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10 DOWNING STREET

From the Private Secretary

25 June 1986

Dear Stephen,

PEACOCK REPORT

The Prime Minister this afternoon held a meeting to discuss the Peacock Report on the basis of the Home Secretary's minute of 11 June. Present were the Lord President, the Chancellor of the Exchequer, the Home Secretary, the Chancellor of the Duchy of Lancaster, the Secretary of State for Trade and Industry, the Chief Whip and Sir Robert Armstrong.

The Home Secretary believed the Peacock Report was likely to be criticised from several different quarters. However its analysis was in many ways attractive, in arguing that there would have to be a move away from regulated broadcasting, and that "pay as you view" was a form of consumer choice preferable to the introduction of advertising across the board. But many of the specific recommendations presented difficulties. They would need to be treated as a cue for debate, with decisions coming later. There were three areas where the statement to be made on publication of the report would need to be more specific. First, major changes were taking place in radio which were not discussed in the report. Moreover it would be important not to jeopardise independent local radio and the Government were committed to an experiment in community radio. A Green Paper on radio was in preparation and the recommendations made about privatisation of Radios One and Two could be dealt with in that context. Secondly, the Peacock Committee by a majority had recommended auctioning of IBA contracts. The next round of licensing would have to take place under the present system unless there were legislation. It would however be possible to consider whether existing licences could be extended if colleagues wished that. Thirdly, the proposal that the only regulation of the programme content of television should be the law of the land would be very controversial and the Government should make its position clear immediately on publication.

In discussion the Home Secretary's general approach was agreed. The conceptual framework adopted in the report was distinguished and the Home Secretary's initial statement should foreclose as little as possible.

It was agreed that the Home Secretary should look further at the position on IBA contracts. There was a strong case for postponing action on a further round of

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contract awards until the next Parliament. The Home Secretary's draft statement would need to be revised in the light of the results of his study of the possibilities.

On the question of the regulation of programme content it was agreed that the law as it stood at present was rightly supplemented by regulation. There were substantial criticisms even of the present system, which would itself become more difficult to operate with the increasing ability to receive transmissions originating in other jurisdictions. It would increasingly be necessary to seek international agreement on regulation of programme content. At this stage the Home Secretary's statement should be firm in saying that any future system must be no weaker than it was now. A possible line to take in answer to questions would be to say that if the existing system of regulation were abolished it would be necessary to consider whether the existing law of the land was adequate. The regulation of programme content would need to be further considered during the course of future detailed study of the Report's recommendations.

Other main points made during the discussion included the following.

- (i) The phasing of the changes would be politically important. There was a strong case for moving as rapidly as possible towards pay as you view (or pay per channel) in order to secure early abolition of the licence fee. A prospect of this kind could provide a defence against expensive proposals to abolish the licence fee for pensioners.
- (ii) The proposal to impose a licence fee on car radios would be very controversial and probably unacceptable and the recommendation to give free licences to pensioners on supplementary benefit would be difficult to handle against the background of the Opposition's promise to give free licences to all pensioners.
- (iii) The question of the level of the licence fee would need to be further considered in the Autumn. Looking further ahead, the Committee had recommended linking increases in the licence to the RPI; one possibility would be to link them to an RPI minus x formula, as with BGC and British Telecom.
- (iv) The form of the ITV levy should be reviewed in further work. A revenue based levy could well be preferable to a profits based levy, with the effect that had on pay levels, restrictive practices, the encouragement of gold plating and the like.
- (v) The question whether using a British Telecom cable network for distribution of television programmes would be pro or anti competitive should also be considered. It was possible that the balance of the arguments had now changed.

- (vi) There would be little purpose in going through the difficult process of changing the basis of licence fee collection if later the system would be moving to pay as you view.
- (vii) The question remained open whether in the later stages the BBC would be free to take advertising if it chose to do so.

Summing up the discussion the Prime Minister invited the Home Secretary to revise in the light of the discussion the parts of the statement dealing with IBA contracts and the regulation of the content of programmes and to circulate a further draft. Further work on the report should be carried forward by a MISC group of Ministers with officials and experts, on the basis of papers prepared by officials and experts. It could well be helpful to associate with the work someone with commercial experience. The Prime Minister invited Sir Robert Armstrong to make detailed proposals on how this should be taken forward. In considering the Committee's recommendations it would be important to distinguish between action to be taken during this Parliament and recommendations which would be for action later.

I am copying this letter to Joan McNaughton (Lord President's Office), Rachel Lomax (HM Treasury), John Mogg (Department of Trade and Industry), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office), Murdo Maclean (Chief Whip's Office) and Michael Stark (Cabinet Office).

John
David

DAVID NORGROVE

Stephen Boys Smith, Esq.,
Home Office



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PRIME MINISTER

PEACOCK REPORT

Douglas Hurd minuted you on 11 June about the Peacock Report. I thought it might be helpful if I gave my views before the meeting on 25 June.

2 I welcome the Committee's ultimate vision of a full broadcasting market based on "consumer sovereignty". But it is disappointing that in the three-stage approach proposed by the Committee, the first stage effectively preserves much of the status quo for a period as long as 10 years. I believe that there should be a full public debate of the report, and that the Government's initial response should not foreclose discussion on the important issues.

Advertising on the BBC (Recommendation 2)

3 I was surprised by the conclusion on advertising (for which I have industry sponsorship responsibilities). I favour advertising on the BBC; though I agree with Douglas Hurd that it would not be easy for us to question the Peacock recommendation.

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However, the Report appears to produce little evidence to support the view that advertising would significantly affect the range of choice open to viewers. I therefore believe that we ourselves should examine this in some depth, particularly the implications of limited advertising and sponsorship on the BBC.

Competitive Tender for ITV franchises (Recommendations 10, 11, 13)

4 I appreciate Douglas Hurd's point about the short-term difficulty caused by the timing of the next round of contracts. However, the greater use of competitive tendering has been a major feature of our approach to other areas of this kind, and if this opportunity is missed now it will not arise again for several years. I therefore believe we should encourage some public debate on this issue rather than reject it straight away for the next round, as proposed in Douglas Hurd's draft statement. However, I accept that timing rules out any change at this stage in the tendering procedures for DBS.

Programmes from independent producers (Recommendation 8)

5 I strongly support the recommendation that the BBC and ITV should be required to make more use of independent producers and I hope that Douglas Hurd can reflect this in his statement. Such

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a move would considerably strengthen the position of the independent sector, which has been stimulated by Channel 4. It would also have a beneficial effect on BBC and ITV production costs as well as the practices of trade unions in the traditional broadcasting field. I would hope that we could achieve this objective through a formal understanding with the broadcasters rather than by legislation.

Telecommunication Common Carriers (Recommendation 15)

6 This issue goes well beyond the Committee's terms of reference and the recommendation runs counter to our current cable and telecommunications policies. Changes in approach might be welcomed by British Telecom, but they could have important consequences for Mercury - and for our hopes that cable systems should develop as local competition for BT. Douglas Hurd will be reviewing cable policy in the autumn. At that time, with the advice in particular of the Director General of Telecommunications, I shall review the telecommunications policy aspects.

Peritelevision Socket (Recommendation 1)

7 In reaching a view on this we would need to look more widely at the use of the TV set in the future - as part of home computer

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systems and for displaying DBS as well as terrestrial TV. I share Douglas Hurd's doubts as to whether this proposal needs to be brought into effect by ~~legislation~~. A voluntary agreement - ~~promoted~~, possibly, by a joint industry-Government initiative along the lines of the Teletext Programme - might be more successful than a mandatory requirement which would be unattractive to consumers generally because of the extra cost.

Collection of licence fee (Recommendation 4)

8 Competitive tendering for public service work is an important part of our competition policy and I support it. I understand Douglas Hurd's apprehension that the recommendation could lead to a confusion of responsibility, and I see attractions in Nigel Lawson's suggestion that the BBC should take over complete responsibility for collection and enforcement. But colleagues must be aware of the fragile industrial relations in the Post Office at the present time. Any change in the collection arrangements would need to be handled with great care.

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Other recommendations

9 There are a number of other recommendations of relevance to my Departmental interest. These include the proposal to privatise Radios 1 and 2, on which I agree with Douglas Hurd's proposal that this should be examined in the Green Paper on Sound Broadcasting. It is important therefore that my Department should be involved in the follow-up work that is undertaken.

PC

PAUL CHANNON

[Handwritten mark]

24 June 1986

(Copied to the Lord President, the Chancellor of the Exchequer, the Home Secretary, the Chancellor of the Duchy of Lancaster, the Attorney General, the Chief Whip and Sir Robert Armstrong).

Department of Trade & Industry

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DBIF for
Peacock meeting. /BF
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PRIME MINISTER

20 June 1986

PEACOCK REPORT: SPECIFIC RECOMMENDATIONS

Recommendation 1: All new television sets sold or rented in the UK market should be required from the earliest convenient date, and in any case not later than 1.1.88, to have a peritelevision socket and associated equipment which will interface with a decoder to deal with encrypted signals.

This is an essential part of Peacock's overall strategy: it should not cost more than £25 per television. Already 18% of all new TV sets have such a socket, and both France and Italy have made them a legal requirement. If the Government were to announce its intention ultimately to switch over to encrypted transmission then the manufacturers would be likely to instal the sockets without the necessity of specific legislation.

Recommendation 2: BBC television should not be obliged to finance its operations by advertising while the present organisation and regulation of broadcasting remain in being.

A central part of the Peacock philosophy but only valid if its other major recommendations are implemented.

Recommendation 3: The licence fee should be indexed on an annual basis to the general rate of inflation.

Peacock proposes that index linking should run from April 1987 starting from a base of a £60 licence fee, (compared to £58 today). The Home Secretary proposes that index linking should run, initially for one year, from April 1988 starting from a base of £58. Both proposals give the BBC less than inflation during 1985 and 1986.

Recommendation 4: To permit the BBC to be the managing agent in the collection of the licence fee, the Post Office should be released from its responsibility as agent to the Home Office for collection and enforcement procedures associated with the licence fee. The BBC should become responsible for inviting proposals for collection and enforcement procedures and for identifying the most efficient and economic collection and enforcement system. (The Post Office, of course, could tender for the role of agent.)

This is worth considering although we agree with the Home Secretary that it would be better for the BBC to take over total responsibility for collection and enforcement of the licence fee rather than just be the managing agent.

Recommendation 5: On the understanding that the proceeds would be used to reduce the cost of the television licence and not to increase the total sum available for broadcasting, a separate licence fee of not less than £10 should be charged for car radios.

Although radio accounts for 28% of BBC expenditure it is difficult to justify singling out just car radios. Because the charge would apply to all cars fitted for radio whether they had a car radio or not, it would in effect be a tax on all cars. The proposal fits oddly with the rest of the Peacock recommendations and is very hard to support.

Recommendation 6: Pensioners on supplementary benefit in households wholly dependent on that supplementary benefit should be exempt from the licence fee.

This is also a surprising recommendation to come out of Peacock. It goes against the grain of allowing pensioners to make their own decisions rather than hypothecating the

benefits on their behalf. The issue having been raised it will be difficult for Government to ignore it completely.

Recommendation 7: The BBC should have the option to privatise Radios 1, 2 and local radio in whole or in part. IBA regulation of radio should be replaced by a looser regime.

Recommendation 7a: Radio 1 and Radio 2 should be privatised and financed by advertising. Subject to the Government's existing commitments to community radio, any further radio frequencies becoming available should be auctioned to the highest bidder. IBA regulation of radio should be replaced by a looser regime.

Peacock believes that advertising on Radios 1 and 2, coupled with looser regulation over independent radio, would encourage advertisers and make independent radio more robust. This could be true; there is certainly a strong case for the BBC not providing services that could equally well be provided in the private sector. Any buyer would expect the BBC to undertake not to re-enter this market. If the BBC licence fee was also reduced to reflect such a sale, then this would be an additional incentive for the BBC to stay honest.

Recommendation 8: The BBC and ITV should be required over a ten year period to increase to not less than 40% the proportion of programmes supplied by independent producers.

This is a vital measure if the BBC's cosy inefficiency is to be ended.

Recommendation 9: The non-occupied night-time hours (1.00 am to 6.00 am) of the BBC and ITV television wavelengths should be sold for broadcasting purposes.

This is a sensible use of resources but the transmissions should not be totally unregulated: the same restrictions should apply as for cable television.

Recommendation 10: Franchise contracts for independent companies should be put to competitive tender. Should the IBA decide to award a franchise to a contractor other than the one making the highest bid it should be required to make a full, public and detailed statement of its reasons.

Recommendation 11: Franchises should be awarded on a rolling review basis. There would be a formal annual review of the contractor's performance by the Authority.

Recommendation 12: Consideration should be given to extending the franchise periods, perhaps to 10 years.

These are sensible recommendations which we would strongly endorse. The inefficiencies of the BBC and ITV companies feed off each other; eliminating the levy would provide a major incentive to improve.

Recommendation 13: DBS franchises should be put to competitive tender.

This seems sensible.

Recommendation 14: Channel 4 should be given the option of selling its own advertising time and would then no longer be funded by a subscription from ITV companies.

Peacock makes this recommendation conditional on Channel 4 continuing to offer complementary services to ITV. With this proviso it is perhaps the right time to start thinking about allowing Channel 4 to progress from being a child of the ITV companies to an adult company in its own right.

Recommendation 15: National telecommunication systems (eg British Telecom, Mercury and any subsequent entrants) should be permitted to act as common carriers with a view to the provision of a full range of services, including delivery of television programmes.

This will be controversial: is it worth sacrificing the potential benefits of competition to the more certain advantage of achieving a national, common-carrier network? Given the disappointing take-up of cable so far there would appear to be strong arguments for concluding that the current fragmented approach may end up with the consumer getting a worse service than might be achieved through a monopoly carrier.

Recommendation 16: The restriction of cable franchises to EEC owned operators should be removed.

There is no longer a flood of applicants for these franchises, so foreigners are unlikely to displace British companies. They could offer a service that the consumer would otherwise not receive.

Recommendation 17: All restrictions for both Pay-Per-Channel and Pay-Per-Programme as options should be removed, not only for cable but also for terrestrial and DBS operations.

This is an essential pre-requisite for moving towards the Peacock goal of electronic publishing. The Home Office is wrong to be frightened of it.

Recommendation 18: As regulation is phased out the normal laws of the land relating to obscenity, defamation, blasphemy, sedition and other similar matters should be extended to cover the broadcasting media and any present exemptions should be removed.

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This actually increases the amount of regulation on broadcasting until stage 2 of the Peacock proposals is implemented sometime in the 1990s. Although it presents political difficulties it must happen sometime.

Peter Warry
PETER WARRY

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Prime Minister

Papers for a meeting
possibly next week.

I strongly recommend
dipping into the report from
page 250 onwards to get
the flavour of the Committee's
approach.

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PRIME MINISTER

PEACOCK REPORT

This note is offered on the strength of having been one of the secretaries to the Annan Committee on the future of broadcasting in the mid-70s, and of a continuing interest in broadcasting arrangements since then.

My impression is that the Peacock Committee, as with all committees on broadcasting, became seduced by the exciting possibilities of the future at the expense of dealing in the political realities of the present. Only that can explain the fact that, as the Home Secretary rather bitterly complains, most of the Report is concerned with arrangements which were outside their terms of reference and on which they took no evidence. However rigorous the analysis, which is what one would expect from a committee with people like Alan Peacock and Sam Brittan, it is flawed by a number of what seem to me fundamental misconceptions. These apply both to their recommendations on existing broadcasting arrangements and those for the future.

Financing the BBC: Peacock's Recommendations

Advertising

The Committee reject, as was only to be expected, advertising on BBC Television. In my view this is right: there is no serious possibility that advertising on BBC Television will be saleable politically. On radio, however, they advocate "privatising" Radios 1 and 2 and financing them by advertising. As the Home Secretary says in his minute, this is a very odd concept. Radios 1 and 2 are not companies or commodities: they are the way in which the BBC happens to use the wave lengths which have been allocated to it. The BBC cannot sell the wave lengths because they are not the BBC's to sell. Nor can the Government force the BBC to give up Radio 1 and 2: even if it took away the wave lengths, the BBC could simply use one of its other wave lengths for a service of that kind.

The Committee's analysis seems to me to miss the obvious answer which is to get the BBC to put advertising on Radio 1 and 2 thereby increasing their income, thereby reducing the licence fee. This of course would be a breach in the BBC's firm front against advertising. As such, they would resist it bitterly. But I find it very difficult to believe that they could seriously argue that advertising would adversely affect the nature of Radios 1 and 2.

Concessionary Licences

On the licence fee, the Committee recommend indexation and free licences for pensioner households dependent on supplementary benefit to be financed by a levy on car radios. If the licence fee is to be retained, and advertising on Radio 1 and 2 rejected, then indexation would help politically. But the proposal for concessionary licence fees is a dangerous one. Quite apart from the initial cost, it would be very difficult indeed to hold the concessions there. There would be very strong pressure first for extension to all pensioners with supplementary benefit and then to all pensioners. This is of course Labour Party policy. The Committee say that they prefer cash benefits to benefits in kind, yet they recommend something which is flatly contrary to that principle.

Car Radio Licence

The Committee salve their consciences by proposing a car radio licence. If this was a serious proposition, it would have been done long ago as a means of reducing the overall licence fee. Their proposal is that a fee should be paid by every owner of a car fitted for radio. Leaving aside the question of equity (is it right to tax people whose cars are fitted for radio, but do not actually have one?), this tax will be unpopular and easy to evade. If charged on a once and for all basis, when a new car is bought, it would add substantially to its cost: if charged annually, in addition to road tax, it would add at least 10%. The Committee only advance this proposal to offset their idea of concessionary licences: better to have neither.

direction totally contrary to its current approach. The popular demand is for more regulation on broadcasting the content of television and not less. But less is what the Committee proposes.

This is a little unfair I think. JH

I believe that the Committee's view of the future is also flawed because it assumes that broadcasting will move in a particular direction, i.e., towards a multiplicity of channels based on distribution by cable. Experience demonstrates that it is almost impossible to say where broadcasting is going. For example, in the last ten years the big development in broadcasting has been the massive increase in video recording. Yet ten years ago all the evidence to the Annan Committee suggested that video was almost likely to be a minority taste, and was in any event up a technological blind alley. I attach a copy of the relevant paragraph in the Report. When you read that the British Radio Equipment Manufacturers' Association thought that there was unlikely to be a very great expansion of demand for video recorders, it becomes clear why British manufacturers completely lost out on the video boom!

The Annan Committee was told that the next ten years lay in cable, and framed its recommendations accordingly. But cable was a flop, and is likely to remain so for the foreseeable future.

Any technological assumptions about the future of broadcasting are likely to be wrong: indeed, almost certain to be wrong. The Committee should not have spent its time constructing elaborate hypotheses about an unknowable future.

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13 June, 1986.

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25.17. In their 1972 Report, the Television Advisory Committee concluded that the most likely market for recording equipment was for education and training and it was not likely to become so widely used by the general public as to make people want less or a different kind of television during the franchise period after 1976. This conclusion was not seriously disputed by those who gave evidence to us, although we received some evidence, for example from the National Video Cassette Working Party, composed of representatives of the video recording industry, which suggested that the market for video equipment would grow rapidly in the late 1970s and that the cost of video disc equipment would be well within the mass consumer pocket. But the BBC believed that even if manufacturers and retailers of discs and cassettes captured a large market by current standards, their audiences would be small by comparison with those of the BBC and ITV, and the IBA believe that video recording would appeal to "only the minority that is acutely choosy in its attitude to broadcasting and can afford the equipment which makes it possible to be choosy". The British Radio Equipment Manufacturers Association also thought there was unlikely to be a very great expansion of demand for video recorders at the present selling price, and the National Television Rental Association suggested that the domestic market for video cassettes was likely to be limited, although they foresaw more future in video discs.

PRIME MINISTER

13 June 1986

PEACOCK REPORT

Our unstated objectives in establishing the Peacock Committee could reasonably have been described as:

1. To knock the BBC down to size, to force them to improve efficiency, and to prevent them from extravagantly expanding into everything from DBS to breakfast-time TV.
2. To bring an end to the regular battles over the level of the licence fee.
3. To prepare the broadcasting structure for the advent of new technology.
4. To help out the rest of the broadcasting industry.

We had anticipated that the best way to achieve the first two objectives was through a measure of advertising on the BBC. But although Peacock does not recommend advertising, he has come up with a package of proposals which, if implemented in full, would still achieve all the above objectives. It is the total package of proposals which is necessary to achieve the objectives, just indexing the licence fee would leave the fundamental problems untouched.

The Committee did not reject advertising on the grounds of economics: although they obtained evidence that suggested that increasing the supply of advertising might reduce the total revenue secured, they generally retained an open mind. Advertising was rejected because it did not meet the Committee's ideals on consumer sovereignty, ie ensuring overall that the majority of individual consumers were able to watch the individual programmes they most wanted rather than being forced by advertising pressures to watch the

programmes that numerically got the highest audiences but did not necessarily give the highest overall satisfaction. If the Committee suspected that only selected recommendations were to be adopted then it might well have preferred to endorse advertising despite the disadvantages.

The Peacock Analysis

Peacock argues that the present, highly-regulated duopoly in television has come about because of the limited amount of frequency spectrum available. If the frequency spectrum restriction had not existed then broadcasting might well have developed as for newspapers, with a multiplicity of opinions and choice. The influence of any single station would have been small and there would have been no need for a state-financed corporation to exploit the monopoly. Peacock believes that broadband cable, DBS, video-taping etc will produce just such a situation in the next 10 to 20 years - true 'electronic publishing' with as many different choices as the consumer demands.

To cope with this revolution Peacock proposes a three-stage approach determined by the rate of take-up of the technology. The three stages are:

1. **Preparatory:** new televisions to have sockets for receiving encrypted signals, a national common carrier broadband cable spine to be developed by BT (and Mercury), more commercial pressures to be put on BBC and ITV, but otherwise status quo.
2. **Intermediate:** more choice now available for consumers, lighter control of BBC and ITV output.
3. **Final:** full range of stations/programmes available, regulation probably reduced to purely the law of the land.

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For the BBC these three stages equate to:

1. Index linking of the licence fee, gradual increase in proportion of programmes made by independent producers, hiving-off of radios 1, 2 and local radio.
2. ^{(No.) Subscription} Pay per view replaces [part of] licence fee, lighter regulation of output.
3. Although some public service element may continue, BBC effectively independent and financing itself through pay per view or indeed with advertising.

Such a deregulatory approach ultimately leaves the BBC without any special controls over its output other than the law of the land. This is not necessarily a bad thing. The current need to control the BBC derives from the influential nature of present duopoly TV output, and the desire to ensure that licence payers' money is not frittered away on unworthy programmes. Once the BBC becomes just one of many channels and its viewers are able to elect whether to watch (and pay for) its programmes, the argument for special control is much reduced. Of course it will still be necessary to ensure impartiality in news and political and industrial controversy, and to require that the output does not offend against good taste and decency. But this can be enshrined in statute, (just as it has been for cable TV) and the need for pre-publication censorship removed.

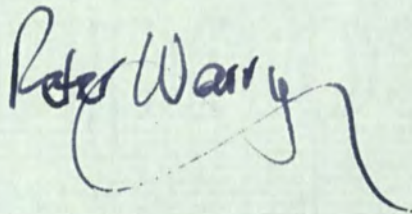
Government Response

The Home Office summary of Peacock is slightly slanted and not a little smug, perhaps reflecting the self-satisfied approach of the vested interests which it sponsors. The Home Office support most of the recommendations that maintain the status quo and would be happy to push the others into the long grass.

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We support the general thrust of Peacock's conclusions and most of his recommendations. But whatever view one takes of the recommendations it would be unwise to peremptorily brush any of them aside - the Peacock Committee, more than most, was composed of powerful and effective communicators. Moreover they specifically state (paragraph 710) that it is not possible just to pick and choose.

There is no necessity to stick our heads over the parapet at this stage. We strongly recommend that the Home Secretary should not rule out anything in his Commons statement. The Report should be allowed to stand or fall on its own merits, and the Government then respond to the public demand.

A handwritten signature in blue ink that reads "Peter Warry". The signature is written in a cursive style with a long, sweeping tail that extends to the right.

PETER WARRY

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PRIME MINISTER

PEACOCK REPORT: FINANCING THE BBC

OBJECTIVES AND CONCLUSIONS OF THE MEETING

1. The principal objective of the meeting you are holding next week is to consider the immediate Government reaction to the Peacock report and the line the Home Secretary should take in the statement he proposes in his minute of 11 June. Since, in essence, the Home Secretary proposes to reserve the Government position on the bulk of the report there is no need to take firm decisions on its recommendations now, save on those the Home Secretary proposes specifically to reject. It is clearly important, however, to get the tone of the statement right, particularly in its treatment of the future of the licence fee, the rejection of advertising and the possibility of a subscription system. To do this the meeting will need to have a general discussion of the substance of the report and its overall thrust.

2. You might also like to use this discussion to establish whether anything might be done, taking account of the report, to take quicker action to introduce an alternative form of finance and to commission work on any options identified.

3. Once the statement has been made on publication of the report (perhaps in the first week of July), the next public step the Home Secretary proposes to take would be an announcement in the autumn of future handling of the licence fee. One possible course would be to delay a decision on whether he should do so until nearer the time and have a further more substantive discussion with colleagues at that point. Such a further meeting could assess the report in the light of public reaction and consider the results of work commissioned as indicated above.

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BACKGROUND

4. You will recall that the Peacock Committee was set up in March last year in response to public interest in the possibility of introducing advertising into the BBC. This had been stimulated by the licence fee review of that year and the feeling that the quality of BBC television had declined and was not notably superior to that of the ITV companies, particularly since the advent of Channel 4. There was also a view that the development of new technology would provide increasing opportunity to break down the current duopolistic service and enable greater competition with its resultant benefits of improved efficiency.

5. The success of the Committee in tackling these issues is doubtful. They have set out a radical vision of the future in which technological advance - cable and satellite transmission - could be used to create a genuine free market with viewers being able to register their preference directly by "pay-per-view". That would accord well with much of the Government's general philosophy but it is many years before it could be brought into being and is to some extent speculative.

6. The difficulties arise from the fact that the Committee have subordinated what can be done immediately to their longterm goal. They rule out advertising on BBC television altogether, and propose the retention of an (indexed) licence fee for a ten year period until technological advance has produced a sufficient spread of broadcasting channels to enable a subscription system to be introduced for the BBC. Under their subscription scheme transmissions would be encoded on broadcast and could only be decoded by possession of a device and code number for the channel for which a subscription would be paid. This in itself is seen as only a second transitional phase before the ultimate goal is achieved of a full unregulated broadcasting market with an indefinite number of channels paid for by whatever means the market can bear.

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7. Although subscription is not in itself an unattractive means of finance, the Committee's timescale of implementation would leave the Government in the difficult position of having to retain the licence system for a 10 year period and having to face the prospect of dealing with a number of short-term recommendations - for example, changes in the structure of the licence fee - which would be politically unpopular for no immediate dividend.

MAIN ISSUES RAISED IN THE REPORT

(i) Advertising Versus Subscription

8. The report rules out advertising as a means of funding the BBC effectively on two grounds. First because of the conclusion, after a detailed economic study, that while the volume of advertising would increase with extension to the BBC the total amount of revenue generated and available to broadcasters would decline. However, the Committee emphasise that their conclusion against advertising would still stand even if they were more optimistic about the likely growth of advertising expenditure and its sensitivity to price reduction. Their principal objection is a philosophical one. They set as their primary objective consumer welfare. They consider that the main defect of a system based on advertising finance is that channel owners "do not sell programmes to audiences, but audiences to advertisers". Within our duopolistic system, they believe the consequence would be to reduce consumer choice through the BBC being driven into a ratings war to attract advertisers and consequent financial pressure being put on ITV companies, which would make it more difficult for them to meet IBA requirements; programmes which did not secure top audience ratings would be squeezed out. The Committee believe that a subscription, on the other hand, would transfer genuine power to the consumer and enable a multiplicity of channels to develop, serving all needs.

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9. This analysis has its attractions but it is open to challenge. While the Committee's findings on the effects on advertising revenue probably do rule out total funding of the BBC from advertising, the Committee is less convincing in its consideration of limited advertising. The BBC is already engaged in competition with ITV companies with many of its programmes and it is hard to see that advertising limited both in total broadcasting time and to a certain percentage of programmes would materially affect the mix of programmes available. The conclusion of the Committee that "the BBC and the regulated ITV system have done far better, in mimicking the effects of a true consumer market, than any purely laissez faire system financed by advertising could have done under conditions of spectrum shortage" presupposes that a laissez faire system would have been the basis on which advertising was introduced: but it would be equally possible for the present regulatory control system to continue. The Home Secretary rightly points out the political difficulties of rejecting the Committee's findings on advertising but it might be possible to put work in hand internally to examine the possibilities for limited advertising. The form of words that the Home Secretary proposes to use would not close off this option.

10. It is by no means clear that the consumer sovereignty enjoyed under a subscription system with a multiplicity of channels would give a better effective range of choice given there would be a price inhibition on the number of channels or programmes for which a subscription could be paid. Since there would be no ban on advertising it is not entirely clear how the market of a mixed supply of free channels by advertising and subscription channels will work and whether the latter would prove profitable. There would certainly be an awkward transition. Given these difficulties the Home Secretary's proposal for an initial neutral response inviting public comment and analysis of the Committee's reasoning seems the right course to take.

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(ii) The Licence Fee

11. The Home Secretary proposes an announcement in the autumn that the present £58 licence fee will be extended for its third year to 1988 (the current settlement runs until 1987 and, unless displaced by a different system, until 1988), with a commitment to an indexed increase for a fourth year based upon the RPI. He points out that this would take the matter beyond the General Election, whenever it took place, and would avoid the need for a messy debate in early 1988. You will probably wish to defer a decision on this point until a more substantive discussion of the Government response to the report can take place. In particular you may wish to consider whether there is any other alternative source of finance that could be identified on the basis of the analysis in the report.

(iii) Privatisation of BBC Radios 1 and 2

12. It is not entirely clear what privatisation means in this context since the most valuable asset - the frequency spectrum - is not owned by the BBC. Moreover, if the BBC lost the frequencies there would be nothing to prevent them making the remaining service more populist. We understand informally that the Peacock Committee gave no thought to these questions, which clearly demand more subtle analysis. In the circumstances, the Home Secretary's proposal that his initial announcement should detach this and the other radio recommendations from the rest of the report, for consideration in the context of his current review of radio policy as a whole, seems right. His current intention is to publish a Green Paper in the autumn, and this will address other controversial issues, such as community radio.

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(iv) IBA Contracts to be Awarded by Competitive Tender and by Rolling Review

13. The timing of this recommendation is awkward as the IBA will be advertising television contracts late next year, select contractors by the end of 1988, and new contracts would begin in 1990. To make changes in this process would require new primary legislation. This legislation would be controversial and would have to be prepared in advance of consideration of the wider issues raised in the report. The Home Secretary is therefore probably right to propose rejecting the recommendation as it stands. You might, however, like to consider whether the possibility of moving in this direction should be kept open for the longer term future.

(v) Programme Content

14. The report recommends both that the content of programmes should be subject only to such regulation as is provided in the general law of the land and that the current unused nighttime airwaves should be used for unregulated broadcasting. The Home Secretary wishes to reject these proposals. He believes they ignore the current concern about broadcasting standards and the particularly intrusive nature of the media. Some would argue that on specific issues - for example, obscenity - the general law was a more effective mechanism than the duties placed on the BBC and IBA. But reliance on the general law would leave areas such as political impartiality unregulated and this is surely unacceptable.

(vi) Telecommunications Systems

15. The proposal that the telecommunications systems should be permitted to act as common carriers runs completely counter to deliberate Government competition policy in this area of providing cable programme services through local interactive networks. This policy, however, has not led to the rapid

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development of cable networks which had been hoped and it may be worth taking a fresh look at the alternatives. There is no need for an early public response.

(vii) Structure of the Licence Fee

16. The Committee's proposals for exempting pensioners on supplementary benefit from the licence fee, abolishing the concession for people in residential care, and extending it to car radios are unattractive politically as is the possibility canvassed of narrowing the differential between the monochrome and colour licence fee. Decisions could not be taken in advance of further consideration of the future of the fee as a whole and are probably best taken on that timetable.

HANDLING

17. You will wish to invite the Home Secretary to introduce his paper. You may then wish to invite general comments on the Peacock approach, and subsequently to go through the particular recommendations the Home Secretary has highlighted. All those present will have views.

AJL

A J LANGDON
13 June 1986