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# Effective Regulation in Latin American Countries

The cases of Chile, Mexico and Peru

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## Abstract

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*This paper provides an analysis of the regulatory processes and their institutional designs within the telecommunications industry of three different countries in the region: Chile, Mexico and Peru. We will identify regulatory institutional designs and examine the regulatory outcomes in terms of the objectives regulatory policies aim to reach. The idea is to identify those institutional characteristics that may be enablers of telecom development and those which may be inhibitors. We find that clarity of roles as well as transparency and participation appear to be key characteristics of a strong regulatory design. The existence of an autonomous agency does not appear to be a significant variable; the most significant variables are transparency and inclusion in the decision making process.*

## Resumen

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*El objetivo fundamental de este documento es proveer un análisis del proceso regulatorio y de su diseño institucional dentro de la industria de telecomunicaciones en tres países diferentes de la región: Chile, México y Perú. Se identifican los diseños institucionales y se examinan los resultados de la política regulatoria en términos de los objetivos que persigue. La principal aportación consiste en identificar aquellas características institucionales que son impulsoras del desarrollo del sector y aquellas que funcionan como inhibidoras. Encontramos que la clara definición de roles, así como la transparencia y la participación parecen ser las características claves para un fuerte diseño institucional. La existencia de una agencia autónoma no parece ser una variable significativa.*



## *Introduction*

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Almost two decades after most of the countries in the Latin American region initiated a deregulation process in their telecommunications sectors, we find that, although they followed the general principles of pro-market reforms, each country adapted these guidelines to their political and economic contexts. Most of these deregulation processes led to the design and enactment of new regulatory frameworks, the creation of independent regulatory agencies, the privatization of formerly state-owned monopolies and the promotion of competition in infrastructure deployment and in service offerings.

The variety of paths followed by each Latin American country led to different sector performances in each country; today we observe different degrees of market concentration, infrastructure deployment and service coverage in the region. Following the literature on regulatory institutions, the argument in this paper is that these differences may be explained, to a significant degree, by the effectiveness of the regulatory institutions<sup>1</sup> created (Levy and Spiller, 1996; North, 2005).

Regulatory policies use norms, rules and contracts to provide incentives which seek to align the firms' decisions to the more general objectives of society (public interest). The possibilities of success are crucially dependent on the effectiveness of institutions where the regulatory process takes place. An effective regulatory institution delivers policies that are transparent and credible (Noll, 1999).

This paper will provide an analysis of the regulatory processes and their institutional designs within the telecommunications industry of three different countries in the region: Chile, Mexico and Peru. We will identify regulatory institutional designs and examine the regulatory outcomes in terms of the objectives regulatory policies aim to reach. The idea is to identify those institutional characteristics that may be enablers of telecom development and those which may be inhibitors.

As regulatory agencies represent the key component of the institutional design, we will focus on the role of specialized regulatory agencies building on the index "Regulatory Framework Index" developed by Gutiérrez (2003). Through the evaluation of the telecommunication law, this index identifies four characteristics in a regulatory agency: (1) autonomy and independence, (2) accountability, (3) clarity of roles and objectives and (4) transparency and participation, which contribute to an effective regulation. Using these characteristics as analytical lenses, we discuss the effectiveness of regulation in Chile, Mexico and Peru. A case study approach will enrich the findings of

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<sup>1</sup> Institutions, understood as rules, norms, beliefs, organizations, property rights, contract enforcement and the rule of law (North 1990), have played a key role in the development of the telecommunication sector.

more general empirical studies by analyzing whether the regulatory policies in each of these countries do strictly follow the underlying laws; by understanding the process of policy implementation beyond that of policy design.

The main conclusion of this document is that clarity of roles as well as transparency and participation appear to be key characteristics of a strong regulatory design. That is, the existence of an autonomous agency does not appear to be a significant variable; in the case of Chile, even though an autonomous regulatory agency does not exist, the telecommunications institutional framework is efficient, open and transparent, a fact which led to a strong performance of the telecommunications industry. In Mexico, the regulatory agency is not autonomous, since it depends on the Ministry for day to day decisions. But more importantly, the regulatory agency COFETEL is not legally endowed with mechanisms to provide a transparent and inclusive decision making process. All this is reflected in the fact that there exist significant barriers for new operators, as well as a legal uncertain environment. Finally, Peru's institutional design presents, in many ways, the text book suggestions; the regulatory agency is autonomous and the decision process is open and transparent. However, according to its own agency, OSIPTEL (2002) there were errors in the policy process that led to the late start of competition, and more importantly the competition framework is incomplete and inadequate to address the entrance of new operators to the market. Today the Peruvian market is very concentrated and prices are high.

The first section of this paper presents some of the main results in the literature of telecommunications reforms while the second will offer an analysis of regulatory institutions in each of these countries. The third section presents a comparative analysis of the regulatory institutions of the countries studied as well as their market outcomes. Finally, we will offer conclusions of the analysis undertaken and identify further lines of research.

### ***Regulation from an Institutional Perspective***

The telecommunications regulatory policy faces the difficult objective of influencing firm's decisions in order to align them with the public interest. Regulatory policies use norms, rules and contracts to provide incentives and the possibilities of success are crucially dependent on the effectiveness of institutions where the regulatory process takes place. An effective regulatory institution delivers policies that are transparent and credible; that is, provide certainty for investment (Noll, 1999).

The regulatory objective is for firms to offer reasonable prices and high quality services; however, it is important to promote investment and technological innovation, which requires reasonable profit. An additional challenge is given by the nature of regulation that includes information

asymmetries between regulators and firms, and the fact the all contracts are always incomplete (Laffont & Tirole, 1993). The complexity of these objectives in addition to the general weaknesses of institutional frameworks has contributed to an inefficient regulation in most of the Latin American region. That is, despite significant efforts, the regulatory objectives have not yet been reached. To be sure, the development of the telecommunications sector in the region has advanced significantly; voice services are now widely available, although not always widely accessible in terms of price. However, access to broadband is dramatically low and this significantly limits the contributions of ICTs to the economic and social development of a country. (Mariscal, 2009)

Still, we find significant differences between countries in the region. Even though most of the countries in the region privatized monopolistic operators, opened the sector to competition and created specialized regulatory agencies, there are significant differences in the nature of the reforms implemented in each country. Empirical studies in this thematic area have addressed the effect of each of these reforms on market outcomes. Wallsten (2001; 2003) finds a positive correlation between privatization –independent regulatory agency and the main telecommunication performance variables. Moreover, he supports the argument that exclusivity periods have a negative effect on tariffs and on telecommunications investment. Noll (2006) undertakes an evaluation of the Mexican telecommunications' sector and concludes that even though privatization had a positive impact on market performance, the sector has not reached its potential due to regulatory inefficiencies.

These studies highlight the importance of introducing competition when the state owned monopoly is privatized, and they also identify the sequence of reform and the efficiency of regulatory institutions as variables which significantly affect outcomes. When analyzing regulatory institutions, a key variable with a positive effect on performance is the creation of a specialized independent regulatory agency. Even though numerous countries established a specialized independent agency there is a difference between the policy design (what is established in the law) and the actual policy implementation.

More recently, empirical studies have tried to capture these differences by constructing indexes that reflect specific country variables and evaluate the effectiveness of the regulatory framework: Ros (1999), Gutiérrez and Breg (2000). Jordana and Sancho (1999) developed two indexes, "*Índice de Fragmentación Regulatoria*" (IRG) and "*Índice de Apertura del Mercado*" (IAM). The first one measures the dispersion among government organizations in charge of telecommunications' regulation, that is, how regulatory activities are distributed among government agencies. The second evaluates the level of competition resulting from reform.

Gutiérrez (2003) develops a “Regulatory Framework Index” (RFI) that measures how regulatory governance has evolved for a sample of 25 countries in the Latin American context. RFI is decomposed into eight sub indices that are useful to evaluate the general regulation policy and core regulatory body characteristics. The general regulation policy includes legal mandate and separation of regulatory and operating activities. Whereas, the core regulatory body concept includes autonomy/independence, accountability, clarity of roles and objectives, and transparency and participation.

For Gutiérrez, agencies’ autonomy/independence means all “those mechanisms that allow the regulatory body to be independent from undue political intervention, whether from industry or the government” (a. Gutiérrez 2003, 231). In order to measure this concept, he uses two variables: financial and budgetary independence, and the ease to remove first level officers.

By “accountability” the author refers to those strategies used to guarantee that regulators behave according to their legal mandate, since the regulators credibility is also affected by the way stakeholders protect their interests. He measures accountability through the presence or absence of mechanisms to resolve disputes.

Clarity of roles and objectives in this index is identified by the unambiguous establishment of a responsible entity for regulatory functions; that is not to have duplicity of responsibilities between the regulatory agency and the telecommunications ministry. Moreover, whether or not an agency has an advisory role or has the capacity to take decisions must also be clearly established. Clarity of roles and responsibilities is included by identifying whether or not the agency has the power to impose fines and set tariffs for basic telecommunications services. Finally, transparency and participation provide the possibility to minimize the potential collusion between regulators and regulated firms. Regulatory process should include: a clear specification of the rules of game and the possibility of having public hearings.

This index provides a useful analytical lens to evaluate the effectiveness of regulatory agencies in the three countries under study. The questions that arise from this index, and which will be included in the analysis provided in the following sections, are:

- 1. Are regulation policies predictable and transparent?*
- 2. Does the agency take its decisions on an independent and autonomous way? Or are there cases of interference from other authorities?*
- 3. Are the operators allowed to participate in the design of policies? Which mechanisms are established for that purpose?*
- 4. What are the mechanisms to resolve disputes?*

## ***Telecommunications Reform in Latin America***

An examination of privatization and competition reform in Latin America shows that three waves of reforms took place in the region between 1980 and 1998 (see table 1). These processes follow two complementary lines of action: on the one hand, governments privatize their telecommunication operators; on the other hand they open different segments of telecommunications markets to competition. Finally, they embed these new economic relationships onto new institutional arrangements. In this study we will focus the analysis on Chile, Mexico and Peru as they represent first, second and third wave of privatization processes and market liberalization. This choice will offer some insights as to the possibility of learning lessons from the starters to the late comers; countries that entered a late privatization process are more likely to implement a more effective reform than those in the first wave of reform, by exploiting experiences gained during the reform processes of the early starters. However, it is important to keep in mind that Peru's national income is significantly lower than both Chile's and Mexico's and that will determine a lower performance.

Most of the telecommunications reforms in Latin America began in the nineties; however, there is an important exception in the region: Chile. This Andean country began its reform in 1982 with the enactment of a sector law with a clear pro-competition spirit; however, it didn't offer regulatory tools to allow new operators to enter the market. It was not until 1988 that the Chilean sector was opened to competition and sold to "Grupo Telefónica" from Spain.

At the beginning of the nineties, a second wave of privatizations began in Argentina Venezuela and Mexico. In Mexico, "Telmex", the state owned monopoly, was sold to the joint venture between the Mexican group "Grupo Carso", Southwestern Bell and France Telecom in 1990. The sequence of reform steps that followed, introduced uncertainties, as it was privatized without having neither a specific law nor a regulatory agency. Six years later, the Federal Telecommunications Law was enacted and a regulatory agency created. Moreover, according to the new license conditions, agreed upon at the moment of the privatization, Telmex was allowed to enjoy a long period without significant competition: from 1990 until 1996 when the sector was opened in the long distance segment of the market.

Finally there is a third wave of privatizations in the region: Nicaragua, Bolivia, Brazil, Colombia, Peru and others, who started their privatization process in the middle-end of nineties. Peru sold its two state-owned companies to "Grupo Telefónica". In 1997 a process of market liberalization took place in Peru. As it can be seen in table 1, many countries followed a slow path in opening their markets to substantial competition and many of them did it incrementally.

**TABLE 1. PRIVATIZATION AND LIBERALIZATION YEARS**

COUNTRY	PRIVATIZATION	LIBERALIZATION				
		LOCAL	LONG DISTANCE	INTERNATIONAL	MOBILE	VALUE ADDED
MEXICO	1990	1997	1997	1997	1989	1989
NICARAGUA	1998				1993	
ARGENTINA	1990	2000	1999	2000	1988	1987
BOLIVIA	1995	1995	2000	2000	1988	1988
BRAZIL	1998	1998	1998	1998	1997	1991
CHILE	1988	1994	1994	1992	1988	1985
COLOMBIA	NA	1995	1997	1998	1994	1992
PERU	1994	1999	1999	1999	1990	1994
VENEZUELA	1992	2000	2000	2000	1991	1991

Source: Jordana and Sancho (2002).

Almost all governments in the region had to create new institutions in order to regulate the new relationships among different actors involved in the newly created environment. There were numerous controversial issues to be addressed in the telecommunications sector agenda: interconnection, facilities leasing, numbering, tariffs, quality standards, distribution of costs, among others.

The governance structure that was created to address these issues in Latin American took one of two paths of action: 1) the creation of independent agencies following the developed country model, or 2) the accommodation of regulation into their established institutional frameworks, usually in telecommunications ministries (see table 2). Most of the countries chose to create an independent agency following the New Public Management suggestions in vogue in those years (Jordana and Sancho, 2002).

**TABLE 2. MINISTRY AND INDEPENDENT AGENCY MAIN CHARACTERISTICS**

<b>MINISTRY</b>	THE REGULATOR IS AN ENTITY INSIDE THE TELECOMMUNICATIONS MINISTRY.
	IT SHARES WITH THE MINISTRY, INFRASTRUCTURE, ORGANIZATION, INFORMATION, ETC.
	IT IS VERY RECEPTIVE WITH ISSUES FROM GOVERNMENT.
	IT IS PERCEIVED AS LESS OBJECTIVE.
<b>INDEPENDENT AGENCY</b>	IT HAS CONTROL AND INDEPENDENT ACTION, EVEN WHEN ITS DECISIONS COULD BE SUBJECT TO MINISTERIAL REVISION.
	IT FAVORS POLICY CONSISTENCY STABILITY OVER THE TIME.
	IT OFFERS A PERCEPTION OF NEUTRALITY DURING A CONFLICT PERIOD.

Source: Our own with Jordana and Sancho's information.

The three countries we analyze in this document made the following choices: Chile decided to remain with a regulator inside the Ministry entity, while

Mexico and Peru created independent regulators which had to coexist with the already existing government structures.

### Case Studies

The analytical lens we are going to follow in the country analysis builds upon the RFI results. According to the variables measured in the index, as depicted in Table 2, Peru is the country with the strongest performance in terms of institutional strength, while Mexico and Chile's regulatory agencies according to this index have a faulty institutional design. Thus, one would expect to find that in the latter two countries performance of the sector to be weaker than in Peru. In order to gain an understanding of why, as we will depict in the performance section, this is not so the following is an analysis of how each country implements its regulatory policies.

**TABLE 3. MAIN CHARACTERISTICS OF REGULATORY AGENCIES IN SELECTED COUNTRIES**

COUNTRY	A) SPECIFIC TAX TO REGULATORY AGENCY	B) REMOVAL OF REGULATORS	C) EMPOWER TO SET TARIFFS	D) ENFORCEMENT TO FINE OPERATORS	E) CLEAR MECHANISM OF SOLVING DISPUTES	F) A MECHANISM TO EXPLAIN OR PUBLICIZE DECISIONS	AVERAGE
CHILE	0	0	1	1	1	0	0.500
MEXICO	0	1	1	1	0	0	0.500
PERU	1	1	1	1	1	1	1.000

Source: Gutiérrez (2003).

### Chile

Telecommunications reform in Chile began with the enactment of the General Telecommunications Act (LGT) in 1982. It was the first country in Latin America and one of the first in the world to initiate a telecommunications reform. Its goal was to eliminate the monopoly and to promote the entry of new operators to encourage competition in local telephony. Even though the regulator, Subsecretaría de Telecomunicaciones (SUBTEL), is part of the Ministry of Transport and Telecommunications, it is reasonably autonomous from political interference. It is allowed to design telecommunications policy and it is mandated to regulate the sector. Among its specific tasks are managing and controlling the use of radio spectrum as well as the procedures for establishing tariffs (Serra and Fischer, 2002). The law enables SUBTEL to impose sanctions when necessary, and they can range from simple economic fines to a suspension of the operation or even to cancelling of the license.

The case of regulatory institutions in Chile is one of a successful learning process. It has been more than twenty years since Chile began its telecommunications reform. The transparency and participatory mechanisms were not in place during the first years of regulating the privatized telephone

company. It was until the year 2000 that firms were included in the deliberation process and in the case of disputes, a commission composed by three members (one representative of the company, one of the regulator and a third person appointed by both of them) was created to settle differences, trying to avoid lengthy and costly trials. Members of this commission, which varies according to the issues to be analyzed, believe that this process has created the opportunity for competitors to dialogue amongst themselves and feel this is an effective participatory process even when the decisions taken not always favor their interests. Moreover, since the creation of this mechanism, the regulatory policies and norms take a shorter time to be implemented from an average of more than a year to 7 months (Rivera, 2002). So, today, the Chilean regulatory system is transparent and its policies are reasonably predictable.

Although the LGT specified a free access to the local telephony network, it had vacuums regarding interconnection, a crucial tool for competition. This situation led to the reform of the Act in 1995; new rules established the right of every operator to interconnect and the obligation to accept such interconnections; all the services that fixed phone companies provided to long-distance carriers were subject to regulation.

Indeed, the regulatory environment has improved with time, adding to the progress of the interconnection settlements and the increased participation of stakeholders is the increased participation of the antitrust organism. Since 1999, the antitrust commission directly intervenes in the determination of the radio-spectrum auctions as well as in identifying the final services that require imposition of tariffs. This made possible the successful auction of wireless bands and the reduction of cross subsidies in the tariff structure. In the process of determination of unfair practices denounced by other firms, the commission consults with SUBTEL.

In the wireless segment of the market, the introduction of "Calling Party Pays" generated the entrance of new firms into the market as the uncertainty regarding payments to the fixed operator was diminished. Most of the changes to the regulatory process can be associated with an increased investment in the sector as well as with a change in its composition as new firms enter the market. Investors respond to perceptions of legal and regulatory certainty (Mena, 2006).

So, despite the fact that SUBTEL is part of the Ministry of Transport and Telecommunications in Chile, it is fairly autonomous and even though political interference may occur occasionally it is usually not the case. SUBTEL, as well as the Ministry and the competition authorities do abide by their respective areas of responsibility. In general, the Chilean regulatory system is transparent and its policies are reasonably predictable. In case of disputes, a three member commission is formed to settle the differences in approaches, trying to avoid lengthy and costly trials.

The participation of stakeholders in the design of policies and regulation is allowed, mainly by using public consultation, which provides SUBTEL with input from interested or affected parties. In 2008 SUBTEL began operating a blog to receive input on sector policies. In addition, all decisions and documents issued by SUBTEL as part of the proceedings before the Court of Defense of Free Competition have been made public. The commission's officers have never been removed from office.

### *Mexico*

Telecommunications reform in Mexico was part of a full scope reform that consisted in a shift from a closed to an open economy, from having strong government intervention in many activities to a reduced public role. It started in 1990, when the national telephone company, Telmex, was privatized. The strategy of reform was creating a "national champion" with a vertically integrated firm that would compete with the strong U.S. telecommunications firms.

Competition was postponed until 1996 and 1998, when long distance and local service competition was introduced. It was not until 1995 when the Federal Telecommunications Act (LFT)<sup>2</sup> was enacted with the provision of establishing an independent regulatory agency. The Federal Telecommunications Commission (COFETEL) was established in 1996, as a decentralized administrative body of the Ministry of Transport and Communications (Secretaría de Comunicaciones y Transportes, SCT) with technical and operational autonomy. According to Wallsten (2003), the sequence of reform matters; postponing the rules to regulate the sector six years after the initiation of reform created uncertainties for entering operators.

While the LFT endows SCT with the power to design telecommunications development policies as well as some regulatory and administrative duties, COFETEL is responsible for issuing technical reports and for giving its opinion on regulation changes, such as granting new concessions and imposing sanctions on operators.

The existence of COFETEL as a decentralized body of the SCT, combined with ambiguities in the definition and the borders of the responsibilities of between these two organizations, has originated numerous conflicts among these agencies and has created legal uncertainties, inefficiencies, and costly administrative structures.

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<sup>2</sup> Due to its Spanish name: Ley Federal de Telecomunicaciones.

**TABLE 4. ISSUING: SCT AND COFETEL**

	SCT (MINISTRY)	COFETEL
POLICY MAKER	X	
REGULATOR	TAKE DECISIONS JUST IN REGULATION ISSUES	X EXPRESS OPINIONS, BUT NOT TAKE DECISIONS
DUTY ON REPORTING ITS ACTIVITY		SCT
REGULATOR BUDGET		IMPOSED BY SCT
DESIGNATION OF REGULATOR CHIEF		EXECUTIVE BRANCH THROUGH SCT
CAPABILITY TO VETO DECISIONS FROM REGULATOR		SCT
RADIO DIFFUSION REGULATION	SCT, SEGOB Y SEP <sup>3</sup>	
SPECTRUM ALLOCATION FOR RADIO DIFFUSION	SCT	

In the context of technological convergence, a new telecom reform was implemented in April 2006. COFETEL now incorporates into its responsibilities radio and television policies. In order to reduce uncertainties commissioners are appointed for periods of ten years. However, COFETEL remains a decentralized administrative body of SCT, with full autonomy to issue resolutions, but without power to grant licenses. This became evident in 2007 when COFETEL announced the program for auctioning spectrum for mobile telephony and Wi-Max, but SCT decided to modify it, arguing that COFETEL did not have the authority to do so. Five months later SCT reviewed the process and reissued the original program.

COFETEL does not have the legal mandate to hold public hearings but public participation (mainly operators) in the policy design and implementation in this sector has increased in recent years by requesting their opinions. Public consultations were conducted for proposed resolutions on number portability and on the Technical Plan for Interconnection and Interoperability,<sup>4</sup> which addresses the asymmetry in negotiating power of operators and includes aspects not covered by the LFT for interconnection and interoperability. However, still, COFETEL does not have clear mechanisms for solving disputes, which has created a conflictive regulatory environment. It does not have mechanisms to explain or provide information that justify policy decisions.

Even though the LFT was originally designed to regulate networks and not services, licenses have been awarded by types of business, meaning that the

<sup>3</sup> SEGOB stands for Secretaría de Gobernación (equivalent to a Ministry of the Interior), and SEP for Secretaría de Educación (Education Ministry).

<sup>4</sup> This Plan has now been enacted as of April of 2009.

operators need one concession for each service they want to provide (Jalife, 2004). Moreover, the process by which concessions are granted has been quite inefficient. Even though the law defines a period of 120 days as the maximum to analyze applications, COFETEL may request additional information on, say, day 119, a fact by which an additional 120 day period is initiated. Besides, SCT can add more delays in the granting of licenses or concessions.<sup>5</sup> Furthermore, spectrum allocation has taken place in 1997 and then until 2005; this lengthy period without spectrum auctions has delayed investment and competition.

The strict application of the LFT in terms of regulating networks and not services would improve the regulatory decisions. And very importantly, there is an urgent need to eliminate inefficiencies in the regulatory process created by the interaction of SCT and COFETEL in regulatory decisions.

So, COFETEL does not have full autonomy from SCT, and frequently its role is restricted to just express opinions. In Mexico, not all sector policies and regulations are transparent or predictable. Sometimes the LFT and its additional rulings have contradictions. The regulatory framework has obligations of transparency and accountability on the side of COFETEL, which must also align its actions with the Law of Transparency and Access to Public Government Information.

The role of those involved in the sector is not always clear, especially in the case of the Ministry and COFETEL. A lack of coordination between the regulator and the antitrust commission has also frequently been observed. Recently external participation in designing policies has been possible, since COFETEL has issued requests for opinions in several topics. In Mexico commissioners have never been removed although they have resigned and there are no specific mechanisms to resolve disagreements between the regulator and operators.

### *Peru*

In Peru, the general policy design of the telecommunications industry, the basic technical plans, the administration and monitoring of the radio spectrum, as well as the granting of licenses fall under the jurisdiction of the Ministry of Transport and Communications (MTC). OSIPTEL, which was established in 1994 as a part of the regulatory reform process, is the telecommunications regulatory agency that has technical, administrative, economic and functional autonomy and it is also the administrative resource for solving disputes between operators. The law, by which OSIPTEL was created, established mechanisms to provide it with financial autonomy. However, OSIPTEL officers (designated for three-year periods) have frequently

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<sup>5</sup> In 2002, a Government Auditing Office found that the average delay for a concession was over 4 years, while for the so-called permits it was of 238 days. The report notes that “the SCT did not comply with the deadlines set out the LFT, and that COFETEL exceeded the deadlines for the issuance of opinions (ASF, 2003: 101).

been people close to the Executive Power, a fact which is perceived as limiting the autonomy of this regulatory body.<sup>6</sup>

Even though the functions of OSIPTEL and the MTC are apparently clearly separated, there are areas that originate confusion and lack of coordination. One example is the access to the market: while the Ministry is responsible for granting the concessions, implying entry to the market, OSIPTEL regulates the market conditions. The participation of the private sector in the board of directors of OSIPTEL has generated often opposed opinions. For some, this was a sign of transparency and an important component of legal certainty, while others believe there is a conflict of interest. As a matter of fact, it occasionally happened that these representatives disclosed classified information. (Alcazar and Pollarolo, 2000).

An additional entity involved in telecommunications regulation is the Committee on Telecommunications —PromCepri—, that is responsible for granting licenses and undertakes biddings to grant concessions for infrastructure. Recently, PromCepri functions were transferred to Proinversión, the agency in charge of promoting investment.

The legislative framework concerning competition is perceived as incomplete and inadequate to address the entrance of new operators to the market as well as the emergence of new technologies (Barrantes and Pérez, 2006). Telecommunications was the only sector, in which the supervision of competition was the responsibility of a sector specific regulator, rather than being under the jurisdiction of a competition or antitrust agency, which caused some duplicity of functions and loopholes. For example, OSIPTEL was responsible for supervising market competition and identifying unfair practices, as long as their origin was inside the telecommunication market. However, OSIPTEL could not possibly intervene, if the anticompetitive behavior had its origins outside the telecom sector. To avoid situations of this nature, OSIPTEL was declared to be<sup>7</sup> responsible: to deal with any dispute arising as a result of actions or omissions affecting the market for public telecommunications services.

In order to solve some of the most important problems in the telecommunications sector regulation, the Peruvian government decided to simplify procedures for granting licenses, to promote the deployment and growth of new applications and services, to ensure regulatory flexibility and an efficient use of network resources and to encourage the entry of new operators. All this, achieved through a general concession, gives the right to offer any public telecommunications service (Barrantes and Pérez, 2006).

Before 2000 there was a poor specific regulation on interconnection, Telefónica del Perú took advantage of this legal vacuum by imposing their own conditions. In 2003 the *Texto Único Ordenado* (TUO) for interconnection

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<sup>6</sup> According to the Law, the Executive branch has the power to remove them.

<sup>7</sup> In the Ley Desarrollo de Funciones y Facultades.

was approved by OSIPTEL, which brought certainty to the sector, as it determines the maximum charges for interconnection among operators (Barrantes and Pérez, 2006).

One of the most important decisions within the CTT was to establish mechanisms to make changes in the regulatory framework, without the need to modify the complete framework, because a larger reform would delay the entrance of new operators and generate larger uncertainty.

So, in the case of Peru, OSIPTEL has been characterized as one of the regulators in the region with greatest autonomy in making decisions and in implementing the applicable regulations. The regulatory framework in Peru is predictable and transparent. Most policies and/or regulations are respected and enforced. OSIPTEL has a website, as well as public hearings. The role of the authorities involved in the telecommunications sector is clear and generally respected. Policy design and implementation is open to the participation of stakeholders through the use of preliminary drafts of standards. The decisions taken by OSIPTEL are made public, and there exist mechanisms to resolve possible disputes.

Even though officers of OSIPTEL have not been removed, they have sometimes been substituted, due resignations for personal reasons. OSIPTEL faces some budgetary problems because of restrictions on amounts and on freedom of expenditure.

Peru had a late start in the introduction of telecommunications reform and in some ways appears to have learned some policy lessons from early starters. The sequence of reform was appropriate and, despite some confusing roles between secondary agencies, the design of regulatory institutions followed the text book guidelines. More importantly, Peru's regulatory entities have learned from their own shortcomings and modified their processes to increase efficiency. However, the competition framework still appears to be weak.

### ***Performance Analysis from a Comparative Perspective***

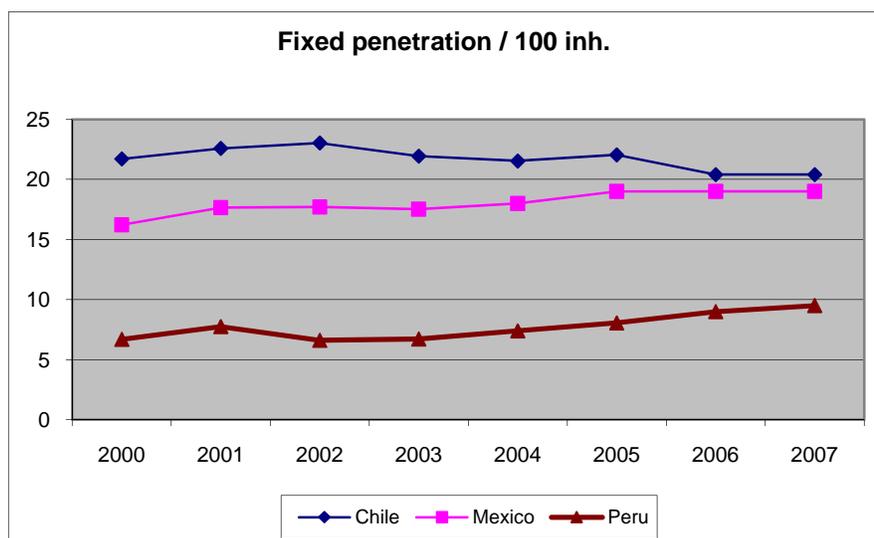
The argument in this paper is that the performance of the telecommunication sector is closely related to the effectiveness of its regulatory institutions. We analyzed the process of policy implementation, beyond the design of the policies. The following section presents an overview of the main market indicators with the aim of exploring some association between institutional strength and performance of the sector.

### ***Penetration and Market Structure in Fixed Telephony***

In terms of fixed telephony penetration, Chile is ahead of the other two countries of our sample; however, as shown in graph 1, Mexico has shown a

higher rate of growth in the last three years; by 2007 it was very close to Chile. Peru keeps growing, but its penetration level is consistent with its significantly lower GDP. The moderate growth since 2005 in Chile and Mexico is probably due to a substitution between fixed and mobile services. As can be seen in graph 2, mobile service penetration increased dramatically in all three countries since 2003. It is interesting to note that in mobile penetration Peru is not significantly behind Mexico, while Chile has the highest penetration value.

**GRAPH 1. FIXED TELEDENSITY: CHILE, MEXICO AND PERU**

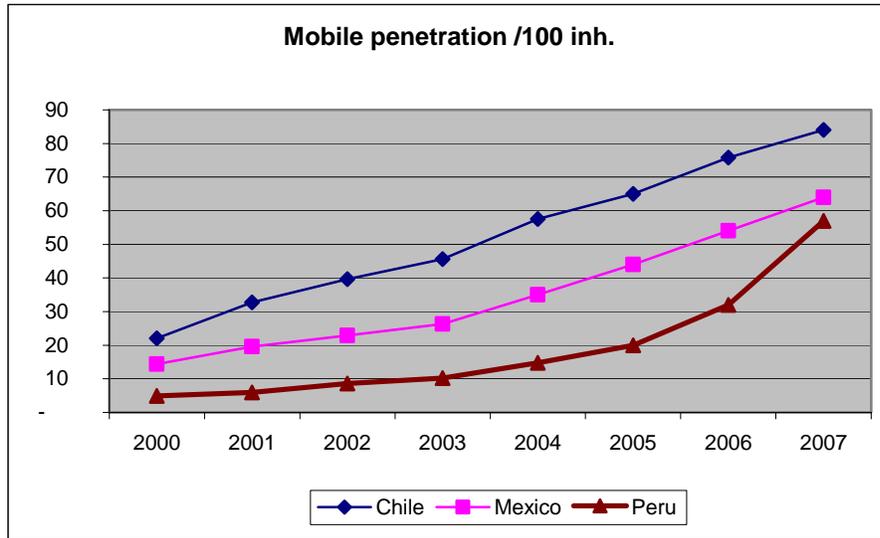


Source: ITU (2007).

### *Penetration and Market Structure in Mobile Telephony*

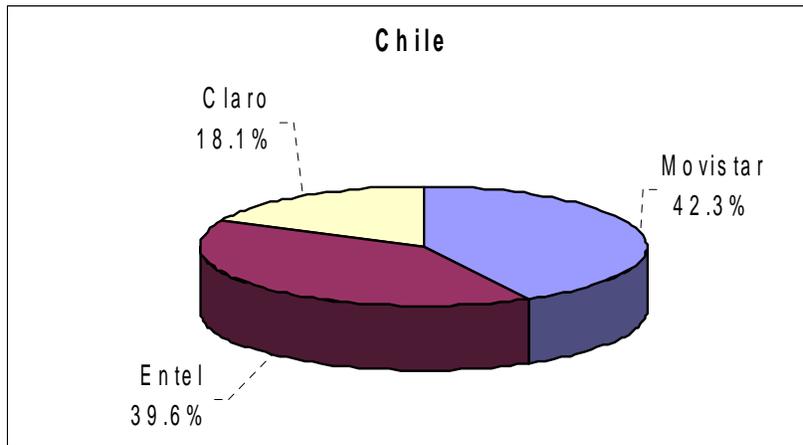
As shown in graph 3, Chile is the country with the most competitive mobile market, since there does not exist one single operator with an absolute control. While Movistar has a slightly higher share of the market, it is followed closely by Entel.

GRAPH 2. MOBILE PENETRATION: CHILE, MEXICO AND PERU



Source: ITU (2008).

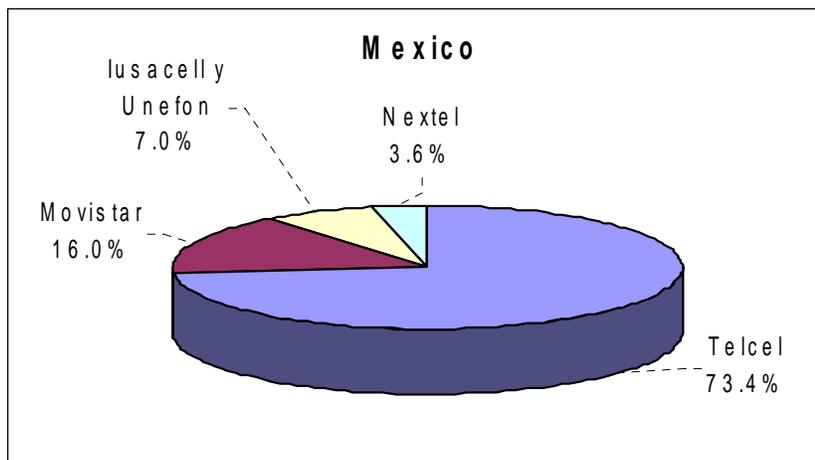
GRAPH 3. CHILE: MOBILE MARKET SHARE



Source: Subtel (2008).

Mexico has an extremely high concentration, due to the market power of Telcel (part of Grupo Carso and América Movil), who accounts for 73% of the total number of subscribers.

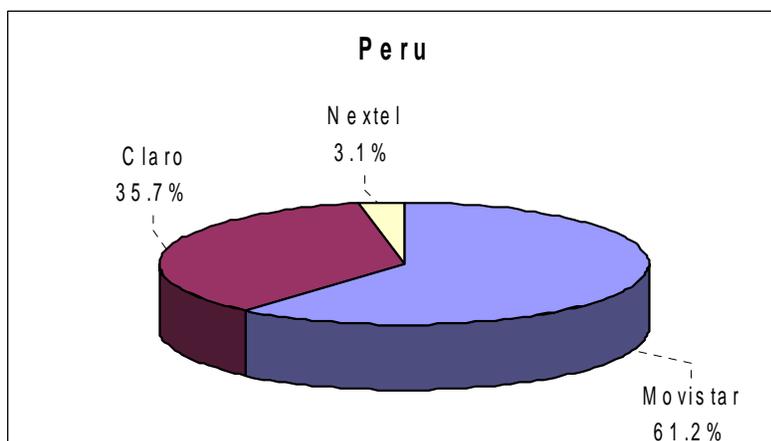
GRAPH 4. MEXICO: MOBILE MARKET SHARE



Source: COFETEL (2008).

Peru's mobile market is also very strongly concentrated. As shown in graph 5 the mobile telephony market is controlled by Telefónica Movistar. There are other two operators, Nextel and Claro, owned by Grupo América Movil from Mexico with 36% of the market share. Interestingly, Mexico and Peru have the same dominant players, but they have opposite roles in the two countries; América Movil is dominant in Mexico, while the majority of the market in Peru is served by Telefónica (see graph 5).

GRAPH 5. PERU: MOBILE MARKET SHARE

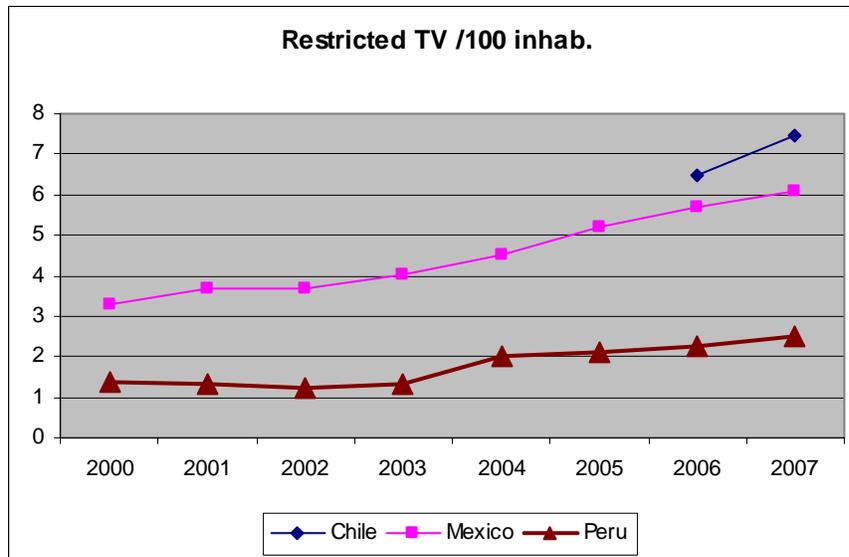


Source: OSIPTEL (2008).

## Restricted TV Penetration and Market Structure

In the restricted TV segment, Chile keeps showing a higher penetration when compared to the other countries under study, but it is closely followed by Mexico, while Peru lags far behind (see graph 6).

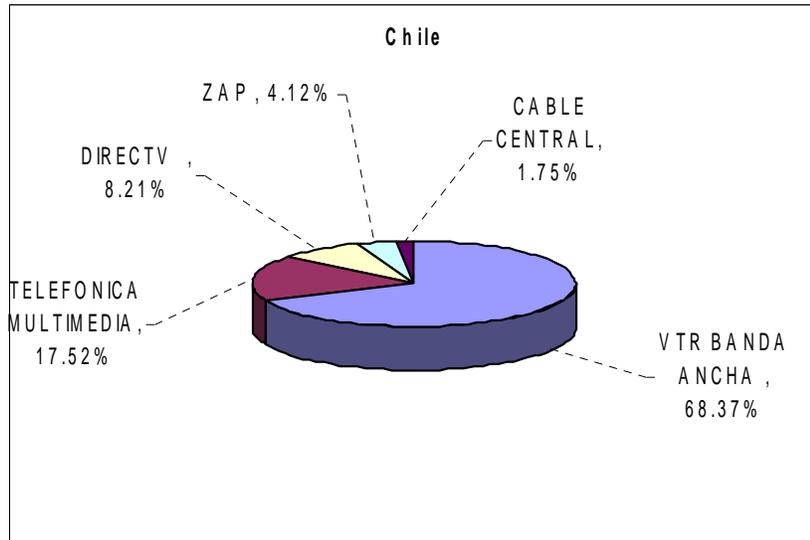
**GRAPH 6. CHILE, MEXICO AND PERU: RESTRICTED TV PENETRATION**



Source: SUBTEL, COFETEL and OSIPTEL (2008).

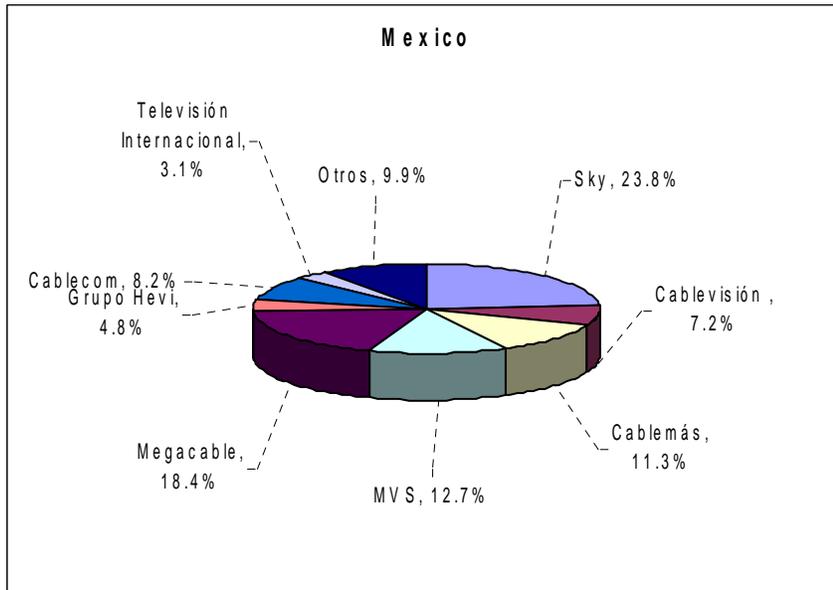
Market behavior for this platform is very different from the one in mobile telephony. Chile and Peru have highly concentrated markets, since in each country there exists one operator with more than 50% of the market share. On the other hand, the Mexican market displays a stronger competition; the firm with the highest share controls just 24% of the total market and there exist more than nine operators offering similar services.

**GRAPH 7. CHILE: RESTRICTED TV MARKET STRUCTURE**



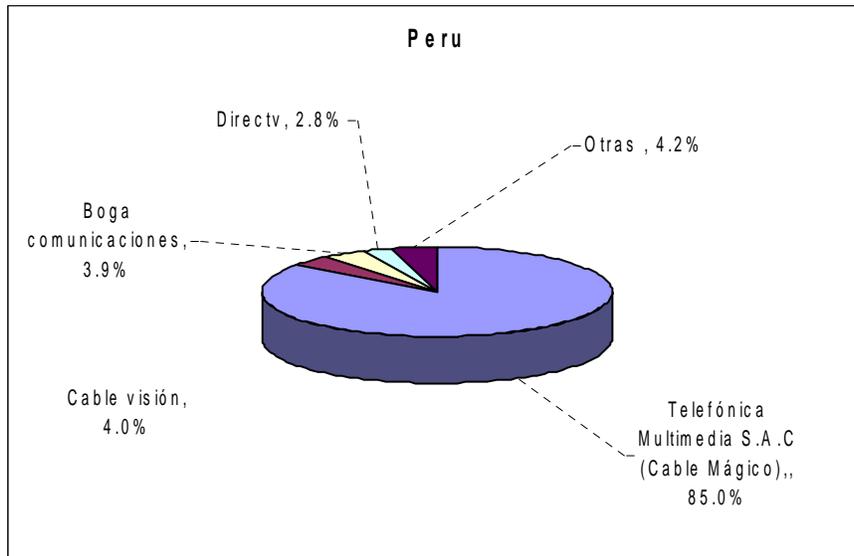
Source: SUBTEL (2008).

**GRAPH 8. MEXICO: RESTRICTED TV MARKET SHARE**



Source: COFETEL (2008).

**GRAPH 9. PERU: RESTRICTED TV MARKET SHARE**

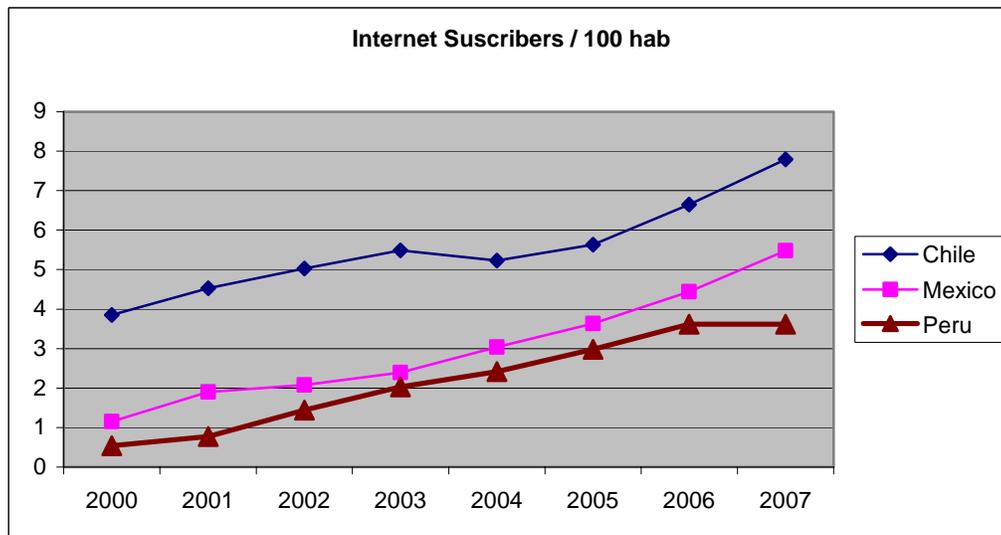


Source: COFETEL (2008).

### Internet Penetration and Market Structure

As can be seen in Graph 10, Chile is the country with the highest Internet subscriber penetration, while Mexico and Peru have similar penetrations, but growth in Mexico has been much faster during the last two years, than in Peru which shows a moderate growth.

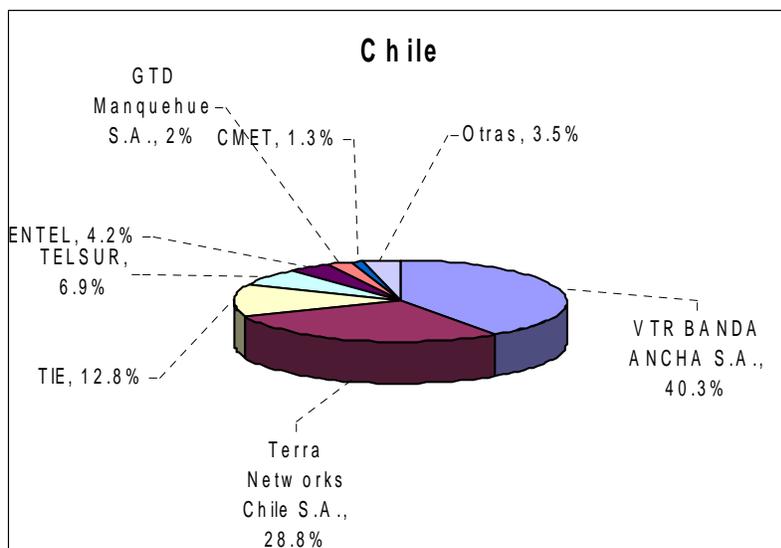
**GRAPH 10. CHILE, MEXICO AND PERU: INTERNET PENETRATION**



Source: ITU (2008).

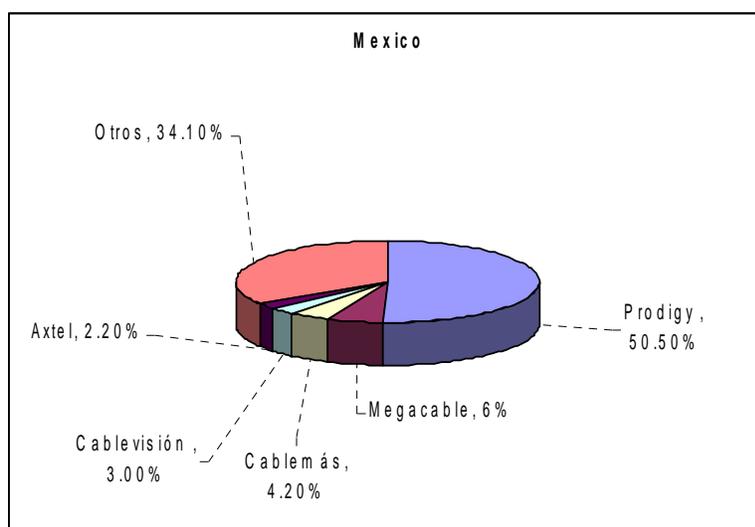
While the Internet market is very competitive in Chile and Mexico, but Telefónica controls 90% of the market in Peru. In Chile, there exists a healthy competition between Internet service providers, and the largest company serves 40% of the market. Finally, Mexico also has a reasonably competitive market, even though the number of service providers is smaller than in the other two countries, and Prodigy (a part of Telmex) serves 50% of the market.

**GRAPH 11. CHILE: INTERNET MARKET SHARE**



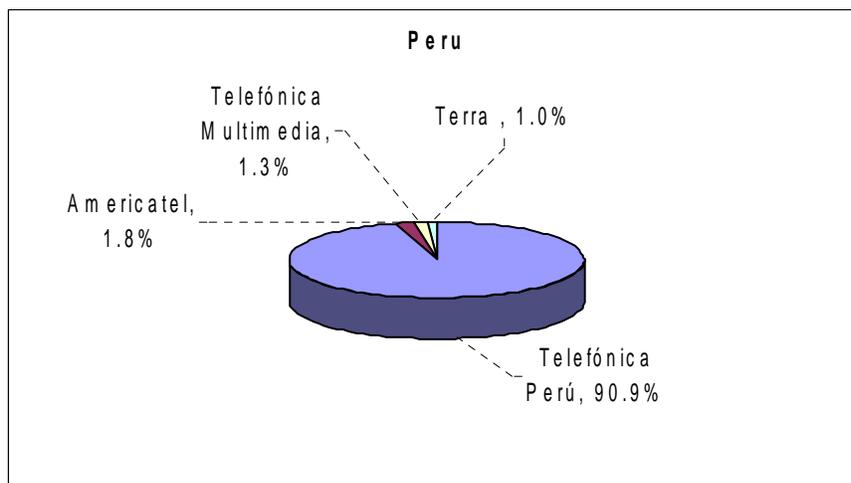
Source: SUBTEL (2008).

**GRAPH 12. MEXICO: INTERNET MARKET SHARE**



Source: COFETEL (2008).

GRAPH 13. PERU: INTERNET MARKET SHARE



Source: OSIPTEL (2008).

### *Herfindahl-Hirschman Index (HHI)*

The number of firms participating in their provision of a service does not always provide a clear picture of the market concentration, since it does not provide information about the market participation of each player. Thus, in order to gain a more detailed perspective, we use the Herfindahl-Hirsch Index (HHI) to measure and compare market concentration.<sup>8</sup>

Based on HHI, Mexico and Peru show high concentration levels in the fixed segment markets; in both countries the incumbents provide service to more than 90% of the market. In the case of Chile, the incumbent maintains 65% of the market share but the level of concentration has been decreasing in recent years.

In mobile telephony, as can be see in table 5, Chile has the lowest concentration although the level of concentration has increased after the purchase of BellSouth by Telefónica. In Peru there has also been a significant increase in market concentration. In Mexico, despite the entry and efforts of new entrants, the market is still dominated by Telcel.

With respect to the Internet segment, even though there have been new operators entering the Chilean market, the larger firms like VTR and Terra have increased their market participation. In Peru, the concentration was more than doubled in a four years period, after Telefónica increased its market share from 46 to 90%. In Mexico the level of concentration has been

<sup>8</sup> The Herfindahl-Hirschman Index (HHI) is a measure of market concentration and thus of its structure. It is the sum of the participation of the firms in the market and takes the value of 0 and 10000. Zero denotes no concentration while 10000 reflects a fully concentrated market. For more details see Miller Richard A. (1972).

declining, originated by the entry of new players and by the use and deployment of new technologies. Telmex's main competitors are the cable TV operators, that offer broad band services.

In the restricted TV market, Mexico has the lowest level of concentration, even after the latest mergers (Televisa, Cablemas, TVI). In Chile the level of concentration is diminishing rapidly, while in Peru, as in its others markets, the level of concentration grew considerably during the period under study.

TABLE 5. HH INDEX

HERFINDAHL - HIRSCHMAN INDEX								
YEAR	2003	2007	2003	2007	2003	2007	2003	2007
COUNTRY	FIXED		MOBILE		INTERNET		RESTRICTED TV	
CHILE	5866	4511	2796	3687	2431	2702	8040*	5070
MEXICO	9239	8489	6256	5694	5450	3781	1749	2489
PERU	9335	9281	3629	5032	3061	8689	6458	7282

Source: elaborated by the authors based on regulator web pages, 2005.

Although in the Chilean case there has been an increase in the level of concentration in the mobile and in the Internet markets, the overall level of competition is strong. In the Mexican case, the mobile and fixed telephony segments of the market face significant challenges for the regulatory and for the antitrust authorities, especially considering the convergence of networks. The Peruvian case shows that Telefónica has increased its market share in all segments of the telecommunications industry.

### *Performance in a Comparative Perspective*

As was mentioned earlier in this paper, the objectives of regulation are to incentivize quality of services and reasonable prices while encouraging investment. Table 6 depicts the quality of institutions as measured by the index developed by Gutiérrez (2003) and shows performance indicators. According to this index, Peru has the highest level in quality of institutions while Chile and Mexico have the same lower level.

However, Chile shows higher performance levels in most indicators. Chile and Mexico have lower tariffs than Peru in the fixed and mobile telephony services, while Mexico has higher prices than Chile. An exception is the Internet market, where Chile is the most expensive of the three. This may be a result of the weak competition framework in Peru that has generated a high concentration in the market and thus higher prices.

**TABLE 6. PERFORMANCE IN A COMPARATIVE PERSPECTIVE (2007)**

COUNTRIES	RFI	PRICE BASKET FOR FIXED*	PRICE BASKET FOR MOBILE*	PRICE BASKET FOR INTERNET*	TELECOM INVESTMENT (% OF REVENUE)	MOBILE PENETRATION**
CHILE	0.5	9.7	11.8	26.7	24.2%***	84.1
MEXICO	0.5	16.1	13.9	20.0	11.2%	63.2
PERU	1.0	18.8	23.0	23.2	16.2%	55.3

Source: The World Bank (2008). \*Prices expressed in US dollars per month. \*\*Subscriptions per 100 inhab. \*\*\*This number corresponds to 2002 and it is from a different source:

[http://www.nationmaster.com/graph/med\\_tel\\_inv\\_of\\_rev-media-telecommunications-investment-of-revenue](http://www.nationmaster.com/graph/med_tel_inv_of_rev-media-telecommunications-investment-of-revenue)

In terms of mobile penetration, which today represents the most common of communication in the region, Chile, again, has the highest level. Still, it is remarkable that Peru, a smaller country with a much lower GDP than the other two countries, has a mobile penetration rate that is not far behind Mexico's.

Perhaps the clearest impact of an efficient regulatory policy is on investment. Investment is closely related to regulatory certainty and Chile's telecommunications investment rate is significantly higher than Mexico's and only moderately higher than Peru's. Mexico's investment rate is possibly associated to the lack of regulatory certainty in the sector.

The value of a more in-depth analysis of a country's regulatory institutions is that it offers a qualitative assessment than cannot be captured in an index. Even though Chile does not entirely comply with the identified characteristics in the RFI and thus received a lower score, it has introduced consultation mechanisms and even though the sector is not regulated by an independent agency, Subtel is autonomous from political interference. The effectiveness of its regulatory system is associated to a higher level of telecommunications development. Peru, a smaller country shows a remarkable degree of development in terms of penetration and investment. Mexico lags behind both countries in regulatory institutions and in sector development.

## *Conclusions*

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The objective in this document was to identify elements in the structure and the operation of regulatory agencies that have functioned as enablers of telecommunications industry in three Latin America countries, and those that have been its major inhibitors. Based on the cases of Chile, Mexico and Peru, we discussed the effectiveness of their different regulatory frameworks by analyzing the institutional process of regulatory design and implementation and presenting each country's results in terms of penetration, prices and investment.

In the case of Chile, the fact that their telecommunications institutional framework is efficient without an autonomous regulatory agency, questions the importance and the necessity of having independence from the executive branch in regulatory agencies. It appears that independence from political interference is more relevant for an efficient sector performance. In general terms, the decision making process is open and transparent and it enjoys a high level of credibility. Transparency and participation in Chile may act as a safeguard against capture. However, there has been a lack of coordination between the involved agencies. The early reform implemented in Chile did not begin smoothly; among other problems, resolving conflicts between operators took a very long time, a fact that had a strong impact in the sector by delaying the entrance of new operators. However, the period of adjustment included a learning process that eventually had a much better coordination between the involved agencies and players.

Indeed, the absence of an autonomous agency does not appear to impede Chilean telecommunications development. Undoubtedly Chile telecom industry displays the strongest performance (among the sample), with higher penetration levels, the lowest market concentrations and the lowest tariffs, with the exception of the Internet market.

In the case of Mexico, the regulatory agency COFETEL is not autonomous and has a strong dependency on the Ministry for day to day decisions. Moreover, COFETEL is not legally endowed with mechanisms to provide transparent, timely, and participatory regulatory processes. Some recent amendments, and newly appointed officers have made some progress in the design and implementation of regulatory policies. However, more needs to be done to incentivize investment. The LFT is a pro-competition law that needs to be interpreted and applied in a more efficient fashion.

Peru's institutional design follows, to a significant degree, the text book suggestions; the regulatory agency is autonomous and the decision process is open and transparent. However, according to its own agency, OSIPTEL (2002), there were errors in the policy process that led to the late start of competition. From an institutional perspective, there was a lack of

coordination among regulatory and competition agencies and more importantly, the regulatory framework concerning competition is perceived as incomplete and inadequate to address the entrance of new operators to the market or to exploit the benefits of new emerging technologies. Despite the fact that Peru is a small country with a low national income, it has obtained a high rate of growth in most of its penetration indicators. However, the high values of the concentration indexes and the high tariffs, which are results of a weak competition framework, are definitely inhibiting the growth of the sector and the distribution of benefits to society.

Identifying and establishing additional relationships between market variables and regulation and policy design is indispensable to get stronger and more suggestive results. A more in-depth analysis, possibly based on interviews with key players in each country, as well as increasing the number of countries in the sample by adding more Latin American countries would certainly enrich this study.

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