T H E
C R I T E R I O N
J O U R N A L O N I N N O V A T I O N

Vol. 3 2018

The OECD Once More on Telecommunications in Mexico: A Proud Accomplice in Reforms Whose Success Is Far from Sure

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According to the OECD Review on Telecommunication and Broadcasting in Mexico 2017, the performance of the industry since the reforms of 2013 and 2014 has been remarkable and demonstrates what can be achieved with evidence-based policy making. In my view, the review rather demonstrates what can be achieved by manipulating the evidence at will. It attributes to the reforms achievements that were well underway long before and closes its eyes to the many difficulties faced during their implementation. It is simply too early to arrive at an evaluation of reforms whose effects cannot be expected overnight. The review is a good example of selling the skin before shooting the bear. By applauding the reforms the way the review does, the OECD lost the opportunity to keep albeit a bit of distance.

I. The OECD's 2012 Review

In January 2012 the Organisation for Economic Co-operation and Development (OECD) published a review of the telecommunications industry in Mexico that raised considerable controversy.[1] The review was commissioned by the Mexican government, specifically the Federal Telecommunications Commission (Cofetel) and the Ministry of Communications and Transport (SCT). The OECD was asked for an independent evaluation of the state of development of the telecommunications industry in Mexico and suggestions for future policy.

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1 Organisation for Economic Co-operation and Development [OECD], OECD Review of Telecommunication Policy and Regulation in Mexico (2012) [hereinafter OECD, 2012 Review of Telecommunication Policy and Regulation in Mexico].

The main findings were that, compared with other member countries, Mexican tariffs for telecommunication services were excessively high and penetration very low. According to the review, the telecommunications industry was dysfunctional and the economy as a whole would have suffered a welfare loss of 1.8 percent of its GDP as a result of the high prices and the low penetration. The review was extremely alarming about the backwardness of an industry so crucial for Mexico's economic development.

According to the OECD, this deplorable state of affairs was due to a lack of competition. The incumbent company in fixed telephony (Telmex) had a market share of 80 percent and its running mate in the mobile market (Telcel) had a share of 70 percent. Until then, all attempts to reduce those market shares had failed, presumably due to an ineffective regulatory system and the anticompetitive practices of the incumbents.[2] That is why the review recommended a series of measures mostly aimed at strengthening the regulatory framework.

Perhaps the most surprising feature of the review was that there was hardly anything new. We had heard the story of the high prices and the low penetration rates since time immemorial from the Cofetel and that of the lack of competition from the Federal Competition Commission (Cofeco). Moreover, the recommendations of the review were a rehash of what the Cofetel had recommended before, in striving for extended powers to intervene. Everything seems to indicate that the OECD found what it was told to find and recommended what it was told to recommend.

The only new thing in the review was an econometric exercise estimating the prices and penetration ratios that would have existed in Mexican markets if competition had been at average OECD levels.[3] These counterfactual prices and penetration ratios were used to estimate the aforementioned welfare loss. Without a doubt, the Cofetel had asked for the OECD study to see its own perceptions of the industry confirmed and to give a higher standing to its own recommendations. Who is going to challenge them when they come from an organization as prestigious as the OECD? And when they come in the suit of science!

It worked. The media were enchanted with the sensational welfare loss, which made it to the headlines of the main newspapers day after day. And the legislators also bought the story. That attention helped to a great extent to gain approval by Congress for a constitutional reform in June 2013, and for the Federal Law of Telecommunications and Broadcasting (LFTR) one year later.

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[2] Strictly speaking, the dominant player in the mobile market was not the historical operator, but for the sake of simplicity I refer to Telcel as the incumbent.

[3] Marta Stryszowka, *Estimation of Loss in Consumer Surplus Resulting from Excessive Pricing of Telecommunication Services in Mexico* (OECD Digital Econ. Papers No. 191, 2012), https://www.oecd.org/centrodemexico/49539257.pdf.

These reforms were enacted in spite of the fact that the OECD review was heavily criticized from several angles. The excessive prices were the result of comparing prices in purchasing power parity (PPP) dollars. Comparing them in nominal dollars would have led to prices in Mexico even somewhat lower than OECD averages and no welfare loss would have been found.[4] Likewise, low penetration ratios could perfectly be explained by the fact that Mexico is among the OECD members with the lowest state of development.[5] Apart from that, the recommendations were criticized for proposing measures that could inhibit investments in the expansion and modernization of infrastructure.[6]

Moreover, there was a mistake in the econometric exercise—not a mistake one might squabble about, but an embarrassing blunder. To obtain the welfare loss, they multiplied the right variable with the wrong variable. This mistake alone was good for more than half the welfare loss the media liked so much.[7] It is no wonder the loss was so alarming. And, worst of all, in Paris they overlooked it. The review was printed including the blunder and with the alarming welfare loss in the first paragraph of the executive summary.

The OECD never answered the critique, nor did it admit the mistake in the econometric exercise. The only reaction was that the review had been elaborated following the normal procedures and that it had been approved by all member countries. Moreover, the OECD refused to reveal the data of the econometric exercise, allegedly for being confidential. So, the OECD opted for not being accountable. That was the situation at the end of 2012.

In 2013 *El Trimestre Económico* dedicated one of its issues to the controversy. The special issue published two of the articles criticizing the review and some contributions by authors invited to comment on the subject. Most comments defended the OECD. An article in which I had drawn the attention to the mistake in the econometric exercise was not included. A year later, *El Trimestre Económico* gave me the opportunity to set the record straight.[8]

[4] *See* Jerry A. Hausman & Augustin J. Ros, *An Econometric Assessment of Telecommunications Prices and Consumer Surplus in Mexico Using Panel Data*, 43 J. Reg. Econ. 284 (2013); Adriaan ten Kate, Sr., Three Best-Selling Stories About Telecommunications in Mexico (Oct. 25, 2012) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2344503.

[5] ten Kate, Sr., Three Best-Selling Stories About Telecommunications in Mexico, *supra* note 4.

[6] J. Gregory Sidak, *The OECD's Proposal to Cartelize Mexican Telecommunications*, CPI Antitrust Chron. Special Issue, May 2012, at 1.

[7] ten Kate, Sr., Three Best-Selling Stories About Telecommunications in Mexico, *supra* note 4.

[8] Adriaan ten Kate, Sr., *La OCDE Sobre Telecomunicaciones en México*, 81 El Trimestre Económico 1016 (2014), *translated in* The OECD on Telecommunications in Mexico (July 16, 2014) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2394901.

II. Reforms Far Beyond the OECD's Recommendations

Although the constitutional reform of 2013 and the LFTR of 2014 have roughly followed the OECD's 2012 recommendations, many of those recommendations were relatively open-ended and had to be adjusted to the Mexican reality. As a result, the reforms have gone far beyond those recommendations and even beyond common regulatory practices in other countries. With the legislators under media pressure, the authorities didn't settle for a slice; they went for the whole pie.

They removed in one stroke a good deal of the obstacles they had found on their way in combating market power in the industry. Since the opening-up of the industry in 1996, industrial concentration had been a thorn in the side of the authorities, who had never been able to reduce it substantially. The main purpose of the reforms was precisely to bring an end to this state of affairs.

The constitutional reform created the Federal Telecommunications Institute (IFT) to regulate telecommunications and broadcasting in Mexico. The new regulator was given autonomy to shield the IFT from political interests. Beyond the OECD's recommendations, the IFT was also given the power to enforce the competition regime in those industries. To make all this possible, a new competition statute was adopted and the Cofeco was transformed in the Federal Commission of Economic Competition (Cofece).

What also went beyond the OECD recommendations was the concept of *preponderance*. It was invented by the proponents of the reforms and sidesteps the advances of competition analysis in the subject matter over the last few decades. The idea was to capture what in competition analysis is known as *market power* or *dominance*, but unlike those traditional concepts, preponderance does not require one to define a relevant market. To my knowledge, there is nothing similar to preponderance in other jurisdictions.

Another initiative of the constitutional reform is the project of the Red Compartida, or shared network. The purpose was to build a last-generation network (4G) in a public-private partnership to make the benefits of modern telecommunications universally available. The initiative is surprising because it is at odds with some generally accepted regulatory principles, such as the non-duplication of infrastructure and the state's hands-off approach. Moreover, the network operator will provide only wholesale services, not services to end users.

The OECD's recommendation to entitle the regulator to declare an operator dominant so as to impose asymmetric regulation, was carried to the extreme in the constitutional reform.[9] The reform does not *empower* the IFT to impose asymmetric regulation; it *orders* the IFT to impose such regulation. By the way, an open-ended mandate is like ordering someone not to hit the bullseye, but to miss it. Now, the question is whether the termination fee for the preponderant player four times lower than that for its competitors, that was recently determined by the IFT, is sufficiently asymmetric to comply with the constitutional mandate

Where the reforms, and particularly their implementation, have remained short of the OECD's recommendations is in allowing Telmex to provide TV services. To achieve that, no reforms would have been necessary; a simple modification of Telmex's concession title would have sufficed. However, the OECD's recommendation came with the condition that the incumbent comply with the asymmetric regulation to be imposed. Given the fact that such regulation is so detailed that there is always something missing, the condition is good enough to postpone the incumbent's entry into the market for TV service to the last judgment. As a consequence, so far the OECD has harvested what it sowed.

To render legal appeals more cumbersome, the reforms were incorporated at very high levels in the Mexican legal system. What one would expect in the secondary law was put in the Constitution, and what would be properly attended in a decree was put in the law. Consequently, the Mexican Constitution now establishes in all detail the requirements to be fulfilled by the commissioners of the autonomous institutes, and the LFTR establishes termination fees equal to zero for the preponderant firms.

Throughout the legislative process the OECD has applauded the reforms, particularly because most of its recommendations were incorporated in one way or another. At the same time, it has kept silent on where the reforms went beyond its recommendations. On only one occasion did the OECD express its concern about the inertia created by incorporating the reforms at such high levels of the Mexican legal system, but it did so unofficially; and when those concerns filtered to the media, the OECD denied authorship.[10]

[9] OECD, 2012 Review of Telecommunication Policy and Regulation in Mexico, *supra* note 1, at 10.

[10] Adriaan ten Kate, Sr., *Las Refiormas de Telecomunicaciones: Quimioterapia para Combatir un Tumos Benigno*, *in* 3 Reforma de Telecomunicaciones y Competencia Económica (Adrián Gallardo & Luz María de la Mora eds., Fundación Colosio 2015), *translated in* Telecommunication Reform in México: Chemotherapy to Cure a Benign Tumor (Dec. 28, 2014) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2543191.

III. The OECD's 2017 Review

In August 2017 the OECD released another review on telecommunications in Mexico.[11] Like the 2012 review, the new one was also commissioned by the Mexican government, now by the SCT and the recently created IFT. On this occasion, the OECD was asked for an analysis of the reforms in view of the recommendations of the previous review and for an evaluation of the industry's performance since the reforms.

The 2017 review can best be characterized by the first paragraph of its preface:

> Mexico's telecommunication reform illustrates how better policies can lead to better lives. Since 2013, this unprecedented structural reform has allowed the Mexican authorities to introduce important changes to modernise the telecommunication and broadcasting sectors, challenging a highly concentrated status quo and moving into a more competitive future. The results have been remarkable and demonstrate what can be achieved with evidence-based policy making.[12]

In the 2017 review, the OECD expresses its satisfaction that most of its recommendations were incorporated in the reforms. It concludes that, of its 31 recommendations, 28 had been implemented and that the three remaining ones were underway. Because the OECD's recommendations hardly went beyond what the Mexican authorities had recommended before, it is not surprising that the recommendations were adopted. The Mexican authorities adopted their own recommendations. In the 2012 review, the OECD had supported them and, now, in the 2017 review, it was pleased to see them implemented. The show must go on!

As regards the industry's performance since the reforms, the review is very positive. It emphasizes the enormous price reductions for mobile services from 2013 to 2016 and attributes them to enhanced competition. Likewise, the OECD celebrates the spectacular growth in mobile broadband subscriptions between 2012 and 2016 and attributes it to the lower prices. The review states that the removal of the restriction on foreign ownership led to more foreign investment, that spectrum availability has improved, that the investment in infrastructure has increased and will increase further with the development of the Red Compartida.

There are no loose ends. Before the reforms the industry was dysfunctional. Prices were high, and penetration was low. The OECD issued

[11] Organisation for Economic Co-operation and Development, OECD Telecommunication and Broadcasting Review of Mexico 2017 (2017) [hereinafter OECD, 2017 Telecommunication and Broadcasting Review of Mexico].

[12] *Id.* at 3.

recommendations for improvement, and the Mexican authorities adopted them. Now, four years later, the panorama is completely different. Lower prices, higher penetration ratios, everything thanks to the enhanced competition resulting from the reforms. Unbelievable, too good to be true! And the OECD celebrates: "The results have been remarkable and demonstrate what can be achieved with evidence-based policy making."

IV. Comparing the OECD's 2012 Review with Its 2017 Review

The big difference between the 2012 review and the 2017 review is that, in the former, Mexico was compared with other member countries, whereas the latter highlights the development of the industry over time. When the OECD compared Mexico in the 2012 review with other member countries, it found Mexico to be the laggard in almost every ranking, and the conclusion given was that the industry's performance had been very poor. An analysis over time would have revealed the opposite: quickly declining prices and penetration increasing more rapidly than OECD averages.[13]

In the 2017 review, the comparisons are over time. It is the evolution of the industry that the OECD considers. Occasionally, Mexico is compared with OECD averages, but not in a systematic way. The result is that Mexico's performance is found to be excellent, which is attributed to the reforms. A comparison of Mexico with the other member countries would probably have delivered results similar to those of the 2012 review.[14]

The 2017 review also demonstrates how easy it is to obtain the results one seeks by varying methodologies. The purpose of the 2012 review was to underscore the deplorable state of development of the telecommunications industry, so the OECD compared Mexico with other member countries. The purpose of the 2017 review was to highlight the impressive performance of the industry since the reforms, so the comparison was over time. Both methodologies ensured the envisaged results.

Another difference between the two reviews is that in the 2012 review there was at least some analysis. There was the econometric exercise, and there were estimates of welfare losses from a lack of competition. Though extremely debatable, the attempt at empirical economic analysis was there. In the 2017 review, there is nothing of the kind. The 2017 review is a simple interpretation by the OECD of a biased choice of data, picking what fits, and leaving aside what does not fit its purpose of celebrating the reforms. Where

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13 ten Kate, Sr., Three Best-Selling Stories About Telecommunications in Mexico, *supra* note 4.

14 Only for mobile services are Mexico's prices now among the lowest prices of its OECD peers, but in 2011 Mexican prices measured in PPP dollars were already at OECD averages and measured in nominal dollars below those averages. *See* ten Kate, Sr., Three Best-Selling Stories About Telecommunications in Mexico, *supra* note 4.

the two reviews coincide is that both see doubtful causal relations where they want to see them.

Paying attention not only to what the 2017 review says, but also to what it is silent about, it appears that there is hardly anything about the findings of the review of 2012. One would expect a progress report to begin where the previous report ended, but in the new review there is not a single word about the dysfunctionality of the industry, nor about the tremendous welfare losses of the economy that figured in the very first paragraph of the executive summary of the 2012 review. Only the recommendations of the 2012 review were taken up, but that was because the OECD was asked to do so. There is no mention either of the controversy provoked by the previous review nor of the special issue of *El Trimestre Económico*. The OECD does not admit that there was controversy, and it prefers to forget what it does not want to remember.

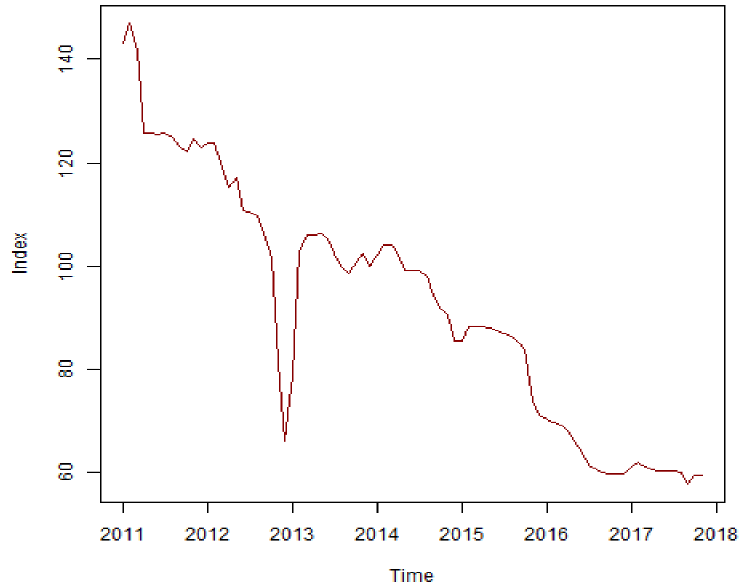
V. Price Reductions

One reason to consider the reforms a success is the reduction in prices, particularly those of mobile services. The 2017 review presents a figure with price indices taken from the National Institute of Statistics, Geography and Information (INEGI) for different telecommunications services.[15] For illustration, I reproduce the figure for mobile services, extending it backwards to 2011. From the figure it appears that from 2014 to 2017 prices decreased by 40 percent. The OECD attributes this reduction to the enhanced competition induced by the reforms.[16]

[15] OECD, 2017 Telecommunication and Broadcasting Review of Mexico, *supra* note 11, at 82 fig.2.2.

[16] *Id.* at 82–83.

Figure 1. Mobile Services Price Index



Source: Instituto Federal de Telecomunicaciones, Banco de Información de Telecomunicaciones (2017), bit.ift.org.mx/BitWebApp.

What the OECD does not mention is that the same prices fell by more than 50 percent from January 2011 to January 2013. That is, in the two years before the reforms prices fell by more than in three years after the reforms. The price decline before the reforms cannot have been due to enhanced competition at times that the Mexican industry was still dysfunctional for a lack of competition (according to the 2012 review). It could be objected that immediately after January 2013 prices jumped back, but even flattening the dip, pre-reform and post-reform reductions are of the same order of magnitude.

From this irregular price behavior, we can learn something else: that comparing prices is always a tricky business. One never knows whether one is comparing pears with apples. Price comparisons become even more complex when products are bundled, as is the common practice in the telecommunications industry. In such cases, the disaggregation of the value of the bundle into prices for its constituent products is so sensitive to what is assumed about the composition of the bundle that the tricky business becomes an almost impossible mission.

That is why the fluctuations of the figure should not be taken all too seriously. Users do not pay less for the same bundle; rather, they pay the same for an extended bundle. That is what happens when a bundle covering 100 Mbps of broadband capacity is extended to 500 Mbps. Does that redefinition of the bundle mean that the price fell by 80 percent? Even when the subscriber did not use more capacity than before? As with a free-refill scheme, drinks were free. In fact, the price dip at the end of 2012 is explained by a temporary promotion campaign by the mobile operators for the "buen fin" of November of that year.[17] In reality, little happened. Consumers kept paying the same for an extended bundle they may have used to some extent, but the price index suggests that there was an earthquake.

The question is now: What can we believe of the price reductions in Figure 1 after the reforms? In my view, there is little doubt that prices have declined significantly—perhaps not exactly in the way that Figure 1 suggests, but, taking value and volume indices for the mobile segment as a whole from 2014 to 2017, a simple division leads to a reduction of the same magnitude. Another question is whether these price reductions are due to the reforms. In view of the fact that there were also important price reductions *before* the reforms, it is not at all clear that the reforms deserve credit. Still another question is whether the price reductions are due to enhanced competition.

VI. More Competition?

Even though the OECD says so repeatedly, it is questionable whether competition really has increased since the reforms. The problem is that strength of competition is not something directly observable and that appearances may be misleading. The presence of many suppliers in a market is not a guarantee that competition is strong, and high industrial concentration does not necessarily imply that competition is weak. The strength of competition does not depend only on structural factors, such as the number of competitors and their market shares, but also on how aggressively the existing suppliers decide to compete—that is, on behavioral factors.

For the OECD, it is only structural factors that count, particularly the market shares of the incumbents and their competitors. The section on competition in the 2017 review is mainly about the evolution of those shares from 2012 to 2016.[18] The OECD reports with some satisfaction that the market shares of the incumbents over that period came down from 69 percent to 63 percent in fixed telephony, from 67 percent to 57 percent in fixed broadband, from 70 percent to 65 percent in mobile telephony, and from 84 percent to 72 percent in mobile broadband.

What, in my opinion, stands out is not so much that the market shares of the incumbents declined, but that they declined so little. At that rate, it would take more than a decade before Telcel's market share of mobile telephony dropped below 50 percent. This is true in spite of the regulatory violence, such as zero termination fees, applied against Telcel since the reforms were

17 "El buen fin" is a kind of thanksgiving.

18 OECD, 2017 Telecommunication and Broadcasting Review of Mexico, *supra* note 11, at 96–98.

enacted. The decline of Telmex's market share in fixed telephony can be explained by the fact that it has never been allowed to provide a triple-play package of voice, video (television), and Internet, and, indeed, it is mainly cable companies that gained the share Telmex lost. Yet, the decline in Telcel's market share in mobile telephony from 70 percent to 65 percent must have been a disappointment to the proponents of the reforms. Without a doubt, they expected more.

Apart from that, these shares were measured using subscriptions. It would have been better to measure them using traffic or earnings. However, the information available in the Banco de Información de Telecomunicaciones (BIT) of the IFT is not sufficient to do so.[19] For traffic in broadband there is only information from 2015 onwards and regarding earnings it is not possible to separate telephony from broadband. Even so, doing what is possible with the available information one finds that the decline in the market shares of the incumbents is less pronounced when measured in traffic or earnings than it is when it is measured in subscriptions.

Even if the strength of competition were adequately measured by market shares, it is not clear that competition in telecommunications markets has increased since the reforms. And even if it were clear, such an increase in competition could not explain the price declines reported by the 2017 review. In the econometric exercise of the 2012 review, no significant correlation was found between industrial concentration and prices for mobile services, so how would a decline in Telcel's market share from 70 percent to 65 percent explain a price decline for mobile services of 40 percent? Once more, the OECD prefers to forget what it does not want to remember.

What does definitely imply more competition in mobile services is the entry of AT&T, which was made possible by the removal of the restriction on foreign investment. There is little doubt that AT&T is a stronger competitor for Telcel than the two companies that AT&T acquired. And indeed, since AT&T began operating in Mexico, it has gained market share from both Telcel and Movistar. The trend is still modest, but it is robust. Yet, it remains to be seen whether AT&T will be able to achieve the critical mass of subscribers necessary to make positive profits.

VII. Mobile Broadband

For the OECD, the star performance of the reforms is the spectacular increase in mobile broadband subscriptions. The preface of the 2017 review declares: "Since the reform was introduced . . . more than 50 million additional people in Mexico have subscribed to mobile broadband," and in the

[19] Instituto Federal de Telecomunicaciones, Banco de Información de Telecomunicaciones, *supra* sources to Figure 1.

introduction of the chapter on market developments the OECD's says: "The number of people with a mobile broadband subscription . . . increased from 24 million in 2012 to over 74 million is 2016."[20] The source is "unpublished material provided by the IFT."[21]

By now, the unpublished material has been made available in the BIT. There, it appears that the number of subscribers to mobile broadband increased from 27.4 million in June 2013 to 76.9 million in June 2017, indeed an increase of almost 50 million. However, in June 2014, when the reforms were completed, subscribers already amounted to 40.5 million. Given that the effects of reforms of this kind cannot be expected overnight, a major part of the increase that the OECD attributed to the reforms had materialized *before* the reforms could have had any effect at all.

Obviously, the spectacular increase in mobile broadband subscriptions is due rather to the appearance of the smartphone a decade ago and to the popularity of its applications. The increase in subscriptions would have happened with or without reforms.

VIII. Preponderance: Comedy or Tragedy?

In competition policy, market power is a concept quite difficult to administrate, not only in Mexico, also in other jurisdictions. After a century of attempting to create some clarity about its meaning and how to measure it, progress remains poor. Therefore, most declarations of substantial market power aimed at imposing asymmetric regulation are doomed to end in endless litigation, at least in Mexico. Fed up with this reality, the Mexican authorities decided to sidestep market power and replace it with a new concept: "preponderance."

Contrary to market power, preponderance does not apply to markets, but to sectors. That way, there is no need to define a relevant market, one of the greatest obstacles in the determination of market power.[22] Also, contrary to market power, preponderance requires not that the economic agent has the power to profitably raise prices—the other great obstacle—but that its market share in the sector exceeds 50 percent, which is much easier to establish. By putting all this in the Constitution, as the reforms did, possibilities for appeal were reduced considerably.

Problem solved! What thus far would have taken years could now be done in only a few months. And indeed, in less than a year after approval of the

[20] OECD, 2017 Telecommunication and Broadcasting Review of Mexico, *supra* note 11, at 80.

[21] *Id.* at 88 fig.2.8.

[22] *See* Adriaan ten Kate, Sr. & Gunnar Niels, *The Relevant Market: A Concept Still in Search of a Definition*, 5 J. Competition L. & Econ. 297 (2008); Adriaan Ten Kate, Sr., The Relevant Market Drama and the Descent of the Hypothetical-Monopolist Paradigm, (June 10, 2013) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2334421.

constitutional reform, and half a year after the creation of the IFT, Grupo Carso was declared preponderant in telecommunications and the Televisa group in broadcasting.

However, sectors are defined according to industrial classifications, whereas markets are defined according to the competitive reach of the products they contain. As a result, most sectors, even the most detailed ones, comprise many markets and cover products that are not at all substitutes for one other. In the Mexican industrial classification, the telecommunications sector happens to include pay TV services. This is an oddity of the Mexican classification, because pay TV is a matter of selling content, in which telecommunications is no more than an input, but for one reason or another, that is how pay TV is classified in Mexico.

The result is that, now, the Carso group is the preponderant agent in pay TV services, as part of the telecommunications sector, even though it does not deliver those services, and is not even allowed to do so. This is more funny than it is serious. If the IFT were to impose an asymmetric regulation on the Carso group for preponderance in pay TV services, that regulation would have little effect for an agent that is not even active in those services. More serious is the fact that Televisa, which does provide pay TV services and does have a market share above 50 percent, goes free. The Televisa group is also preponderant, but in broadcasting, which does not include pay TV.

In view of the protests provoked by this strange situation, the IFT returned to the old concept of market power and initiated an investigation to determine whether Televisa had substantial market power in the pay TV market. In March 2015, the IFT released a preliminary finding that confirmed that Televisa had substantial market power. In October 2015, this preliminary finding was reversed in a definitive resolution establishing that Televisa did not have substantial market power. Upon a number of appeals, the Court Specialized in Telecommunications and Competition resolved in March 2017 that determination of market power should be done all over again. A month later, the IFT reiterated its previous decision, resolving that Televisa had substantial market power. Upon appeal by Televisa, the Supreme Court invalidated the IFT's decision in February 2018.

Where this comedy could become a tragedy is in the measures of asymmetric regulation that could result from preponderance, not only with respect to local-loop unbundling, but also (and particularly so) regarding the functional separation of Telmex. It is not yet clear what exactly this functional separation will entail, but the functional separation that the IFT recently approved seems to go beyond a structural separation.

IX. Vertical Separation

The vertical separation of Telmex has its origin in the OECD's recommendation to authorize the regulator of the industry "to impose functional, and, if necessary, structural separation of an operator that continues to abuse its dominant power."[23] The reforms have gone a step further by authorizing the regulator to impose an accounting, structural, or functional separation on a preponderant agent without the need to show an abuse of dominance.[24] And in fact, in February 2017, the IFT ordered Telmex to functionally separate after a first review of the state of preponderance in telecommunications.

The purpose of vertical separation is to enhance competition in downstream markets. By removing the incentives of the dominant player in the upstream market to leverage its power in the downstream market, the playing field is leveled. That is at least the idea. What is lost with vertical separation is coordination between the activities in the upstream and downstream markets—a coordination that may be necessary when services in the upstream market are differentiated (tailor-made). Such coordination is particularly important between upstream investments and downstream operations.

Whether the gains in competition outweigh the losses from a lack of coordination depends on the case at hand. In mobile telephony there is little experience, and in fixed telephony experience is divided. For a few European countries, and for Australia and New Zealand, some research has been done on whether vertical separation in fixed telephony has brought more penetration. In the U.K., it has been found that the functional separation of British Telecom has brought short-run benefits in the form of lower prices, but negative effects in the long run in the form of less investment.[25]

However, one need not go far to find examples of industries where a dogmatically applied vertical separation has led to disastrous results. Take the Mexican petrochemical industry, without a doubt an industry with strong comparative advantages, but in which a strict separation between primary and secondary products—the former reserved for the state, the latter being produced by private companies—has never allowed the industry to exploit those advantages. After decades of efforts fixed investments in the industry have turned into scrap and private investment has mostly disappeared.

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[23] OECD, 2012 Review of Telecommunication Policy and Regulation in Mexico, *supra* note 1, at 11.

[24] Decreto por el que se Reforman y Adicionan Diversas Disposiciones de los Artículos 6o., 7o., 27, 28, 73, 78, 94 y 105 de la Constitución Política de los Estados Unidos Mexicanos, en Materia de Telecomunicaciones [Decree by Which Various Provisions on Telecommunications of Articles 6o., 7o., 27, 28, 73, 78, 94, and 105 of the Political Constitution of the United Mexican States Are Amended and Added], Diario Oficial de la Federación [DO], 11 de Junio de 2013 (Mex.).

[25] *See, e.g.*, J. Gregory Sidak & Andrew P. Vassallo, *Did Separating Openreach from British Telecom Benefit Consumers?*, 38 World Competition 38 (2015).

Evidently, the telecommunications industry is different from the petrochemical industry, but it is not difficult to find some similarities.

X. The Red Compartida

Another initiative that was not among the OECD's 2012 recommendations is the Red Compartida (RC), or shared network. Its purpose is to bring the benefits of modern telecommunications to every corner of Mexico by means of a new wholesale network. The idea is to employ bandwidth more efficiently than what is actually achieved by interconnecting integrated networks. The project will be carried out by a public-private partnership (APP), in which the state contributes 90 MHz in the 700 MHz band, and a pair of optical fibers belonging to the Federal Electricity Commission (CFE). To avoid conflicts of interests, integrated operators are excluded from the APP. Services should be provided at competitive prices and on non-discriminatory terms.[26]

As a general rule, those who build telecommunications networks are integrated operators and they do so for their own use, not to sell network services to their competitors. When they sell network services, they do so because they are obliged to interconnect with the others, but they do not see that practice as a business, and less so when interconnexion fees are regulated at bargain prices. The RC does exactly the opposite. Its operator is going to sell network services, as if it were a business. The great unknown is whether the competitive prices and the nondiscriminatory terms will leave room for a reasonable return.

As there is no clear division of labor, the RC will compete with the existing networks of integrated operators. There is an implicit division of labor because the RC will use the 700 MHz band, which has advantages for the long range, but in principle the RC will cover the whole country and will not be prevented from acquiring radio spectrum of higher frequencies. Even so, it is unlikely that the vertically integrated operators were very concerned about such competition, as their business is in providing services to end users. They will simply see where they can save on the effort to build their own network by using the RC's services. This will have a negative impact on their incentives to invest in their own networks.

A network operator selling only wholesale services is something relatively new in mobile telecommunications. In fixed telecommunications there are several cases of functional or even structural separation, usually ordered by the regulators, but in the mobile segment the experience is limited. There have been a few cases initiated by local governments in densely populated

[26] What is meant by competitive prices and by non-discriminatory terms remains obscure in the reforms. As costs are usually location-dependent, flat pricing is discriminatory by definition. It will be interesting to see how the authorities will tackle those kinds of unsolvable problems.

areas, but these are still in an experimental stage. To my knowledge, there is nothing similar to the RC with respect to its coverage and ambition.

Private participation in the project was achieved by intense lobbying, followed by a sham bidding process set up by the SCT. The result was a tender with a single participant who happened to win. The other candidate was disqualified for not having presented the guarantee in time (a derisive guarantee in view of the magnitude of the commitments). The winner was not an existing company, but a consortium set up for the purpose. The parties in the consortium had little experience in building networks. Those who do have experience are the integrated operators, but they were excluded from the tender.

The winning consortium was composed of a couple of equipment providers and financing companies. Time ago, one of the equipment providers was a world leader in handsets, but it missed the boat in the market for smartphones and is now struggling for a comeback. The other is a Chinese firm interested in being in the Mexican kitchen. If these companies were to have conflicts of interest, such conflicts of interest are not of the kind that worry the Mexican regulator. As regards the companies that finance the project, they are not private firms risking their own capital, but development banks backed by public funds. So, their private character is questionable.

In its 2017 review, the OECD expresses some reservations about the RC project: "[A] bold, large and pioneering project of this nature will face challenges," and "[n]ot meeting objectives will have a high opportunity cost and carry potential reputational damage."[27] The OECD also gives general recommendations, such as "ensuring the project's success must be a priority for Mexico," and that the winning bidder "must actively promote the use of the RC,"[28] as if that were something different from what everybody does when marketing his products. In general terms, however, the OECD supports the RC project.

Altogether, the RC project seems to be a leap in the dark. Whether it will lead to something worthwhile will remain unknown for at least another five years—unless it does not overtly fail before! In the meantime, the authorities have opted to close their ears to the skepticism and to defend the project with rhetoric.

XI. The Reality Show of Convergence

Due to a peculiar restriction in its concession title, Telmex has never been allowed to provide television services. Since time immemorial Telmex has

[27] OECD, 2017 Review of Telecommunication Policy and Regulation in Mexico, *supra* note 11, at 52.
[28] *Id.* at 52.

been asking for the removal of the restriction, but so far without success. To my knowledge, there is nothing similar to such a restriction in other countries. There has always been opposition to Telmex entering television markets, particularly by the free-to-air duopoly, but also by cable operators who see their business threatened. Thus far, the authorities have lined up with these interests.

The issue became relevant again with the Convergence Agreement of 2006. At that time, it was suggested to give Telmex a chance to enter triple-play, but to give the cable operators, which were just entering the fixed telephony market, a head-start of two years. Everything under the condition that Telmex would comply with all obligations of its concession title, particularly those of universal service. The condition was never fulfilled, at least not in the perception of the regulator. Now, not two, but twelve years after the adoption of the Convergence Agreement, we are still in the same situation.

What has changed is the condition. First, the removal of the restriction was conditioned on Telmex's provision of universal service. Now, it is compliance with the asymmetric regulatory measures that would open the door to Telmex. It is not clear what role the OECD has played in this change, but one of the recommendations in the 2012 review comes with this new condition.[29]

Both conditions are difficult to satisfy. Universal service is a laudable objective, but reality imposes its limits. Some areas are simply too expensive to cover, and demand there is too low to justify the effort; so some flexibility in setting targets is absolutely necessary. Even if Telmex were reasonably prepared to comply with its obligations, but within the limits of economic viability, there would always be arguments to maintain that it did not. The same can be said of asymmetric regulation. Even if Telmex were reasonably disposed to cooperate, its competitors, knowing themselves backed by the regulator, would keep complaining that Telmex did not comply.

Moreover, the conditions (universal service and asymmetric regulation) have little to do with television services. The permit to enter into television services is rather used as a bait. But the beast has little confidence. It could bow and scrape for many years to learn afterward that it was not enough. After decades of pulling the rope in a tug of war, the credibility of the regulator is torn to pieces.

The result of this reality show is that we now have a penetration ratio of barely 15 percent for triple-play,[30] at a time when streaming is already replacing free-to-air and pay TV services. As a consequence, Mexico has now wasted more than a decade without taking advantage of a fiber-optic network that

[29] OECD, 2012 Review of Telecommunication Policy and Regulation in Mexico, *supra* note 1, at 10.

[30] OECD, 2017 Telecommunication and Broadcasting Review of Mexico, *supra* note 11, at 110 fig.2.28.

could have brought better and cheaper pay TV to more households—all this in order to safeguard competition in a market in which the dominant player (Televisa) has been allowed to consolidate freely.

The OECD has long been aware of this problem. It has recommended to remove the restriction from Telmex's concession title on some previous occasions, but instead of recommending it as a priority, the OECD added the condition of compliance with asymmetric regulation. With so many disapproving eyes on Telmex, such a condition is good enough to postpone Telmex's entry into TV services to the last judgment. The OECD has harvested what it sowed.

XII. Competition at the Crossroads

There are two kinds of competition. On the one hand, we have competition that lowers prices, enhances the purchasing power of consumers, reduces the income of producers, and that some people believe is measurable by market shares and concentration indices: the so-called *static competition*. On the other hand, we have competition that does away with what does not work anymore, that drives the least efficient firms out of the market, and that gets us to a new equilibrium after a change in the circumstances, be it due to innovations or be it for other reasons: *dynamic competition*.[31]

Contrary to static competition, dynamic competition tends to concentrate market power in the hands of one or just a few firms. This is not necessarily the case, but after a change in circumstances, it is unlikely that many firms end up more or less equal. Therefore, the result of dynamic competition is usually a situation in which static competition has little chance. Even so, welfare gains from dynamic competition tend to be far superior to those from static competition. Therefore, combating dynamic competition in order to preserve static competition is mostly counterproductive. You lose more than you win.

This is exactly what the Mexican authorities, backed by the OECD, have done, and keep doing, by implementing the reforms. They opted for static competition instead of dynamic competition. Everything is about lowering prices and about reducing the market power of the incumbents. The asymmetric regulation is there to avoid the leveraging of upstream market power against the downstream market, where static competition is to be preserved. What is missing is a dynamic view of where the telecommunications industry is heading for, given technological and commercial developments.

I do not pretend to know precisely where the telecommunications industry is heading, but some trends seem to be clear. Not only in Mexico, but all

[31] *See, e.g.*, J. Gregory Sidak & David J. Teece, *Dynamic Competition in Antitrust Law,* 5 J. Competition L. & Econ. 581 (2009).

over the world, fixed telephony is on its way back, having been in decline for a decade. Fixed broadband services are likely to resist somewhat longer, but they nonetheless belong to a declining segment of the market. The regulation the Mexican authorities intend to apply in this field (local-loop unbundling and the functional separation of Telmex) are extremely tricky interventions requiring continuous attention from the regulator and giving rise to endless conflicts. The authorities intend to apply this regulation in spite of the fact that what one can expect from somewhat more static competition in this area is limited.

In mobile telephony, on the other hand, there are strong trends toward consolidation. These are mainly due to strong economies of scale and network externalities, not only in infrastructure, but also in operation. Over the last decade, there have been many mergers and acquisitions between mobile operators all over the world. When only a few years ago the optimal number of mobile operators per country was considered to be four, now it is three. Some people have put their hope on mobile virtual network operators (MVNOs) for their innovative business models, but it is unlikely that these MVNOs will ever become a real competitive threat to the vertically integrated operators. Moreover, from them one cannot expect any contribution to the expansion and modernization of infrastructure. Altogether, one cannot expect too much benefit from more static competition in the mobile markets either.

That is to say, the Mexican regulator is promoting a kind of competition that is unlikely to deliver important benefits to end users. In 1996, when the industry was opened up to competition, this strategy may have worked, but the industry is no longer the same. Moreover, the regulator does so in an extremely interventionist way with high regulatory costs. At the same time, it does not take advantage of a much more beneficial type of competition that is just around the corner. The only thing that is necessary to release it is to give Telmex a chance to provide television services. What is behind all this? The danger of a winner that would take all? Or a lack of willingness to oppose vested interests?

XIII. What If?

What if the diagnosis by the Mexican authorities of the troubles of the telecommunications industry was wrong? What if those troubles were less troubling than what they want to make us believe? What if the relative backwardness of the industry were not due to a lack of competition, but simply to the state of Mexico's development in general? What if the resilience of the incumbent companies to the regulatory violence given rise to by the reforms, were not due to the effectiveness of their anticompetitive conduct, but simply to the possibility that end users might prefer the services of the incumbents to those of their competitors? The fact that Telcel turned out to be the greatest beneficiary of enhanced number portability points in that direction.

What if the supposedly poor performance of Mexico's telecommunications industry were attributable not to a lack of competition, but to a huge distortion of the incentives for the incumbents to invest? What if the lack of appropriability of the returns on such investments deters them? What if the industry rather needed a coordinated effort by the integrated operators to develop the infrastructure together? What if the companies best positioned to lead such efforts were the incumbents? What if the participation of the competitors was due not to their readiness to join in, but to their eagerness to get a piece of the pie by free-riding as much as possible on the existing infrastructure?

I don't want to say it is like that, but I do not either exclude the possibility that it could be like that. If it were, the telecommunications reforms of 2013 and 2014 would lead us nowhere, the Mexican authorities would be betting on the wrong horses, and in the long run the big losers would be the end users.

Conclusion

By prematurely accepting to evaluate the performance of Mexico's telecommunications industry since the reforms of 2013 and 2014, and by doing it the way it did—that is, by establishing far-fetched causal links between the reforms and the achievements and by celebrating the reforms as an example of what can be achieved with evidence-based policy making—the OECD lost the opportunity to keep albeit a bit of distance. Where we stand now, there is no guarantee at all that the reforms will be successful, and if they fail, such failure might be difficult to keep undercover.

In my view, the recent OECD study exemplifies what can be achieved by cherry-picking the evidence. It mentions whatever confirms some predetermined points of view and closes its eyes to what contradicts them. The review should be seen as a friendly gesture on behalf of the OECD Secretariat toward a government in a bad need of some positive signals, toward the end of an administration that was plagued by adversities.