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The privatization of the Argentine telephone system

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This article presents a detailed analysis of the situation of the Argentine telephone system prior to 1990 and evaluates the process of its subsequent privatization. Its main conclusion is that the previous situation of a State quasi-monopoly will probably end in a private oligopoly.

The main objective of the privatization was to do away with State subsidies for that sector and make services cheaper; however, it is possible that the forms taken by the process will generate a regressive transfer of resources, with respect both to customer tariffs, which have gradually been diverging from the cost structure, and to the equipment supply industry, which will no longer enjoy a preferential relationship with the National Telecommunications Company (ENTel).

Another objective was to modernize telephone services by introducing competition into the sector. However, competition will depend basically on the modification of the conditions laid down in the current transfer contracts.

In the light of these considerations, the article concludes that the regulatory framework may be unstable.

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Introduction

From the mid-1940s up to the end of 1990, the telecommunications industry of the Argentine Republic was similar in structure to that of most other countries: a big State company – in this case the National Telecommunications Company (ENTel) – with monopoly powers over 95% of all telephone communications¹ and over telex, fax, data transmission, transport of radio and television signals, etc. At the same time, as was also the case in the rest of the world, since ENTel was a quasi-monopolistic purchaser of telecommunications equipment, it decisively contributed to the establishment of an oligopolistic structure in the domestic supply of communications switching and transmission equipment, within which the relative shares of each company remained more or less stable until the late 1980s.

Today, in the early 1990s, little remains of that situation: the State monopoly over services is dead and has given way to a private oligopolistic structure; the regulatory framework has been completely changed, and the relative shares of the various suppliers within the domestic equipment market have changed significantly.

The pressure to privatize came from two different sources. Firstly, there was a political decision to favour the creditors of Argentina's foreign debt and, at the same time, alleviate the short-term fiscal deficit. As will be seen below, the transfer of ENTel to the private sector was effected mainly through the acceptance of debt paper in exchange for State assets and monopoly rights over a number of services. This involved advance payment of both interest and capital and constituted an extremely significant event for the Peronist government: the use of debt capitalization mechanisms in the sale of the telephone company would prove to foreign creditors not only the authorities' will to honour their commitments, but also their capacity to do so.

¹The remaining 5% belonged to two private companies: CAT (established in 1916) and CET (established in 1927), both subsidiaries of the Swedish firm Ericson. In the late 1980s, CET was acquired by CAT.

Secondly, all over the world telecommunications equipment and services suppliers and their major customers were pushing for a change in the regulatory framework and for a type of privatization which would allow them to explore the new possibilities opened up by the evolution of the sector at the international level (Herrera, 1990). On the one hand, the spread of microelectronics in the industry had relativized (in some subsectors) the importance of economies of scale and created opportunities for investment both in the production of new equipment and the supply of new kinds of services; this—in the eyes of certain companies and major customers—called into question the functionality of the current regulations, which had been designed to control a monopolistic market offering almost exclusively “traditional” voice transmission services. On the other hand, in the headquarters of the most important equipment suppliers, it was perceived that the investments made in the light of the “technology race” had created large amounts of idle capacity (in some cases due to overestimation of the growth potential of the respective markets), and it was sought to reduce this

idle capacity by expanding exports of the latest generation of products. The success of such a competitive strategy based on exports depended largely, in turn, on the possibility of changing the purchasing policy of the companies engaged in the provision of services, which still maintained protectionist attitudes with respect to a small number of suppliers. Finally, it is worth noting that in some developed countries the companies engaged in the provision of services opted for the transnationalization of their activities, which led them to support the privatization movement in those markets to which they sought to gain access.²

Thus, the fact that the transfer of ENTEL to the private sector was undertaken for the purpose of paying part of the foreign public debt and alleviating the short-term fiscal crisis, rather than solving the serious problems of the domestic telecommunications system, imparted some special features to the regulatory framework which emerged from the process, with important consequences both for consumers and for the structure of the domestic equipment supply industry.

I

The period prior to privatization

In the early 1980s, Argentina had less than 8.5 telephone lines per 100 inhabitants. In 1985, that figure rose to 10, thanks to a network expansion plan called Megatel.

Even though this level of “telephone density” was slightly higher than the average in countries with per capita incomes similar to that of Argentina, a large part of the population continued to be outside the network (which is unequally distributed both in terms of social sectors and regions) and the quality of service continued to be deplorable.³

At the same time, ENTEL—like most of the world’s telecommunications companies—maintained a positive operating balance, although it faced growing financial difficulties in expanding and modernizing its network. This situation led to high foreign indebtedness, since the prohibition of use of the local financial market by State companies made each new loan more expensive. The difficulty of financing expansion was, in turn, related to three factors. Firstly,

the ENTEL planning and work control systems suffered from policy discontinuity,⁴ the absence of multi-year

² The most important case is that of the Baby Bell companies in the United States, not only because of their weight within the structure of the telecommunications industry at the international level (the North American market is equivalent to approximately half of the world telecommunications market), but also because of their ability to influence the United States Government in their favour.

³ By way of example, according to data provided by the General Supervisor of Public Companies, in the late 1980s the percentage of faulty calls was double that considered normal by international standards and the annual average number of complaints was four times greater. Both local and interurban transmission services were deficient in this respect.

⁴ For example, between March 1984 and October 1987 there were four Ministers of Public Works, four Communications Secretaries and three General Managers of ENTEL.

expansion plans⁵ and work control systems, and the lack of coordination between the planning of customer hook-up⁶ activities and equipment acquisition policy (Herrera, 1989). In this chaotic situation, ENTel could not even evaluate the price actually paid for each exchange,⁷ and the connection of the thousands of lines acquired took years, weighing heavily on the company in the form of higher fixed costs. Secondly, ENTel's purchasing policy meant that it had to pay very high prices for equipment and construction work. Finally, the tariff structure for the services provided did not allow the State company to make up for costs due –among other things– to the perverse combination of policy discontinuity, administrative and management chaos,⁸ and overpayment of subcontractors⁹ and equipment suppliers.¹⁰

⁵ The public network was not expanded gradually but rather in abrupt increments, because of the concentration of huge investments in brief periods (as extreme examples, in 1975 only 6 000 lines were installed, while in 1979 the figure was 200 000). Normally, the decision to undertake such investments and the selection of expansion objectives (in quantitative and qualitative terms) was in the hands of a very small group of political functionaries named by the current Executive, while the participation of engineers, technicians and other qualified personnel of the ENTel permanent staff was extremely sketchy, to such a point that sometimes their technical opinion was not even sought.

⁶ This refers to the system of connections between customers and their respective telephone exchanges.

⁷ For a number of reasons (lack of precise specifications for the goods and services to be acquired, indexing mechanisms, partial payment on reception of materials, etc.), the prices really paid by ENTel could be very different from those specified in contracts for equipment supply or construction works. See Herrera, 1989, pp. 121 – 123.

⁸ Over a period of more than twenty years, the Supervisor of Public Companies only accepted ENTel's financial statements twice, and even then with reservations.

⁹ In particular, the Union of Telephone Workers (FOETRA) has made numerous accusations of over-billing in respect of the subcontracting of work to install lines between the exchanges and subscribers.

¹⁰ During the second half of the 1980s, under the Radical Party government, it was proposed that the issue of financing investments could be resolved by asking applicants for new telephone lines to pay for the new equipment in advance (up to that time ENTel had only charged connection costs). Under this system of payment, the Megatel Plan was launched (1985) with the aim of installing one million new lines in five years. The anticipated results, in terms of financing expansion of the system, were not attained, however, basically because the prices eventually paid for the equipment were very much higher than those foreseen when the Plan was launched.

From the industrial point of view, it is important to note the stability both of the duopolic structure of the domestic supply of telephone exchange equipment (with the domestic affiliates of the American company, ITT, and the German company, Siemens) up to the end of the 1980s, and the predominance of another group of transnational company affiliates in the production of public transmission equipment. In that situation, domestic capital had little opportunity to sell products directly to ENTel.

During the era in which electromechanical technologies prevailed, the State company's purchasing policy obliged supplier firms to maintain productive capacity within the country, although no specific conditions were imposed with regard to technology transfer and there were no particularly stringent requirements for the incorporation of domestic components in the products sold. Even so, the degree of domestic integration of the Argentine affiliates of telecommunications equipment producers reached a level of around 90% in 1973 (Argentina, 1986). A number of factors contributed to this situation: a competition strategy based on the reduction of costs; the adaptation of products and production processes to local conditions; the barriers raised against the entry of new competitors, exploiting the advantages of being first in the market; the financial capacity to maintain large margins of idle capacity over long periods;¹¹ and the possibility of persuading ENTel and other State companies to pay higher prices than those obtaining for the same equipment in developed countries.

In the early 1980s, ENTel's decision to incorporate semi-electronic and electronic exchanges in the system meant new criteria in the selection of suppliers. The most notable results of this change –in terms of the structure of domestic industry– were a radical setback in the levels of domestic content of production and the entry of Japanese firms into the Argentine telecommunications market. Moreover, for the first time price competition played an important role in the strategies of firms competing for the domestic market, even though ENTel still paid very much higher prices for digital equipment than those prevailing on the international market. In the

¹¹ The absence of multi-year equipment acquisition plans in ENTel made the ability to maintain high levels of idle capacity for long periods a key element in suppliers' competition strategies.

mid-1980s, however, after the Siemens affiliate acquired most of the shares of the ITT affiliate, the telephone exchange equipment market resumed its traditional duopolic structure, this time with the firms involved being the affiliate of the German company and an affiliate of the Japanese firm NEC, in association with a big domestic capital group.

In the late 1980s and early 1990s, the companies with plants in the country experienced a double threat to their relative position in the Argentine market. On the one hand, the Executive signed economic cooperation agreements with, among others, the Government of Italy, which meant that telecommunications equipment produced in that country would

now be imported into Argentina. On the other hand, in October 1987 the Radical Party government announced its decision to privatize ENTEL. I will not go into detail here on the ways in which each of the firms involved reacted to these changes in the environment in which they had been operating, but I do feel that it is interesting to note that they resorted to strategies of lobbying and the formation of cartels, seeking political support on the grounds that their continuance as ENTEL suppliers would guarantee not only the maintenance of domestic levels of production, investment and employment, but also further progress in the process of improving domestic technological capacity.

II

The privatization process

The origins of the privatization process lie in the measures taken by the military government in the 1979-1983 period, when several secondary or peripheral activities previously carried out by ENTEL were transferred to the private sector.¹² Later, the Radical Party government continued that policy of peripheral privatization—especially with respect to the contracting-out of the installation of lines between the exchange and the subscribers—and sold several value-added services, although it was frustrated in its intention to sell 40% of the ENTEL shares

to Telefónica Española.¹³ At that time, privatization of the network was openly opposed by some parties of the Left and State workers, who even expelled from the telephone workers' union some members who supported privatization; equipment suppliers associated with the financial sector sabotaged the government's initiative by presenting themselves as candidates to be the future operators of the system, while in 1985 the Peronist legislators blocked the legislation needed to implement the project.

Subsequently, however, under the Peronist government, the effective transfer of ENTEL to the private sector was effected on 8 November 1990, only three months after the Decree regulating the privatization process was signed. To achieve his goals, the President of Argentina legislated by means of Decrees, making use of the extraordinary powers which

¹² Among the most important of these privatization measures were those involving work on the installation of lines between the exchanges and subscribers and others involving systems of financial collaboration whereby—in certain localities of the country—the private sector could be responsible for the purchase of land, construction of the telephone exchange building, the installation of telephone exchange equipment and long-distance links, and the construction of the networks of lines to the subscribers.

¹³ The proposal of the Radical Party government, which was paralyzed in the National Congress by Peronist legislators, provided for the sale of 40% of the ENTEL shares to Telefónica Española, which would pay US\$750 million for them (with a margin of variation of 20%). Of the US\$750 million, two-thirds was to be paid in cash (US\$200 million within the first year and the rest in 30 months) and the remaining third was to be paid through debt capitalization mechanisms. The proposal of the Spanish firm required that the mixed company thus formed would retain monopoly control over all services, but would not be obliged to provide public telegraph services nor to attend the population of remote localities.

the Peronist and Radical legislators had given him (Petrazzini, 1991) and invoking the Economic Emergency and State Reform laws, which had opened up the possibility of privatizing public service companies.

The basic mechanism for privatization consisted in dividing the company into two regions (North and South) and auctioning 60% of its total stock package,¹⁴ with a fixed minimum price.¹⁵ The auction would be won by those who offered the most Argentine foreign debt paper in payment, over the minimum price (the minimum amount acceptable was 3.5 billion dollars for each zone).¹⁶

The sale of ENTel led to the formal creation of four new telecommunications companies. Telecom Argentina (Telecom) and Telefónica Argentina (Telefónica) offer basic telecommunications services throughout the country, while they also own equal shares of the other two companies: TELINTAR, which provides international services, and STARTEL, which offers the so-called "services under a competitive regime" (mobile radio-telephony, mobile maritime radio services, telex, and data transmission within the national territory).¹⁷

With regard to the sectoral regulatory framework for this change, three aspects should be noted: firstly, although a majority of Deputies and Senators

say that they agree on the need for a new telecommunications law, the National Congress has yet to approve one.

Secondly, in the first half of 1990, the Communications Secretariat—responsible until then for the drafting and execution of national policy for the sector and for control of the companies operating in it—became a Sub-Secretariat,¹⁸ but on 31 January 1991 that Sub-Secretariat was dissolved and its approximately 400 employees were dismissed. Thus, the State was left with virtually no technicians with experience in the field of telecommunications. The re-establishment of a Communications Sub-Secretariat, many months later, did not change that situation.

Thirdly, a few months before the sale of ENTel, but several months after the conditions for private sector acquisition of that company were established, the National Telecommunications Commission (CNT) was set up (June 1990) to serve as a regulatory and control body.¹⁹ However, more than a year after the State monopoly disappeared, that Commission, which lacks human and financial resources, is conspicuous by its absence in the definition of the main aspects of present and future domestic telecommunications policy. On the one hand, none of the significant disagreements which have arisen between the State and private firms in the past year have been settled in the CNT. On the other hand, the users of the public network find themselves totally defenceless (for example, the CNT has been unable to force the companies to give way in some clear cases of over-billing for services).

In this context, in order to make some prospective conjectures with respect to this sector it will be necessary to analyse in greater detail the characteristics of the consortia which acquired parts of the ENTel package and to study the fine print of the transfer contracts which they signed with the Argentine State.

¹⁸The Ministries of Economy and of Public Works and Services were merged to form the Ministry of the Economy and Public Works; the Public Works and Communications Secretariat came under this new Ministry and, in turn, was responsible for the Communications Sub-Secretariat.

¹⁹According to its terms of reference, the CNT is to regulate, control and oversee all telecommunications services, administering the radio frequency spectrum (except for radio broadcasting) and ensuring compliance with the conditions established by the State for the companies which purchased ENTel stock (tariffs, mechanisms for selecting equipment suppliers, quality and network expansion goals, etc.). It is also responsible for protecting the public interest, defending customers, and certifying equipment.

¹⁴The remaining 40% was sold later to company personnel (10%), telephone cooperatives (4.8%) and the public (25%).

¹⁵This minimum was US\$100 million for the Northern region and US\$114 million for the Southern region, to be paid in cash on taking possession, plus a somewhat higher sum (US\$228 million for both regions) in six-year promissory notes, with a three-year grace period.

¹⁶The consortium which bought the Northern region offered US\$2.308 billion in debt paper, while that which bought the Southern region offered US\$2.72 billion (reference is always to the nominal values of the debt, including the corresponding interest). In the secondary market, this paper was valued at around 12% of its face value, and payment of the principal was scheduled for the twenty-first century. In this regard, it is interesting to note that: i) for the 30% of shares of the Southern region sold later, more than US\$800 million in cash was received, and for the 30% corresponding to the Northern region, US\$1.2 billion; ii) this later sale changed the composition of the consortia (for example, in the case of Telecom, the participation of the domestic group Pérez Companc increased by around 5 percentage points).

¹⁷For its part, Telecom Argentina acquired 160 000 lines from CAT (see note 1) for US\$67 million (*Ambito Financiero*, 25 February 1992).

III

Features of the purchaser consortia and the transfer contracts

The participants in Telecom Argentina are STET, *France Cables et Radio*, the Pérez Companc group, and the Morgan bank, while the participants in Telefónica Argentina are Telefónica de España, the Techint group and Citibank. Thus, each of the consortia which dominate the domestic telecommunications market are made up of at least: i) a large European State company, linked in turn to several equipment suppliers; ii) one of the main creditor banks of the Argentine foreign debt; and iii) a large domestic economic group.²⁰

The domestic economic groups forming part of these consortia²¹ grew up as State suppliers (mainly in the construction sector, but also in telecommunications) and are among the principal beneficiaries of State subsidies to domestic industry. Moreover, being among the private companies with the highest absolute levels of foreign debt, they supported the proposal in the early 1980s to make private foreign debt a State responsibility, so that they played a significant part in the State indebtedness which it was proposed to pay off through the sale of ENTel.

By purchasing 60% of the shares of ENTel, the consortia acquired the company's assets (f.c.c. of nearly all of the US\$1.5 billion debt, which was taken over almost entirely by the State); licenses to provide services for an indeterminate period; and monopoly rights for seven years (extendable to 10) over basic domestic services in the corresponding regions (Southern for Telefónica and Northern for Telecom) and all international services (telephone, data transmission, Telex, and value added services, etc.). Moreover, through STARTEL, which inherited the ARPAC network from ENTel (for data transmission through package processing), they can operate in

the second band of mobile cellular telephones and offer domestic data transmission, telex, etc. services, since in this latter area there is no prohibition against the entry of new firms.

The acquisition of the mobile cellular telephone services²² warrants special comment, since in February 1992 conversations about that service between the private consortia and the Ministry of the Economy were publicly revealed. That Ministry, against the opinion of Telecom and Telefónica, maintained that the second band of mobile telephone services (the MOVICOM firm already operated in the first band, prior to privatization) should be awarded on the basis of bidding.²³ Agreement was reached at the end of February: the consortia could offer that type of service without having to take part in a bidding contest, but in return they must agree to make an average 3% reduction in their charges for mid-range and long-distance communications, and they must also accelerate the previously agreed timetable for price reductions in respect of new telephone lines (*Página 12*, 1992).

With respect to this latter point, it should be noted that: i) the 3% reduction is insignificant in view of the fact that long-distance and international tariffs in Argentina are generally very much higher than the average rates in developed countries for the same services, which, in turn, bear no relation to service costs and reflect extremely high surcharges; and ii) the reduction in respect of the installation of new lines –the price of which is also extremely high– would probably have occurred in any case because, at those high prices, the demand for new lines would not have been in line with Telefónica's and Telecom's plans for network expansion.

²⁰ For more details on the relation between the big domestic economic groups and the privatization processes, see Verbinsky, 1990.

²¹ In some cases, they associated themselves, either directly or indirectly, with the private service company which is now a member of the consortium (Acevedo, Basualdo and Khavisse, 1991).

²² At the international level, this sector is changing the whole shape of the industry, and many specialists believe that it is the spearhead for the introduction of competition in the network.

²³ The position of the Argentine Minister of the Economy was publicly and emphatically supported by the United States Ambassador in Argentina, who stated that it was his duty to defend the interests of United States companies, such as Motorola, which wished to enter the Argentine mobile telephone market.

IV

Concrete results and potential instability

In addition to acquiring assets, licenses and monopoly rights to provide basic domestic and, especially, international services, the consortia have also taken on a number of commitments. These are not expressed in terms of obligatory investments, but rather as the obligation to achieve certain levels of service quality and physical network expansion goals. If the contract conditions are fulfilled, by the end of the century the Argentine network will have a million or a million and a half more telephones,²⁴ together with substantial improvements in the quality of services (measured, for example, by the number of calls actually completed, repair time delays, etc.), even though it will still be operating far below the average efficiency of European or North American networks.

With respect to the expansion goals proposed, it is necessary to take into account: i) the feasibility of attaining those goals; ii) the possible sources of the financing needed to reach them; and iii) the likelihood that the State really will ensure that the original contractual conditions are respected after the transfer to the private sector.

With respect to the first point, internationally there is a very high correlation between teledensity (the number of lines per 100 inhabitants) and the per capita gross domestic product.²⁵ As noted above, after the Megatel Plan was launched, Argentina reached a teledensity of approximately ten lines, a figure slightly higher than the average for countries with similar per capita GDP. On the other hand, the number of applications to join Megatel has been somewhat below government expectations. It may be assumed that putting another million lines on the market would be a resounding failure for lack of

demand, unless there were a significant increase in real wages, a considerable reduction in hook-up prices, or a real boom in economic activity. In view of these facts, everything seems to indicate that the consortia will find it hard to attain the expansion goals to which they are committed unless they are willing to lower the hook-up prices laid down in the transfer contracts.²⁶ At all events, to the extent that the expansion strategy adopted by the consortia is centered on the digitalization of the existing installations in order to be able to offer the higher-income sectors improved access to the network –and particularly to special and international services– the rate of expansion of the network will be partially conditioned by the extent and speed with which the business community changes the role of telecommunications within the production process, by moving towards new ways of organizing production, marketing and distribution which make greater use of informatics (Herrera, 1992).

With regard to the investments which the firms must make in fulfillment of their contracts, five aspects may be mentioned. Firstly, during the first three years the companies can charge applicants for new lines between 50% and 100% of the direct costs in advance.²⁷ Secondly, the authorized scales of charges are sufficiently high to allow for a reasonable level of self-financing of investments. Thirdly, the consortia received 295 000 lines which had been bought by ENTel before the transfer but had not been connected (debts to equipment suppliers for

²⁴ When ENTel was transferred to the private sector, it had 3 500 000 telephone lines and two ground stations (Balcarce and Bosque Alegre) for satellite communications. Only 3 100 000 of those lines were functioning, however.

²⁵ Obviously, the teledensity/GDP ratio is only one indicator of network development, and it is insufficient because it reveals nothing about the possibility of access to the network by the various social sectors, nor about its geographical distribution, nor about maintenance of the infrastructure which ensures effective access to services (Noguera, 1991).

²⁶ In fact, hook-up prices for new lines were recently renegotiated. This may benefit the consortia, because for a certain length of time –sufficient to cover the demand from the higher-income sectors– the old and very high rates will be in effect, while later the reductions will make it possible to capture an intermediate segment of the market which, although unwilling to pay very high hook-up prices, may be able to pay the current high charges for telephone calls.

²⁷ Up to 50% can be charged in respect of home service, while for other types of service the maximum is 100%. The concept "direct cost of a line" includes, in addition to the cost of telephone exchange equipment and access to the interurban and international networks, such items as a proportion of the cost of land and buildings, energy, etc. After the third year, instead of cash payment they must take out a debt instrument in dollars, due in five years from the date of issue, with an interest rate of 7% per annum.

that purchase were assumed by the State). Of that total, Telecom and Telefónica can sell 205 000 lines²⁸ to the public at prices of between US\$1 000 and US\$3 000, and the corresponding connections will be taken into account in the State evaluation of the fulfillment of network expansion goals. Fourthly, connection of the lines acquired through the use of the nearly US\$200 million in credits granted by the governments of France and Italy in negotiations with the Argentine government prior to the transfer²⁹ will be accounted for in the same way. Finally –an issue to which I will return below–, the companies can finance the expansion of the basic network with income from international services, over which they exercise monopoly rights.

Before referring to the possibility that the conditions for the provision of services stipulated in the contracts which transferred ENTEL to the private sector can be maintained, I will make some observations on the structure and level of tariffs in order to make it easier to understand why I believe that those agreements are intrinsically unstable.

According to the terms of the transfer contracts, during the first two years the private firms can adjust the tariffs for basic local, national and international services monthly in accordance with the consumer price index (CPI), and they can also vary them in dollars when substantial changes occur in the real exchange rate (the initial tariff was 4.2 US cents per unit in November 1990).³⁰ During the following five years, tariffs are to be reduced by 2% per annum in

real terms. After the period of exclusivity, there will be no price controls as long as there is real competition.³¹ The private companies may transfer to their prices all taxes, rates and national contributions that they must pay, with the exception of the profits tax.³² In order to gain an idea of the size of the tariff increase with which the private consortia began their operations (4.2 US cents per unit), it may be recalled that from the beginning of 1985 up to a couple of months prior to the privatization, the average quarterly price per unit was never more than 220 Australs (at March 1990 values) and was always less than 1.5 US cents. In March 1991, however, the average rate was 380 Australs or nearly 4 US cents (at March 1990 values). As for the prices for interconnections and use of the public network by other telecommunications service suppliers, the contracts stipulate that Telefónica, Telecom and TELINTAR must charge normal and non-discriminatory prices, though they do not spell out the criteria for determining normality and non-discrimination.

These two problems in respect of tariffs (customers who must pay very high rates and potential competitors of STARTEL who could be paying discriminatory connection charges, to the detriment of effective competition)³³ are a very important source of potential conflict. The situation could have a negative impact on both private users and on firms in general, especially transnational companies, which make heavy use of the services or which plan to expand their activities as suppliers of telecommunications services in the domestic market.

²⁸ The other 95,000 lines had already been paid for by customers to ENTEL before the transfer. There are another 105,000 unconnected lines which it would be reasonable to maintain in reserve for technical reasons.

²⁹ To a large extent, the conditions for the use of those credits oblige the consortia to buy equipment from companies connected with firms which are members of the consortia. For example, the suppliers which are beneficiaries of the Italian credit include Techint and Italtel.

³⁰ Between 8:00 a.m. and 8:00 p.m. from Monday to Friday, and between 8:00 a.m. and 1:00 p.m. on Saturdays, the length of a unit for local calls is two minutes; at other times, it is six minutes. For long distance calls, the length of a unit varies with the distance and the time the call is made. Moreover, residential customers pay a fee of 274 units in advance every two months, while commercial customers pay 2 460 units. This fee gives them the right to make additional calls equivalent to 200 and 330 units, respectively, at no additional charge during the following two-month period (this applies to customers in areas of high telephone density), so that the tariff system penalizes those who use their telephone less. The original set of tariff rates may be adjusted when the devaluation rate of the dollar is more than 25% greater than monthly inflation, either in a single month or in three months, cumulatively.

³¹ The reference point is the consumer price index. If the rights to exclusivity are extended for three years, tariffs are to be reduced by 4% per annum in real terms during that period.

³² It is important to note that because of the privatization the State will cease to receive revenue from a tax equivalent to 30.4% of the value of a call unit which ENTEL charged its customers and which was intended to help pay pensions. Moreover, the government guaranteed the companies that the tariff scheme would be maintained and, in the last instance, it promised to pay them compensation if it found itself obliged to intervene for any reason by lowering the price of telecommunications service. As a final safeguard, if the authorities were to decide not to pay that compensation, the companies would acquire the right to adjust rates every six months for the first two years, so as to ensure a profit margin of at least 16% over the fixed assets in use.

³³ See Noan (1989) and Helm and Yarrow (1988).

Maintaining this regulatory scheme, which made business communications so expensive and kept powerful oligopolistic international companies out of the Argentine market was not viable, and finally the facts spoke for themselves: hardly anything remains of the original contracts as far as tariffs are concerned. The new agreement—signed on 28 November 1991, nearly eight months after the privatization—reduced the price of business telecommunications, at the expense of residential users, so that Telecom and Telefónica would not suffer.

This new tariff agreement³⁴ was ratified by Decree and was basically reflected in the following changes:³⁵ i) tariffs were dollarized and raised by 1.3% over the rates in effect at the time of signing the new agreement, and it was agreed that they would be adjusted in the future twice yearly—on April 1 and October 1—according to the United States consumer price index;³⁶ a system of gradual reduction of hook-up prices, beginning in November 1992, was established, to culminate in 1997 with the equalization of residential and business prices at a level not exceeding the average current price in countries with mature networks;³⁷ iii) an increase in basic fees was introduced which favoured business users to the detriment of residential customers, with a probably neutral impact on Telecom and Telefónica income from monthly fees (for residential customers, the number of call

units made available at no additional charge over the monthly fee was reduced³⁸ and the monthly fee itself was raised, while the minimum monthly cost of commercial lines was lowered),³⁹ and iv) renegotiation of the entire tariff structure was promised, with a view to lowering the cost of telecommunications for the business sector and at the same time increasing residential prices in such a way that overall Telecom and Telefónica will not suffer from those tariff modifications.

There is an peculiar feature of the privatization of telephone services in Argentina which is not unrelated to the subsequent renegotiation of the tariff structure. Thus, the transfer contracts do not propose the separation of international from domestic services, which would create the possibility of allowing the entry into the market of companies previously excluded and avoid a situation in which users of international services would subsidize the rest; on the contrary, the contracts allow Telecom and Telefónica to dominate local, national and international telecommunications simultaneously and authorize them to finance expansion of the network through crossed subsidies for ten years, using TELEINTAR income for that purpose. The results have also been rather unusual: as noted above, privatization began with sharp price increases in real terms for all services, instead of the anticipated reductions in the price of international services and increases in local services (as in other countries). This policy, which sparked angry protests, especially on the part of some big users of the system, has placed the telephone consortia in an excellent position for the subsequent renegotiation of relative prices.

In order for the Argentine State to be able to closely monitor the evolution of the cost structure of the consortia and thus be able to know what kind of tariffs could prevent cross-subsidies or discrimination against potential competitors of STARTEL, firm political will (which the government has not yet shown) and a team of qualified technicians devoted

³⁴ Tariff levels have been a bone of contention between the government and the consortia ever since 1 April 1991, when the Law on the Convertibility of the Austral was promulgated, prohibiting price indexing throughout the country and requiring that tariffs—calculated in dollars—be returned to the August 1990 level. The government was not able to achieve full compliance with this law on the part of the telephone companies, and in the end the price per call unit was lower than that which would have resulted from the application of the formula established in the contracts, but was 21.5% higher than that prescribed by the Law on Convertibility. For their part, the companies declared that, if they considered it opportune, they could, in the future, demand the tariff increases (even retroactively) which they were now giving up, but to which they would have been entitled under the transfer contracts if the Law on Convertibility had not intervened. At that same time, moreover, the value added tax collected through telephone tariffs was lowered from 16% to 11%.

³⁵ See, in this respect, Telefónica Argentina (1991).

³⁶ The price per call unit was raised by 1% on 1 April 1992.

³⁷ That average is estimated at US\$250. For the coming fiscal year, hook-up charges will be US\$1 800 for business and US\$900 for residential customers.

³⁸ By 39.4% for those in areas with more than 200 000 telephones, for example.

³⁹ The monthly fee for residential customers in areas with more than 200 000 telephones was raised by 46%, while it was lowered for business customers in similar areas.

to the attainment of this objective are needed.⁴⁰ It is worth recalling that dismantling the technical capacity of the State in the area of telecommunications was

a preparatory step for the sale of ENTel shares (dissolution of SECOM, dismissal of its technicians, creation of a spurious CNT).

V

Effects of the privatization of ENTel

Finally, I will address the effects which the privatization of ENTel has had and will continue to have on the telephone equipment supply industry. Inasmuch as the bulk of the demand for telephone equipment comes from the companies operating the networks, the transfer of the networks' assets to the private sector could lead to a veritable earthquake among the suppliers already established in the country, which could suffer severe damage to their relative positions in the domestic market.

The consortia which acquired ENTel are under no obligation to purchase equipment from any particular firm,⁴¹ although they are obliged to make acquisitions by public tender when their purchases amount to more than US\$500 000 per year, giving preference to companies with plants in Argentina, if their prices are not more than 10% higher than those of other companies (the 10% clause). Moreover, they are obliged to respect several purchase commitments

made by the State during the months prior to the privatization (including those deriving from the credits granted by the governments of Italy and France). With regard to future purchases, Telefónica and Telecom are not allowed to supply their own equipment to end-users, although they may supply, install and maintain equipment made by others, in competition with other firms. Such equipment must have been approved by the regulatory authorities, and all producers of approved equipment have the right not to be subjected to discrimination in their dealings with Telefónica and Telecom.

In fact, the 10% clause alone could cause more political problems than an policy of real protection of those industries installed in the country. If anything was proved by the decades of implementation of the "Buy National" regime, it was that it is perfectly feasible to arrange public tender contests in such a way as to exclude certain suppliers. Although at this time it is difficult to predict the future composition of the domestic public equipment supply market, it may be expected that the combined effects of the technological revolution, underdevelopment and privatization will probably lead to a considerable structural (rather than merely transitory) decline in the levels of domestic content in the production of telephone exchange equipment.

At all events, if the experience of the past year is generalized and projected into the future, a trend may be observed towards the introduction of at least a third supplier, while purchases will continue to be made from those companies which were the principal suppliers of the State company,⁴² even though they are not linked to one or another of the members of the consortia. The maintenance of such purchases,

⁴⁰ This task is particularly complicated because the combination of rapid technological progress with the privatization process has generated marked informational asymmetries, to the detriment of the State's power to control developments. The government itself recently stated that the sale of 30% of the shares of Telecom (which only took place in March 1992, although it had been announced for December 1991) was delayed because it had not been able to secure from the Board of Directors of Telecom Argentina the data on the economic and financial evolution of the company needed for the preparation of a prospective balance-sheet for future shareholders. For its part, the company denied the government's statements, maintaining that its reluctance to collaborate in the sale of the remaining ENTel shares was related to difficulties in reaching agreement on the tariff issue. (*Ambito Financiero*, 1991 and *Clarín*, 1991).

⁴¹ ENTel's traditional suppliers pressured that company, in the final months prior to privatization, to accept advance deliveries of material and equipment, with no regard to previously established schedules, but rather so that the State would assume the commitments arising from those deliveries. In some cases, this benefited the consortia in two ways: on the one hand, because ENTel bought equipment from firms related to them, and on the other, because this increased the stock of assets which they received.

⁴² Although they may be given a relatively smaller share, at notably lower prices.

even apart from the formal commitments made with the government, is probably related to two types of considerations. On the one hand, it may be politically expedient to avoid confrontations with companies which have considerable lobbying capacity with the government authorities, thus avoiding "making waves" until the private operators are firmly established and they have completed their negotiations on the sectoral regulatory framework. At the same time, importance will probably be attached—at least temporarily—to the economies deriving from the need to ensure compatibility of equipment and to acquire detailed knowledge of the characteristics of the domestic network, as well as the possibly greater capacity of firms already established in the country to respond without delay to a substantial increase in demand.⁴³

Within this context, the most likely outcome is that the transnational equipment suppliers will decide, quite apart from the strict logic linked to the evolution of their cost structures, to maintain their plants in the country as an element of political pressure in the hope of gaining purchase decisions from Telecom and Telefónica,⁴⁴ even though they may be obliged to completely restructure their domestic production. Moreover, it must not be forgotten that

the transnational companies which operate within Argentina also do so in Brazil and, in some cases, in Mexico and other Latin American countries. Consequently, if those companies believe that, in the long term, the present government initiatives aimed at the creation of subregional trading blocs (Mercosur, for example) will be consolidated, they may seek to restructure their operations in order to apply schemes for complementary production by their affiliates in the different countries and/or the elimination of redundant plants.⁴⁵

Moreover, it is probable that in the coming years, even though tariff barriers will tend to fall, there will continue to be a place for small and mid-size local firms producing mechanical parts or components for equipment used in customer service networks and for end-user equipment, especially telephones, private branch exchanges, etc. Those companies will have the advantages of geographic proximity, the persistence of certain levels of tariff protection,⁴⁶ and lower costs in comparison with other companies which would be obliged to adapt their programmes and products to the conditions of the local network and the characteristics of the end-users (Herrera, 1992).

VI

Final comments

Perhaps the most noteworthy aspect of the Argentine privatization process is that, although it formed part of a strategy aimed, among other objectives, at ending State subsidies of economic activity and lowering the price of services through increased efficiency on the part of the companies offering them, it has

ended up generating a new mechanism of regressive resource transfer.

In fact, privatization was preceded by a generalized increase in charges, and moreover, since the guidelines laid down for the adjustment of such charges separated the prices charged from the cost

⁴³ Especially in view of the high levels of idle capacity which most of them still have. For an analysis of a similar situation in North American industry, see Herrera (1992).

⁴⁴ Similar strategies are being applied by the main equipment suppliers even in the Eastern European countries. For example, the German firm Siemens—one of the most important suppliers of the Argentine market—has set up mixed companies for the manufacture of equipment in Poland, Czechoslovakia, Romania, Hungary and the Ukraine, so as to put itself in a favourable position when it comes to competing for public telephone supply contracts. On 27 January 1992, that company announced an agreement to provide 12 new telephone exchanges in Poland, worth a total of US\$36 million (*The Economist*, 1992).

⁴⁵ It must not be forgotten that, in general, the decision to make direct investments in the production of public telephone equipment in Latin America was taken only in those cases in which that option was perceived to be a condition for access to the market imposed by national governments, since the small size of the markets in question meant that those investments were not economically justified even when electromechanical technology predominated (Herrera, 1992).

⁴⁶ Currently—in spite of reductions in the average level of duties for industrial products in general—tariff protection for the production of all types of end-user telephone equipment is very high, since end-users who wish to import them must pay tariffs of 50%.

structure, it is not even likely that increased private efficiency in the future will mean the lowering of prices for services to an extent that truly reflects those lower costs, given that the corresponding service licenses have given the consortia monopoly rights. In this sense, it is interesting to compare the recent agreement for the assignment of the second band of mobile cellular telephone service to STARTEL. It may be recalled that in return for this agreement, Telecom and Telefónica granted a discount of only 3% on the high international rates charged by TELEINTAR. Meanwhile, the international press had been giving permanent coverage to the complaints by North American, Japanese and European companies that in spite of the recent reductions and the fact that they are much lower than the Argentine rates, international telephone charges in most developed countries are 50% to 100% higher than the actual costs.

The private telephone companies, for their part, are not willing to pay the excessively high prices with which ENTel favoured its equipment suppliers. This means that, quite apart from the transfer of resources from customers to the consortia through higher prices, there is another transfer from the equipment producers to Telecom and Telefónica, TELEINTAR and STARTEL, through the lower prices that the latter pay for their equipment.

Consequently, privatization has not eliminated the old mechanisms of the regressive transfer of resources, but only given them a new form.

Another central objective announced by the government authorities which is far from being achieved is the transformation of the sector through the beneficial mechanisms of competition. If some of the conditions established in the ENTel transfer contracts are maintained, it is probable that in ten years' time (when the monopoly rights of Telefónica, Telecom and TELEINTAR are supposed to end), far from the entry of new capital, there will simply have been consolidation of the dominant position of the present consortia in the provision of basic national services and all international services, with very few new firms having emerged in the area of domestic value-added services.

With regard to the possibilities of the appearance of effective competition now or within ten years, the following should be noted: i) the presence of two firms providing basic services (Telecom and Telefónica) does not of itself create a situation of competition, since each company exercises monopoly

control over different areas of the country; moreover, their rates are established on the same basis and are adjusted by the same indexes so that, at least in terms of prices, there probably could not even be "competition by comparison"; ii) economies of precedence are very important in the telecommunications industry; this means that the first company to enter a market has competitive advantages over others, both because of its knowledge of the characteristics of demand and of the installed network and because it can impose its own technical standards, with which others entering the market later must conform; iii) the fact that the firms can operate simultaneously in subsectors which are still natural monopolies or oligopolies and in others which may be potentially competitive, opens up the possibility of using cross-subsidies as a way of impeding competition; and iv) the private consortia can impose discriminatory conditions of access to the basic network on independent operators who wish to compete with them in important areas.

All this reveals the potential instability of the regulatory framework created in the privatization process. At the present time, the losers have been not only residential users, who do not currently seem to have much chance of changing the situation in their favour, but also the big users of international services (affiliates of transnational corporations, news agencies, the financial system, etc.); potential suppliers of all kinds of international services whose expectations that privatization would allow them to enter the market have been frustrated; domestic value-added service suppliers, who have been forced to accept the conditions for connection to the network imposed by the dominant consortia, and equipment suppliers who have lost ground in the Argentine market. It is reasonable to suppose that the mobilization of this set of interests against the monopoly powers of Telecom and Telefónica (which has already begun) will not be content with the relatively marginal modifications made after ENTel was transferred to the private sector and will, in the mid- or short term, achieve a redefinition of the current regulatory framework, at least with respect to conditions of access to the international telecommunications market.⁴⁷

⁴⁷ In this regard, it is worth recalling that the United States Government aims to reduce the income received by Latin American operators for processing calls from abroad. If these pressures by the United States are successful, this would be a serious reverse for TELEINTAR.

To sum up, it can be stated that the continuation of the current regulatory framework would mean the consolidation of the duopoly beyond the time limits established for exclusive rights, and some of the most powerful sectors most severely affected by the Telecom and Telefónica monopoly in the market have already begun to react. The potential for conflict implicit in the current legislation is somewhat attenu-

ated, however, by the sluggishness of the national economy, which helps to keep the demand for telecommunications services relatively low. If the economy began to register sustained growth, however, this would be incompatible with the maintenance of the current legislation and the stability of the relative position occupied by the consortia which dominate the market today.

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