The original documents are located in Box 11, folder "Economic Policy Board (2)" of the James M. Cannon Files at the Gerald R. Ford Presidential Library.

2/27/76

ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE

Proposed Agenda

Monday, March 1, 1976

No EPB Executive Committee meeting

Tuesday, March 2, 1976

1. Reform of Communications Regulation — MacAvoy

Wednesday, March 3, 1976

No EPB Executive Committee meeting

Thursday, March 4, 1976

No EPB Executive Committee meeting

Friday, March 5, 1976

No EPB Executive Committee meeting

THE WHITE HOUSE

WASHINGTON

MEMORANDUM FOR THE PRESIDENT

THROUGH: JIM CANNON

FROM: ED SCHMULTS
PAUL MacAVOY

SUBJECT: Reform of Communications Regulation

ISSUE

As part of your Regulatory Reform Program, the Domestic Council Review Group (DCRG) has examined Federal regulation of the cable television industry and has developed options for reducing over-regulation principally of cable television.

Restrictive controls of cable have been much discussed in the FCC, Congress, and the Executive Office in recent months. Hearings concerning cable television are tentatively scheduled in the House in March. Your decision is required to determine the posture your Administration will take in these hearings and in subsequent cable reform efforts.

BACKGROUND

Proposals to limit FCC regulation of cable television have circulated for years. President Nixon's Cabinet Committee on Cable Communications issued a report recommending cable de-regulation early in 1974.

For the past few months, a Domestic Council Review Group task force has been working to develop specific reform proposals for cable de-regulation. The House Subcommittee on Communications has recently produced a report recommending drastic changes in the Federal regulation of cable and plans to hold two week hearings in March. The Senate Communications Committee has also expressed an interest in holding hearings on cable. The FCC has reduced its regulation of cable in recent months, partly we believe in response to the DCRG review.

The Domestic Council task force held a series of meetings with all the industries and special interest groups concerned with cable television in October and November. Subsequently a panel of leading economists in the field of communications was convened by the task force to examine and make recommendations on this issue. The resulting data and testimony have been incorporated into a set of options for your decision.

DISCUSSION

Current FCC regulation of cable television as well as broadcast television is based on the Communications Act of 1934, a statute which was chiefly promulgated to apportion the limited frequency capacity of early broadcast technology. At first, cable was not regulated by the FCC. Intense pressure from television broadcasters, however, induced the FCC to impose regulations to the extent that cable affected the broadcast industry. In effect, cable technology, which has the capacity for delivering an abundance of television signals, has been tied to a regulatory structure geared to bandwidth scarcity, virtually assuring that cable would not supplant important elements in the broadcast industry.

Since 1968, the FCC has softened the terms of its regulation of cable. Two major restrictions, however, remain.

(1) the prohibition against importation of part or all of more than two distant signals by a cable operator.

(2) the ban on showing certain sports events and movies for a fee over pay cable.

These regulations have the effect of limiting the growth of the cable industry and denying greater services to its subscribers (currently ten and a half million).

The broadcast industry claims that the distant signal restrictions are necessary to prevent the use of program material by cable operators who do not pay copyright fees. (This argument will be blunted somewhat when the Congress acts on copyright legislation now before it.) Broadcasters claim that pay cable regulations prevent the removal of key sports events and movies from the airways as a result of being purchased outright by cable interests. Finally, they maintain that the penetration of cable into broadcast markets resulting from the lifting of these regulations would force many broadcasters in smaller cities out of business and result in the decline in general programming for all broadcast stations.

FINDINGS

The attached report, prepared by the staff of the Council of Economic Advisers for the DCRG, analyzes in detail the FCC cable regulations and the economic impact of rescinding them. The report finds that lifting distant signal regulations would promote moderate cable growth and provide more diverse programming for cable consumers. This form of de-regulation would have little or no impact on the broadcast industry in the larger urban areas (containing 80% of the population) but would reduce the revenues of smaller local stations, having an adverse impact on the functioning of some of them. The recision of pay cable regulation on movies would have no adverse impact and would provide greater programming for cable consumers. The report, however, maintains that certain significant sports events (i.e., Super Bowl, World Series, etc.) may need protection against removal from over-the-air television by cable interests.

The conclusions of the Domestic Council Review Group are that current FCC regulation of cable is unduly repressive and anti-competitive. The DCRG recommends selective abolition of the distant signal restrictions, dependent on settlement of the copyright issue, and also the pay restrictions, with some provision for the protection of discrete sports events. There are several options open to your Administration to promote these reform measures.

OPTIONS

(1) Submit legislation that would remove FCC restrictions on (a) the importation on distant signals in the top 75 markets, with the same copyright provisions contained in copyright legislation before the Congress, and (b) pay cable regulations in all markets, with caveats against siphoning of certain sports events. (For further explanation, see pages 20-22 of Tab A.)

(2) Submit a report or "White Paper" that outlines the DCRG findings on cable regulation and competition in the broadcast industry, which could be used as a basis for in-house reform by the FCC (which could substantially relieve competitive restrictions on cable) or as a basis for legislative action by Congress. (See pages, 23-25 of Tab A and Tab B.)

(3) Submit specific legislation and a more general report (i.e., combine options 1 & 2).

(4) Do nothing more than testify in favor of cable de-regulation in Congressional hearings.

The following is an analysis of the above options:

(1) Submit legislation.

<u>Pro</u> -- Would be a clear, concise proposal to eliminate unnecessary regulation, similar to the rail, air, and truck bills.

-- Would promote competition and diversity in television programming available to cable subscribers.

-- Would be favorably received by cable operators, cable consumers, knowledgeable public interest groups and to some degree movie producers.

-- Would respond to the numerous Congressional requests for Administration cable legislation that have followed the publication of the Cabinet Committee Report in 1974.

<u>Con</u> -- Would not deal with some larger first amendment questions including the potential for cable to assume a monopoly over television programming in certain areas over a period of time.

-- May lead to a deterioration of programming in some markets.

-- Will be strongly opposed by television networks, broadcast interests, and by some special interest groups who are influenced by broadcast arguments on this issue.

(2) Submit a report or "White Paper".

<u>Pro</u> -- Would provide a more detailed forum for developing a comprehensive regulatory policy than does a narrow legislative proposal.

-- Could have an immediate effect by influencing current FCC deliberations on liberalization of regulations.

-- Would receive nearly the same favorable response from pro-cable interests as would legislative proposals.

Con -- Legislation may be necessary to move the FCC to further de-regulation of cable.

-- Could be perceived as a weakening of your regulatory reform program in the face of stiff broadcast opposition in an election year.

-- The White Paper would by definition explore certain first amendment questions which could be fuel for a larger controversy than just the de-regulation of cable.

-- Broadcaster criticism of the Administration would still be evident in reaction to a "White Paper".

(3) Submit both a report and legislation.

Pro -- Would establish a comprehensive Administration position in both short term legislative needs and long term development of cable and other communications media, regulated by the Federal government.

-- Would allay criticism both of the "quick fix" approach inherent in specific de-regulation legislation and failure to take leadership in response to immediate needs, which would be implicit in the issuance of a report without legislation.

Con -- (Same as Con arguments of Options 1 & 2.)

(4) Do nothing except offer Congressional testimony.

Pro -- Would force the Congress to bear the brunt of broadcasters virulent opposition to change.

-- Would allow your Administration to avoid difficult task of proving its assessment of the economic impact of reform proposals.

Con -- Would be perceived as backing down on the part of the Administration to carry out regulatory reform in the face of broadcast opposition.

-- Could allow the Congress to wrest the issue of regulatory reform from your Administration.

COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

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

February 25, 1976

MEMORANDUM TO: DOMESTIC COUNCIL REVIEW GROUP ON REGULATORY REFORM

FROM: Paul W. MacAvoy

SUBJECT: Regulatory Reform in Broadcasting

During the 1950's and 1960's, the Federal Communications Commission 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.

By that time it had become clear that, for technological and economic reasons, VHF broadcasting stations could not be located in many smaller markets, and that only five or six channel could operate in the largest markets. The FCC 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 more stations than communities but not many more than one or two in each community, and most of these on the UHF band.

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 Books, 1974).

The FCC's objective was not simply availability of TV throughout the Nation; that could have been accomplished using only the VHF range.2/ The distinctive feature of the 1952 plan was, rather, its emphasis on localism. The FCC saw local TV stations as "...instruments for community enlightenment and cohesion, much like the hometown newspaper of an earlier era."3/

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" 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 circumstances was to provide better TV or simply some TV. Somwhat 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, as well, cable was able to enter these markets because many consumers were willing to pay for the added diversity that it could provide.4/

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

3/ Noll, Peck, McGowan, op. cit., p. 100.

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

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.5/

The FCC responded to this situation in 1966 by freezing cable in the largest one-hundred television markets.6/ 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.7/ At most, three

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5/ 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. 2 (May 1966), pp. 227-251. This study, which is referred to again below, was the first important econometric work on CATV.

6/ 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 one hundred markets. This point, which is discussed further below, has never been adequately explained by the FCC.

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

non-network signals can be imported in the top fifty markets, at most two in the next fifty, 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.8/ The restrictions are strongest in the top fifty markets, when most movies and serials off the networks are blacked out. As a result, the distant signal is typically blank half of the time. Third, pay cable services are limited to providing sports events that are not generally televised over-the-air.9/ FCC rules also essentially exclude from pay cable current motion pictures, and in some instances, even movies over 10 years old if they have been televised in the community within the past three years.

Individually, and collectively, these restrictions have a significant impact on CATV. The FCC's restrictions 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.

1. The Policy Problem and Proposals

The CATV policy problem is set by two broad facts. First, the public has demonstrated willingness to pay for the improved quality and diversity offered by CATV.

8/ 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 fifty markets, and the exclusivity rules do not apply to smaller markets.

9/ The FCC pay TV rules effectively eliminate sportscasts on a pay basis for sporting events shown in the market within the past 5 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.

Second, the FCC's rules have restricted the growth of CATV and, more important, its value to consumers. Thus, there is a public interest rationale for examining this regulation. The question is whether there is sufficient public interest in changing FCC restrictions on CATV. These are avowedly protectionist and if they have no other rationale should be rescinded. The introduction of a new technology almost invariably erodes the position of established firms, but this effect as such, is not counter to the public interest. However, the CATV problem may not, in fact, be so simple. First, in the absence of new legislation, imported signals would be widely disseminated by the cable companies without remuneration to those providing the programming. The economic effects would presumptively be adverse, since scarce resources in programming would be treated as if they were free.10/ Second, the imported signals could so "fragment" the market for local over-the-air broadcasting that the local service is eliminated. This could result in reduced total service to all viewers. Third, taking the limits off pay cable could "siphon" exposure to important live events as well as from broadcast television.

The FCC's current restrictions thus should be examined for effects on the presentation of the widest variety and the highest quality service to the consumer.11/ Specifically, reforms that should be considered center on (a) distant signal importation and exclusivity rules and (b) pay cable.12/

10/ The economic aspects of the copyright issue are discussed in B. Mitchell and R. Smiley, "Cable, Cities, and Copyrights," Bell Journal of Economics, Vol. 5, No. 1 (spring 1974), pp. 235-263, and R. Posner, "The Appropriate Scope of Regulation in the Cable Television Industry," Bell Journal of Economics, Vol. 3, No. 1 (spring 1972), pp. 98-129.

11/ The costs of restrictions on CATV are detailed in W. Comanor and B. Mitchell, "The Costs of Planning: The FCC and Cable Television," Journal of Law and Economics, Vol. 15, No. 1, pp. 177-206 (April 1972).

12/ Some suggestions for reform along these lines are presented in Cable Television: Promise versus Regulatory Performance. U.S. House of Representatives, Committee on Interstate and Foreign Commerce, Subcommittee on Communications, 94th Congress, Second Session, January 1976. See also Cable, Report to the President of the Cabinet Committee on Cable Communications, 1974.

(a) Distant signals. The first type of distant signal legislation would lift the FCC restrictions altogether, subject to the payment of copyright fees on program use as set out in the bill now before Congress. The second is a variant on "retransmission consent," whereby cable systems would essentially "affiliate" themselves with a major independent station, bargaining for the right to retransmit its signals. Copyright owners presumably would receive their compensation by charging the station more. The proposal is an alternative to the accommodation achieved in the pending copyright bill. (S. 22).

(b) Pay programming. Two types of pay legislation have been circulated, the first proposing to eliminate the requirements 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 is justified on the grounds that the supply of the first, in theory, is expansible while the supply of the second is not.13/

13/ The FCC recently issued new cable regulations but their likely effect is not yet clear. Federal Register, April 7, 1975, Vol. 40, No. 67 - Part III, page 15546-15578 also Dockets of March 28, 1975, May 27, 1975, and October 31, 1975.

2. Forecasts of the Effects on the Cable Television Industry.

There are currently about 3400 cable TV systems in the country. Approximately 85 percent of these systems have less than two thousand subscribers and only a little more than 1 percent have 20,000 or more subscribers. There are now about 10.5 million cable subscribers, or roughly 16 percent of the television homes in the United States. It is expected that cable will eventually serve about 50 percent of television homes, with the penetration rate above the national average in smaller markets and less than the national average in larger markets.14/

Relaxation of current restrictions on distant signal importation and the exclusivity rules would cause CATV to grow more rapidly and would increase somewhat CATV's eventual penetration rate. The effect is likely to be most pronounced in, very roughly, markets 26-100. The larger markets are not likely to be strongly affected because the demand for cable is relatively weak in large markets.15/ Small markets are not likely to be strongly affected because the costs of microwave transmission would prevent small CATV systems from taking advantage of liberalized rules on distant signal importation.16/

14/ 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.

15/ This is the case basically because in larger markets there are typically at least five or six high quality signals available off-the-air.

16/ An FCC staff estimates that microwave transmission is only 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 increase the revenues of CATV systems. This would make investment in CATV more attractive and tend to strengthen the many CATV systems that are now weak financially.

The effects of liberalization on the growth and eventual size of the CATV industry, while noticeable, would not be large. Econometric work indicates that, for every additional imported signal, market coverage by cable increases by about 2 to 3 percent. These estimates suggest that unlimited importation might increase market penetration from roughly 50 percent to 60 percent of households in a typical middle-sized or small-sized city by the middle 1980's.

It is important to recognize that CATV is growing and will continue to grow even if the exclusivity rules and the restrictions on distant signal importation remain unchanged. Correspondingly, any adverse effects of CATV on local stations in the smaller markets will persist in the absence of changes in these rules. Thus, elimination of the exclusivity rules and limitations on distant signal importation would only modestly strengthen existing trends.

The most significant impact of eliminating the current restrictions would be on the service offered by CATV.[17] Once a microwave system has been built, the added cost of importing additional signals from a given location is low. Consequently, it can be expected that stations will be imported in bundles. Currently, there are over 350 private microwave systems and the removal of all restrictions would result in these stations importing more stations and giving the consumer more choice. The low marginal cost of the additional signals suggest that where cable companies currently operate microwave systems their service offerings to their customers or viewers should be increased. In major markets the importation of programming from other major markets would significantly increase the attractiveness of cable. For example, cities such as Philadelphia could import a number of signals from New York.

17/ Some argue that the limited new penetration resulting from additional distant signals means that few additional signals will be imported. This argument is not correct. If importing stations are allowed to price additional imported signals at marginal cost, importation may be profitable even with no additional penetration. No estimates of this effect have been made, but there is no doubt that importation of distant signals would be encouraged. The conclusion also ignores the very small marginal cost of importing additional stations when one station is already being imported. In this case, small increases in revenue would be sufficient to induce importation of several additional signals.

CATV systems could also be expected to experience some gains from relaxation in the exclusivity rules. As was mentioned above, in the top fifty markets, blacking out can run as high as 50 percent. This certainly limits the value of the imported signal to consumers. Blacking out is currently defended on the grounds that it protects the property rights of the owners of the blocked programs. However, granting the validity of the property rights, the current exclusivity rules are not the only solution and perhaps not the best solution. Changes in the copyright laws could lead to a system of fees for imported programs. Such a system would protect valid property rights but, unlike the exclusivity rules, would not artificially limit the diversity of programming offered to consumers.

In summary, elimination of the exclusivity rules and restrictions on distant importation would have two broad effects. First, CATV would grow more rapidly and eventually achieve somewhat higher levels of penetration than if the rules are retained. Second, and much more important, elimination of these rules would permit CATV systems to offer present subscribers more diverse programming or simply more programming. Both effects, while believed to be important, are not expected to be so substantial as to change the nature or extent of cable legislation decabe.

3. <u>The Economic Effects on Broadcasters</u>

Signal importation by cable makes available more channels for audience viewing. This fragments the audience, reduces the number who view the 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.18/ 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.

Laying aside questions about where the public interest in television lies, the importance of these considerations turns on the magnitude of the effects of CATV deregulation on the number and economic health of local broadcasters.

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 off-the-air broadcasts that is relevant. The effects on the availability and quality of off-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

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18/ 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.

fairly small; (2) cable penetration is less in larger than in smaller markets,19/ and (3) the profit rates of the broadcasting companies are sufficiently large to prevent failure as a result of these changes.20/, 21/ The revenues of stations in larger markets presumably would decrease somewhat, or grow less rapidly. However, with profit rates or tangible equipment greater than 100 percent per year (as shown in Table 1), would not

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

20/ Neither original cost nor book value includes the purchase price of the francise. When the price of the francise 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 francise is entirely a pure rent; francises would still be available even if their price fell to zero.

21/ 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.

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)	1,947	(¹)
VHF	11	(−3,330)	8,503	(¹)
Total, small market	297	27,303	164,283	16.6
Large market (top 100):				
Network:				
UHF	58	7,299	45,585	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	433,433	514,691	84.0
All stations:				
Network:				
UHF	117	6,300	72,179	8.7
VHF	453	508,411	507,630	100.2
Independent:				
UHF	80	(−12,272)	44,502	(¹)
VHF	31	8,347	54,668	15.3
Total, all stations	671	510,786	679,979	75.2

¹ Loss.

Source: FCC.

lead to either a decrease in broadcast quality or a significant decrease in the number of stations.<u>22/</u>

<u>22/</u> 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 16 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 <u>focused on smaller television markets</u>. 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 CATV growth in particular areas before similar effects will be seen in the larger markets as well.

The letter from Mr. Lester W. Lindow (footnote 17), 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 <u>stop</u> 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 "protections" afforded under the FCC rules, are less significant).

Unlimited signal importation will actually help some independent stations in larger markets, especially those few very high quality independent stations that have been said to have "super station" potentials. A station whose signals are carried by cable systems into distant markets will market time to regional rather than local advertisers in order to capitalize on its larger regional audience.23/ Also, the station will "sell" its signals to cable systems directly under the proposal considered here; this will provide a substantial additional source of revenues, at least until regional advertising becomes more widely established. As such stations that have better programming of an entertainment nature reach out for a regional market, local advertisers will switch to stations which lack regional aspirations and whose signals are not carried outside the markets in which they are located. This reassignment of customers would follow the pattern established in network broadcasting whereby the network sells time to national and regional advertisers while local stations sell time to local advertisers.

The available evidence does delineate the market size beyond which relaxation of current restrictions would have significant adverse consequences. Elimination of the exclusivity rules and of restrictions on distant signal importation, coupled with appropriate copyright protection, would probably not seriously reduce the availability or quality of off-the-air broadcasts in the largest 75 or 80 or 90 markets. The question of the adverse impact, then, centers on the roughly 150 smaller markets.

To put the significance of this issue in perspective, it is crucial to recognize that approximately 80 percent of the population lives in the top 80 markets. There is no reason to impose restrictions on large markets which are needed, if at all, only in smaller markets.

23/ 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.

The thrust of the research done to date is that unlimited signal importation would have significant adverse effects on local stations in smaller markets.24/ However, there is a considerable degree of uncertainty on how large the effect on these stations would be of the removal of restrictions on cable.

The most extreme forecast of adverse impacts from unlimited signal importation appears in a consulting report by Statistical Research, Incorporated, for the National Association of Broadcasters. This report estimates losses of audience for independent broadcasters of up to 25 percent in prime time and 61 percent in "early fringe" time as a result of the entry of four imported independent distant signals. This would be expected to result in a loss of slightly less than 23 percent of total revenues. The conclusion is that the importation of four signals would result in reducing 48 percent of the profitable stations in the country below the break even point. By inference, then, the elimination of restrictions on importing signals would result in the disappearance of half the country's over-the-air broadcasting stations.

The NAB forecast is based on detailed observations of stations already on the margin of losses. But data on profitability by type of station shows effects on the industry as a whole. The networks, stations owned and operated by the networks and network affiliated VHF stations are now extremely profitable. Independent VHF stations are less profitable on average, but still substantially more profitable than U.S. industry in general. Independent UHF stations, of which there are 62, are unprofitable as a group. But it is generally thought that CATV will increase the profitability of UHF stations. Consequently, a simple comparison of existing gross margins with predicted decreases in revenue does not imply a disastrous decline in the industry as a whole.

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

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24/ This was the basic conclusion of Fisher and Ferrall, op. cit. See also: L. L. Johnson, "The Impact of Cable Television on Broadcasting" (mimeo, no date).

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 eight cases cited in available material, five show only limited diversion and three show substantial diversion.25/ Thus, it seems that serious economic impacts on some small stations will occur, but it is not known how widespread this will be.26/

It is also pertinent to note that the networks have the means and an incentive to cushion reductions in local station revenues. As fragmentation of local viewing audiences occurs with the entry of cable, the local affiliate of the networks would experience reduced revenues from local advertising. In response, the networks would have to increase the revenues from national advertising paid to the local broadcaster 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 result 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 likely to be close to failure under any circumstances, the ultimate result is not likely to be a reduction in the number of stations.

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 will tend to make the programming of local stations more truly local. Rather than simply going out of business, broadcasters are very likely to respond to cable with strenuous efforts to differentiate and expand their product. Local programming should have some special value for audiences, and over-the-air broadcasters ought to be able to provide this local programming better than cable companies. Thus, in response to cable fragmentation, broadcasters ought to

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25/ 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.

26/ FCC, "Economic Evaluation," op. cit., suggests that importing distant signals to very small markets is not economically feasible.

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 should strengthen the financial viability of the local broadcaster.

This section contains two major points. First, unlimited signal importation apparently does not raise serious problems of the availability and quality of off-the-air broadcasts in the larger markets, but could for stations in smaller markets. Second, in terms of the values of localism, the effects of unlimited importation are ambiguous. It would tend to reduce local station revenues, which of course, works against quality local programming. However, competitive pressures work in the opposite direction. Competitive pressures from cable might not eliminate local broadcasters but might tend to direct them towards more specialization in local programming as stations differentiate their offerings in response to signal competition.

4. The Economic Effects on Consumers

The consumers of cable services will realize an improvement in signal quality and, more important, an increase in viewing options. The potential costs are reduced quality and number of over-the-air broadcast services.

Measures of the benefits of increased diversity can be based on consumers' demonstrated "willingness to pay." An econometric model by Noll, Peck, and McGowan related the number of subscribers to CATV to price, income, the number of households, system age, and a measure of the added diversity afforded by cable.27/ The relationship they derive implies that increasing the number of signals from nine to ten will, for a system with 10,000 subscribers, provide annual benefit of $39,000.28/ Assuming that annual benefits remain unchanged, the present value (at a discount rate of 10 percent)

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

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

of the benefits stream from providing one additional channel to all cable subscribers in the United States is over $400 million.

The costs to consumers of "lost broadcasting" from cable competition, while difficult to measure, depends on market size. Non-subscribers in large markets, where most of the population is found, are very unlikely to be affected by cable: the over-the-air broadcast material will be much the same for them as it would have been in the absence of cable. Consumers that reside in small towns may be affected differently. Those that already have access to cable -- approximately one-third of rural residents in most states -- will not lose service. Those consumers in small towns not now wired to the cable but willing to purchase the service will, of course, be better off as a result. But households too isolated to wire onto the system or not wanting to wire onto the system will experience a diminution of the quality of programming if some local broadcasters go out of business upon the advent of cable.

In summary, different groups of consumers would gain or lose from freeing up restrictions on cable television. The gainers would be current subscribers and consumers not now having access to cable who attach to systems as they become available under the less restrictive rules. The losers are those in isolated locations that do not attach and as a result experience some reduction in the quality of over-the-air broadcast signals because of the entry of cable. Given the concentration of TV households in large cities, it is extremely unlikely that consumers as a whole would be disadvantaged.

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 the 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 broadcast TV does not have a market 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 however 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 elastic supply. It is very reasonable to expect that pay cable would, in fact, lead to a significant increase in the supply of programs, especiall specialized programs.

Unique and popular live broadcast, especially sports events do pose a problem. Their diversion from over-the-air broadcast to pay television would leave the vast majority of consumers without access. In order to prevent this, there may have to be restrictions applied on cable which would allow broadcast exclusivity or at least would prevent cable exclusivity.

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

6. Summary and Policy Evaluation

The cable television industry has been the object of almost unparalleled regulatory control. Ten years ago the FCC petitioned Congress for legislation to provide a mandate for cable television regulation. The legislation was not forthcoming. Even without Congressional authorization, cable televisior has become more regulated than over-the-air broadcasting. Detailed and complex regulations have been adopted prescribing the content of cable programming, limiting the amount of advertising, requiring "free" cable services to various users -- regulations which have no counterpart in broadcasting. This expansion of FCC regulation of cable was accomplished administratively, by employing "ancillary jurisdiction" procedures.

There is no public interest rationale for the present form and scope of FCC restrictions on CATV. The FCC has restricted CATV more severely in larger than in smaller markets. Precisely the opposite pattern would be more consistent with consumers' interests. Granting the value of localism, there may be good reason to impose restrictions on CATV in smaller markets. There is no apparent need in the larger markets for the current restrictions on distant signal importation or, assuming appropriate copyright protection, for the exclusivity rules. Eliminating current restrictions on CATV would tend to reduce the revenues of stations in larger markets, but would not seriously reduce the quantity or quality of off-the-air broadcasts. The benefit of eliminating these restrictions would be a large increase in the diversity of programming available to a significant fraction of the viewing public.

Based on these findings, there are two options for the future development of policy: (1) propose legislation reducing controls on cable in keeping with these economic findings, (2) issue a DCRG "white paper" or "report" on these findings without proposing legislation.

(1) Legislative Proposals

There are three critical parts to current FCC regulation of cable television:

a. restrictions on distant signal importation;

b. the exclusivity rules; and

c. restrictions on pay cable.

Comprehensive legislation would act on each of these three areas, but each could also be dealt with separately.

Restrictions on distant signal importation are, from the point of view of reform, the simplist part of current

FCC rules. Given the protection provided by current exclusivity rules, legislation might simply eliminate restrictions on distant signal importation. Alternatively, an "adverse impact" requirement might be substituted for the current restrictions. That is, unless local broadcasters could demonstrate substantial harm as a result of distant signal competition, and show how that harm would affect service to the public, no restrictions on this activity could be imposed by the FCC.

Elimination of restrictions on distant signal importation would produce immediate results by increasing the choices available to the Nation's 12 million cable subscribers. The gains to these consumers are probably worth at least one half billion dollars per year. At the same time, lifting the restrictions on distant signal importation would probably not seriously harm the quantity or qualty of off-the-air broadcasts at least in the larger markets.

Proposing such legislation would trigger broadcaster opposition keyed to the prospect of further competition with small market TV stations. These stations are not highly profitable, but many of them provide one of the few sources of local and other news available to rural residents,29/ and some could go out of business to the loss of these viewers. By limiting reform to controls on the top 75 to 100 markets, however, this issue could be eliminated. And in five years perhaps a case could be made for eliminating controls on the remaining smaller markets.

29/ The most recent Roper Poll indicates, for instance, that 65 percent of people surveyed reported that they depend on TV for most of their news, up 14 percent from a decade earlier. The percentages for the other sources of news are 41 percent, newspapers; 21 percent, radio; and 4 percent for each of magazines and "other people." See: "Trends in Public Attitudes Toward Television and Other Mass Media, 1959-1974," Roper Organization, Inc., (1975), p. 3. This does not mean that TV stations devote any great amount of time to news, local affairs, or the like. An "average" TV station devotes about 9 percent of its day to local news and public affairs programs -- roughly half as much time as is given over to airing commercials.

The exclusivity rules and restrictions on pay cable are more important than limitations on distant signal importation. Because of the exclusivity rules, distant signals, even those which are not duplications of local broadcast signals, must be blacked out a majority of the time. The value of CATV to consumers is accordingly reduced. Relaxation of restrictions on pay cable promises a fundamental change in television programming. Where television is now strongly orientated to programs with mass appeal, pay TV would be able to serve a wide variety of specialized interests.

While important, legislative reform of the exclusivity rules and restrictions on pay cable would be quite difficult. On both of these topics, reform must be preceded by, or coupled with, action on copyright protection. Legislative action on copyright has been slow in coming in recent years and is complicated by committee jurisdictions different from those for communications regulation. Proposals for changes in these aspects of cable regulation cannot be put forward without those initial actions of other committees.

(2) Issuing a "white paper" or "report" on cable regulations

Substantial improvement in the existing situation, if not complete deregulation of cable television, does not necessarily require legislation. It could, instead, be accomplished by FCC decisions. Such a change in direction, however, would require a change in regulators' disposition to reaffirm that market competition must be trusted to serve the public unless the case is very clearly established on the record that it hasn't. The purpose of a report, then, would be to say that, although regulation is anticompetitive, it is improving along those lines. Thus, by administrative exhortation the report would seek to achieve marginal or specific changes within the FCC.

If cable television is to compete freely in the marketplace, it should be required to do so in a manner consistent with the purposes of copyright protection. Since the copyright issue has not been resolved,30/ the "report" should not urge

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30/ Copyright legislation is currently before Congress, where it has been the subject of debate for almost 20 years. Like most major legislation, this copyright bill is a compromise measure that is not wholly satisfactory to any one side of this multifaceted problem. Consequently, the proposed bill may or may not provide a satisfactory resolution of the copyright issue as it bears on CATV.

the FCC to entirely deregulate CATV. The FCC could be urged to introduce pro-competitive policies in two areas: (a) pay cable; and (b) distant signal importation.

(a) Pay Cable

Currently, the FCC rules essentially bar movies three to ten years old from pay-cable, with minor exceptions, and most popular sports televised within the past five years. The appeal filed by Home Box Office, a Time, Inc. subsidiary and the largest pay cable firm, and a number of cable and broadcast firms, is now pending resolution in the D.C. Court of Appeals. Most of the private parties have challenged the rules on First Amendment grounds. The Justice Department, as one of the statutory respondents, however, has attacked the Commission's rules on antitrust grounds.31/

A decision on the appeal is expected this year. Even were the FCC's decision to be sustained, which many think unlikely, signficant change would still be possible. Under the rules, pay cable may bid for the right to show any movie already under contract to a station or its parent network. The practical obstacle is, as the Commission recognizes, that most movie contracts with television are "exclusive." The FCC has under consideration proposals to administratively reduce the time period of exclusivity specified in these contracts. Given the FCC's penchant for marginal decisions, a reduction in exclusivity terms that increased availability of feature films to cable TV could be furthered by exhortation in the "white paper."

31/ Justice argues that the rules might be supportable, had the Commission laid the proper record, but that the FCC failed to adequately consider the competitive consequences of the rules in any meaningful sense. The FCC declined, for example, in issuing its rules, to quantify or identify the various competitive consequences of its actions. Justice criticizes this, which is reversible error under several recent Supreme Court decisions; it also argues that the Court should consider the failure on the part of the FCC to require broadcasters to air any of the programs its rules would reserve to their exclusive use.

(b) Distant Signal Importation

The FCC's 1972 rules on cable effectively limited the geographic area from which signals could be imported. These restrictions on "leapfrogging" made the importation of distant signals unduly and, in some cases, prohibitively costly.32/ The FCC recently rescinded its anti-leapfrogging rules.33/ However, the FCC retains its limitations on the

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32/ In general, the rules provided that if the signal of a top-25 market independent were imported then the closest two markets had to be "tapped." For example, the cable system in Buffalo was allowed to import two signals, but required to import signals from Cleveland and/or Pittsburgh, the closest two top 25 markets. These cities are at almost opposite ends of an axis running through Buffalo. The New York City stations desired by many subscribers were not importable -- except by those very few Buffalow cable systems which were grandfathered in because they had been constructed and were operating considerably before the advent of the FCC regulation of CATV. Hence, to bring in the few signals allowed under the FCC rules, cable systems in Buffalo would have been required to build microwave relay systems in opposite directions to out-of-state markets, not to the market whose signals were most likely to appeal to system subscribers.

33/ Except for an unimportant caveat in the case of UHF independents.

number of distant signals that can be imported into any of the top 100 markets.

The "report" could urge the FCC to consider the desirability of liberalizing, or eliminating, restrictions on importation of distant signals into the top 100 markets. This might be accomplished by adopting new rules or, preferably, substituting an "adverse impact" test for the existing limitations on distant signal importation.

In summary, the FCC has the authority at this time to liberalize its rules on pay cable and distant signal importation. Basically, the FCC could change the assumptions upon which its restrictions are based. Instead of requiring cable television systems to demonstrate they will do no harm, the Commission could more in accord with traditional principles require that harm be established. Except with respect to cable television, a requirement that the case for special protection be clearly established is a familiar feature of the FCC's broadcast regulations. Presumably such an approach is both workable and effective in protecting the public interest; at least the Commission has followed it for nearly a generation in broadcasting. The feasibility and desirability of major deregulation initiatives in cable television regulation could be made clear to the FCC, through Executive exhortation to change commission policy leadership.

COMMUNICATIONS IN A FREE SOCIETY

(Outline of Administration White Paper)

I. Background

The historical growth of the Federal Government's role in communications focusing on the Federal Communication Act of 1934 and subsequent developments.

II. Statement of Administration Policy Goals

The Administration has been dealing with market competition in reducing government intervention in the markets for goods and services. However, competition in the marketplace of information and ideas is even more fundamental because such competition is essential to the protection of our individual first amendment rights. The goals of the Administration might be stated as follows:

1. Broadcast policy should rely more on competitive market forces and less on government regulation. Fair competition among the technologies should be encouraged. The development of new communications media should be fostered by freer access to the marketplace.

2. Cable television has the potential for extending and offering access to an abundance of communications services. Cable should be allowed to prove its value in the marketplace.

3. Public broadcasting is an important contributor to greater choice and quality of programs.

4. Opportunities for new sources of talent and creative programming should be encouraged. Only by enhancing quality, diversity, and accessibility of programs can a greater abundance of media serve the public good.

III. Administration Position on Communication Issues

A. Regulatory Reform in Broadcasting and Cable Television. (See CEA Paper on Regulatory Reform, Tab A.)

B. Other Communications Issues (e.g., fairness doctrine, cross media and multiple ownership, separation of transmission facilities and programming, Federal/State regulatory conflicts, new communications technologies).

FOR OFFICIAL USE ONLY

Business Conditions Report

February 27, 1976

U.S. Department of Commerce
DOMESTIC AND INTERNATIONAL BUSINESS ADMINISTRATION
Bureau of Domestic Commerce

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FOREGOING RESTRICTIONS MAY BE REMOVED
90 DAYS AFTER PUBLICATION

CONTENTS

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Enquiries and suggestions are welcomed.

INDUSTRY HIGHLIGHTS

INDUSTRY HIGHLIGHTS

RETAIL SALES: GAINS EXPECTED TO CONTINUE THROUGH 1ST QUARTER 1976

CURRENT
- Total retail sales continued to advance and were 13 percent ahead of comparable 1975 figure for January 1 - February 14 period.
- All categories shared in sales increase with gains varying from low 6 percent gain for food stores to high of 23 percent for automotive dealers.
- For most recent week (ending February 14) all sales, with the exception of food, were particularly strong. Furniture, home furnishings and equipment stores were 33 percent ahead of the same period last year while building materials, hardware and farm equipment dealers were ahead by 18 percent.
- Although current strength is partially attributable to year-to-year comparisons, February gains still appear genuine as consumer optimism and spending power continue to improve.

RETAIL INVENTORIES: DECLINE CONTINUES IN DECEMBER

CURRENT
- Total retail inventories in December 1975 (unadjusted) declined by a substantial $5.5 billion compared to November 1975. Non durable goods accounted for $5.0 billion of the decline with the general merchandise category dropping $3.7 billion.
- Sharp decline can be attributed to Christmas sales, seasonal factors, and liquidation of inventories of W. T. Grant Company. On January 1, 1975 Grant inventories totaled $407 million.
- Total inventories in December 1975 at $71.1 billion were 1.3 percent less than at the end of December 1974, despite sales in 1975 which increased 8.6 percent over 1974.
- Retailers in all categories succeeded in turning over merchandise and satisfying consumer needs while tying up less capital in inventories in 1975. Combined stock to sales ratio in December 1975 was 1.51 and in December 1974, 1.67.
- As retail sales are showing continued strength (see preceding retail sales article), retailers may have to add to inventories before end of 1st quarter.

WHOLESALE TRADE: INVENTORIES BUILD GRADUALLY

CURRENT

- Merchant wholesalers' 1975 sales of $438.9 billion, although down 2 percent from 1974, were 20 percent higher than in 1973 (a very good year) and much higher than any other year of previous decade.
- By trade group, comparisons with 1974 sales levels showed mixed results, with 7 trade groups showing gains and 10 indicating declines.
- Durable goods sales were down 8 percent at year-end compared with 1974 sales. Only 2 of 9 commodity lines, machinery and equipment and motor vehicles, showed modest sales gains of 2 percent.
- Fourth quarter 1975 durable goods sales show some buoyancy and yield hope for better sales in first quarter 1976.
- Fourth quarter sales were 25.2 percent of total 1975 sales, while sales in same 1974 period were 24.6 percent of total. Moreover, comparing December sales of each year, 6 trade groups showed gains in 1975, 3 of them 15 percent and above.
- In nondurables, 1975 sales of $253.1 billion were 3 percent above 1974 sales. Inflation, however, nullified any real gains. Five of the 8 trade groups recorded dollar gains ranging from 1 percent in tobacco to 10 percent in beer, wine and distilled alcoholic beverages.
- Comparing December nondurables sales of each year, 7 trade groups showed increases in 1975, with dry goods and apparel up sharply, 32 percent.
- Stock-sales ratio for wholesaling, as of December 1975, dropped 7 points from November due to 3 more trading days and higher sales in December. The ratio for both durables and nondurables declined.
- Industry sources explain that inventories are rising, especially in durables, but only gradually. As several durables lines are keyed to activity in construction industry, there is caution over building up inventory until new housing shows more strength.
- General attitude of wholesalers is guarded optimism. They acknowledge that recovery is under way but are proceeding cautiously.

FIBRE BOXES: STRONG RECOVERY CONTINUES

CURRENT

- Upturn in fibre box business in final quarter 1975 continued into 1976 as average shipments for January were 24 percent above same 1975 period.
- At end of January, price per thousand square feet of corrugated products shipped was $28.23, up 0.7 percent from December 31, but 0.9 percent below January 1975 quotations.
- During month of January, consumption of containerboard averaged 282,000 tons per week, an increase of 15.2 percent over January 1975.
- Containerboard inventories on January 1 were 6.6 weeks compared with 6.1 weeks as of December 1, 1975 and 8.4 weeks as of January 1, 1975.

BUSINESS INCORPORATIONS: 1975 TOTAL APPROACHES HISTORICAL PEAK

CURRENT

- With 30,261 incorporations in December 1975, new U.S. business incorporations reached a total of 327,989 in 1975, according to Dun and Bradstreet, Inc.
- 1975 total is 2.8 percent above 319,149 in 1974, and is a recovery from 5 percent lag at end of first half 1975. 1975 total is only 0.4 percent short of historical peak of 329,358 achieved in 1973.
- New York with 3,818 new incorporations for 1975, and California with 2,643, led the nation in individual state gains for December 1975.

HOUSING: RENTAL VACANCY RATE DECLINES IN FOURTH QUARTER 1975

CURRENT
- National rental vacancy rates declined to 5.4 percent in fourth quarter 1975, lowest since first quarter 1972, and considerably below 6.1 percent to 6.3 percent rates of first three quarters 1975.
- Decline in rental vacancy rates reflects sharp decline in multi-family housing construction since mid-year 1973.

AUTOMOBILES: IMPORT CAR INVENTORY RISES TO 120 DAYS SUPPLY

CURRENT
- Between December 31 and January 31 import new-car stocks in U.S. increased by 90,731 units or 26 percent to a total of 438,652 units -- from 86 selling days' supply to 120 days.
- Lack of U.S. demand for small cars as indicated by recent domestic car selling trends could result in a glut of small cars and subsequent pressure on prices.
- Datsun and Toyota have introduced incentive contests for dealers and salesmen for February-April period.
- Unwilling to increase its small-car inventory GM has shutdown its South Gate California small car plant and cancelled plans to start Chevette output there as of March 1.

AIRLINES: MORE SEATS IN PLANES

CURRENT
- Most U.S. airlines are increasing their seat-mile capacity by putting more seats in present planes.
- Airlines are adding more seats by removing first-class seats and replacing them with cheaper, less spacious coach seats.
- The 11 major domestic carriers intend to add more than 9,600 seats this way, according to a Wall Street Journal survey.
- Survey further indicates that these programs may be costing already depressed aircraft industry more than $750 million in lost sales.

TREASURY BORROWING: 1976 WILL TOP 1975

CURRENT
- Treasury will increase borrowing in 1976 even if recovery proceeds at a considerable pace.
- Estimates of Treasury new money needs for calendar year 1976 are $87.0 billion compared to $85.4 billion for 1975. 1976 total is broken down into $26.5 for first quarter, $11.5 for second, $22.5 for third, and $26.5 for fourth.
- Government securities market has benefited during past year from significant amount of available funds seeking investment outlet, especially from banks experiencing sluggish business loan demands.
- If private demand for funds increases later in year, the substantial amount of Treasury borrowings projected for the second half of this year could cause interest rates to rise.

COMPUTERS: JOINT VENTURES HELP U.S. FIRMS IN WESTERN EUROPE MARKET

- IBM has supplied over half of $20 billion installed computer base in Western Europe. Government and state-owned industries account for over 15 percent ($3 billion) of the installed base. One-third of government-owned base is of IBM production.
- Portion of installed base not supplied by IBM has come from both European producers and other American companies.
- As part of recent agreement between Honeywell-Bull and the Compagnie Internationale pour l'Informatique (CII) in France, Honeywell Information Systems (HIS) is expected to gain easier access to the French government computer market.
- Other U.S. computer firms (except IBM) are expected to increasingly seek to enlarge their shares of lucrative government markets by this method of joint ventures with European firms.

CURRENT
- Sperry Univac's new joint venture with Datasaab in Sweden is seen as prime reason for Swedish Government purchase of over $20 million worth of large Series 1100 Univac computers.

° Univac won this order in competition with IBM, and the same two U.S. firms are competing for a $5 million order for the Swedish Weather Bureau.

° Univac is apparently duplicating this pattern in Spain with Uniforesa, its joint venture formed with Spanish Instituto Nacional de Industria.

-- Iberia Airlines, the government-owned airline, last year replaced IBM and Siemens computers with Univac systems for reservations and operations.

-- Last week, Univac announced that it had received a $1.1 million contract with Spanish Air Ministry for a computer system to be used in logistics and administration.

CALCULATORS: JAPANESE PRODUCERS FEEL PRESSURE FROM ASIAN COMPETITORS

° Since early 1970's, Japanese and U.S. calculator manufacturers have been competing for U.S. and world markets. U.S. manufacturers have regained their domestic market from Japan, but find the pressure from price cutting and technical innovation continuing both at home and abroad.

CURRENT ° Japanese manufacturers are feeling pressure from Asian competitors, notably Hong Kong, Taiwan, South Korea, Singapore and Malaysia.

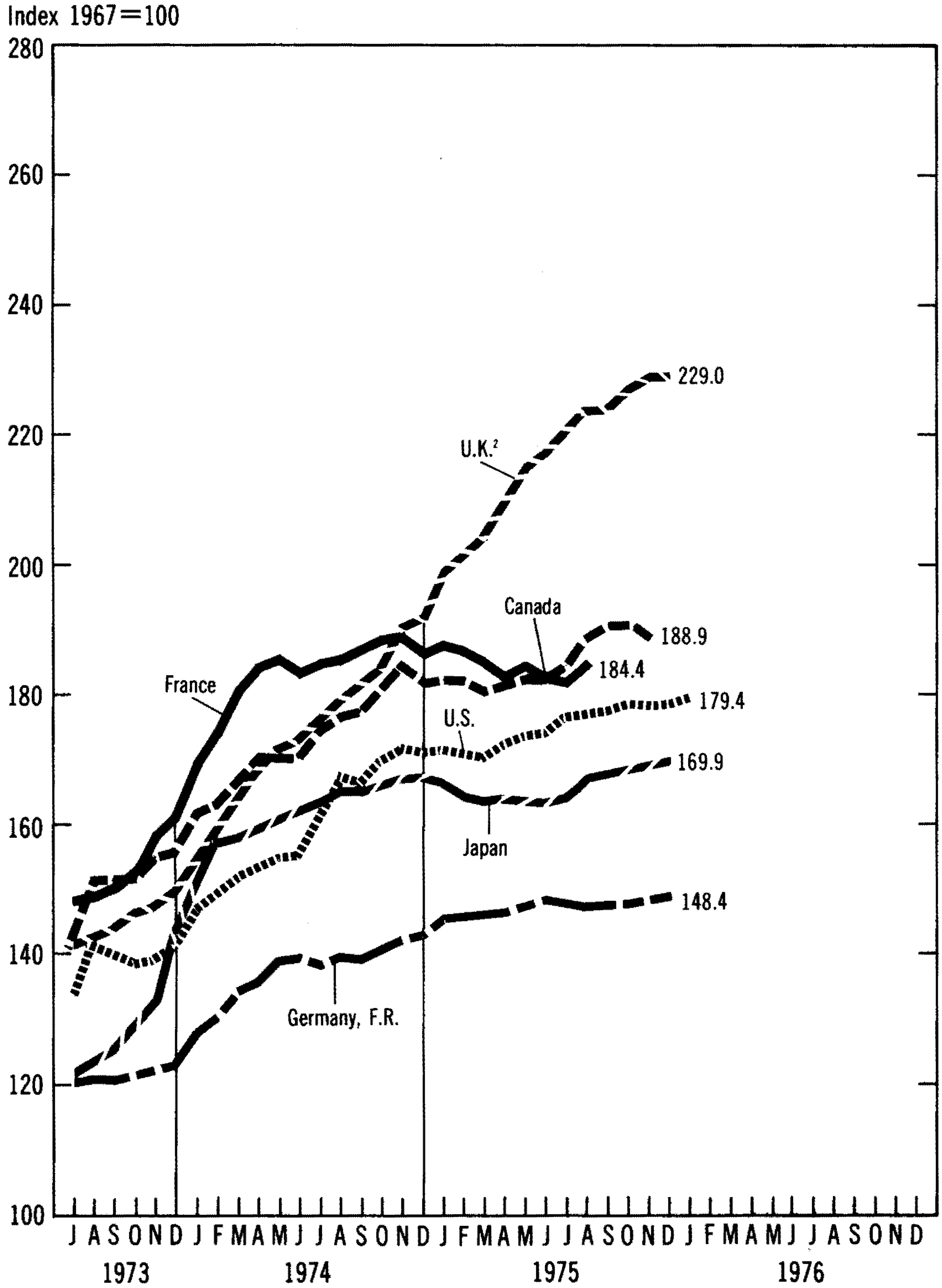
° Eight-digit 4-function handheld calculators have export prices of $7.00 (FOB) in Japan, whereas equivalent price in Hong Kong is only $5.10 (FOB).

° Japanese firms admit that they have reached the limit of cost cutting they can achieve with their present assembly technology, and that their competitors presently have an edge in lower labor costs and cheaper integrated circuits and display components.

INTERNATIONAL WHOLESALE PRICE INDEXES[1]

All Commodities

(Not Seasonally Adjusted)



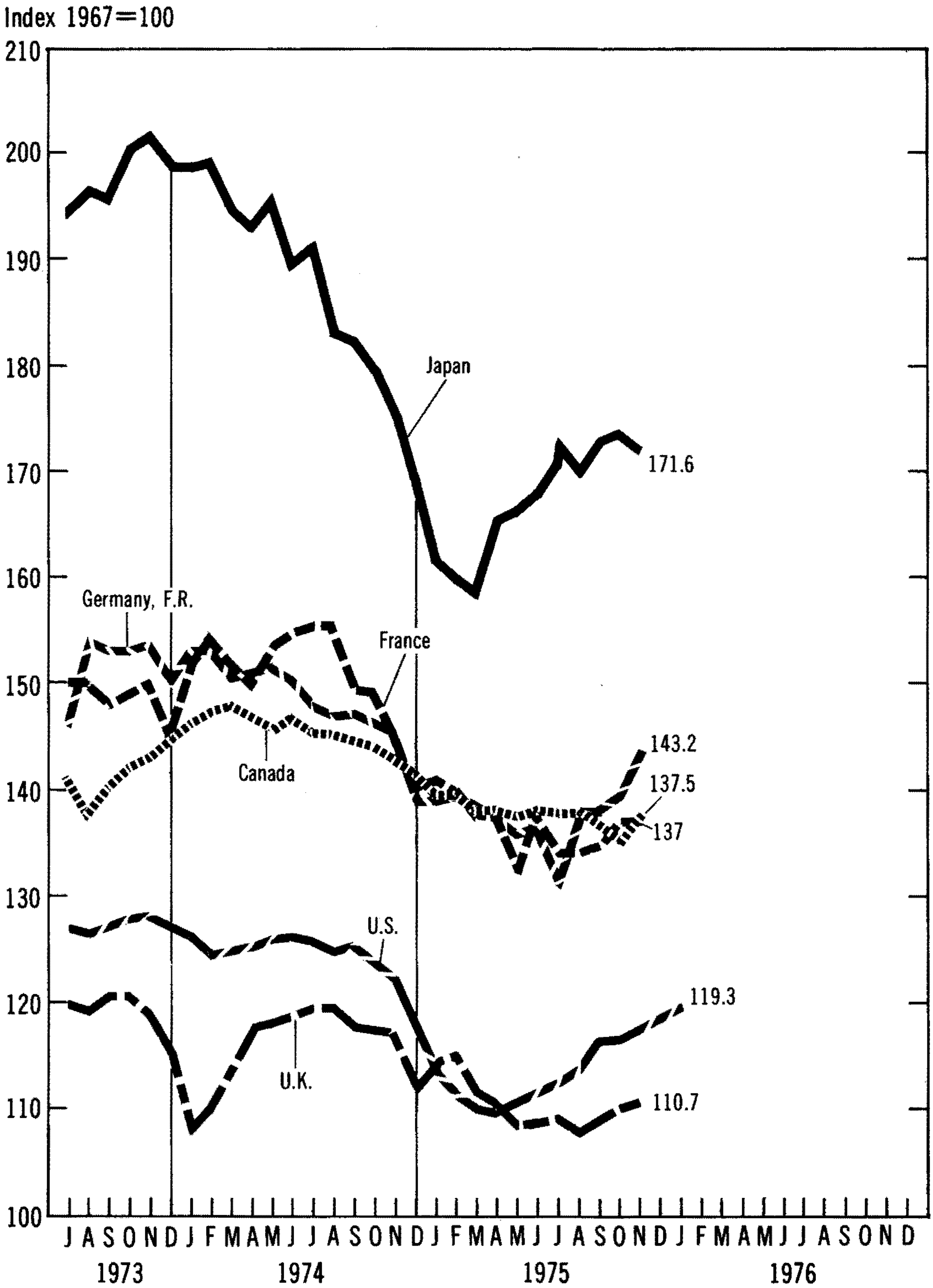
1/ Indexes of wholesale prices are in terms of national currencies. Coverage is not strictly comparable from country to country.

2/ Manufactured goods only.

Source: Bureau of International Commerce

INTERNATIONAL INDUSTRIAL PRODUCTION

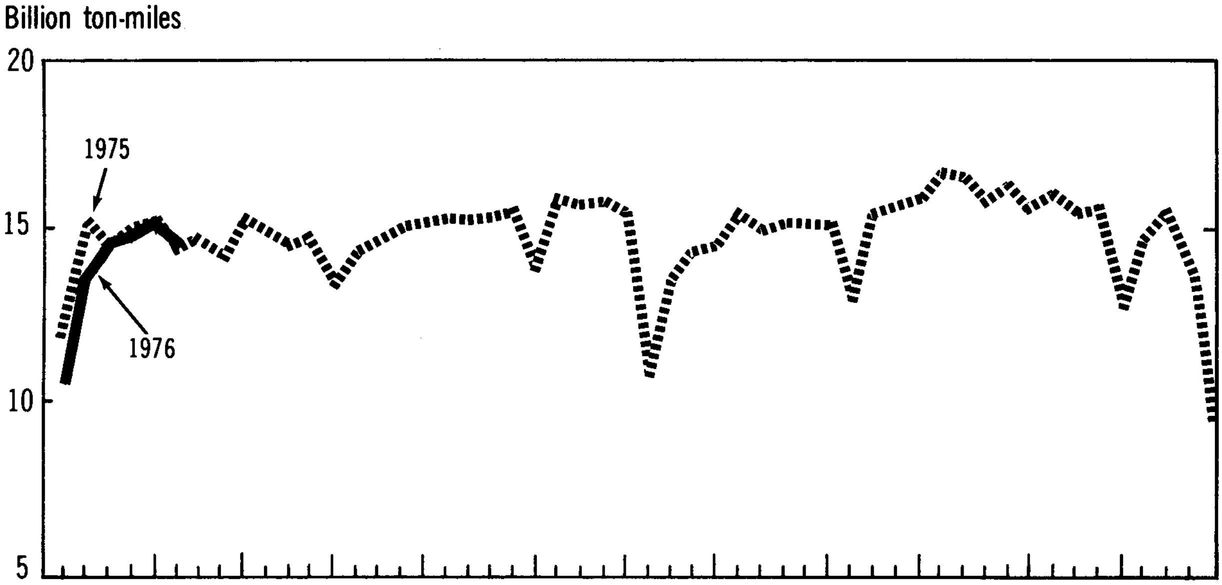
(Seasonally Adjusted)



Source: Bureau of International Commerce

FREIGHT MOVEMENT

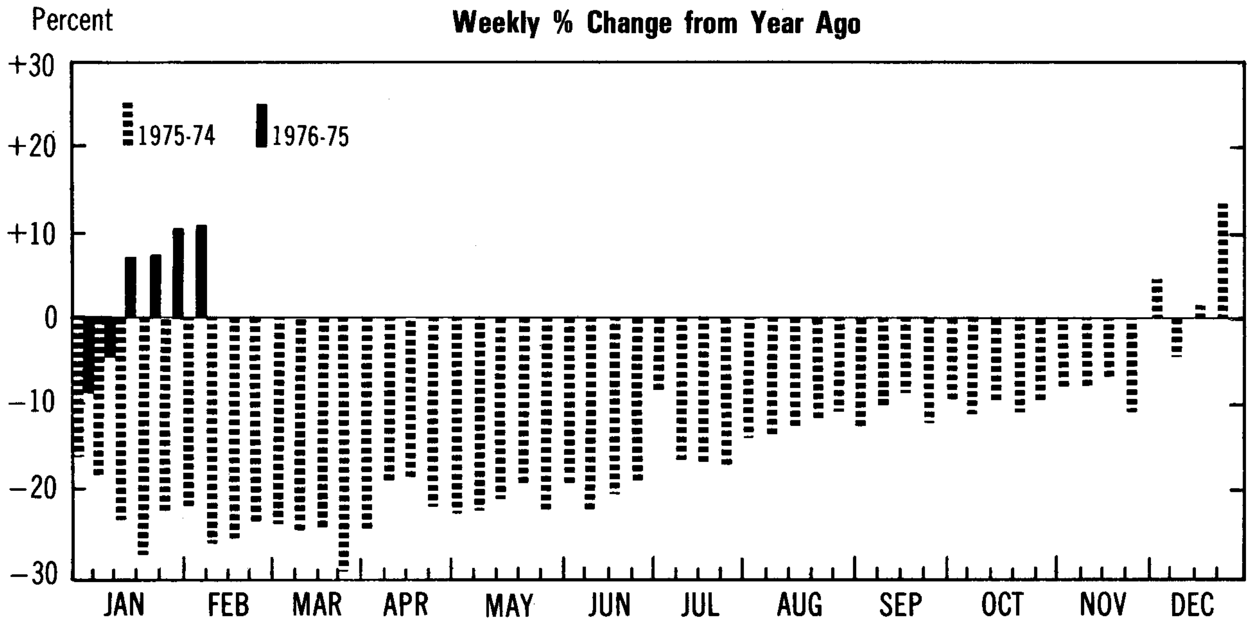
CLASS 1 RAILROADS



Source: Association of American Railroads

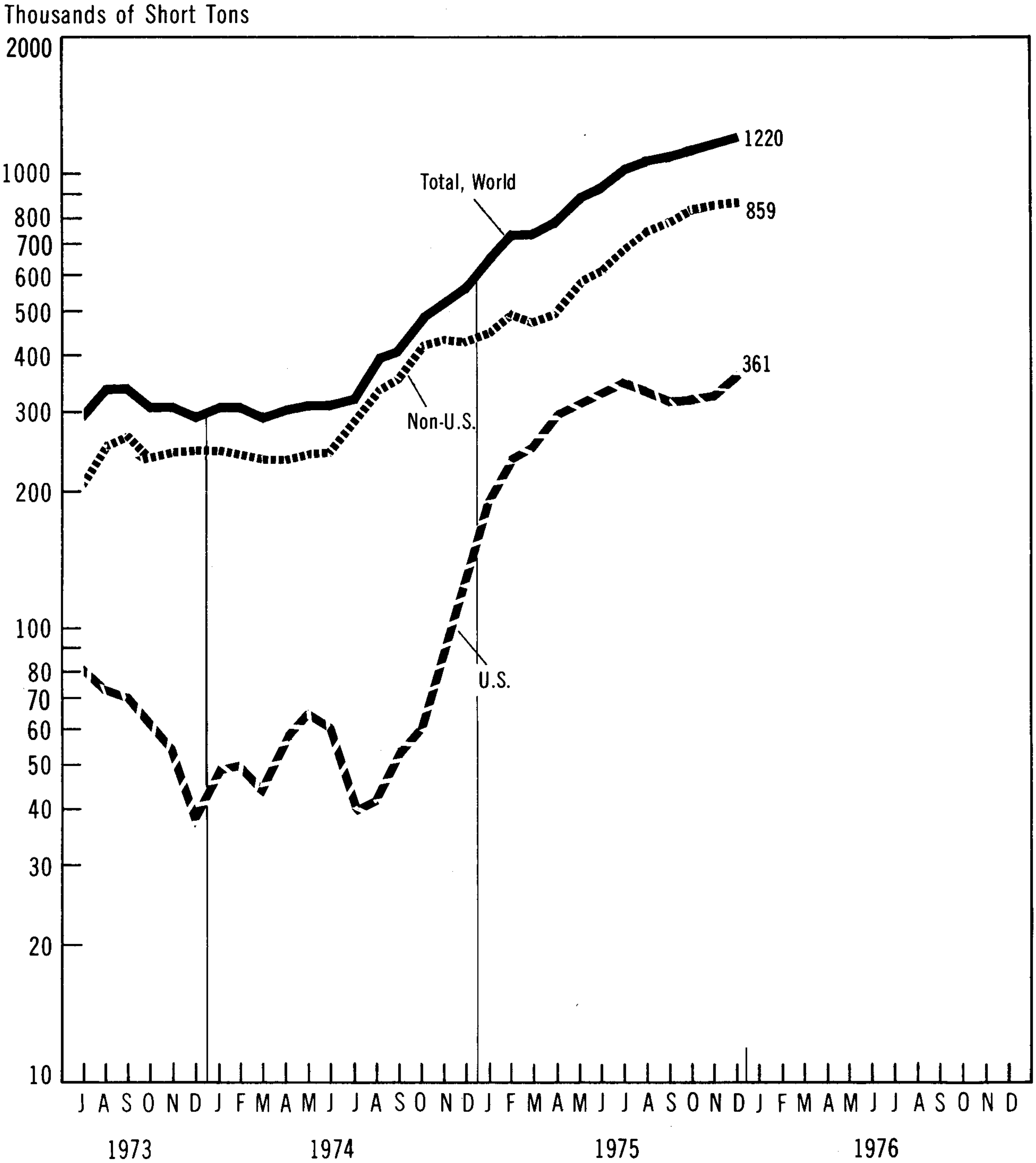
TRUCK TONNAGE

Weekly % Change from Year Ago



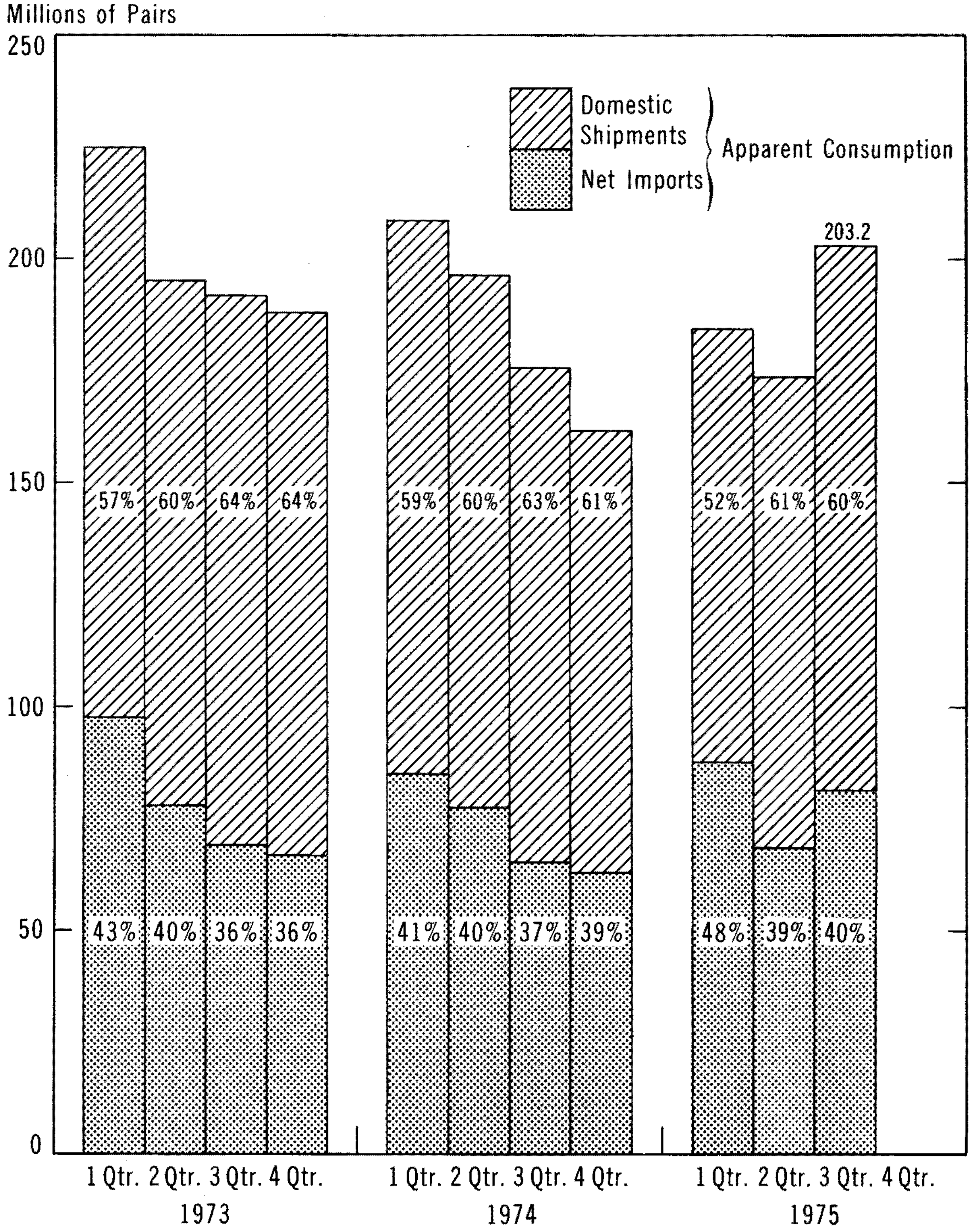
Source: American Trucking Associations

REFINED COPPER STOCKS
(End of Month)



Source: American Bureau of Metal Statistics

NONRUBBER FOOTWEAR



Source: Bureau of the Census.

SUPPLY

SUPPLY

POLYVINYL CHLORIDE: GOODYEAR EXPANDING PRODUCTION UNIT

- Vinyl chloride monomer (VCM) is raw material for polyvinyl chloride (PVC), one of the five largest volume plastic materials.
- VCM has been linked to cancer of the liver, accounting for 38 deaths worldwide. OSHA regulations now limit workplace exposure to 1 part per million (ppm) average over any 8-hour period. Estimated costs to meet OSHA and EPA standards are high. (See Business Conditions Report, January 16, 1976.)
- During December 1974 Goodyear shutdown production of PVC by 50 percent, or 50 million pounds, at Niagara Falls, New York, because of the high cost of complying with OSHA regulations. Uniroyal closed its Painesville, Ohio plant on December 31, 1975 for same reason.

CURRENT

- Goodyear will spend $650,000 to expand production of PVC dispersion resins at its Niagara Falls plant. Completion is expected late this year.
- New production unit will meet OSHA standards and is expected to bring plant capacity to more than 75 percent of level before shutdown. 20 new jobs will be added as a result.

COPPER: ASARCO TACOMA PLANT GRANTED 5 YEAR AIR EMISSION VARIANCE

- ASARCO's Tacoma, Washington, copper smelter produces 120,000 tons of refined copper per year, or about 8 percent of U.S. total.
- Tacoma is only U.S. producer of arsenic trioxide (a by-product used in pesticides) and only U.S. smelter capable of processing certain foreign copper-bearing ores.
- Puget Sound Air Pollution Control Agency originally recommended that a one-year variance from particulate-emission and sulphur-dioxide standards be granted ASARCO's Tacoma smelter.

° In December 1975, ASARCO asked for a 5-year variance and proposed to commit $4.7 million toward emission controls.

CURRENT ° Puget Sound Air Pollution Control Agency has now granted ASARCO a 5-year variance from emission standards.

° ASARCO estimates that by 1980, when all its pollution control devices are in operation, total emissions, including arsenic, from main stack will be reduced 90 percent from 1971 levels.

COPPER INTERNATIONAL: UNCTAD SETS MARCH DATE FOR MEETING

° On September 1, 1975, Secretary of State recommended that a consumer-producer forum be established for every key commodity (including copper) to discuss how to promote efficiency, growth, and market stability.

° In November 1975, Intergovernmental Council of Copper Exporting Countries (CIPEC) reversed an eight-year policy and called for a dialogue between copper producing and consuming countries for the purpose of price stabilization. (See Business Conditions Report, November 28, 1975.)

CURRENT ° United Nations Conference on Trade and Development (UNCTAD) has set March 22, 1976, for a preliminary meeting in Geneva of the world's leading copper producers and consumers.

° The U.S. is expected to receive an invitation and to attend the meeting.

LABOR

LABOR

GARMENT WORKERS: DRESS CONTRACT RESULTS IN WORK STOPPAGE

° Apparel industry's first guaranteed hourly minimum wage was established in recently settled International Ladies Garment Workers Union dress contract (see Business Conditions Report, February 6.)

° Contractors, due to union negotiating structure, were not represented in the talks, although they actually pay any negotiated wage increase.

° Contractors believe they are entitled to additional payment per dress from jobbers before any minimum hourly wage can be paid.

° Jobbers contend that increase in dress payment will subsidize continued inefficiency on the contractor's part which is fostered by existing piece work rates.

CURRENT ° Production shutdown by contractors comprising a third of all dress manufacturers began on February 17 as a result of this dispute.

° Shutdown has idled estimated 15,000 to 36,000 workers and has come at a sensitive time when spring dress fashion deliveries are at their peak.

° Continued stoppage would force retailers to transfer orders from affected manufacturers to those still operating, thus affecting delivery timing throughout apparel market.

TEACHERS: MORE STRIKES THIS YEAR

CURRENT ° More than 160 teacher strikes have already occurred this school year, compared with 121 during entire school year one year ago, according to the National Education Association.

° Record number of teacher strikes could occur this school year, breaking previous record of 1969-70 when 181 strikes occurred.

AIRLINES: FIRST NO-STRIKE AGREEMENT

- National Air Lines and Air Line Employees Association, representing about 3,300 reservation, airport, and office clerical workers of the airlines, signed formal no-strike agreement which provides for binding arbitration of economic issues, if necessary.
- Agreement, which is supplementary to the current contract (in effect until June 1, 1977), provides for minimum wage increase of five percent annually if wage issues must go to arbitration.
- Arbitration agreement, which affects only economic issues, will remain in effect indefinitely until it is used, in which case it will be renegotiated in next round of contract bargaining.
- Agreement is believed to be first of its kind in airline industry, according to Federal Mediation and Conciliation Service.

FEDERAL EMPLOYEES: INCREASE IN UNION CONTRACTS

- In 1975, number of employees covered by negotiated agreements rose over one million for the first time according to U.S. Civil Service Commission.
- 53 percent, or 1,083,017 workers, of the entire nonpostal federal work force were covered by negotiated agreements in November 1975. A year earlier, 985,000 workers were covered by contracts.
- Civil Service Commission noted that percentages are based on total employment, including employees not eligible for union representation. Consequently, percentages do not indicate level of union representation among eligible employees.

STRIKES

(Source: Federal Mediation and Conciliation Service)

- During week ending February 18, approximately 79,300 employees were involved in 233 work stoppages throughout the United States.

- Seven work stoppages were in the major and/or significant category where 1,000 or more employees were in the bargaining unit.

- During approximately same year-ago period, there were 213 work stoppages in effect, involving 81,097 employees. Sixteen of the work stoppages were in the major and/or significant category.

NEW AND SETTLED MAJOR STRIKES

(Source: Federal Mediation and Conciliation Service)

- New:

  Dress Manufacturers Assn.
  and the ILGWU Dressmakers
  Joint Council
  New York City & Vicinity
  Between 15,000-36,000 employees;
  began 2/17/76

- Settled:

  Washington Post Company
  and Various Craft Unions
  Washington, D. C.
  1,330 employees (Approximately
  325 employees still out);
  began 10/1/75, ended 2/16-2/22/76

  Ship Building Co's.
  and the IAM
  San Diego, Cal.
  1,441 employees; began 10/1/75,
  ended 2/12/76

  Ship Building Co's.
  and CJA, IBEW & PAT
  San Diego, Cal.
  800 employees; began 10/1/75,
  ended 2/13/76

TEXTILE/CLOTHING WORKERS: TWO MAJOR UNIONS TO MERGE

- Amalgamated Clothing Workers of America (ACWA) has estimated membership of 325,000 comprised primarily of workers in men's and boys' clothing. Membership is spread throughout U.S. with a developing Southern concentration.

- The Textile Workers Union, with 170,000 members, is concentrated in the Northeast.

CURRENT

- Officials of both unions announced tentative plans to merge in June, culminating year-long negotiations. Merger will establish largest union in apparel industry, supplanting 430,000 member International Ladies Garment Workers Union.

- Pending merger is attributed to challenges of increased apparel imports from low wage countries and non-unionization of the South, which each union finds increasingly difficult to resolve individually.

- Combined membership and strengthening of leadership will have a positive impact upon union efforts to reduce imports from low wage countries.

CANADIAN PAPER INDUSTRY STRIKES: TENTATIVE AGREEMENT RATIFIED AT LEADING NEWSPRINT COMPANY

- 5,000 striking Canadian Paperworkers Union (CPU) members, employed by Abitibi Paper Company Ltd. of Toronto, last week voted to accept tentative agreement reached between union and company negotiators in Toronto.

- Agreement will give workers 14 percent increase in first year of a three year contract, 10 percent in second, and eight percent in third.

- After Abitibi mills reopen, 25 percent (all in Eastern Canada) of total Canadian newsprint capacity will remain idle.

- Following similar contract settlements in early January, Canadian domestic and export newsprint prices rose $25 per ton. Concurrently, domestic newsprint producers raised prices by $25 per ton.

PRICES

PRICES

RAILROADS: FREIGHT RATES RISE

° January 1976 price index for total railroad freight was only 0.1 percent above the December 1975 level, but 14.3 percent over January 1975 index (1969=100), according to Bureau of Labor Statistics.

° Of the groups of products transported by rail, primary metal products bore the greatest yearly increase, 16 percent, while wood and lumber products bore the least rise, 11.7 percent.

CURRENT ° Interstate Commerce Commission has approved a rail freight rate increase estimated to average 4.7 percent, subject to later investigation and refund of any part of increase not receiving final approval.

° Southern Pacific Transportation Co. (and its controlled and affiliated railroads) originally refused to join request for this increase. All Western railroads have now refused to join in filing higher rates, expressing concern for adverse impact increase would have as they compete with nonregulated truckers of agricultural commodities.

° Action by Western roads has led to speculation that ICC finally may reject rate rise for all railroads.

° If all railroads had gone along with increase, Association of American Railroads estimates indicate it would bring nearly $800 annually in additional revenue. With Western lines out, additional annual revenue would amount to approximately $300 million.

CUTTING TOOLS: RECENT PRICE BOOSTS NOT SPREADING

° Cutting tool makers are not responding to recent 6 percent price hikes on perishable cutting tools initiated by National Twist Drill (see Business Conditions Report, January 30, 1976.)

° Most manufacturers believe current market is still too soft to support across-the-board price increases even though labor, material, and energy costs have increased.

° Contributing to manufacturers' reluctance to raise prices is highly competitive nature of perishable cutting tool market. Competition is so severe that significant discounts are being offered on large contracts.

TIN PLATE: BEVERAGE CAN MANUFACTURERS RECEIVE REBATES

° Steel producers had announced a price increase of approximately 8 percent on tin plate, effective February 1, 1976.

° Increase, first since January 13, 1975, was continuation of industry effort of last August and September to offset effects of August 1 contractual labor increases as well as rising material costs.

° Tin plate comprises 6.5 percent of steel tonnage. In beverage market, especially tab opening type for carbonated products, aluminum has made impressive inroads. Glass is being competitively priced and promoted, especially for returnable non-littering appeal.

° To check market penetration by competitive materials, National Steel, third largest steel producer, announced in early February a special tin plate rebate effective March 1, 1976, for beverage can application.

CURRENT ° U.S. Steel, largest producer, announced February 18, 1976, a much more sweeping "development incentive" to beverage can producers, also effective March 1, 1976.

° Incentive of $1.50 rebate per 1,000 cans was on two-piece cans to intensify technological development, and on standard 3-piece cans to provide a "promotional incentive."

° For the two-piece can, competitive with aluminum tab-top, U.S. Steel offers to participate in research, especially to find a way to eliminate throwaway tabs.

- Details of the U.S. Steel action have not yet been publised. Action seems to offset previously announced tin plate price increase as far as beverage cans are concerned.
- Reductions may be as much as $40 per ton for U.S. Steel, and about $9 per ton for National Steel.
- Other tin plate producers have not acted but will probably meet U.S. Steel action.

COFFEE: HIGH BEAN PRICES AND RELATED COSTS PUSH RETAIL PRICES UP

- An accumulation of disasters in the world's coffee growing regions is sharply curtailing coffee bean supply at least through 1977, raising unroasted coffee prices to record levels. Transportation, energy, packaging, and labor costs have also risen.
- Since August 1975, increase in wholesale price for ground coffee has been 49 percent and 38 percent for freeze dried coffee. Although prices have risen, retailers have partially absorbed wholesale increases.

CURRENT

- Retail prices of national brands of ground roasted coffee are expected to rise to as much as $2 a pound and instant coffee to as much as $3.59 for a 10-ounce jar (3 pounds of beans make one pound of instant).
- U.S. expects to approve the recently negotiated international coffee pact, scheduled to take effect October 1. Under the agreement, exports by coffee growing countries will be regulated by a quota system. However, quotas are not expected to be imposed until at least 1979 due to present and anticipated high coffee prices.

FOOD: OUTLAYS CONTINUE CLIMB

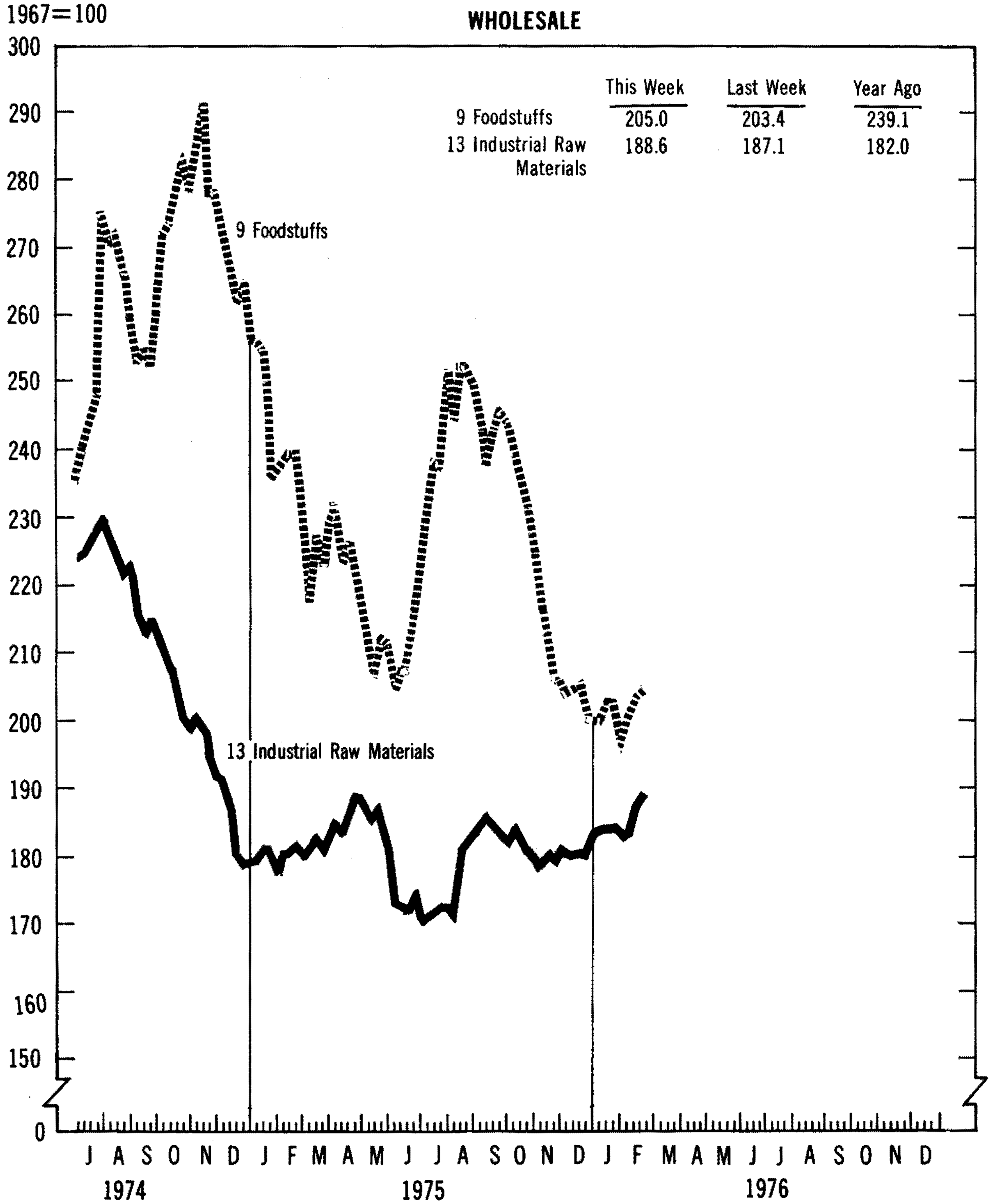
- In 1960, according to the Agriculture Department, consumers spent 16.1 percent of disposable income on food at home.
- Proportion gradually declined during 1960's and early 1970's, reaching 12.5 percent in 1973.

° Trend reversed in 1974, as proportion rose to 13.0 percent. This helped fuel some of the recent consumer discontent with food prices.

CURRENT ° Climb continued in 1975, reaching 13.1 percent by year-end. Trend could contribute to continued consumer discontent over food prices.

PRICE INDICATORS

TUESDAY SPOT PRICES



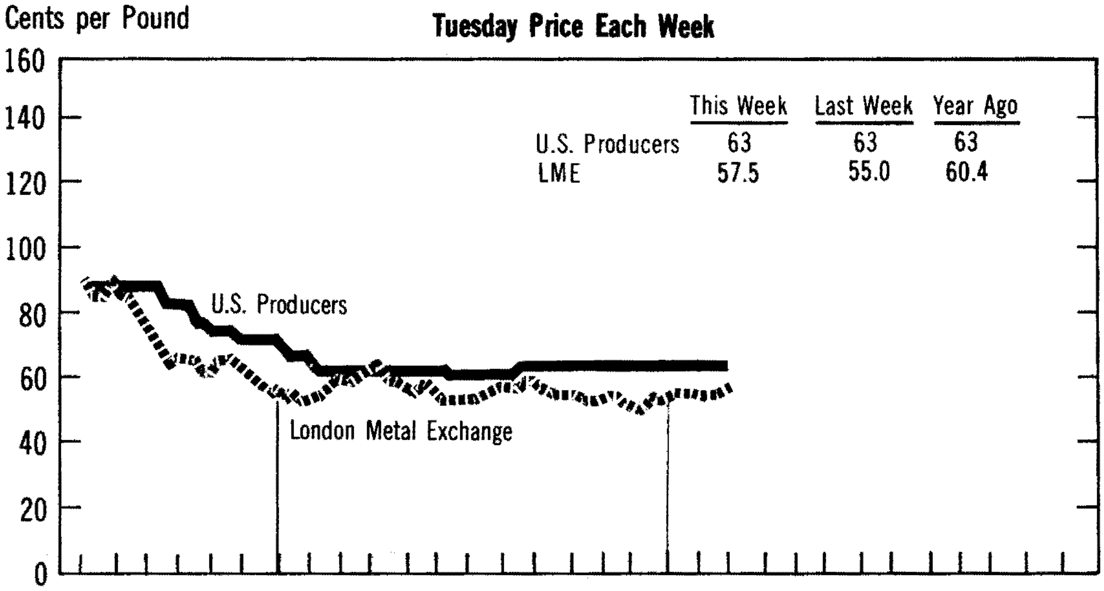
Source: Department of labor

KEY COMMODITY PRICES

COPPER PRICES

(Wirebar Basis)

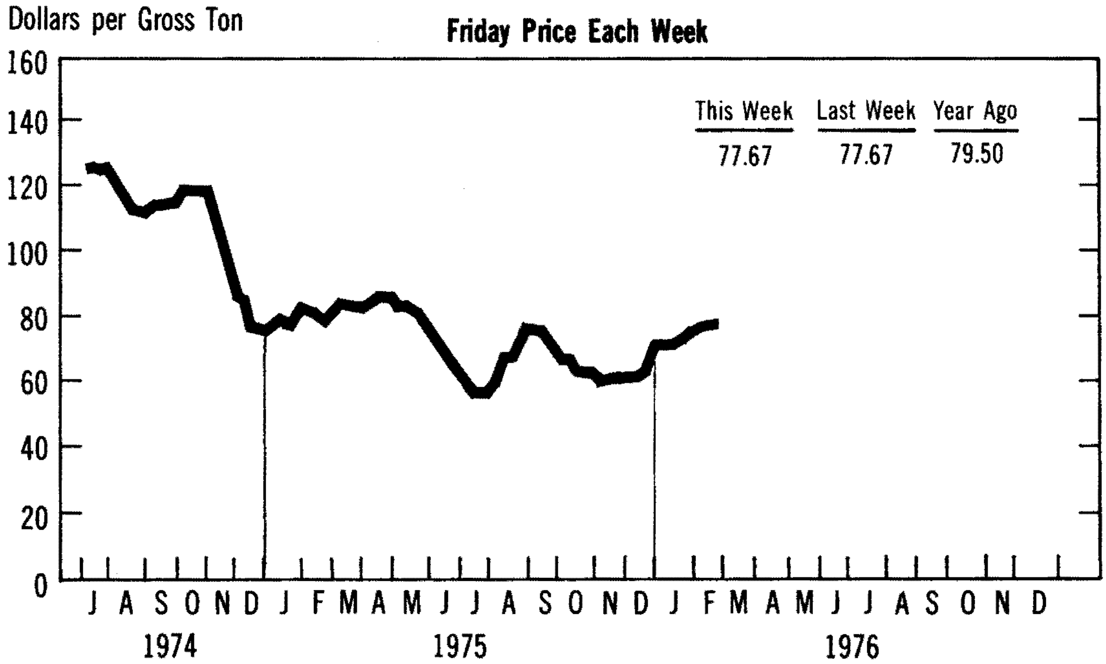
Tuesday Price Each Week



FERROUS SCRAP

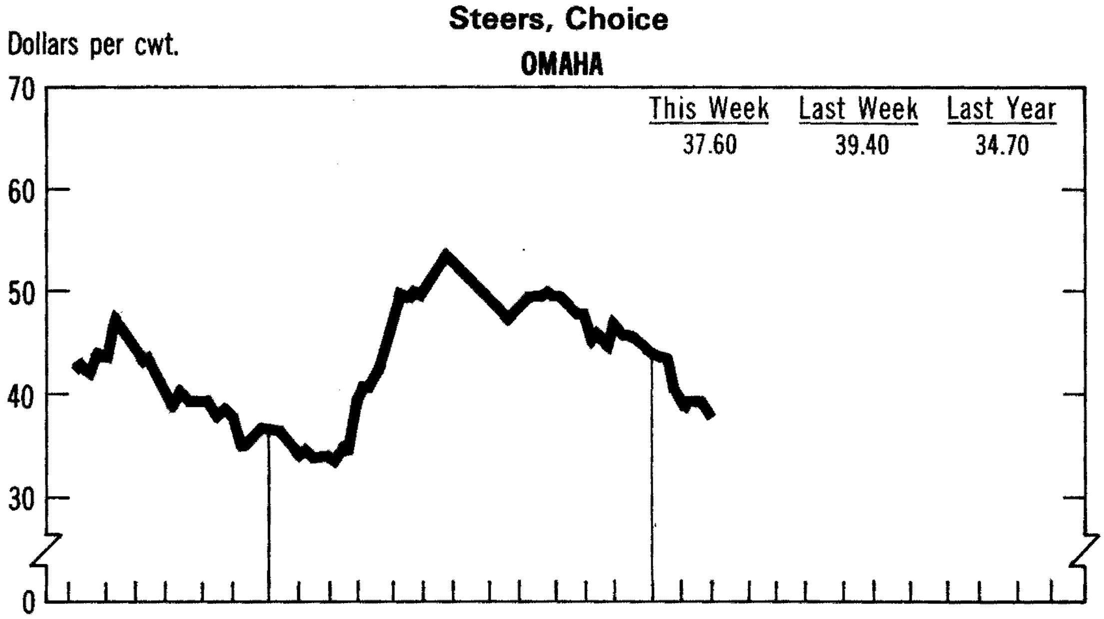
(Composite Price, No.1 Heavy Melting Steel Scrap Pittsburgh, Chicago, Philadelphia)

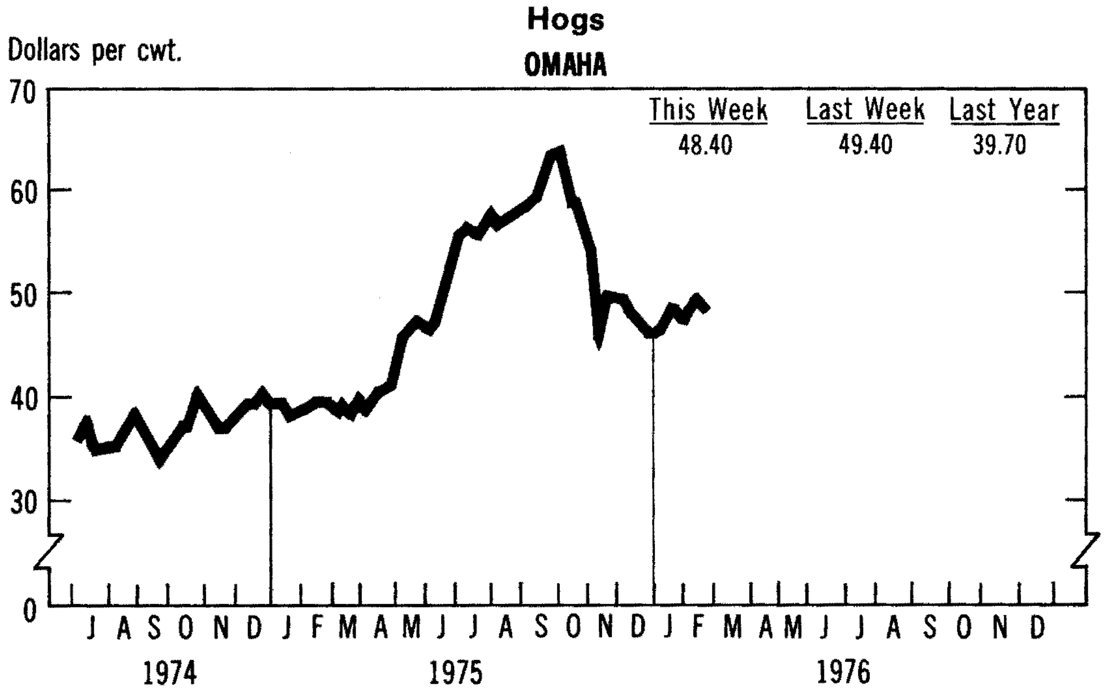
Friday Price Each Week



Source: American Metal Market

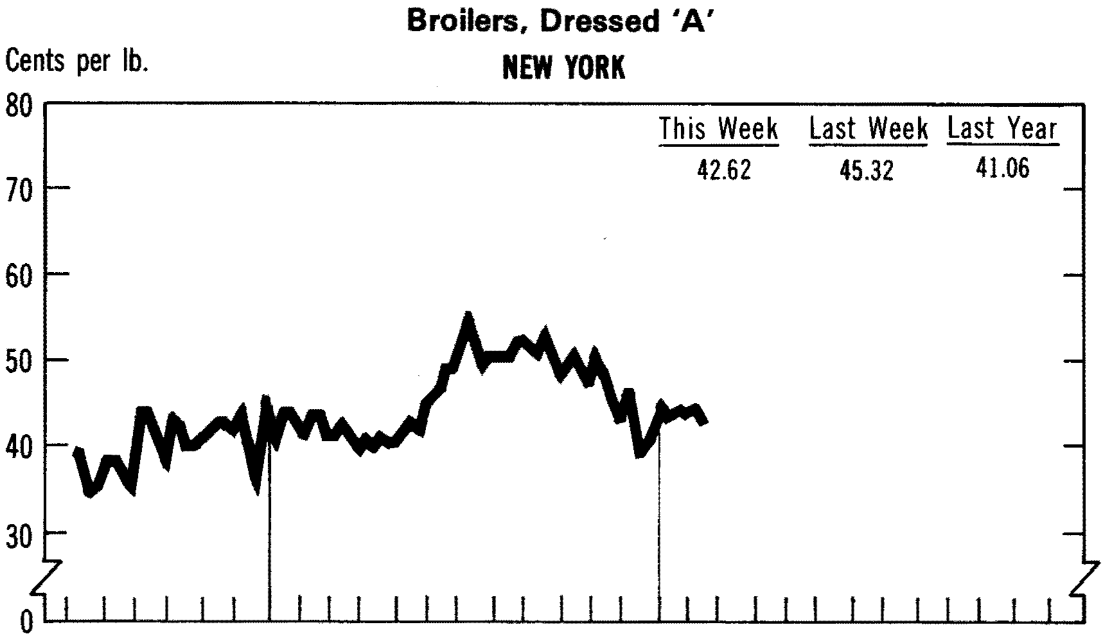
SPOT AGRICULTURAL PRICES

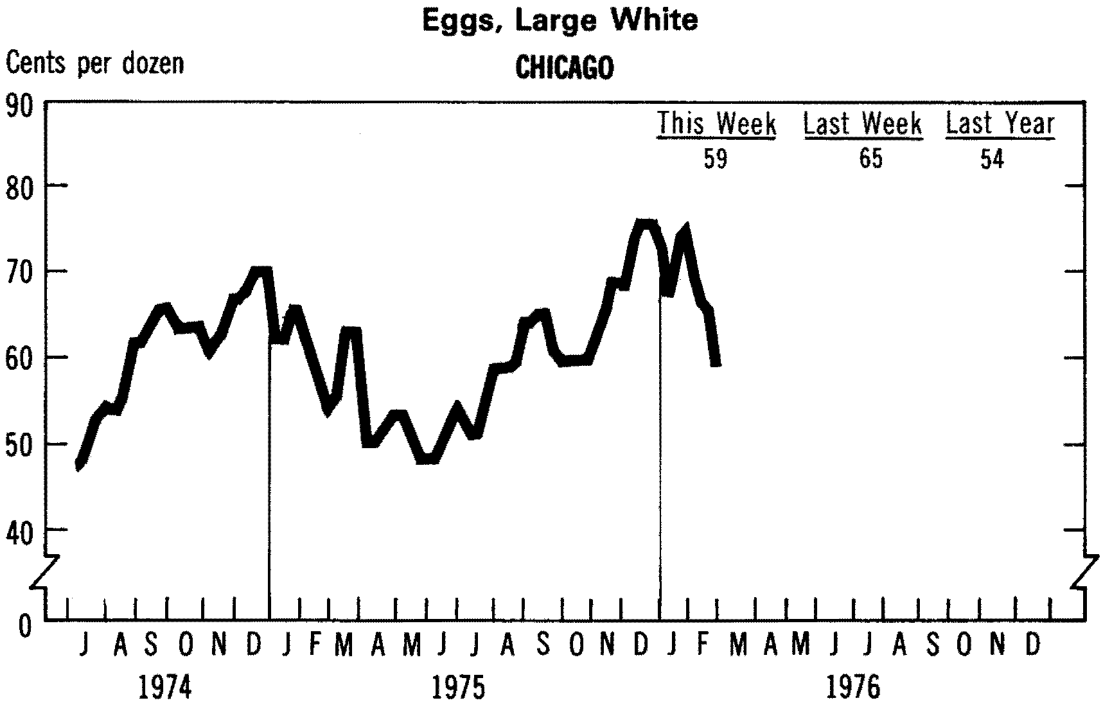




Source: Agricultural Marketing Service, Department of Agriculture.

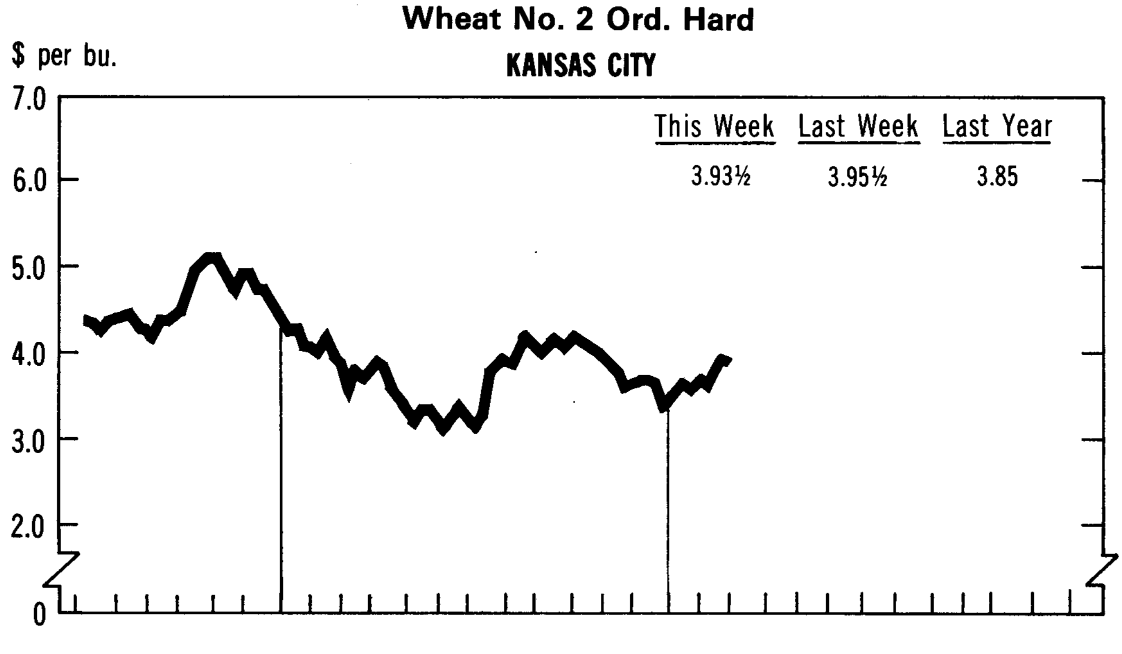
SPOT AGRICULTURAL PRICES

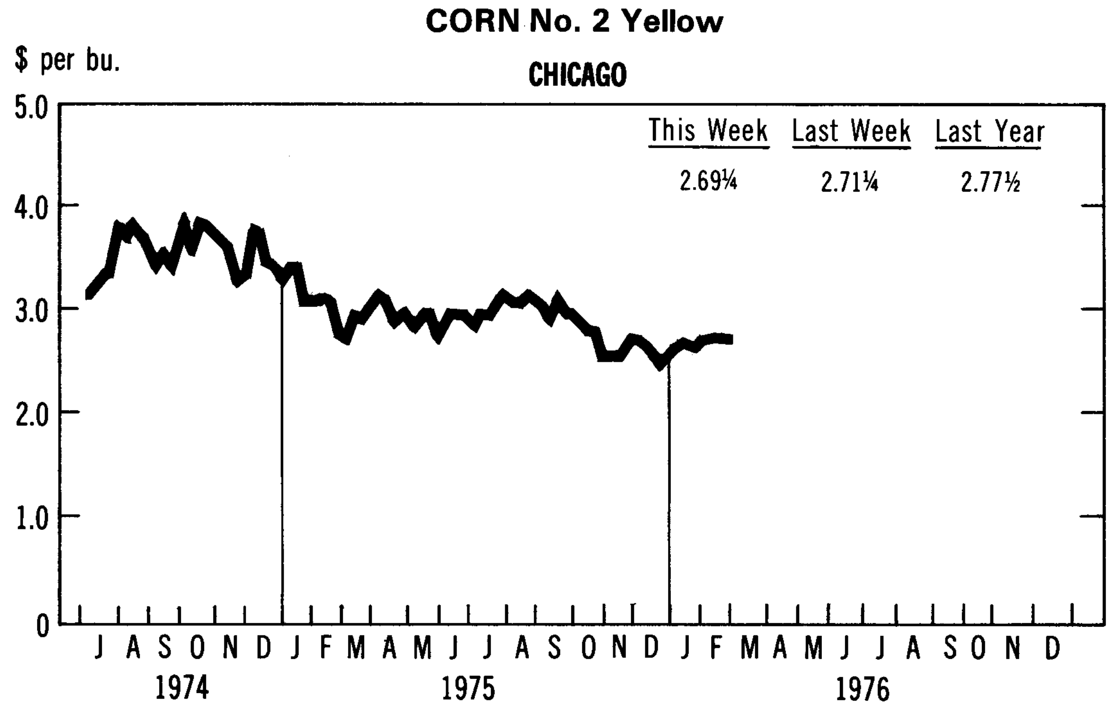




Source: Agricultural Marketing Service, Department of Agriculture.

SPOT AGRICULTURAL PRICES



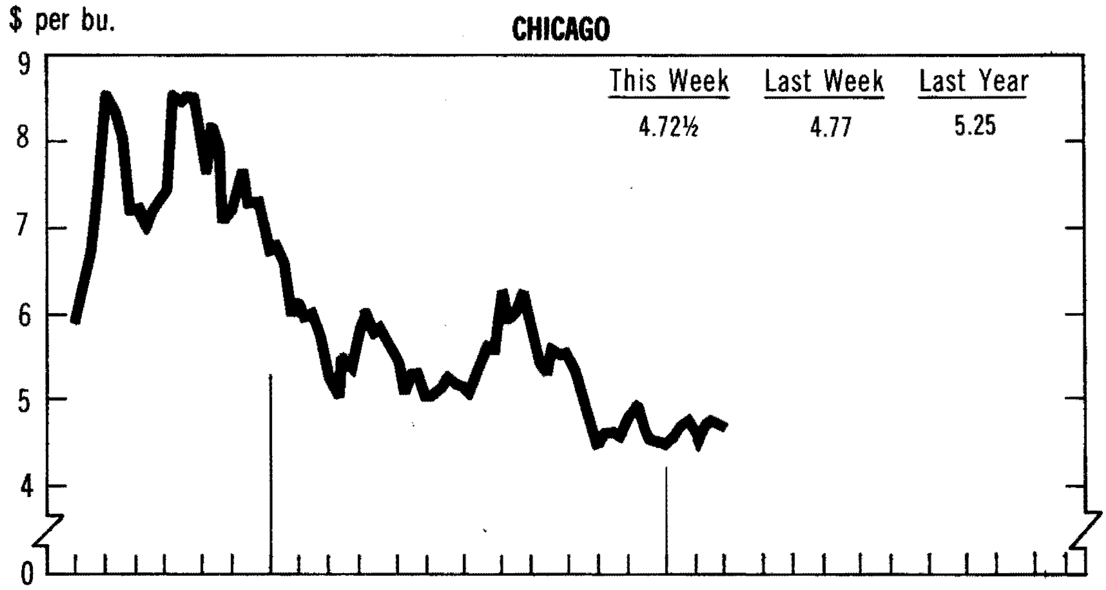


Source: Agricultural Marketing Service, Department of Agriculture.

SPOT AGRICULTURAL PRICES

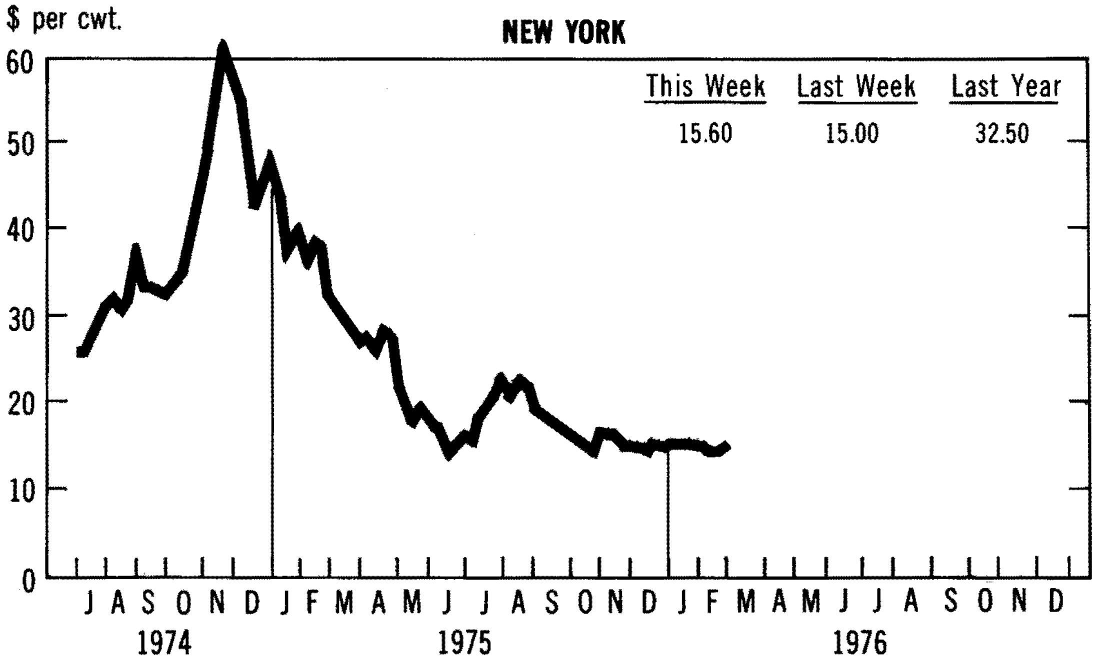
Soybeans No. 1 Yellow

CHICAGO



Raw Sugar

NEW YORK



Source: Agricultural Marketing Service, Department of Agriculture

ISSUES

ISSUES

RAILWAYS: SYSTEM FOR NORTHEAST-MIDWEST

° United States Railway Association announced on February 12 that because Chessie System and Southern Railway System did not accept offers to acquire certain lines of bankrupt railroads, it has been forced to abandon its recommended ConRail structure in favor of "the less competitive but larger unified ConRail."

° The unified system will have 17,000 miles of line, compared to 15,000 for the preferred ConRail system.

° Unified ConRail structure is expected to fare somewhat better financially than the smaller ConRail because it offers greater potential to rationalize plant and facilities and increase operating efficiency.

° Its main disadvantage is that it would give greater market power to a single rail company.

° The unified ConRail system will require initial government funding of $2.026 billion instead of the $1.841 billion for the smaller system.

° The House already has voted $2.03 billion to help finance the project.

NONRUBBER FOOTWEAR: ITC FINDS "SERIOUS INJURY" FROM INCREASED IMPORTS

(See chart in Business Indicators.)

° The International Trade Commission (ITC) has found that the U.S. nonrubber footwear industry is suffering serious injury from increased imports and, in their report to the President on February 20, recommended various measures to assist the industry.

° Suggestions for relief include:

-- increasing tariffs from current rates (6 to 15 percent) to 25 to 35 percent, depending on the price, with 3 percent reduction annually until a final 13 to 23 percent level has been reached;

-- 5-year tariff-quota allocated according to respective aggregate footwear imports during calendar year 1974; above-quota imports would be subject to a tariff of 40 percent, to be reduced 5 percent annually over a 5-year period; and

-- trade adjustment assistance for workers, firms and communities under the 1974 Trade Act.

° American Footwear Industries Association doubts tariffs will be effective and will continue to urge the President to adopt quantitative quotas to insure more effective control of imports.

° Volume Footwear Retailers of America, whose members sell more than half the footwear in the U.S., plan to urge the President to reject the Commission's tariff and tariff-quota recommendations because of their probable inflationary impact at the consumer level.

° The President has until April 20 to determine what action, if any, he will take on ITC's recommendations.

DRUGS: RESULTS OF FDA COUGH AND COLD REMEDIES STUDY

° In 1974, the retail sales value of over-the-counter (OTC) cough and cold remedies was $679 million. Most were of the multiple-active ingredient type.

° In 1972 FDA established 17 independent advisory review panels to evaluate the safety and effectiveness of non-prescription drugs. 5 panels have completed their reviews, with appropriate recommendations.

CURRENT ° Another FDA advisory panel recently completed a three-year study of OTC cold remedies and concluded that:

-- there is no generally accepted treatment that will prevent or cure the common cold;

-- many active ingredients used in cough and cold remedies are of questionable benefit; and

-- although not readily available on the market, single-ingredient remedies are preferable to multi-ingredient types because the former offer selectivity in evaluating self-treatment of individual symptoms.

° Study could result in a major marketing change from multi-ingredient to single-ingredient cough/cold remedies. Number of products offered may increase with a possible expansion of dollar sales volume.

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