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UNAPPRECIATED BENEFITS OF ADVERTISING & COMMERCIAL SPEECH

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FEDERAL POLICY MAKERS, state legislators, and state attorneys general have recently shown interest in regulating commercial advertising and marketing.¹ Several new regulatory initiatives are being proposed, or are already underway, that could severely curtail or restrict advertising or marketing on a variety of platforms.² The consequences of these stepped-up regulatory efforts will be profound and will hurt consumer welfare both directly and indirectly.

The affected platforms range from traditional media (newspapers, TV and radio broadcasters, etc.) to the newest media outlets (the Internet, online ad networks, social networks, video games, mobile devices, and interactive television). This expanded regulatory activism would apply to issues and products including pharmaceuticals, tobacco,³ alcohol, advertising during children's television programming,⁴ online marketing to children,⁵ the loudness of ads on television,⁶ product placement marketing⁷ and testimonials,⁸ and more. Perhaps the most notable of these efforts is the recent push to impose a comprehensive regulatory regime on online advertising and data collection efforts in the name of enhancing consumer privacy.⁹ This might include a so-called "Do Not Track" mechanism that would block advertising or data collection through the mandatory reengineering of web browsers.¹⁰

REGULATING COMMERCIAL SPEECH

ADVERTISING CAN BE an easy target for politicians or regulatory activist groups who make a variety of (typically unsubstantiated) claims about its negative impact on society. Up until the late 1970s, federal policy makers—especially Federal Trade Commission (FTC) officials—aggressively regulated advertising and marketing citing concerns such as deception, annoyance, offensiveness, or its effect on children. At root, what unites all such concerns, both then and now, is a general anxiety about advertising being a supposedly manipulative or unnecessary force in society. John Calfee of the American Enterprise Institute has aptly dubbed this the "fear of persuasion" and noted that such "attacks on advertising are ironic in the extreme" since "the essence of persuasion is the absence of coercion."¹¹

The aggressive regulatory stance of the '60s and '70s eventually came under intense scrutiny by economists and the

courts, however, and federal authorities reconsidered and relaxed advertising regulations throughout the 1980s and '90s. Academic and government research revealed that, despite the best of intentions, advertising and marketing restrictions were driving up prices, creating barriers to entry, and denying consumers important information about goods and services.¹² That latter problem eventually captured the attention of the Supreme Court, which began ruling in the '70s that restrictions on commercial speech were an affront to the First Amendment. For these reasons, the FTC and the courts largely deregulated advertising markets—at least the most onerous, preemptive policies—and then, more sensibly, focused on policing clear-cut cases of deceptive advertising or consumer fraud.

HOW ADVERTISING & MARKETING BENEFIT CONSUMERS

THE ROLE OF commercial speech in a free-market economy is often misunderstood or taken for granted. Despite regulators' concern, consumers actually benefit from advertising and marketing in three important ways:

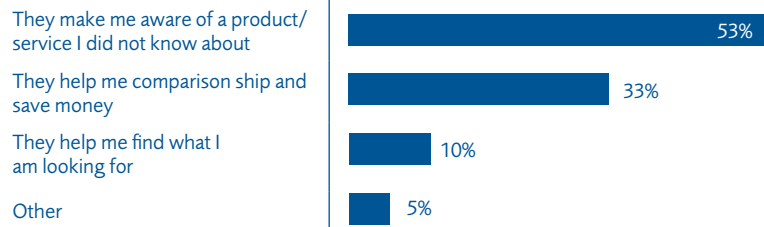
1. Informational / Educational Effects

Advertising provides important information and signals to consumers about goods and services that are competing for their allegiance. This helps address an otherwise intractable information problem that would go unsolved without advertising's claims and counter-claims about goods and services. As Nobel laureate economist George Stigler pointed out in his legendary 1961 article on the economics of information, advertising is "an immensely powerful instrument for the elimination of ignorance."¹³ Similarly, John Calfee has argued, "advertising has an unsuspected power to improve consumer welfare" since it "is an efficient and sometimes irreplaceable mechanism for bringing consumers information that would otherwise languish on the sidelines."¹⁴ More importantly, Calfee argues:

Advertising's promise of more and better information also generates ripple effects in the market. These include enhanced incentives to create new information and develop better products. Theoretical and empirical research has demonstrated what generations of astute observers had known intuitively, that markets with advertising are far superior to markets without advertising.¹⁵

In other words, *advertising educates*. It ensures consumers are better informed about the world around them, and not just for the goods or services being advertised.¹⁶ It also raises general awareness about new classes or categories of goods and services. It helps citizens in their capacity as consumers to become knowledgeable about the options at their disposal and the relative merits of those choices. For example, a February 2010 poll by About.com found that "While one-third of the

WAYS THAT ONLINE ADS HELP WHEN RESEARCHING/SHOPPING ONLINE ACCORDING TO U.S. INTERNET USERS (JANUARY 2010)



Source: eMarketer, About.com "2010 Consumer Survey" (January 20, 2010)

online buyers who were aided by ads said they helped them save money, the majority appreciated online ads for informing them about a product or service previously unknown (see figure 1).¹⁷ This is the educational power of advertising at work and it suggests that many consumers do understand and appreciate the benefits of commercial speech.

Because of the important educational role played by advertising and marketing in the economy, the Supreme Court has made it clear that, like other forms of speech, commercial speech deserves First Amendment protection. "Both the individual consumer and society in general may have strong interests in the free flow of commercial information," the Court noted in *Va. Pharmacy Bd. v. Va. Consumer Council*.¹⁸ "As to the particular consumer's interest in the free flow of commercial information, that interest may be as keen, if not keener by far, than his interest in the day's most urgent political debate," Justice Blackmun stressed in that decision.¹⁹ The Court continued:

So long as we preserve a predominantly free enterprise economy, the allocation of our resources in large measure will be made through numerous private economic decisions. It is a matter of public interest that those decisions, in the aggregate, be intelligent and well informed. To this end, the free flow of commercial information is indispensable.²⁰

The Court's reasoning in its commercial speech jurisprudence, notes Media Institute scholar Richard T. Kaplar, can be summarized with the following syllogism:

Economic concerns are as important to our society as political concerns. By extension, economic information is as important as political information. Political information receives full First Amendment protection. Therefore, economic information should receive full First Amendment protection.²¹

"Truthful speech about lawful products and services deserve full First Amendment protection." Kaplar concludes. "This is a simple proposition, but its implications for freedom of speech extend far beyond advertising."²²

2. Market / Competitive Effects

Advertising also keeps markets competitive by keeping competitors on their toes and forcing them to constantly respond to challenges by rivals who are offering better or cheaper services. This ensures consumers have more choices at their disposal. “The freedom to advertise encourages businesses to create new brands and improve old ones,” argues William F. Arens, author of *Contemporary Advertising*.²³ Moreover, he notes, it “promotes the existence of more sellers, and that gives consumers wider choices.”²⁴

As a result, advertising helps keep prices low (or even at zero) for many goods and services, especially media and entertainment offerings.²⁵ In *Bates v. State Bar of Arizona*, the Supreme Court confirmed the importance of advertising and marketing to the free-market economy, noting:

commercial speech serves to inform the public of the availability, nature, and prices of products and services, and thus performs an indispensable role in the allocation of resources in a free enterprise system. In short, such speech serves individual and societal interests in assuring informed and reliable decisionmaking.²⁶

3. Media Promotion / Cross-Subsidization

Third, advertising benefits society by subsidizing the creation of news, information, and entertainment. “Advertisers are critical to the success of commercial media because they provide the primary revenue stream that keeps most of them viable,” argues Robert G. Picard, author of *The Economics and Financing of Media Companies*.²⁷ Mary Alice Shaver of the University of Central Florida puts this support in context: “Advertising revenues pay for virtually all broadcast media, 70 percent to 80 percent of support for newspapers and an equally high percentage for magazines.”²⁸

Advertising is proving increasingly to be the only media industry business model with any real staying power for many media and information-producing sectors. Pay-per-view mechanisms, micropayments, and even subscription-based business models are all languishing.²⁹ Consequently, the overall health of modern media marketplace and the digital economy—and the aggregate amount of information and speech that can be produced or supported by those sectors—is fundamentally tied up with the question of whether policy makers allow the advertising marketplace to evolve in an efficient, dynamic fashion.

Increasingly, however, consumers are showing a strong preference for advertising-supported content and services, especially online where “free” is the order of the day.³⁰ Of course, the “free” business model predated the Internet in the form of advertising-supported over-the-air TV and radio broadcasts and low-cost daily newspapers. Without the cross-subsidy that advertising provided, those media outlets would have had

to charge significant sums for the information and entertainment they made available to the public.

Which raises another under-appreciated point: Advertising support promotes media independence. As Arens rightly notes, “[advertising] facilitates freedom of the press and promotes more complete information.”³¹ In the early days of the American republic, “private contributions, subscriptions, or political parties supported most newspapers,” notes Anthony R. Fellow, author of *American Media History*.³² But advertising helped liberate media operators from both public and private patronage and influence. Commenting on the importance of advertising to journalism legends such as Joseph Pulitzer and William Allen White, media historian Paul Starr, author of *The Creation of the Media*, says “just as abundant advertising gave Pulitzer the independence to criticize corporate as well as government abuses, so it gave White the material basis for his editorial independence.”³³ Starr concludes that, for newspaper providers large and small alike, “the increasingly strong commercial foundation of journalism became a basis of independent power and influence, locally as well as nationally.”³⁴

CONCLUSION

FOR THESE REASONS, a stepped-up regulatory crusade against advertising and marketing will hurt consumer welfare since it will raise prices, restrict choice, and diminish marketplace competition and innovation—both in ad-supported content and service markets, and throughout the economy at large. Simply stated, *there is no free lunch*. Something must sustain that content and culture and, increasingly, that something is advertising. That is equally true for traditional “analog era” media content as for newer digital and online offerings.

While it will likely be difficult to slow or reverse the current campaign against advertising and marketing, at a minimum, the surreal “something-for-nothing” quality of these debates must end. Those who criticize advertising and call for expanded regulation should be required to provide a strict cost-benefit analysis of the restrictions they propose. In particular, regulatory advocates must explain how the content and services supported currently by advertising and marketing will be possible if those techniques are choked off. Importantly, the “harm” critics claim advertising or marketing efforts give rise to must be concrete, not merely conjectural. Too much is at stake to allow otherwise.

ENDNOTES

1. “The prospect of more government regulation of advertising and marketing took on new life in 2009, alarming marketers and ad executives.” Suzanne Vranica, “For Ad Industry, 2010 Promises Scant Relief,” *The Wall Street Journal*, December 24, 2009, B5, <http://online.wsj.com/article/SB10001424052748703521904574614223788268550.html>. Dan Jaffe, executive vice president for government relations at the Association of National Advertisers, told *The Journal*, “We have never seen this type of scrutiny. There is nothing we do that is not under a microscope right now.”

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8. Federal Trade Commission, *Guides Concerning the Use of Endorsements and Testimonials in Advertising*, October 2009, www.ftc.gov/os/2009/10/091005endorsementguidesfnnotice.pdf.
9. See Adam Thierer, "Online Privacy Regulation: Likely More Complicated (And Costly) Than Imagined," *Mercatus on Policy*, Mercatus Center at George Mason University, December 6, 2010, <http://mercatus.org/publication/online-privacy-regulation>.
10. Tanzina Vega and Verne Kopytoff, "In Online Privacy Plan, the Opt-Out Question Looms," *New York Times*, December 5, 2010, <http://www.nytimes.com/2010/12/06/business/media/06privacy.html>.
11. John E. Calfee, *Fear of Persuasion: A New Perspective on Advertising and Regulation* (Washington, DC: AEI Press, 1997), 2.
12. See, e.g., George Stigler, "The Economics of Information," *Journal of Political Economy* 69, no. 3 (June 1961): 213–225; Philip Nelson, "Advertising as Information," *82 Journal of Political Economy* 4 (1974): 729–754.
13. Stigler, "The Economics of Information," 213. "Since Nobel laureate George Stigler's 1961 article on the economics of information, economists have increasingly come to recognize that, because it reduces the costs of obtaining information, advertising enhances economic performance," note Howard Beales and Timothy Muris. "[W]hat consumers know about competing alternatives influences their choices. Better information about the options enables consumers to make choices that better serve their interests." J. Howard Beales and Timothy J. Muris, *State and Federal Regulation of National Advertising* (Washington, DC: American Enterprise Institute, 1993), 7–8.
14. Calfee, *Fear of Persuasion*, 96.
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24. *Ibid.*
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26. *Bates v. State Bar of Arizona*, 433 U. S. 350 (1977).
27. Robert G. Picard, *The Economics and Financing of Media Companies* (Bronx, NY: Fordham University Press, 2002), 122.
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29. To some extent, these are all just variations of a fee-for-service business model. "Micropayments," for example, would require a small payment for each media unit accessed or downloaded, such as \$1 per news article or song.
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32. Anthony R. Fellow, *American Media History*, 1st ed. (Boston: Wadsworth, 2005), 315.
33. Paul Starr, *The Creation of Media: Political Origins of Modern Communication* (New York: Basic Books: 2004), 263–4.
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