not be harmed. The problem is to determine how seriously the middle-sized markets will be affected and how large this "middle size" is.

27/ The FCC Report and other evidence suggests that advertisers are currently unwilling to pay for exposure to other than local audiences. However, this fact may simply reflect the present absence of regional networks.

28/ FCC "Evaluation of Leapfrogging."

There have been three major studies that forecast significant harm to smaller local stations from CATV. The first was Fisher's 1966 article. 29/ This article cannot be used to estimate the additional effect of distant signals since this variable was not significant. Generally the study had the same kinds of econometric problems as Park's. 30/ In Fisher's study the constant term explained much of the variation in cable viewership. Measures of the amount of duplication between signals were the only other significant variables. Their coefficients were strongly negative, contrasting to small positive coefficients on the same variables when used to explain over-the-air broadcasting audiences. Also, in projecting the impact on broadcasters the study considered only fractionalization of audiences, not the additional audiences broadcasters get because of cable. Finally, the study's predictions of severe financial impact from CATV growth in small markets is based on 13-year old data, do not seem to have been confirmed by events.

The most extreme forecast of adverse impact from unlimited signal importation appears in a consulting report by Statistical Research Incorporated 31/ for the NAB. The NAB used this report to estimate that over half the stations in the country would be driven out of business. They based this on an analysis of audience

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29/ F. M. Fisher and F. E. Ferrall, Jr., et al, "Community Antenna Television Systems and Local Television Station Audience, "Quarterly Journal of Economics, Vol. 60, No. 2 (May 1966), pp. 227-251.

30/ Park. "Prospects for CATV in the Top 100 Markets.

31/ The Potential Impact of CATV on Television Stations, Statistical Research Inc., fall 1970.

share of independents in the largest markets. In the largest markets the study projected audience losses to independents of 25 percent in prime time and 61 percent in early fringe. However, for markets with imported independents the study only estimated 33 percent audience loss in early fringe and 16 percent in prime time for local stations. In addition, the one valid regression of CATV growth on local audiences found that there was no significant impact on fringe audiences and that the impact at other times explained only about a third of the variation in audience size. Thus, the study does not produce soundly-based conclusions.

Park's study also forecast significant impact on smaller markets, 32/ based on a number of assumptions, however, which probably exaggerated CATV growth and impact. The study was weakened by the assumption that the whole Nation could be wired at the same cost per house as those homes already wired; also it did not account for competition in the fringes of markets but assumed that all markets were autarkic.

The effect of CATV on UHF television stations is also of importance. The available evidence indicates that cable will help UHF in the short term. The Statistical Research Inc. study found that cable reduced the tuning handicap substantially. 33/ Studies by Park 34/ and the FCC staff 35/ found that in many cases audience

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32/ R. E. Park, "Potential Impact of Cable Growth on TV Broadcasters," Rand Corp., R 587FF, October 1970. Also see FCC staff report.

33/ Statistical Research Inc., D-1 to D-14.

34/ R. E. Park "Cable TV and UHF Broadcasting"

35/ "The Economics of the TV-CATV Interface," FCC Staff report, July 1970.

fragmentation was more than offset by the reduction of the UHF handicap. MST claimed in 1971 that the UHF handicap was rapidly decreasing but the handicap does not appear to have been overcome yet. In addition, an examination of UHF stations in Toronto, where there is a great deal of competition on the cable, found that these stations' success was in large part due to being carried on cable. 36/ Thus, it appears that UHF stations are not likely to be severely affected by CATV growth, even with distant signals. However, reestimation of the effect of cable on UHF using current data seems necessary to settle the debate.

The greatest impact of cable growth will probably be on VHF stations. Many of these stations are extremely profitable and could absorb a significant impact. The networks, stations owned by the networks and network affiliated stations in the top 100 markets are all highly profitable. Some independent VHF stations and most UHF stations might benefit from relaxed rules. The most likely to be hurt are network VHF stations in the middle-sized markets. Thus, an analysis is necessary of profit margins for the stations most likely to be adversely effected. This requires detailed station-by-station projection of operating revenues and costs for the coming five to ten years.

Forecasts of the effects of CATV on local stations are based on relationships which describe penetration and the connection between audience size and advertising. While useful, such information does not go directly to the question of the effect of unlimited signal importation. Examples from particular markets which do address this issue show a mixed pattern. Of the eleven cases cited three show substantial diversion. 37/ However, no stations appear to have closed or drastically cut local service.

36/ House Report, p. 47.

37/ Three cases are cited in a letter dated November 7, 1975, from David C. Adams, Vice Chairman, National Broadcasting Company, to Paul W. MacAvoy. Five cases appear in Federal Communications Commission, "Economic Evaluation," *op. cit.*

The same is true of the cases analyzed by Statistical Research Inc. This emphasizes the importance of estimating the effect of distant signal importation using actual cases rather than a model.

The survival of local stations in the face of cable deregulation would be affected by a number of important additional factors. The networks have the means and an incentive to cushion reduction in local station revenues. As fragmentation of local viewing audiences occurs with the entry of cable, the local affilitate of the networks would experience reduced revenues from local advertising. in response, the networks could increase the revenues from national advertising paid to the local broadcaster and would do so if they valued their local outlets. Local stations would get an increased share of their revenues from the networks and a decreased share from local advertising. The results would not be the loss of local broadcasting, but rather a reduction in the profits of the networks. Since the networks and their wholly-owned subsidiaries are not close to failure, the ultimate result is not likely to be a reduction in the number of stations to the extent that this pattern develops.

The existing literature has, apparently without exception, overlooked the question of how broadcasters will respond to competition to cable. Effective response would, of course, limit revenue losses. But, more important than this, competition from cable could tend to make the programming of local stations more truly local. Rather than simply going out of business, broadcasters could respond to cable with strenuous efforts to differentiate and expand their product. Local programming should have some value for audiences, and over-the-air broadcasters may be able to provide this local programming better than cable companies. Thus, in response to cable fragmentation, broadcasters could increase local programming and reduce national or pre-packaged programming which is duplicative of that arriving over the cable. The strengthening of local programming in competition with the cable could very well strengthen the financial viability of the local broadcaster.

For all these reasons we have only a very rough idea of the potential impact of CATV expansion on broadcasters. Several new studies are needed. Perhaps the first would update Park's study using the latest work of Crandall and Frey on future CATV growth. This would provide an indication of the effect of CATV systems of about 10,000 on the broadcasters. If Crandall and Frey's work is extended to analyze the prospects of CATV systems of all sizes then the effects in all markets could be estimated. Even more useful would be an analysis of the impact of CATV on broadcasters by using actual data rather than a model with separately estimated parts. The Statistical Research study does contain useful data from Neilson and Arbitron. This data gives viewing patterns for CATV and non-CATV homes in the same market. Updated and combined with other data they could provide the basis for a time series and cross-section analysis of the actual effect of CATV distant signal importation. This would include the adjustments made by local stations, the changes in program costs for purchased programs, and the change in payments from the network.

4. The Economic Effects on Consumers

Consumers of cable services would likely experience improved signal quality and, more important, an increase in viewing options as a result of the removing of restrictions on the use of signals. However, there could be an overall reduction in the quality and number of over-the-air broadcasters, which would reduce the quality of reception of those not on the cable. Some consumers could lose over-the-air reception entirely if they do not subscribe to cable or if cable is not available in their area. The problem then is to assess the trade off between those who get benefits from greater availability on the cable and those who are hurt by loss of broadcasting services of the cable.

To date only the benefits of another station to cable consumers have been estimated, based on the usual "willingness to pay" methodology. An econometric model by Noll, Peck, and McGowan related the number of CATV subscribers to price, income, the number of households, system age, and a measure of the added diversity afforded by cable. [38] The relationship they derived implies that increasing the number of signals from nine to ten will, for a system with 10,000 subscribers, provide annual benefit of $39,000.[39]

38/ Noll, Peck, and McGowan, op. cit., p. 297.

39/ This figure is an estimate of the increase in consumer's surplus including both benefits to current subscribers and new subscribers.

Assuming that annual benefits remain unchanged, the present value (at a discount rate of 10 percent) of the benefits stream from providing one additional channel to all cable subscribers in the United States is over $400 million.

This is only part of the complex "trade off" problem which needs further research. To date the question of lost service has not been properly treated. First, the actual reduction in the number of stations broadcasting as a result of changes in FCC policy has not been estimated. It is expected that station closings and the greatest reduction in the level of service will occur in the middle-sized markets. But as indicated below those are preliminary conclusions that do not describe changes likely to occur in each Metropolitan and rural region. The benefits to those who get stations over cable but are now receiving only a poor or limited number of signals have not been indicated in detail as well. Second, changes in FCC policies for over-the-air broadcasting coincident with changes in cable regulation could increase the number of homes receiving over-the-air broadcasts. This could be done by relaxing regulations on the installation of satellite and repeater stations, and allowing them to originate local services. 40/ In addition, over-the-air stations could be allowed to consolidate, thereby creating stronger signals which would reduce the number of homes unable to receive over-the-air broadcasts. 41/ This would provide incentives for stronger over-the-air programming, through higher purchase prices for better programming as a result of maintaining audience by reducing the attractiveness of cable TV. 42/

40/ Paul I. Bertz, Robert C. Spoonberg, Fred P. Zenditte, "Broadband Communications: Rural Areas - Final Report, Denver Research Institute, March 1973, for OTP.

41/ H. J. Levin, "Spectrum Allocation Without Markets," AER, Vol., 60, May 1970, pp. 209-218. Comments pp. 219-24. Noll, Peck, and McGowan, Chapter 3, also to discuss this.

42/ Noll, Peck & Gowan, Chapter, analyzes economies of scale in program production.

A careful examination of these questions could indicate that relaxation of controls on CATV need not reduce the number of homes receiving stations over-the-air.

It is important to note, however, that the changes outlined above could have effects on the nature of TV programs. The FCC's policy of localism may be seriously affected. To the extent that localism is reduced, then estimates need to be made of the costs and benefits of such reduced decentralization. First, the nature of the reduction in localism needs to be determined. At present, local news receives good ratings and is often profitable. Apparently, local news originating from repeaters and satellites is possible at low costs. 43/ This news source coupled with the superior coverage of regional stories made possible by financially stronger regional stations might be preferred by the viewer to present local news. In addition, independent stations offer more local service programming than network stations. The main loss would occur in non-prime time, non-news local programs. Estimates should be made of the economic and social impact of these programs. These losses need to be compared with the benefits obtained by viewers from better reception and from the more specialized and local programs that cable and pay cable are likely to offer.

Another problem is the question of rents and their relationship with supply. Some have noted that many performers receive large rents and so could be expected to supply their services even if the price dropped substantially. 44/ These consumers would not experience

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43/ Subcommittee Print, "Cable Television: Promise versus Regulatory Performance" prepared by the staff for the use of the Subcommittee on Communications of the Committee on Interstate and Foreign Commerce, U.S. House of Representatives.

44/ Noll, Peck, and McGowan.

significant program loss. However, others have noted that competition and rents are compatible. 45/ What must be established, in order to argue that there will not be significant program supply effects if prices for entertainment material drop, is rents on the margin. Both Crandall 46/ and Owen Beebe and Manning 47/ have analyzed the market for programs. Their approach is quite different but both conclude that some of the rents to producers and performers are inframarginal. Owen Beebe and Mannings' approach is potentially productive because it is the most comprehensive and sophisticated analysis so far but it has not been empirically tested. Of course all

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45/ S. M. Bensen and B. M. Mitchell. Noll, Peck, and McGowan's "Economic Aspects of TV Regulation, Bell Journal of Economic and Management Science, spring 1974, p. 30.

46/ R. W. Crandall, "The Economic Effect of Television-Network Program Ownership," Journal of Law and Economics, v. 14 (October 1971).

R. W. Crandall, "FCC Regulation, Monopsony, and Network Television Program Costs," Bell Journal of Economics and Management Science, v. 3 (1972).

47/ Owen Beebe and Manning, "TV Economics" existing programs are fixed in supply and a lower price for them will not affect supply. Rents to networks and larger stations have been established and the predictions that reduced demand will only reduce rents, not supply, over some range, seems reasonable.

In summary, different groups of consumers would gain and lose from freeing up restrictions on cable television. The gainers would be current subscribers and consumers not now having access to cable who are able to subscribe under the less restrictive rules. The losers would be those placing a high value of local programming received over the air and reduced by cable fragmentation. Some consumers may lose service entirely, although this is not likely. Some reduction in the quality of over-the-air broadcast signals may be experienced. The magnitude of most of these effects have to be estimated.

5. Pay Television

The abundant channel capacity in cable makes it possible to provide programming on a per-channel or per-program pay basis. Unlike over-the-air television, which as a mass media must appeal to mass audiences, the programming on a cable channel can be directed towards more specific, less popular, tastes and desires. Therein lies the crucial advantage of pay cable.

Broadcasters essentially act as brokers who deliver attention of an audience to advertisers. The advertisers interests lead to programming with a mass appeal, to the exclusion of programs directed to specialized interests. At its roots, this situation exists because TV does not have a market situation in which viewers can register the intensity of their preference for particular types of programs - it's "watch" or "not watch." Pay cable, in contrast, allows consumers to express the intensity of their preferences by paying for particular programs.

Pay TV would benefit consumers as a whole only if it increased the total supply of programs. The supply of some types of programs -- e.g., the World Series --

cannot be increased. Most types of programs, however, are available in increased supply if program prices are increased from the additional demands. It is reasonable to expect that pay cable could lead to an increase in the supply of programs, especially specialized programs.

Unique and popular live broadcast, especially sports events, pose a problem. Their diversion from over-the-air broadcast to pay television would leave the vast majority of consumers without access.

It does not appear so far that movies and other entertainment would be in such restricted supply, however. At present, major distributors are able to schedule pictures first in metropolitian theaters, then in local theaters, then on network, television, and finally on syndicated television. Pay cable exhibition would likely delay the television exhibition of such films. Such films woud be released to television after their pay cable run, in order to capture the advertising revenues from those audiences unwilling to pay to see the movie earlier. This is the present sequence, so that there is no restriction of access likely from cable television as a result of payment for first-run movies.

All these conclusions are tentative. Further research is needed into the programming offered on pay TV as it expands, as is further consideration of the Hartford experiment in over-the-air pay TV. In that experiment, serious music was one of the most popular offerings, suggesting that the claims of pay TV proponents may be valid.

An extensive theoretical analysis of the trade off for consumers between gains for cable users from pay TV and losses of others has been made by Owen, Beebe, and Manning. They find that under reasonable conditions that consumers will be better off with pay TV than with free TV. However, their conclusion rests on hypothetical assumptions which they have not tested. An empirical test of this model would be required before analysis would support open access for cable to all program materials.

The effect on the poor of pay TV is an Important question. Noll, Peck, and McGowan have estimated the social value of free TV at between $20 and $30 billion a year, and viewing patterns by income group indicated that a proportionately large share of this goes to lower income groups. They note that the higher prices alleged to be the result of TV advertising are on goods bought by the poor and so the poor "pay" a significant part of the cost of free TV. These are very rough calculations. However, they do suggest that free TV is not a "free lunch" even for the poor. They correctly point out that losing free TV would have a negative income effect on all over-the air viewers and especially poor ones. But these calculations are not now helpful in assessing the effects of shifting some programs from free to pay TV. More detailed work is necessary on gains and losses of viewers groups before these effects can be evaluation.

6. Educational television

The effect on educational TV and public broadcasting of changes in cable regulation needs to be examined. ETV stations suffer all the handicaps of UHF signals and as well usually have lower broadcast power. The research on the UHF handicap suggests that ETV would be helped by the expansion of cable by gaining much better viewer access; but whether it helped more than it would be hurt by the importation of distant signals is not known. In addition, ETV and PBS revenue is not closely related to audience size, so the effects of fragmentation on station viability are difficult to assess and have not been assessed. Moreover, the FCC now stops the importation of distant ETV signals if a local station or educational authority can show harm; the unlimited importation of distant signals would help those ETV stations now foreclosed by FCC rulings, but it is not known "which" would be helped and "how much" of an economic difference it would make.

An important consideration here is the level of marginal costs of importing additional signals. If marginal costs are "low," then importation of ETV signals could be economical. A number of ETV signals, some ETV stations would have bigger signals, some ETV stations would have bigger audiences, and some homes would receive ETV for the first time. The larger audiences for some stations might increase donations and would permit exploitation of economies of scale in audience size. Thus, the costs and benefits to ETV of more signal importation are highly problematical at this time.

COMMUNICATIONS--HOLD

Communication
HOLD

Chairman 4/8/75

press conference: Everyone distressed by state of economy in country & govt about basic questions -

(Broader Book)

can't solve

can do better

Art Friendly - said more

Congress $32 yr (Rockefeller)

Congressional Institute

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THE WHITE HOUSE

WASHINGTON

REQUEST

April 12, 1976

MEMORANDUM FOR JIM CANNON

FROM: LYNN MAY

SUBJECT: Domestic Council Review of the Organization of Telecommunications Functions with the Executive Branch

Per your question on the attached, if the President is aware that a study is ongoing and is not expecting an interim report, I see no need for an information memo at this time.

Attachment: March 26, 1976 Memo on the above subject.

THE WHITE HOUSE

WASHINGTON

REQUEST

March 26, 1976

Lynn May -

MEMORANDUM FOR JIM CANNON

FROM: LYNN MAY Lynn May

SUBJECT: Domestic Council Review of the Organization of Telecommunications Functions with the Executive Branch

The Domestic Council working group has completed the first phase of its study of telecommunications functions in the Executive Branch. Summarized below is the progress of that study:

Background

In December, the Domestic Council established a working group comprised of representatives from OTP, OMB, NSC and the Counsel's office to examine and make recommendations, if deemed necessary, for the re-organization of telecommunications functions within the Executive Branch. This initiative was divided into two consecutive stages: the first stage, just completed, examined the effectiveness and appropriateness of the current operational functions of OTP. The second stage will entail the assessment of the long-range needs of a communications policy office within the Executive Branch.

Discussion

The first phase of the study consisted of a paper prepared by OTP, which reviewed the current operational structure of OTP. The paper clearly established, with some caveats,that there are separable management and policy functions within OTP, which could be re-organized in a different format within the Federal structure. After some review of the OTP report, however, the working group concluded that any recommendations for re-organization should await completion of the second phase of the study. Accordingly, instructions were given to representatives of McKinsey and Arthur D. Little to carry out their assignments in determining the long-term need for a telecommmunications office within the White House. The working group is hoping to complete the study by June 1, 1976.

If you feel that an information memo to the President on this subject is appropriate at this time, I will be glad to prepare it.

cc: Art Quern
Ed Schmults

Lynn -
what, in brief, would we say to the President?
Is there enough to warrant an info memo?
Jim

EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

MAY 18 1976

Honorable John Eger
Director
Office of Telecommunications Policy
Executive Office of the President
Washington, D.C. 20504

Dear Mr. Eger:

On March 26, you requested OMB's concurrence in a proposal to provide Federal Telecommunication Systems (FTS) lines to each governor citing OMB's authority under Title III of the Intergovernmental Cooperation Act of 1968.

I am unable to concur in your proposal for two reasons:

1. The proposed telecommunication service which you describe in your letter and accompanying papers is not a "specialized or technical service" as defined in the law nor should OMB's regulations issued under the Act (OMB Circular A-97) be construed to include such a proposal.

2. Should GSA provide this service, we believe it would conflict with Title III's requirement that such services be provided "consistent with, and in furtherance of, the government's policy of relying on the private enterprise system to provide those services which are reasonably and expeditiously available through normal business channels."

Furthermore, in light of these questions, we have difficulty in understanding the basis for the 1971 decision that "this (FTS) service (under Title III) is available only to states which maintain a full time representative in Washington." We therefore request that your office reexamine the telecommunications policy implications of the 1971 decision to determine if it is an authorized use of Federal facilities consistent with current policy.

Sincerely,

(Signed) Paul H. O'Neill

Paul O'Neill
Deputy Director

COPY TO F. LYNN MAY

5/31/76

Lynn What ever happened to this? Jim

THE WHITE HOUSE

WASHINGTON

May 20, 1976

MEMORANDUM FOR DAVE GERGEN

FROM: LYNN MAY Lynn

SUBJECT: Possible Material for Economic Speech in California

The President could raise an issue that is sensitive in California, particularly the San Fernando Valley - the Federal Government's growing in-house audio-visual capacity, which denies a badly depressed motion picture industry a source of contracts and revenue. The President could cite the accomplishments of his Administration in correcting this through the work of the Office of Federal Procurement Policy and state that his Administration will continue its efforts to get the Federal Government out of activities that the private sector can perform.

Suggested Remarks The following is suggested language on this subject:

"My record on curtailing the growth of the Federal Government is clear. I have vetoed unwise Federal spending measures and have submitted legislation to reform unnecessary and uneconomic government regulation. My Administration is also working to eliminate the fantastic spread of the Federal agencies' capacity to duplicate for its own use the products and service of the private sector - thereby it denying jobs and contracts.

The motion picture industry here in California and elsewhere has suffered from this process. This industry, whose labor pool averages close to 50% unemployment annually, only receives about 20% of the nearly $44 million spent annually by the Federal Government on audio-visual production in Federal Region IX, which includes California. This means that $35.1 million in Federal audio-visual production in this area is performed in-house.

I think that is wrong and I am working to change it. Last August, my Administration issued policies to restrict the use of Government personnel as performers in audio-visual productions and to phase out all Federal in-house motion picture film processing facilities except those required for time-critical research, intelligence or combat purposes. While these actions have curbed the proliferation of Federal film-making, more needs to be done. My Administration, under the leadership of the Office of Federal Procurement Policy, is currently developing a uniform contracting system for motion picture productions, to ensure that all qualified firms are aware of Government bidding opportunities.

I am committed to working with the motion picture industry, other audio-visual industries and concerned officials, like Congressman Barry Goldwater Jr., who has been a leader in this issue, to return jobs and contracts assumed by the Federal Government back to California and the private sector."

NOTE: Bob Peters, President of Paramount Oxford Films, has convened a meeting in Los Angeles of the leaders of film, T.V. and radio companies and unions on May 21st to plan strategy to curtail Federal involvement in the audio-production field.

Attachments: TAB A, Background memo from Hugh Witt, Administrator of the Office of Federal Procurement Policy

TAB B, Background analysis of the Federal Audio-Visual Production's Impact on the Private Sector Nationwide and in California, prepared by the Association of Media Producers.

cc: Jim Cannon
Jim Cavanaugh
Bob Orben

A

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL PROCUREMENT POLICY

MAY 17 1976

MEMORANDUM FOR: Lynn May

Subject: Improved Management of Federal Audiovisual Activities

The following information is submitted in response to your May 13th telephone call to Jim Currie of my staff:

1. Federal audiovisual activities currently identified by the Office of Federal Procurement Policy for intensified management include the production, processing and distribution of finished products in the following media: motion pictures, television, still photographs for projections, mixed media packages and audio (radio) programs.

2. Estimates indicate that annual Federal expenditures in the audiovisual area approximate $500 million. Over $150 million is spent for motion pictures, television and other common media productions.

3. Efforts to curb the proliferation of in-house Government operated audiovisual facilities have been discussed for many years. It was not until last year, however, that the Executive Branch took specific steps to limit audiovisual activities in Washington (sometimes called "Hollywood on the Potomac") and return movie making and other audiovisual jobs to California and the private sector.

4. Specific actions taken in August of last year for which the President can take credit include:

    a. The issuance of a policy to restrict use of Government personnel as performers in audiovisual productions except when performing their own jobs; where necessary for training programs, or where required skills cannot be obtained from professional acting sources, and

    b. The issuance of a policy to phase out all in-house motion picture film processing facilities except for those required for time critical research, intelligence or combat purposes.

5. The results of these policies are:

    a. Federal supply schedule contracts for motion picture film processing services are now in effect.

Over 40 companies under contract. First year's business approximated $1 million.

b. The Department of Defense closed 13 motion picture film processing activities in December 1975. Six were in California. Personnel savings estimated at $384,000. Three additional activities have been identified for closure by July 1, 1976. Review underway at 12 other facilities.

c. Department of Agriculture motion picture film processing activity to be phased-out by May 31, 1976. Of the 31 persons previously employed at the facility estimates are that only 12 will be retained. Annual personnel savings should total approximately $275,000. An additional space savings of $100,000 is also expected.

6. In addition to phasing out in-house audiovisual operations, we're also attempting to make it easier for private firms to do business with the Government. We're developing, and plan to have implemented by the end of the year, a uniform contracting system for motion picture productions. One of the objectives of this system is to ensure that all qualified firms are aware of Government bidding opportunities. A second objective is to establish a focal point within the Government where prospective contractors can go for information regarding bidding opportunities.

7. Our work in the audiovisual area is an example of what we're doing in just one industry. Our major thrust is to review all in-house Government operated industrial-commercial type activities. The purpose of the review is to ensure that the Government is relying on the private sector for commercial and industrial products which it requires. This includes the review of everything from in-house laboratories, ADP facilities, and telecommunication centers to training units and other support activities in an effort to return as much work to the private sector as possible.

8. Supplementary information:

a. Congressman Barry Goldwater, Jr. has become the champion of the audiovisual industry's cause and has heretofore taken credit for the improvements we have made. He has contributed to several articles in various audiovisual trade journals and if you decide to use the audiovisual program as an example of the Administration's goal of returning work to the private sector, you may or may not want to mention his efforts.

b. The Air Force's Aerospace Audiovisual Center is located in San Bernardino, California. It employs approximately 300 military and 245 civilian personnel. The facility is presently underutilized and its continuation as a Government owned and operated facility probably cannot be justified under strict enforcement of our contracting-out policy. The facility is in Congresswoman Pettis' district and she is interested in seeing it retained as a Government operated facility.

Hugh E. Witt
Administrator

B

FEDERAL GOVERNMENT AUDIO-VISUAL PRODUCTION:
IMPACT ON THE PRIVATE SECTOR

I. GENERAL

Although there have been several studies of Federal audio-visual activities, there has been no definitive research undertaken to reveal the actual magnitude of in-house government audio-visual production. For this reason, any evaluation of the impact of these activities on the economy in general, and labor and management in particular, must proceed on the basis of extrapolation. However, even utilizing results of narrowly focused investigation, and industry employment statistics, the data yielded shows significant impact on the commercial audio-visual industry.

The Office of Federal Management Policy, within GSA, estimates that the Federal government has a capital investment in audio-visual facilities, equipment, and inventory of approximately $1 billion, with expenditures of about $500 million annually.

The educational media industry statistics for 1975 show gross <u>sales</u> of $277 million, up 1.8% from 1974. It is fairly obvious that gross receipts of the commercial sector, from which production expenses must be <u>subtracted</u>, are only 50% of what the Federal government spent on its own production. Further, only 2.5% of total industry sales were to the Federal government.

In a study of four Federal agencies in the Washington area (DOD, DOT, HEW, and Justice) and of the activities in Region IX (excluding Hawaii), it was revealed that Federal government in-house production of audio-visual materials totaled $78,954,162.00. This clearly does not include $87,665,000.00 spent for equipment; nor does it include the 5,737 personnel employed in these activities.

In addition, of 96 audio-visual activities studied in the four Washington-area Federal agencies, only 22 had been reviewed for compliance with OMB Circular A-76. In Region IX (excluding Hawaii), there were 95 activities, of which 46 were reviewed. Although OFMP asked whether each of the activities had been reviewed, it did not, by its own admission, question the need for the activity to be performed in-house.

The economic impact of transferring government in-house production to the commercial sector will be examined later.

II. CALIFORNIA

Within the educational audio-visual industry, approximately 40% of the commercial production occurs in California. Thirty-two percent of production of television film, feature film, and commercials are produced in that state.

Nevertheless, the California motion picture labor pool averages close to 50% unemployment annually. Of 14,000 members of the Screen Actors Guild (SAG), 11,000 are unemployed; within the International Association of Theatrical and Stage Employees (IATES), 6,300 out of 18,000 are unemployed. Of the two groups, 4,200 are working other jobs, and 11,818 are receiving unemployment compensation at a cost of $12,980,000.00 annually.

Government audio-visual production in California appears to be doing much better. In Region IX (excluding Hawaii), which covers all of California, there are at least 95 reported audio-visual activities with a budget totaling $43.9 million annually and employing 2,459 people. Only 20% of the Region IX dollar volume is performed by commercial contract, according to OFMP. This means that $35.1 million in Federal audio-visual production in California is performed in-house. This figure is almost three times the amount paid to unemployed individuals in the California motion picture and audio-visual industry.

Included in the Region IX expenditure is an $11,691,000.00 budget for the Aerospace Audio-Visual Service (AAVS) at Norton Airforce Base.

Although Airforce policy requires reliance on the private sector for acquisition of goods and services, only 15% of the AAVS audio-visual production is performed on contract; $9,945,000.00 reflects the AAVS in-house production. The figure is 75% of the amount paid annually by the State of California for unemployment compensation of members of the A-V/ motion picture industry.

In light of the fact that 40% of commercial educational and training A-V materials are produced in California, if the combined government A-V production expenditures of $78.9 million (within HEW, DOT, DOD, Justice, and Region IX only) were expended for contracts instead of in-house production, California would receive $31.8 million in additional audio-visual production business. New York would receive approximately $23.6 million, and Chicago and other areas about the same as New York. This figure is not the economic impact figure; it is merely production dollar volume. It is extremely significant that the $78.9 million production expenditure derives only from <u>known</u> A-V activities in four agencies, in addition to Region IX. As mentioned previously, total Federal government expenditures are $500 million.

III. ECONOMIC IMPACT

Again, basing impact computations only on known activities in four Federal agencies and Region IX, the economic impact of transferring audio-visual activities to the private sector yields direct and indirect benefits to the Nation in general and California in particular. Benefits are computed on the assumption that the four agencies and Region IX spend a minimum of $78.9 million on A-V production annually, and on the fact that 40% of production in the commercial sector occurs in California. Given these assumptions, transferring $78.9 million in production dollar volume to the private sector will yield 40% of the volume, or $31.8 million in new production to California.

Direct Benefits from $31.8 Million in New California-Based Production:

New Wages	\$25,440,000
Net Take-Home Pay	\$16,536,000
Rentals & Purchases Associated with Production	\$ 6,360,000
Total New Investment Resulting from \$31.8 million in New Production Transferred to California from Federal Government	\$22,896,000
California Tax Collections	\$ 1,500,000

\$31.8 million in new production = 100 hours in new TV programs produced in California

\$31.8 million in new production = 21.65% increase in employment in California

Indirect Benefits from $31.8 Million in New California-Based Production:

[Multiplier effect:

(1 ÷ marginal propensity to save) x (new investment) = (impact on California economy)]

$$\frac{1}{.10} \times \$22{,}896{,}000 = \$228{,}968{,}000$$

Assuming that the average gross wage in the production industry, including overtime, is equal to \$400 a week, an investment of \$228,968,000 would create 572,400 new man-weeks of employment or approximately 11,500 new full-time year-round jobs. This figure should be compared to the approximately 11,800 individuals in the motion picture/A-V industry who currently receive unemployment compensation in California.

IV. CONCLUSIONS

The in-house production figure of \$78.9 million (for known activities in four agencies and Region IX) is only 16% of the estimated \$500 million spent on A-V production annually by the Federal government. Nevertheless, if the transfer of only 16% of the government's A-V business yields \$228,968,000 in economic stimulus to California, which receives only 40% of the government transfer (with New York, and the Midwest each receiving 30%), the transfer of

100% of government audio-visual production can be seen as a boon to the economy.