The Role of Advertising in America

An Overview by the Association of National Advertisers (ANA)

Introduction

Advertising occupies a major place in American society. Linked to the bedrock principles that shaped our nation – free speech, competition and individual choice – it has served the public since colonial times as a source of vital information about our open, market-based economy.

Advertising is a positive force in our free society. Protected by the First Amendment, it informs the public, promotes competition, fuels economic growth, creates jobs and fosters a wide array of media choices for consumers.

Protected by the First Amendment

The First Amendment to the U.S. Constitution states: "Congress shall make no law…abridging the freedom of speech or of the press…" In a long series of cases, the U.S. Supreme Court has conclusively extended this protection to "commercial speech." As a result, advertising of lawful products and services, conducted in a non-misleading way, is fully protected by the U.S. Constitution.

Driving the Economy

According to a landmark study conducted by the highly regarded consulting firm Global Insights under the direction of a Nobel Laureate in Economics, advertising is a remarkably powerful economic force. Nationally, it generates over $5 trillion in economic activity, or approximately 20 percent of U.S. total economic activity. Sales of products and services stimulated by advertising support 21 million jobs, or 15 percent of the total jobs in the country. In addition, another Nobel Laureate in economics, George Stigler, also has noted that advertising is a critical force in fostering economic efficiency and competition throughout the US economy.

Fostering Affordable Media Choices

Advertising enables consumers to enjoy a vast array of media choices. Commercial television and radio are available to the public at no cost, thanks to advertising. In addition, advertising revenues provide substantial support for most print publications, large portions of the Internet and cable, giving people access to immense information and entertainment content at little cost. This support helps democratize access to information. The public, wherever they are located geographically and regardless of their income level, have more information available to them than at any other time in history.

Educating the Public

Advertising informs consumers about product choices available in the marketplace. Increasingly, it also educates them about issues that affect their lives. Recognizing the power of advertising to educate, the industry annually voluntarily devotes multi-billions of dollars worth of creative and media resources to high-visibility public service campaigns.

100th ANNIVERSARY

A Tax Deductible Cost of Business

Advertising is a cost of doing business. Under the federal tax code, advertising expenditures, like all other ordinary and necessary costs of doing business, are 100% deductible in the year in which they are incurred. Periodically, however, policymakers have considered limiting or denying deductibility of advertising costs as a way of generating additional corporate tax revenues. At the state level, lawmakers have occasionally proposed broadening sales tax laws to include a tax on the process of advertising. To date, at both the federal and state level, all advertising taxation efforts have been either defeated or later abandoned, as government officials have recognized that severe economic consequences would result. These include decreased consumer demand, slower economic growth, increased unemployment, lower business profits and, ultimately, reduced tax revenues.

A Heavily Regulated Industry

Advertising is a heavily regulated industry. At every level of government – federal, state and local – advertising is closely scrutinized. The Federal Trade Commission (FTC), the government agency with principal authority over the industry, has the power to ban or regulate advertising it believes to be false, deceptive or unfair, as well as impose penalty actions against advertisers who violate the law. In addition to this government oversight, the advertising industry has long embraced a strong self-regulatory process administered under the National Advertising Review Board (NARB) of the Council of Better Business Bureaus (CBBB). A special entity within NARB, the Children's Advertising Review Unit (CARU), closely monitors children's advertising.

Advertising: A Powerful Force in Stimulating Economic Activity and Job Growth

According to a 2004 landmark study conducted by the highly regarded consulting firm Global Insights under the direction of Dr. Lawrence R. Klein, a 1980 Nobel laureate in Economics, advertising is a remarkably powerful economic force. Nationally, it generates over $5 trillion in economic activity, or approximately 20 percent of U.S. total economic activity. Sales of products and services stimulated by advertising support 21 million jobs, or 15 percent of the total jobs in the country. More information about the Global Insights study is available at http://www.ana.net/advocacy/getfile/15322.

The study highlights in detail how advertising expenditures – via a chain reaction –stimulate sales activity and jobs throughout every sector of the economy. These impacts are ramified through the key interactions of three vital tiers of the economy:

Tier One: Retail and Manufacturing – Advertising helps manufacturers and retailers generate sales by announcing their products and services to the consumer. In this tier, advertising agencies and content creators design campaigns and purchase advertising space across the media spectrum. As an example, an automotive company uses advertising to introduce a new line of fuel efficient cars.

Tier Two: Suppliers to Retail and Manufacturing – As sales increase from the introductory advertising, a chain reaction begins, stimulating sales and creating jobs within a second tier of businesses: suppliers to, and distributors for, the tier one retail and manufacturing businesses. In the automotive example, suppliers of steel, plastics, paints and automotive components experience an economic surge.

Tier Three: Inter-industry Activity – The economic impact then spreads to a third tier of related businesses, whose products support the initial sales. For example, within the automotive industry, tire manufactures, parts distributors and service stations benefit from business as cars are driven and begin to age.

The Global Insight study employs a sophisticated econometric model that estimates and predicts advertising's contributions to economic activity and job growth on a national as well as individual state level. It provides powerful proof that advertising is a major driver of the U.S. economy – one that should be respected and fostered by policymakers at the federal, state and local levels.

In addition, Nobel Laureate in Economics George Stigler demonstrated that advertising was one of the most powerful engines of economic growth by fostering economic efficiency and competition throughout the US economy.

To compete and grow in today's marketplace, companies must efficiently reach consumers, alerting them to new product innovations and competitive price points. Advertising is by far the most efficient way to communicate such information.

Advertising is critical to local companies as well as national or global marketers. Many local businesses engage in cooperative advertising, whereby national manufacturers and local retailers share advertising costs. For many such businesses, from drug stores to supermarkets to restaurants, cooperative advertising is the cornerstone of their marketing efforts.

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Advertising: The Financial Foundation of Affordable Media and Web Services

Vast, affordable media options enrich our society and underpin a core American value: the democratization of knowledge and information. Advertising plays a critical role in fostering this abundance of information, as it provides the financial foundation for the immense number of media and Web services available to U.S. consumers.

Commercial broadcasting, both radio and television, is supported solely by revenues from the sale of advertising time and space.

Other types of media, including the Internet, newspapers, magazines and large segments of cable television rely heavily on advertising for a major portion of their revenues. Indeed, without advertising dollars, many of today's media outlets would not exist, and the cost of those that survived would be substantially higher for the consumer.

Advertising revenue has helped lead to a tremendous proliferation of media choices. For example, television viewers in the early 1950's and 60's could watch only three broadcast networks. Today, viewers can choose from multiple broadcast networks, hundreds of cable channels and direct broadcast satellite programming.

The advertising-supported business model has also fueled the explosive growth of the Internet, creating a low barrier-to entry for an immense number of entrepreneurial online businesses. According to research firm comScore, more than 200 million Americans age 15 or older use search engines each month. These consumers are going to the Internet to access – at no cost – all types of content: from news and health, to sports and entertainment, to job listings and travel recommendations. The most popular Internet search engines, news outlets, entertainment portals, photo and video sharing services and social networking sites all give consumers free access to vast content and online experiences thanks to their advertising revenues.

The online media has developed at an extraordinary pace. It took 38 years for radio to reach 50 million Americans; network television took 13 years and cable television took 10 years. It took only about three years for the Internet to reach 50 million users in the U.S.

According to the Interactive Advertising Bureau (IAB), there was $23.4 billion spent on advertising and paid search on the Internet in 2008. To put this in perspective, the Internet today is a bigger advertising medium than radio, outdoor advertising and about the same as consumer magazines. (www.iab.net). However, policymakers need to refrain from imposing undue restrictions that would limit the effectiveness of interactive advertising, thereby diminishing the flow of ad dollars into this promising new media channel.

> The economic health of most of our country's media, including the online marketplace, rests primarily on the strong financial foundation provided by advertising.

Advertising: The Compelling Arguments Against Ad Taxes

Advertising is a cost of doing business, much like employee wages, utility costs and office supplies. The Internal Revenue Code has permitted all of these costs, including advertising, to be deducted in the year they are incurred since Congress enacted the tax code in 1913. However, several times since the late 1980's, Congress has considered legislation to limit or deny this deduction or to require that advertising costs be amortized over several years. To date, all efforts to alter advertising's 100 percent deductibility have been defeated because in reviewing this potential change to the tax code, policymakers concluded that it would be counterproductive.

This conclusion echoes the findings of prominent studies conducted by independent consulting organizations, such as Wharton Econometrics Forecasting Associates and Lexecon. These studies concluded that by limiting the deductibility of advertising expenses, the government would make advertising more expensive, forcing businesses to either reduce the amount of advertising or increase the cost of their goods and services. In either case, the result would be a decrease in consumer demand, slower economic growth, increased unemployment, lower corporate profits and, ultimately, reduced tax revenues for the government.

At the state level, advertisers pay a multitude of taxes, including, where applicable, state income taxes, property taxes and sales taxes on their purchases of goods. Again, in an effort to find new revenue sources, certain state and local lawmakers have proposed – and in some cases enacted – taxes on the process of advertising. Florida, Arizona and Iowa experimented with ad taxes; however, in each instance, they found them counterproductive and quickly repealed the laws. In Florida's well documented case, many advertisers reduced their media expenditures. In the state's top six media markets, national spot-TV advertising declined an average of 11.8 percent within six months of the imposition of a sales tax on advertising. Not surprisingly, the state abandoned this tax within a year of its imposition.

> Advertising taxation efforts have been found to be counterproductive, as government officials have recognized that severe economic consequences would result.

Advertising: A Heavily Regulated Industry

Advertising is a heavily regulated industry. At every level of government – federal, state and local – advertising is closely scrutinized. The Federal Trade Commission (FTC) is the principal government agency with regulatory authority over advertising. It can ban or regulate advertising it believes to be false, deceptive or unfair, as well as impose penalties on advertisers who violate the law. The Federal Trade Commission also requires that every material claim in advertising be adequately substantiated. Any ad that fails to meet this requirement will violate the FTC Act and face significant penalties.

For certain industries, other federal government agencies have oversight of advertising. For example, the Securities and Exchange Commission regulates advertising of stocks, bonds and other related financial instruments; the Department of

Transportation regulates airline advertising; the Food and Drug Administration regulates advertising for prescription drug products; the Federal Communications Commission (FCC) oversees time limits for advertising directed to children; and the Treasury Department's Bureau of Alcohol, Tobacco and Firearms regulates certain aspects of alcohol beverage advertising.

Advertising: A Strong Self-Regulatory System

In addition to this government oversight, the advertising industry has long embraced a strong self-regulatory process administered under the National Advertising Division/National Advertising Review Board (NAD/NARB) of the Council of Better Business Bureaus (CBBB). NAD/NARB's mandate is to ascertain the truthfulness and accuracy of national advertising claims. Since its inception nearly 40 years ago, NAD/NARB has reviewed well over 5,000 cases. In the vast majority of instances (over 90 percent) where advertising was found to be misleading, the ads were voluntarily modified or discontinued. In the limited number of cases where companies refused to adhere to the self-regulatory requirements, the NAD/NARB as a matter of course forwards these cases to the appropriate governmental regulatory groups for further action.

NAD/NARB decisions are made public, providing valuable information to consumers and other companies. Information about the self-regulatory system and NAD/NARB cases is available at http://www.narcpartners.org.

Numerous FTC Commissioners have cited the NAD/NARB system as a model of effective industry self-regulation.

A special entity within NAD/NARB, the Children's Advertising Review Unit (CARU), oversees advertising directed to kids. CARU takes into account the special vulnerabilities of children, namely their inexperience, immaturity and lack of cognitive skills necessary to evaluate the credibility of advertising. To address concerns about commercial messages being incorporated into program content and interactive games, CARU strengthened and expanded its guidelines for advertising directed to children in 2006. See www.caru.org.

Advertisers acknowledge their responsibility to be part of the long-term solution to societal problems. For example, in 2007 in response to concerns about rising childhood obesity, 13 major food companies representing over two-thirds of all children's advertising worked with CARU to create the Children's Food and Beverage Advertising Initiative. These corporations publicly agreed to devote at least half their advertising directed to children on television, radio, print and the Internet to promote healthier dietary choices and/or to messages that encourage good nutrition and healthy lifestyles.

There are now 16 companies in the program. Their pledges also include the elimination of third-party licensed characters in advertising directed to children; the elimination of product placements in programming directed to children; and a commitment not to engage in advergaming unless the game incorporates "better for you" products and/or healthy lifestyles. These voluntary commitments are carefully monitored by the Council of Better Business Bureaus. More information about the Children's Food and Beverage Advertising Initiative is available at www.bbb.org/us/children-food-beverage-advertising-initiative.

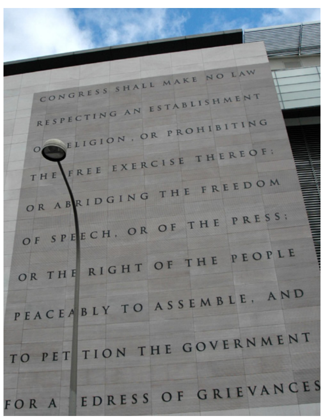
To protect consumer privacy in the online environment, ANA and four other industry groups (the American Association of Advertising Agencies; the Direct Marketing Association; the Interactive Advertising Bureau; and the Council of Better Business Bureaus) released a set of self-regulatory principles on July 2, 2009 for online behavioral advertising. Those principles, developed over several months of discussion, require advertisers and websites to clearly inform consumers about their data collection practices and enable them to exercise control over how that information is used.

The CBBB will implement accountability programs to promote widespread adoption of the principles. The self-regulatory program is expected to be implemented at the beginning of 2010. This is the first time that representatives of the entire advertising ecosystem have come together to develop information collection principles. The principles are designed to address consumer concerns about the use of personal information and interest-based online advertising while preserving the ability of marketers to deliver more relevant advertising to consumers. More information about the project is available at http://www.ana.net/news/content/1801.

> In addition to government oversight, the advertising industry has long embraced a strong self-regulatory process.

The strongest force for honest national advertising, however, is not government regulation or self-regulation, but the fact that advertisers are dependent for their success on millions of sales that can be accomplished and maintained only through repeat business and the maintenance of consumer trust.

Advertising: Protected by the First Amendment



The First Amendment to the U.S. Constitution states: "Congress shall make no law . . . abridging the freedom of speech, or of the press . . ."

Throughout our history, Americans have viewed protection of freedom of speech as an essential element of our democracy. However, advertising or "commercial speech" has been accorded constitutional protection only in recent years. In 1942, in *Valentine v. Chrestensen*, 316 U.S. 52 (1942), the U.S. Supreme Court held that government bans or restrictions on "purely commercial advertising" were not limited by the First Amendment.

Not until 1976 in *Virginia Board of Pharmacy v. Virginia Citizens Consumer Council*, 425 U.S. 748 (1976), did the Supreme Court affirmatively extend First Amendment protection to commercial advertising. In that case, the Court declared unconstitutional a law that precluded price advertising for prescription drugs. Virginia's arguments that price advertising would foster a lower level of professional conduct by pharmacists and harm the customer-pharmacist relationship were rejected. The Court saw an alternative to the "paternalistic" approach of banning all prescription drug price advertising:

"That alternative is to assume that this information is not initially harmful, that people will perceive their own best interest if only they are well-enough informed, and that the best means to that end is to open the channels of communication rather than to close them. It is precisely this kind of choice between the dangers of suppressing the information, and the dangers of its misuse if it is freely available, that the First Amendment makes for us." 425 U.S. 748, 770 (1976).

Indeed, Justice Blackmun, writing for the Court, stated that both the individual consumer and society in general have strong interests in the free flow of commercial information: *"As to the particular consumer's interest in the free flow of information, that interest may be as keen, if not keener by far, than his interest in the day's most urgent political debate."* He concluded that the free flow of information is also indispensible to the proper allocation of resources in a free market system and to the debate about how that system should be regulated or altered.

Since 1976, the U.S. Supreme Court has strengthened the First Amendment protections for advertising in a long series of cases. The test for the protection of commercial speech was formulated by the Court in *Central Hudson Gas & Electric Corp. v. Public Service Commission of New York*, 447 U.S. 557 (1980). The Court, while reaffirming advertising's First Amendment protections, established a four-part test for evaluating the permissible boundaries for government regulation of advertising. The *Central Hudson* test asks: (1) whether the speech concerns lawful activity and is not misleading; (2) whether the asserted governmental interest is substantial; and if so, (3) whether the regulation directly advances the governmental interest asserted; and (4) whether it is not more extensive than necessary to serve that interest.

When the courts analyze an effort by the government to ban or restrict advertising, the government must "demonstrate that the harms it cites are real and that its restriction will in fact alleviate them to a material degree." *Edenfield v. Fane*, 507 U.S. 761, 771 (1993).

The high-water mark for First Amendment protection for advertising came in the case of *44 Liquormart v. Rhode Island*, 517 U.S. 484 (1996). The Supreme Court unanimously struck down a Rhode Island law that banned all price advertising for alcohol beverage products. In so doing, the Court expressed one of its strongest statements ever about the importance of advertising in a free market economy. The Court rejected the government's argument that advertising about so-called "vice products" was entitled to less First Amendment protection. The Court has now made it clear that truthful, nondeceptive advertising about every legal product and service has the same strong protection under the First Amendment.

In *Thompson v. Western States Medical Center*, 535 U.S. 357 (2002), the Court struck down a Food and Drug Administration (FDA) restriction on advertising for compounded drugs. Former Justice Sandra Day O'Connor writing for the majority of the Court stated that "if the First Amendment means anything, it means that regulating speech must be a last – not first – resort."

Taxes and the First Amendment

The Supreme Court has also made it clear that the use of discriminatory taxation to suppress speech violates the First Amendment. In *Speiser v. Randall*, 357 U.S. 513 (1958), the Court recognized that "speech can be effectively limited by the exercise of the taxing power" and "a discriminatory denial of a tax exemption for engaging in speech is a limitation of free speech." 357 U.S. at 518.

In *Arkansas Writers Project, Inc. v. Ragland*, 481 U.S. 221 (1987), the Supreme Court stressed that "above all else, the First Amendment means that government has no power to restrict expression because of its message, its ideas, its subject matter or its content . . . Regulations which permit the government to discriminate on the basis of the content of the message cannot be tolerated under the First Amendment."

Efforts by the government to tax, ban or restrict truthful advertising based on its content violate the First Amendment.

Public Service Advertising – The Advertising Council

One of the most important activities of the advertising community is the development of public service advertising. In 1942, The Advertising Council was established by ANA, the American Association of Advertising Agencies, the Magazine Publishers Association, the National Association of Broadcasters, the Newspaper Advertising Bureau and the Outdoor Advertising Association of America. The Ad Council was established to be the central body through which volunteers from business, advertising and media create and distribute public service campaigns.

Over its lifetime, The Ad Council has been responsible for a number of memorable campaigns. Smokey Bear works for fire prevention; ads for the United Negro College Fund teach us that "a mind is a terrible thing to waste;" and McGruff the Crime Dog works to "take a bite out of crime." The Ad Council also has taken a lead role in efforts to combat alcohol and drug abuse and drunk driving, with the "Friends Don't Let Friends Drive Drunk" campaign. The common thread among all Ad Council campaigns is the promotion of individual volunteer actions to solve America's social problems.

The Advertising Council is supported solely through the contributions and volunteer efforts of numerous corporations, advertising agencies, broadcasters and publishers. Since 1942, more than $41 billion in media space and time has been contributed in media support of Ad Council campaigns. In 2008, more than $1.83 billion was donated for the various campaigns. Beyond the media contributions are the invaluable voluntary efforts of the advertiser/campaign coordinator and the advertising agency in creating each of the campaigns. More information about The Ad Council is available at www.adcouncil.org.

The devastating national problem of drug abuse is the focus of another major advertising industry public service initiative. The Partnership for Drug Free America leverages the power of advertising to deter usage and to put useful information in the hands of parents, teens, teachers and friends. More information about this project is available at www.drugfree.org.

> The advertising industry voluntarily devotes immense creative and media resources to high-visibility public service campaigns.

The Association of National Advertisers (ANA) is the industry's premier marketing and advertising trade association. Founded in 1910, the Association is the only organization exclusively dedicated to serving the interests of corporations that market their products and services in the U.S.; many of our members also have global operations. ANA's membership is a cross-section of American industry, consisting of manufacturers, retailers, and service providers. Representing more than 9,000 separate advertising entities, these member companies market a wide array of products and services to consumers and other businesses.

ANA's headquarters are in New York City and we maintain an office in Washington, D.C. If you would like more information about the Association, please visit our website at www.ana.net or contact us at (202) 296-1883.