Comments on

"CONCEPTS OF COMPETITION AND EFFICIENT POLICY IN THE TELECOMMUNICATIONS SECTOR"

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The articles by Roger Noll and William Shepherd both deal with the future role of government regulation in telecommunications. The pending dissolution of the Bell System resulting from the government's antitrust suit against AT&T raises a number of important regulatory issues that both Noll and Shepherd address. Two issues stand out as particularly critical: the role that regulation should have in the newly created Long Lines sector; and the policies that should be adopted with respect to permitting competition between regulated Bell Operating Companies (BOCs) and Long Lines, and with respect to permitting regulated telecommunications firms to enter other related and unrelated sectors of the economy.

On the first of these issues, Noll and Shepherd appear to disagree. Shepherd sees Long Lines as presently being "a virtual mo-

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nopolist," capable of earning "high excess profits," and entry as being exceedingly difficult (Shepherd, p. 113). Further, he feels that potential entrants will be highly vulnerable to predatory actions by Long Lines, thereby preventing a rapid erosion of Long Lines' dominant market position (Shepherd, p. 114). Until "Long Lines' market share on all major lines [falls] below 50 percent" (Shepherd, p. 113), effective competition will not be possible and regulation will have to be maintained.

Noll is more hopeful. He believes that effective competition in the Long Lines sector is probably already possible; and, in any case, that a free market is the lesser evil. Future potential entrants, he argues, will probably be the likes of IBM, Xerox, and Comsat/Hughes, companies that will be considerably "less vulnerable to anticompetitive practices" by Bell (Noll, p. 61). Further, he argues that "the possibility that anticompetitive strategies will be effective seems less threatening to the future development of the industry at this juncture than would be the alternative: to turn the game exclusively over to the competitors" (Noll, p. 63). Regulation, Noll believes, will very likely result in the protection of new entrants, rather than in the fostering of a truly competitive environment.

The disagreement between Shepherd and Noll stems first from their different perceptions of the effectiveness of future entry into the Long Lines sector, and second from their varying faith in the wisdom and effectiveness of government regulators. Shepherd thinks that effective entry will be difficult for some time, if indeed it is ever possible; Noll believes that such entry is possible now, or will be in the near future. Shepherd has considerable faith in government regulators as instruments for the creation of an environment in which effective competition is possible; Noll is more pessimistic about the motives and wisdom of regulators, and about their ability "to keep their eye on the right ball."

Thus, the disagreement between Shepherd and Noll is largely factual in nature; or, put another way, it is over which economic theory or model is most applicable to the new market environment in telecommunications. For this reason, Shepherd devotes most of his article to a critical analysis of the "new" sustainability and contestability theories. His point, put simply, is that the factual environment assumed by these theories is not consistent with his view of the new telecommunications environment. These theories, therefore, can not help us to develop sensible public policies in this sector.

While Shepherd clearly does a service by zeroing in on the underlying assumptions of these theories, he just as clearly goes too far when he makes such assertions as "contestability . . . [is] based on extreme assumptions and conditions, and . . . is apparently of little relevance to most markets, including those in the telecommunications sector" (Shepherd, p. 116). The fact that Shepherd and Noll—two recognized scholars in the telecommunications area—cannot come to an agreement, even for the area of telecommunications, on just how effective potential entry is likely to be, reveals the oversimplification involved in such a sweeping generalization. Further, in another sector of the economy about which I am more knowledgeable, banking and financial markets, I believe the contestability theory may be quite valid. In particular, in statewide branching, state banks can presently enter local banking markets throughout the entire state easily and cheaply, so that there are often many potential entrants and competitors for every local banking market. In these circumstances, the local market structure (e.g., concentration) may be unrelated to market performance, just as the contestability theory predicts.

One criticism of both Shepherd's and Noll's articles is that they do little to advance our understanding of the present factual environment in telecommunications. Since for both of them the assumptions they probe about this environment are critical to their conclusions about future regulatory policies, one would have expected them to dig a little deeper into the existing and potential technologies and to be more specific and explicit about the key characteristics of the Long Lines markets. The Long Lines sector is not a single, homogeneous market, but rather consists of many submarkets with substantial factual distinctions; competition may be possible in some but not in others.* One leaves both the Shepherd and Noll articles feeling that neither author provides enough factual understanding for

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*For example, there may be more potential entrants into in-state, long-distance-only telephone service than into interstate service. Microtec, Inc., for instance, has recently filed an application with Florida's Public Service Commission to provide such service in Florida. (See *New York Times*, June 10, 1982, p. D6, col. 2.)

us to decide who is right; in both articles, fervor of assertion is substituted for convincing factual analysis.

On the second issue—which policies to adopt with respect to permitting competition between regulated BOCs and the Long Lines sector firms, and with respect to permitting regulated telecommunications firms to enter other sectors of the economy—Shepherd and Noll are in greater agreement. Shepherd concludes: "The BOCs should probably be permitted to enter any business, including long-distance transmission and local programming activity on cable, while cable and other entities should also be permitted entry into BOC markets" (Shepherd, p. 115). Noll concludes "that AT&T should continue to be regulated, but should be permitted to enter essentially any market it wants" (Noll, p. 61). Also, he argues that "[t]he separate subsidiaries feature is . . . a relatively unimportant symbolic act" (Noll, p. 61).

In reaching these conclusions, both Shepherd and Noll emphasize the technical and efficiency benefits that such "cross-entry" is likely to generate. Both authors, especially Noll, also recognize the potential anticompetitive aspects of such a free cross-entry policy, but nevertheless conclude that the potential benefits outweigh the potential costs.

While I too share this view as a general proposition, a workable regulatory policy remains to be devised. Regulators will presumably be called upon to decide which other industries regulated telecommunications firms will be permitted to enter. Or do Noll and Shepherd propose no restraints at all? Here neither Shepherd's nor Noll's article provides us with much guidance about how regulators should decide this issue. Are some industries, because of their structural features, more prone to suffer the anticompetitive effects that Noll foresees and discusses? Will some evidence of potential technical efficiencies be required? Once entry has taken place, what is the appropriate regulatory oversight? Until issues such as these are explored, the implications of the recommendations made by Shepherd and Noll will remain vague.

Perhaps I am being unfairly critical of Shepherd and Noll for not doing more. If so, it is because I regard their conclusions as being far from modest. While both authors are informative and thought-provoking, neither in my mind provides an empirical and conceptual case sufficient to support his conclusions. This, of course, is grist for future discussion.