Notes on the possible consumer price effects of the proposed requirement for streaming services to fund Swiss content (4% rule in "Lex Netflix")

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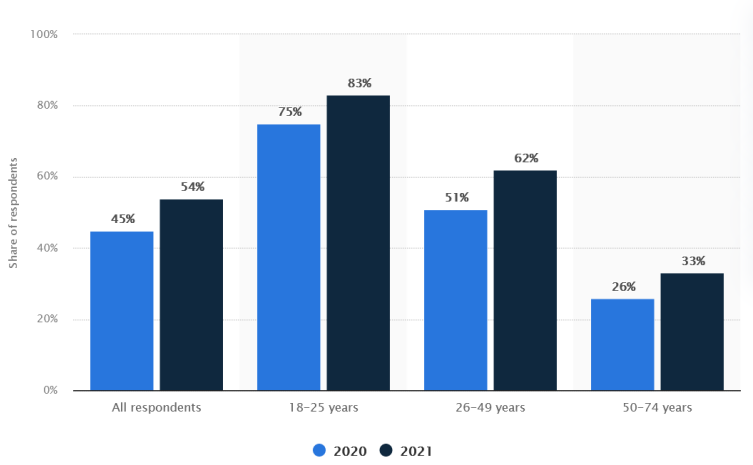
While the range of possible consumer price effects is wide in theory, there a reasons to expect the price effect to be significantly less than 4%.

To evaluate the impact on prices of the requirement that streaming services devote at least 4% of their revenues to Swiss audiovisual content, we note the following observations:

- Netflix is the main provider of streaming video and TV content, and other streaming services provide limited competition. As of August 2021, Netflix had 2.8 million Swiss users, which dwarfs Disney+ 650,000, Apple TV+ 320,000 and Amazon Prime 300,000. (Television had 6.3 million viewers, 4.6 million for YouTube, and 690,000 for Play Suisse.)
- The substitutability between Netflix and other providers, including standard TV, seems limited, not least given the age divide for each category. (The graph below reports answers to the question: "Do you use the fee-based streaming service Netflix as your main source for video and TV content?")



Source: https://www.statista.com/statistics/1135616/netflix-reach-by-age-group-switzerland/

Given the above, Netflix probably faces, and chooses prices, for a residual demand which will not be significantly affected by the 4% requirement (strong monopolistic price-setting power).

As a first step, assume that 4% revenue is taxed without a benefit to Netflix. In that context, there exists a theoretical possibility that the tax would give Netflix an incentive to raise consumer prices by more than 4%, by less than 4%, and even by 0%.

A more realistic view can however be gained by focusing on standard benchmark demand configurations.

A first benchmark case is known as an "isoelastic demand".[1] In that case, the 4% requirement would lead to a price increase of essentially 4%.

A second benchmark case is "linear demand".[2] In that case, it can be shown that the 4% revenue requirement would likely lead to a price increase between 0.5 and 1%.

There are reasons to expect the relevant demand segment to be closer to the linear benchmark than to the isoelastic benchmark (albeit not necessarily precisely linear).[3]

For a confident estimate, however, empirical information would be needed on the price sensitivity of user demand. This could be obtained either by tracking how the actual number of users responded to price changes by streaming platforms (e.g. responses to the recent increase in Netflix's Swiss subscription rates), or through a user survey.

Another reason for expecting the firm's optimal price response to be closer to 0% than to 4% is that the 4% revenue requirement is not a pure tax on revenue but can be spent by the firm on marketable content. That content will likely be a close substitute from the consumer perspective to the foreign content it will replace on the streaming platform.[4]

When setting profit-maximizing prices, sophisticated firms will focus on marginal cost rather than average cost. While the 4% constraint would most likely increase the streaming firm's *average* cost, it might lower its marginal cost. For example, if own-production Swiss content were to replace content purchased from foreign suppliers on a pay-per-view basis, then the firm's marginal cost would fall, as the cost of streaming own-produced content to an additional viewer is basically zero.

If such shift from pay-per-view fees to own production material results, for instance, in a 2% decrease in the overall marginal cost, the range of price increases discussed above would shrink further, possibly to as low as 0.25%.

More generally, if the production function of streaming services were such that marginal cost (i.e. the cost of serving an additional subscriber) is essentially zero, then the effect of the 4% requirement on the subscription price would be zero or very close to zero regardless on the shape of demand.

For a confident estimate of the price implications due to firms' cost structures, information would be needed on the nature of streaming platforms' fixed and variable costs of own-produced and bought-in content.

In sum, while the range of conceivable price effects is wide in theory, there are reasons to expect (*ceteris paribus*) consumer price rises to be considerably less than 4%, and probably closer to 0% than to 4%.

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[1] Isoelastic demand implies that, regardless of the streaming service price level, a 1% price increase will always lead to a 1% decrease in users (and so a 1 CHF price increase leads to very small change in the *absolute number* of users if the price is high, but a huge reduction in users if prices are sufficiently low).

[2] Linear demand implies that, regardless of the price level, each 1 CHF price increase leads to the same decrease in the absolute number of users.

[3] One reason is that an isoelastic demand curve implies that an increase in 1 CHF in the marginal cost would lead to a more than 1 CHF in price of a firm facing a residual demand curve, or a more than 100% pass-through (for comparison, a linear demand would lead to just a 50% pass-through). Empirical studies find that more often than not pass-through rates fall between 0 and 100% across a wide range of market structures.

[4] The streaming platform will have an incentive to substitute any mandated Swiss content not for foreign "blockbusters" but for marginally profitable foreign content.

The *ceteris paribus* qualification is important. Any potential price changes induced by the proposed measure will likely be dwarfed by changes in demand due to the evolution of viewing habits, technology and strategic changes in the footprint of competitors in the Swiss market that are unrelated to the evaluated measure. It is also conceivable that providers would justify price increases with the new legal requirements not out of a strictly economic profit-maximizing calculation but as an act of political signaling aimed at deterring further restrictions on their activities.