The media and an informed electorate – an economist’s perspective

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Abstract

The media make an important contribution to the public’s understanding of policy issues. They are therefore important contributors to the workings of a democracy.

Economic theory provides powerful tools for analysing markets. These include specification of a theoretical ‘ideal’ market and identification of possible market distortions or ‘failures’. This theory also provides frameworks for understanding possible policy interventions to address these failures, including explanations of their effects.

This paper presents a theoretical economic structure for news media markets as providers of information on policy issues. Conceptually, it could be imagined that there are markets operating for the purchase and sale of information through newspapers, television and radio. Sufficient conditions are suggested for such markets to work in an ideal manner. This is contrasted to actual news media markets, identifying six possible market failures and associated policy interventions (including public provision). In part, this discussion may help to explain current policies on the news media, both in terms of why they have been introduced and how they may work. In addition, they may indicate the thinking underpinning the decisions to introduce the policies, why those interventions were selected. If the theory is relevant, this gives a useful structure for understanding and influencing the news media. If the theory is not relevant due to misrepresenting the actual operation of the news media, others may be able to see flaws in the reasoning. Economists could then take note of these errors to improve their understanding and resulting policy recommendations.

“The media have something in common with political parties. Their constitutional role is vital to the functioning of the system… In both cases it is assumed that the forces of market competition will impel the behaviour which is optimal for the good functioning of our system of government. In both cases the assumption is open to serious doubt.” (Palmer, 1996, p. 21)

1. Introduction

Palmer questions the effectiveness of news media markets in fulfilling their constitutional role. They are relied on to provide a broad awareness and understanding of policy issues. These issues are commonly matters that are of general importance
and require some collective response. For many issues, the general public will have had limited direct experience. Much of the information possessed by the public will have been obtained from elsewhere. The benefits of gathering information are small in relation to the costs. Not only is little knowledge held initially, but also responses require collective action, so an individual alone has little ability to influence outcomes. Hence, there is not a strong incentive to invest heavily in becoming well informed.

The news media are important participants in the processes of making and implementing policy.¹ They are influential in shaping people’s perceptions and their understanding of issues, and in turn this affects people’s choices and behaviour. Ekstrom even refers to journalism as the link between citizens and society (Ekstrom, 2002, p. 275). He stresses its political importance in a democracy, and he also suggests that the information is widely accepted:

“The ubiquity of journalism serves as a mechanism influencing the public acceptance of knowledge claims. A commonplace form of knowledge very easily becomes a valid form of knowledge.” (Ekstrom, 2002, p. 276)

This bears some similarity to Hardin’s ‘street-level epistemology’:

¹ The news media are one component of the media as a whole. It may be difficult always to identify them as providing a distinct product with a market or markets of their own. This paper begins by assuming that such a distinction can be drawn. Blurred boundaries are then considered among the factors affecting market operation.
“the bulk of our knowledge...depends on others in various ways. We take most knowledge on authority from others who presumably are in a position to know it. Indeed, we take it from others who themselves take it from others and so forth all the way down. There are finally no or at best vague and weak foundations for most of an individual’s knowledge.” (Hardin, 2002, p. 216)

Goldberg, referring to the US news media, states this point critically when he says:

“The problem is that so many TV journalists simply don’t know what to think about certain issues until the New York Times and the Washington Post tell them what to think.” (Goldberg, 2001, p. 18)

The aim of this paper is to consider, from an economist’s perspective, whether the news media are likely to fulfil their democratic function effectively. Some attempts at theorising have been undertaken outside economics. Palmer (1996) takes some steps towards “a constitutional theory for the media”, but does not spell out a formal structure. Ekstrom (2002) sets out a useful theoretical framework for TV journalism, but it is essentially a descriptive tool.

Economic theory suggests market structures for certain types of goods and services that may work well, and other structures which display ‘market failure’. Where market failure can arise, economic theory also suggests possible interventions to limit or correct for this failure. The value of this structure is that it provides a systematic analysis of the effects of interventions, considering interrelationships between the
various participants. It is not enough simply to intervene to prevent a perceived problem. The intervention changes the structure and associated incentives, and there will then be further rounds of changed behaviour. Without further analysis that incorporates these responses, there can be unanticipated consequences from intervention. For example, court ordered name suppression can place restrictions on the freedom of newspapers, but may be ineffective for the internet. Consequently newspapers may come to be seen as less useful sources of information, with the internet becoming more attractive. Heavy control of newspapers may then simply result in faster growth of uncontrolled internet sources, thereby undermining the effectiveness of the controls.

The approach taken in the paper is to consider conditions necessary for an ‘ideal’ market for news, after which a series of potential market failures and associated policy options are identified. An analogous, but somewhat narrower, approach has been taken by Hamilton (2004), considering four types of market failure.

Many of the interventions suggested by economists as a response to specific market failures would match controls that are already in place. For these, economic theory gives possible explanations for their existence and may indicate how effective they might be and what side-effects might be observed. Note that it is necessary to go beyond an application of standard theory that is based on a generic view of markets. Any market analysis must recognise the specific characteristics of the products, and the nature of demand and supply. In addition, even if the economic approach is flawed as a representation of news media markets, the perspective may reflect the thinking
that is driving interventions, providing a basis for understanding why people think they might work. Identified flaws in the approach can then indicate why some policies may be ineffective and how they could be improved.

The structure of this paper is as follows. Part 2 presents an economic view of an ‘ideal’ market for news in terms of efficiently providing information. Part 3 considers market failures. Conclusions are drawn in Part 4.

2 An economic approach: an ‘ideal’ market for news

Economics has a concept of perfect competition. In an economy where markets are perfectly competitive, the resulting outcome is optimal according to the Pareto optimality criterion. When this perfect competition is not achieved, it is considered that there are ‘market failures’, distortions when the market does not work in an ideal way. While the structure could be challenged\(^2\), it may be worth applying this approach to the provision of information through the news media. This would involve identifying sufficient requirements for the news media market(s) to be perfectly competitive. Failure to meet these sufficient requirements would then constitute market failure and possibly justify forms of intervention to improve on the imperfect reality.\(^3\)

\(^2\) See, for example, Schumpeter (1976), in particular the discussion of creative destruction in Chapter 7, and Blaug (2001).

\(^3\) Note that this is a partial analysis as it does not consider the operation of other markets in the economy.
To illustrate, consider a very simple application of this approach. A market for information that meets economists’ required assumptions for perfect competition would be considered to have some desirable characteristics. In particular, the best information suppliers (for a price) would out-compete the others, so inefficient suppliers would be driven from the market. In reality, news media markets may differ from this perfectly competitive structure in various ways. First, there may be a limited number of suppliers. This could justify intervention in the form of competition policy or public supply. Second, people may not be good judges of the quality of news provided. This could call for intervention in the form of regulation of standards. Third, people’s news media consumption decisions may be based on aspects other than demand for information. They may be looking for entertainment, for example. This could be seen as people’s preferences being distorted away from those which are considered to be in their best interest. The economic term for this phenomenon is ‘merit wants’. A standard policy approach under these circumstances is to subsidise information provision. These points are dealt with in more detail in section 3 of this paper.

It is important to understand the nature of this form of analysis. As with all models using ‘static analysis’, the following economic model asks whether, in the current period, the right information will be provided. It is not saying it is a desirable model in an absolute sense. There could be other objectives, including development over time. It is simply asking, by comparing the actual to the theoretical, ‘Can we, with the existing structure, expect to get good information imparted in an efficient way?’
2.1 A possible framework

The intention here is to specify features required to match those under perfect competition. The approach is based on the inherent nature of the product. ‘Market failures’ are defined in relation to this structure. In contrast, observed markets include the effects of regulations and other policy interventions. Often such interventions are introduced to correct for failings arising from the nature of the products themselves. For example, some services, such as education and health care, are publicly provided, but they could be provided through markets. There are economic reasons (such as income distribution, or equity) for public provision. As there may also be non-economic reasons, such as political ideology, it should not be assumed that all observed market interventions are justified according to economic theory.

The standard conditions for perfect competition are:

1. Many buyers and sellers (so none can individually influence price, they are price takers);
2. A homogeneous product;
3. Freedom of entry and exit;
4. Perfect information.

For now it will be assumed that conditions 1 and 3 are met, considering problems with these at a later stage. Condition number 2 could be more difficult in that information provided through the news media is not homogeneous. However, the same could be said about many products. Economists analyse markets for labour, housing, or DVDs,
for example, not to mention newspapers, magazines and pay-TV channels. Perhaps people could be considered to be buying individual items of information, with the same information being provided from many sources. Condition 4 requires some explanation, given that the market is for information. In the context of economic analyses of markets, perfect information means perfect information about the nature of the products and the prices at which they are available from individual suppliers. This could be restated as consumers being perfectly discerning, being able to tell what is accurate and relevant information, in addition to knowing the price.

An additional condition that is sometimes expressly stated is one of there being no externalities (spillovers). This means that all costs and benefits of transactions affect only the parties to the transactions and are reflected in prices paid and received.

Economic theory includes assumptions about behaviour, with consumers maximising their utility and suppliers maximising their profits. In relation to information on policy issues, we could consider the public as consumers and the news media as suppliers, with a third group of players, politicians, providing information for the news media to pass on (i.e. inputs into production). The following assumptions are designed to give a structure that will meet economists’ criteria for a perfectly competitive news media market. They do not match the real world, but that is central to the analysis. Deviations from these assumptions could lead to other outcomes, or ‘market failure’, and associated corrective interventions:
The public (voters/consumers) are not fully informed on policy matters, so they look to the news media for information and they are prepared to pay for this. They are able to perfectly discern the quality and accuracy of the information provided as they are perfectly informed on the products provided.

The media are profit-maximising, and so they respond to the public’s demand for information according to the public’s willingness to pay. They are more competitive if they are more accurate, so they have an incentive to expose politicians’ distortions if there are any.

Politicians want votes. They can either try to fool the news media and give false information, or they can give accurate information. They are competing with other politicians/parties, and the public is discerning, so false information will be exposed. Hence politicians give accurate information.

Under these assumptions, with sufficient competition in the news media, the conditions for perfect competition are met, news media providers make no abnormal profits and the optimal level of information is provided, the public is optimally

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4 In practice, advertisers also have an indirect influence. This is considered later.
5 This assumption is presented here so as to meet the conditions for perfect competition as specified in economic theory. Other objectives, such as ideology, could affect news media behaviour and outcomes, as discussed in McCluskey and Swinnen (2007). Ideological groupings of the public may also affect the market, as discussed below.
6 This is the same assumption used in Downs (1957) in his economic theory of democracy. His model of political processes is widely known. It includes one notable assumption, “Throughout this thesis, we assume that no false (i.e. factually incorrect) information exists…” (Downs, 1957, p. 46)
informed taking into account the cost of provision of information and the value to
them of the information.\(^7\)

### 3 Possible failures

A deviation from the perfectly competitive ideal is considered as ‘market failure’. These deviations are identified and their determinants are specified according to theory. This gives a basis for anticipating and explaining behaviour. From this framework, policy options in response to market failures can then be considered and their impact understood according to the theory.

In this section some of the significant possible market failures are discussed. Deviations from the assumptions of the perfectly competitive model described above can arise for various reasons. Considered here in turn are: 1) public failure to accurately judge quality; 2) news media meeting consumer demands other than information; 3) a limited number of suppliers; 4) two-sided markets; 5) principal-agent issues; and 6) the role of politicians. Structural changes, including media convergence, are not discussed, although they will have an impact over time. For reasons of space, public goods and natural monopoly are omitted.

#### 3.1 The public are not so discerning.

The public may not be able to accurately judge the quality of the information being conveyed. Consequently, the signals they give through the market may not be

\(^7\) Note that, if information is costly to gather and pass on, or if an issue is of limited significance, optimal consumption levels will be low and the public may not be well informed.
accurate enough to deter poor quality information suppliers. While some members of
the public may be able to identify contradictions and inconsistencies in news stories,
beyond that they have little (besides reputation) on which to base an assessment of
news quality. This problem is well recognised, as described in Part 1 above (Ekstrom,
2002; Goldberg, 2001; Hardin, 2002). Problems of accuracy of the message have been
mentioned by others (Hay, 1996; Posner, 2007).

Policy interventions can be applied to limit this failure. Limitations to consumers’
ability to judge products are a common problem in many markets, including those for
professional services, housing, cars, and electrical goods, for example. Even if an
individual can undertake a full assessment before spending money, the costs can be
prohibitive.

A common policy response is to impose standards, with associated monitoring and
enforcement mechanisms. This reduces uncertainty at the cost of reduced choice, as
only complying options are available.

For the news media, controls can and are placed on the sort of information that can be
conveyed. In particular, there can be penalties imposed for deliberately false and
misleading information. Self-regulation could also occur, with professional standards
and disciplinary procedures, but they may be problematic. Such processes exist for
lawyers, psychologists and others, although periodically doubts are raised about the
effectiveness of internal complaints procedures that are not independent and may not
be impartial.
It should not be assumed that the available policy options for the news media are effective or efficient. Enforcement may be slow and costly, and controls may be seen as restrictions on the ability of the news media to convey information. There may also be ways to circumvent the controls (Ekstrom, 2002; Goldberg, 2001). For example, individual facts may be correct, but the overall presentation may be misleading. This can be due to selective reporting or the choice of specific spokespeople to present alternative viewpoints (Goldberg, 2001, p. 20). Consequently there is intervention in the form of a requirement of ‘balance’ in coverage.

3.2 The public may want other things from the news media

People’s demand for news media products can be based on a number of factors, of which policy-relevant information is just one. Consumers may make a trade-off, accepting less or poorer information in exchange for more of something else. For example, there may be demand for other topics, such as sports news, or classified advertising, or they may seek a different ‘style’ of news, focusing on excitement, sensationalism, or the unusual.

Downs concedes that people may obtain information for entertainment, considering that otherwise it is for production, consumption or political purposes (Downs, 1957, p. 215). Ekstrom refers to “[o]ther factors, like entertainment and relaxation, and the ability of television newscasts to provide vicarious adventure and spectacular

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8 As specified by Section 4(d) of the Broadcasting Act 1987 and standard 4 of the Free-to-Air Television Code of Broadcasting Practice (TVNZ, 2005).
attractions” (Ekstrom, 2002, p. 274). Bourdieu, also describing television, talks of a focus on ‘pure entertainment’ and ‘mindless chatter’ (Bourdieu, 1998, p. 3). Pape and Featherstone refer to information, entertainment, education and persuasion (Pape & Featherstone, 2006, pp. 4-5).

The standard economic approach is based on the concept of consumer sovereignty, whereby it is assumed that the consumer is the best judge of his/her interests. Conversely, ‘merit wants’ are goods or services that are beneficial for people, and that they should be consuming in reasonable quantities, but for some reason they are not aware of all the benefits so they under-consume. Education and healthy housing are commonly suggested as examples.9

Information required to understand and participate in policy debate might be considered a merit want. Economic options to increase consumption of a merit want include education on the importance of the good or service so as to increase expressed demand, subsidising its provision if people are likely to buy more when it is cheaper, or, for some items, controls on consumption levels. A merit want argument might be used to support a case for subsidised provision of news, as with taxpayer-funded broadcasting.

3.3 Imperfect competition: few suppliers

In this situation there could be limited choice for consumers, so there is less need for suppliers to be concerned about the quality and price of their product. In an extreme
case there may be one supplier, in which case the only choice open to consumers is whether to buy the product at all. Even with a few suppliers, there is scope for abnormal profits and or inefficient production in terms of not providing the best possible quality at the prevailing price (termed X-inefficiency by Leibenstein, 1966).

The case of a limited number of suppliers has been considered by Hotelling in a classic article (Hotelling, 1929). He discusses the location of ice cream vendors on a beach, concluding that two vendors would locate close to each other as they are competing for customers in the ‘middle ground’. Similarly for news providers, if each is aiming for the largest audience possible, then with one or two suppliers, both would focus on ‘mainstream’ views. It is only with a large number of competing suppliers that a range of minority interests would be well covered. ¹⁰

Policy responses could include competition policy or public supply. Competition policy could be used to limit mergers that would result in reduced competition, and public supply could result in direct involvement in supply decisions or specification of the criteria to be met. In New Zealand, this type of intervention is covered by the Commerce Act (1986), which is one of the pieces of legislation guiding the work of the Commerce Commission.

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⁹ Some of the issues surrounding merit wants are debated in West and McKee (1983).
¹⁰ This indicates a possible limitation of the theory, in that consumers are assumed to be evenly distributed. If they are clustered around ideological positions, then the distribution would be bi-modal or multi-modal, justifying differentiation even with a small number of suppliers.
The Commerce Commission’s reasoning in a news media context is described in its Decision No.445. It relates to an application in 2001 by Wilson and Horton Limited, seeking clearance to acquire the business assets of Power Plant Productions Limited relating to the Havelock North Village Press newspaper business (Commerce Commission, 2001). The Commission’s definition of a market is described in Paragraph 22:

For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, could impose at least a small yet significant and nontransitory increase in price, assuming all other terms of sale remain constant (the ‘ssnip test’). For the purpose of determining relevant markets, the Commission will generally consider a ssnip to involve a five percent increase in price for a period of one year.

The process of analysis is summarised in Paragraph 31:

Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. Unequivocal substitutes are combined. For each initial market so defined, the Commission will examine whether the imposition of a ssnip would be likely to be profitable for the hypothetical monopolist.

The Commission then considered there to be two markets relevant to the case, a print news media market in the Hawkes Bay and a print media advertising market in the Hawkes Bay. It found that there would not be a substantial lessening of competition in either of these markets, so clearance was given.
3.4 Two-sided markets

“Two-sided markets involve two distinct types of users, each of whom obtains value from interacting with users of the opposite type over a common platform” (Wright, 2004, p. 44).

The public are not the only ones to benefit from the media, and they are not the only source of revenue to media providers. We could consider adding an additional group of participants, advertisers, as a second side to the market. Pricing and product decisions are influenced by both sides of the market. A standard market analysis considers only suppliers and consumers. If we ignore advertisers, it would be difficult to explain the economic rationale for free local newspapers. Such newspapers aim for advertising revenue. They are therefore likely to emphasise ‘soft’ news, promotional items and personal interest stories.

Hamilton, focusing on the US, discusses this in relation to network evening news programmes. He contends that, although the main viewers of these programmes are in the 50+ age group, producers still make decisions on content based on the interests of younger viewers, particularly younger female viewers (18-34).

“[P]rogrammers will try to attract younger viewers to the network evening news, in part to increase news advertising revenues and in part to add these viewers to the audience that stays with the network into the prime-time schedule.” (Hamilton, 2004, p. 71)
This commercial dimension to the news was also described by Goldberg (2001). Similarly, Franklin states, “News media have increasingly become part of the entertainment industry instead of providing a forum for informed debate of key issues of public concern” (Franklin, 1997, p. 4). He distinguishes between interesting the public and the public interest.

The issue of possible influence of advertising on news content and style should not be ignored. A possible market response could come through the public distrusting news media that are believed to be under outside influence. Alternatively standards could be imposed through editorial direction, or via outside regulation to contain the extent of distortion or confusion between news and advertising, for example. There are problems with both of these. How are the standards, internal or external, determined? Can the overseers be trusted? A more extreme intervention could be public provision, especially if this is taxpayer-funded/subsidised. Just as content by a supplier in the market may be influenced by pressure from others, so too could that of a supplier which is funded or run publicly. Controls or safeguards may also be necessary there. In other words, just as there may be market failure in provision through markets, there can also be public sector failure with publicly funded or provided goods and services.

The phenomenon of two-sided markets provides an economic reason to question the analysis undertaken by the Commerce Commission in the Wilson and Horton case described in Section 3.3. The Commission considered the news and advertising markets individually without addressing the possibility of one influencing the other. If the news content in some newspapers is governed by a desire to appeal to advertisers,
then it may be wrong to consider the suppliers to be competing against each other in the news media market. If so, the Commission’s analysis could have overstated the amount of competition.

An application by Fairfax Newspapers in 2005 to acquire Rodney newspapers from Times Media (Commerce Commission, 2005) raised this specific point in Paragraph 1.4:

Fairfax considers that the nature of local news and information services in the Rodney district (primarily the fact that all sources of news/information are free and that the provision of local news is therefore driven by a desire to attract advertisers) means that it cannot be considered separately from the provision of advertising services.

The next paragraph of the application contended that the Rodney market was broader than just print media, suggesting that the internet and local radio also provided local news and advertising. The Commerce Commission, which gave consent in Decision 561, considered both these aspects, making specific reference to theories on two-sided markets.

### 3.5 Principal-agent issues

The news media could be considered as acting on behalf of, or as agents of, the public. In relation to policy issues, this is an important aspect of the functioning of a democracy. As Sir Geoffrey Palmer writes:

“All news reporting involves over-simplification of reality, but television political news in New Zealand involves the most
distortion…Journalists are more than gatekeepers. Their activities help to determine what people think. That is why the media has constitutional significance.” (Palmer, 1996, p. 21)

The public is relying on the news media to select the ‘right’ information. There are similarities between say subscription to a newspaper for daily news and the concept of a principal engaging an agent to act on his/her behalf. This can work effectively if the agent is aware of the principal’s interests and has strong enough incentives to act in those interests. The outcome depends in part on i) the expertise of the agent and ii) the level of supervision possible for the principal. As the services are provided over a long period, issues of reputation, credibility and confidence in an information supplier are important. This can be a useful safeguard if there are competing suppliers. Other safeguards can include professional standards, with codes of conduct and disciplinary bodies.

3.6 The role of politicians

As an angle related to that of two-sided markets, the news media could be considered as an intermediary between politicians and the public, in which case politicians have a direct interest in the actions of the news media and the news media require a degree of co-operation from politicians. This is a constraint that can affect the production of news media services. Incentives for politicians to provide information for the public are not straightforward. Politicians and parties are competing against each other. They have incentives to provide favourable information on themselves and perhaps unfavourable information on opponents. The resulting situation may depend on the number of parties and the extent to which they may have to co-operate with each other.
(as with coalitions under MMP, for example). Rather than providing information, politicians may find it more productive to compete in other ways, such as with photo opportunities, headline grabbing, or sound bites. Rather than debating with reasoned arguments, they may find it more effective to use alternative ‘modes of argumentation’ (Dunn, 2004, pp. 394-418) or to rely on promotion of key, loaded terms (Curran, 2006), attempting to shape perceptions, as described in literature on the use of language such as with Fairclough’s ‘ideological-discursive formations’ (IDFs) (Fairclough, 1995, p. 40).

One counter to news media manipulation by politicians would be to have independent, critical commentary. Transparency and assistance for researchers and investigative reporters can be promoted through legislation such as the Official Information Act (1982), if it works effectively. Public media funding with protection against political interference may help. Alternatively, competition among think-tanks representing a range of viewpoints may limit political distortions. Conversely, the news media may have its own biases, so increasing media power may simply support these. Goldberg (2001) and Hamilton (2004) both contend that there is a left-wing bias in the US news media.

4 Conclusions

In summary, an economic approach may give a useful structure for assessing the extent to which the news media can inform the public on policy matters. It can highlight some possible weaknesses and indicate market and policy responses. There are several significant reasons why the news media operating through an unregulated
market may fail to optimally inform the public. A range of policy interventions is possible, including regulations, subsidies and public provision. The implementation of regulations involves administrative and compliance costs, as with complaints procedures and requirements to provide information, and they may have their own failings. Similarly, there are limitations to the effectiveness of subsidies and public provision as alternative interventions. Economics can provide useful insights into these issues. There is a further qualification, however. If the participants’ objectives or perspectives differ from those assumed, then economic models may fail to accurately identify their behaviour and responses to interventions.

References


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