

The Future of Regulation

Symmetry Regulatory & Competition

Based on
*Regulatory Reform for Exchange Carriers:
Competition through Regulatory Symmetry*
Closing Address, 1994 ITS Conference, Sydney
Mark Schankerman, London School of Economics

Agenda

- Symmetrical Regulation
- Strategic Entry Deterrence
- Transition to Competition
- Price Caps Reform
- Universal Service
- Productive Offset

Agenda

- Symmetrical Regulation

Symmetrical Regulation

Prevents

- Social Inefficient Entry
- Technical Efficient Loss

Symmetrical Regulation

**Asymmetrical Regulation
Intrinsically Bias Towards
Firms or Technology**

Asymmetrical Regulation Criterion

- Deterrents by Incumbent
- Least Costly Resolution

Symmetrical Regulation: Benchmark

- **Asymmetrical Unjustified**
- **Regulatory Instrument**

Agenda

- **Symmetrical Regulation**
- **Strategic Entry Deterrence**

Strategic Entry Deterrence

- **Preemptive Investments**
- **Vertical Price Squeeze**
- **Predatory Pricing**
- **Cross Subsidization**

Strategic Entry Deterrence

- **Preemptive Investments**
Implies
 - ▶ **Indivisible Sunk Costs**
 - ▶ **Small Markets**
 - ▶ **Sunk Costs on Exit**

Strategic Entry Deterrence

- **Preemptive Investments**
Foiled By
 - ▶ **Superior Technology of Entrant**
 - ▶ **Incomplete Information**

Strategic Entry Deterrence

- **Preemptive Investments**
- **Vertical Price Squeeze**

Strategic Entry Deterrence

- **Vertical Price Squeeze**
 - ▶ **No Competitors**
 - ▶ **Mandate Interconnection Inappropriate**
 - ▶ **Require Competition before Price Caps**

Strategic Entry Deterrence

- **Preemptive Investments**
- **Vertical Price Squeeze**
- **Predatory Pricing**

Strategic Entry Deterrence

- **Predatory Pricing**
 - ▶ **Not If below MC of Competitors**

Strategic Entry Deterrence

- **Predatory Pricing**
 - ▶ **Establish & Maintain Market Power**
 - ▶ **Irrational if LR Profit Maximizer**

Strategic Entry Deterrence

- **Predatory Pricing**
 - ▶ **Unbundling, Open Architecture & Mandate Interconnection Prevent**

Strategic Entry Deterrence

- **Predatory Pricing**
 - ▶ **Ineffective with Contestable Markets**
 - ▶ **Place Price Floors**
 - ▶ **Antitrust Remedies**

Strategic Entry Deterrence

- Preemptive Investments
- Vertical Price Squeeze
- Predatory Pricing
- **Cross Subsidization**

Strategic Entry Deterrence

- **Cross Subsidization**
 - ▶ Incumbent & Entrant
 - ▶ Maintenance of Market Power

Strategic Entry Deterrence

- **Asymmetrical Unjustified**
- **Symmetrical Regulation Benchmark**

Transition to Competition

- **Strategic Game**
 - ▶ Stage One: Potential Suppliers Decisions
 - ▶ Stage Two: Price Competition

Transition to Competition

- **Strategic Game**
- **Requires Expectation of Competition at Stage Two**

Transition to Competition

Any Regulatory Restrictions at Stage Two will Affect Entry Decisions at the First Stage

Transition to Competition

Policy Implication is to set the Transitional Rules Now, Not at Some Future Date

Agenda

- Symmetrical Regulation
- Strategic Entry Deterrence
- **Transition to Competition**

Transition to Competition

Decisions on Critical Issues which Affect Entry & Investments Decisions

Now, not After Implementing Reform

Agenda

- Symmetrical Regulation
- Strategic Entry Deterrence
- Transition to Competition
- **Price Caps Reform**

Price Caps Reform

- **Competitive Provision of Access**
 - ▶ Technological Developments
 - ▶ Mix of Provision
- **Functional Definition**

Price Caps Reform

- **Contestable Markets**
- **Applications to Telecoms**
 - ▶ Interconnection
 - ▶ Facilities Available
 - ▶ **Narrow Market Definition**

Price Caps Reform

- **Market Share NOT a Guide**
 - ▶ Endogenous
 - ▶ Penalizing Efficiency

Price Caps Reform:

Recommendations

- **Functional Definition**
- **Accessible Facilities**
- **Flexibility versus Competition**
- **Market Definition Narrow**
- **Reject Market Share Criterion**

Agenda

- Symmetrical Regulation
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- Transition to Competition
- Price Caps Reform
- **Universal Service**

Universal Service

- **Targeted Subsidies**
- **NOT Service Subsidies**
- **Minimizes Distortions**
- **Minimizes Bypass Problems**

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- Transition to Competition
- Price Caps Reform
- Universal Service
- **Productive Offset**

Productive Offset

- **LR TFP Correct Measure**
- **Partial Measures Incorrect**
- **NOT Firm's Performance**

Summary

- **Technology Outgrown Regulation**
- **Comprehensive Reform Needed**

Summary: Recommendations

- NO Asymmetrical Regulation To Control**
- **Pre-emptive Investment**
 - **Vertical Price Squeezes**
 - **Predatory Prices**
 - **Cross Subsidization**

Summary: Recommendations

- **Regulatory Symmetry *Unless***
 - ▶ **Incumbent Deters Entry**
 - ▶ **Redress is Less Costly**
- **Comprehensive Reform**
- **Transitional Framework NOW**

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