Beesley Lecture **September 24th 2009**

"What is the role of public service broadcasting in the digital age?"

Do we have the tools, do we have the structure, do we have the mind-set to re-invent public service broadcasting for the digital age? That is the subject of my lecture tonight, launching the Beesley series.

For over thirty years, from 1955 to 1988, the UK enjoyed a stable, managed broadcasting sector, built on spectrum scarcity. For much of that time, not only did the BBC have sole use of the licence fee, but ITV enjoyed a monopoly of TV advertising. This was the age of the duopoly. The advent of Channel 4 in 1982 was seamlessly integrated. In the background, cable slumbered: a few franchises offering a smattering of choice. Happy days.

Spectrum scarcity allowed regulators to induce ITV to supply news, current affairs, documentaries, religion, arts, children's programmes, regional services and education, in exchange for free spectrum and those advertising privileges. Channel 4 was required to offer innovation and an alternative to ITV. The BBC, with its guaranteed income, was expected – without specific prompting – to supply at least as much if not more than the commercial sector in these public service categories.

Public service broadcasting – or PSB – was capable of two definitions in this period: the whole system of managed content, or the elements within the system that a purely commercial version of broadcasting would not provide.

Recently, both the BBC and the media regulator Ofcom have tried to add a third approach – asking whether individual programmes display certain characteristics or fulfil certain purposes. I have been explicit in my criticism of this. It is impossible to name a single BBC programme that fails to meet such tests. Moreover, under this approach, all kinds of content from broadcasters with no PSB duties can claim to deliver PSB – such as Discovery, Sky News, Sky Arts and National Geographic.

The most important test this methodology fails is that it does not tell you what to do. Does the state need to intervene in broadcasting? If so, how, and at what cost? What we know for certain is that the age of spectrum scarcity has been replaced by an age of spectrum plenty, and that the old means for ensuring delivery of PSB from the commercial sector are no longer effective. What we do instead is less clear.

Meanwhile, the very nature of broadcasting is being transformed. We can no longer even be confident that linear broadcasting is the sole means of intervention. Content that looks like PSB can be found all over the Internet.

The old PSB system was unravelled in two stages. First, Sky enlarged its subscription package to include broadcasters such as Disney, CNN and Nickelodeon, turning its brand from a broadcaster into a platform. The rapid growth of analogue multi-channel provision, fuelled by subscription earnings, suggested a new paradigm of symmetry and stability. We now had three systems, each with their own funding stream – licence fee, advertising and pay.

However, within a decade came the second wave of destruction: the launch of digital technology, with Sky again taking the lead. This offered consumers not just a huge increase in channel choice, but interactivity, smarter set-top boxes with hard drives, sophisticated electronic programme guides, interactivity, betting, transactions and a pathway to broadband, high definition and 3D. Cable followed, though at a distance.

The response from the terrestrial broadcasters, supported by government and regulators, was digital terrestrial television, or DTT. The first version, ITV Digital, a pay-TV service, was a colossal failure, succumbing to Sky's superior product and marketing.

Then DTT became primarily free-to-air, under BBC leadership. Freeview built an impressively large consumer base, driven by very low cost set-top boxes and a modest array of additional channels. This success persuaded ITV and Channel 4 to switch their pay-TV channels to free-to-air, sacrificing subscription revenue for the increased advertising that access to millions of Freeview homes promised.

The change in the landscape, however, had one very obvious victim: the old PSB system as an organic whole. The trade-off, between access to scarce spectrum and delivery of commercial PSB, could not be sustained under conditions of spectrum plenty. Indeed, the more that ITV, Channel 4 – and latterly Five – became dependent on advertising, the more directly they were threatened by loss of viewers to the mass of new channels.

This process was exacerbated by three further factors. First, the merger of Carlton and Granada triggered a regulatory remedy designed to prevent potential abuse of ITV's dominant airtime sales position. This had the unintended effect of driving down the price of TV advertising for all commercial broadcasters. In addition, the rapid growth of advertising on the Internet siphoned revenues out of television. Then the recession, and the accompanying slump in advertising, completed a triple whammy.

Just as importantly, a key response by the terrestrials to the digital challenge – the launch of families of channels – added to the drain on resources that could be devoted to PSB. None of the new channels launched by ITV, Channel 4 or Five has any PSB obligations.

The atrophying of commercial terrestrial PSB was well under way when the Broadcasting Policy Group, which I chair, published its report on the future of the BBC, in 2004. We saw that future as entwined with the issue of PSB as a whole. Then, as now, we could see four possible ways to approach the issue of how or whether to deliver PSB in the digital age.

The first is that the market, now no longer constrained by spectrum scarcity, will deliver all that the consumer needs, and there is no requirement for state intervention. On that basis, the licence fee could be abolished, and both the BBC and Channel 4 privatised.

The second is that market provision is steadily expanding, and that no intervention is required beyond a less well-funded BBC, and whatever Channel 4 happens to deliver.

A third approach addresses an implicit problem left hanging by the previous position: how to ensure plurality of PSB supply. It leaves the BBC essentially untouched, but seeks a separate funding source to support alternative provision of PSB content.

This is the current position of Ofcom and the government, and their preferred source of funding for non-BBC PSB, over and above what Channel 4 delivers, is the part of the licence fee earmarked for digital switchover assistance, which will not be needed for that purpose after 2012.

Finally, there is the position our study group adopted: that whatever PSB might from time to time be required needs to be delivered through a contestable fund, open to all producers and distributors of digital content.

We identified the progressive collapse of commercial PSB supply as the driving force of change. We expected this to lead to an enlarging of the BBC's already dominant position in the provision of key PSB elements, such as current affairs and regional news, underscoring the need to protect or re-invent plurality of supply. This in turn would require a radical re-think of the way PSB was funded.

We recommended using the digital switchover process to replace the BBC licence fee with voluntary subscription, whilst establishing a small, separate PSB fund to fill in the gaps in market provision of content. Our approach was informed by a key litmus test. We defined PSB as that content which society valued, but which the market failed to provide, either at all, or in sufficient volume. High quality content that the market could readily supply required no state support.

We reckoned that programmes like Blue Planet as well as EastEnders were easily funded from market sources, whereas many minority interest programmes were probably not. However, we did not want public service content to be defined by delivery system or even genre. For instance, we could imagine certain drama projects – such as Red Riding or Occupation – qualifying for support. Nor did we offer a view as to how much non-market content might be publicly funded. Quantum was a political decision, and could change over time.

This approach sharply conflicted with the BBC's own view of itself, as a provider of a full range of content, popular and specialist. That view was partly rooted in its funding mechanism. After all, if nearly all householders paid the licence fee, surely they were entitled to a full range of output.

From the universal compulsion to pay the licence fee the BBC derived a doctrine of universality, which justified spending the bulk of the licence fee on content that either mimicked the market or could easily have been financed by market mechanisms. But our study group could not understand why it was necessary to prosecute 100,000 people a year in order to pay for a Saturday night ballroom dancing competition.

We were accused of trying deliberately to marginalize the BBC. Where we saw the licence fee as an anachronism that digital switchover would render redundant, our critics saw it as a moral statement: a collective intervention in what otherwise might become a wasteland of lowest common denominator programming.

We saw a wider frame of reference: how, in the digital age, could we deliver a PSB system that was transparent, accountable, pluralist, good value for money, and scalable to changing needs, rather than embedded in self-sustaining institutions?

And one of our biggest concerns was that, irrespective of the rights or wrongs of the licence fee, and the ways in which the BBC spent it, the rapid decline of commercial PSB would increasingly leave us with a monopoly supplier of key genres, including highly sensitive ones such as current affairs, with possible negative consequences for our democracy.

As it has turned out, in this key respect, we were wrong, as was revealed in this summer's Ofcom report, dealing with PSB in the years since we published. We had assumed the BBC would naturally expand to fill the vacuum left by the commercial sector. After all, what else is the licence fee for? In fact, the BBC chose to play a much more subtle game.

The report revealed that the BBC had used the run-down of commercial PSB supply as cover for a transfer of resources to its own non-analogue activities. Rather than be seen as the last of the big spenders, the BBC has cut back its major channels.

Calculating everything in 2008 prices, Ofcom found that total commercial network spend had dropped by 8% between 2004 and 2008. Shockingly, despite the BBC's inflation-proofed guaranteed income, the decline in spend by BBC1 and BBC2 was far greater: 13%.

Across the terrestrial system, the most important victim was first-run origination, which fell by 14.5%. But spend on all the key PSB categories also fell: education by 28%, arts by 33%, religion by 34%, regional programmes by 39% and children's programmes by 48%.

With children's, spend on first run origination by the BBC, including its specialist digital children's channels, fell by £20 million; less than ITV's cut, but not by much. Tellingly, the proportion of children's viewing devoted to actual children's programming on the terrestrial channels fell from 32% to 12%.

The same pattern can be seen right across the PSB range: viewing of religious programmes fell by 23%, music programmes by 52%, arts programmes by 58% and education programmes by 70%. ITV's spending on programmes for the nations and regions fell by £41 million, but the BBC's decline is not far behind, at £34 million.

Effectively, the BBC has joined its commercial rivals in a tactical shift of resources from the main channels accessible by all homes to purely digital channels and non-broadcast activities. In the process, the viewing share of the five terrestrial channels has fallen from 75% in 2004 to 61% in 2008: a startling decline that is much faster than the rate of increase in take-up of digital viewing equipment, which might otherwise be seen as the proximate cause. Which is chicken and which is egg? For every percentage point drop in network spending, the five terrestrial channels lost two percentage points in viewing share.

This seemingly self-destructive policy begins to make sense when the growing universe of multi-channel homes is examined. What the terrestrial channels have done is collectively divert resources to their portfolios of digital channels, of which only the BBC's have any explicit public service purpose or remit.

Across all multi-channel homes, the outcome has been that, between 2004 and 2008, the viewing share of channels not owned by the terrestrials has dropped from 35% to 28%, whilst that for the terrestrial portfolio channels has risen from 7% to 16%. This actually understates the situation, as it excludes the most popular basic pay-TV package, UKTV, which the BBC controls editorially and half-owns, and also Channel 4's half share in the EMAP music channels. The terrestrials have been starving their analogue viewers in order to crowd out their rivals in multi-channel.

Should we be surprised by any of this? At one level, perhaps not: it was clear from the very start that the launch of DTT was designed to re-entrench the position of the five terrestrial channels, after a decade of steady erosion in their viewing share by the rapid take-up of satellite and cable. They were gifted the best part of the capacity on DTT, and the channels they own and control now command 89% of viewing on Freeview, which has become effectively a closed system.

As consumers take up Freeview, they make the platform more valuable as a driver of advertising revenue, so justifying the extra investment in digital channels by the commercial sector. The BBC, too, is happy, as its roll-out of new digital services protects overall viewing share and reach across their channel portfolio, so shoring up the justification for the licence fee.

Of course, the last people to adopt digital – predominantly the poor and the old – suffer deterioration in the quality of the analogue services on which they rely. But their ability to recognize this loss, let alone vocalize it, is very limited. And impoverished single mothers have no greater political clout than economic clout.

Where has the BBC's money gone? We know about the shift of resources to the nations and regions. This is an exercise in devolution with a price tag in excess of a billion pounds, though I sometimes wonder what the good burghers of Leeds and Newcastle make of the massive investment in Salford.

There has also been a significant expansion of spending online. Five years ago, bbc.co.uk cost less than £70 million a year – even then regarded as a very significant figure, but utterly dwarfed by the average for the last two years: £180 million.

Many people approved of the BBC's pioneering role in encouraging internet take-up, and the news part of the website is regarded as of high quality. However, as has become increasingly apparent in the last two years, the collapse of advertising in regional and national newspapers has led them to seek to replace those revenues online, where the huge BBC spend acts as a barrier to both advertising opportunities and experiments in direct payment.

This is not to endorse James Murdoch's accusations, in his recent speech at Edinburgh, of land-grabs for state-sponsored journalism. The implication that the BBC is editorially controlled by the state is false and malicious, and any online land-grab goes back a decade or more. It is the disastrous state of the finances of print journalism that has set the BBC's lavish budgets in high relief.

It is fruitless to point out to commercial news organisations that newspapers in the US are in just as much trouble as in the UK, and that the decline in newspaper readership and advertising revenue is long term. What those organisations see is that any chance of monetizing their online content – a modest hope at best –

is not helped by the BBC making the products of its own vast online activities available free. Nor is their mood much lightened by Mark Thompson's disparaging of their business acumen, as if the BBC had nothing to do with their plight.

The BBC's head of news, Helen Boaden, disingenuously points out that licence-fee-payers have already funded the online services: why should they be forced to pay again? The implication is that the online offerings are merely a spin-off of underlying activity. Yet all of BBC newsgathering, plus its 24-hour news channel, costs £150 million; so £180 million constitutes a pretty hefty spin-off!

Perhaps Ms Boaden means that, having been funded by inclusion in the licence fee, the online services should not attract an additional charge: but no-one was ever given the choice as to whether to pay a lower licence fee without online content, or a higher licence fee including online content – just as no-one is given the choice as to whether to pay the licence fee at all (other than to dispense with their television set).

A while ago, at an IEA Hobart Lunch lecture, I half-jokingly hypothesized the notion of the BBC launching a national newspaper, delivered to every home in the country, free of advertising, and with impeccably impartial news reporting. This could probably be produced for less than the £7 per licence fee that the BBC's online services cost. The quality would be high, but the devastating likely impact on a range of national and regional newspapers made the whole idea seem fanciful.

No doubt the BBC Trust would veto such a new service proposal if it was ever advanced by management. It vetoed a recent proposal for local video news, on the grounds that it would cause damage to commercial players. Yet if circumstances change such that pre-existing services are seen to cause substantial damage to those same players, why does not the same argument hold good? It's a bit like Obama and the Israeli settlements: is "natural growth" any more acceptable than "new build"?

Subsequent to the Murdoch speech last month, various BBC voices have been heard saying that the Corporation needs to be more careful not to damage other media enterprises. The chairman of the BBC Trust has even sent an open letter to licence fee payers implying that a thorough review of the BBC's activities might result in a smaller BBC. Sale of a minority stake in BBC Worldwide has been mooted.

I regard this as inverse Sarkozy syndrome: trying to seem smaller without actually becoming smaller. A typical example was the BBC's much-touted publication of the expenses incurred by its senior executives. It turned out that this was just the limited amount re-claimed by those executives, after they had initially laid out cash. 99% of total executive expenses are actually covered by central bookings, so not requiring re-imbursement, and so still unpublished.

The chairman also claims support from an Ipsos opinion poll for the BBC's argument that reducing the licence fee by £5.50 is a better way of disposing of the digital assistance monies after switchover than allocating them to non-BBC broadcasters. This finding was contradicted by a DCMS-commissioned poll which – surprise, surprise – supported the DCMS preference for re-allocating the money to non-BBC PSB. The Culture Secretary, Ben Bradshaw, even dared the BBC to give the £5.50 back anyway.

Polls are notorious for supporting the views of those who commission them. However, I could not help noting that the BBC's Ipsos poll demonstrated that three times as many people wanted the switchover cash back than have it spent on BBC services. It makes one wonder how deeply into BBC services the public would be willing to cut in order to reduce the licence fee.

The Trust was also keen to quote from an ICM poll showing high levels of respect and admiration for the BBC: but was less interested in the same poll's confirmation that a substantial majority would rather the BBC was not funded by the licence fee.

In my view, inviting pollsters or politicians or pundits – let alone competitors – to determine the size of the BBC, and which services might be dispensed with, is a slippery slope. Is BBC3 really worth the £500 million it has cost so far? Is the move to Salford really worth the reported £876 million cost, still rising?

Should Hollywood movies, or series, or music-driven radio services or premium sport be a charge on the licence fee? If a Conservative government is cutting back on ministerial cars and salaries, can a licence fee reduction be far behind the threatened licence fee freeze? Jeremy Hunt's pledge to reduce Mark Thompson's salary would save all of 2p off the licence fee. He is unlikely to call a halt there. Is the battle over the digital support fund going to turn into a long war of attrition? Does the BBC really wish to endure a death of a thousand cuts, when a permanent solution to all its problems is so close to hand?

A smart BBC might call Mr Bradshaw's bluff now, by just returning the switchover fund and its associated responsibilities to Whitehall, where they belong, and reducing the licence fee immediately. But if such a manoeuvre were just a tactic to protect the rest of the licence fee as solely for the BBC's benefit, it is very risky, when a clear majority of people have for some years said – when asked – that they would prefer to replace the licence fee altogether.

Mark Thompson's recent comment about the licence fee – "despite endless invitations from critics for the public to turn their back on it, they haven't" – is somewhat disingenuous. Faced with lurid warnings that failure to pay the licence fee might result in a criminal record, and that TV Licensing knows every address in the UK, there might just be a minor reluctance to engage in mass civil disobedience.

No doubt East Germany's leader, Erich Honecker, was heard boasting, before the Berlin Wall was pulled down, that not many East Berliners had tried to escape over the Wall, despite all the West's blandishments: ignoring the small matter of the trigger-happy snipers guarding the "death strip".

Nor is it much comfort when two-thirds of respondents to the ICM poll say they think the licence fee is good value. After all, why should one-third of homes have to subsidize the other two-thirds? Indeed, this sword cuts both ways. The higher the proportion satisfied with the deemed value of the licence fee, the stronger the argument for making payment voluntary. What is there to fear? Conversely, the lower the proportion satisfied, the harder is the case for keeping the fee compulsory.

The merits and disadvantages of the licence fee system, practical, political and ethical, have been argued exhaustively. The conclusion reached by our study group was that digital switchover offered the first opportunity for actually implementing a subscription mechanism for funding the BBC. We felt that such a switch would be good for the BBC, as well as paving the way for a more rational system of PSB supply.

What we did not foresee was how the steepening decline in the fortunes of the BBC's commercial rivals would expose the BBC's flank to a much wider range of critical attack. Channel 4's chairman recently complained that the BBC enjoyed £900 million a year more income than all its commercial terrestrial rivals combined, with the consequent crowding out effect growing as that surplus rose.

Less than twenty years ago, the revenue of ITV alone was double the BBC's, but today ITV's income is less than half the BBC's. That's the compounding effect of an above-inflation-proofed licence fee being applied to an ever increasing number of homes.

And it's not just size and wealth that worries the BBC's competitors: it is scope and scale. If you check the Sky EPG, you will find that the total number of services owned or controlled by the BBC is 51. Yes, 51.

The litany of complaints to which the BBC is subjected is legion. Executives are paid too much. Talent is paid too much. Brand and Ross are deeply offensive. The BBC is ageist. The Salford move is political correctness run wild. Fake competitions and copycat shows tarnish the BBC's good name. Scheduling Strictly Come Dancing against The X Factor is too competitive. A Muslim should not run the BBC's religious programming. Worldwide should not have been allowed to buy Lonely Planet. Because of the licence fee, everyone thinks they own a piece of the BBC, and have the right to whinge and pontificate. In such a culture of complaint and entitlement, what is most at risk is creativity.

Recently, BBC2's The Culture Show sent Greg Dyke to New York to talk to the creative heads of HBO, in order to discover their magic secret. HBO only produces about 80 hours of programming a year, but it is nearly all of the highest quality – particularly drama and comedy. The Sopranos, Sex and the City, Six Feet Under, Curb Your Enthusiasm, John Adams, Generation Kill, Flight of the Conchords, Entourage, Band of Brothers: all have been acclaimed and honoured.

The Wire, with its 60 hours of detailed, highly political and convincingly presented portraits of Baltimore, its police, its schools, its newspaper, its docks and its drug gangs, unsentimental yet deeply humane, is widely described as the best drama ever made for television. Putting aside the insufferable self-satisfaction of The Wire's creative team, it is hard to dispute that boast: there is no credible BBC counter-claimant.

Greg's interviewees gave a simple reason for their success: their funding mechanism. Dependent solely on subscription, HBO can take great creative risk. If subscribers don't like what they are getting, they can cancel. Writers, actors and directors flock to work for HBO. Nowhere in films or television is there so much creative freedom – certainly not at White City.

Subscription funding would raise many issues for the BBC. Would news, the Proms, children's programming, and their like still be provided in the absence of a compulsory licence fee? In my view, absolutely: they would be key attractions for potential subscribers. Would radio continue to be provided, on its present scale, and without any advertising, if the signals could not be encrypted? It is certainly possible, not least as a marketing strategy. Would the iPlayer continue to offer access to content straight after transmission? For subscribers, definitely: it would constitute a major benefit.

Would BBC news services be available without charge, either on television or the internet, as well as on radio? Of course: but a huge proportion of BBC online spending is nothing to do with news. Mark Thompson told The Guardian this month that he would rather the BBC was abolished than encrypt news to stop people seeing it. As Mr Winner might say, calm down, dear. Sky News and Sky Sports show how there is plenty of room for website news content in the clear, even if Sky charges for access to other content.

What level of public subsidy might a subscription-funded BBC seek from a contestable fund? There are plenty of candidates, of which radio and orchestras might be the strongest. Conversely, there would be normal competition concerns applied to this newly liberated organization. After all, the BBC is not only the nation's biggest broadcaster, but also owns its biggest production and distribution companies. Partial divestment of BBC Worldwide might not suffice.

Of course, there are many aspects of subscription which are unambiguously attractive: flexible charging for different levels of service, single-set households paying less than multi-set ones; the chance to launch specialist channels such as sport or music; above all, freedom to operate without every Tom, Dick, Ben Bradshaw and Jeremy Hunt opining on every aspect of your activities, which should be of concern to nobody other than your subscribers.

And perhaps there is one other benefit which last month's public haranguing would make particularly apposite. Missing from James Murdoch's diatribe was any reference to what one of his predecessors as Sky CEO – Sam Chisholm – called the "most honest form of broadcasting" – subscription. I suspect Sky would much rather focus on reducing the BBC's income and clout, than see it possibly become a formidable rival for revenue.

Especially threatening to Sky would be a successful transition of the BBC to subscription, followed by the BBC launching its own basic pay subscription card for satellite, onto which might piggyback the likes of UKTV, Discovery, NBC, and perhaps even re-launched pay-TV services from ITV, Channel 4 and Five. Sky derives an 85% profit margin from its basic tier service, and keeps most of its channel suppliers in a tight commercial arm-lock. If the BBC could loosen that grip, James Murdoch might look back on Edinburgh 2009 with very mixed feelings.

An important part of Sky's success has been its willingness to take on the competition authorities. Any investigation is resisted. Any adverse finding is challenged. Delay is a regular tactic. Nearly three years after the acquisition of 17.9% of ITV, Sky still holds the shares, despite a series of regulatory calls to divest.

Likewise, Sky has complied with the requirement to make its premium channels available to other retailers, but not at a price that makes any sense to them; and it is not required to make available the HD versions of those channels. Unsurprisingly, it concentrates its marketing on HD.

In Edinburgh, Murdoch was almost as scathing about Ofcom as about the BBC. Yet we should beware of taking his critique too seriously. This summer, Ofcom published a devastating report on Sky's premium channel pricing. It showed how Sky would be the biggest beneficiary from a 30% cut in its wholesale prices, as this would incentivize the likes of BT and Virgin Media to sell these services to their own customers, a far lower proportion of whom than Sky's customers take premium channels.

Jeremy Darroch, James Murdoch's successor as Sky CEO, last week asserted that Ofcom's investigation was misconceived. He made three errors in his counter-attack. First, the requirement for Sky to supply its premium channels came long ago from the OFT, not this summer from Ofcom. Ofcom was simply trying to deal with Sky's successful frustration of the requirement through its pricing policies.

Secondly, he revealed that he had been willing to comply with Ofcom's proposed pricing levels, if Ofcom had approved another Sky venture which had been ruled anti-competitive: as if to say, let me substitute one abuse for another.

And he ignored the most crucial evidence of abuse of a dominant position: Ofcom's revelation that Sky was seemingly willing to sacrifice hundreds of millions of pounds in profit, provided Virgin Media and BT – and their customers – also suffered. Sky is probably lucky that Hollywood studios have not filed collective suit for deliberately restricting their income, insofar as their revenues from Sky are related to the take-up of movie channels. Mr Darroch needs to re-read his Emerson: "the louder he spoke of his honour, the faster we counted the spoons".

James Murdoch is right to criticise our competition regime for its lack of bite: but in doing so he sounds like the burglar who bemoans the lack of bobbies on the beat. Curiously, he compares the German system favourably.

Yet when his immediate predecessor as Sky CEO, Tony Ball, in his role as chairman of the giant German cable company KDG, bought 18% of a rival, the German cartel office forced him to dispose of the shares within weeks, at a significant loss.

Of course, if the OFT, Ofcom or the Competition Commission had been similarly empowered, and Sky had been forced to divest its ITV stake quickly, it would have saved the company over £600 million pounds, as the shares have lost two thirds of their value since Murdoch and Darroch bought them, in a wheeze designed to frustrate a possible Virgin Media merger with ITV. Perhaps that £600 million explains the hankering after the German system.

James is also wrong to complain about the regularity – though not the over-elaborated content – of Ofcom's reviews of PSB. They are a requirement of the 2003 Communications Act. And although they might seem pettifogging to some, the monthly bulletins dealing with complaints and breaches of rules are actually very valuable.

There can have been few more excruciating days in the life of the BBC Trust than the publication of Ofcom's forensic report on fake BBC competitions, which revealed in detail all the instances that BBC management had withheld from the Trust's own inquiry, and which the Trust had been too trusting to dig out itself.

There is, I acknowledge, a difficulty, with regards to Ofcom. Although it regularly reports on specific types of programming that are recognized as PSB genres – children's, education, news, religion, arts, current affairs, regional – it actually adopted four years ago a methodology which blurs the distinction between these genres and the mass of broadcaster activity.

It decided, in 2005, to define PSB in terms of purposes and characteristics. As can be expected, these were rather like motherhood and apple pie. Purposes included supporting UK origination, stimulating learning and encouraging diversity and understanding of the world, whilst characteristics included innovation, challenge, high quality and engagement.

The result is that 100 pages of the latest Ofcom report on PSB are devoted to updating the supposed performance (according to audience research) of the various terrestrial channels as measured against the list of PSB purposes and characteristics. Nothing useful emerges from this analysis. One is tempted to adapt Oscar Wilde's definition of foxhunting: this is the insatiable in pursuit of the immaterial.

Indeed, I wonder if anyone stands back and asks how 20% of the latest sample can approve Channel 4's delivery of high quality children's programmes, when it broadcasts none; or how 31% can approve Five's delivery of high quality UK originated soap and drama, when – apart from Minder – it broadcasts none. Although Ofcom may classify the Australian soaps, Home and Away and Neighbours, as UK origination because Five pays so much for them, no viewer would do so.

Another complaint from James was that Ofcom spends too much time on policy, rather than restricting itself to research and analysis. This seems to me a negligible point. Policy is for politicians. For Ofcom to draw conclusions from its analyses is only natural, and probably desirable, given the low status and limited skills of that Cinderella of Whitehall, the DCMS.

In fact, far from trying to determine policy, Ofcom's most recent review of PSB seemed, if anything, to have been hi-jacked by ministers in key respects; such as the quixotic idea, elaborated in Lord Carter's Digital Britain report, that the best way to preserve an alternative PSB supplier to the BBC was – to house Channel 4 within the BBC!

The much-vaunted joint venture between Channel 4 and BBC Worldwide has yet to materialize, nearly a year after first being touted as a done deal. Indeed, its main proponent within Channel 4, chief executive Andy Duncan, looks likely to exit Horseferry Road before he can bring it to fruition. Yet perhaps the most troubling aspect of this attempted tie-up is the clue it gives as to the mind-set of ministers and regulators. The search for a sticking plaster solution to institutional problems is typical of a backward-looking approach to PSB, which is increasingly unsuited to a rapidly changing broadcast environment.

The creation of Channel 4, in its time, was the brilliant and surprising act of a newly elected Conservative government. However, the ingenious structure which enabled Channel 4 to become so successful – a small executive, dispensing a budget provided by ITV in exchange for selling Channel 4's airtime – was subsequently dismantled by the 1990 Broadcasting Act and the 2003 Communications Act. The first turned Channel 4 into a self-owned corporation, far less accountable to its regulator. The second allowed all the careful protections built into previous legislation to be sloughed off, with predictable consequences.

The 1990 Act permitted Channel 4 to sell its own airtime, which it did with great success. But it also required Channel 4 to hand over to ITV 50% of its surplus revenues, whilst retaining 25% in a statutory reserve, which could only be spent with ministerial approval.

To begin with, much of the benefit of Channel 4's sales success was soaked up by the ITV funding formula, until a determined campaign dislodged ITV from the equation. However, despite publishing, year after year, a whole series of promises to spend those recovered revenues on programming, Channel 4 in 1998 instead embarked on a strategy of diversification. This was driven by the then Chief Executive, Michael Jackson, who had decided PSB was old-fashioned, and sought to turn Channel 4 into what he called a multi-faceted media corporation.

From the start, this initiative faced legal challenges. The most important was from a leading media QC, who submitted an opinion that it was arguably illegal for new services like E4 and Film Four to be funded by Channel 4 without written ministerial permission.

Channel 4 tried to claim that a clause in the 1990 legislation allowed the Corporation to assist non-core services that were "incidental or conducive" to the main purpose of the Corporation, which was to protect the Channel 4 service itself. However, this broad permissive language clearly did not over-ride the very specific protections built into the Act: otherwise, why would Parliament have included them? Ministers and regulators had turned a blind eye to Channel 4's behaviour, but this authoritative opinion was hard to ignore.

So the Labour government, which had been noisily persuaded to abolish the ITV funding formula, now acceded to another – much more covert – Channel 4 campaign. The 2003 Communications Act removed all the restrictive clauses, and for good measure, also abolished the statutory reserve, so releasing an accumulated £84 million.

Under Michael Jackson – and to a lesser extent under his successors – Channel 4 has squandered the best part of £300 million on non-core activities: nearly all its accumulated post-tax profits since 1990.

The Film Four production and distribution companies lost £40 million before being closed. Attheraces cost Channel 4 £23.3 million before it withdrew from the venture. The pay-TV channels – E4 and Film Four – suffered from poorly designed business models, and lost over £160 million before allegedly reaching breakeven after a decade.

Meanwhile, to sustain this diversification strategy, staff numbers almost doubled, to 1200, and staff costs grew to five times the 1990 level. Even today, after successive slimming exercises, Channel 4's 900 employees cost £66 million last year, or on average £73,000 per annum each, which for many people is for a 4-day week, as Fridays are "flexible".

80 of the staff earn over £100,000 a year. The three top executives cost Channel 4 £4.8 million over the last two years – more than twice as much as the Corporation's total profits.

Only 200 of Channel 4's staff actually work on commissioning and scheduling. There are 21 in strategy, 24 in marketing, 41 in press and PR, 43 in IT, 65 in finance, 113 in sales – and over 300 in digital businesses. The Corporation spent over £40 million on marketing last year, and £18 million on business development and research. £5 million was written off on "onerous contracts" and £16 million on failed programmes and developments.

For four years, Channel 4 has been pleading poverty, forecasting annual deficits of over £100 million in the near future, and asking for either part of the licence fee or access to the BBC's assets: top-slicing or bottom-slicing, as the BBC puts it. Yet it was still able to spend over £29 million in 2007 on a half-share in EMAP's music channels, seemingly ignoring the intense pressure on margins in that sector. £1 million went on a failed speech radio station, followed by further undisclosed millions on the 4Radio digital venture, subsequently abandoned.

Last March, Channel 4 spent £500,000 on 50% of a website, written off within 8 months when its joint venture partner went bust. Life One Broadcasting was bought in 2007 for £3.6 million, which was promptly written off – Channel 4 had only wanted its EPG slots. Ostrich Media absorbed £500,000 before it closed, Popworld £200,000 and Fingertip Software £1.5 million. Project Kangaroo cost £6.4 million before being abandoned.

According to the Corporation's most recent accounts, at least there was one piece of good news – the digital channels were at last making a profit, reportedly £41 million, in contrast with an apparent £7 million loss at Channel 4 itself. However, this reported loss was engineered by excluding £22 million of Channel 4 income from rights and interest.

Moreover, under "other operating expenditure" of £36.4 million, the accounts attribute 97% of such costs to Channel 4, and just 3% to the 11 digital channels. Similarly, with indirect costs and cost of sales, 85% of the total is attributed to Channel 4 alone. These allocations are, frankly, unconvincing.

The balance sheet confirms suspicions. The supposedly profitable businesses within the Corporation, other than Channel 4, turn out to have assets of just £7 million and liabilities of £64 million. Buried in a footnote is an internal liability of £92 million. This was only revealed to be a debt from the digital channels to Channel 4 when executives admitted so to Parliament, after being congratulated on the apparently "phenomenal profitability" of the digital channels.

It is not just the woeful financial performance of the new ventures that causes concern. They constitute a major distraction from Channel 4's core purpose: contributing to PSB. In joining the general switch by terrestrial channels towards the attractions of Freeview, Channel 4 has shifted not just resource but also audience to the non-PSB side of its activities.

For 20 years, Channel 4 averaged a 10% audience share, despite the steady rise of multi-channel competition. Last year, it achieved its lowest audience share since 1986 – 8.2% – whilst its digital services surged to 3.7%. Half their recent growth in share has been at the expense of Channel 4 – which is the only one of the Corporation's services with a specific PSB remit.

Channel 4's accounts reveal that only £153 million of its £500 million programme budget is spent on core PSB. Given that PSB content is unlikely to achieve a higher audience share than non-PSB content, we can conclude that at most one-sixth of the Channel 4 portfolio's viewing share is to core PSB content: less than 2%. What we have is a small public service dog being wagged by a very large commercial tail.

Despite this, despite the pleas of poverty, despite the calls for public support, Channel 4's board this summer reportedly allowed management to bid £100 million for the 11 wholly commercial Virgin Media channels, which – if the bid had not failed – would have left the one PSB channel surrounded by 22 non-PSB channels. Surely by now it is apparent that Channel 4 needs not just a new chairman and a new chief executive, but a new board, new governance, a new remit and a new start.

If Channel 4 sold off its non-PSB channels, and concentrated on its core purpose, it could dramatically reduce staff and costs. If it entered into a joint venture with Five, it could save tens of millions a year in addition. There is no reason why Channel 4 should not continue to play its core role for many, many years, if it just abandoned its delusions of grandeur, for which all board members of the last decade carry some responsibility.

The most recent delusion, running alongside the will'o'the'wisp of the BBC Worldwide deal, was the proposed joint airtime sales venture with Sky. Given the Competition Commission's rejection of any significant easing of restrictions on ITV airtime sales, it is likely they will give short shrift to a combination controlling an even larger market share. It was sad to see Channel 4 suckered into yet another Sky diversionary tactic, designed to head off a possible sales deal between Channel 4 and Five.

Yet politicians – and Ofcom – seem reluctant to give up the institutional fix which is their knee-jerk response to perceived problems. There may well be a shortage of children's origination: but there is no reason to fund Channel 4 to plug the gap, given that it has shown no interest in children's programming for 27 years. Likewise, all kinds of Internet projects might justify £50m of public funding: but there is no reason at all to funnel it through Channel 4.

Understandably, Ofcom can only work with the tools it has been given. It has been charged by statute with monitoring and protecting PSB, but has almost no influence over the BBC, which is responsible for over 90% of PSB content. Even the PSB it is required to monitor does not include radio, where far more than 90% of the public service content comes from the BBC, yet no-one – including Ofcom – has ever raised any issues about plurality of supply in radio.

Ofcom's first review of PSB concluded that a new institution, the Public Service Publisher, might be the answer to the structural changes in PSB supply. Despite successive re-workings, that concept has now been shelved – in my view, sensibly. Likewise, the concept of a contestable PSB fund, which our study group proposed in 2004, and which Ofcom rejected then, has now become the preferred means of intervention to plug the gaps in PSB supply – again, sensibly.

But by now questions must arise as to whether replacing an expensive ITV regional news service, even with a less expensive version, is the best way to prioritise scarce resources. And the proposed support for more UK originated children's programmes smacks of a well-orchestrated producer lobby pushing to the head of the queue.

For the funding of any intervention, Ofcom looks primarily to a slice of the licence fee, even though it has published this week a prediction that the rising scale of losses on regional news could drive ITV to dump that main PSB obligation a year or more before the digital switchover monies become available.

So it seems to me a great pity that so much political and bureaucratic blood is being spilled over less than 4% of the licence fee, when the key issues – of whether, how and to what degree the public should fund content which the market fails to supply in sufficient volume – need a far more fundamental structural approach.

Ofcom cited this week 20 years of research showing that the BBC could easily survive the switch to subscription; but itself clings to the licence fee. Hard-headed realism? Or blinkered institutional mentality?

What is the thread that draws together all that I have said, about digital terrestrial television, the BBC, the licence fee, Sky, Channel 4 and Ofcom? It is simply this: we grew up with a controlled and licensed broadcasting system which, by its very limited nature, delivered and constituted public service broadcasting. Those conditions have disappeared, but the corporatist mind-set has not. Incumbent privileges are the rule. That Sky was able to overcome them has, paradoxically, given it a first mover advantage that has become almost impossible to dislodge.

The BBC was a corporate creature of the 1920's – the age of the Forestry Commission and the London County Council. Channel 4 became a corporate creature in the 1990s. Even ITV is a child of regulation. The habit of control is hard to break. The 2003 Communications Act that created Ofcom spoke of citizens and consumers, but in broadcasting the balance is askew.

What we need is a much stronger competition regime, and a fair and transparently financed broadcasting structure. That will allow consumer consent and choice to play their proper role, and creativity to flow freely.

In turn, that will enable us to identify the need, and the means, to intervene in broadcasting for public service purposes, in the right context.

In the end, it will be politicians, not regulators, who decide. But the present government is never going to get its head around the simple proposition that funding Newsnight through a universal and regressive tax is unjust, and funding EastEnders by a compulsory charge is unnecessary. Perhaps an incoming Conservative administration will prove as radical as the last one, thirty years ago, which abandoned its manifesto commitment to an ITV2 and boldly embraced the then innovative Channel 4. Perhaps.

Re-shaping the BBC's funding, and re-imagining public service broadcasting in the digital age, are obverse sides of the same coin. The forthcoming election could not be more timely in creating an opportunity for decisive action. Let us hope the electors, and the elected, get it right.

David Elstein 24 September 2009