Submission by
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Budget Policy Division
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2016-17 pre-Budget submission

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EXECUTIVE SUMMARY

- Broadcasting licence fees were originally set for analogue, single channel free-to-air television services. A plethora of domestic and international players are now delivering content to consumers in range of ways, driven by new technology, business models and consumer behaviour. Urgent action is required to remove broadcasting licence fees to reflect these market changes and rebalance the regulatory playing field.
- Commercial free-to-air broadcasters currently deliver a $3.2 billion economic surplus, including $2.8 billion invested back into the Australian economy through its broad costs base.
- As part of this contribution, commercial free-to-air broadcasters continue to be the largest investors in the screen production industry in Australia. Free TV members spent more than $1.5 billion on Australian content in 2013-14 to deliver high quality local sports, drama, documentaries, children's programs, and news and current affairs to Australians at no charge to the viewer.
- The extremely high cost of meeting local content obligations is a cost unique to domestic free-to-air broadcasters. This investment in local content, as well as the social and economic impact of a thriving domestic production industry which flow from the broadcasters' investment, are matters that need to be taken into account when valuing the financial contribution made by broadcasters and the overall public benefit that flows from a healthy free broadcasting sector.
- Conversely, the new media market entrants do not make any substantial investments in Australian content, pay no revenue-based fees, and in some cases do not even pay their fair share of tax in Australia.
- Licence fees for commercial free-to-air broadcasters in Australia remain higher than in any other market on any comparative measure. On a percentage of revenue basis, Australia is nearly twice as expensive as Singapore, with other international markets at significantly lower levels. This disparity is compounded by Australia's content obligations, which are far more onerous than other regimes around the world.
- Spectrum charging should reflect the cost of managing spectrum, in line with world best practice. A spectrum charge should not be a treated as a substitute for existing licence fees.
- Removing broadcasting licence fees is a critical tax reform that recognises the changing nature of the media industry and lessens risk of market failure in the sector. It will address some of the regulatory imbalance in the media market, and enable a popular and valued Australian industry to continue to deliver highly esteemed services to Australian viewers.

- Changes to the producer offset are also recommended as a supplementary measure to encourage and reward investment in Australian content, however this measure should not be a substitute for licence fee reform.

Introduction

Free TV Australia (Free TV) represents Australia's commercial free-to-air television broadcasters including metropolitan and regional licensees. At no cost to the public, our members provide television content across a broad range of genres, as well as rich online and mobile offerings. The value of commercial free-to-air television to the Australian public remains high. On any given day, free-to-air television is watched by more than 13.6 million Australians.

Free TV welcomes the opportunity provide a submission to the 2016-17 pre-Budget process.

The media market today is rapidly evolving. The diversity of services and platforms available now was not envisaged when licence fees were originally set for analogue, single channel free-to-air television services. The media landscape has evolved substantially since that time. Urgent action is required to remove broadcasting licence fees to reflect these market changes.

Free TV members are delivering more services to Australians using less spectrum, as well as innovating and investing in new technology and content delivery mechanisms. Commercial free-to-air broadcasters continue to be the largest investors in the screen production industry in Australia. Commercial free-to-air broadcasters spent more than $1.5 billion on Australian content in 2013-14 – delivering high quality local sports, drama, documentaries, children's programs, and news and current affairs to Australians at no charge. In addition to their investment in Australian content, broadcasters comply with a range of other costly regulatory obligations which do not apply to competitors, such as captioning and classification time zone requirements.

At the same time, new entrants are flooding into the market driven by new technology, business models and consumer behaviour. This is generating significant competition in the broadcast market. These new entrants do not make any substantial investments in Australian content, pay no revenue-based fees, and in some cases do not even pay their fair share of tax in Australia.

The long term structural changes to the media market mean that licence fees are no longer an appropriate regulatory intervention, and must be abolished as a priority. A number of overseas governments have reviewed their free-to-air licence regimes in recent years, in recognition of the evolving market. These reviews have resulted in substantial regulatory and financial concessions for commercial free-to-air television broadcasters in countries such as the United Kingdom and Germany. In particular, the licence fees imposed on these businesses have been substantially reduced or removed.

In Australia, licence fees relate directly to the broadcasting licence which broadcasters are required to hold. Broadcasters also pay an additional fee separately for their access to spectrum through apparatus licence fees based on the number of transmitters used by the broadcaster.

This is common globally – very few established Western markets charge broadcasters directly for access to spectrum; Governments and regulators typically extract value through broadcast licence fees and levies.

A review of licence fees is occurring simultaneously with the Government's review of spectrum licensing arrangements. Spectrum charging should reflect the cost of managing spectrum, in line with world best practice. A spectrum charge should not be a treated as a substitute for existing licence fees.

Economic contribution of commercial free-to-air broadcasters

The commercial free-to-air industry is a major contributor of value to the Australian economy and a positive driver of economic welfare. Free-to-air television is the only platform that delivers high-quality Australian programmes, including news, current affairs, sports and culture to all Australians for free.

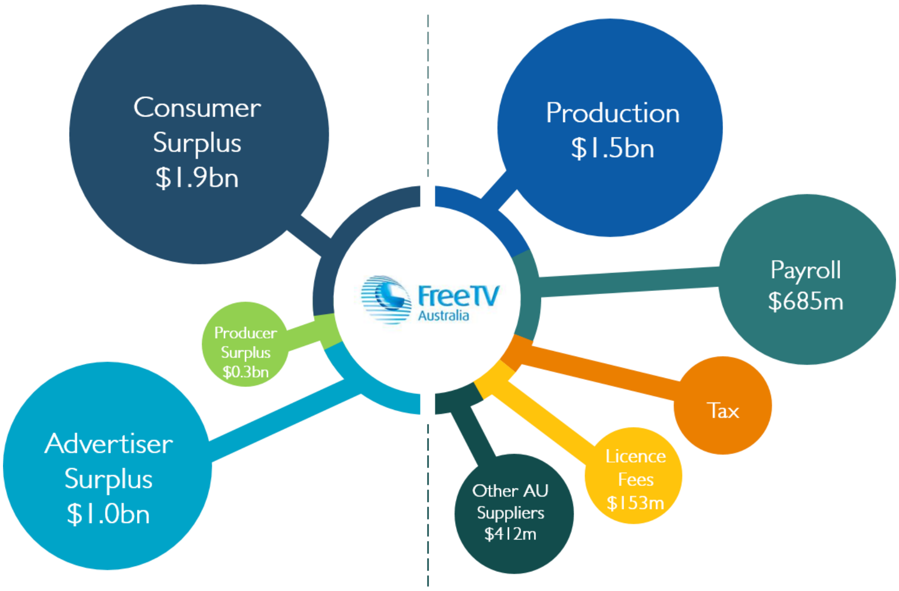
A report by Venture Consulting, The Value of Free TV, released in May 2015, found that the commercial free-to-air television industry is responsible for:

- $3.2bn per annum of economic surplus;
- $2.8bn per annum of economic investment back into the Australian economy;
- $6 out of every $10 spent on Australian content;
- employing 7,232 people across technical, operational, financial and management roles; and
- paying significant taxes in Australia.[1]

Commercial free-to-air broadcasters retain just $0.3bn per annum of the total economic surplus for themselves, meaning that over 90% of the economic value generated by the industry is accrued by the industry's customers, the viewers and advertisers, rather than the broadcasters.[2]

[1] Venture Consulting, The Value of Free TV, the contribution of commercial free-to-air television to the Australian economy, May 2015. Available at: http://www.freetv.com.au/SiteMedia/W3SVC751/Uploads/Documents/FreeTV_Economic_Study_Report_Venture_Consulting.pdf

[2] Ibid, at page 5



One of the largest direct contributions that Free TV members make to the economy is their investment in the local screen production sector. This investment represents the delivery of a number of public policy outcomes, including a strong and vibrant production sector, skilled local employment, and ensuring a strong cultural Australian voice is accessible to all viewers for free.

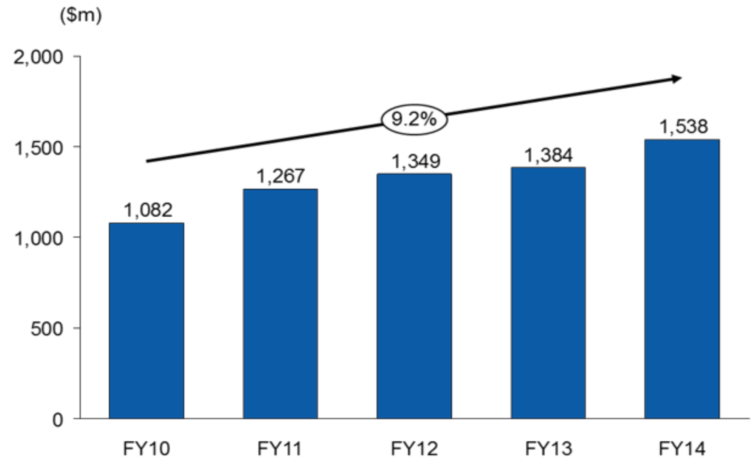
In 2013/14 commercial free-to-air broadcasters invested a record $1.54 billion in Australian content, approximately 79% of their total content expenditure.[3] Every commercial free-to-air broadcaster exceeds their regulatory obligations for Australian content.[4]

The graphs below illustrate the scale of the commercial free-to-air broadcasters' investment, including in relation to national and pay TV broadcasters. More recent market entrants such as Netflix do not produce any Australian content.

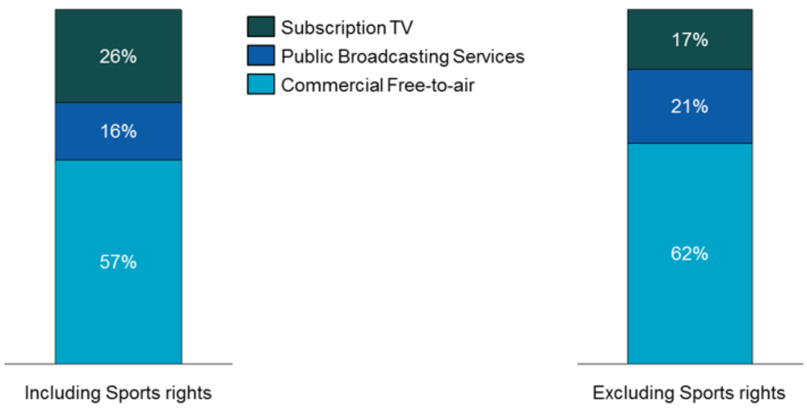
[3]http://www.freetv.com.au/SiteMedia/W3SVC751/Uploads/Documents/RECORD_1.54_BILLION_DOLLAR_COMMITMENT_TO_FREE_AUSSIE_CONTENT.pdf

[4] Source: ACMA 2014 Annual Compliance Results: http://acma.gov.au/~/media/Community%20Broadcasting%20and%20Safeguards/Information/pdf/2014%20Compliance%20with%20Australian%20Content%20Standard%20and%20Childrens%20Television%20Standards%20pdf.pdf

Domestic content spend by commercial free-to-air TV



Spend on Local Content by Industry, FY 2014



The Australian Screen Association in its report, *Economic Contribution of the Film and Television Industry in Australia*, released earlier this year, found that the Australian film and television industry collectively contributed a significant $5.8 billion into the nation's economy in 2012-13, supported more than 46,600 full time jobs and generated almost $2 billion in tax revenues.[5]

The extremely high cost of meeting local content obligations is a cost unique to domestic free-to-air broadcasters. This investment in local content, as well as the social and economic impact of a thriving domestic production industry which flow from the broadcasters' investment, are matters that need to be taken into account when valuing the financial contribution made by broadcasters and the overall public benefit that flows from a healthy free broadcasting sector.

[5] Australian Screen Association, *Economic Contribution of the Film and Television Industry in Australia*, February 2015 - http://www.screenassociation.com.au/uploads/reports/ASA_Economic_Contribution_Report.pdf

A healthy commercial free-to-air sector benefits the Australian economy. Ongoing regulatory review, including the abolition of licence fees, is required to ensure that the free-to-air broadcasters can remain competitive and continue delivering quality services to all Australians for free.

Rapidly evolving technologies disrupting traditional media

Licence fees were set at a time when spectrum was the only platform for the delivery of visual content to Australian living rooms, giving the three commercial broadcasters a strong base from which to develop healthy and profitable businesses.

Historically the market and regulatory eco-system was in balance:

- Free-to-air broadcasters were the only mass-market broadcasters in Australia, because of their access to scarce spectrum licences;
- Broadcasters took on significant financial and regulatory obligations in acknowledgement of this position and the responsibility it entailed; and
- The regulatory regime was in balance, with the licence fee implicitly recognising the scarcity value of terrestrial broadcasting spectrum and the way in which this enabled the free-to-air business model.

Since that time, the media landscape has fundamentally altered, and continues to develop and evolve at a rapid pace.

A plethora of domestic and international players are now delivering content to consumers in range of ways. The dynamic market has led to significant competition.

Some competitors, such as pay TV, have been in the market for some time, while other services (such as Netflix, Presto and Stan) have been in the market for less than one year. Over the top streaming services have already had a major impact, reaching an estimated 3 million+ Australians today, forecast to grow by 2019.[6]

These market changes have led to significant increases in content costs, while simultaneously eroding revenue share.

Removing licence fees will create a more level financial playing field and enable commercial free-to-air broadcasters to look at opportunities to redress the current imbalance, including making the significant investments in digital platforms and assets that are needed to compete with global players such and Google, Apple and Netflix. While it is unclear how much tax is being lost by the Australian Government due to multinational tax evasion and minimisation, Free TV notes the following media reports:

- SMH Business Day reported that while Google should be paying at least $136 million in tax in Australia (on an approximated profit before tax of $454 million), it is actually paying less than $500,000.[7] Google's local ad revenues have been estimated to be in the vicinity of $2 billion.[8]
- The ABC reported that multinational corporations operating through tax havens may be paying an effective tax rate of as little as 15 per cent.[9]
- The Sydney Morning Herald recently reported that Apple paid just $85 million in Australian taxes last year, despite making $8 billion in local revenue.[10]

In contrast to these new media entrants, commercial free-to-air broadcasters pay all relevant corporate and payroll taxes in Australia, in addition to paying licence fees and costs associated with compliance of other expensive regulatory obligations. These contributions are part of the $3.2 billion economic surplus generated by commercial free-to-air broadcasters in Australia.

Australian Licence Fee regime is a global outlier

At the time of enactment of the licence fee regime in 1964, licence fees were set at 9% of broadcasters' gross advertising revenue.[11] In recognition of the rapidly

[6] Ovum, "Australian OTT Video – Creating a New TV Market" report, published 18 November 2015; Telsyte; Roy Morgan Research; Mumbrella; Venture Consulting
[7] SMH Business Day, *Google paying a fraction of the tax in Australia it should*, Michael West, 9 February 2015.
[8] ABC, The Drum, *Googling a solution for raising tax revenue*, Peter Lewis and Jacquie Woods, 10 March 2015.
[9] ABC The Drum, Document reveals multinationals should pay, Ian Verrender, 4 May 2015
[10] Nassim Khadem "Apple's $85 million tax bill a fraction of its $8 billion revenue" *Sydney Morning Herald* 26 January 2016
[11] *Television Licence Fees Act 1964*, s 6.

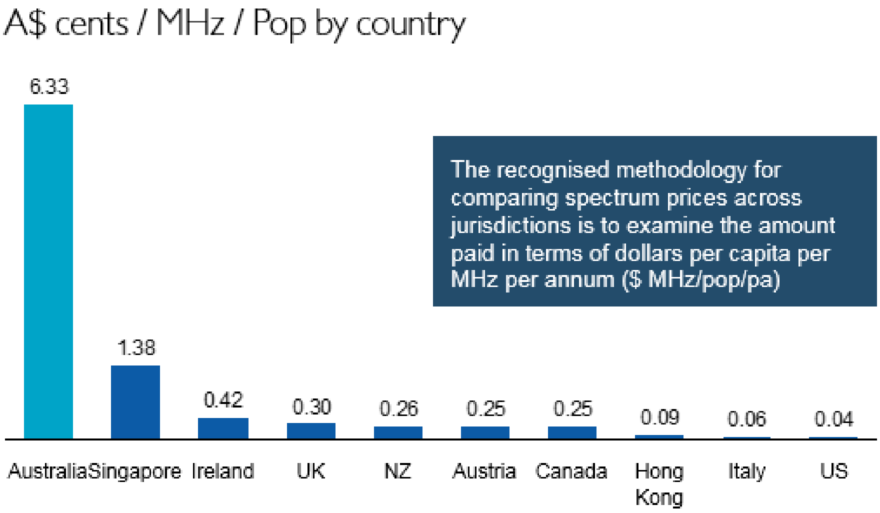
changing media environment, Australian broadcasters' licence fees were reduced in 2012 to up to 4.5% of gross revenues[12].

However, even with such a reduction, the licence fees for commercial free-to-air broadcasters remain higher than in any other market on any comparative measure.[13] Further reductions would empower broadcasters to innovate and compete more effectively as they do in other sophisticated markets.

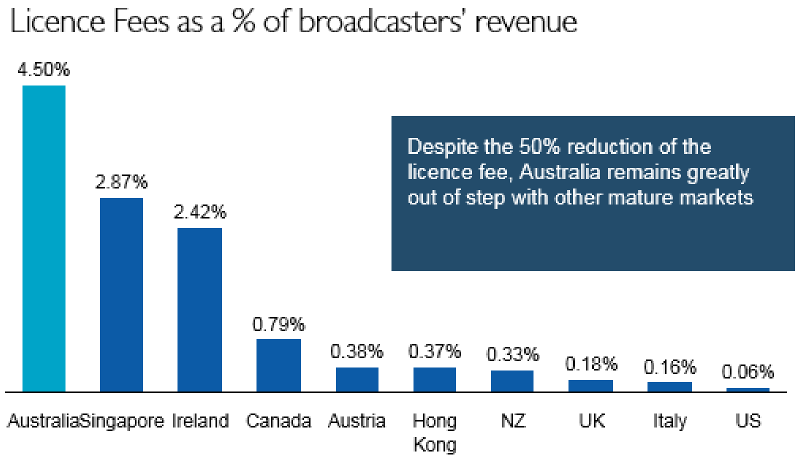
Countries including Singapore, New Zealand, the UK and the US, have all reduced their licence fees or shifted to a cost-recovery model in recognition of the changing media market and the enduring importance of a vibrant free-to-air broadcasting sector.

On a measure of A$ cents/MHz/Pop by country, Australia is about five times more expensive than the second most onerous regime Singapore and 150 times greater than the United States. On a percentage of revenue basis, Australia is almost twice as expensive as Singapore with other markets at significantly lower levels. This disparity is compounded by Australia's content obligations, which are far more onerous than other regimes around the world.

The graphs below demonstrate costs on A$ cents/MHz/Pop by country, and Licence Fees as a % of broadcasters' revenues across a range of comparable jurisdictions.



[12] Television Licence Fees Act 1964, s 6.
[13] Venture Consulting, Op. Cit., 2014.



Broadcasters are thriving in countries such as the UK that have proactively reduced or abolished their licence fees. Removing licence fees in Australia would create a more level financial playing field, enabling Australian broadcasters to make the significant investments in digital platforms and assets needed to compete with global players.

It is worth noting that in markets where licence fees have been reduced or abolished, there have been no parallel increases in spectrum access pricing. This reflects the distinct nature and purpose of broadcast licence fees as opposed to spectrum levies.

The chart below details international approaches to setting fees for free-to-air broadcasting services. The three main modes are market pricing, administrative pricing, and % of revenue.

		Australia (2014)	USA (2014)	Canada (2013)	UK (2014)	Singapore (2014)	Italy (2011)	Ireland (2013)	Austria (2012)	Hong Kong (2014)	New Zealand (2014)
Approach	Market Pricing			✓							✓
	Admin Pricing		✓	✓	✓			✓		✓	
	Set % of Revenue	✓				✓	✓		✓		✓
FTA Industry Fees (A$m)		152.10	25.43	15.45	10.82	19.47	9.21	6.15	4.65	2.09	1.22
Population (m)		23.5	318.5	35.2	64.6	5.6	60.5	4.6	8.5	7.2	4.5
Fees per capita (A$)		$6.48	$0.08	$0.44	$0.17	$3.49	$0.15	$1.34	$0.55	$0.29	$0.27
MHz post-DSO		102	190	178	56	252	258	320	223	336	106
Fees per Mhz / pop (A$¢)		6.33	0.04	0.25	0.30	1.38	0.06	0.42	0.25	0.09	0.26
FTA Industry Revenue (A$m)		3,575	45,070	1,944	5,996	677	5,660	254	1,016	564	367
Fees as % of Revenue (%)		4.50%	0.06%	0.79%	0.18%	2.87%	0.16%	2.42%	0.38%	0.37%	0.33%

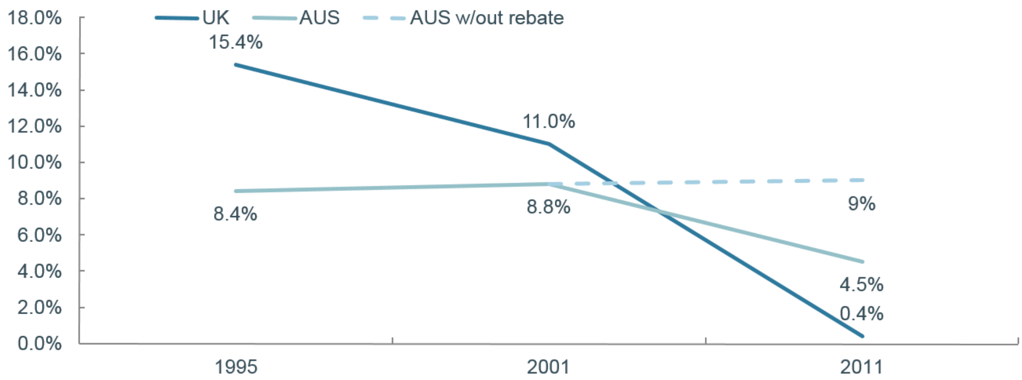
Case study – UK licence fees

Media organisations and spectrum management in the United Kingdom are both regulated by the Office of Communications (Ofcom), which has significantly reduced the spectrum cost component of the licence fees in the past decade.

Changes were first implemented in 2005 to reflect the "significant reduction in value associated with what was considered to be the principle right attached to the licence – the privileged access to scarce analogue spectrum."[14]

Free-to-air broadcasters in the UK pay a licence fee set when they first bid for their licences, and a regulator fee to cover a share of the costs of running Ofcom. The UK licence fee comprises two parts: a fixed cash component and a variable component based on broadcaster's revenue. These fees were revised down in 2005 and again in 2010.

Licence fees for free-to-air broadcasters in the UK are now effectively zero, with a full transition to a US style regulatory cost recovery model.



Licence fees require urgent action

Urgent action is required to remove broadcasting licence fees in Australia. Commercial free-to-air broadcasters are under pressure from combination of increased local content costs, fragmenting audiences and a dramatic increase in largely unregulated competitors, who do not pay tax or invest in Australian content or people. Licence fees paid by free-to-air broadcasters are stifling innovation and competition.

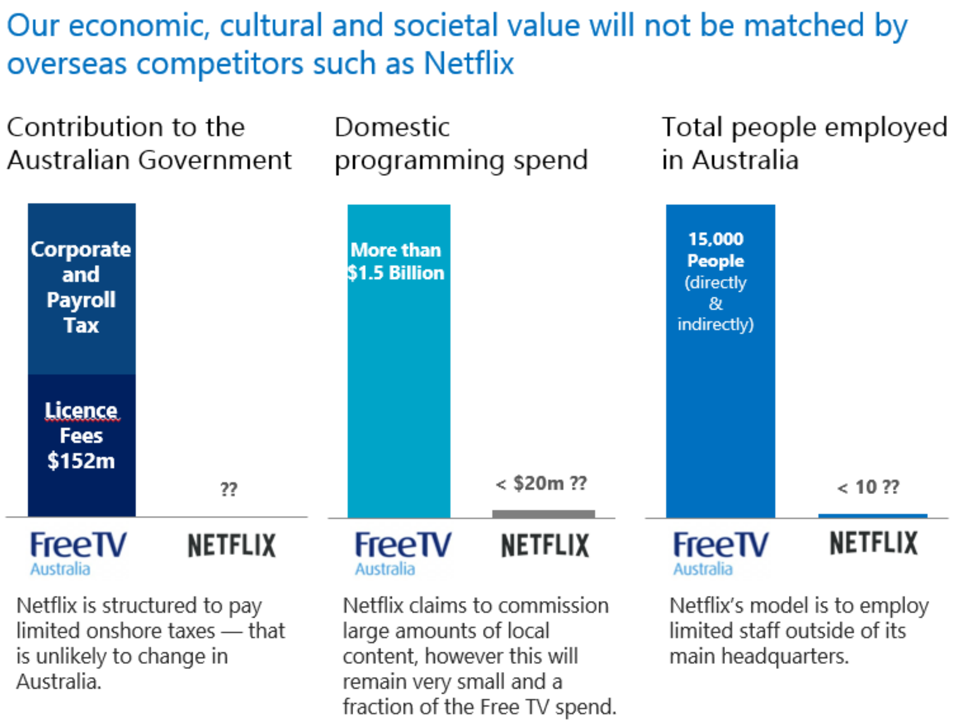
The latest PricewaterhouseCoopers analysis from the report *Australian Entertainment and Media Outlook 2015-2019* states that free-to-air advertising revenues are forecast to stagnate through to 2019, with a zero Compound Annual Growth Rate (CAGR) forecast over the next five years.[15] As noted above, Free TV members have significant obligations in relation to Australian content and are the foundation of the Australian screen production sector, investing more than $1.5

[14] See: http://stakeholders.ofcom.org.uks/binaries/consultations/channel3_consultation/statement/ch3ch5fin.pdf
[15] PricewaterhouseCoopers Australian Entertainment & Media Outlook 2015-19; at page 113

billion in FY13-14.[16] Delivering these public goods is increasingly expensive, and broadcasters cannot continue to invest at current levels.

In this context, the outdated licence fees place free-to-air broadcasters at a competitive disadvantage with competing platforms such as Pay TV and online providers, which are not subject to industry specific taxes.

The graph below highlights the disparity between the cultural and economic contributions of Australian free-to-air broadcasters, with recent market entrant Netflix – which is now estimated to be in at least 10% of Australian households, even though it has been operating for less than 12 months.[17]



Spectrum Charging

In tandem with the review of licence fees, the Government is proposing to reform spectrum licensing and pricing arrangements.

If a spectrum charge is applied, it should be set at a rate to cover the costs of managing spectrum in line with world's best practice. It is imperative that any spectrum pricing regime is not structured as a like for like equivalent of the current licence fee regime.

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[16] Australian content expenditure figures compiled by Free TV. See: http://www.freetv.com.au/SiteMedia/W3SVC751/Uploads/Documents/RECORD_1.54_BILLION_DOLLAR_COMMITMENT_TO_FREE_AUSSIE_CONTENT.pdf

[17] See: http://www.roymorgan.com/findings/6499-netflix-reach-one-in-ten-australian-homes-september-2015-201510142329

Commercial free-to-air broadcasters have a fundamentally different business model to telecommunications companies, and this must be acknowledged in any spectrum pricing model.

In particular, the price and terms of broadcasting spectrum must account for the significant regulatory obligations that broadcasters are subject to. Broadcasters provide their services to the viewing public for no charge and monetise their services by selling advertising. This is in contrast to the direct revenue per user model that characterises the telecommunications market.

As highlighted by the Venture research, much of the economic benefit created by broadcasting is in the form of consumer benefit that does not flow through to the broadcaster. For this reason, broadcasters do not have the resources to 'compete' for spectrum against telecommunications or other content providers who operate on a different business model.

What's at risk?

The commercial free-to-air television industry's ability to continue providing public interest outcomes is threatened by the financial impact of the current regulatory framework, particularly the level of licence fees.

Over the last five years, Free TV broadcasters have invested $6.62bn in Australian content.[18] At the same time, some of the commercial free-to-air broadcasters are making substantial investments in online services and digital channels and technologies to enhance services for viewers. Free TV networks are the major underwriters of the Australian production sector, employing over 15,000 people both directly and indirectly.[19]

Despite the increasingly crowded media market, free-to-air television remains the only industry sector willing and able to deliver this investment to the Australian public. The fastest growing media sectors, such as SVOD services, have not and will not invest in Australian content and news production on the same scale as commercial free-to-air television.

The current situation of very high licence fees, zero growth forecasts, and escalating production costs is unsustainable. Commercial free-to-air broadcasters are facing a competitive, structural and economic squeeze, which shows no sign of abating. With already limited funds for innovation, licence fees compound this squeeze and place broadcasters at a competitive disadvantage to the wave of new players.

In the absence of licence fee relief, broadcasters will be forced to reduce local content spend across a range of genres. This will have a significant and

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[18] Australian content expenditure figures compiled by Free TV. See: http://www.freetv.com.au/SiteMedia/W3SVC751/Uploads/Documents/RECORD_1.54_BILLION_DOLLAR_COMMITMENT_TO_FREE_AUSSIE_CONTENT.pdf

[19] Venture Consulting, op cit, pp 6

detrimental impact on viewers, who will experience a deterioration in their current services, and facilitate the dominance of international content.

Benefits of change

Removing broadcasting licence fees is a critical tax reform which recognises the changing industry and lessens the risk of market failure in the sector. It will address some of the regulatory imbalance in the media market, and enable a popular and valued Australian industry to continue to deliver highly valued services to Australian viewers.

Abolishing licence fees will also give all broadcasters a greater capacity to innovate and invest more in the services that Australians highly value and rely on, including, for example, Australian productions and local news services.

A healthy and vibrant commercial free-to-air broadcasting sector will result in positive outcomes for government, through a continued delivery of a strong economic surplus and a range of other positive public policy outcomes, such as continued investment in the production sector, ongoing local employment, and a strong Australian cultural voice on television.

Producer offset

While the abolition of licence fees remains the top priority for free-to-air broadcasters, changes to the producer offset are a further supplementary measure that can be taken to strengthen the Australian content production industry.

The Producer Offset is a refundable tax offset that was introduced in July 2007 as part of the Australian Screen Production Incentive (ASPI), the Australian Government's package of measures to boost support for the Australian film and television industry. One of the key aims of the Offset was to assist Australian producers to build stable and sustainable production companies.[20]

The producer offset for television is only 20% while for feature films the available offset is 40%. There is no reason to provide more favourable incentives for film, particularly as television has greater reach and popularity with Australians than film.

If the producer offset for television is doubled to 40%, in line with the offset available for feature films, this would be consistent with the principle of regulatory parity, and in-line with a recommendation of the Convergence Review.[21]

The premium Australian television content produced for television is equally valuable to viewers, and contributes to a vibrant and successful production sector in the same measure as content produced for feature films.

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[20] Screen Australia Report, Getting Down to Business – The Producer Offset five years on, 2012.

[21] Australian Government (2012) *Convergence Review- Final* Report at p 59

The offset for television content should be brought into line with the current rate for feature films, to reflect the level of investment made by the producer rather than where the content is first shown.