Executive summary

An overall assessment

Introduction

OECD countries have recognised the increasing role played by the telecommunications sector as a means of improving productivity and economic growth while enabling governments to improve provision of public services. Mexico, with the lowest GDP per capita in the OECD, a high inequality of income distribution, and a relatively high rural population, needs the socio-economic boost provided by greater access to more efficient communication services, in particular high speed broadband. The welfare loss attributed to the dysfunctional Mexican telecommunication sector is estimated at USD 129.2 billion (2005-2009) or 1.8% GDP per annum.

This report reviews telecommunications policy and regulations in Mexico and puts forward a number of recommendations. These recommendations are not new, reflecting to a large part best practice frameworks already in place in many OECD countries which have helped develop competition in those countries.

Ensure low barriers to entry and "contestable" telecommunication markets

- Foreign investment restrictions on fixed-line telecommunication operators in Mexico should be eliminated. The current review of these restrictions should aim at total elimination of existing foreign investment caps.
- The existing concession system should be reformed to a simpler class-licensing regime except where there are resource scarcity constraints, such as spectrum. Where existing obligations remain, these should be effectively monitored and enforced. Entry of resellers should be simplified and encouraged and entry of mobile virtual network operators facilitated by requiring obligatory national roaming requirements.

Ensure that regulations and regulatory processes are transparent, non-discriminatory and applied effectively

- The current legal system, which allows the courts to suspend and overturn policy and regulatory decisions systematically, is harming the public interest and needs reforming. Proposals include setting up special judicial panels to hear court appeals on telecommunication issues where the judges have knowledge of the telecommunication sector or creating a specialised Federal Court that can deal with appeals in this sector. The most rapid way to stimulate a change in behaviour of market participants is to ensure that the regulator's decisions remain in force until the appeal process has run its course.

Institutional issues: Policy and regulatory functions

- Measures need to be put in place to eliminate the so called “double window” and separate responsibilities for policy formulation (Ministry) and regulatory and market monitoring functions (regulator).
- The regulatory authority should have greater independence and autonomy in carrying out its responsibilities, which are to ensure that the telecommunication market is competitive and delivers public policy objectives.
- The regulator should have greater budgetary independence and should have a clearly identified source of funding that will meet its needs.
- The regulatory authority should be empowered to impose meaningful fines that are sufficiently high (much higher than at present) to act as a deterrent and ensure that regulations are adhered to and regulatory objectives met. It should also have the power to request information from firms so as to carry out its responsibilities and sanction firms that do not meet reasonable requests.
- Quality of service indicators should be published on a regular basis. At the wholesale level, firms with dominant power should provide service level agreements to new entrants providing relevant indicators for access to leased lines and other network elements.
- The regulatory decision-making process should be more transparent and include publication of the reasons for decisions, and provide an opportunity for stakeholder comments to be made and considered. Formal public consultation and transparency procedures should be established for Cofetel based on internal rules that Cofetel needs to follow in order to enhance the speed of response to complaints and requests, and in carrying out its other responsibilities.

Reform regulations to stimulate competition and eliminate them except where clear evidence demonstrates that they are the best way to serve the broad public interest

- Cofetel should be authorised to regulate interconnection tariffs *ex-ante* to foster competition among operators as well as facilitate sector development and growth, providing regulatory certainty and a level playing field in the mobile market.
- The fixed line incumbent, Telmex, should be required to consolidate local dialling areas as determined by Cofetel.
- Cofetel should be authorised to declare bottlenecks and essential facilities and to establish non-discriminatory conditions for access to these facilities. Access to essential facilities should include local loop unbundling of the incumbents local loops, including collocation at cost-based pricing.
- Cofetel should be empowered to undertake market reviews, declare that a player or players have significant market power and put forward appropriate remedies, including asymmetric regulation.
- Telmex should be authorised to provide television services only when it is subject to adequate asymmetric regulations and there is evidence that it is complying with them and not resorting to judicial challenges to delay or suspend their fulfilment.

- The renewed efforts by Cofetel to move forward with the transition to digital terrestrial television are welcome and continued efforts should be made to ensure that the process moves forward rapidly to ensure that the transition is complete by 2016. In this context the licensing of new DTT broadcasters (including one or two additional national licenses) should move forward**.**
- Cofetel should have the authority to impose functional, and, if necessary, structural, separation of an operator that continues to abuse its dominant power and to help ensure that there is equal access and equivalence of inputs.
- Responsibility for setting and administering the price cap scheme used to regulate Telmex's end-user prices should be under the responsibility of Cofetel. The price cap framework needs to be changed so that Cofetel has the sole responsibility for determining the "X factor" in the cap and it should be strengthened through the use of sub-caps such that average prices borne by consumers do not remain high because the sharp fall in some prices where competition exists.
- The practice of registering prices by telecommunication operators should not be necessary other than wholesale prices of operators with significant market power.
- Sufficient spectrum should be released to meet the growing demand for mobile broadband data service. Care should be taken in the auction design to ensure that a single firm does not emerge having dominance in the mobile broadband data market. To facilitate the development of the broadband market the Government should auction more of CFE's "dark fibre".
- Legal changes are needed in order to promote efficient infrastructure sharing and to remove barriers to obtaining rights of way, since the current framework has not been effective.
- The government should clarify the policy on universal service, and articulate explicit plans on how to implement this policy.
- Consumers can play an important role in developing market competition if they are empowered. Profeco and Cofetel should clarify their roles and responsibilities and action should be taken to facilitate consumers in switching service provider.

Shortcomings and challenges

The lack of telecommunication competition in Mexico has led to inefficient telecommunications markets that impose significant costs on the Mexican economy and burden the welfare of its population. The sector is characterised by high prices, among the highest within OECD countries, and a lack of competition, resulting in poor market penetration rates and low infrastructure development. As highlighted above, the resulting loss of benefit to the economy is estimated at USD 129.2 billion (2005-2009) or 1.8% GDP per annum. While there has been growth in mobile, fixed, broadband and pay-television markets, Mexico does not compare favourably with other OECD countries that have developed more open and competitive markets and distributed ensuing benefits to consumers.

The Mexican telecommunications market is dominated by a single company with 80% of the fixed line market and 70% of the mobile phone market. Insufficient competition has resulted in poor market penetration (subscribers per 100 inhabitants) for fixed line, mobile and broadband markets, ranking Mexico 34th, 33rd, and 32nd respectively, of the 34 OECD countries. Relative to other OECD countries, Mexico is ranked last in terms of investment per capita. Profit margins of the incumbent nearly double the OECD average.

Consolidation in the cable TV market has resulted in a few firms as the major national players. Despite the limited geographical coverage, their bundled offers (double- and triple-play) provide an increasingly competitive response to the incumbent in urban areas.

Unlike most OECD countries, pro-competitive decisions have been slow to emerge in Mexico and, when taken, have been frustrated by ineffective regulatory and legal systems. While in recent years there have been clearer and more forceful initiatives to foster a more competitive environment, all market segments feature a dominant firm, with a large market share gap between its closest competitors. The sector regulator (Cofetel) lacks sufficient enforcement power and autonomy to perform its role. A lack of clear division between policy formulation and regulatory functions, in addition to inconsistent inter-agency procedures, has multiplied the opportunity for legal challenges and has created confusion within the industry, constituting barriers to market entry and effective competition. A greater transfer of power to Cofetel is needed, along with more accountability, and transparency, if it is to be an effective regulator.

One of the main barriers to competition is that decisions are either not enforced or suspended by the courts, which also diminishes effective development of regulations. Dominant operators have exploited the weak institutional framework, by abusing Mexico's unique legal injunction system, whereby regulatory decisions under judicial review are summarily suspended, in favour of the plaintiff. Mexico is the only OECD country where this is the rule, not a very rare exception. This system not only encourages legal challenges, but provides financial gain for the incumbent, while causing economic harm to new entrants.The current process must be amended to allow for decisions to remain in force until a court decides otherwise.

Many key steps have been taken to establish a pro-competition regulatory regime in the Mexican telecommunication sector. However, greater development is urgently needed in areas such as *ex-ante* regulation, including access and/or asymmetric regulation to address the growth opportunities within broadband, in line with OECD best practice. Asymmetric regulation is necessary to curtail the market power of incumbents, but despite finding the incumbents dominant in the market, appropriate regulation has not been applied. *Ex-ante* regulation in OECD countries, whether asymmetric or not, is applied to remedy enduring bottlenecks, where network facilities would be uneconomically duplicated, or infrastructure sharing, where entrants must purchase services from incumbents. In Mexico, there are a large number of areas where new entrants have no facilities and interconnection is costly. The local loop of the incumbent in those areas should be considered as bottleneck facilities. The inability to mandate, or at least set out, reasonable conditions for infrastructure sharing is arguably one the main bottlenecks that prevent competition.

In the case of Mexico, existing processes fall seriously short of OECD best practice with respect to regulatory certainty and timeliness. For example, interconnection rates in OECD countries are usually set *ex-ante*, which delivers a better outcome in terms of legal certainty and actual implementation of the decisions. In 2009, Cofetel issued a comprehensive Technical Plan considered OECD best practice, including: adoption of open network architectures, non-discrimination, unbundling of unnecessary service elements, ensuring network capacity and rate requirements. However, injunctions granted to several operators ignored the public interest arguments put forward by Cofetel resulting in a suspension of the Plan.

Convergence of telecommunications and audiovisual services is a challenge to regulatory frameworks in most OECD countries; more so in Mexico, however, where it may also provide an opportunity to address ineffective competition. The implementation of digital terrestrial television needs to be accelerated while ensuring a balanced outcome for the affected stakeholders and avoiding exclusion.

Mexico needs a forward thinking broadband plan to ensure a competitive Next Generation Access market. Some countries have adopted various separation remedies (functional, operational and vertical) to avoid market dominance and ensure competitive service offers, as most areas may only support one player. The power to impose such remedies, if necessary, should be available to the telecommunication regulator.

Given the lack of geographic coverage of fixed lines in Mexico, wireless networks are likely to be a key in delivering the economic benefits of broadband. The key challenges are thus the provision of capacity and a more balanced, competitive structure in the industry. The incomplete reach of fixed broadband also implies an uncomfortable situation whereby spectrum could be simply released to dominant mobile operators. Therefore, new spectrum awards should be designed with the goal of creating a more competitive structure in the mobile sector.

The recent auctioning of some dark fibre capacity belonging to the national electricity company was an important step towards creating more competition in the backhaul market. More fibre should be made available on the market.

Significant barriers to infrastructure sharing are encountered by new market entrants in Mexico, including the lengthy permit granting procedure, the need to request rights of way and, the fact that there is no requirement for operators to share their own passive infrastructure, such as ducts and cell towers, making deployment a major barrier to competition.

The restriction of foreign ownership places Mexico among only three OECD countries with similar laws. This restriction is detrimental to creating effective competition, leads to a lower local investment performance, reduces the effectiveness of competition, and slows the diffusion in new technologies.

The unsatisfactory performance of telecommunications markets in Mexico is due in part to the relentless use of injunctions, in particular by the fixed and mobile incumbent, which cannot be addressed by a dysfunctional legal system and has replaced, to a large extent, the right and responsibility of government to implement economic policy and regulation. When commendable efforts have been made towards reform of policy and regulatory frameworks, the ability to implement recommendations has been frustrated by legal processes.

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