Taxes, Local Journalism, and Transition to the Public Sector

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In the wake of corporate consolidation and the ascendency of the internet, newspapers and other media outlets have been unable to maintain their levels of investigative and local reporting. A decline in the availability of reliable local news coverage is likely to result in a less-informed citizenry and may directly impact the health of the democracy. The Knight Commission hopes to alleviate this concern by recommending public and private measures designed to help communities meet their information needs.[1] This memorandum focuses on six proposals for tax reform that, if adopted, would further the Commission's pursuit of its goal. Specifically, the report recommends a state sales tax exemption for print and online journalism subscriptions, a federal tax credit for the support of investigative journalism, permissive joint operation of for-profit and not-for-profit journalism enterprises within the federal tax exemption regime, amendment of the deduction limitations for contribution of a newspaper business to a not-for-profit organization, deferral of gain in taxable acquisitions of newspapers by not-for-profit organizations, and permissive use of tax-exempt conduit bond financing in such acquisitions. Each of these recommended measures is meant to alleviate the tax burden on struggling organizations.

I. Shifting the subsidization of subscription and journalism costs

Traditionally, the bulk of print journalism revenue came from its sale of advertising. This stream of income allowed newspapers to both pay reporters and charge less for subscriptions. In effect, advertising revenue subsidized the creation and public consumption of newspapers and other news periodicals. This relationship was made possible by the highly inefficient nature of print advertising. Advertisers who did not have access a tailored medium, such as a trade journal, could be assured the greatest chance of reaching their target audiences through a broadly distributed publication. News publications were one such choice.

Technological advancement has placed the traditional advertising subsidy in flux. First and foremost, internet news publication has resulted in decreased demand for print editions of news periodicals. This, in turn, has decreased the relevance and profitability of print advertising. Second, the resulting deficit has not been covered by the migration of advertising to online editions of newspapers. Using data collection, advertising firms are now able to track particular consumers' demographic data, browsing habits and personal preferences. As a result, niche businesses with target audiences are no longer

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[1] *See* http://www.knightcomm.org/background.

required to take a blunderbuss approach to advertising. Instead, they may purchase it on websites of broad interest but may specify that it only be shown to their chosen demographic. They may also seek out niche sites, which have proliferated with increased public internet literacy. Or they may specify that they will only pay for advertisements to which the audience responds by clicking. Each of these new forms of targeted marketing are made possible by advances in technology, and each one vitiates the need for businesses to announce their services and wares to literally everyone who reads the news. Reduced ad revenue has been the natural result of these advances.

Technological advancements in advertising have not reduced newspapers' revenue stream in isolation. The lack of geographical restraints on the distribution of internet content has increased competition for a limited pool of advertising dollars. Customers who formerly subscribed to the Cleveland Plain Dealer may now read the Chicago Tribune with similar ease. Furthermore, because internet publication is essentially costless, it has allowed individuals and small organizations to compete on equal footing with large ones. As a result, an astonishing array of blogs and other independent content providers compete with news periodicals for advertising revenue. In essence, the end result for local news in many parts of the country may be a trade-off between quality and quantity. By reducing and diffusing advertising revenue, technological advance has hobbled the ability of news organizations to provide independent investigative reporting on issues of local interest.

There is no immediate reason for this trend to reverse. Consequently, one might expect newspapers to increase the cost of subscription. This has proven difficult because online content is available for free. Nonetheless, good journalism is costly. In order to sustain it, newspapers must be able to replace lost advertising revenue. Because journalism is a public good that presumably results in positive externalities even to those who do not consume it, some level of public subsidy is appropriate.[2] This report focuses the subsidization of journalism through the tax system.

II. State sales tax exemption for print and online subscriptions to news content

One way in which governments can aid the provision of journalism is through enactment of state and local sales tax exemptions. Although simple, this measure could replace a portion of the revenue formerly derived from advertising. Unlike a direct government subsidy, however, the benefit of a sales tax exemption is nominally bestowed on the consumer rather than the producer. As a result, sales tax exemption would not raise questions of editorial independence or undue government influence. The exemption could have a beneficial effect in at least two other ways. First, a lower out-of-pocket cost to subscribers could encourage additional customer subscriptions and result in increased revenue.[3] Alternatively, newspapers could charge more for their product in the absence

[2] If a substantial portion of the citizenry is adequately informed, it is not only likely to spread information to journalism non-consumers, but also to make better election and political participation decisions. These effects should result in a more informed electorate, as well as more interested local candidates, appointees and volunteers.
[3] This, of course, assumes that some potential customers refrain from buying the news periodicals due to their cost, rather than reasons such as environmental concern or greater convenience of online access.

of a tax, which would also produce more revenue.[4] The success of either route would depend in large part on consumer reaction to changes in price, but even if neither came to fruition, enactment of a sales tax exemption would still serve an important function: it would act as a signaling mechanism. News coverage of the exemption would carry journalism's critical situation into the public debate and would function as a free form of advertising for local news outlets. By granting an exemption, states would clearly acknowledge journalism as both a public good and a priority in governance, possibly setting the stage for journalism's move from the private sphere into the public one.

III. Refundable tax credit for investigative journalism

A second simple way in which government could aid journalism is the enactment of a refundable federal or state tax credit for the support of investigative reporting. Unlike a sales tax exemption, the benefit of such a credit would accrue directly and immediately to news organizations. Unlike a deduction for donor contributions to news organizations, the credit would be equally available to all publications and would not make subsidization dependent upon donor preference.[5] Finally, in economic terms, a refundable credit is a more efficient subsidy than either a sales tax exemption or a deduction for donor contributions. It does, however, raise the specter of undue government influence upon the editorial process. Accordingly, the statutory guidelines for eligibility would have to be meticulously drafted, and responsibility for administration of the credit would have to be entrusted to non-partisan administrators.

Investigative journalism is an appropriate target for a tax credit for a number of reasons. First, in recent years, news organizations have been unable or unwilling to sustain their previous levels of investigative reporting. Such journalism requires a much greater investment of time and resources than other forms of journalism, and it is not guaranteed to produce useful or profitable material. As a result, smaller news periodicals

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[4] The relevant assumption in this case is that customers account for tax when internalizing the price of purchased items. If customers react only to an item's sticker price, as some researchers have suggested, a higher stated price may dissuade some customers from purchasing the paper despite the fact that its actual cost has not changed.

[5] For all but the most popular news organizations, providing a federal tax deduction to news organization donors would be redundant in light of the proposed tax credit. It is likely that the legislature would enact one, but not both, proposals. A tax credit is preferable for a number of reasons. First, it would apply to any organization that met the specified statutory requirements, so its availability would not depend upon the popularity of the organization claiming it. Large, small, popular and unpopular organizations would be placed on equal footing under a credit system but not under a donor deduction system. Second, a deduction meant to incentivize donation would likely affect only relatively wealthy people who itemize; therefore, any subsidy provided by the deduction would be fiscally regressive. Wealthy taxpayers who itemize their deductions are already over-represented in the tax system and in the government generally. A tax credit would not increase this disparity, but a donor deduction would. Third, the credit can be tied directly to investigative reporting, whereas tying the use of a deductible donor contribution to investigative reporting would require an additional layer of regulation and oversight. This would make the deduction more inefficient than the credit from an economic standpoint. Finally, from a news organization's perspective, the credit guarantees cash in hand, but a deduction provided to donors does not. The credit provides a greater degree of budgetary certainty, so a news organization could comfortably expend resources with the full knowledge that it would be partially reimbursed. A deduction does not provide similar comfort. For these reasons, this report recommends a credit in lieu of a deduction.

that struggle with finances are less able to support it. Furthermore, news periodicals that belong to a corporate conglomerate may not be permitted to engage in it if the board of directors focuses heavily on its duty to maximize shareholder profits. Nonetheless, investigate journalism serves vital democratic functions, first as a societal educator and watchdog, and second as a deterrent of bad government, business and institutional behavior. A tax credit would provide both a reward and an incentive for private production of these positive externalities. As a result, the enactment of a credit would not be inappropriate from a policy perspective.

Finally, the burden placed upon taxpayers by such a credit is likely to be limited by the natural transition of news periodicals into web-based multimedia operations whose revenue is derived from something other than simple ad hosting. News periodicals' current business model is unsustainable. In order to survive, these businesses must evolve, perhaps by transferring part or all of their function from the private into the public sector. A tax credit would smooth this transition by providing news organizations with an incentive to maintain at least a portion of the talent pool. After all, investigative journalism cannot exist without trained journalists. Once the transition to a new business model is complete, the credit is likely to be unnecessary, either because news outlets have harnessed a new source of revenue or because, as members of the public sector, they are no longer fully taxable.

IV. Joint operation between for-profit and not-for-profit journalism enterprises

A. Current restrictions on joint operation

It is currently possible for not-for-profit enterprises to operate jointly with for-profit ones, but the tax law makes these operations difficult. Joint ventures which take the form of separate business entities or of contractual joint operating agreements must pass a "close scrutiny" test to avoid jeopardizing the not-for-profit organization's tax exempt status.[6] The arrangement, however structured, must not pit the not-for-profit organization's charitable mission against its duty as a business owner to maximize the profit available for distribution to its venture partners.[7] The Internal Revenue Service has named three factors that are indicative of a satisfactory relationship.[8] First, the venture must serve an exempt purpose.[9] Second, if the not-for-profit organization is a general partner (meaning that it is exposed to liability and participates in management), the organization's activities must be substantially related to the charitable purpose of the not-for-profit organization.[10] Finally, the benefits received by the non-exempt partners must be incidental to the exempt purpose of the venture.[11]

Although the concept of charitably oriented joint ventures seems simple in the abstract, it has been a subject of both litigation and uncertainty. As a consequence, these

[6] GCM 37852 (1979).
[7] *Id*.
[8] GCM 39005 (1982).
[9] *Id*.
[10] *Id.*
[11] *Id*.

ventures are expensive to form and operate. Furthermore, they are the subject of heightened attention from the Internal Revenue Service.[12] Even worse, the statutes and regulations applicable to not-for-profit organizations that are private foundations create an added layer of complexity in joint ventures, both as participants and as passive investors. The statutory and regulatory restrictions reinforce a false dichotomy between the public and private sectors when, in fact, the objectives of both could be furthered by laws recognizing the very real and significant overlap and potential synergy between the two.[13] In other words, existing laws discourage what would otherwise be the organic formation of mutually beneficial partnerships between non-profit and for-profit enterprises.

B. Social Benefit Enterprises

1. Low-Profit Limited Liability Company

State and federal law should recognize the value of for-profit/not-for-profit ventures. These collaborations generally occur through a joint venture, the operating agreement of which is tailored to comply with federal regulatory tax burdens placed on the non-profit member. These agreements are cumbersome, costly to draft, and severely restricted by the Internal Revenue Service. As a result, a grass roots movement has arisen among not-for-profit enterprises seeking better alternatives to existing business forms. Referred to by various names, these new forms of business would be managed in accordance with a charitable mission contained in the operating agreement. As a result, the restrictive fiduciary duty to maximize profit applicable to the directors and officers of for-profit enterprises would no longer be of concern.

Vermont is the first state to have created a non-profit/for-profit hybrid entity. The low-profit limited liability company, or L3C, operates according to an explicitly stated charitable mission, with profit as a secondary concern.[14] It is hoped that L3Cs will overtly qualify as program related investments for private foundations without resort to the expensive and time consuming Internal Revenue Service private letter ruling process.[15] This would make them ideally situated to receive funds from private foundations and would provide foundations with outlets for charitably oriented investment that may also turn a profit.

As yet, it is unclear how the Internal Revenue Service will react to the L3C. It is, in essence, a partnership and should be taxed as one in the absence of statutory amendments. So long as the entity does not elect to be taxed as a corporation, its income and loss will be passed through to its members, who will be taxed as though they earned the income and loss directly. Essentially, this means that the earnings of tax-exempt members will only be taxed to the extent that the income is unrelated business income, while the earnings of for-profit and individual members will be taxed at those members' ordinary rates.

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[12] *See e.g,* Announcement 92-83, 1992-22 I.R.B. 59, § 333.4.
[13] For a good example, we need only look to ProPublica.
[14] 11 V.S.A. § 3001(23).
[15] Nicole Wallace, *New Business-Charity Hybrid Sought*, The Chronicle of Philanthropy (March 2008).

In a fully-functioning business, such as a newspaper, the partnership allocation of gains and losses among the for-profit and non-profit members is likely to be extremely complex and may raise questions of substantial economic effect with the Internal Revenue Service. Ideally, Congress or the Treasury Department will recognize the unique status of the L3C as a facilitator of for-profit/non-profit collaboration and will not hamper the usefulness of the structure as a bridge between those two large financial sectors. One potential solution would be to create a special designation for the L3C within the Internal Revenue Code and the corresponding Treasury Regulations that would outline permissible boundaries for the allocation of gains and losses by tying those allocations to particular investment tiers within the entity. In the alternative, state or federal laws could greatly simplify tax analysis by requiring the allocation of gain and loss according to the member's interest in the entity, as well as requiring for-profit members to periodically restore their negative capital account balances, if any. A third solution would be an amendment to the L3C statutory language to allow a series LLC approach using tranched ownership interests, which would protect the charitable organization to a greater extent under the Internal Revenue Service's joint venture rules. The issue is extremely complex and its analysis would require a great deal of additional time and effort. This report recommends an additional in-depth evaluation of the current tax implications and potential amendments to the Internal Revenue Code. Although it is a beneficial first step, simple adoption of the L3C statute by states will not entirely remedy the federal tax barriers to for-profit/not-for-profit joint ventures. Additional work is needed.

2. England's Community Interest Company

England's community interest company, or CIC, is another form of social benefit enterprise. Like the L3C, the CIC is a for-profit company dedicated to pursuit of a social mission.[16] Also, like the L3C, the CIC is meant to spur philanthropic investment.[17] There are, however, some fundamental differences between the two entities. First, the government has proposed a limitation on equity finance of the CIC, preferring instead that the enterprises be funded through grants, tax credits and low-interest loans.[18] Second, CICs are subject to an "asset lock."[19] The relevant law requires all of the assets of the CIC to be used for the benefit of the community.[20] This prevents CICs from distributing their assets, including profits, to their members except to the extent permitted by rules applicable to the organization's equity interests.[21] Equity investors' returns are duly limited: both dividend and overall returns on equity interests in CICs are capped.[22]

[16] *See* Frequently Asked Questions for Community Interest Companies, available at http://www.cicregulator.gov.uk/faq.shtml.
[17] *Id.*
[18] *Id.*
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.*

Finally, CICs are more transparent than L3Cs. They are required to file reports annually that describe their use of funds and their activities within the community.[23]

This form of business, which is designed to aid philanthropic entrepreneurs, would fit nicely within the United States statutory and regulatory framework and possess benefits that the L3C does not. Because a CIC's for-profit equity interest is limited and its assets are statutorily locked for furtherance of the organization's social mission, the CIC would make a nearly ideal vehicle for joint ventures from a United States tax perspective. In addition, the CIC mimics the aspects of the L3C that make the entity attractive to private foundations searching for program related investments. This report enthusiastically recommends further consideration of the community interest company for possible incorporation into the existing state and federal statutory regime.

V. Amended deduction for the contribution of newspaper businesses to not-for-profit organizations

Another way in which Congress could ease the transition of willing news periodicals moving from the private to the public sector is to provide an unlimited deduction for contributions of controlling interests in newspapers to not-for-profit organizations. Under the current Internal Revenue Code, deductions for charitable contributions are generally limited to 50% of an individual's "contribution base,"[24] but contributions of appreciated capital property are limited further and may not exceed30% of an individual's contribution base.[25] Deductions by corporations are generally limited to 10% of their income.[26] Although the non-deductible portion of a charitable contribution may carry forward into a future year, the carry-forward may be of limited use depending upon the interplay of the taxpayer's income, other deductions, credits, and in some cases, the alternative minimum tax. The charitable deduction, then, is at best an impartial and flawed incentive for the contribution of news periodical businesses to not-for-profit organizations.

To make such contributions more attractive, Congress should consider revising its deductible contribution limitations when those limitations apply to the transfer of a controlling interest in a newspaper to a not-for-profit organization. Although a full deduction with a generous carry forward period would be ideal, even a fifty percent across-the-board deduction would be an improvement. The amended limitation should be made applicable to both individuals and corporations, since both of these groups are likely to be among donors to whom the current limitations apply. In addition, Congress should coordinate the amended limitation for individuals with a revision of the alternative minimum tax. Unless the two are amended in concert, revision of the deduction

[23] *See* Overview of a Community Interest Company at 7, available at http://www.cicregulator.gov.uk/Leaflets/OverviewLeafletMarch2008.pdf.
[24] 26 U.S.C. § 170(b)(1)(A). The contribution base is generally the taxpayer's adjusted gross income calculated without regard to net operating loss carrybacks. *See* 26 U.S.C. § 170(b)(1)(G).
[25] 26 U.S.C. § 170(b)(1)(c).
[26] 26 U.S.C. § 170(b)(2).

limitations might be rendered moot by the AMT.[27] If enacted, these amendments would provide a fuller, more effective incentive for the contribution of ownership interests in news organizations to not-for-profit corporations.

VI. Deferral of gain in taxable acquisition of newspapers by not-for-profit organizations

Even if the limitation on deductions is amended as described above, the vast majority of news periodical owners will want to sell their businesses rather than contribute them, and most will try to pay as little tax as possible. Generally, this will mean trading an ownership interest in a news organization for an ownership interest in another business through tax free reorganization. Not-for-profit acquirers of news organizations are at an inherent disadvantage relative to for-profit acquirers. This is because news organizations are often in corporate solution, and it is difficult to conduct a tax free corporate reorganization with a not-for-profit acquirer. Conversely, it is relatively easy to conduct a tax free acquisition with a for-profit acquirer, particularly if that acquirer is a corporate conglomerate. One way to encourage the transfer of news organizations to not-for-profit enterprises would be to level the taxable acquisition playing field. This could be done by deferring the taxable gain realized by the sellers of news organizations, just as would be done in a tax free corporate reorganization.

This idea finds some purchase in existing law. The Internal Revenue Code contains a number of provisions that allow tax free transfer of individual assets or entire businesses. The motivation behind many of these provisions is that taxpayers who exchange one interest for another have not withdrawn their capital investment from the marketplace but have merely changed its form. For instance, when the shareholders of one corporation exchange their stock for shares of another corporation, the exchange is generally not taxable. Likewise, when the holder of an asset exchanges it for an asset of like kind, the exchange is usually free from taxation. In both of these instances, the owner of the exchanged item defers its taxable gain by transferring the basis of the old asset or stock to the new asset or stock.

When a not-for-profit enterprise acquires a news organization from its for-profit owners, the situation is much different. In all likelihood, the not-for-profit enterprise will have neither stock, nor assets of a like kind, to exchange with the news organization's original owners. Instead, the acquisition is likely to be a sale for cash and debt. Because the news organization's owners will have withdrawn their capital from the marketplace instead of simply changing the form of their investment, they will be fully taxed on any gain inherent in their ownership interests. This difference in the character of the two transactions presents a conceptual difficulty if one's goal is to create tax parity between for-profit and not-for-profit acquirers of newspapers.

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[27] Under 26 U.S.C. § 56(b), taxpayers may not claim miscellaneous itemized deductions when computing their alternative minimum taxable income. Section 67(b)(4) of the Internal Revenue Code specifies that charitable deductions are miscellaneous itemized deductions. In all likelihood, a taxpayer who deducts in excess of 30% of his or her adjusted gross income will be subject to the alternative minimum tax, so tandem amendments would be necessary to make an increased deductible contribution limit meaningful.

The tax treatment of involuntary conversions presents a more apt framework for tax relief. Under section 1033 of the Internal Revenue Code, if property is compulsorily or involuntarily converted into cash as a result of destruction, theft, seizure, requisition or condemnation, the property owner may reinvest the proceeds in similar property without recognizing the gain which was inherent in the converted property. Although a news organization acquired by a not-for-profit enterprise is not requisitioned per se, it is transferred from private ownership into the public sector, a result the effect of which is not wholly unlike the government's exercise of eminent domain through condemnation proceedings.

Using section 1033 as a template, Congress could defer taxable gain on the acquisition of a news organization by a not-for-profit enterprise if the news organization's original owners reinvested proceeds of the acquisition into the stock or assets of another media outlet. The timing and basis provisions of section 1033 would still apply. Under the statute, reinvestment would have to occur within three years of the close of the taxable year of the acquisition, and the basis of the newly acquired interest would equal the basis of the transferred interest. The resulting effect would be deferral of recognition of taxable gain roughly equivalent to that produced by a tax free corporate reorganization or the exchange of like-kind property. This would put not-for-profit organizations on equal footing with for-profit corporations in news organization acquisition deals and would increase the likelihood that owners would be willing to transfer their interests to not-for-profits organizations.

VII. Tax exempt bond financing in not-for-profit acquisition of newspapers

Although enactment of the foregoing recommendation could make owners of news organizations more willing to sell, only a select few not-for-profit organizations will actually have the resources needed to buy. Organizations without the necessary endowment will be forced to borrow. In this situation, not-for-profit organizations are once again disadvantaged relative to for-profit organizations. For-profit organizations are generally able to deduct interest payments from their adjusted gross income, which makes the overall cost of borrowing lower. An interest deduction is not valuable to not-for-profit organizations, and while some might say that this is a small price to pay for overall tax exemption, it nonetheless raises the effective cost of not-for-profit borrowing.

This inequality could be remedied by allowing not-for-profit acquirers to use the proceeds of tax exempt bond financing. Tax exempt bonds typically bear a lower interest rate than taxable ones, which would increase not-for-profit acquirers' ability to borrow. Access to this type of financing would actually over compensate not-for-profit acquirers, placing them on better footing than their for-profit competitors.[28] A second, less drastic alternative would be a tax reduced bond, although no ready corollary exists in the current Internal Revenue Code.

[28] From a pure tax policy perspective, the disparate result is not desirable. Nonetheless, it would undoubtedly further the interests of not-for-profit acquirers, who would produce a public good with the proceeds. For profit borrowers, who have a fiduciary duty to maximize profit, may not contribute to the same extent. From this standpoint, the uneven playing field less objectionable.

The federal government permits the use of tax exempt bond financing in a number of other areas involving quasi-governmental and charitable institutions. For instance, tax exempt bonds may be used to pay for airports, docks, sewage facilities, low income housing, transportation and energy facilities, student loans, and hospitals.[29] In fact, the Internal Revenue Code explicitly grants charitable organizations access to tax exempt bond financing if they are described in section 501(c)(3) of the Code.[30] Some news organizations may qualify for this status, but many will not. As a result, if the acquisition of news organizations by not-for-profit organizations is found to be desirable and feasible, Congress should consider other ways in which to explicitly provide tax exempt bond financing to not-for-profit acquirers, regardless of which section 501 category applies to them.

A number of possibilities exist. Congress could create a new category of bond tailored toward the not-for-profit acquisition of news organizations. This solution is neither likely nor efficient, since a statutory framework already exists in so many other contexts. Congress could also explicitly state that news organizations are considered charitable for purposes of section 501(c)(3). This solution is also unlikely because there is no policy basis for exempting all news publishers from taxation. Furthermore, there is currently a functioning dichotomy between for-profit publishers, who actively conduct their operations to maximize profit, and not-for-profit publishers, who operate within strict statutory and regulatory guidelines in exchange for exemption. The most workable solution, then, is the addition of a news periodical category to section 145 of the Code, which provides tax exempt bond financing for organizations described in section 501(c)(3). The added language could specify that not-for-profit organizations meeting certain criteria would be treated as organizations described in section 501(c)(3) solely for the purpose of obtaining tax exempt bond financing under section 145. Such language would make borrowed funds more accessible to not-for-profit acquirers of news periodicals without subjecting them to the full range of restrictions applicable to section 501(c)(3) charities. This, in turn, may encourage the transition of some news organizations from the private into the public sector.

VIII. Conclusion

There are a number of ways in which Congress and state legislatures might aid the distribution of information within communities through corporate, antitrust, communications and other laws. The proposals in this report focus only upon a few of many possible changes to existing tax rules. At least six possibilities present themselves: state sales tax exemption of news products; the provision of a tax credit for investigative journalism; facilitating the collaboration of for-profit and not-for-profit news organizations; removing the deduction limitation for the contribution of ownership interests in news organizations to not-for-profit organizations; deferring taxable gain on the sale of news organizations to not-for-profit organizations, and finally, ensuring that tax exempt bond financing is available to not-for-profit purchasers. These six proposals would aid traditional news periodicals as they transition to a new business model, or

[29] *See* 26 U.S.C. §§ 141 – 153.
[30] *See* 26 U.S.C. § 145.

perhaps to an entirely new sector of the economy. The availability of local journalism is undoubtedly a public good that provides positive externalities even to those members of the public who do not consume it. Accordingly, it would be fitting to move local journalism, which is threatened in the current regulatory and business climate, into the public sector. These proposals are one step in that direction.

The Pixelization of Journalism

by Charles M. Firestone

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http://www.huffingtonpost.com/charles-m-firestone/the-pixelization-of-journ_b_557318.html

The journalism industry is in turmoil. The digital revolution has hit content providers of all kinds, changing their business models and in some cases altering the nature of the underlying content itself. Music has seen this most starkly. But print content, most particularly newspapers, have also faced significant disruption. Digitization and the communications revolution have placed in the consumer/user the tools to access the content they want, when they want it, at little or no cost.

But there needs to be something to access: content needs to be created and paid for at some level.

We are in a period of enormous experimentation in the quest for revenue models. In the past music companies and newspapers aggregated content to appeal to a broader audience. Consumers would pay for that aggregation usually just to have access to a small portion of it. The CD album bundled a number of pieces from an artist. Yes, many enjoyed the full album, but more often bought the album for one or two favorite tunes. iTunes disaggregated the album as a revenue model. Today, the consumer may still pay close to the same amount per song as it cost on the CD, but he/she does not have to purchase the aggregated product, and can select the artist and tunes to pay for.

Similarly in the newspaper, there are many sections that a consumer pays for: local, national and international news, weather, sports, arts, business, health, life style features, obituaries, marriage announcements and the like. Furthermore, the functions of gathering the news, sourcing it, contextualizing it, suggesting what to think about it, and distributing it are all performed by the same entity.

With its near monopoly distribution channel for delivering news and information to the home, newspapers had their heyday into the 1990s. Yes, radio and then television posed some competition. But ironically, the evening news on television spelled the demise of the evening newspaper, resulting in winnowing the field to a monopoly newspaper entity in most cities.

With a monopoly distribution system, the economics of bundling make sense. The consumer will want access to some of the content, and will pay for more in order to get that access. The bundler gets more per customer and will have lower costs delivering a single product that has wider appeal, than if it had to customize to each customer's liking. The cable television business is a modern example of this.

But as new digital tools and enterprises emerge, they disrupt the monopoly aggregator model. One can now purchase the song, not the album. As video becomes more common on the Web, people will move to view and in many instances purchase individual shows "over the top," not the cable channel or television network. Former FCC Chairman Kevin Martin waged a battle against the cable industry seeking to change their business model to *a la carte,* allowing the subscriber to choose and pay for only those channels he or she actually wanted. He did not succeed as a regulator, but the digital revolution may disaggregate even the cable channel if the unit of consumption is the show, or series, and becomes available over the Net.

As it is happening in other content industries, it is apparent that the journalism business is unbundling. The functions that a newspaper performed alone can now be undertaken by new, nimble entrants, by repurposed other players, or by the public itself.

Let's take a typical life cycle of a news story. (1) Someone digs up the facts, and (2) composes a story. There are (3) sources for the story, the (4) facts are verified and (5) authenticated. The story, if well written, (6) contextualizes the facts, and either inherently in the story, or in a separate editorial, the entity (7) analyzes the consequences. It also either makes a bundled news provider through (8) filtering or curating processes, and then is (9) distributed to the customer.

These functions have been performed by single news organizations, newspapers, and television stations most notably. But today there are many different entities that can pick off one element or another and contribute to the news value of the story. So, there are people and entities, such as environmental organizations, that dig up the facts but do not develop the story. There are new entities such as ProPublica or the Center for Investigative Journalism that are developing the story, but not distributing it, sending it instead to other established distributors like newspapers and television stations. There are bloggers who verify and authenticate without being in any other part of the story – for example, the people who revealed the phoniness of the National Guard memo about George W. Bush that Dan Rather reported on CBS's *60 Minutes.* And there are now aggregators or curators on the Internet, e.g., Google News or Huffington Post, who highlight and link to news stories that they have not written.

Just about all of these functions have been performed in the past. Whistle-blowing is not a new phenomenon, and newspapers have long published news wire stories. But the extent of disaggregating is much greater as the opportunities for niche players in the news business become more vibrant.

Juxtaposed onto this trend of disaggregation is the search for new revenue sources for journalism. Revenues have been streaming away from the print media in recent years in huge amounts. But the expected savior, online journalism, has not delivered the cash flow that publishers expected. The good news is that audiences for journalistic organizations have vastly increased. But the value to advertisers of those visiting their sites was about one-tenth the value of a reader of print media. The cost per thousand rates (CPM) just did not hold up in the latter half of 2008 and into 2009.

The question arises, then, how will journalism, so necessary to our daily public and private lives, sustain itself? This is a broader question than sustaining any one journalistic organization or even type of distribution system. Though, some would argue with some credence that since newspapers have large experienced staffs with ingrained journalistic values, and have usually served as the news agenda setter for all media in a locality, they should be protected in some way.

I am not alone as seeing the next five to ten years as a period of experimentation for a sustainable revenue model. Clay Shirkey analogizes this period to the century following invention of the printing press, described by Elizabeth Eisenstein in *The Printing Press as an Agent of Change* (Cambridge University Press 1979*).*

The good news is that there are many revenue streams for news and information visible today. These include the staples of customer subscription and advertising. A news organization can charge fees for carriage of its content. It can enter into barter or cooperative arrangements. For non-profit entities and L3Cs (low profit corporations), there is the possibility of philanthropic grants. Of course an endowment is always helpful, and other philanthropic models are emerging such as the Sandler arrangement with ProPublica. Tip-jar or voluntary contributions have worked very well for public radio. And David Westphal and Geoffrey Cowan have catalogued a history of government subsidies through tax breaks, government subsidies through cheaper postal rates, or requirements for governments to advertise legal notices in newspapers.

The matrix below places the disaggregating functions of news on one axis with the various sources of revenue on another. The point of this is not to be exhaustive of the categories of each of the axes. Some might find other functions or other sources of revenue.

The point is that as new entities emerge, or older ones transform, they will undertake bits and pieces of the journalistic chain. And they will find revenues from a variety of sources in new and strange combinations. As the squares in the matrix light up, e.g., philanthropic sources and fees to support investigative journalism that does not editorialize or distribute themselves, the different combinations are limitless. The chart becomes a pixeled picture of the journalism business going forward.

Journalists serve as watchdogs to the effective operation of government, and provide much of the information a citizen needs to exercise his or her functions of citizenship. They also supply much of the day-to-day information necessary for an individual to get along in civil society. As the Knight Commission on the Information Needs of Communities in a Democracy so aptly describe, these functions are all essential to a thriving democracy. So too is the quest for finding sustainable models for the functions of journalism, however they are realized.

Matrix of Revenue Sources for Various Journalistic Functions

Revenue Source: JOURNALISTIC FUNCTION:	Adver-tising	Subscrip-tions	Fees; sales of info.	Micro-payments	Barter; Co-ops	Corp. Under-writing	Philan-thropic Gifts	Voluntary Contribs; Tipjars	Endow-ment	Govt
FACT-FINDING										
VERIFICATION										
AUTHENTI-CATION										
CONTEXT-UALIZATION										
ANALYSIS										
EDITING/ FILTERING										
AGGREGATION										
LINKING; AGENTING										
DISTRIBUTION										