

**The Benefits of Privatization? The Mexican Experience in the
Telecommunications Industry**

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Abstract

The paper analyses the privatization of the Mexican Telecommunications incumbent during the early nineties and point out the unexpected outcomes of the sale. In this regard, a public monopoly was transformed into a private one without an adequate regulatory framework and with few incentives to the development of competition. Nevertheless, current strengthening of the regulator has been beneficial to the industry and to consumers.

Key Words: Privatization, Regulation, Monopolies, Mexico, Telmex.

The Benefits of Privatization? The Mexican Telecommunications Experience

1. Introduction

Privatization is thought to improve overall economic efficiency, hence improving general welfare. Any denationalisation programme should be designed to seek Pareto improvements, meaning that employees, consumers, government and new owners will be better off, or at least no worse due to policy implementation (Vogelsang 1995). In this regard, privatization policies share at least four main objectives summarised by López-Calva(1998:6): i) to achieve higher allocative and productive efficiency; ii) to strengthen the role of the private sector; iii) to improve the public sector's financial health, and; iv) to free resources for allocation in other areas of government activity. Therefore, privatization should not be assessed only in terms of revenue raised by a government but also by the impact in microeconomic efficiency. Privatization in this sense is targeted to improve and broaden the range of services with better quality and lower prices.

Nevertheless, there are arguments which claim that privatization would reduce services available and would induce an increase in prices. Welfare would be affected due to profit maximising firms looking for reliable and profitable customers instead of providing services for the whole society. According to Megginson(2000:15), 'the transfer of State Owned Enterprises (SOEs) to the private sector reorients their basic purpose away from the political goal and toward the economic objective' of maximising profits. According to the latter, and in relation with the telecommunications industry, private providers would use their monopolistic position to exploit consumers and even the government.

Through this paper I will evaluate the privatization of the Mexican telecommunications operator (Telmex) and will argue that the benefits from privatization were diffuse. The Telmex experience shows us that privatization has many components and the success of the programme is entwined with several variables to be taken into account. Furthermore, the economic and political environments were determinants in crafting the institutional framework and the industry structure. However, rephrasing Vogelsang(1995), in a well implemented privatization programme, every actor should consider itself as a winner in the long run due to the re-distributional effects of denationalisation. I will argue that Telmex's post-privatization performance did not have the desirable effects on consumer welfare; nonetheless, the overall effect of Telmex's privatization has been positive for general welfare.

The paper will be structured as following: The next section will address the privatization debate, in which I will define the main concepts and justification for denationalising public companies and the particular case of telecommunications; part three briefly analyses the Mexican Privatization programme; part four will deal with the Telmex case study, and finally; parts five and six will deal with the Mexican constraints when privatizing public companies and my concluding remarks in which I state that the lack of adequate regulation policies –at the beginning of the programme- are in much measure to blame for the outcomes.

Nevertheless, a recent effort in strengthening regulators is helping to develop competitiveness in the telecommunications industry.

2. The Privatization Debate: A Brief Survey

The privatization wave in the eighties redefined the state's participation in the economy. Authors such as Megginson (2000:22) argued that 'privatization has not ended state involvement in the economy, but rather transformed it'. Hence, gains from denationalisation –supposedly– are translated into gains for the welfare system. This shift implied that the state would reallocate resources into other priority areas rather than subsidising production. Following the argument, many people expected reductions in public spending; however, the reality was the opposite. Social and public spending rose in most countries which embraced privatization programmes, meaning that the welfare systems were expanded. In other words, it is possible to consider divestiture as an instrument to reallocate resources efficiently through the market.

Privatization has an important ideological content, namely, recognising that states are inefficient as providers of goods and services. Mostly, arguments in favour of denationalisation are primarily based on productivity and efficiency analyses. Most of them support the view that every public activity should improve when divested. Privatization theorists (Vickers and Yarrow 1991; Boussofiane, Martin et al. 1997; López-Calva 1998; Shleiffer 1998; La Porta and López-de-Silanes 1999; Cuervo and Villalonga 2000; Megginson 2000; Bortolotti, D'Souza et al. 2001; Megginson and Netter 2001; Chong and López-de-Silanes 2003) implied that in competition, firms act efficiently reducing costs, whilst providing goods and services required by society. These arguments stand on the basis that profit-seeking companies would perform better and at lower cost than public enterprises. On the other hand, there are arguments that claim that denationalisation would reduce the range of services and induce an increase in prices. Welfare would also be affected due to profit maximising firms looking for reliable and profitable customers instead of providing services for the whole society. Following this argument, and in relation with the industry I am interested, the transfer in ownership usually led to a private monopoly during a period.

Research done on privatization has one main objective: 'to determine the proper role of the government in the economy' and as Megginson and Netter(2001:329) argue, studies vary from economics, management, law, industrial organisation, among many others. The *Economic Theory on privatization* is by far the most widely used in the last decades. This set of approaches are based on the statement that a private firm performs better –on average– than parastatals companies. Barnekov and Raffel(1990:135) claim that the 'private sector is assumed to be inherently dynamic, (...) and private institutions are thought to be intrinsically superior to public institutions'. Thus, since the eighties scholars have been interested in productivity and efficiency rates, and ownership structures of public companies. La Porta and López-de-Silanes(1999) and Sheshinski and López-Calva(1999) proved empirically that privatized firms witnessed rapid and positive

changes in productivity and efficiency in post-privatization years, even when performing in non-competitive markets¹.

One premise in economics is that ownership does not matter, and performance among firms would not differ from each other in markets with complete information, perfect competition and complete contracts. In principle, as markets fails, state ownership is justified under non-competitive conditions, such as in natural monopolies, in which the presence of more than one firm is not justified on 'efficiency grounds' (Sheshinski and López-Calva, 1999:5). This so called Social View takes into account that private provision of such services could lead to monopolistic behaviour at the expense of both the consumer and the government. State ownership assumes that the market has failed and the only way to solve the problem is via ownership, regulation and provision of social welfare.

There are two important assumptions on the effects of privatization. First, it is expected that once a firm is privatized, its efficiency and productivity rates will improve. Second, it is also implied that denationalization is accompanied by industry's liberalisation –meaning the improvement of competition- and regulation activities within non-competitive industries –e.g. natural monopolies and networks. From this stand, many studies (La Porta and López-de-Silanes 1999; Ramamurti 2000; Megginson, Bortolotti et al. 2002; Chong and López-de-Silanes 2003) affirm that increases in efficiency and productivity are strongly related with performing in competitive environments. Vickers and Yarrow(1991:117) argued that SOEs in competitive industries have similar performance to their private counterparts. Hence, I do understand that efficiency and performance may be not related to privatization but rather to competition. They state, however, that even in competitive environments, 'SOEs are less profitable and less efficient than private firms'. The argument shows, nonetheless, that competition is a more important variable than ownership in those types of markets.

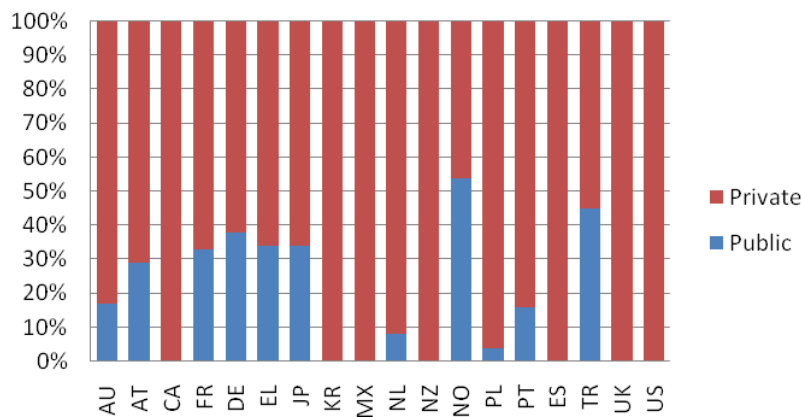
In non-competitive markets, the discussion goes further. State ownership is tolerated because of the social benefits of controlling monopolistic forces. Evidence, however, suggests that even in monopolistic industries, private firms perform better than public ones. Yet, performance increases are not related only to ownership but to the introduction of regulatory institutions and policies. In this light, most research has concluded that privatization programmes had beneficial effects in countries, industries and firms. Ramamurti(2000), argues that the improvements in privatized companies are a reflection of the market structure. SOEs performing in competitive markets are inherently more efficient than those operating in non-competitive or monopolistic structures. Therefore, privatization might be a useful instrument to improve efficiency and productivity rates in SOEs operating in competitive markets. In natural monopoly industries, however, privatization does not seem to be the explanatory variable for performance increases, but other factors.

Telecommunications has been the paradigmatic industry when talking about privatization of SOEs. Public telecommunications operators (PTOs) were

¹ Both studies were done for the Mexican privatization programme.

considered as entities and agencies of strategic interest and as agents able to redistribute wealth across a country. The industry was organised, mostly as a public monopoly with the capacity to impel growth and economic development and as a forefront of industrialisation policies. Since the early eighties, however, impelled by economic, political and technological changes, the industry has been in process of transformation. The privatization of the United Kingdom's PTO represents for the industry what Bortolotti et al(2001:3) claim as a 'truly epochal shift in the balance of state power within every economy where denationalisation is attempted'. An efficient telecommunications sector has been to policy makers, vital for the well functioning of the economy. In other words, the states were not capable of managing the industry financially and technically.

Fig 1. PTOs Ownership Structure. Selected Countries



I have become interested in this industry because virtually every country has privatized their former monopolistic telecoms provider and these changes in ownership have brought changes in several spheres: from industrial organisation to employment levels, from wider services to 'lower' prices, and, from consumer benefits to social welfare, among many other things. Telecommunications is interesting to analyse not only because of rapid changes in industry structure, but because it is a very sensitive industry to divest in almost every political and economic environment. In this regard, telecoms 'provides the basic infrastructure for the information highway and thereby the centre of the economic changes' (Katz 1997). This industry moreover, was redefined: from a monopolistic national service to a global customer-oriented range of services, which in most cases were accompanied by liberalisation, competition and regulation.

Denationalisation of national PTOs has played an important role in the economy. Megginson et al(2002:3) argue that usually these utility companies represented the largest financial effect of privatization. Furthermore, it had big impacts on the development of stock markets representing 'on average 30 percent' of trading volume. Telecommunications industry should be understood as a multiplier for growth in other industries. In other words, 'this industry has a great potential for technology spillovers into the larger economy' (Doh, Teegen et al. 2004:233).

Due to the development of new technologies in last 30 years, the natural monopoly argument has abandoned the telecommunications sector. These technological factors allow sufficient economies of scale and scope in the production of services. This means that new entrants have the opportunity of building new networks that easily can be operated at the same time as the incumbent's. Given these changes and political and economic contingencies, governments opt to privatize their PTOs. These decisions have impelled a significant growth in the industry, because they have allowed the entrance of new competitors, new technologies and a new set of policies which are designed to control the once heavily regulated industry (Katz 1997).

I had credited the general concepts and considerations about denationalisation policies with strong links to the telecommunications industry. In this regard, PTO's privatization effectiveness should take into account the following: i) privatization is desirable due to improvements in efficiency and productivity rates, even in monopolistic market structures; ii) in natural monopoly conditions, productivity and efficiency are strongly correlated to industry's liberalisation and regulation. Therefore, introduction of competition is desirable; iii) government's role, is to promote competition and regulate public utilities; iv) societal groups should consider themselves better off after privatization, and; v) privatization effects should be reflected into the state's wealth.

In the next section of the paper I will explain the Mexican privatization programme and in particular for the telecommunications company. I will argue that denationalisation was driven by savvy politicians and economists in order to comply with international arrangements. Thus, privatization in Mexico was considered the ultimate measure to stabilise the economy and its financial requirements. However, this need to be consistent with International Organisations led to lack of regulation of privatized utilities, and therefore to the detriment of consumers' welfare at the first stages of divestiture.

3. The Mexican Case: Privatizing to Save the State

In 1982, the Mexican government owned more than 1100 parastatals, which accounted for more than 14% of the Gross Domestic Product (GDP) and almost 40% of fixed capital investment. The debt crisis in 1982 spurred the Mexican government to redefine its role in the economy. The state began to privatize, merge and sell off most of the public sector companies. By 1994, the number of SOEs was reduced to just over 200, and with the exception of highly politicised and strategic companies –mainly oil, water and electricity-, the rest was divested. The Mexican privatization programme is regarded as one of the most important efforts made in developing countries (LDCs), in terms of size, scope and number of companies denationalised.

Table 1. Public Sector Development	
Period	SOEs
1917-1940	36
1941-1954	144
1955-1970	272
1971-1975	504
1976-1982	1155
1983-1993	258
1994-2003	200

Commonplace arguments apply to the extent that privatization in Mexico was driven by macroeconomic stabilisation requirements, needs for international recognition and legitimacy and furthermore, sponsored by international organisations such as the International Monetary Fund (IMF) and the World Bank (WB). The main goals of the ‘privatization programme’² were to raise government revenues, to balance its budget and to pay off the large amount of external debt. Overman (1995:51) stated that the 1982 budget deficit was more ‘than 12% of the GDP’ and that the government was using more than 50% of banks loans to finance its debt. The De La Madrid’s administration rapidly began an austerity programme which included privatization in order to reduce government’s expenditures.

The *Disincorporation*³ Programme is divided according to scholars into two main phases. The first, from 1982 to 1988, is understood as an experimentation stage which comprised mergers, liquidations and privatization of small companies, usually performing in competitive markets. From this point of view and following Overman (1995:51), even when the impact of these sales was often small in the economy, it sent a clear and resounding message to international organisations and foreign investors: Mexico was taking the first ‘step toward revitalising the economy’. These political and economic manoeuvres helped Mexican politicians to *regain* investors’ confidence and positioned Mexico as an *international player*. The programme aimed at the same time at a shift in the state’s economic activity; the Import Substitution Industrialisation (ISI) model was exhausted, and Mexico embraced Washington’s recommendations on trade liberalisation and open economies. In 1986, the country was granted membership of the General Agreement on Tariffs and Trade (GATT).

The De La Madrid administration was bolstered by the Ministry of Budget and Planning which designed and implemented the *Economic Modernisation programme*, and in 1988 those called *technocrats* rose to the presidency. Salinas’s term (1988-1994) is considered as the pinnacle of the privatization and modernisation programme of the Mexican economy. During his tenure, more than 90% of privatization resources were obtained. Among the firms divested were the

² The Mexican privatization programme comprised –mainly- three administrations: De La Madrid (1982-1988), Salinas (1988-1994) and Zedillo (1994-2000).

³ Disincorporation was the term used by Mexican politicians, avoiding the politically-charged Privatization.

two national airlines, mining companies, steel and iron mills, telecommunications and finally the banking and insurance system. According to Gates (2009), Salinas's economic and political savvy were determinants for the programme's success. In the aftermath of the programme, inflation was reduced by 20%, GDP was growing between 3-4%, and in 1991 it was signed the North America Trade Agreement (NAFTA) which prompted economic liberalisation.

The programme is said to have some 'constraints', however, it 'fits the traditional pattern of divestiture' within developed countries (Overman 1995:51). In that respect, one of the main peculiarities of the programme was the change in companies' administrative control. In 1988, Salinas created the Privatization Unit –dependant of the Ministry of Finance (SHCP). Thus, to avoid political controversy at the core of SOEs to be privatized, the government transferred SOEs directorates to the SHCP unit, instead of the controlling secretariats. The unit in charge was allowed to manage specific sales and to determine the method of divestiture, and more important to select and authorise the bidders which were to participate in the sale.

Another important feature of the programme was the lack of stock market mechanisms to denationalise SOEs. In other words, it is said that privatization in Mexico did not help to democratise capital ownership, as happened in the United Kingdom, but rather to strengthen financial elites. Therefore, almost every privatization in Mexico was conducted through a two-stage bidding process. First, the *Unit* pre-screened the possible bidders and invited them to take part in the second stage. Then, the Privatization Unit and the commercial banks evaluated the bids –mainly the price- to agree on the sale. It is possible to argue that the government in order to obtain the largest amount of resources identified and selected the *new owners*, which mostly were large industrial conglomerates, wealthy businessmen and foreign groups. This set of decisions led to capital concentration in very few hands hence, privatization benefits were diffuse.

Nevertheless, the Mexican Disincorporation programme is hailed as one of the most successful policy programmes in LDCs. The large amounts of resources gained from privatization were used to stabilise –at least for a while⁴- the Mexican economy and to finance other social programmes. For example, '81%' of those resources were used to repay international debt –and therefore, the possibility to access more credit from international organisations-(MacLeod 2005:55). Moreover, public resources –often from denationalisation- were used to launch the *Solidarity* programme, aimed to alleviate poverty through economic transfers and better health and education services.

It is possible to summarise the success of the programme based on the following facts. First, the method chosen to privatize –open-bidding format- helped the Mexican government to screen the 'best possible' buyers for the divested companies. This method secured the transfer of the firms at the best price –even when in share-issue privatization the price is usually higher. Second, the Mexican government achieved its financial objective; the *modernisation programme* –

⁴ Most financial gains from privatization were 'evaporated' in the 1994-1995 Mexican crisis (*Tequila Crisis*).

privatization, 'liberalisation' and 'de-regulation'-helped to stabilise its macroeconomic indicators and furthermore, it gave the government international legitimacy. Third, with few exceptions, companies' efficiency and productivity rates rose; this meant that profitability increased 20% in the post-privatization period. Finally, the role of the private sector and its institutions (e.g. the stock market) were enhanced with divestiture.

On the other hand, the programme had important constraints for consumers. First and paradoxically, one of the strengths is one of its weaknesses. The bidding-method did not allow common Mexicans to become part of privatization. In other words, the 'industrial ruling elite' did not change. Second, and because of the previous economic-industrial structure, public monopolies were transformed into private monopolies at consumers' expense. Third and last, privatization is thought to be an instrument to depoliticise decisions, however, the Mexican privatization programme was charged with political decisions and with firm-state-employees bargaining.

In the next section of the paper I will analyse the Telmex privatization and some of the outcomes of the sale. I will describe the background of the company, and then the process of its privatization. Furthermore, I want to look at the bargaining and the institutions crafted after the sale.

4. The Telecommunications Industry: Spreading the Benefits

Teléfonos de México (Telmex) has not a great history. It was created in 1947 after a group of Mexican investors bought the two main providers of telecommunications services in the country: the Ericson and ITT companies. Attempts to integrate both networks failed, due to the lack of resources, and in 1971, Telmex was nationalised when the government acquired 51% of its shares, whilst the remaining shares were owned privately and quoted in the stock market. The firm has a concession granted from 1976 to 2026 to provide telecommunications in Mexico. In 1990 was privatized in an open-bid process to a consortium led by the Mexican industrial group Carso, and France Telecom and Southwestern Bell Company as foreign partners.

For the majority of the seventies and until the mid-eighties, productivity declined considerably in Telmex. Company's public perception did not disagree. Telmex was lacking in investment, was overmanned and the quality of services was poor. Even worse, in 1985 an earthquake in Mexico City destroyed most of the network and more important the control centres. Nevertheless, in the following years company's performance did improve, physical investment increased and productivity rose. In this light, and given those dramatic improvements, Telmex was named company of the year for three consecutive years (1989-1991). Many variables could help to explain this: first, following the earthquake, the government invested heavily in physical infrastructure –mainly replacing from analog to digital technologies- to rebuild and expanding the network; second, productivity per employee increased given those circumstances, and the 'use' of human resources was needed. And third, as Tandon(1994) argues, the managerial actions taken by the administrative unit and the financial and legal restructure of the company helped to improve the company's finances.

Following Tandon and Abdala (1994:418) 'it is unclear what motivated the divestiture of Telmex. The company was increasing its investment, had no financial trouble and the quality was improving. On the other hand, Telmex was considered –at that time- as the breakpoint of the privatization programme. It was –in part- privately owned and the biggest company on the stock market. Moreover, technological changes in this particular industry allow rapid growth and increase in investment. However, the authors argue, the company was chosen for its symbolic importance and because of the possible magnitude of the sale. Given that the 1976 concession granted monopolistic market power to the company, the price was expected to be high.

In 1989, president Salinas announced the decision to privatize Telmex. Nevertheless, privatization had been thought off way before. In September 1989, administrative control was transferred from the Ministry of Communications and Transportation (SCT) to the Ministry of Finance and its Divestiture Unit. The first task was to restructure the company's capital stock structure to make the sale easier. Before privatization the company had two types of shares: AA which only could be owned by the government and A shares which were privately owned without any restriction. The privatization Unit reduced the number of AA shares to 51%, by converting 4.9% into type A-shares. It, then it created L shares – without voting rights- accounting 1.5 L per each AA and A shares. In summary, the AA and A shares were the controlling stock of the company with only 40% of the total number of shares. AA shares, nonetheless, alone are enough for the administrative control (51% of voting rights shares).

In December 1990, the controlling stock was offered in an open bid process. The bid was won by Carso and its associates which bought the complete stock of AA-shares (10.4% Carso, 5% Bell and 5% France Telecom). The consortium, hence, is able to exercise control of the company with only 20.4% of the total capital. In an extremely efficient political manoeuvre, the government granted a loan to the Telephone Union (STRM), which allowed the union to purchase 4.4% of type-A shares. The rest of the stock is privately owned and quotes in the stock market. By 1992, the government –treasury- had raised more than 6 billion dollars from Telmex. The sale was considered, therefore, 'at the beginning of the 1990s, not only the most important single privatization in Latin America, but was, along with the sale of further BT tranches in the UK, the most important in the OECD'(Clifton 2000).

Nonetheless, this is not the complete history. As stated before, during the seventies and the eighties the company's performance was poor. In many senses politicians were preparing Telmex for divestiture. During most part of the eighties, profitability was stagnant –mainly because of high inflation rates. In the same way, prices for services did not increase in real terms, but rather decreased until 1987. However, in 1988 productivity and profitability began to rise at considerable rates. The main reason of these increases, following Tandon and Abdala (1994) and De la Garza and Herrera(1997), was the price revisions taken in 1988 and in 1989. There are two principal arguments behind these adjustments: first, the government was preparing to divest the company and started to change the company's tax regime. Second and in order to get more resources from the

sale, the government reduced cross-subsidies among services. It is possible to argue that *elastic* services were overpriced –e.g. long distance calls-, whilst *inelastic* services –e.g. installation, rents and local calls- were underpriced, basically because of *social welfare*. The adjustment, therefore, allowed Telmex to charge more –almost 5 times- for *inelastic* services and to obtain more resources from them than in the previous period. Hence, profitability increases are highly correlated to price increases.

In other words, it is possible to state that during the early eighties, consumers were gaining because of government's subsidies for telecommunications services. However, when the company was set to be privatized, the government changed its structure rapidly. The government tried to make Telmex interesting and profitable for the sale. Consumer welfare was, therefore, 'wiped' early before privatization, and it could be said that consumers were worse off in 1991 than in the decade before. These increases meant that Mexico in 1990 had by far the highest taxes for telecommunications services in the world (Tandon and Abdala 1994). Along with the price increases, the government changed its position toward Telmex. In the pre-privatization period, revenue from the company used to be through indirect taxation. This meant that the government could keep prices down –benefiting consumers-, whilst getting revenue from the company's returns. In consequence, private shareholders –at that time- were losers, because profits were taken by the government. Furthermore because of this taxation regime, the company was unable to finance new investment.

Taxation and price adjustments allowed the government to raise revenue by direct taxes from consumers, and at the same time increasing the value of the company in order to be divested. Stock value of the company did increase with the new regime, and therefore shareholders won with the changes. Strongly correlated to price increases was the regulatory authority at the time. Telecommunications were regulated by the SCT along the line of their British counterparts. Mexican regulators adopted the price-cap regulation method –RPI-X⁵- for a basket of services allowing the company to modify its tariffs individually according to the X. In other words, the regulatory structure permits to increase prices to inelastic services whilst reducing elastic ones, with the restriction that the increase is set below the X percent. According to De la Garza and Herrera (1997) income structure changed radically in 1990 and in the post-privatization years. Pre-privatization income was clearly skewed to international long distance calls (54%) –very elastic service-, whilst local services accounted nearly 15%. After both, the price reform and privatization, local calls accounted for 43 percent and international services were reduced to 20 percent⁶.

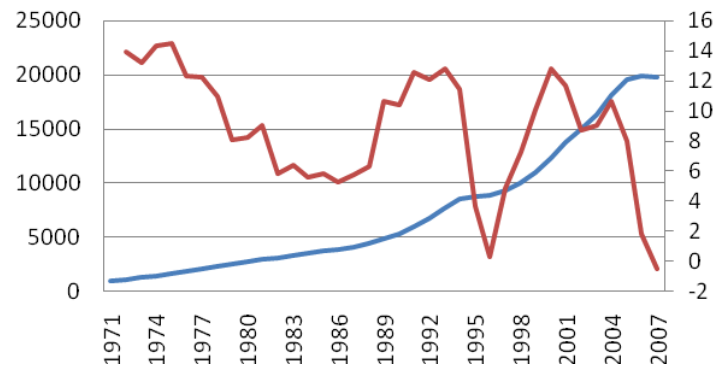
As explained in the last paragraph, consumers were affected by the government willingness to privatize. Consumer welfare was *sacrificed* with higher prices in order to obtain more resources from the sale. On the other hand, the government

⁵ RPI-X, Retail Price Index minus an X percent determined by the Regulatory Authority. This method was designed by Littlechild in 1983 to regulate private utilities in monopolistic market structures in Great Britain. Beesley, M. E. and S. C. Littlechild (1989). "The Regulation of Privatized Monopolies in the United Kingdom." *The RAND Journal of Economics* 20(3): 454-472.

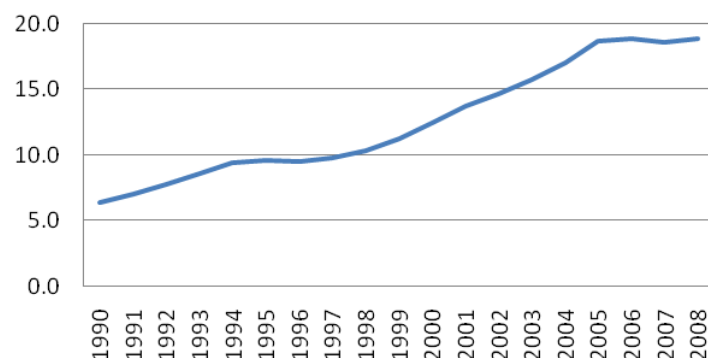
⁶ These data are for the years 1987 and for 1994.

was supposed to use those resources to improve general welfare through new programmes –as seen in the *Solidarity* programme- and the company was supposed to improve services, in quality and quantity. Telmex's privatization had important clauses to be taken into account: '1. The number of lines in service must expand at a minimum of 12 percent per year until 1994; 2. All towns with more than 500 inhabitants must have telephone service by 1994; 3. Number of public telephones should be increased from 0.8 per 1000 inhabitants to 5 per 1000 in 1998, and; 4. The waiting time for a new connection should be reduced to one month by 2000.' (Tandon and Abdala 1994:420)

Fig 2. Fixed Lines in Service (thousands) and Growth Rates (%)



**Fig 3. Teledensity in Mexico
Fixed lines per 100 inhabitants**



What happened with privatization? As it was clearly stated beforehand, consumers were affected by government's policies and not due to privatization at the first sight. However, policies were designed to impel the privatization process, and therefore ought to account as divestiture effects. Price reforms were motivated because of the intention to sell the company, and not to reflect real costs of operating the company. These arguments could refute La Porta and López-de-Silanes(1999) empirical findings which state that profits from privatization were not induced by changes in prices, rather due to improvements in efficiency and productivity. Nevertheless, as cited previously, productivity and efficiency rates

have been improving since privatization, as well as investment and the quality of services.

Fig 4. Price Changes before Privatization (real prices)

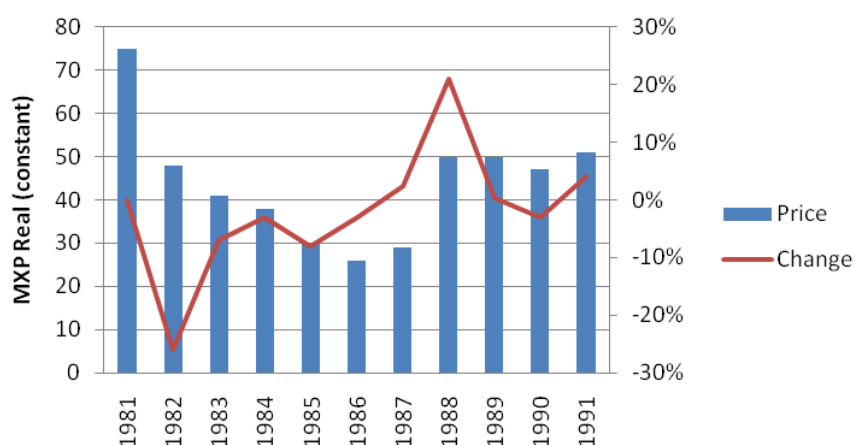
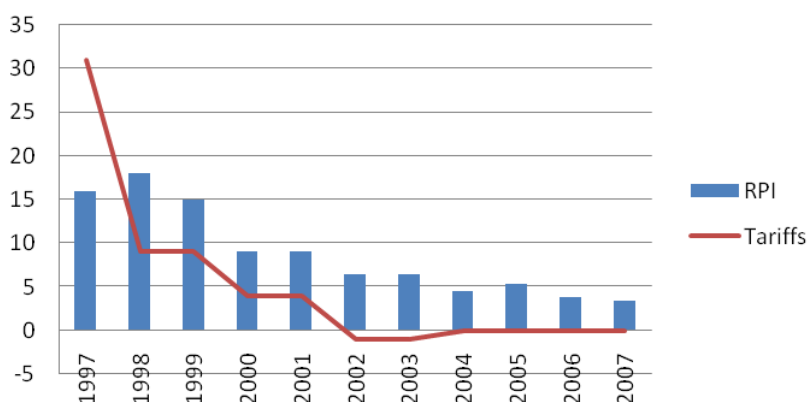


Fig 5. RPI and Telmex Tariffs changes (%). Regulatory Grip and Introduction of Competition

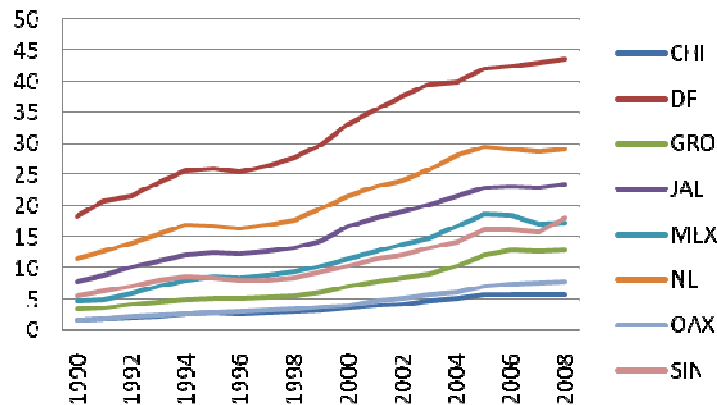


Mexican consumers, however, are still paying the costs of *such benefits*. The sale helped the government to achieve its objectives. It was a successful sale, completed in few months and without political struggle. During the first years of private ownership, the company invested heavily in new technologies and by the year 2000, the whole network was digitalised. On the other hand, Mexican telecommunications still are ranked among the highest (in prices) at the OECD and even in comparison with Latin America. Telmex's performance, however, has been in line with privatization clauses. Following the argument, the number of fixed lines and public telephones has been growing accordingly to the *rates* agreed in the concession, however, still are way behind other countries. Telmex is ranked among the biggest telecommunications companies in the world, but profits do not relates with further investment.

According to the latter, it is possible to argue that Telmex's investment has been targeted in profitable and reliable customers rather than to improving

telecommunications services among the whole society. Mariscal(2004) argues that teledensity variance is gargantuan; Telmex has increased telephone penetration in big cities whilst in poor states, investment has only be enough to cope with the governmental clauses. For example, in Mexico City there are almost 45 lines per 100 inhabitants. Meanwhile in Chiapas –the poorest state in Mexico- there are only 6 lines per 100. Despite industry’s liberalisation the incumbent still have a virtual monopoly on the fixed-line services with more than 90% of the market.

Fig 6. Teledensity Selected States 100 Lines per 1000 Inhabitants



But who is to blame about these outcomes? My first assumption and following Wallsten(2002), is that the regulatory framework in Mexico born weak, hence giving *no incentives* to the company to expand its network. I state that regulation in Mexico is weak based on the following: prior to privatization, telecommunications services were regulated by the controlling Ministry, in this case the SCT. This meant that the SCT played as *manager* and as *regulator*. It was until 1993, when the Federal Competition Commission (CFC) was created, and only in 1996 the Federal Telecommunications Commission (Cofetel) was established. Moreover, none of the agencies have legal capabilities to sanction, but to recommend. It is valid to think that Agencies are independent, however, both are intertwined to Federal Secretariats; the CFC is part of the Ministry of the Economy⁷ (SE) and Cofetel is dependent to the SCT directives. Such lack of independence does not help to regulate efficiently the company. Moreover in recent years, both agencies have had completely opposite views over the telecommunications industry.

⁷ Previously it was named as the Ministry of Trade.

Table 2. Industry's Sequencing	
1989	Mobile competition (Regional Oligopolies)
1990	Price Cap Regulation
1991	Telmex Privatization
1993	Creation Competition Commission (CFC)
1996	Creation Telecoms Commission (Cofetel) Long-Distance
1997	Competition Fixed Lines
1999	Competition (Regional Oligopolies)
2006	Triple Play Services (open)

The second assumption, points toward governmental policies before and after privatization. In this regard, I think that there are two main problems with the sale. The first one is the concession title granted to the company. As stated before, Telmex concession licence runs from 1976 to 2026. This means that the owners enjoy a quasi monopoly over the fixed line market. I argue that the concession title was not modified by the government, due to the price they wanted for the sale. Granting market power in the transfer secured successful biddings. Second, the most dramatic –as I explained before- was restructuring company's prices and tariffs and its tax regime before divestiture. These changes were also motivated to achieve a *smooth* and rapid sale, guaranteeing buyers a profit-making company. On the other hand, the Mexican government achieved its goals: reducing international debt obligations, gaining recognition from the international community –mainly the United States government, and the international credit agencies such as the World Bank and the IMF-, and signing the North American Trade Agreement with the USA and Canada. Mexico did gain international notoriety and was considered as one of the main examples in the developing world about the benefits of economic liberalisation and international trade.

Third, I assume that the government, union and management colluded in political and economic arrangements which represented immediate benefits for the three groups to the detriment of consumer welfare during the first stage of privatization. I understand this first stage as the period comprised from 1990 to 1996 when competition for long-distance services was open to international providers. Following my assumption, it is possible to see a *war of attrition* in order to delay reforms designed to open the market to new competitors, whilst the incumbent – both the management and the union- pursued rent-seeking activities without strong opposition (Alesina and Drazen 1989; Bortolotti and Pinotti 2008). I argue that the government colluded in the sense that institutions created to regulate monopolistic behaviour were not capable to undermine company's market power and union's bargaining forces.

According to the latter, the STRM played a significant role in the divestiture process. Following Clifton(2000), De la Garza and Herrera(1997) and Mercado(1994), the telephone union was capable to negotiate *vis-a-vis* with both government and management to agree privatization. During the Salinas term –as written before- very large companies were privatized, among them, the two flagship airlines, as well as the telecoms company and one of the biggest steel companies in the country. Labour relations were not at all pleasant for employees and unions. For example, when the President announced the Aeromexico –one of the airlines- privatization, the Union reaction was to strike. Nevertheless, and to make the sale easier, the government declared the company into bankruptcy dismissing its entire staff and then proceeding to the sale. The new management *re-hire* just half of the workforce. Two other important cases were within the public unions: the Secretary General of the Oil Company (PEMEX), the richest and most powerful union was imprisoned due to the lack of support in the general election –the government stated that was motivated by corrupt practices inside the union. The second one was the forced resignation of the Teachers Union Secretary (SNTE) to promote a more favourable person toward the government. The STRM, however, received a very different treat from the executive.

I have two arguments to justify the differentiated treatment received by the STRM. In the first place, the sale of Telmex was the biggest attempted by the Mexican government and needed bureaucratic and moreover, the union support. Mr Salinas himself hailed the STRM as the cornerstone of Mexico's *New Unionism*; a union capable to understand the needs of modernisation, technological change and new employment conditions. Second, the STRM was opposed in a first instance to the programme, however, and as Clifton(2000) says: 'the carrots were quite rewarding but the sticks were large'. It is possible to argue that the STRM co-operated with the government due to the experiences suffered by other unions in order to avoid coercive tactics from the government. Industry's structure and *juncture*⁸ moreover, gave the union leverage to negotiate with both, government and management and to place union's interests in the *table*.

This leverage capacity gave the union possibilities to agreed good terms for employees. When the company was privatized, the government granted a low-interest loan of more than USD 350 million to purchase 4.4 per cent of the company's voting shares⁹. Mr Salinas moreover was the principal speaker at the inauguration of the STRM new building. Regarding the management, the union agreed to co-operate to ensure a *smooth* transition from public to private control. The STRM, nevertheless conditioned its support to the following: a) That the company commit to an intensive modernisation programme which allow employees to be trained; b) Labour flexibility; c) That the collective contract was revised and modified¹⁰, and; d) Prohibition of employee lay-offs. Following these agreements, employees at Telmex received a substantially increase in wages, and

⁸ As I already state, in 1985 an earthquake destroyed most of the network in Mexico City, and due to investment plans the privatization plan needed the support of the union.

⁹ However and because of Mexican Law, in order to participate and vote in the board the shareholder(s) must own at least 10% of company's shares.

¹⁰ The collective contract was changed in the following sense: in the pre-privatization period existed in the company 580 different job categories. The new contract only has 41 categories, allowing job flexibility.

as Tandon and Abdala(1994) argue, these policies impelled labour productivity. They argue that this should be considered ‘as an indication of labour’s increased commitment as it prepared for divestiture’.

5. Expectations Satisfied?

Throughout this paper I have mentioned the principal arguments behind privatization of State-owned enterprises even in natural monopoly conditions. From this stand, the firm level improvements in productivity, profitability and efficiency are attributed to denationalisation policies. States have been able to reduce their fiscal deficits, to allocate resources into other programmes and to impel the private sector role in the economy. The Telmex case is not different; as I have explained in the previous section of the paper after privatization, company’s performance improved substantially. Labour productivity rose, investment had steadily increased, teledensity grew according to goals set beforehand and the quality of services improved in relation with the pre-privatization period. The Mexican government, on the other hand, improved its fiscal deficit, gained international credibility and reduced its financial burden. More important, it completed the biggest privatization effort in Latin America without opposition and in a very rapid pace. Looking at these facts, it is possible to conclude that the Telmex’s divestiture was a complete success. I think, nevertheless, that the programme has brought negative consequences to both, the public and the industry.

It is impossible to deny Telmex’s success during the last 20 years; however there are constraints which had affected mainly customers and industry development in Mexico. I will start my conclusion with data from the World Economic Forum and its Competitiveness rankings. Mexico has never been among the best-ranked countries; however, in 2009 was ranked 60th whilst in 2008 was 52nd. One of the main arguments behind the low score is that ‘good markets suffer from inadequate competition, with overregulated and closed economic key sectors such as telecommunications’ (WEF 2008:24). These facts show that Mexico still lacks from competition development. Institutions designed to impel competition face several political and economic pressures. As I stated before, the main agencies in charge of developing competition, first have no independence or enforcement rights and second, both *regulators* usually oppose each other in policy implementation.

Telmex political and economic significance essentially weakens the competition leverage. The company accounts for at least 30% of trading value in the Mexican stock market. It employs more than 80,000 people¹¹, and has other operations in Latin America, being the second most important telecommunications company in the region after Telefónica de España. Telmex, therefore, is the cornerstone of Mexican National Champions. Following the argument, it is possible to argue that Mexico’s industries are intrinsically in nature, monopolistic or oligopolistic, giving no chance for development of competition. I support my argument based on the following assumption: as I explained, in 1982 there were more than a

¹¹ Telmex employs 80,000 people in its Mexican division, and 35, 000 in the rest of Latin America.

thousand SOEs, and by 1994, just 200 remained in state's control. Privatization in Mexico was mainly used as an instrument for economic stabilization, rather than market deregulation and liberalisation. In this connection, and supported by international organisations, the Mexican government opted for transferring public monopolies to private hands. According to Mariscal(2004:92), 'the sale of a firm with substantial market power offers significant source of income (...) and thus increases its ability to refund the WB's funds'.

6. Telmex Nowadays and Concluding Remarks

The Teléfonos de México privatization has many different faces and characteristics and therefore, should be evaluated in a holistic way. The first thing that comes into my mind is that we cannot claim that the programme was unsuccessful. It is observed that after privatization, the telecommunications industry has grown considerably. During the last twenty years, the company has invested in new and better services, addition of lines and technological improvements among many other things. Moreover, real prices had been declining since 2000¹² and the trend it is expected to continue. In addition to that, according to the OECD(2007), Mexico has been one of the few countries that had increased its number of lines from the year 2003 (around 15% per year). Nevertheless, there is a *catch*; there are only 19 million fixed telephone lines in a country with more than 100 million inhabitants and services still are unavailable in certain regions of the country. As I cited before, Telmex's growth has targeted profitable cities instead of distributing welfare –I assume that telecommunications are an important component of societal welfare because it helps economic and regional development.

What has happened to consumers? In the last paragraph I stated that prices have not change for the last 9 years. There is a question, however; why Mexico still is considered as one of the most expensive countries referring to telecommunications services in the world? In recent history, prices have changed radically three times, and therefore, the answer could lay there. In 1989-1990, just before privatization, the government decided to increase prices substantially wiping consumer benefits. Prices increased fivefold in just two years. After privatization, Telmex increased again its prices according to the regulatory framework set beforehand, but still prices were constantly increased. Then, in 1997 when the market was open to competition, and against all theoretical arguments, prices were increased substantially. Due to the fact that competition was opened only for long-distance services, local tariffs rose to alleviate loses from other market segments. Finally, in 2000 Telmex changed to fixed-rent tariffs (inclusive of some calls); Telmex still has control of the more inelastic services and at the same time the company is protecting from competition, and what Darbshire(2005) calls the *regulatory grip*.

¹² In the year 2000, Telmex changed its pricing structure. This means that instead of having "measured services", the rent is inclusive of 100 local calls without time limit. After that, Telmex charge calls per unit instead of time. However, long-distance (national and international) still are measured by minute. Even more important since 2000, Telmex has not changed its local tariffs and long distance and mobile calls tariffs are declining.

Regulation therefore is becoming an important player in controlling monopolistic behaviour in the Mexican telecommunications industry in the last decade. There have been two major decisions that had benefited the consumer: First, granting concessions to cable companies to provide *triple-play*¹³ services whilst Telmex's not, and second allowing number portability in the fixed and mobile markets. The first decision was aimed to refrain Telmex from the possibility of providing television services and therefore to strengthen its dominant position in the telecommunications sector. Portability, on the other hand, permits customers to change its fixed or mobile telephone provider whilst keeping the same number; beforehand, telephone numbers were owned by companies, instead of the consumer.

Several conclusions are to be learned from the Mexican privatization programme, and especially in the telecommunications sector:

1. Telmex privatization, per se should be considered as a successful sale. However, many constraints have to be drawn. Privatization should be accompanied by a strong institutional design to avoid undesirable consequences to consumers. As Vickers and Yarrow(1991) wrote, benefits from privatization are strongly correlated with industry's competition, liberalisation and deregulation. Telmex's performance has been increasing since privatization, however as there are no benchmarks, and it is impossible to make a counterfactual. Regulatory grip in the last years, nevertheless, has impelled competition and possibly has helped to lower prices and broaden services. The main lesson is that a well designed privatization programmes takes into account regulation from the first stage; From this point of view, sequencing does matter.
2. Due to the lack of institutional capabilities, monopolistic rents were distributed among owners and employees. These rents are strongly related to leverage capabilities of both, the union and the management. Following the argument they could have exerted pressure over governmental agencies to delay the opening of the market.
3. Privatization has many entwined components; if one fails, the others will fail too. I assume that in Mexico privatization was driven by economic stabilization objectives and due to the need of a vast amount of resources. According to my own interpretation, privatization in Mexico did not take into account consumer or industry welfare but the government's objectives: big sales at big prices. Market failures were supposed to be corrected within some time, but not at the beginning. And as I wrote before, the government made enough resources to manage the eighties and nineties economic downturns.
4. Finally, consumers have been paying for monopolistic telecommunications services. Even when real prices had declined for the last 9 years, consumers still are paying for the price's increases of 1990 and 1997. At the same time, Telmex's competitors are unable of lowering their prices because of –high- interconnection charges to the main network.

¹³ For the matters of this paper, I do understand *triple-play* service as a bundle, in which a single company provides cable television, broadband internet and telephone services to a single customer.

Mexico is a country with many paradoxes. It is a country that has been intensively studied but which is little understood. Economic, social and political disparities are norm and not exception. Mexican industries were built as monopolies-oligopolies to impel regional and national growth during the 20th Century, and in the 21st Century these companies have been transformed into Mexican ambassadors to the world and hailed as national champions. It is not difficult to find a Corona or Sol beers in London; CEMEX rail *sleepers* are found in the National Rail network all over England. Telmex mobile operator has more than 150 million lines in 17 countries in Latin America. And it is possible to account for many other industries.

In conclusion, Mexican telecommunications are in process of transformation to a more open and competitive industry; nevertheless this process could be slow and difficult because of Telmex's economic significance. The main task for the Mexican government, and following the World Economic Forum recommendations, is to develop and enforce competitiveness in the country. Regulation agencies must be granted with administrative independence and with legal capabilities to enforce and sanction. As we learned through the paper, competition will improve company's and industry's performance. Furthermore full competition will drive to lowering prices and therefore to consumer welfare. Mexican privatization showed the constraints of a developing country embarking into reshaping its economic system. At a first glance, privatization in Mexico was the transfer of public monopolies into private ones due to the lack of institutional capabilities and policy design; however, almost thirty years later, Mexico must decide between protecting its National Champions or developing a competitive environment in which all, consumers, employees, companies and the government will be better off rather than in oligopolistic markets.

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