



Mexican Telecom Industry: (Un)wanted Monopoly?

Mexico's telecommunications industry, to a large extent is dominated by wire-line operator Telmex and mobile operator Telcel. Both belong to Carlos Slim – the world's richest man as per *Fortune's* list in August 2007. Telmex provides local, domestic long-distance and international fixed-line voice services, Internet and data communications, while Telcel provides wireless services. Both Telmex and Telcel hold a mammoth portion of the market share in the Mexican telecommunication industry. In this context, these companies have been constantly criticised that they take undue advantage of their dominance and thwart competition in the industry. It is also said that the weak regulatory authorities and flaws in regulations abetted the Mexican telecom giants in ensuring low competition. However, these companies defend themselves by arguing that they invest more than their competitors and provide good services throughout the country including low-margined rural areas.

Mexican Telecommunication Industry – A Overview

Before privatisation, Mexico's national telephone company – Telefonos de Mexico (Telmex), suffered from high operating costs, under-investment, service delivery shortcomings, low reliability and thus, tarnished image. The quality of its basic services was far below the normal standards, while value-added services were non-existent. For instance, the wait for a new telephone connection was above 3 years and tariff structure was prohibitive. Amid these inefficiencies, voices were raised in favour of privatising the company.

In 1989, President Carlos Salinas de Gortari decided to privatise the company. "Once privatisation was decided upon...policymakers had to decide whether, to maintain Telmex as a vertically integrated or...separate it horizontally, that is, to sell the different telephone services separately: local services, long distance, cellular, value-added services."¹ The key players involved in the

¹ Mariscal Judith, "Telecommunication Reform in Mexico: and Institutional Perspective", http://www.telecomide.org/documentos/008DTDAP-JMariscal-Telecommunication_Reform_Institucional-03.pdf, page 7

This case study was written by Hepsi Swarna under the direction of Saradhi Kumar Gonela, IBSCDC . It is intended to be used as the basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation. The case was compiled from published sources.

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Background Reading: Chapter 9, "Imperfect competition and the monopoly problem", *Economics* (Paul A. Samuelson and William D. Nordhaus)

policy reform were – National Investors, Telephone Union, Telmex, Foreign Investors, World Bank, Secretariat of Communications and Transport (SCT) and *Secretaría de Comercio y Fomento Industrial* (SECOFI)². National investors, Telephone union, Telmex and SCT preferred vertically integrated firm, whereas foreign investors, World Bank and SECOFI favoured market segmentation.³ Policymakers believed that market segmentation would enhance social welfare. However, because of time constraint for formulating and implementing the same, government decided to maintain Telmex as a vertically integrated firm. “An additional constraint, not openly acknowledged by policymakers, was given by the need to respond to preferences from newly established alliances that favoured an integrated firm.”⁴

In 1990, Grupo Carso Telecom, owned by Carlos Slim, acquired Telmex through a joint venture with Southwestern Bell and France Telecom for an exceptionally low price of \$1.75 billion. Since foreign investment was limited to 49%, the two foreign companies teamed up with Grupo Carso Telecom. According to the agreement between the three, Grupo Carso possessed operating control of the company, Southwestern Bell was responsible for improving operations and developing paging and cellular divisions, and France Telecom concentrated on line expansion and modernisation. Although many foreign companies had offered higher amounts in the public auction, Grupo Carso Telecom won the bid. The fact that majority ownership would stay in Mexico, was a major determining factor than any specific business logic.

After privatisation, Telmex was granted seven competition free years in both domestic and international telecommunications services on the condition that it invests at least \$14 billion in upgrading the network and technology during that period. The company was given 5 years time to cut down waiting time for a new line to the maximum of 6 months. It was also asked to double the number of telephone lines in service. The decision to allow monopoly for Telmex, though temporarily, was based on three arguments. “First, foreign investors would require it (monopoly) in order to purchase Telmex for a substantial amount. Second, monopoly facilitated pursuit of a ‘universal service’ objective – to serve households who could not afford service that was priced to recover its full cost, and to bring service to areas that were under-served because of difficult terrain, low population or generally low incomes. Third, monopoly was regarded as necessary to get private firms to commit to a major investment to improve service even to businesses and high-income households. Major investment would be required simply to eliminate the long waiting-list for service and the high rate of failure in completing or holding calls.”⁵

After privatisation, services improved tremendously. Earlier, people had to wait on the streets for a Telmex car to pass and bribe the technician for a line repair. Telmex also did better than expected in reducing the waiting time for a new line by bringing it down to 3 months. The number of wire-line (fixed line) and wireless telephones in service has grown significantly.

² Ministry of Trade and Industrial Development

³ “Telecommunication Reform in Mexico: and Institutional Perspective”, op.cit., page 14

⁴ Ibid., page 15

⁵ Noll G. Roger, “Priorities for Telecommunications Reform in Mexico”, <http://siteresources.worldbank.org/INTMEXICO/SPANISH/Resources/noll-paper.pdf>, pages 5–6

Although services improved, prices still remain high in Mexico. According to the Paris-based Organisation of Economic Cooperation & Development (OECD), Mexico remains one of the OECD countries with the highest telephone charges, especially for business use (Exhibit I). Eduardo Garcia, a business journalist in Mexico, observes, “If not for those rates, Mexican businesses would have generated better profits and could have paid their workers better. Mexico would have been a more efficient economy.”⁶ These high rates, in turn, resulted in low overall wire-line and wireless penetration (Exhibits II (a) & (b)) and a low broadband penetration rate (Exhibit III). In 2006, in Mexico, it was reported that, “Only 18% have a phone line, phone calls costs 50% more than the OECD average, and only two in 100 have broadband, which puts the Latin American country second to last in the OECD rankings.”⁷ Amidst all these spectacles and flaws, the Mexican telecom industry rests under the dominance of Telmex, even after expiry of monopoly period.

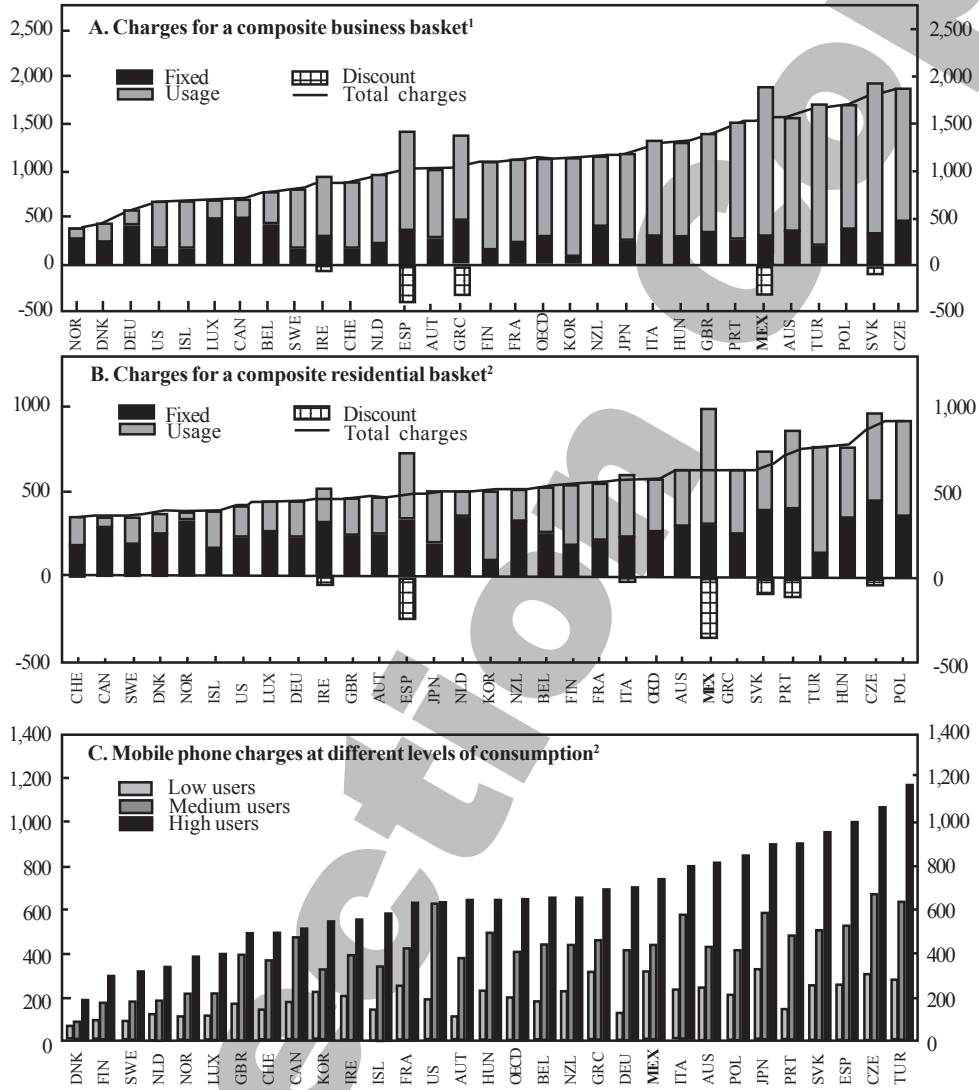
Few competitors have managed to break through the market share of 90% held by Telmex (by 2008). The necessary institutional and legal support to create a competitive market was absent during the reform process. Roger Noll (Noll) an economist at Stanford University, who advised Mexican government on privatisation of Telmex believes, “the key error was not to set up an independent regulator in advance of the sale.”⁸ Thus, a private monopoly replaced a public monopoly. In spite of Telmex’s monopoly in wire-line, the Mexican government allowed Slim to enter the wireless market too. In 2000, Telmex’s cellular operations in and outside Mexico were spun-off and the new company hence formed was named America Movil, which went on to become Latin America’s largest mobile phone operator. The Mexican arm of America Movil, named Telcel, enjoys a similar kind of dominance as, its fixed-line sister concern, Telmex does.

⁶ Padgett Tim, “Carlos Slim’s Embarrassment of Riches”, <http://www.time.com/time/business/article/0,8599,1642286,00.html>, July 11th 2007

⁷ Adams Greg, “Why Mexican phones cost a bundle”, http://www.nzherald.co.nz/topic/story.cfm?c_id=286&objectid=10377782, April 18th 2006

⁸ Authers John and Silver Sara, “Slim’s pickings: Latin America’s richest man eyes up his next undervalued target MEXICO”, <http://search.ft.com/ftArticle?queryText=carlos%20slim&page=4&y=9&aje=false&x=15&id=050425001205&ct=0>, April 25th 2005

Exhibit I Telephone Charges in the OECD in \$ (PPP* terms), August 2006



*Purchasing Power Parity

¹ Excluding VAT.

² Including VAT.

Source: "Economic survey of Mexico 2007: Improving infrastructure in Mexico", http://www.oecd.org/document/8/0,3343,en_2649_34569_39415560_1_1_1_1,00.html

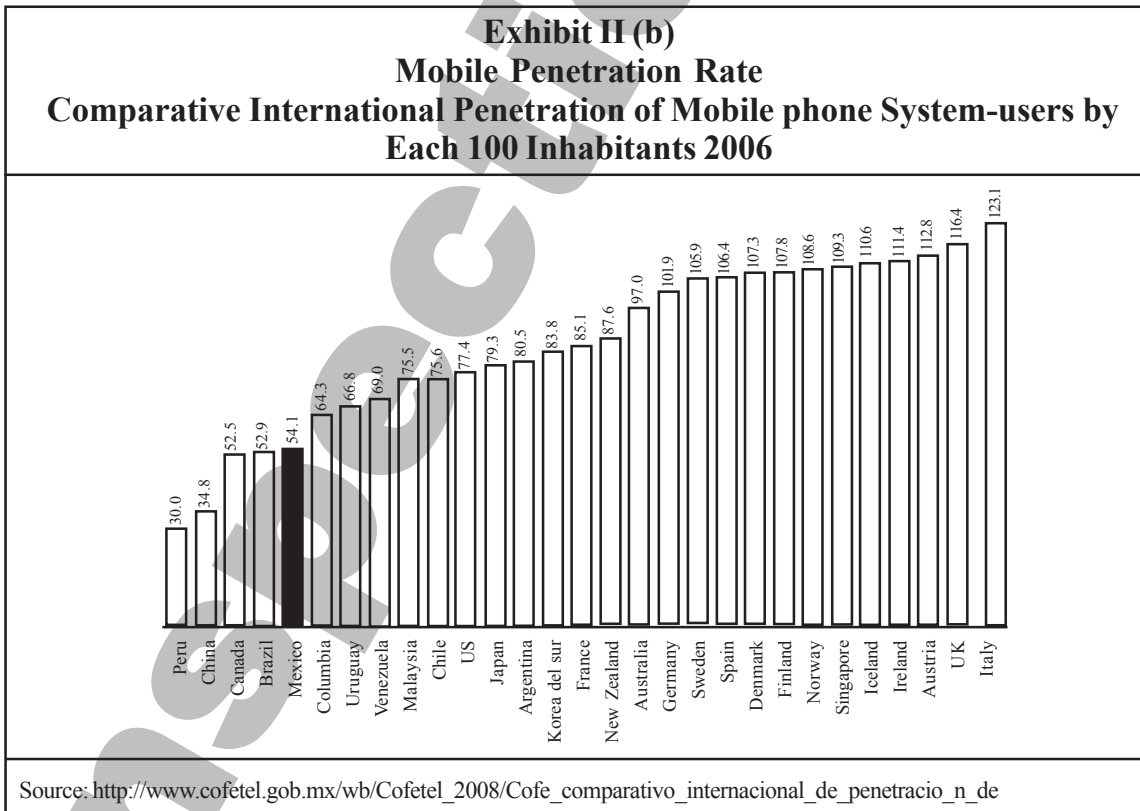
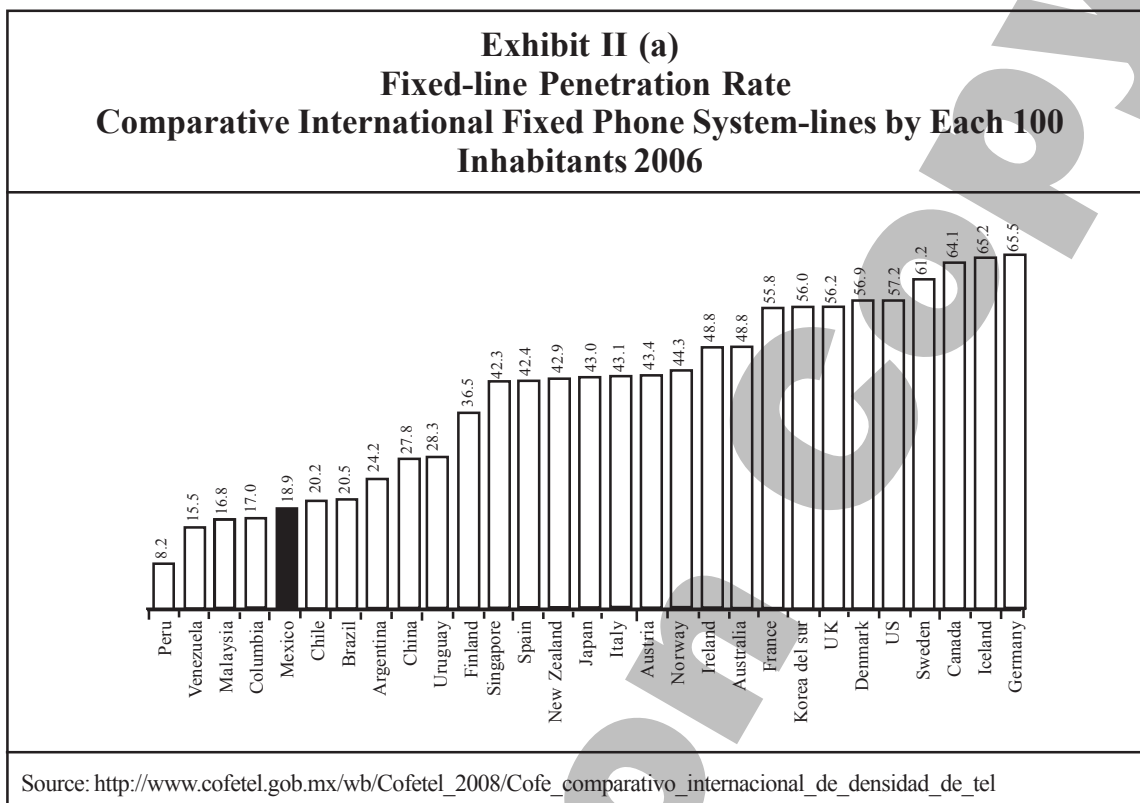


Exhibit III						
Broadband Penetration Rate						
OECD Broadband Subscribers per 100 Inhabitants, by Technology, December 2006						
	DSL	Cable	Fibre/LAN	Other	Total	Total Subscribers
Denmark	19.6	9.4	2.6	0.4	31.9	1,728,359
Netherlands	19.5	12.0	0.4	0.0	31.8	5,192,200
Iceland	28.8	0.0	0.2	0.6	29.7	87,738
Korea	11.4	10.7	7.0	0.0	29.1	14,042,728
Switzerland	18.8	8.8	0.0	0.9	28.5	2,140,309
Norway	21.7	3.8	1.5	0.6	27.7	1,278,346
Finland	23.5	3.5	0.0	0.3	27.2	1,428,000
Sweden	16.0	5.2	0.0	4.8	26.0	2,346,300
Canada	11.4	12.3	0.0	0.1	23.8	7,675,533
Belgium	14.0	8.4	0.0	0.1	22.5	2,353,956
UK	16.5	5.1	0.0	0.0	21.6	12,993,354
Luxembourg	18.2	2.2	0.0	0.0	20.4	93,214
France	19.1	1.1	0.0	0.0	20.3	12,699,000
Japan	11.1	2.8	6.2	0.0	20.2	25,755,080
US	8.5	10.3	0.3	0.6	19.6	58,136,577
Australia	15.0	3.3	0.0	1.0	19.2	3,939,288
Austria	10.6	6.4	0.0	0.3	17.3	1,427,986
Germany	16.4	0.5	0.0	0.1	17.1	14,085,232
Spain	12.1	3.1	0.0	0.1	15.3	6,654,881
Italy	13.8	0.0	0.4	0.6	14.8	8,638,873
New Zealand	12.7	0.6	0.0	0.7	14.0	576,067
Portugal	8.7	5.1	0.0	0.0	13.8	1,460,341
Ireland	9.1	1.3	0.0	2.0	12.5	517,300
Hungary	6.1	3.8	0.0	2.0	11.9	1,198,709
Czech Republic	4.8	2.1	0.0	3.7	10.6	1,086,620
Poland	5.2	1.6	0.0	0.1	6.9	2,640,000
Slovak Republic	3.4	0.7	0.9	0.2	5.1	274,108
Greece	4.4	0.0	0.0	0.2	4.6	512,000
Turkey	3.8	0.0	0.0	0.0	3.8	2,773,685
Mexico	2.7	0.8	0.0	0.0	3.5	3,728,150
OECD	10.5	4.9	1.1	0.3	16.9	197,463,934

Source: <http://www.oecd.org/dataoecd/37/39/38449070.xls>

Monopoly of Telmex and Telcel

While Telmex got natural monopoly through privatisation, Slim implemented ‘Gillette Plan’⁹ to establish Telcel’s dominance in the mobile market. Following this strategy, mobile phones were sold at cheaper prices, as once the customer bought a mobile phone they needed prepaid phone cards to use it constantly. The strategy worked well and the company made huge profits. According to a report in 2008, “America Movil, the largest cell phone operator in Latin America, provides service to 7 out of every 10 mobile users in Mexico, well ahead of the No. 2 operator, Movistar, the brand of Spain’s Telefonica.”¹⁰

Telmex’s direct competitors include fixed line companies such as Axtel, Alestra, Maxcom Telecomunicaciones and cable TV companies like Megacable Holdings. In 2006, Mexico had around 20 million fixed lines in service, out of which Telmex had 18.3 million fixed lines in service. The number of fixed line subscribers is going down in Mexico as customers are switching to wireless services. In the first quarter of 2008, Telmex had 17.8 million fixed lines in service with 90% of the market share while all the other operators having decimal share.

Telcel operates on GSM technology, while the other operators Telefonica’s Movistar is based on GSM and Grupo Lusacell (merged with Unefon) is into CDMA technology. Digital trunking operator Nextel de México is emerging as a strong competitor for post-paid business customers. For the first quarter of 2008, Mexico had 71 million mobile subscribers out of its population of 109 million people. Telcel, Movistar, Lusacell and Nextel had 51.4 million, 13.3 million, (just under) 4 million and 2.3 million subscribers, translating to a market share of 72.5%, 18.7%, 5.6% and 3.2% respectively.

Having established their monopoly, both Telmex and Telcel have been charging high prices for all its services including Internet services. However, excessive charges are denied to such an extent that once, Slim even raised questions on the credibility of OECD. In an interview with *BusinessWeek* in 2007, “he called the OECD charges false and denied he’s a monopolist.”¹¹ Even, the *Comision Federal de Telecomunicaciones (Cofetel)*¹² denies the accusations of over pricing. It states that Telmex’s charges have risen by less than inflation since 1998 and the prices were frozen since 2001. Further, it claims that local call prices are at or below international averages and it has forced Telmex to expand the network. But according to Professor Noll, the international comparisons are unrealistic, since many foreign companies offer packages including free long-distance calls or unlimited local calls.¹³ He opines, “Prices were bound to fall because of the nature of technology in the sector. If there have been improvements, it’s because reductions in costs have caused the profit-maximising monopoly price to fall. It’s still the profit-maximising monopoly price.”¹⁴

⁹ Slim’s Gillette plan is modelled on the Gillette’s practice of selling shavers for a low price and then making profits on the replacement razor blades.

¹⁰ Aspin Chris, “Mexico widens power probe of Slim’s America Movil”, <http://www.reuters.com/article/marketsNews/idINN3022791220080430?rpc=44&pageNumber=1&virtualBrandChannel=0>, April 30th 2008

¹¹ Smith Geri, “Carlos Slim’s Fat Fortune”, http://www.businessweek.com/globalbiz/content/jul2007/gb2007073_887601.htm, July 4th 2007

¹² Federal Telecommunications Commission

¹³ “Slims pickings: Latin Americas richest man eyes up his next undervalued target MEXICO”, op.cit.

¹⁴ Ibid.

Added to imposing higher prices on customers, Telmex is also accused of charging competitors high interconnection fees. In Mexico, the charges are said to be high above the average cost incurred for interconnection service. For instance, in 2000, Avantel's¹⁵ 60% of the revenue directly went to Telmex in the form of interconnectivity fees. By all accounts, the revenues of Telmex and Telcel can be attributed to the fact that they have abused their dominant position, by over-charging customers and competitors. Regulatory frame work and anti-competitive authorities are blamed for letting both the companies' scot free.

Regulation in Mexico

Article 13 of the Federal Law of Economic Competition of Mexico defines a company as monopoly, by examining whether it can unilaterally set the prices or restrict the supply in the relevant market without the competitive agents being able to act or to potentially counteract that power.

In 1993, to ban anti-competitive behaviour by companies, Mexico adopted Federal Law of Economic Competition (LFCE). The competition policy goals of LFCE are: “to protect the competitive process and free market access by preventing monopolies, monopolistic practices and other restraints of the efficient functioning of markets for goods and services.”¹⁶ *Comisión Federal de Competencia (CFC)*¹⁷ was created to enforce LFCE. CFC is responsible for investigating abusive monopoly practices of companies. It also determines the companies, which have dominant position in any sector.

LFCE classifies monopolistic practices as absolute and relative. Absolute monopolistic practices are prohibited. This include four types of horizontal agreements¹⁸ between competitors such as price fixing, output restriction, market division and bid rigging. Whereas, relative monopolistic practices are not termed illegal unless a company is found to have substantial power in the respective market. Vertical agreements¹⁹ like vertical market division, resale price maintenance, tied sales, exclusive dealing and refusal to deal are considered to be relative monopolistic practices. Other horizontal practices are also termed as relative practices – collectively treated as a catch-all provision – that will unduly damage or impair the process of competition and free access to production, processing, distribution and marketing of goods and services.²⁰

In conjunction with the above, the competition laws around the world also prohibit two types of monopolistic behaviours under abuse of dominance provisions. They are exploitative conduct and exclusionary conduct.²¹ However, Mexican competition law does not prosecute exploitative practices

¹⁵ Avantel, a long-distant company, competitor of Telmex, entered the Mexican long-distance market in 1995.

¹⁶ “Competition Law and Policy in Mexico: An OECD PEER REVIEW”, <http://www.oecd.org/dataoecd/57/9/31430869.pdf>, page 11

¹⁷ Federal Competition Commission

¹⁸ An agreement between competing firms in the same industry, which may result in reduced competition.

¹⁹ An agreement between two or more companies operating at different levels of production, distribution or supply chain. These arrangements can, but not limited to, substantially prevent or lessen competition and thus can potentially violate antitrust laws.

²⁰ “Competition Law and Policy in Mexico: An OECD PEER REVIEW”, op.cit., page 19

²¹ A dominant firm when it uses its monopoly power to exploit the customers or the suppliers, it is known as exploitative conduct. Charging monopoly prices to customers and paying low prices to suppliers are examples of exploitative conduct. A conduct which aims at excluding competition to maintain market power is termed as exclusionary conduct. Refusal to deal, filing lawsuits in order to suppress competitors and increasing rival costs are some of the examples of exclusionary abuse.

such as charging monopolistic prices, but encourages actions against exclusionary abuses. “Unlawful conduct is defined solely in terms of exclusionary practices at the expense of competitors or other firms in the chain of distribution, and not in terms of exploitative practices at the expense of consumers.”²² There is no provision for fair competition under this law, neither does it talk about protecting the interest of small enterprises and restricting business concentration. Even though both Mexican constitution and LFCE ban monopoly, no section of law deals with monopoly as such or with abuse of dominance.

Competition and Regulation in Context of Mexican Telecom Industry

“You don’t tug on Superman’s cape, you don’t spit into the wind, you don’t pull the mask of that old Lone Ranger and you don’t mess around Slim.”²³

– Jim Croce

Until 1995, in Mexico the national telephone industry was regulated by SCT. In 1996, a Presidential decree created Cofetel as an autonomous entity from SCT to regulate and develop the Mexican Telecom Industry. Cofetel is responsible for implementing regulations and technical standards. It is also responsible for resolving the conflicts between competitors regarding interconnection fees. Cofetel has operational and technical autonomy but lacks political autonomy. It limits to suggesting on major issues to SCT and SCT retains the power to grant all concessions – it is the final deciding authority. Once a decision is made, Cofetel implements it.

Telmex is regulated through price cap.²⁴ The price cap consists of a basket of five services – installation charges; monthly rental fee; local measured services; national or domestic long-distance and international long-distance. Leased lines²⁵ are not under the price cap, Telmex is not regulated in that aspect. From time to time, the value of basket is re-estimated by the government and it requires Telmex to pass the benefits of productivity and efficiency to the customers to reduce the real value of basket by a definite percentage. The reduction is equal to 4.5% per year. Annual price increase is calculated by deducting 4.5% from the rate of inflation for the respective year. Owing to technological improvements and augmented efficiency, “Telmex has experienced productivity gains in excess of the 4.5% target, allowing it to earn increasing profits while not raising prices as fast as is allowed under the price-cap formula.”²⁶ Telmex sends a letter to the Cofetel with the rates, then Cofetel decides whether the rates have to be registered or not. Once the rates are registered, it’s a sort of consent that the rates are applicable.

Competition entered the Mexican long-distance market in 1997 and later in other segments of telecommunications like local service and mobile market. Since foreign investment was limited to

²² “Competition Law and Policy in Mexico: An OECD PEER REVIEW”, op.cit., page 25

²³ Friday Bill, “Once Upon a Time in Norte America: The Rise of Carlos Slim”, <http://www.losangeles.browwaha.com/article.php?id=962>, March 14th 2007

²⁴ Price cap is the maximum value for a price index of basic residential and business services.

²⁵ A leased line is a symmetric telecommunications line connecting two locations. It does not have a telephone number and each side of the line is permanently connected to the other. Leased lines can be used for telephone, data or Internet services.

²⁶ “Priorities for Telecommunications Reform in Mexico”, op.cit., page 17

49%, AT&T entered the long-distance market as a joint venture with Alestra. Worldcom followed suit by joining with Avantel, but Telmex retorted with patriotic marketing and advertising. In 1998, Avantel intended to introduce long-distance calls from public phones using prepaid cards. As majority of the public phones were operated by Telmex, Avantel was denied a free number by Telmex – a prerequisite for long-distance calls – and the initiative faced major obstacle. Avantel also faced high interconnection fees. When it took Telmex to court for monopolistic practices – Telmex kept it at bay by getting a judge to issue an arrest warrant for the top lawyer of Avantel. “Avantel eventually defaulted on its debt in 2001, much of which were scooped by Mr. Slim and later sold for a profit.”²⁷ Frank Voytek, AT&T’s representative on Alestra’s board says, “Our expectation when we made our investment was that the regulator would enforce the regulations”.²⁸

“Part of Cofetel’s problem in implementing effective regulation arises from its inability to convince the courts that its regulations are reasonable and necessary. An important aspect of judicial review in Mexico is the *amparo*.”²⁹ An *amparo*³⁰ can result in obtaining a stay order in the implementation of a court decree for years. Even if the party, which filed the *amparo*, loses the lawsuit, much time elapses by then. In 1997, for example, CFC determined that Telmex had substantial power in five telephony markets namely, local telephony service; national long-distance service; international long-distance service; access or interconnection to local networks; and interurban transport. In August 1998, Telmex filed an *amparo*. Telmex successfully challenged before court the authority of CFC to declare it dominant in five telecommunications markets. Time and again Telmex filed many *amparos* challenging the decisions of CFC and Cofetel, and this *amparo* abuse has costed Mexican economy dearly. Karina Duyich, former head of AT&T Mexico’s legal department remarks, “Since 1998, Slim has made use of more than 60 *amparos* to thwart decisions by Mexico’s antitrust agency, the *Comisión Federal de Competencia*, ordering Telmex to reduce its interconnection rates – the fees rivals must pay to use Telmex trunk lines. Telmex’s very aggressive use of the *amparo* has ended any hope of an open telecommunications market in Mexico.”³¹

In 2000, CFC once again came down on Telmex for its refusal to deal with the competitors. For instance a customer who called a toll free number (an 800 number) operated by other long-distant operator using Telmex public phone, had to buy its prepaid cards. But the toll free numbers operated by Telmex were accessible without any charges. Telmex refused to deal with the competitors regarding the issue. Because of this, a case was filed against Telmex and it was

²⁷ Luhnow David, “The Secrets of World’s Richest Man”, <http://online.wsj.com/article/SB118615255900587380.html?mod=US-Business-News>, August 4th 2007

²⁸ Preston Julia, “INTERNATIONAL BUSINESS; Competitors of Telmex Say It Still Acts Like a Monopoly”, <http://query.nytimes.com/gst/fullpage.html?res=9802E1DB163FF937A35757C0A9669C8B63&sec=&spon=&pagewanted=2>, April 4th 2000

²⁹ “Priorities for Telecommunications Reform in Mexico”, op.cit., page 20

³⁰ An *Amparo* is a proceeding established in Articles 103 and 107 of the Mexican Constitution to provide citizens with protection against unconstitutional acts of the government. An action for *amparo* can be filed whenever a fundamental human right provided under Federal Constitution is allegedly infringed by any government agency. Parties can attack the government agency decisions in an *amparo* because the due process clause in the article 16 of the Mexican Constitution requires that agency orders articulate the ‘legal basis and justification for the actions taken’.

³¹ Roberts M. James and Ortega Israel, “How Reforms in Mexico Could Make the U.S More Secure”, <http://www.heritage.org/Research/LatinAmerica/bg2135.cfm>, May 13th 2008

ordered to enter into an agreement with its competitors. As a result Telmex provided a free toll free number to competitors who concluded an agreement with it. But by then competitors had lost considerable amount of business.

In the same year, Cofetel ordered a 63% reduction in interconnection fees, which Telmex charged its competitors for international calls. However, Telmex took advantage of Cofetel's weakness and delayed in complying with the order by filing injunctions in various courts. In the meantime, there was a significant progress in the reduction of Mexican domestic interconnection fees, but international long-distance interconnection fee remained mostly unchanged. Mexico failed to address concerns of US telecom companies in regard to the high interconnection fees, which Telmex charged US carriers. In 2002, US requested a WTO panel to take up the matter. In 2004, US won the WTO telecommunications case against Mexico – in particular against Telmex. It was estimated that Mexico's artificially high interconnection charges resulted in excess payments by US companies and consumers well over \$1 billion since 2000.³²

It has not been easy to compete in Mexican mobile market too. OECD referring to Telcel in its report (Economic survey of Mexico 2007: Improving infrastructure in Mexico) declared, "In the mobile telephone market, in particular, the dominant firm is using its market power to squeeze out other players".³³ But Slim has always maintained that he likes competition, and commented that, "We have never opposed the entry of a competitor, let them come on in."³⁴ In 2004, Movistar, the second largest mobile operator in Mexico, to increase market share, started selling mobile handsets at a cheaper price. But many of its sold phones were never used. Movistar discovered that Telcel purchased its handsets, replaced the chip and resold them. Movistar filed a case against Telcel. In 2006, CFC announced Telcel guilty of monopolistic practices as it refused to allow SMS exchange with Nextel. In November 2007, Movistar filed many complaints against Telcel and Telmex with CFC. It appealed CFC to compel both the companies to connect its competitors to their network on fair terms. In 2007, government started an investigation into dominance and monopolistic practices of Telmex in broadband Internet. In 2008, as many as eight probes were initiated against Telmex and Telcel, of which six are investigating Telmex's dominance related issues, while one is into interconnection fee of Telcel and another to determine whether Telcel wields substantial power in Mexican mobile market. Eduardo Perez Motta, president of CFC said that these investigations would be concluded by mid-2008. All eyes are set on the results of the ongoing investigations, competitors are hoping that after investigations are through, both Telmex and Telcel will be made to reduce the interconnection fees.

CFC's and Cofetel's major constraint are their limited powers and the *amparos* filed against their rulings. These *amparos* delay regulatory rulings against the companies. Also, time and again, Telmex and Telcel have used skilful lobbying and legal battles to defend themselves against regulation and antitrust prosecution. Telmex has repeatedly delayed signing interconnection agreement with

³² "US wins WTO Telecommunications Case Against Mexico", <http://www.america.gov/st/washfile-english/2004/March/20040312162758ASrelliM7.784671e-02.html>, March 12th 2004

³³ "Economic survey of Mexico 2007: Improving infrastructure in Mexico", http://www.oecd.org/document/8/0,3343,en_2649_34569_39415560_1_1_1_1,00.html, October 4th 2007

³⁴ Malkin Elisabeth, "New Commitment to Charity by Mexican Phone Tycoon", http://www.nytimes.com/2007/06/28/business/worldbusiness/28slim.html?_r=1&scp=5&sq=&st=nyt&oref=slogin, June 28th 2007

competitors. Due to its dominant position, it does not respect the interconnection fee fixed by Cofetel and continues to charge high tariff per minute. Mexico's constitution has always banned monopolies, but it is a country where corruption is widely spread. Nearly 62% of the companies have admitted to the fact that they reserve money to bribe government officials.³⁵ Slim is alleged to have friends in high places. Actions to curtail Telmex's monopoly power during Carlos Salinas, Ernesto Zedillo and Vicente Fox administrations have not yielded desired results. There were rumours that President Carlos Salinas, who sold Telmex to Slim, secretly benefited from the sale. Critics believe Slim alone has not crushed competition; he had help from Mexican Presidents Ernesto Zedillo and Vincent Fox. In 2000, President Vincent Fox appointed Pedro Cerisola, a former employee of Telmex as Secretary to SCT. During his tenure (till 2006), he was alleged for protecting Telmex's interests. Denise Dresser, a political analyst and professor at the Instituto Tecnológico Autónomo de México says, "Mexico has a dense, intricate web of connections and personal ties between the government and the business class, this ends up creating a government that doesn't defend the public interest, that isn't willing to go out and regulate in the name of the consumer, it is rather willing to help its friends, its allies and, in some cases, its business partners thrive at the expense of the Mexican people".³⁶

Slim's political connections combined with the weak regulatory system of Mexico enabled him to defend his companies against the accusations of monopolistic business practices. It is widely published that Telmex's and Telcel's market dominance can be attributed to hands off policy of Mexican legislature and no British or US government would have allowed this. Perez Motta says, "Mexico's telecommunications regulatory framework and regulator remain weak and have failed, to some extent, to foster access and competition, Telmex has challenged CFC and (*Comision Federal de Telecomunicaciones*, or Cofetel) decisions before the courts and has been successful in delaying enforcement. All these circumstances have allowed it to maintain and exercise its market power through relative monopolistic practices."³⁷ Cofetel has been criticised for lacking teeth to enforce effective regulation. Researchers at Syracuse University note, "Since its creation, Cofetel has assumed what can only be described as a pro-Telmex role in implementing its regulatory duties. As a result, the incumbent enjoys a monopoly over local, long distance, cellular and Internet services in Mexico. Its highly dominant position is largely because regulators have failed miserably."³⁸ Whatever the reason may be, the Mexican economy and Mexican people are facing the consequences.

³⁵ Varsavsky Martin, "Carlos Slim is the richest man in the world: Should Mexicans be proud?", <http://english.martinvarsavsky.net/general/carlos-slim-is-the-richest-man-in-the-world-should-mexicans-be-proud.html>, July 21st 2007

³⁶ Coster Helen, "Slim's Chance", <http://members.forbes.com/forbes/2007/0326/134.html>, March 26th 2007

³⁷ "Why Mexican phones cost a bundle", op.cit.

³⁸ Ibid.

Effects of Monopoly of Telmex and Telcel

“The great evil in economics is not communism, not socialism, not capitalism, not landlords or bosses, not unions, not feudalism or industrialization or automation, not progress or lack of it, and not any scarcity of natural resources. No, the great evil in economics is COERCIVE MONOPOLY.”³⁹

– Fred E. Foldvary

In the bid to sell Telmex, Mexican government hiked telephone tariffs. In 1990, it eliminated indirect taxes on telephone services and allowed Telmex to absorb the remaining taxes into the prices. As a result local calls, which accounted for major part of the revenue for telecom companies, increased from 16 pesos per minute to 115 pesos.⁴⁰ According to a 1992 World Bank report on Telmex sale, the biggest losers from the privatisation of Telmex were the consumers, who had to bare the additional burden of 92 trillion Mexican pesos in the form of higher charges. The government, domestic shareholders and employees gained 16, 43 and 23.5 trillion pesos respectively. The best gain was bagged by the foreign investors who captured 90% of the net benefits from the sale, translated into 67 trillion pesos. “The privatisation of Telmex, along with its attendant price-tax regulatory regime, has the result of ‘taxing’ consumers – a rather diffuse, unorganised group – and then distributing the gains among more well-defined groups, (foreign) shareholders, employees and the government.”⁴¹ However, the report projected that the consumers would benefit in the long run by reduced prices.

The projection proved to be a rather far fetched imagination. The Mexican customers are saddled under high telephone charges since then. Owing to high charges, the usage rate (minutes of use per subscriber per month) is very less in Mexico, thus resulting in deadweight loss⁴². Professor Noll opines, “there is enormous loss of efficiency arising from the dominance of Telmex, especially with respect to the underutilisation of the network (low minutes of use) and the low penetration of the Internet.”⁴³ He also says, “Mexico has low wire-line penetration, but many developing countries have low wire-line penetration. The big problem is that Mexico does not offset this with high wireless penetration. Moreover, wireless penetration is less than it seems because many intensive business users carry cell phones for multiple carriers in order to take advantage of the much lower within-system calling charges compared to the extremely high prices for inter-system calling.”⁴⁴

Economists opine that high costs of telephone and Internet services that resulted from lack of competition are hindering Mexican economy’s growth. In Mexico “high telephone and electricity costs, blamed on monopolies, are driving many factories to countries like China.”⁴⁵ Felipe Calderón, who became the President of Mexico in December 2006, vowed to make Mexico more competitive by dismantling monopolies. In November 2007, he affirmed once more, that increasing competition in telecommunication industry was his priority. But, till mid 2008, there were not any significant move against big companies. Some say that the telecom investigations which are ongoing will be a big test of whether President Calderón and CFC are up to the task.

³⁹ Foldvary E. Fred, “Natural monopolies”, <http://www.progress.org/fold74.htm>

⁴⁰ Hansen Karen, “Privatization Of Mexico: Telmex”, <http://www.50years.org/factsheets/telmex.html>, April 1997

⁴¹ Hansen Karen, “Privatization Of Mexico: Telmex”, <http://www.50years.org/factsheets/telmex.html>, April 1997

⁴² Deadweight loss refers to deficiency in resource utilisation due to inefficient allocation. It could also be defined as loss in total welfare due to a monopoly market. A monopolist’s high prices and low output create deadweight loss.

⁴³ Excerpt from an exclusive interview of Prof. Roger Noll conducted by the author. Please refer Annexure I for the full interview.

⁴⁴ Ibid.

⁴⁵ Bremer Catherine, “Stick to goals on monopolies, US tells Mexico”, <http://www.reuters.com/article/companyNewsAndPR/idUSN0127660320070202?sp=true>, February 1st 2007

Annexure I Interview with Prof. Roger Noll



Roger Noll is a professor of Economics University of Stanford. He has a Ph.D. from Harvard and B.S. California Institute of Technology. Prof. Noll's research interests include public policies towards business, rational actor models of public policy making, political behaviour and legal processes. He had been a consultant to the Government of Mexico during privatisation of its telecom sector.

1) It is reported in some quarters that Mr.Slim abuses his monopoly by over charging customers and the peers with higher interconnectivity fees. How do you read, rather what do you read into, such reports? Also is he correct in denying high charges saying he provides good services?

I think it is not appropriate to attribute the pricing of Telmex solely to Mr. Slim. Telmex is a publicly traded corporation, and all of its owners and executives are responsible for its performance. In addition, Telmex is regulated by Cofetel, which bears some responsibility for its prices. Telmex is among the world's most profitable telephone companies. These profits arise from high prices across the board, including interconnection charges that are above the marginal and average cost of interconnection service. The quality of service is irrelevant to whether prices exceed average and marginal cost and profits substantially exceed the competitive return on investment. In addition, using the standard measures of service quality that are used by the International Telecommunications Union to assess the performance of telecommunications carriers throughout the world, Telmex is not a leader among carriers in peer nations (that is, nations with roughly Mexico's per capita income, distribution of income, and geographic and demographic characteristics).

2) Is it therefore right to say that Mr.Slim is thwarting competition or is he playing fair?

Telmex certainly has not provided any assistance to its competitors, but to expect otherwise is misguided. The history of incumbent monopoly telephone companies in all nations after competition was made legal is similar. Incumbents always try to protect their monopoly. The difference between Mexico and other countries where the performance of the telecommunications industry is superior is that public policy in Mexico has not succeeded in promoting competition, partly because Cofetel is a very weak regulatory agency and partly because Mexico has not reformed its administrative procedures, including the standards and process for judicial review of decisions by Cofetel and the Competition Commission. Thus, the fault for the failure of the Mexican telecommunications industry to be reasonably competitive and to provide services at reasonable prices to its citizens rests with the government.

3) It is argued that privatisation of Mexican Telecom industry replaced a public monopoly with a private monopoly. Do you confer with this argument? or is there any economic logic against this argument?

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This assessment overstates the problem. Competitors have become important in long distance, wireless telephony, private lines, and Internet services. The problem is that in all markets Telmex and its affiliates remain dominant, and in markets where competitors have secure footing, prices are too high and the penetration and use of service is too small relative to achievable goals and accomplishments in peer countries such as Argentina, Brazil and Chile. Among peer nations, only South Africa performs as poorly. There is no reasonable economic excuse for this performance.

4) According to COFETEL, in 2006 tele-density of Mexico was just 18.9. Can such a low tele-density be attributed to excessive tariffs? As demand for telecom services is elastic, are high prices putting way customers.

Mexico has low penetration of wire-line telephony, but many developing countries have low wire-line penetration. The big problem is that Mexico does not offset this with high wireless penetration. Moreover, wireless penetration is less than it seems because many intensive business users carry cell phones for multiple carriers in order to take advantage of the much lower within-system calling charges compared to the extremely high prices for inter-system calling. And because calling charges in Mexico are so high, Mexico has abnormally low usage rates (minutes of use per subscriber per month).

5) Telmex has been a monopoly for about 18 years (with around 90% market share) and Telcel for 8 years (with more than 72% market share). And neither would be facing serious competition in the near future. Do you see this as a market failure or a well orchestrated competitive dynamics? or is it the nature of the industry that lets this type of dynamics to operate?

Telmex has been a monopoly for far longer than 18 years. Before it was a private monopoly, it was a public monopoly. Moreover, technically Telmex is not a monopoly for most services. Instead, it is a dominant firm that effectively can prevent its competitors from taking away most of its market share while charging high prices for ordinary service. There is no natural reason for the dominance of Telmex. Telmex is dominant because the Salinas, Zedillo and Fox administrations and the Mexican legislature did not take the actions that were necessary to produce a more competitive industry.

6) In some industries, for example in telecom, airlines and steel, there is no room for too many players and over the industry life cycle, a dominant player would emerge (assuming of course that the dominance hasn't been achieved out of anti-competitive policies) that would become a monopoly. Is it correct to term all such monopolies as 'competitive monopolies'?

The premise of this question is incorrect. In many other developing countries, these industries are competitive in most segments. While no nation has robustly competitive fixed wire-line access service, many nations have competitive, low-price wireless access and usage that competes effectively with fixed line service. Airlines can be and are competitive in many nations that are smaller and poorer than Mexico – dominance of a single carrier arises only where policy favors it. The dominant technology for producing steel in developing nations is minimills that reprocess scrap, and there is no reason for this to be a monopoly. Moreover, steel is actively traded internationally, so a necessary condition for domestic monopoly is protective tariffs or import quotas.

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7) Do you think such competitive monopolies should be dealt with stern action or should they be allowed to operate the way Telmex and Telcel do? What are the ramifications of each of these measures, the latter implying maintaining a status quo? What is the role of COFETEL in such episodes?

I disagree that there is any such thing as a “competitive monopoly.” I agree that some firms inherit substantial market power, and that this power can not be eroded unless government adopts strong pro-competitive policies. The dominance of Telmex/Telcel arises from interconnection policies, and Cofetel and the Competition Commission have proved to be powerless to deal with it.

8) Is there any dead-weight loss occurring because of this? if there is, how can we quantify the dead weight loss occurring due to this monopoly?

Of course there is enormous loss of efficiency arising from the dominance of Telmex, especially with respect to the underutilization of the network (low minutes of use) and the low penetration of the Internet.

9) Across the world anti-competitive authorities are becoming stricter and stricter. The recent one being in Britain, OFT initiating an investigation into Britain’s retailers. In fact, in some countries the legal actions are initiated suo motto. And Mexico being very close to America, how should one look at such instances of market dominance?

I do not fully understand this question. Mexico has strong competition policy judging from the goals established in its legislation, and the Competition Commission is competent, as is the Ministry of Transportation and Communications. But the details of the statutes in both competition policy and regulatory policy are poorly conceived and ineffective in achieving these lofty goals.

Source: Exclusive interview of Prof. Roger Noll conducted by the author.