Law and Business Review of the Americas

Volume 16 | Number 4 | Article 7

2010

Are You Being Served - The Consequences of Telemex Monopolistics Privatization

Luigi Manzetti

ARE YOU BEING SERVED? THE CONSEQUENCES OF TELMEX MONOPOLISTIC PRIVATIZATION

*Luigi Manzetti**

I. MAIN ARGUMENT

IN the 1990s many countries in the former Soviet bloc, Latin America, Africa, and Asia adopted, in varying degrees, reforms aimed at replacing failed state intervention with market-driven policies. Theoretically, they were based upon the theories of neo-liberal economists such as Freidrich von Hayek and Milton Freidman, whose ideas inspired the political agenda of Augusto Pinochet, Margaret Thatcher, and Ronald Reagan in the 1970s and 1980s. By 1989, important international financial institutions (IFIs) such as the International Monetary Fund (IMF), the World Bank, the U.S. Treasury Department, and think tanks came to the conclusion that market reforms, based upon the same neo-liberal ideas, were the only way to revive the ailing economies of less developed countries. John Williamson described this convergence of policy prescriptions as the "Washington Consensus" because many of its proponents were based in the U.S. capital. The Washington Consensus originally developed in the late 1980s as a set of policies to help Latin America to get out of a decade-long stagnation period.[1] However, as more countries began to ask for the Import Substitution Industrialization (ISI) assistance, its prescription came to be extended to other regions of the world moving away from communism and ISI. Its main features were economic deregulation, trade liberalization, and privatization. Among these three, privatization was probably the most controversial because it symbolized the reversal of decades of ISI and government control of the commanding heights of the economy. Consistent with the von Hayek and Friedman theories, the Washington Consensus argued that the divestiture of government (or state)-owned enterprises (SOEs) would accomplish both economic and political goals. Economically, it would bring about competition and consequently, better products, lower prices, and greater attention to customers' needs. Politically, it would deprive politicians of the discretionary power to favor powerful lobbies within the business and

* Luigi Manzetti; Department of Political Science, Southern Methodist University.

1. John Williamson, *What Should The World Bank Think About The Washington Consensus?*, 2 (Peterson Inst. for Int'l Econ., Working Paper, 2000), http://www.iie.com/publications/papers/paper.cfm?ResearchID=351.

labor sectors and, in the process, prevent them from engaging in corrupt and collusive activities.

However, despite its potential for creating growth and competitive markets, the record of privatization worldwide to date is quite mixed. Economists often point to technical difficulties, market failures, and lack of secure property rights. Political scientists instead have stressed how political opportunism was often associated with poor results and crony capitalism. According to this line of thought, the way governments carry out privatization and set up the regulatory policy (particularly in the strategically important sector of public utilities) is crucial. When governments manage a state divestiture process following political criteria in order to retain political support from key socioeconomic vested interests, privatization results in the re-assignment to well-connected groups in the private sector. In turn, the early winners of the privatization process will become the staunchest opponents of market competition and any subsequent effort to introduce competition in their monopolistic markets will cause major losses to the country in terms of economic efficiency and welfare improvements. In his "winner takes all" thesis, Hellman argued that the beneficiaries of "politically managed" privatization processes will do everything in their power

> [t]o block specific advances in the reform process that threaten to eliminate the special advantages and market distortions upon which their own early reform gains were based. Instead of forming a constituency in support of advancing reforms, the short-term winners [will] seek to stall the economy in a *partial reform equilibrium* that generates concentrated rents for themselves, while imposing high costs on the rest of society.[2]

The aim of this paper is to bring support to this argument by showing how political considerations have played a crucial role in shaping Mexico's regulatory framework in the telecommunications sector. Consistent with the Hellman thesis, I will bring evidence of how, under monopolistic conditions, the Mexican private telecommunications company has thus far provided a service to consumers that is far below that of other Latin American countries and has imposed unreasonable costs to domestic businesses. In other words, the argument of this paper is that political exigencies have conspired against the establishment of market competition in the telecommunications sector thus creating a significant obstacle to the country's economic development.

II. ON THE ROLE OF REGULATION IN PUBLIC UTILITIES

By the 1950s Mexico, like the rest of Latin America, had acquired firm control over the public utility sector under state ownership. This meant that state-owned enterprises (SOEs) in such areas as telecommunications,

2. Joel S. Hellman, *Winners Take All: The Politics of Partial Reform in Postcommunist Transition*, 50:2 WORLD POL. 203, 204-05 (1998).

telephones, and water and sanitation were left to regulate themselves under the supervision of a variety of government departments or ministries. By the late 1980s, hard-pressed by severe budget constraints, Mexico came under intense pressure from the United States, the IMF, and the World Bank to privatize many of its public utilities, which were plagued by severe financial losses and were no longer capable of meeting basic investment requirements in service coverage and technology upgrading.

In fact, since Mexico was the first large Latin American market to embark upon utility privatization, it became an important test case for what was at the time a spirited debate about the role of regulation in a market economy with or without privatization.[3] While most argued that privatization was unavoidable since SOE management had failed, others contended that it was not the type of ownership that mattered but rather the way a public utility was actually run. As Noll noted in this regard, "The key point is that operating efficiency is substantially improved if the enterprise faces a hard budget constraint and is relatively free of political interference in its day-to-day business decisions."[4] Eventually, the view that privatization was always the best option became the dominant line of thinking at the IMF and the World Bank, thus leading critics like Joseph Stiglitz to contend that the two IFIs took too much of an ideological-political stance that downplayed economic efficiency considerations.[5] In the early 1990s, the IMF and World Bank made financial assistance conditional upon the adoption of the divestiture of SOEs in public utilities, often relegating the establishment of a regulatory framework after companies had been transferred to the new private owner. This quick and dirty approach clashed with much of the literature on utility regulation, which postulated the creation of regulatory institutions enforcing legal and technical standards first, particularly in those markets characterized by natural monopolies or where competition was difficult to achieve.[6] In fact, most experts underscored how the design of regulatory institutions,

3. Chile had privatized its public utilities in the late 1980s, but they were smaller in size and the government was a military dictatorship, which left many skeptical about the feasibility of such a radical policy under a democratic regime.
4. Roger G. Noll, *On Privatizing Infrastructure Industries*, World Bank Development Report Planning Conference (July 2001), http://www.accc.gov.au/content/item.phtml?itemId=853305&nodeId=fcb2ef79e754b7bd71c99dcf04896b84&fn=Roger%20Noll%20%28paper%29%20-%20On%20Privatizing%20Infrastucture%20Industries%20.pdf.
5. *See* INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT AND THE WORLD BANK, GLOBAL MONITORING REPORT 74, 131 (2005); JOSEPH E. STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS 54 (2002); NGAIRE WOODS, THE GLOBALIZERS: THE IMF, THE WORLD BANK, AND THEIR BORROWERS 136 (2006).
6. *See* ROBERT BRITT HORWITZ, THE IRONY OF REGULATORY REFORM: THE DEREGULATION OF AMERICAN TELECOMMUNICATIONS 32 (1989); Ronald R. Braeutigam, *Optimal Policies for Natural Monopolies*, *in* 11 HANDBOOK OF INDUSTRIAL ORGANIZATION 1289, 1290, 1298-99, 1342 (Richard Schmalensee & R.D. Willig eds., 1989); William Glade, *Privatization in Rent-Seeking Societies*, 17 WORLD DEV. 673, 673-82 (1989); Roger G. Noll, *The Future of Telecommunications Regulation*, *in* REGULATING TELECOMMUNICATION NETWORKS (Eli Noami ed. 1983); Roger G. Noll, *Economic Perspectives on the Politics of Regulation*, *in* 11 HAND-

as well as their degree of independence from political institutions, was pivotal in shaping utility companies' performance after privatization. According to Noll:

> the performance is better if regulators are independent of both the legislature and the executive, if regulatory processes are open and transparent, if judicial review is speedy, if the standards for judicial review clearly focus on whether the agency acted within its mandate and had a reasonable basis for its decisions, if regulatory policy is designed to favor largely unregulated competition, as opposed to monopoly or managed competition, wherever competition is feasible, and if regulation of the residual monopoly is oriented towards maximizing economic efficiency (including suppression of monopoly pricing and anticompetitive behavior). Moreover, privatization is likely to be more successful when most, if not all, of these governance institutions (including the commitment to competition) are in place before privatization proceeds.[7]

Why then from the outset of the privatization process in Latin America (including Mexico) have the IMF and the World Bank relegated the establishment of regulatory institutions to a second phase of the reform process? There are three main reasons explaining such contradictory behavior. First, IFIs believed that the window of opportunity to privatize could close quickly and putting in place a regulatory framework was time consuming, which could give enough time to anti-reform forces to stop state divestiture. Second, privatizing in a monopolistic way would allow governments to increase their sale price. Third, both the World Bank and the IMF wanted Mexico to pay back its loans quickly as more and more countries in the early 1990s were seeking their financial assistance. Thus, despite much rhetoric about creating competitive markets, IFIs were quite willing to sacrifice a level playing field and efficiency gains to achieve short-term political and financial goals.[8] Ironically, this allowed for the retention of much political discretion that, according to the IFIs themselves, privatization was theoretically supposed to eliminate.

III. PRIVATIZATION AND REGULATORY POLICY IN MEXICO

During the presidency of Raul Salinas (1988-94), Mexico went through a radical shift in economic policy. In the aftermath of the financial crisis of 1982, the U.S. government and the IMF provided Mexico with an emergency loan package to help the country avoid bankruptcy. But, aid came at a dear price as Mexico had to accept stiff conditions that forced the country to reverse the import substitution industrialization development model that had dominated macroeconomic policy since the late

---

BOOK OF INDUSTRIAL ORGANIZATION 1253, 1254-58 (Richard Schmalensee & R.D. Willig eds., 1989).

7. Noll, *supra* note 4, at 1-2.
8. *See* STIGLITZ, *supra* note 5, at 76, 132.

1920s. Under President Miguel de la Madrid (1982-88), the country started a painful process of economic restructuring by cutting government expenditures and attempting some minor privatizations. But, it was under Salinas that the thrust of market reforms, with strong backing from the United States, the IMF, and the World Bank (the latter two provided both economic and technical assistance) began to truly reconfigure the Mexican economy. Salinas not only drastically cut economic barriers to pave the way for Mexico's bid to join the North American Free Trade Agreement (NAFTA), but also launched an ambitious state divestiture program, which on paper was supposed to modernize the country's economy and improve its efficiency in allocating resources.

Salinas' privatization was a major turning point in defining the role of the state in Mexico, and, as can be seen in Tables 1, 2, and 3, it reversed six decades of steady state encroachment in the economy. By the time his mandate was over, Salinas had either liquidated or privatized some 258 of the country's most important SOEs. Some economic analyses have contended that the overall effects of privatization in Mexico were positive in terms of greater service provision, firms' profitability, productivity gains, fiscal revenue, and overall welfare benefits for the poor.[9] But, they also acknowledged that the privatization process required transparency and "[s]pecial requirements such as bans on foreign direct investment or cash-only payments [led] to substantial price discounts for firms sold."[10] Indeed, political analyses of Mexico's privatization program under Salinas and thereafter point out how many powerful domestic groups received preferential treatment, which allowed them not only to acquire important rents under monopolistic conditions but, in turn, enabled them to earn enough cash flow to extend their clout in other lucrative markets .[11]

That political concerns were very important in shaping Salinas' divestiture strategy was obvious from the outset. In a recent study, Murillo argues that two factors explain the way reforms in public utilities took place in Argentina, Chile, and Mexico: 1) the level of political competition, which determined the timing of reforms (the greater the amount of political opposition in and outside of Congress, the less likely privatization would occur), and 2) the partisan orientation of the incumbent, which affected how much regulatory discretion would be used after privatization (if the reforming president was a pragmatist reforming out of necessity, he would do so in a way to still maximize state control).[12] Mexico fits Murillo's "pragmatic" approach because the state divestiture process affected public utilities unevenly. While telecommunications was priva-

9. *See* Rafael La Porta & Florencio López-de-Silanes, *The Benefits of Privatization: Evidence from Mexico*, 114 Q. J. OF ECON. 1193, 1235-1237 (1999); Alberto Chong & Florencio López-de-Silanes, *Privatization in Mexico*, 5-6 (Inter-Am. Dev. Bank, Working Paper No. 513, 2004).

10. Chong & Lopez-de-Silanes, *supra* note 9, at 3.

11. JUDITH A. TEICHMAN, PRIVATIZATION AND POLITICAL CHANGE IN MEXICO 10-12, 89-92 (1995).

12. MARIA VICTORIA MURILLO, POLITICAL COMPETITION, PARTISANSHIP, AND POLICY MAKING IN LATIN AMERICAN PUBLIC UTILITIES 1 (2009).

tized in 1990, electricity remained mostly under government control. Indeed, Salinas ruled out the privatization of electricity and only in 1992 did he allow some minor reform; but private investors could only enter the generation part of the business and could only sell to SOEs. The reason behind this inconsistent approach rests to a large degree on political grounds. In fact, Salinas faced greater opposition to privatize electricity than telecommunications, mostly because the former service privatization could negatively affect a much larger number of consumers with obvious political consequences. Let us now examine in some details the privatization of the telecommunications sector.

IV. TELMEX PRIVATIZATION

Mexico established Telmex, the SOE with exclusive control of the telecommunications sector in 1972 (which was rather late by Latin American standards), but soon experienced the same problems as other countries in the region including high deficits due to low tariffs, limited coverage, and an increasingly outdated technology due to lack of investments. As the fiscal deficit reached five percent of the gross domestic product in 1989, privatizing Telmex offered Salinas an opportunity to raise some badly needed funds.[13] It would also send a clear signal to the international community that Mexico was serious about implementing market reforms by shedding one of its most important and potentially lucrative SOEs.[14] Salinas made it clear from the start, however, that "[t]he government should not directly control the economy but rather serve as an overseer that would impose the discipline, order, and efficiency the system required."[15] Put differently, the government would reform, but on its own terms not according to the tenets of free market economics as postulated by neo-liberal theorists. According to Salinas' view, the Mexican government would retain a substantial discretionary role in establishing the rules of the game even after privatization was complete. To make Telmex financially attractive, the Salinas administration decided to increase tariffs. For instance, charges for local calls rose from 16 pesos per minute to 116 pesos per minute.[16] The government also waived an indirect tax on telephone service, ensuring that the remaining taxes would be incorporated into the new tariff structure, and paid off most of Telmex's debt.

These concessions notwithstanding, the real deal maker was selling Telmex as a vertically integrated company with exclusive monopolistic conditions on all services. The president used three main arguments to

13. *See* Bradford De Long, Christopher De Long & Sherman Robinson, *The Case for Mexico's Rescue: The Peso Package Looks Even Better Now*, FOREIGN AFF., May-June 1996, at 8, 10.
14. *See generally* WORLD BANK, WORLD BANK CONFERENCE ON THE WELFARE CONSEQUENCES OF SELLING PUBLIC ENTERPRISES: CASE STUDIES FROM CHILE, MALAYSIA, MEXICO, AND THE U.K. (1992).
15. MIGUEL CENTENO, DEMOCRACY WITHIN REASON: TECHNOCRATIC REVOLUTION IN MEXICO 195 (2nd ed., 1994).
16. WORLD BANK, *supra* note 14.

justify his controversial decision to turn a government monopoly into a private monopoly.[17] First, by restricting bids to domestic investors (foreign minority stakeholders were allowed but primarily to provide the needed technology and financing), the company would remain under Mexican control. To accomplish that, the government created different types of shares determining who would control the company. Mexicans nationals were the only ones who could acquire shares granting "managing rights" which could not be sold until the monopoly period expired. Second, foreign business partners demanded monopolistic conditions to justify their investments in joint ventures with domestic firms where they had to put up a large amount of capital to upgrade obsolete Telmex infrastructure.[18] Third, monopolistic conditions could justify the government's demand upon the new owners to provide "universal service" to low-income communities both in urban and rural areas, even though the government committed itself to provide large subsidies to those communities after privatization.[19]

Interestingly enough, several international investors had openly contradicted the government's stance on the monopoly concession even before the Telmex sale. In fact, some favored the option of breaking up Telmex into smaller, regional operators, to keep investment, labor, and operating costs down. Furthermore, some of the most distinguished consultants the Mexican government hired for advice argued strongly in favor of the establishment of a competitive market rather than a monopolistic one.[20] But, Salinas was determined to manage the Telmex privatization in a way that would strengthen his political support and minimize opposition to his leadership. First, by selling to a domestic investor under very lucrative conditions, he could bring into his camp what was likely to become a major company that would surely contribute generously to his Institutional Revolutionary Party's electoral campaigns for years to come. Second, a monopoly would also please the Telmex union, which would have seen its bargaining power and workforce significantly reduced under a competitive state divestiture. Indeed, the Telmex union was more than happy to endorse the president's plan. After privatization, the union bosses retained their privileged status, their affiliates kept their jobs, and both gained financially as they obtained 4.4% of the company stock, which appreciated considerably after the sale due to Telmex's high profit margins. Third, by keeping the company in Mexican hands Salinas would appease both left-wing political parties and the nationalistic faction within his party, which were both ideologically against foreign investments. In conclusion, by the time the company was ready to be sold,

17. *See* Roger G. Noll, *Priorities for Telecommunications Reform in Mexico* 5 (Stanford Inst. for Econ. Policy Research, Working Paper No. 06-035, 2007), http://siteresources.worldbank.org/INTMEXICOINSPANISH/Resources/noll-paper.pdf.

18. *Id.*

19. *Id.*

20. Roger Noll & Fernando Salas, *Reestructuración y privatización de teléfonos de México*, Mimeograph, 1990.

Salinas had effectively brought into his camp all the vested interest groups and organizations which could have derailed the process.

The World Bank played a critical role both financially and politically. In 1989, it provided Mexico a $500 million loan to fund its privatization program and an additional $22 million in technical assistance in 1990 to prepare for Telmex's divestiture.[21] It also publicly displayed strong support for Salinas' plans.[22] Despite its early statements expressing a preference for a privatization that would create a competitive environment, the World Bank eventually approved the government's controversial privatization method. In justifying its decision, the World Bank argued that after all:

> [s]ector solutions are shaped by the country's political institutions and electoral arrangements, the interests of constituency groups and the role of the government judiciary. Regulatory arrangements that seem optimal from a sectoral viewpoint may not be feasible, and compromise solutions are necessary. In particular, the economic benefits of improved services following privatization of a state-owned enterprise may well outweigh the rents captured by an imperfectly regulated monopoly.[23]

In the end, the main bidders were two domestic entrepreneurs: Roberto Hernandez of the investment bank Acciones y Valores de México (Accival) and Carlos Slim, owner of Grupo Corso. Both were self-made men who did not belong to the traditional Mexican business elite, but had developed strong political ties with the ruling PRI. Slim, in particular, had been involved in the NAFTA negotiations and had been an outspoken endorser of Salinas' economic reform agenda. After lengthy closed-door negotiations, Slim, in association with Southwestern Bell and France Télécom, prevailed and acquired Telmex in a deal that included a seven-year monopoly clause for both domestic and international calls and related services. To sweeten the deal, the Mexican government did not establish any regulatory agency framework prior to the divestiture process, and did not subject the company to anti-trust laws. Thus, until President Ernesto Zedillo created the Federal Telecommunications Commission (COFETEL) in 1996, the federal agency which would eventually oversee the whole sector, regulation remained under the control of the executive branch, specifically the Secretary of Communications and Transportation (SCT), allowing the government to alter the concession contract as it saw fit even after privatization. For example, the government delayed granting the licenses necessary to open the local domestic market to private competition until 1995 and the long-distance calls market until late 1996.[24] Thanks to the government's manipulations, Telmex acted like an unregulated monopoly for almost seven years.

---

21. WORLD BANK, *supra* note 14.
22. *Id.*
23. Judith Mariscal, *Telecommunications Reform in Mexico from a Comparative Perspective*, 46 LATIN AM. POL. & SOC'Y 83, 91-92 (2004).
24. MURILLO, *supra* note 12, at 89.

V. POLITICAL CLOUT AND REGULATORY CAPTURE

The Telmex acquisition allowed Slim to make large profits in a very short period of time while also granting him tremendous political and economic clout in Mexico. By the mid-1990s, the Corso Groups (within which Telmex was the largest) accounted for about forty percent of Mexico's stock exchange worth, granting Slim tremendous bargaining power with political authorities.[25] As Mariscal noted:

> With the purchase of Telmex, the only Mexican company with stock traded in the international exchange markets at the time, Slim would acquire an international profile. A large, integrated company also conferred on its owners extensive political power. Indeed, this company became a strategic asset; any significant movements Telmex stock made on the Mexican stock exchange influenced the financial stability of the country.[26]

Such influence was instrumental in enabling Slim to convince Presidents Ernesto Zedillo (1994-2000), Vincente Fox (2000-2006), and Felipe Calderon (2006-present) to continue Telmex's dominance of the telecommunications sector in Mexico from 1994 onward. The continuation of the Slim-government cozy relationship could be seen in the aftermath of the financial crisis that hit Mexico in 1995. That year a legislative proposal to inject market competition after Telmex's monopoly status was set to expire was substantially watered down. To help the government keep inflation under control Slim agreed to refrain from price increases (for a year). In return, the bill languished in Congress due to lengthy negotiations as Telmex and its congressional backers from the PRI stonewalled making significant concessions to open the Mexican market. By the time Congress approved the new law, Telmex's interests had prevailed. First, COFETEL that in the original bill was supposed to become an autonomous agency, remained under firm executive control. Second, the telecommunications law restricted foreign investments, imposed stiff investment requirements on new market entrants, and granted Telmex substantial network rents. Also, although from 1996 to 1998 the government eventually allowed some competition to offer services in paging, wireless personal communication services (PCS), and internet, the new companies had to use the Telmex network, which put them at a great disadvantage. Moreover, Telmex's market power was strengthened by the fact that it provided a large array of services that its competitors could not. Thus, many customers selected Telmex precisely because it is a "one stop shop" company.[27]

The PRI eventually lost the presidency to the supposedly pro-business center-right Partido Acción Naciona (PAN). In the mid-1990s the PAN

---

25. *Mexican Billionaire Carlos Slim Promotes Public-Private Partnership to Boost Development, Growth*, ALL BUSINESS.COM, Mar. 29, 2006, http://www.allbusiness.com/north-america/mexico/877520-1.html.
26. Mariscal, *supra* note 23, at 91.
27. Noll, *supra* note 17, at 10.

had made the creation of telecommunication sector competition part of its electoral platform, but once in power President Fox found it difficult to move forward due to strong congressional opposition led by legislators from the PRI and the left-wing Partido de la Revolución Democrática (PRD). Indeed, Slim seemed to have convinced politicians of all persuasions of the necessity of promoting Mexican capitalism through strong government-private sector ties. In 2005, a year before the 2006 presidential elections, he disclosed the so-called "Acuerdo de Chapultepec" in which he championed the idea of private-public partnerships to promote major infrastructure projects. The PRI and PAN candidates enthusiastically supported the plan and, although unofficially, so did the PRD. But, to many such a plan seemed to be a new dress for the old practice of government-subsidized private capitalism.[28] In conclusion, Telmex owes the retention of its monopolistic status over two decades, regardless of the party in power, to Slim's ability to protect government constituencies and his generous campaign contributions to all major parties. Denise Dresser described Slim's clout as follows:

> Just as the PRI denied the existence of a regime that controlled everything, Carlos Slim denies any aspirations of an enterprise that wants full control. Yet he is accomplishing this, signature by signature, consensus by consensus, applause by applause. The Acuerdo de Chapultepec [is the vehicle] that legitimizes surrender. It symbolizes the collective permission to push for individual interests.[29]

As noted, the government manipulation of the telecommunications sector after privatization favoring Telmex could be accomplished precisely because Salinas had retained a substantial amount of regulatory discretion in the hands of the executive branch, which could be used to pick winners and losers with relative ease. Even after 1996, when COFETEL became operative, the agency could do little to reverse the asymmetrical power relationship that Telmex had been able to develop during the regulatory vacuum of the early 1990s. The agency has remained chronically weak in enforcing rules since the SCT, which is very susceptible to political considerations, still has the ultimate say in any decision affecting telecommunications. Moreover, its decision-making process is often secretive, cumbersome, and fails to exercise a true oversight

---

28. Besides keeping close ties with the leaders of Mexico's major parties, as part of his popular outreach program Slim has created a number of charitable institutions including the Telmex Foundation and the Carso Foundation, which fund a wide array of health, education, and poverty alleviation programs.

29. *Mexican Billionaire Carlos Slim Promotes Public-Private Partnership*, *supra* note 25. In another article Dresser further commented about Slim's cozy relationship with the Mexican political establishment in these terms, "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. . . But 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." Helen Coster, *Slim's Chance*, FORBES, Mar. 26, 2007, http://www.forbes.com/forbes/2007/0326/134.html.

role.[30]

Mexico's political system, characterized by weak checks and balances and an executive very permeable to the lobbying influence of key interest groups, has proved fertile ground for Slim's power of persuasion found a fertile ground to sway things his way .[31] Thanks to the acquiescence of government regulators, Telmex has been able to corner the telecommunications market and engage in 1) systematic price gauging (charging much higher prices than is considered reasonable or fair); 2) a variety of tactics to delay, deny, or provide poor access to competitors to its network; 3) the manipulation of price cap regulation (which adjusts the operator's prices according to the price cap index that reflects the overall rate of inflation) to its advantage; and 4) retain high charges for local calls even though technological improvements have made such calls much cheaper compared to 1990.[32]

The courts have not fared much better than the executive and the legislature in promoting a level playing field. In the past fifteen years, challenges by telecommunications companies to Telmex's uncompetitive practices have often fallen on the deaf ears of regulators and courts alike. In fact, the Mexican courts have actually worked as an additional means for Telmex to prevent competition. In a recent study, researchers found that Telmex successfully used judicial injunctions to delay administrative rulings and legal suits.[33] Adding insult to injury, in several cases Telmex's use of court injunctions enabled it to prolong litigation for several years.

To defend its monopoly status, Telmex points out that from 1990 to 2009 the number of fixed lines tripled (from 6.4 million to almost 19 million) and so did its wireless business, which by 2006 had reached 50 million units.[34] Moreover, its productivity has improved tremendously, ranking among the highest in the world. Equally important is the fact that the large profits accrued over the years have enabled Telmex not only to invest in improving service quality and availability at home, but also to acquire other telecommunications companies around the world (including the assets of AT&T Latin America, Brazilian Embratel, Argentine Techteland, and the Chilean Chilesatin) turning it into a champion of Mexican capitalism.[35] Indeed, by 2010, Telmex had become the

30. Noll, *supra* note 17, at 25.

31. *See* Santiago Levy & David Walton, *Equity, Competition, and Growth in Mexico: An Overview*, in No Growth Without Equity?: Inequality, Interests, and Competition in Mexico 24 (Santiago Levy & David Walton eds., 2009).

32. *See* Organization for Economic Co-operation and Development [OECD], Latin American Competition Forum, Santiago, Chile, Sept. 9-10, 2009, *Session IV: Competition Issues in Telecommunications, Mexican Telecommunications Interconnection Regime: Executive Summary* 1, 5-7 (2009), *available at* http://www.oecd.org/dataoecd/39/63/43628914.pdf.

33. Rafael del Villar, *Competition and Equity in Telecommunications*, *in* NO GROWTH WITHOUT EQUITY?: INEQUALITY, INTERESTS, AND COMPETITION IN MEXICO 321, 333 (Santiago Levy & David Walton, eds., 2009).

34. Noll, *supra* note 17, at 4.

35. In 2004, Telmex acquired AT&T's Latin American operations, giving it a large presence in Colombia, Peru, Chile, Argentina, Brazil, and Uruguay. Subsequently,

largest publicly traded company in Latin America and was listed on the Mexican Stock Exchange, NASDAQ, and the New York Stock Exchange. Concomitantly, Carlos Slim had amassed a fabulous fortune, making him the third-richest man in the world by 2009.

VI. THE ECONOMIC CONSEQUENCES OF TELMEX'S DOMINANCE

Despite these accomplishments, most observers, as noted at the beginning of the paper, agree that the Telmex privatization has served Mexico poorly.[36] In 2009, even the governor of the Mexican Central Bank, Guillermo Ortiz Martinez, accused Telmex of systematically obstructing competition, forcing consumers to pay some of the highest rates in the world, and creating a serious impediment to economic growth.[37]

To understand how Telmex's dominance has hurt Mexico, I will examine the data coming from Mexico as well as compare Telmex's performance with that of companies in other countries for the provision of the most important and widely used telecommunication services. For instance, the National Index for Prices to Consumers (INPC) reflects the fact that Mexicans spend a disproportionate amount of money on Telmex's services when compared to other products (Figure 1). The impact of Telmex's charges is so large because the company controls, among other services, ninety-one percent of fixed phone lines (Figure 2). To better comprehend Telmex's dominance in comparative perspective, Figure 3 shows the mobile market share of the largest provider vis-à-vis its competitors in four countries with demographics similar to Mexico's (Hungary, Turkey, Poland, and the Czech Republic). As it can be seen, Telmex is by far the most monopolistic company in this sample. Such dominance in fixed and mobile telephone (and a host of other services, including cable) has allowed Telmex not only to financially outperform its domestic competitors (Figure 4) in excess of opportunity costs, but also to accrue a tremendous amount of economic resources over the last twenty years.[38]

One of the negative results of this state of affairs, is that since Telmex charges high fees for a host of services, this reduces the amount of service demanded for fixed and mobile telecommunications (Figures 5 and 6). Moreover, it negatively impacts Mexican businesses that are forced to pay more than competitors abroad for the same service (Figure 7).

Telmex's monopolistic status has other adverse consequences as well. Before privatization, Salinas justified transferring the company as a monopoly by arguing that, as part of the deal, the new operator would pro-

---

it bought Embratel, Brazil's largest and most important long distance operator, as well as Chile's Chilesa and other smaller telecommunication companies in the Caribbean. By 2010, Telmex had also established extensive cable services in most of the Latin America markets where it was previously operating.

36. *See* Levy & Walton, *supra* note 31, at 6.
37. *Mexican Billionaire Carlos Slim Promotes Public-Private Partnership*, *supra* note 25.
38. *See* Noll, *supra* note 17, at 7.

vide universal service for marginal areas that otherwise would be unprofitable to cover.[39] Did lower class consumers benefit from Telmex privatization as Salinas originally claimed? According to Telmex, consumers did benefit based on the number of fixed lines, mobile lines, and the number of internet subscribers (as displayed in Figures 8a, 9a and 10a), and overall the company performs well by international standards. But once the raw data is adjusted according to income distribution, Mexico ranks among the worst performers, as seen in Figures 8b, 9b, and 10b.

VII. CONCLUSION

This paper has tried to show that the collusive way in which President Salinas privatized Telmex allowed its new owner, Carlos Slim, to adopt a "winner takes all" approach that severely penalizes both Mexican consumers and businesses. Moreover, it has shown how after Salinas, successive administrations have kept regulation policy under tight control, allowing for a discretionary decision-making style that has discouraged competition while enabling Slim's Grupo Carso to develop into one of the most important Latin American multinationals. Consistent with Hellman's theory, Telmex has become a major obstacle to market reforms in Mexico thanks to the connivance of political parties from all sides acting with a misguided sense of economic nationalism.

But there are signs that some changes may finally take place. In 2009, COFETEL auctioned new wireless bands for fixed and mobile telecommunications services. Furthermore, digital cable operators are now being allowed to provide telephone services.[40] But from an institutional standpoint, as long as all three branches of government and the most important political parties remain susceptible to the lobbying power of people like Carlos Slim, Mexico will remain characterized by a highly concentrated ownership in key sectors (in addition to telecommunications) that prevent it from growing to its full potential.

The key question then becomes whether there will be the necessary political will to change the status quo. As long as politicians' preferences are shaped by narrow, short-term, partisan interests, it is likely that Slim and his fellow billionaires in Mexico will exploit any crack in the system to keep the current state of affairs in place, which does not bode well for the future.

39. Less known to the public was the fact that after privatization the Mexican government provided hefty subsidies for universal coverage.

40. *See* David Adams, *Mexico's Telephone Titan*. PODER 360 (Feb. 2010), http://www.poder360.com/article_detail.php?id_article=3570&pag=1.

TABLE 1. STATE-OWNED ENTERPRISES IN MEXICO 1917-2003[41]

Main Focus of State Activity	Period	Number of SOEs (end of period)
Public administration, creation of infrastructure, administration of natural resources and provision of basic services.	1917-1940	36
Import-substitution oriented investments (capital-intensive and long-maturity areas; industry input suppliers); transportation and communications; and social security institutions.	1941-1954	144
Stable development, unplanned expansion: Regional development, production expansion, and creation of employment.	1955-1970	272
Planned expansion: oil bonanza, government as an industrial investment engine.	1971-1975	504
Planned expansion: Bank nationalization, government investment in strategic areas and takeover of firms in distress.	1976-1982	1,155
Main program of liberalization of the economy and divestiture of the state owned sector.	1983-1993	258
Consolidation of the privatization program: public utilities and pension system.	1994-2003	210

TABLE 2. STATE-OWNED ENTERPRISES 1982-2003[42]

	1982-1988	1989/1993	1994/2003
Total at the beginning of period	1,155	666	258
Creation	59	39	108
Liquidations / Shutdowns	294	193	58
Mergers	72	17	16
Transfers	25	11	26
Privatizations	**157**	**226**	**56**
In Process*			37
Total at the end of the period:	**666**	**258**	**210**

41. Chong & Lopez-de-Silanes, *supra* note 9, at 8 tbl.1.
42. *Id.* at 10 tbl.2.

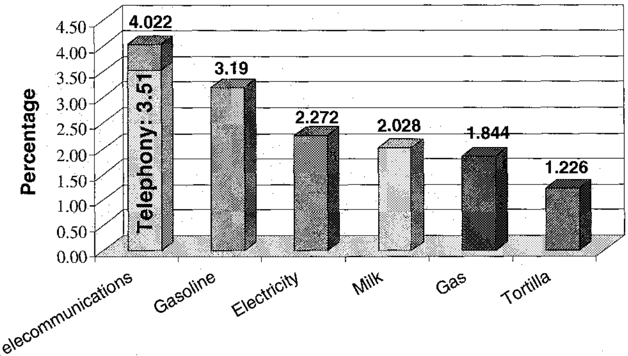
TABLE 3. THE PRIVATIZATION PROGRAM IN PERSPECTIVE[43]

Year	Companies Privatized	Number of transactions (privatization contracts)
1983	4	2
1984	3	1
1985	32	10
1986	30	16
1987	22	17
1988	66	51
1989	37	29
1990	91	63
1991	65	37
1992	21	10
1993	12	8
1994	1	1
1995	1	7
1996	1	16
1997	2	12
1998	3	13
1999	32	5
2000	16	2
2001	0	0
2002	0	0
2003	0	0
Total:	**439**	**300**

43. *Id.* at 11 tbl.3.

FIGURE 1[44] COMPETITVE AND CONSUMER LANDSCAPE IN MEXICO

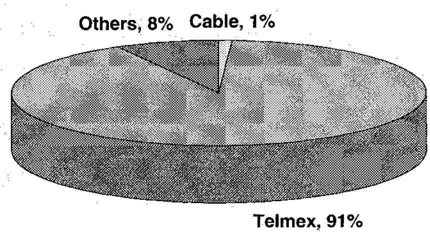
INPC Pondering



INPC: .National Index for Prices to Consumers
Source: Banxico. www.banxico.org.mx

FIGURE 2[45] COMPETITVE AND CONSUMER LANDSCAPE IN MEXICO

Fixed Telephone Line Service Distribution in Mexico

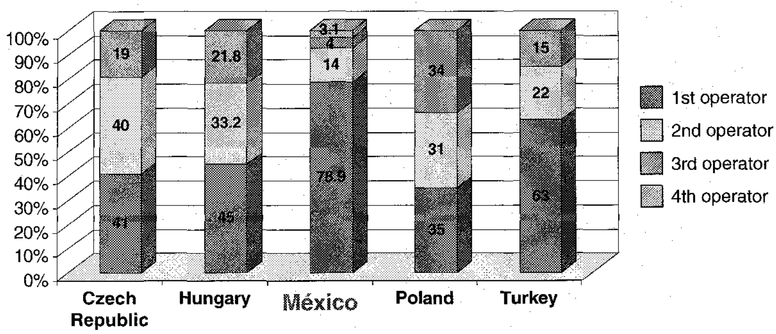


Source: Cofetel. Reporte de actividades 2006-2007, Telmex. Reporte del 1er trimestre 2007, Canitec

44. Alejandro Puente, President of Canitec, What Keeps Holding the Mexican Economy Back?: A Discussion on Competition and Consumers, Lessons from the Telecommunications Sector 4 (Apr. 8, 2008) (video and powerpoint available at http://www.wilsoncenter.org/index.cfm?fuseaction=events.event_summary&event_id=39993.
45. *Id.* at 6.

FIGURE 3[46] COMPETITVE AND CONSUMER LANDSCAPE IN MEXICO

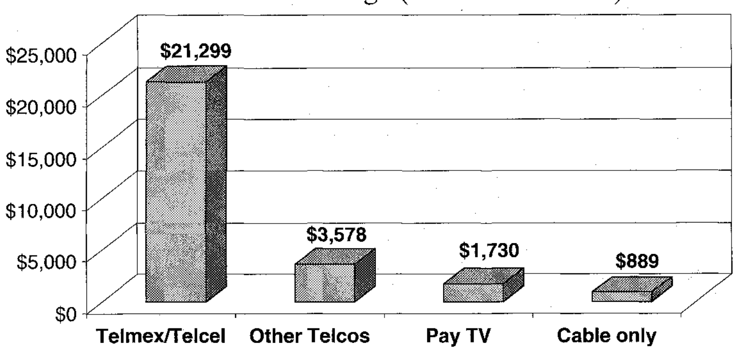
Market Relative Distribution



Source: OCDE Communications Outlook 2007. Focus on Mexico

FIGURE 4[47] COMPETITVE AND CONSUMER LANDSCAPE IN MEXICO

2006 Annual Earnings (Millions of USD)

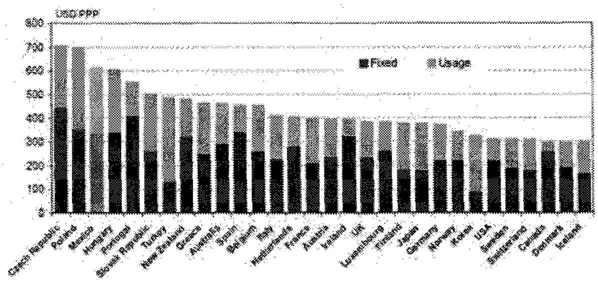


Source: Merill Lynch, 2007

46. *Id.* at 7.
47. *Id.* at 8.

FIGURE 5[48] COMPETITVE AND CONSUMER LANDSCAPE IN MEXICO

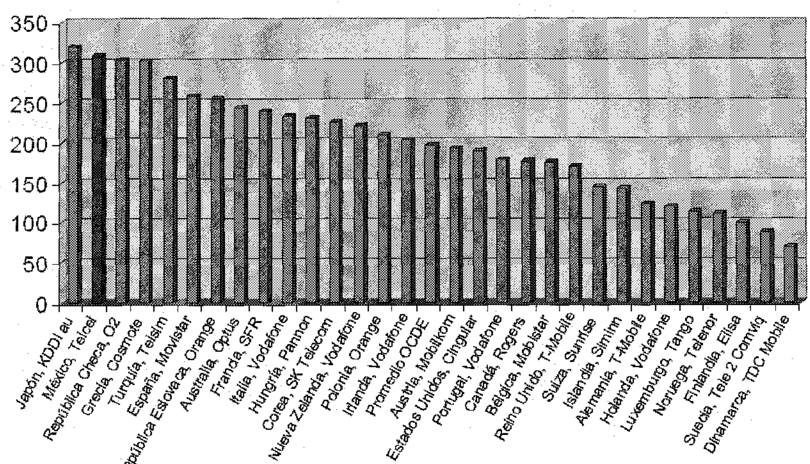
Los-usage Fixed Residential Service Fees



Source: OCDE Communications Outlook 2007. Focus on Mexico

FIGURE 6[49] COMPETITVE AND CONSUMER LANDSCAPE IN MEXICO

OECD basket for low-usage mobile telephony sesrvice

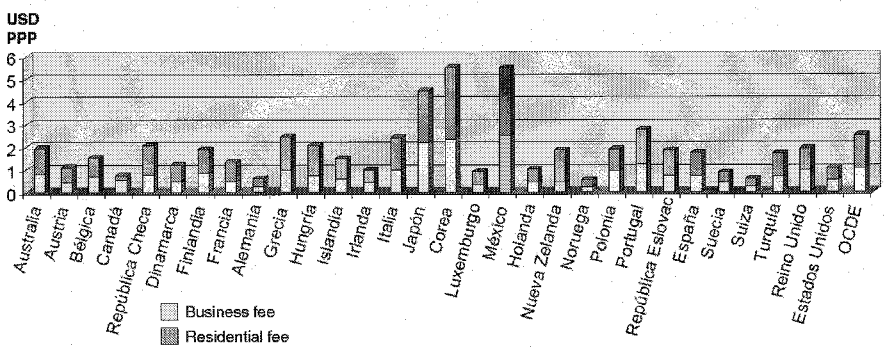


Source: OCDE Communications Outlook 2007. Focus on Mexico.

48. *Id.* at 9.
49. *Id.* at 10.

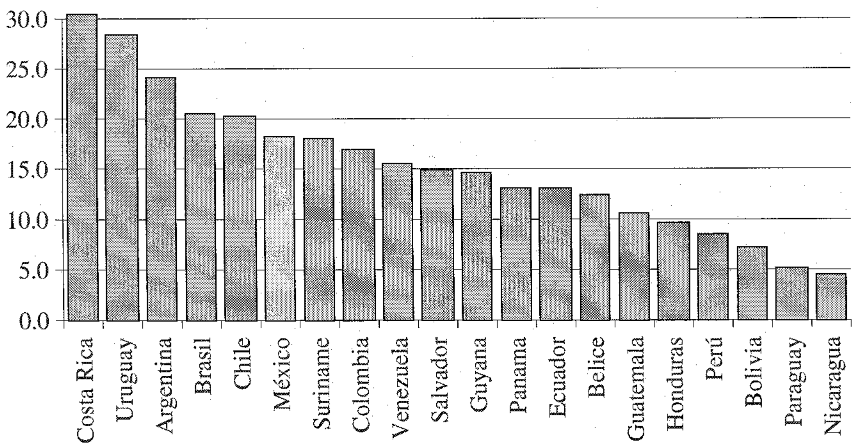
FIGURE 7[50] COMPETITVE AND CONSUMER LANDSCAPE IN MEXICO

Fees for International Service



Source: OCDE Communications Outlook 2007. Focus on Mexico.

FIGURE 8A[51] FIXED TELEPHONE LINES PER 100 INHABITANTS



50. *Id.* at 11.
51. Telefonica de Mexico, 2009.

FIGURE 8B (ADJUSTED BY INCOME)[52]

Fixed Telephone Lines per 100 inhabitants

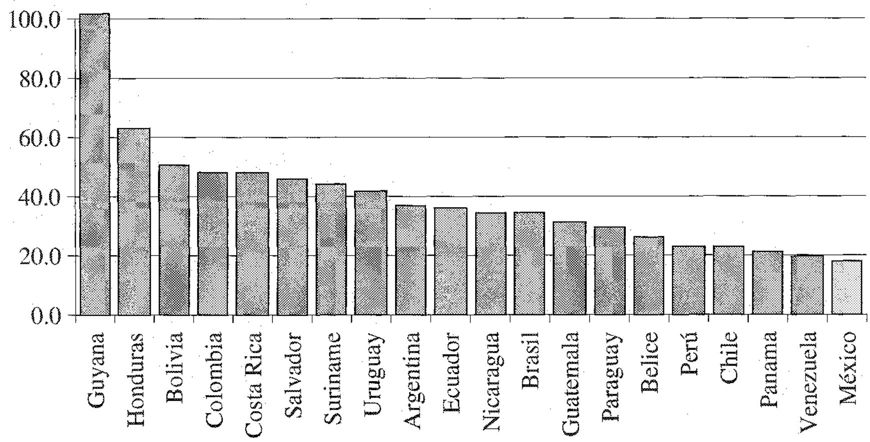
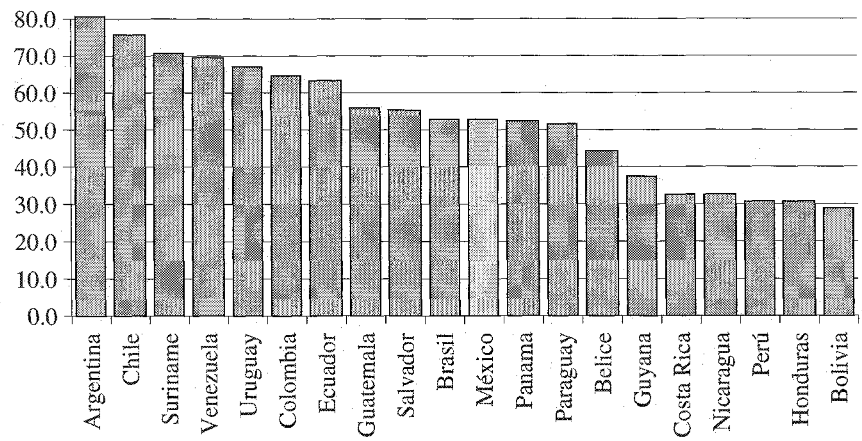


FIGURE 9A[53]

Mobile Lines per 100 inhabitants



52. *Id.*
53. *Id.*

FIGURE 9B (ADJUSTED BY INCOME)[54]

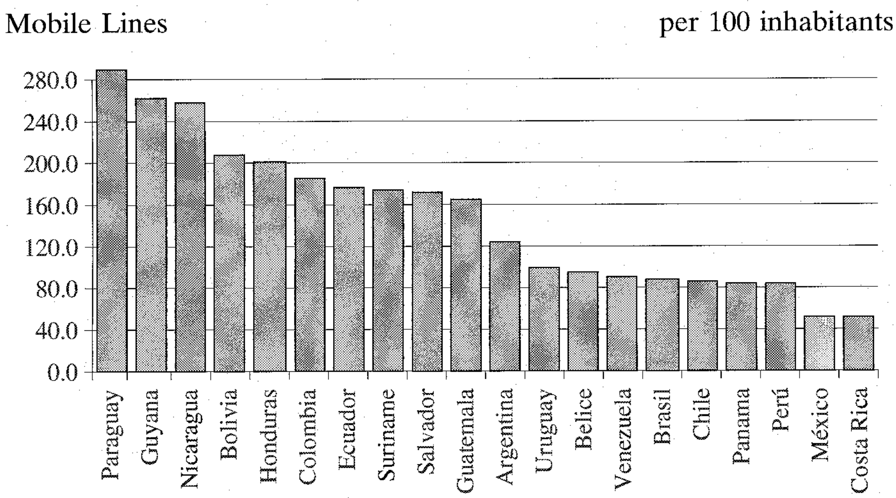
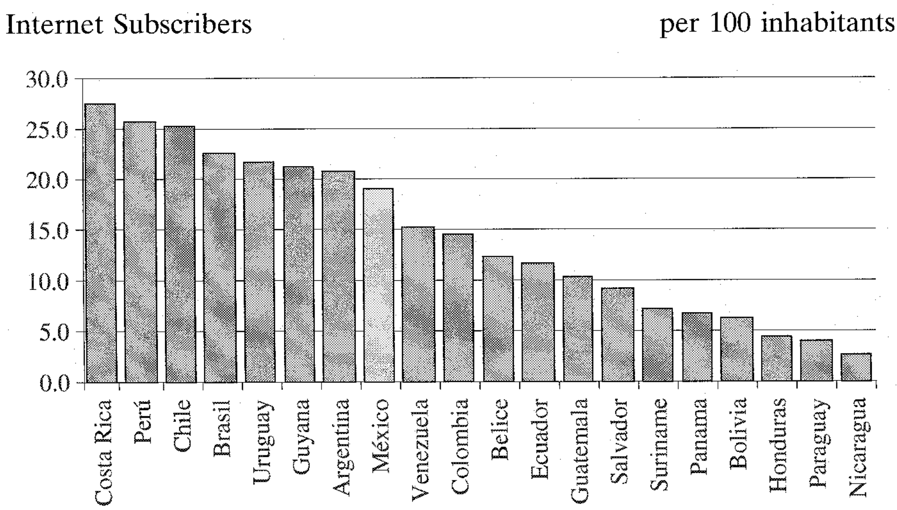
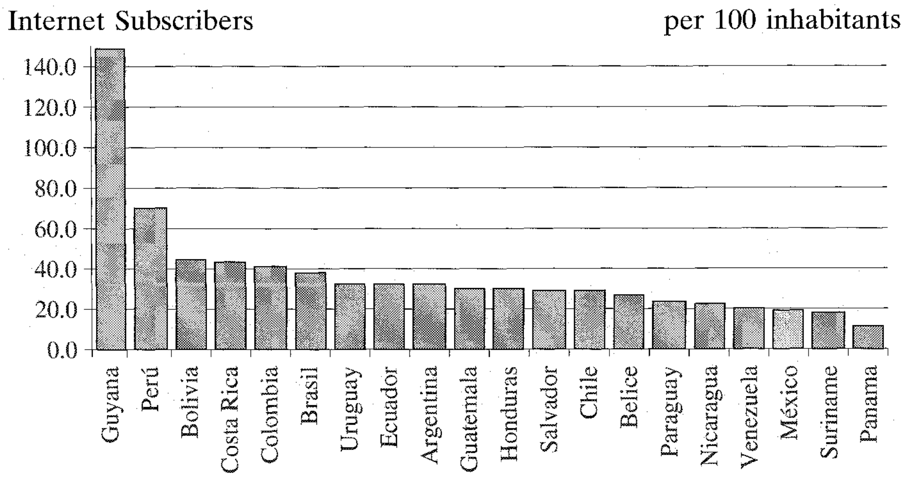


FIGURE 10A[55]



54. *Id.*
55. *Id.*

FIGURE 10B (ADJUSTED BY INCOME)[56]



56. *Id.*