OECD

COUNTRY STUDIES

# Mexico - The Role of Competition Policy in Regulatory Reform

**1998**

## Introduction

The Review is one of a series of country reports carried out under the OECD's Regulatory Reform Programme, in response to the 1997 mandate by OECD Ministers. This report on the role of competition policy in regulatory reform analyses the institutional set-up and use of policy instruments in Mexico. This report was principally prepared by Mr. Michael Wise for the OECD.

## Overview

## Related Topics

# Regulatory Reform in Mexico

## The Role of Competition Policy in Regulatory Reform

**ORGANISATION FOR ECONOMIC CO-OPERATION**

**AND DEVELOPMENT**

Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

– to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;

– to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and

– to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

The original Member countries of the OECD are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries became Members subsequently through accession at the dates indicated hereafter: Japan (28th April 1964), Finland (28th January 1969), Australia (7th June 1971), New Zealand (29th May 1973), Mexico (18th May 1994), the Czech Republic (21st December 1995), Hungary (7th May 1996), Poland (22nd November 1996), Korea (12th December 1996) and the Slovak Republic (14th December 2000). The Commission of the European Communities takes part in the work of the OECD (Article 13 of the OECD Convention).

*Publié en français sous le titre :*

LE ROLE DE LA POLITIQUE DE LA CONCURRENCE DANS LA RÉFORME DE LA RÉGLEMENTATION

# FOREWORD

Regulatory reform has emerged as an important policy area in OECD and non-OECD countries. For regulatory reforms to be beneficial, the regulatory regimes need to be transparent, coherent, and comprehensive, spanning from establishing the appropriate institutional framework to liberalising network industries, advocating and enforcing competition policy and law and opening external and internal markets to trade and investment.

This report on *The Role of Competition Policy in Regulatory Reform* analyses the institutional set-up and use of policy instruments in Mexico. It also includes the country-specific policy recommendations developed by the OECD during the review process.

The report was prepared for *The OECD Review of Regulatory Reform in Mexico* published in 1999. The Review is one of a series of country reports carried out under the OECD's Regulatory Reform Programme, in response to the 1997 mandate by OECD Ministers.

Since then, the OECD has assessed regulatory policies in 16 member countries as part of its Regulatory Reform programme. The Programme aims at assisting governments to improve regulatory quality — that is, to reform regulations to foster competition, innovation, economic growth and important social objectives. It assesses country's progresses relative to the principles endorsed by member countries in the 1997 *OECD Report on Regulatory Reform*.

The country reviews follow a multi-disciplinary approach and focus on the government's capacity to manage regulatory reform, on competition policy and enforcement, on market openness, specific sectors such as telecommunications, and on the domestic macro-economic context.

This report was prepared by Michael Wise in the Directorate for Financial and Fiscal Affairs of the OECD. It benefited from extensive comments provided by colleagues throughout the OECD Secretariat, as well as close consultations with a wide range of government officials, parliamentarians, business and trade union representatives, consumer groups, and academic experts in Mexico. The report was peer-reviewed by the 30 member countries of the OECD. It is published under the authority of the OECD Secretary-General.

**TABLE OF CONTENTS**

**Background Report on The Role of Competition Policy in Regulatory Reform**

Competition policy should be integrated into the general policy framework for regulation. Competition policy is central to regulatory reform, because (as Chapter 2 shows) its principles and analysis provide a benchmark for assessing the quality of economic and social regulations, as well as motivate the application of the laws that protect competition. Mexico has adopted a modern competition policy as part of a larger, deliberate effort to open itself to the world economy. Though much has been done, competition policy's role in the process is still being established. The competition law, incorporating up-to-date economic analysis intended to promote efficiency, is new. The tradition of state control and protection is much older. Until recently, major sectors of the economy were either in state hands or subject to price controls, so the economy is still getting accustomed to new competitive realities. In the government, arguments for the protection and promotion of competition confront traditional arguments for the protection of incumbent national firms. In the private sector, larger businesses resist the introduction of significant domestic competition. Many newer firms that owe their existence to the liberalising process support competition enforcement, but in the larger public, interest and support are less clear.

As regulatory reform stimulates structural change, vigorous enforcement of competition policy is needed to prevent private market abuses from reversing the benefits of reform. A complement to competition enforcement is competition advocacy, the promotion of competitive, market principles in policy and regulatory processes. Mexico's competition laws and enforcement structures are sufficient to prevent or correct collusion and unfair practices. The conception of competition policy contained in the competition law is thoroughly modern and entirely consistent with pro-competitive reform. Indeed, it was drafted with that purpose in mind. The competition agency has tried to assert competition principles in newly deregulated and privatised industries. In this process, it faces strong opposition. Some decisions, particularly at the early stages, seemed to anticipate opposition by tolerating anti-competitive conditions, in some cases rationalising those actions as appropriate to a newly expanded North American or global market. But competition policy decisions, including some in connection with regulatory proceedings, have nonetheless curtailed the plans and operations of some nationally prominent firms. Competition problems arising from regulatory and privatisation actions still call for high priority attention, in enforcement and advocacy. For dealing with market power, the division of responsibility between the competition policy agency and other bodies, although conceptually plausible, seems to be difficult to implement well. To make competition policy effective in these matters, it may be necessary to give the competition agency even stronger tools to ensure that its identification of competition problems in regulated industries leads to effective measures to solve those problems.

## 1. THE CONCEPTS OF COMPETITION POLICY IN MEXICO: FOUNDATIONS AND CONTEXT

Mexico's competition policy is part of a larger reform effort, initiated in the mid-1980s, to move away from protection and central control and instead develop a market-based economy. The major elements of this effort were ending price controls, liberalising trade and investment, privatising state enterprises, reforming regulation, and adopting a modern competition policy. Thus, the motivation underlying Mexico's competition policy is to cement a general market-liberalising reform program.

Competition policy objectives are set out explicitly in the competition law: "to protect the competitive process and free market participation by preventing and eliminating monopolies, monopolistic practices and other restraints of the efficient functioning of markets for goods and services."[1] The relationship between competition policy and regulatory policy is recognised in the structure of the laws that now regulate sectors, such as telecommunications and transportation, that were one characterised by state-owned monopoly. In several of those laws, regulation of prices or other conduct is only authorised if there is substantial market power in the industry. Whether there is market power is determined by the competition agency, under the principles of the general competition law.

Efficiency is the primary, and perhaps the sole, criterion for applying the competition law. Other commonly encountered competition policy concerns are subsumed in the efficiency-based analysis. For example, there are no doctrines or interpretations about fairness or fair competition, nor about protecting the interests of small enterprises or limiting industrial concentration. The explicit bases for competition policies and laws in many OECD countries have tended to emphasise efficiency in recent years, so in this respect, and in others, Mexico's relatively new law takes advantage of the evolution of competition policy and theory elsewhere. Although the law is part of a program to develop a more market-oriented economy, the law takes no explicit note of the goal of promoting economic growth. Of course, it is implicitly understood that growth should follow from greater competition and efficiency.

Box 1. **Competition policy's roles in regulatory reform**

In addition to the threshold, general issue, whether regulatory policy is **consistent** with the conception and purpose of competition policy, there are four particular ways in which competition policy and regulatory problems interact:

- Regulation can **contradict** competition policy. Regulations may have encouraged, or even required, conduct or conditions that would otherwise be in violation of the competition law. For example, regulations may have permitted price co-ordination, prevented advertising or other avenues of competition, or required territorial market division. Other examples include laws banning sales below costs, which purport to promote competition but are often interpreted in anti-competitive ways, and the very broad category of regulations that restrict competition more than is necessary to achieve the regulatory goals. When such regulations are changed or removed, firms affected must change their habits and expectations.

- Regulation can **replace** competition policy. Especially where monopoly has appeared inevitable, regulation may try to control market power directly, by setting prices and controlling entry and access. Changes in technology and other institutions may lead to reconsideration of the basic premise in support of regulation, that competition policy and institutions would be inadequate to the task of preventing monopoly and the exercise of market power.

- Regulation can **reproduce** competition policy. Rules and regulators may have tried to prevent co-ordination or abuse in an industry, just as competition policy does. For example, regulations may set standards of fair competition or tendering rules to ensure competitive bidding. Different regulators may apply different standards, though, and changes in regulatory institutions may reveal that seemingly duplicate policies may have led to different practical outcomes.

- Regulation can **use** competition policy methods. Instruments to achieve regulatory objectives can be designed to take advantage of market incentives and competitive dynamics. Co-ordination may be necessary, to ensure that these instruments work as intended in the context of competition law requirements.

In principle, other laws that affect competition policy, such as those governing former state enterprises, must be applied consistently with the competition law. Regulatory policy complements the competition law to address the market power of a former monopolist in deregulated sectors. Price regulation can be applied to prevent exploitative abuse of dominance, while the competition law prevents and corrects exclusionary abuses of a dominant position. In practice, though, other ministries involved in the regulatory process may advance development-related goals that may not be consistent with promoting competition conceived as efficiency. In several sectors, notably transport and energy, public policy seems to include the goal of creating or protecting a large, nationally based firm. In the division of responsibility over market power between the competition authority and the regulator, it is the regulator that most often has the final say in designing the rule, and thus it is the regulator's conception of policy balance that governs as a practical matter. That conception is not always consistent with efficiency-based competition.

Competition policy, in the sense of promoting and protecting free competition rather than controlling prices and investment, is a new phenomenon in Mexico. The Constitution has prohibited monopoly since 1917[2] (indeed, since the mid-1800s), but the constitutional prohibition was only a statement of political aspiration, not a basis for government policy. Instead, by the 1970s, much of the Mexican economy was under price or entry control or in the hands of state-owned monopoly, in an environment of import protection and strong state supervision. The goal of competition policy was to eliminate the evils of private monopoly, and this goal was accomplished by price control and state ownership. The result was nonetheless monopoly, albeit publicly sanctioned. The effective policy about competition was to suppress it, not protect or promote it. By the mid-1980s, as a number of factors led to financial and economic crisis, it became clear that the old economic policies, including the policy about competition, could no longer support growth. The government changed economic direction, to replace control with market competition.

Two fundamental steps, both rooted in competition policy principles, led the reform effort. The government ended most domestic price controls and reduced constraints on new entry. And the government moved on several fronts to open the economy to trade and investment. Mexico eliminated most compulsory import licenses, abolished official import prices, reduced the maximum tariff by 80% (and cut the average tariff in half), adhered to the GATT, and entered the North American Free Trade Agreement (NAFTA). From 1984 to 1995, imports quadrupled (as did exports). Import liberalisation stimulated domestic competition in tradable goods sectors.

Another avenue to greater competition was privatisation of state enterprises, to reduce the temptation for protectionist intervention and increase the potential for market-based discipline. The largest single effort was the 1991 sale of the telephone monopoly for $US 6 billion. Eighteen commercial banks were privatised in 1991 and 1992, for a total of $US 13 billion. Formerly public firms in steel, sugar, airlines, TV broadcasting, satellite services, and railroads are now privately owned. Licenses and concessions for activities that were formerly performed by the state, such as natural gas storage, transportation and distribution, and seaport facilities, have been auctioned to the private sector.

Deregulation and regulatory reform accompanied privatisation. The sequencing was not always what might have been hoped for. Telecommunications illustrates the problems. There, a general regulatory structure was not in place until after the privatisation (although concession titles contain provisions that address some of the problems of monopoly), and inadequate consideration seems to have been given to the post-privatisation industry structure. In addition to longer-term objectives such as modernising the network and expanding coverage, a major short-run privatisation goal was evidently to maximise revenue by selling market power. Reform should prevent former state-owned monopolies from turning into private monopolies, as well as remove constraints on competition and eliminate unnecessary regulations.

The final step was the introduction of a general competition law. In 1993, the basic legal framework for reform was completed when Mexico adopted the Federal Law of Economic Competition (LFCE),[3] and the Federal Competition Commission (CFC) was created to enforce it. Liberalising trade was a critical step toward competition, but could not by itself be enough. Removing official trade barriers could not assure competition if those were simply replaced by private barriers. Dominant domestic firms, or export or import cartels, might hinder competition by collusion or by imposing exclusivity on domestic distributors and retailers. And import liberalisation could not ensure competition in non-traded sectors. Moreover, as a party to NAFTA, Mexico committed to adopting measures to proscribe anti-competitive business conduct.[4] The competition law was being prepared during the same period that Mexico was negotiating NAFTA, although the law was adopted before NAFTA came into force.

The competition law adopts many of the most advanced ideas and practices from around the world. The experts in the ministry of trade and industry who prepared the law consulted with colleagues from academia and competition agencies in other countries (and from the OECD). The law balances efficient and strong treatment of the most harmful competitive constraints with economically sensitive analysis of others, and it applies an integrated treatment of market power in all relevant situations. The law's elegant logical organisation and clear conceptualisation reveal its origin as a product of technical expertise, more than political creativity and compromise.

The level of support for the new direction of competition policy in the wider public or business communities is uncertain, although it is evidently growing now that the institutions have been in place long enough for people to become familiar with them. A number of factors, including the CFC's economics-based approach, its observance of careful, and sometimes time-consuming, procedures, and the delays from frequent judicial challenges, as well as the impression that some of its decisions have accommodated non-competition interests, have led to a public perception that the agency is not strong. Uncertainty about the extent of support for competition policy could be especially troublesome in the changing Mexican political situation. The government's present lack of majority in the legislature may considerably narrow its margin of manœuvre. There are indications of support for competition policy among legislators, although some of that support is interested in using competition policy to achieve purposes that would not be consistent with the CFC's economics-based approach. Neither the CFC nor others in the government have done much yet to educate the general public about the benefits of a modern competition policy. The lack of a clear public message and broader support could make competition policy less effective, just as Mexico's reforms are entering the stage in which general, horizontal principles like competition law, rather than sectoral regulatory decisions or trade policies, will be more important tools for ensuring that the promised benefits of reform are achieved.

## 2. THE SUBSTANTIVE TOOLKIT: CONTENT OF THE COMPETITION LAW

The general competition law shares its substantive foundation with a program of reform based on market principles. The absence of a competition law had probably encouraged the business and government behaviours and policies that made reform necessary. Now, legislation for sectoral privatisation and deregulation is taking advantage of its new competition policy institutions' capacity for making economically-based judgements about the definition of markets and the assessment of market power or effective competition. The competition law is self-contained and generally coherent. Its conceptual framework could make the law the touchstone for measuring the adequacy and success of other reforms.

The principles of Mexico's competition policy appear in three documents. The Constitution, Article 28, bans monopolies and monopolistic practices; however, the ban on monopolies is subject to significant sectoral exceptions. The Federal Law of Economic Competition (LFCE) implements the Constitutional provision by preventing and penalising anti-competitive conduct and mergers. The law does not provide for correcting monopoly as such, despite the Constitutional authority; rather, the law addresses particular practices by which monopoly might be attained or strengthened. And Regulations to implement the LFCE, which were published in March 1998, develop specific aspects of the law. In addition, provisions of other regulatory laws refer to the CFC and its powers.

The LFCE classifies practices as either absolute or relative. Absolute monopolistic practices are prohibited *per se* and are legally void *ab initio*. Parties to these practices cannot defend them by claiming that they are efficient; rather, their inefficiency is presumed conclusively. Violators are subject to administrative sanctions under the LFCE. In addition, the CFC may report associated criminal conduct to the public prosecutor. Relative practices may be found illegal only if the agents have substantial power in a defined relevant market. The sanctions for relative practices are limited to civil remedies under the LFCE, and parties may offer efficiency defences.

Box 2. **The competition policy toolkit**

General competition laws usually address the problems of monopoly power in three formal settings: relationships and agreements among otherwise independent firms, actions by a single firm, and structural combinations of independent firms. The first category, **agreements**, is often subdivided for analytic purposes into two groups: “horizontal” agreements among firms that do the same things, and “vertical” agreements among firms at different stages of production or distribution. The second category is termed “**monopolisation**” in some laws, and “**abuse of dominant position**” in others; the legal systems that use different labels have developed somewhat different approaches to the problem of single-firm economic power. The third category, often called “**mergers**” or “**concentrations**,” usually includes other kinds of structural combination, such as share or asset acquisitions, joint ventures, cross-share-holdings and interlocking directorates.

**Agreements** may permit the group of firms acting together to achieve some of the attributes of monopoly, of raising prices, limiting output, and preventing entry or innovation. The most troublesome **horizontal** agreements are those that prevent rivalry about the fundamental dynamics of market competition, price, and output. Most contemporary competition laws treat naked agreements to fix prices, limit output, rig bids, or divide markets very harshly. To enforce such agreements, competitors may also agree on tactics to prevent new competition or to discipline firms that do not go along; thus, the laws also try to prevent and punish boycotts. Horizontal co-operation on other issues, such as product standards, research, and quality, may also affect competition, but whether the effect is positive or negative can depend on market conditions. Thus, most laws deal with these other kinds of agreement by assessing a larger range of possible benefits and harms, or by trying to design more detailed rules to identify and exempt beneficial conduct.

**Vertical agreements** try to control aspects of distribution. The reasons for concern are the same—that the agreements might lead to increased prices, lower quantity (or poorer quality), or prevention of entry and innovation. Because the competitive effects of vertical agreements can be more complex than those of horizontal agreements, the legal treatment of different kinds of vertical agreements varies even more than for horizontal agreements. One basic type of agreement is resale price maintenance: vertical agreements can control minimum, or maximum, prices. In some settings, the result can be to curb market abuses by distributors. In others, though, it can be to duplicate or enforce a horizontal cartel. Agreements granting exclusive dealing rights or territories can encourage greater effort to sell the supplier’s product, or they can protect distributors from competition or prevent entry by other suppliers. Depending on the circumstances, agreements about product combinations, such as requiring distributors to carry full lines or tying different products together, can either facilitate or discourage introduction of new products. Franchising often involves a complex of vertical agreements with potential competitive significance: a franchise agreement may contain provisions about competition within geographic territories, about exclusive dealing for supplies, and about rights to intellectual property such as trademarks.

**Abuse of dominance** or **monopolisation** are categories that are concerned principally with the conduct and circumstances of individual firms. A true monopoly, which faces no competition or threat of competition, will charge higher prices and produce less or lower quality output; it may also be less likely to introduce more efficient methods or innovative products. Laws against monopolisation are typically aimed at exclusionary tactics by which firms might try to obtain or protect monopoly positions. Laws against abuse of dominance address the same issues, and may also try to address the actual exercise of market power. For example under some abuse of dominance systems, charging unreasonably high prices can be a violation of the law.

**Merger control** tries to prevent the creation, through acquisitions or other structural combinations, of undertakings that will have the incentive and ability to exercise market power. In some cases, the test of legality is derived from the laws about dominance or restraints; in others, there is a separate test phrased in terms of likely effect on competition generally. The analytic process applied typically calls for characterising the products that compete, the firms that might offer competition, and the relative shares and strategic importance of those firms with respect to the product markets. An important factor is the likelihood of new entry and the existence of effective barriers to new entry. Most systems apply some form of market share test, either to guide further investigation or as a presumption about legality. Mergers in unusually concentrated markets, or that create firms with unusually high market shares, are thought more likely to affect competition. And most systems specify procedures for pre-notification to enforcement authorities in advance of larger, more important transactions, and special processes for expedited investigation, so problems can be identified and resolved before the restructuring is actually undertaken.

### *2.1. Horizontal agreements: rules to prevent anti-competition co-ordination, including that fostered by regulation*

The absolute monopolistic practices that are subject to *per se* prohibition include four kinds of hard-core horizontal agreements among competing agents: price fixing, output restriction, market division, and bid rigging. The statute indicates some particular kinds of conduct along with the general categories. For example, the price fixing clause prohibits information exchanges with the purpose or effect of fixing or manipulating price; the output restriction clause prohibits commitments relating to frequency or volume; the market division clause covers both potential and actual markets; and the bid rigging clause covers agreements about participation as well as about bid levels. The listing of relative monopolistic practices includes only one specific kind of horizontal agreement, collusive boycotts, but it also includes a catch-all provision,[5] which would subject other kinds of horizontal arrangements to economically-based case-by-case treatment.

The absolute prohibition of these hard-core horizontal agreements cements one of the important reforms, the elimination of publicly sanctioned, but privately arranged, price control. Until the mid-1980s, prices for most goods and services were fixed by law, and the ostensibly regulated price level was often the result of an agreement among the members of the industry. Industries were, and are, organised into "business chambers" subject to the supervision of the Ministry of Trade and Industrial Promotion (SECOFI). As in other countries with corporatist traditions, semi-official industry trade bodies have been a common source of competition policy concerns. The laws providing for these business chambers were recently revised to limit their powers of exclusion, by making membership voluntary rather than compulsory, and to discourage their temptation to collusion. The old structure provided a convenient forum for reaching and enforcing agreements about regulated prices. Nearly all prices are now decontrolled, although SECOFI retains authority over the few that are not.

Much of the CFC's enforcement work, especially at first, has been directed at rooting out the old habits that this system of business chambers and price controls had supported. The CFC has fined a number of industry associations that fixed their members' prices.[6] In March 1995, the CFC fined the National Road Transport Chamber for horizontal price fixing. The chamber had distributed a reference price guide for negotiations between users and motor carriers. Despite the formal deregulation of this industry between 1989 and 1993, the guide specifically established the aim of setting minimum prices. The March 1998 LFCE Regulation announces that a price fixing violation will be presumed where a trade association communicates an instruction or recommendation and competitors set prices that are identical or, in the case of tradable goods or services, that are higher than world market prices (adjusted for trading costs).

Use of *per se* prohibitions balances the policy criterion of strict economic efficiency with an administrative criterion of enforcement efficiency. There may be some instances where *per se* rules condemn practices that have no anti-competitive effect in the particular circumstances. If many sellers face a single buyer and the price is inefficiently low because of the buyer's market power, permitting the sellers to act together might in theory improve efficiency, for example. To preserve simple rules, though, the law does not permit sellers to do this. Any problem of buyer market power has to be addressed directly, and not by permitting sellers to collude. Agreements between competitors with a small total market share are unlikely to harm competition, but these too are nonetheless subject to the law. Theory suggests that price fixing agreements between firms with small market shares would be uncommon, because those firms lack the market power that would make those agreements effective. But experience shows that small firms nonetheless collude enthusiastically, perhaps showing that in small markets they may indeed have at least short-term market power when they act together. In addition, small firms may not know what the law prohibits or may lack good legal advice. And small firms may be tempted to act together in response to new economic conditions and uncertainties. In any event, the CFC has brought exemplary enforcement actions against small firms. This runs some risk of alienating potential allies in small business. On the other hand, collusion among small businesses may also have a directly observable effect on another important constituency, consumers. Smaller firms may co-ordinate some activities without violating the law by joining together in "integrating companies." This is a program, managed also by SECOFI, to assist small and medium sized firms to take advantage of scale economies and purchasing efficiencies. The CFC has determined that price standardisation by such integrating companies would not necessarily violate the law.[7]

The ban on horizontal agreements has been applied to agreements that were evidently sanctioned by local government, although not imposed by regulation. For example, an agreement among local tortilla producers allocated areas of the market in order to prevent entry of new competitors who provided home delivery services. The CFC penalised the firms involved and issued a recommendation to the state government to prevent the municipal authorities from supporting this type of action in the future.[8] And the law has been applied to agreements concerning sales to state-owned monopolies, despite the constitution-based exemption for these monopolies themselves. Five sellers of barium oxide to Pemex, the state oil monopoly, agreed to fix sales terms and conditions in order to neutralise Pemex's bidding process. All five suppliers were fined.[9]

The *per se* prohibitions have been applied in reforming sectors, notably transport, to good effect. So far, the law's no-compromise approach has not led to legislation providing for less-competitive exemptions or other arrangements, at least at the national level. Although a *per se* rule can be a temptation to run up a large number of relatively trivial cases against small firms that cannot defend themselves, not all small firm cases are trivial, and there is much to be said for clarity in the law. On balance, the law about horizontal agreements is excellent.

### *2.2. Vertical agreements: rules to prevent anti-competitive arrangements in supply and distribution, including those fostered by regulation*

All kinds of vertical agreements are treated as relative monopolistic practices. The LFCE specifically identifies market division, resale price maintenance, tied sales, and exclusive dealing. The March 1998 LFCE Regulations also specify exclusive dealing in exchange for special discounts. Other types of vertical agreements may be reached under the catch-all provision. Relative monopolistic practices are illegal only if they demonstrably harm competition in the particular case; that is, the practices must unduly displace other agents from the market, substantially limit their access, or establish exclusive advantages in favour of certain persons. And the responsible party must have substantial market power in the relevant market. Parties may offer a defence on the grounds of efficiency, for which the burden of proof lies upon the presumed responsible party.[10] Unlike in most other OECD countries, there is no *per se* prohibition against resale price maintenance.

Treating all vertical agreements as relative practices, subject to case-by-case analysis, reflects the law's thoroughgoing economic basis. The main criterion is substantial market power, so vertical agreements are allowed if the producers or distributors involved face sufficient horizontal competition. The same result has been reached in practice in many other jurisdictions even under laws that do not draw such an explicit distinction. One benefit the CFC sees in this rule, which presumes efficiency and requires a market-power showing before finding a violation, over a rule that presumes violation but then permits exemptions based on efficiency, is that it imposes less of a regulatory burden, both on parties and on the agency involved. To be sure, "prohibitive" rules such as those of the EU give the administrator more power to intervene, but they also increase the enforcement workload and lead to complex, difficult regulatory distinctions.

Enforcement concerning vertical agreements seems to have had little to do with regulatory or privatisation situations or issues. The CFC finds no indication that anti-competitive agreements in supply or distribution have been required or encouraged by existing or previous regulations. In any event, the LFCE fully applies to regulated sectors and even to conduct of legally protected monopolists that falls outside the scope of their protection. One of the CFC's early decisions required Pemex to change its practices about dealing with distributors in order to improve retail-level competition. And some actions have been taken under the LFCE to ensure that the pro-competitive intentions of market opening have not been defeated by private exclusive dealing or market division agreements.

The approach to relative practices thoroughly embodies the CFC's economic approach. Mexico's treatment of vertical price controls is an interesting contrast to the practices of other Member countries, which usually apply something akin to a *per se* prohibition.

### *2.3. Abuse of dominance: rules to prevent or remedy market power, especially arising from reform-related restructuring*

Monopoly is prohibited, both by the LFCE and by the Constitution, but there is no separate section of the law about monopolisation or abuse of dominance. Rather, single-firm practices that may be defined as abuse of dominance or monopolisation in other countries are treated as relative monopolistic practices under Mexico's law. Some of these practices are specified in Article 10 of the law and Article 7 of the LFCE Regulations: refusal to deal, boycott, predatory pricing, price and other forms of discrimination, cross-subsidisation, and raising rivals' costs. Other practices could be reached by the catch-all provision, if done by firms with market power and if there were an adverse effect on competition. The Regulations clarify the criteria applied for defining the relevant market and for determining the existence of market power. The same legal predicate for LFCE liability, of showing market power, is applied in other, sectoral regulatory programs, thus providing a critical link between competition policy and regulatory policy.

The LFCE does not address abusive (high) pricing.[11] Violation is defined in terms of exclusionary practices at the expense of competitors, and not in terms of exploitative practices at the expense of consumers. The idea behind this approach is that if a firm exploits its market power by charging supra-competitive prices to consumers, that conduct will normally invite new competitors to enter, and it is thus self-correcting. Only if the dominant firm tries to maintain or enhance its dominance by engaging in a monopolistic practice—that is, excluding competitors—will the CFC step in.

Restructuring a monopolised network industry is not within the law's powers, because the Constitutional prohibition of monopoly as such is not implemented in the LFCE. Sector-specific laws and privatisation programs deal with this issue. Some of the early privatisations, notably in telecommunications, paid too little attention to the need for restructuring, with the result that the newly private industry was born as an inadequately regulated monopoly. More recently, though, CFC advice has been sought in these processes, which are discussed further below. Problems of network access, where the concern is discrimination or cross-subsidisation that harms competition in complementary markets, might in principle be reachable under the LFCE. But the usual approach has been for the sectoral legislation or regulation to set out rules governing access, rather than to apply the LFCE's general principles and procedures.

Similarly, because monopolistic pricing is something the LFCE does not remedy, other agencies apply sector-specific regulations to control abusive pricing by dominant firms. A necessary precondition for this price regulation is the existence of market power. Laws about railroads, airlines, natural gas and telecommunications include this market power standard. The CFC is responsible for assessing and identifying market power in those sectors. If the CFC finds there is market power, that finding becomes the basis for price controls imposed by the sectoral regulator.

The LFCE has been applied to other practices involving dominant firms in protected, privatised, or deregulated industries. In 1995, for example, the CFC took action against price discrimination by a subsidiary of Pemex, even though Pemex still has a constitutionally-based monopoly over crude petroleum and certain basic petrochemicals. This protection no longer extends to many intermediate petrochemicals, though. Pemex illegally discriminated between two types of users of ethylene oxide, an intermediate product for which Pemex is still the only producer. And the CFC challenged one of the major domestic airlines, Aeroméxico, for vertical division of markets and refusal to deal with travel agencies that sold other airlines' tickets.

Some abuses are also subject to sector-specific regulations. For example, the 1995 Federal Telecommunications Law contains *per se* prohibitions of cross-subsidisation and discriminatory treatment. This approach is not quite the same as under the LFCE, where such practices would be analysed case-by-case to determine their actual net effect. To be sure, it may be that the sectoral agency is considering policy objectives and values other than competition policy, something which the CFC itself would not do in similar circumstances. The continuing controversies over access to telecommunications markets suggest that standards which sectoral regulators apply are not always those of an economically-based competition policy.

Although the LFCE does not address exploitation of market power, it has been applied to address predatory pricing. The LFCE Regulations define predation as sustained pricing below average total cost or occasional pricing below variable cost. Although this pricing tactic is treated as an exclusionary device, the legal standard does not include a judgement about the likelihood of post-success recoupment of losses suffered to force a competitor out. The CFC has spent considerable time and resources on a predatory pricing case. After two rounds of proceedings over several years, the CFC found that Warner Lambert dominated the chewing gum market, with a share between 65% and 73%, that it had power to control price, that its prices were persistently below average total cost, and that the victim's losses were caused by Warner Lambert's conduct. The CFC imposed a fine and injunction; the matter is now on appeal. The standard in the Regulations was developed in deciding this case.

Treating dominance solely in the context of particular practices incorporates a lesson from the experience of others, that using legal tools to restructure monopoly can be costly and difficult, perhaps futile. It may represent a judgement that, despite the economic costs of monopoly, the costs of breaking it up and of forgoing some of its possible productive efficiencies are likely to be greater. Unfortunately, that means the law has few tools for dealing with structurally dominant firms that were inherited from before. The CFC can take action if they do something exclusionary, but it may not be easy to make those cases, because fear of commercial retaliation may inhibit customers and would-be competitors from complaining.

The lack of a means for dealing with monopolistic structure except in the context of privatisation means the law must tolerate conditions contrary to its purpose of eliminating monopolies. Of course, the cost of the remedy might be so high that toleration actually is, in some sense, efficient. But if no structural remedy is adopted, it is necessary to ensure that highly concentrated industries face real competition through other means. The principal source would be international trade. Yet some highly concentrated industries are protected by anti-dumping duties or other constraints against significant imports. A feasible, and perhaps even more effective, alternative to breaking up companies would be preventing or undoing anti-competitive trade arrangements, including both private agreements limiting competitive entry and official acts with the same effect.

### 2.4. *Mergers: rules to prevent competition problems arising from corporate restructuring, including responses to regulatory change*

Mergers whose objective or effect is to reduce, distort or hinder competition are prohibited. The CFC considers factors such as whether the merging parties would obtain the power to fix prices unilaterally or to substantially restrict competitors' access to the market, and whether actual or potential competitors likely would inhibit such power. The LFCE Regulations now provide for an explicit efficiency defence, assigning the burden of proof to the merging parties. The firms' financial conditions and prospects may also be taken into account in the evaluation of harm to competition, although there is no explicit "failing firm" defence. The Regulations also clarify the criteria applied for defining the relevant market and for determining the existence of market power.

Merger activity has increased in Mexico recently, as it has around the world. In its first (partial) year of operation, the CFC concluded 34 merger reviews; in the second year, that number nearly tripled to 89, and it has grown steadily until in 1997 it reached 218 and represented 46% of all cases. Few mergers have been challenged. In 1997, the CFC objected to only two, and imposed conditions on three others. A significant proportion of CFC cases—32% in 1997—has involved reviews of participants in privatisations and public auctions for licenses and concessions. These cases require an analysis similar to that of mergers.

Most mergers are occurring in industries that are restructuring or consolidating either because of trade liberalisation and deregulation or because of financial crisis. Commercial banking, for example, has undergone substantial restructuring. First, privatisation encouraged new entry, domestic and foreign, but then the peso crisis of the mid-1990s required many mergers and acquisitions. The CFC has not blocked any mergers in the banking sector. The relevant product market has typically been found to be the whole range of banking and credit services provided by commercial banking institutions, and the geographic market has been found to be national, on the grounds that there are no legal impediments to branching throughout the country and the major banks have national coverage. These conclusions have led the CFC to find smaller structural changes and less risk of anti-competitive effect. A 1993 merger (after privatisation, but before the major financial crisis struck) between two privatised, second-tier banks was one of the first mergers that the CFC reviewed. The CFC has reviewed several post-crisis acquisitions by foreign banks, which have increased their market share from 1.4% in 1994 to 15.6% in 1996. Because the acquirers brought needed financial strength and competition against the traditionally dominant position of the Big Three national banks, these transactions did not raise the commonly asserted trade-off between the protection of competition and the protection of stability.

Substantive criteria for merger analysis appear in a regulation issued in July 1998.[12] The regulation sets out structural criteria, which are applied in the context of general principles for defining markets and identifying barriers to entry in Part III of the March 1998 LFCE Regulations. The July 1998 regulation is one response to a concern, expressed by some in the business community, that the CFC's standards for deciding about mergers were not transparent or comprehensible. One structural criterion is based on the Herfindahl index (HHI), that is, the sum of the squared market shares of all the firms in the market. The regulation sets out a "safe harbour" for combinations that raise the HHI by less than 75 points, or that result in an HHI below 2 000. In addition, the regulation applies criteria based on an index of dominance. This is similar to, and derived from, the HHI: it is the sum of the squares of each firm's share of the HHI. Two additional safe-harbour rules follow: a transaction is considered unlikely to affect competition adversely if it does not increase the index of dominance, or if that index's resulting value is less than 2 500. These concentration-based indicators are not determinative. The CFC will also examine other factors that are relevant to determining whether letting the firms merge would lead to substantial market power, that is, to the power to control prices or substantially restrict competitors' access to the market.

Premerger notification obligations are indexed to the minimum general wage (fixed at 30.20 pesos in 1997). One basic threshold is 12 million times that reference. Notification is required if a transaction exceeds that level, or if it results in holding more than 35% of the shares or assets of a firm with sales or assets over that level. Notification is also required if the parties' assets or annual sales total more than 48 million times the index and the transaction involves an additional accumulation of assets or shares over 4.8 million times the index. Mergers outside Mexico must in principle be notified to the CFC if they produce effects within the country; however, the LFCE Regulations exempt from notification mergers between foreign firms that do not imply additional control over a firm located in Mexico. All notified transactions are subject to inquiry, which is subject to strict deadlines. So far, the CFC has generally been able to resolve cases in less than 100 days; the average is about 35 days.[13] Sanctions for failure to notify may include a fine, up to 100 000 times the index. The CFC may contest a merger that does not need to be notified, but only if it does so within a year after the transaction.

At least as important as the merger review process, at least so far, has been the closely-related responsibility to review privatisation proposals and procedures. Procedures for reviewing participants in privatisations and auctions for licenses and concessions differ from those for mergers, and indeed may vary with particular proposals or programs. There are no thresholds and deadlines may depend on specific auction rules. The CFC performs these functions pursuant to an administrative directive of the Inter-Ministerial Divestiture Committee and powers granted by a number of particular statutes and regulations. These typically require that potential participants not be blocked by the CFC. In general, in its analysis the CFC applies criteria that are highly similar to those of merger reviews. Of the 154 reviews concluded in 1997, the CFC objected to two and imposed conditions on another. The CFC prohibited two firms from bidding for rural grain storage facilities. One of these firms, a maritime transport company, had already obtained one of the three regions of the privatised national railroad system. The acquisition of the storage facilities would give it too much strategic control over the transport and storage of national and imported grain.

Remedies for mergers with anti-competitive aspects are either corrective or preventive. Few mergers have been blocked. A combination of two sugar refineries was rejected because corrective remedies would probably be unsuccessful, and the CFC opposed a merger of two packaged meat companies whose combined share of national supermarket sales for some products would have been nearly 60% (and which would have controlled the national refrigerated distribution network). Preventive remedies consist of obligations such as to notify about future mergers, antidumping complaints, or applications for exclusive permits. Remedies like these were imposed on transactions involving sugar refineries, petrochemical firms and natural gas distributors. Contractual remedies may require the elimination of exclusivity clauses or the commitment to facilitate competitors' entry, prevent discrimination, or guarantee the commercial independence of the companies involved in the merger. Measures of this kind were used in mergers in the textile and metal industries and in radio and TV broadcasting, among others. Finally, structural remedies require the divestiture of assets. Such remedies were imposed in the Kimberly Clark-Crisoba merger.[14]

Several notable merger-related decisions have involved privatised and deregulated industries. CFC investigation and informal communication of concerns evidently halted a proposed reconfiguration in the telecommunications and television industries. The proposed transaction would have given Telmex, the historic national telephone monopoly, control over a major group of cable TV firms, while the broadcast company, Televisa, would maintain control over a number of applicants for UHF and MMDS concessions. The CFC and others were concerned about the evolution of subscription TV and basic local telephone markets, particularly in the Mexico City metropolitan area. The measures that the CFC indicated would have been necessary to eliminate the threats to competition could have substantially altered the parties' plans, and they decided to withdraw before the investigation was concluded.

In airlines, a complex and difficult structural matter has been underway for several years. Airline deregulation had already begun to lead to new entry, increased services, and greater price competition, when financial reverses stalled the process. CFC has countenanced the combination of the two major domestic air carriers, Aeroméxico and Mexicana, into a holding company, whose acronym is CINTRA. Before the competition law was adopted, Aeroméxico had acquired control over Mexicana, with the authorisation of the Ministry of Communications and Transport (SCT). A condition of that authorisation was that the combination would be subject to the new competition law when it became effective. The airlines' deteriorating economic and financial situation led to their being taken over by creditor banks. CINTRA was incorporated at the banks' initiative, to be a holding company charged with improving the airlines' financial situation. Since then, shifts in bank capitalisation and ownership have led to the government holding a controlling interest in CINTRA.

The holding company arrangement is clearly unattractive from a competition policy perspective. It may have been thought inevitable, both because of support from the banks and the other ministry and because limitations on foreign investment in this sector meant there were few if any realistic alternative purchasers, so that blocking the combination would not have improved the situation. In any event, the CFC's acceptance of the holding company was subject to conditions that were intended to maintain competition between the two airlines: separate accounts, independent management, and performance monitoring and periodic reporting on market conditions by a consultant appointed by the CFC. Such conditions are difficult to apply effectively and are obviously a second-best substitute for clear structural separation. If the CFC finds there is no competition, then the SCT may set fares, and if the CFC finds unlawful practices, the parties must suspend them or take corrective action. The CFC may order that the combination be dissolved if there is substantial damage to competition.[15] Despite these safeguards, there are doubts about the vigour of the airlines' continued competition. Board memberships at first were identical; CFC intervention reduced that some, but did not eliminate board overlaps completely, and managerial relationships too have not been kept distinct. The CFC has been investigating whether fare levels show the exercise of market power in some city-pair markets, calling for remedial action. This situation is a major test of the effectiveness of Mexico's competition policy and institutions.

The law about structural combinations is generally complete and modern, but in one respect more clarity might be useful. A party's financial weakness may count in the assessment of likely competitive effects, but beyond that there are no principles describing how it is to count, and what presumptions, if any, are applied. This leaves a great deal of room for non-transparent discretion. Some transactions, in banking and the CINTRA combination in particular, have probably been motivated by concerns about disposing of assets in virtual bankruptcy. The CFC's reported decisions note that motivation and the concern that failure would diminish competition, but the reports are conclusory. The factual basis underlying that reasoning should be made clearer.

### *2.5. Competitor protection: relationship to rules of "unfair competition"*

The law treats unfair competition in a way that is consistent with its economic motivation. The law's provisions about relative monopolistic practices address actions that harm competitors, rather than those that affect consumers directly. Thus, they have the appearance of measures aimed at unfair competitive practices. But the underlying purpose of the law is efficiency, and the CFC specifically rejects the idea that it should be based on fairness. As a consequence, some practices that are often considered "unfair competition" are not addressed. Sales below cost is now included in the LFCE Regulations' list of relative monopolistic practices, but it is evaluated under predatory pricing standards and subject to a market power test.

The CFC has received complaints about alleged abuse of economic dependence. The LFCE's market power standard means it deals with such complaints about vertical contract relationships if horizontal competition is impaired.

### *2.6. Consumer protection: consistency with competition law and policy*

Despite the mutual support they might offer each other, in the Mexican legal system the competition and consumer protection laws are enforced separately by two different agencies. The Federal Consumer Protection Law is enforced by the Federal Prosecutor for Consumers. This office is located in the same ministry, SECOFI, where the CFC is assigned for administrative purposes. The consumer law's stated objectives are to promote and protect consumer rights and to procure equity and legal security in relationships between suppliers and consumers. That office also enforces the remaining price controls and the rules about weights and measures. The CFC finds there are relatively few overlaps between that conception of consumer policy and the issues that arise under competition policy, and consequently there is little communication between the two agencies.

On one occasion, the CFC was asked for an opinion on a proposed regulation of comparative advertising. The CFC responded based on the likely effects on competition, and advised that comparative advertising is unlikely to adversely affect the competitive process, although problems might arise related to intellectual property rights or to the quality of information given to consumers. Thus, the CFC recommended that any consumer regulation about this issue not be concerned about relations between competitors, but rather should concentrate on relations between suppliers and consumers. The Prosecutor for Consumers evidently followed this advice, since it did not proceed with the proposed change in this regulation.

The CFC has had no program to explain the benefits of competition and competition law enforcement to consumers, although a division devoted to public outreach has just been established. It would have to undertake such an effort on its own, for there is no significant national consumer organisation to work with. In light of the potential complementarity of their purposes and the relationship of the responsible agencies to the same ministry, the lack of more formal co-ordination between consumer and competition policies in SECOFI is surprising. Contacts now appear limited to exchanging information about cases that might affect each others' jurisdiction. The SECOFI consumer office issues a consumer-oriented magazine that might be a vehicle for telling consumers about how they benefit from preventing anti-competitive conduct.

## 3. INSTITUTIONAL TOOLS: ENFORCEMENT IN SUPPORT OF REGULATORY REFORM

Reform of economic regulation could fail if vigorous action is not taken to prevent abuses in developing markets. The CFC has an adequate set of substantive tools; the next question to examine is whether they are effectively employed.

### *3.1. Competition policy institutions*

The CFC, which has sole responsibility to apply the LFCE, is a separate entity attached to SECOFI. The CFC decisions are made by majority vote of the plenum of five commissioners. The CFC president chairs the plenum meetings, co-ordinates the CFC's work, issues its annual report, represents the CFC publicly, and can appoint and remove personnel. The Executive Secretary, appointed by the CFC president, is responsible for operational and administrative co-ordination, and for legally certifying undertakings such as plenary sessions. The CFC's work is done by general directorates for legal affairs, economic studies, concentrations, investigations, privatisation, regional operations, international issues, administration, and public information. The CFC's principal formal ties to other regulatory authorities are through its participation in inter-ministerial committees, generally as an observer, where it advises about design of regulations and privatisation strategies. Competition policy issues related to regulation are also considered by the Economic Deregulation Unit in SECOFI, described in Chapter 2. The EDU participated in drafting the LFCE, and continues to participate in review of regulations and proposals, including those of the CFC.

Decisional independence is protected by the terms of the commissioners' tenure. The CFC's president and the other four commissioners are appointed by the president of Mexico for staggered ten year terms, and are removable only for cause. The CFC commissioners are thus insulated from the usual practice of virtually complete personnel turnover after presidential elections every six years. In contrast to some sectoral agencies, the basis for the CFC's independence is in the law, not a lower-level normative act, and the commissioners are appointed by the president, not by ministers. They are still exposed to political pressure and other persuasion, but their tenure protects them somewhat from consequences of decisions that conflict with other ministries' designs. Officials at the highest levels have tried to lobby CFC commissioners. The CFC's official position in response is that it has to act on its own. Although connected administratively to SECOFI, the CFC is technically and operationally autonomous and thus is not responsible to the Minister for its decisions. This formal independence is important. The finance ministry and the Congress are responsible for the CFC's budget and so maintain a means of indirect control over policy.

Some have criticised the CFC for lack of transparency in its decision criteria. So far, the principal means of explaining its decisions has been its annual report, which includes summaries of the most illustrative cases. The CFC has now begun publishing its decisions and reasoning in a periodical gazette; in addition, summaries will also be published in the Official Journal of the Federation. The complete texts of the law, the regulations and annual reports, and summaries of decisions since July 1997 are available at the CFC's Internet website.[16] The CFC has also begun to announce when it is undertaking investigations, naming the industry but not the likely target. This practice has had the desired effect of attracting evidence, as well as the less desirable effect of alerting targets and encouraging them to take pre-emptive legal action.

The CFC participates in several inter-ministerial groups that are concerned with issues that affect competition policy, such as privatisation. It is not usually a voting member of those groups, though. It participates principally in order to assist in analysing competition issues and to prepare for quick issuance of opinions. Without a vote, the CFC may be perceived as a less important factor in these groups' deliberations. Of course, the CFC exercises significant power in the ensuing processes, by determining whether firms can participate. The CFC's relations with other regulators have sometimes been difficult. Not only is the CFC's jurisdiction under the LFCE very broad, but also several sector-specific laws give the CFC authority over important issues in other ministries' or agencies' jurisdiction. The LFCE and sector-specific laws may lead to different results. Some competition-related sectoral rules are more stringent than the generally applied competition policy, for example. And in some sectors, notably telecommunications, there have been disagreements about the design of competition-related regulations and remedies.

### *3.2. Competition law enforcement*

The LFCE is a prohibition-based law, implemented through *ex post* law-enforcement, rather than an administered one based on reviewing applications for permission or exemption. The high level of economic content may makes its application appear discretionary, though. The CFC may begin a law enforcement or other matter either in response to a complaint or on its own initiative.[17] Increasingly, the CFC is treating complaint-based matters as *ex officio* ones. The CFC's information-gathering powers are the same regardless of the matter's origin or object. Remedial powers are substantial. The CFC may impose fines or order the suspension or correction of the forbidden practice. This includes the power to dismantle illegal mergers.

The LFCE and the CFC's Regulations set out a procedure which gives parties a chance to make a formal response to the case and order against them. Further appeals to the courts can take two forms. A party who claims that a legally protected interest has been infringed by CFC action may resort to the *amparo* action before a Federal District Court, to challenge the legality or constitutionality of the CFC's decisions.[18] Parties have often availed themselves of this constitutionally-granted process right, and the result has been to delay CFC proceedings. Not only do parties challenge final CFC decisions, but they also take the CFC to court to dispute preliminary and intermediate actions. Once the *amparo* is initiated, the judge can enjoin the administrative proceeding pending the judicial decision. Until its comprehensive regulation appeared in March 1998 explaining how the law was being interpreted and applied, many *amparo* suits complained (generally unsuccessfully) that the LFCE was unconstitutionally vague. In addition to the *amparo* challenge, it is possible to challenge fines by appeal to an administrative court, the Federal Tax Appeal Tribunal.[19] The CFC believes its success rate in both *amparo* suits and administrative appeals has generally been good, at least on important substantive issues.

Clear deadlines and time targets control CFC proceedings. Some deadlines are in the LFCE, and others are set by the Regulations. For ordinary law enforcement matters, the CFC has committed to reaching a final decision within about 90 to 150 days after receiving a complaint. Merger matters are to be concluded within 90 days, although that time can be extended in exceptional cases. If a party petitions for reconsideration (within 30 days after a CFC decision), the CFC will act on that petition within 60 days. Some observers have criticised the CFC for deciding slowly, but often the reason has been either delays due to *amparo* appeals or punctilious observation of necessary procedures to reduce the risk of losing such appeals.

Box 3. **Enforcement powers**

**Does the agency have the power to take investigative action on its own initiative?** The CFC, like most Member country agencies (19), has power to issue prohibitory orders on its own initiative. In one-quarter of the countries, even such "cease and desist" orders can only be issued by a court or separate decision-maker. About half of Member country agencies, including Mexico's, can impose financial penalties directly. Mexico's CFC also has the power to issue mandatory orders, such as divestiture.

**Does the agency publish its decisions and the reasons for them?** Virtually all Member country enforcement agencies publish their decisions and reasoning in some form. Where agencies do not do so themselves, effective decisions are made by courts that do. The CFC has now begun to publish summaries of its actions regularly, without waiting to collect them in an annual report.

**Are the agency's decisions subject to substantive review and correction by a court?** All Member country competition agencies must defend their actions in court if necessary.

**Can private parties also bring their own suits about competition issues?** Some kind of privately initiated suit about competition issues is possible in nearly all jurisdictions. In a majority of countries, agencies explain the reasons why they do not take action in a particular case, and a party who is disappointed by the competition agency's inaction can challenge the agency in court. In Mexico, the right of private suit is limited to a follow-on proceeding to collect damages.

### *3.3. Other enforcement methods*

The CFC and its processes control application of the LFCE. There is no other source of substantive law about competition policy issues, either at the state or federal level. Rights of private action are limited to a claim for damages, after the CFC has found a violation. This avenue has not yet been used. When it is, the court is likely to ask the CFC its views about the appropriate amount of damages.

Proceedings before the CFC may be started by the CFC itself, acting on its own initiative, or in response to complaint from a private party. Complaints about absolute monopolistic practices can be filed by any person. Complaints about relative monopolistic practices and mergers should be filed by the affected party. Provided that the complaint meets the conditions for standing set out in the LFCE and the Regulations, the CFC must deal with the case; it does not have the discretion to reject it without reaching some decision. A disappointed complainant may have some recourse to the courts to correct an alleged error, through the *amparo* process.

### *3.4. International trade issues in competition policy and enforcement*

Mexican competition policy is one element of a program that began with major steps toward market openness. Thus, is it unsurprising that the CFC and the decisions under the LFCE attend to this substantive dimension, in defining relevant geographic markets and determining the existence of market power. Analysis of market conditions in Mexico must take into account increased competition from abroad since import liberalisation began in the mid-1980s. And actual or potential new entry made possible by less restrictive foreign investment rules can make a difference in assessing market power. Still, in many cases the CFC defines markets as national, because of market and demand characteristics. But it does take into account the effect that imports and foreign investment may have on the market power of firms operating in Mexico.

Three types of practices related to international markets affect domestic competition, and thus are of concern for the CFC. First, import liberalisation in Mexico may be impaired by private barriers to trade raised by domestic firms with market power. Those firms could hinder the entry of foreign goods, for instance, by pre-empting access to essential distribution channels. The CFC can take action when the responsible parties are established in Mexico. For example, in 1995 the CFC fined two producers of domestic appliances, with a combined Mexican market share over 80%, for colluding to grant discounts to retailers who promised not to sell appliances produced outside the NAFTA area. Second, anti-competitive practices abroad may have adverse, cross-border effects on competition in a Mexican market. The most common case is a foreign export cartel that is permitted in the country of origin. Third, mergers abroad may also affect competition in Mexico, for example, because one or more of the merging parties have subsidiaries or important sales in Mexico. In these last two cases, the CFC’s possible responses are limited, for although it has legal power to address the substantive issues, it is not empowered to investigate or impose (and collect) fines on firms located abroad. Of course, the CFC’s power to act in Mexico can encourage parties to co-operate with its processes, even where that cannot be compelled. For addressing these kinds of issues effectively, co-operation with the competition authorities of the country where the practice takes place seems essential.

Competition policy also is concerned about the analysis of allegedly unfair practices in international trade. Mexico implemented an antidumping and countervailing duty mechanism after it adhered to the GATT in 1986. This subject is now governed by the 1993 Foreign Trade Law and its Regulations, which are applied by another part of SECOFI, the Unfair Trade Practices Unit (UPCI). The CFC is concerned that enforcement of unfair trade laws against imports may in practice distort competition in domestic markets. Antidumping duties imposed by the UPCI have protected national producers with a dominant position in the domestic market. In other cases the duties simply delay an effective market clearing process by protecting inefficient domestic firms. This problem is not limited to Mexico, of course. Other countries’ competition authorities have found that alleged dumping practices are not inconsistent with healthy competition, typically because the exporter lacks power to monopolise a market in the country of import. The CFC follows the antidumping and countervailing duty decisions through participation in the inter-ministerial Foreign Trade Commission, which must approve UPCI resolutions. The CFC cannot block the UPCI’s resolutions, because it has no veto power, but on several occasions it has ventilated its concerns about the effects of antidumping and countervailing duties on domestic competition.

Procedures for responding to complaints about anti-competitive behaviour under the LFCE make no distinction between foreign or national firms. Hence, both have the same right to file complaints. Of course, asserting jurisdiction over practices abroad is often difficult. Mexico has no formal co-operation agreements with other countries about competition policy. The CFC follows the general co-operation principles established in NAFTA and in other trade agreements, as well as co-operation principles promoted within the framework of international organisations, particularly the OECD. It has used these channels to notify, or receive notification, about possible problems on a few occasions. The CFC believes it has ample, informal communication on technical issues, with agencies in other countries, especially those of the NAFTA partners.

Box 4. **International co-operation agreements**

Eight Member countries have entered one or more formal agreements to co-operate in competition enforcement matters: Australia, Canada, Czech Republic, Hungary, Korea, New Zealand, Poland, and the US. And the EC has done so as well.

### *3.5. Agency resources, actions, and implied priorities*

Commitment to effective enforcement, as measured by resources employed, has been reasonably stable. In terms of personnel, CFC staffing has held steady for several years, at about 165 employees. In terms of budget, though, the picture is different: it fell about 30% (in real terms) between 1994 and 1997. This drop reflects budget and economic troubles that have hit Mexico since the 1995 financial crisis. For 1998, the budget for personnel has been increased significantly, despite a budget total that is about the same as in 1996. The budget stringency may be impeding work, to some extent, as the total budget per employee for 1997 was only about half what it was in 1994.

Among the five commissioners, there are three economists and two lawyers. In the CFC as a whole, there are about 30 economists, 30 lawyers, and 50 officials with other professional backgrounds. About 20 staff are occupied with regulatory issues: opinions about new regulations, trade policy, and other government programs. Investigation and prosecution of anti-competitive actions takes about another 35 staff from the directorates of Investigations and Legal Affairs. And about 25 staff from the Concentrations and Privatisation directorates are involved in merger and privatisation reviews. Directorates often collaborate and support each other. A high priority, in terms of staff time, has been given to regulatory and related issues.

Many complaints were submitted during the first year of the CFC's operation, probably due to the expectations generated by the enactment of the law. The high rate at which those early complaints were dismissed—90%—is probably explained by the complainants' lack of knowledge and experience. That rate has declined, as complainants have been receiving better advice about what the law can and cannot do. Some cases dismissed for procedural shortcomings were nonetheless pursued *ex officio*. During the first years, actions against anti-competitive conduct relied largely on *ex officio* investigations, and concentrated on three aspects: recently deregulated sectors afflicted with anti-competitive inertia, economic activities shielded by administrative barriers to entry, and concentrated markets characterised by exchange of information between competitors.[20] Activity picked up markedly in the next years, for several reasons. The business community became increasingly aware of the law and CFC's functions. Many more mergers and acquisitions were filed. And the CFC became involved in decisions about privatisation of state companies, issuance of public permits and concessions, and granting rights concerning ports, telecommunications and natural gas distribution.[21]

The latest case data shows the CFC's emphasis on *ex officio* proceedings and the high proportion of matters that conclude with no finding of violation. In 1997, the CFC handled 60 proceedings against conduct-based problems. Of these, most (35) were *ex officio* investigations, and 25 were private complaints. Of the 52 cases that were concluded, one-quarter (13) resulted in penalties or recommendations. The rest were either withdrawn or summarily dismissed, or no violation was found. In 1997, the CFC also examined 212 mergers and acquisitions, most of them the result of pre-merger notifications (22 were *ex officio* investigations, and one originated as a complaint). The CFC concluded 219 merger cases, approving 192, requiring conditions for 20, and blocking two (five were dismissed or withdrawn by the parties).[22]

Table 1. **CFC enforcement activity**

| | **Horizontal agreements** | **Vertical agreements** | **Mergers*** | **Interstate trade barriers** |
|---|---|---|---|---|
| 1997: investigations or matters opened | 8 | 45 | 351 | 7 |
| • Sanctions or orders sought | 7 | 2 | 8 | 3** |
| • Orders or pecuniary sanctions imposed | 6 | 1 | 17 | _ |
| • Total pecuniary sanctions imposed (pesos) | 911 156 | 2 209 675 | 1 492 312 | _ |
| 1996: investigations or matters opened | 9 | 17 | 236 | 3 |
| • Sanctions or orders sought | 4 | 2 | 11 | 4** |
| • Orders or pecuniary sanctions imposed | 4 | 2 | 10 | _ |
| • Total pecuniary sanctions imposed (pesos) | 38 053 | 39 946 | 360 005 | _ |
| 1995: investigations or matters opened | 14 | 19 | 149 | 1 |
| • Sanctions or orders sought | 3 | 5 | 13 | 0** |
| • Orders or pecuniary sanctions imposed | 3 | 0 | 4 | _ |
| • Total pecuniary sanctions imposed (pesos) | 276 682 | 27 450 | 354 000 | _ |
| 1994: investigations or matters opened | 30*** | | 94 | |
| • Sanctions or orders sought | 5*** | | 2 | |
| • Orders or pecuniary sanctions imposed | 2*** | | 2 | |
| • Total pecuniary sanctions imposed (pesos) | 139 705*** | | 1 556 726 | |
| 1993: investigations or matters opened | 32*** | | 63 | |
| • Sanctions or orders sought | 0*** | | 2 | |
| • Orders or pecuniary sanctions imposed | 0*** | | 1 | |
| • Total pecuniary sanctions imposed (pesos) | 0*** | | 512 000 | |

* Includes privatisations, licenses, and permits.
** Recommendations to the corresponding authorities.
*** Horizontal and vertical combined.
*Source:* CFC.

 

Although the CFC has not adopted explicit enforcement priorities, it has paid special attention to official barriers to interstate trade imposed by state governments. In recent years, the CFC has taken action against barriers imposed by several state governments on interstate trade in flowers, eggs and fresh meat, among others. And in recently deregulated sectors, the CFC has taken actions against price fixing in transport and against consolidation in telecommunications.

## 4. THE LIMITS OF COMPETITION POLICY FOR REGULATORY REFORM

### *4.1. Economy-wide exemptions or special treatments*

There are few exceptions from the LFCE. Some of the activities excluded are like those excluded in most countries: legally constituted labour associations, copyright and patent holders, and export trade associations (of small producers). Another important set of exemptions applies to the "strategic sectors" identified in Article 28 of the Mexican Constitution, which are not considered monopolies although the LFCE does apply if they engage in monopolistic practices.

Technically, authorisation by a federal or state government official does not excuse private conduct that violates the LFCE. Practically, the CFC recommends that other authorities not encourage or issue rules or orders that put parties in that position. The CFC rejects the claimed excuse as a matter of principle, but it may lead to a reduction in the penalty. The party who has to pay for the LFCE violation might complain against the other agency for giving bad advice or instructions. No court has faced and decided this issue, though.

Public enterprises are not exempt as such. The state, its agencies, and its companies as economic agents are subject to the LFCE. State-owned enterprises involved in the strategic areas established in the Constitution are subject to the law with respect to monopolistic practices that are not specifically within the strategic sectors. Pemex has been subject to several actions for practices outside the sector where it enjoys constitutional protection. Government entities whose conduct restricts competition may get an admonition, rather than an order or a fine, where they are not participating in conduct as economic agents and the CFC thus does not have jurisdiction over them. For example, an action against a collusive boycott in notarisation services concluded with economic sanctions against the private parties involved and a recommendation to the public official whose action formed the basis for the boycott effort.[23]

One important area of enforcement against public bodies is aimed at state government action that restricts trade between the states. The LFCE[24] implements the Constitution's prohibition against such action by holding that "acts performed by state authorities with direct or indirect objectives to prevent the entry or exit of goods or services from state territories, of domestic or foreign origin, shall have no legal force or effect." In theory, then, after the CFC makes such a ruling, private parties could ignore the local officials' acts with impunity. Restrictions on interstate trade are nevertheless pervasive. Many of them pre-date the LFCE and the effective enforcement of the constitutional ban. The CFC lacks the power to punish a local government or to issue a mandatory order constraining its conduct. Thus, the CFC's usual action about a government entity's restraint is a recommendation; if the local government does not take action itself to remove it, that is followed by a declaration that the restraint is legally void.

Small and medium sized firms receive no special treatment under the LFCE, other than what would follow from economic principle. There is no *de minimis* rule, and hard-core horizontal agreements are prohibited *per se*, regardless of the size of the firm. But there is a degree of implicit protection in the rule-of-reason approach taken for all other conduct (although substantial market power depends on firm's size relative to its market, not its absolute size).

Box 5. **Scope of competition policy**

**Is there an exemption from liability under the general competition law for conduct that is required or authorised by other government authority?** Unlike the majority of Member countries (15 out of the 27 reporting), Mexico's law does not recognise an exemption from the general competition law for conduct required by other regulation or government authority.

**Does the general competition law apply to public enterprises?** Mexico, like every Member country except Portugal and the US, applies its general competition law to public enterprises.

**Is there an exemption, in law or enforcement policy, for small and medium sized enterprises?** Four Member countries reported some kind of exemption or difference in treatment for small and medium sized enterprises: Belgium, France, Germany, and Japan.

### *4.2. Sector-specific exclusions, rules and exemptions*

The LFCE applies to all areas of economic activity, including those areas subject to specific, sectoral economic regulations. The strategic sectors reserved to the state under Article 28 of the Constitution are excluded from the law's prohibition of monopoly, but entities engaged in the exempted strategic sectors might be found to violate the law's strictures against monopolistic practices. The strategic areas now include coinage and paper money, postal service, telegraph and radiotelegraphy, petroleum and other hydrocarbons, basic petrochemicals, radioactive minerals, nuclear energy, and electricity. Recently, satellite communications and railroads were taken off the list (by constitutional amendment), in order to open up those sectors to competition And electricity sector has been partially opened up to private participation, despite its status as strategic area. Under certain circumstances, private parties may now generate electricity for their own use or for sale to the state-owned electricity monopoly.

For several regulated sectors, independent regulatory agencies have been established: telecommunications (the Federal Telecommunications Commission, or COFETEL, which is in the Ministry of Communications and Transport), electricity and natural gas (the Energy Regulatory Commission, CRE; its role in electricity is limited because that sector is still largely state-owned), insurance (the National Insurance Commission) and pension funds (the National Pension Fund System Commission). Some other sectors, such as transport and pharmaceuticals, are directly regulated by federal ministries. The financial sector is regulated by the Ministry of Finance, the National Banking and Securities Commission, and the Mexican central bank. None of these government entities have authority to apply the LFCE, nor are these sectors exempt from it.

Since 1995 several sectoral laws and regulations have included provisions to promote competition, which are applied by reference to the CFC. In addition, the CFC must appraise the prevailing conditions of competition prior to the introduction or elimination of official prices by the regulatory authorities. (The government has some power to establish price ceilings without regard to firm or industry market power. The Federal Executive determines which products are eligible, based on the statutory criteria (that they are necessary to the national economy or essential for basic needs), and SECOFI sets the ceilings after negotiation with interested parties. In the mid-80's, about 70% of all products were subject to some form of price controls, but as of 1996 that was reduced to only two products, tortillas (which were subsidised by the government) and medicines.

## 5. COMPETITION ADVOCACY FOR REGULATORY REFORM

The LFCE empowers the CFC to comment on the effects that existing laws, regulations, agreements and administrative acts may have on competition, on the effects of contemplated changes to federal programs and policies, and, upon request by the Federal Executive, on the effects on competition of new laws and regulations proposed to Congress. And the CFC has played a central role in the processes of privatisation and of awarding concessions and licenses, both in the design of the necessary law and regulations and in implementing them.

The CFC participates in inter-ministerial committees in order to inject competition policy into regulatory decisions. The CFC's role has been principally to prevent administrative measures that could produce anti-competitive effects. The committees include the Inter-ministerial Privatisation Commission, the Inter-ministerial Public Spending and Financing Commission, the Consulting Committee for the Opening of Local Telephone Services, the National Standards Commission for, and the Foreign Trade Commission. The CFC thus participates in competition-related policy making about privatisation, licensing, standards, regulation, and foreign trade.

The CFC is directly concerned with competition aspects of sector-specific regulation and in the allocation of licenses and permits, including reviewing applicants for these assets. Partly as a result of its competition advocacy, the CFC has been given this role explicitly, under the Seaport Law, the Law on Roads, Bridges and Road Transport, the Navigation Law, the Railroad Services Law, the Federal Telecommunications Law, the Civil Aviation Law and the Airport Law, and the regulations on natural gas and on pension funds.[25] The CFC has two functions under these rules. First, the CFC can determine which economic agents may participate in auctions for public enterprises, concessions, licenses and permits. Second, the CFC may determine whether effective competition exists, or whether one of the agents has substantial market power, as a condition for a sectoral regulator to impose regulation such as price caps. In that connection, the CFC may also determine that competition has been restored, because of changes in market conditions, so the regulation should be terminated.

**Telecommunications deregulation.** Liberalisation of telecommunications began in 1991 when the telephone monopoly, Telmex, was privatised. Competition though wireless telephone services began in 1993. As part of the privatisation process, Telmex retained its monopoly in long distance telephony until the end of 1996. After the privatisation, and before the end of that period of Telmex exclusivity, the Ministry of Communications and Transport designed the telecommunications regulatory framework. In that process, the CFC urged that the number of competitors in long distance and local not be limited (that is, that all qualified applicants should obtain a license), and that new competitors (which would be principally those in long distance and in wireless telephony) should obtain unrestricted and non-discriminatory access to the local network, still controlled by Telmex. The CFC also contributed to other competition-related aspects of the telecommunication legislation, such as those dealing with terms for public network concessions, access to value-added services, open-architecture networks, interconnection agreements, and exclusive contracts.

**Incumbent market power.** The sector regulator, COFETEL, can regulate the tariffs and services of dominant firms in order to facilitate entry and enhance competition. But that power depends on the CFC, for it is up to the CFC to determine whether a carrier is dominant. The CFC has now made such a formal determination. During the second half of 1997 the CFC carried out an *ex-officio* investigation, which concluded in December 1997 that Telmex does indeed have substantial market power in five relevant markets: local telephony, interconnection services, national long distance, international long distance and the resale of long distance. The market power in local telephony, national long distance services, and international long distance services is directed at final consumers, while the market power for access or interconnection services and transport services most directly affects other carriers. Telmex owns virtually all of the local public networks and provides local and interconnection services. Entry has occurred in long distance services, but the entrants' infrastructure is still modest compared to Telmex's network. Thus, long distance companies rely on Telmex's capacity for their access to final consumers and to provide long distance services in some routes. Telmex's vertical integration and its ability to fix prices without other competitors being able to offset such power, as well as the existence of important entry barriers, were taken into account in determining its dominant position. This decision, which the CFC reaffirmed in February 1998 and submitted to COFETEL, is likely to be appealed by Telmex. The only issues on appeal will be procedural or constitutional, though, as the CFC determination of market power is conclusive. The next step is for COFETEL to design and implement appropriate regulations.

**Local telephony rules**. COFETEL's local telephony rules incorporate some of the CFC's recommendations to promote competition in local telephone services, but COFETEL rejected others. One that was included is the definition of local telephone service areas. The number of local service areas, which are based on switching groups, will be gradually reduced from 1 500 to 485 over a five-year period. The intention is to reduce the investment requirements for new carriers and so reduce barriers to entry while promoting scale economies in the use of capacity. A contentious issue is the settlement paid to local operators for terminating an international call. The rules about this were intended to be non-discriminatory among different local service firms, but there has been considerable dispute about how these rules affect other parties. Local providers are also required to register at least five unbundled interconnection components, subject to separate rates and billing. Services are to be provided at non-discriminatory rates, making no distinction among service suppliers performing similar operations, including its subsidiaries or affiliates. Non-discrimination is to be enforced by the relatively weak means of requiring an integrated firm to keep separate accounts for its own operations, though. The rules introduce the principle of "calling party pays" in mobile service. In countries where this charging system has been implemented, mobile telephony has developed much faster than in Mexico, where the receiver paid for the call. But CFC concerns about the need for a clearer separation in the rules between mobile and fixed telephony were ignored. A difficulty in addressing the separation issue is that controls over fixed telephony are contained in the Telmex concession agreement.[26]

**Satellites.** The CFC has been involved in the design of the framework for the privatisation of the satellite system. The communications satellite system was sold off in 1997. There was a discussion of whether to sell the whole satellite system (consisting of three geostationary satellites and one additional orbit slot currently not occupied) in one package or to split it up in two packages. Selling it as a unit might create a dominant position at the expense of users, but also might yield a system that could take advantage of economies of scale and scope. It would also likely fetch a higher price. In the end, the CFC did not object to the privatisation of all satellite assets in one package because it considered that the eventual winning bidder would still face sufficient competition from services provided by foreign satellite systems, which have become possible due to agreements reached with the US and other countries. In addition, there may be competition from optic fibre and microwave technologies, and eventually from low-orbit satellites. The CFC also did not object to any of the participants in the privatisation process, finding that, because of these other sources of competition, acquisition by any of them would not threaten to create market power.

The CFC promoted the incorporation of competition criteria into the privatisation framework. Here again, one important element was conditioning the Minister's power to impose special regulatory obligations on a CFC finding of market power. In addition, the CFC argued for rules against discrimination or cross-subsidisation. To prevent satellite users from accumulating satellite capacity in order to impede the entry of new competitors, a party that acquires the right to satellite capacity must use it within 180 days or lose that right to another claimant. The CFC is also involved in determining who may obtain a license to bring in signals from foreign satellite systems.

**Spectrum auctions.** Radio spectrum frequency licenses are issued through an auction process. Interested parties must get CFC authorisation in order to participate in the auction process. In the design of auction programs, the CFC has made efforts to include measures to rationalise frequency allocation, facilitate the entry of interested parties, and prevent anti-competitive practices. Thus, it has supported the establishment of simultaneous ascending auctions, the imposition of spectrum caps, the establishment of clauses to discourage collusion between competitors, and the application of the "use it or lose it" principle. Different conditions or requirements have resulted, depending on the particular market conditions and prospects for each band auctioned.

One 1997 auction was aimed at building a capacity supply market for microwave point to point and point to multi-point systems. Restrictions ensured the presence of at least five operators in every geographical market, with each acquiring no more than 20% of the spectrum auctioned. The CFC did not oppose any particular bidder's participation, because the structural conditions were deemed sufficient to protect competition. By contrast, the CFC imposed some conditions on another 1997 auction for frequencies used by fixed and mobile wireless and PCS services, because these wireless access services can affect competition in local telephone markets. The CFC and COFETEL agreed to limit the accumulation of frequencies and licences. In addition, the CFC imposed conditions on Telmex's participation, because it had already determined that Telmex has market power in the markets for local telephony and interconnection. Telmex would be subject to an audit in order to review the conditions of competition in the market, and more importantly, Telmex would have to wait 24 months before starting its commercial operations (except for rural telephony services) in order to ease the entrance of new competitors. A principal reason for nonetheless permitting Telmex to participate at all, despite the risks to competitive conditions, was that Telmex alone still has a "universal service" obligation in rural areas, which might be best served by these newer technologies rather than traditional ones. Participation could also permit Telmex to continue upgrading its technology.

Some conditions were imposed to ensure competition in mobile radio-paging services, where 24 parties expressed interest in the 27 regional concessions and nine national ones. One party would be limited to the equivalent of four of the national concessions (through some combination of national and regional licenses). In any region, no single party could have more than four concessions (regional, national, or a combination). And no one could get more than two concessions of the three concessions offered in each region. The limits applied to groups of companies connected common shareholders and other corporate links. Because the telephone network is an input into paging services, competition depended on establishing non-discriminatory access to this network. Thus, the CFC subjected the participation of a Telmex subsidiary to an agreement for interconnection fees between Telmex and the paging service companies. The other bidders were all approved, with the exception of a firm that already held four national concessions.

A few limits were imposed on an auction of frequencies for pay TV and radio in 46 regional markets, to ensure continued competition from alternatives. There were already 190 companies with cable networks, and licenses for microwave (MMDS) systems had been granted throughout the country. Other pay TV services are available too, such as direct satellite broadcast, but the extent of competition among them is limited, to the extent that they are aimed at populations with different income levels. Cable and MMDS operators were only allowed to apply for licenses in geographic areas that were not covered by their previous licenses. This CFC decision had the effect of permitting a major firm, Cablevisión, to bid for spectrum in the rest of the country. Cablevisión already had an important presence in the pay TV market, but mainly in the Federal District, where no licenses were auctioned.

Few issues arose in the auctions for mobile aeronautical radio communications and point-to-point microwave links. The auction rules excluded parties who already held a concession or permit to provide these services, in order to ensure a minimum number of competitors. Otherwise, the CFC determined not to reject any particular bidder. But the CFC did suggest that, because increased demand and technological change could affect future values, the frequencies be granted to administrators who would then market them among final users.

**Railways.** Privatisation is now underway. Licenses to build and operate railways have been granted through a two-part competitive bidding process, involving technical qualification as well as money. Licenses are only granted to Mexican companies, in which foreign investment may not exceed 49% of equity. The CFC participated in the process of drafting the law and regulations, and several features of the privatisation program respond to CFC recommendations. In particular, the CFC urged that railroad concessions in different regions should be granted to different companies. Competition with road transport would be promoted by eliminating the possibility of cross subsidies between railroad regions and by stimulating the efficiency of the network. Competition within the rail network would also be encouraged by a structure that permitted regional comparisons of costs and prices. The CFC has issued opinions about the bidders for five railways: Coahuila-Durango, Nacozari, Pacífico-Norte (FPN), Noreste (FNE), and Tijuana-Tecate. The CFC and the Ministry, SCT, agreed on rules placing some limits on cross-ownership. Ferrocarril del Noreste (FNE) was limited to 5% ownership in FPN, and FPN was limited to 5% of the companies licensed for the main south-east route. In some situations, notably the Coahuila-Durango route, an obligation to grant tracking and haulage rights was imposed in order to avoid market power abuses.

The CFC was also involved in the process of developing the basic Railroad Service Regulations, which define trackage and haulage rights and establish procedures for applying for those rights and for setting the applicable terms, conditions and fees. They also set out procedures for setting rates when, in the CFC's opinion, conditions of competition do not exist. These can be initiated at the request of the affected user or at the initiative of either the Ministry or the CFC. Rates are to be set equal to those that would be charged by an efficient carrier, using a method previously submitted to the CFC. The regulations also set out means for granting third parties concessions to provide a specific transportation service when the original concessionaire ceases to do so.

**Ports.** The CFC is involved when port administrations are privatised or operating license rights are auctioned. The rules prevent combining directly or indirectly two or more terminals that provide the same kind of service in the same relevant geographic market. And the CFC must approve particular bidders here, as in similar auction proceedings.

**Air transport.** Starting in 1995, the CFC participated in the discussion and preparation of the drafts for the airports and civil aviation laws, in conjunction with SCT. The provisions in the Airports Law related to competition include transparent criteria for concessions and permits for managing, operating, and building airports, allocation of concessions through public auctions, regulation of mergers and acquisitions, obligation to provide services without discrimination and to make available open access to suppliers of auxiliary services, and guidelines for regulating rates and prices when, in the CFC's opinion, conditions of competition do not exist. The actual process of privatising the airports began in 1998. There are similar powers concerning airline fares; if the CFC determines that there is market power in a relevant market, typically a city-pair or associated airport markets, then the Ministry may regulate the fares. The civil aviation law is still being applied in ways that prevent potentially efficient new entry, though. The Ministry includes a test of likely profitability in permit and route decisions, ostensibly to protect safety.

**Natural gas distribution.** The CFC must approve participation in auctioning exclusive distribution permits for natural gas. As elsewhere, the CFC applies a merger-like analysis. The CFC determines the participants' market shares and whether there is market power or restraints on competition. So far, the CFC has not opposed or placed conditions on participation in these auctions. It decided to bar one bidder in Mexico City, but changed that decision on reconsideration.

The CFC also contributed to the 1995 regulations that laid the groundwork for introducing private market competition. The process is complicated by the fact that the incumbent in much of the country is Pemex, which retains a constitutional monopoly on natural gas production and also still owns much of the pipeline network. The regulations call for removal of restrictions on natural gas imports, in order to promote the functioning of market forces at the primary sales level. Transportation, storage, distribution, and marketing activities are to be unbundled and provided independently, without the sale of one service depending on the acquisition of another. Vertical integration of transport and distribution within a single region is permitted only if it leads to greater efficiency. Because it was thought critical to promote investment in infrastructure, concessions would be exclusive, at least for a period of time, and competition would be for the market, not within it. Exclusive distribution permits would be awarded on the basis of the best service and lowest prices. And the concessionaires' market power is limited by giving resellers free access to the concession area and by granting permits for self-supply. Participation in auctions for exclusive distribution permits is subject to the approval of the CFC. Price and rate regulations may be removed when, in the CFC's opinion, conditions of competition exist.

## 6. CONCLUSIONS AND POLICY OPTIONS FOR REFORM

### *6.1. General assessment of current strengths and weaknesses*

The Mexican government recognised the imperative need to move the basis of its economy away from protection and privilege and undertook a long-run plan to do so. From ending price control through liberalising trade and investment and privatising state-owned enterprises to adopting a modern competition law, the plan is founded on free market competition.

The analytic quality of the competition law is a significant strength. The law is consistent and coherent, based on economic analysis and the goal of economic efficiency. It affords a solid foundation for applying competition policy both in law enforcement and in other policy issues. This modern analytic approach is continued in the recent LFCE Regulations. All are models of well-balanced economic sophistication. Some details might be touched up. The predatory pricing test seems loose and likely to find violations too often; a corrective could be adopting a clear "recoupment" requirement. And in merger review, more transparency in the treatment of the competitive effect of poor financial health would be welcome.

The CFC has spent a commendable proportion of its effort on advocacy and dealing with competition policy problems outside of traditional law enforcement. Here, the regulatory structures sensibly assign critical tasks to the CFC, to make analytically consistent judgements about presence of market power. The same standards are applied by the same expert body whether the issues is merger or other competition law enforcement, or licensing, privatisation or natural monopoly regulation. This consistency integrates competition policy into regulatory policy.

Expert craftsmanship is a clear strength. But that strength implies a weakness as well. The competition law, like the rest of the reform program, is the product of experts in the government. The competition law and policy lack a clear base of support in the public at large. Although legislators are reportedly interested in the CFC's work, and the CFC receives an increasing number of complaints now that the public and smaller businesses are more aware of its existence, the constituency for competition policy is not well identified. Moreover, there has little visible effort to develop a public constituency, through media relations, systematic relationship with consumer protection institutions (which are admittedly rudimentary), or otherwise. Perhaps the strongest constituency supporting competition policy is new entrants, which appreciate how liberalisation has made their businesses possible. But even for them, support may fade unless the CFC is clearly seen as an important instrument in market-opening, barrier-lowering action. Major, established businesses, which have not shaken habits learned under the old system, would prefer market arrangements to be managed so they would not be taking any investment risk, and are not above making direct appeals at the highest levels of government in a effort to preserve their privileges.

Uncertainty about how far to commit to real competitive reform is demonstrated in some of the divisions of labour. Giving the CFC the important task of identifying market power is analytically sound. Having another body, such as COFETEL for telecommunications, decide what will be done about that problem shows that someone else has the ultimate voice about that competition policy issue. Additional evidence of mixed priorities about competition policy is the fact that the market-opening and privatisation processes have left a few highly concentrated industries in place from the pre-reform era, without providing for means to break them up or even exposing them to effective import competition.

Uncertainty about the degree of support may be one reason for what looks like temporising in some early CFC decisions, and it may also underlie the persistent assessment by others in the government and the private sector that the organisation is "weak." The perception of weakness may be unavoidable for an organisation founded on policy and ideas, particularly ideas as complex and ambiguous as those of industrial organisation economic theory, in a society that values personal power, contacts, and influence. But one result of following analytic principles is that interested parties could portray some CFC decisions to look like compromise positions that avoided confronting powerful economic players. In privatisation proceedings, the national liner shipping firm was permitted to buy one of the major rail concessions, the major cable firm was allowed to participate in related spectrum auctions, and Telmex was allowed to bid in the wireless phone auction, albeit with mild conditions. Some claim the CFC has bowed to financial industry interests, in permitting CINTRA to continue to exist and in taking few actions concerning competition in financial services markets. In each of these controversial cases, the CFC defends its decisions by pointing out the strength of the conditions it imposed or the lack of a demonstrable anticompetitive effect in the circumstances.

And on the other hand, the CFC has taken some visible and vigorous actions against major economic interests. Its ruling about Telmex's market power, its actions against abuses by Pemex, and its findings about CINTRA's market power would counter the image of weakness—provided other regulators follow up with action consistent with those rulings. Is it a measure of the CFC's increasing independence and strength, rather than weakness and irrelevance, that the CFC was not involved in negotiations to settle the controversies about entry and pricing in telecommunications? Perhaps it was strength, for the CFC warned the negotiating parties, public and private, that an agreement about price levels could attract law enforcement attention. Often, CFC decisions are only a first step, and other parts of the government must take the effective actions, which the CFC cannot require or control. If other government bodies ignore or evade CFC findings, that fact will demonstrate the value Mexico actually places on competition policy as a tool for reform. For competition policy and enforcement to cement reform, other agencies must learn to accept its results, rather than resist them on behalf of industry clients.

### *6.2. The dynamic view: the pace and direction of change*

The CFC may be tempted to get away from the politically charged problems of regulatory policy and focus more on law enforcement. Whether that is a sound strategy depends on the reasons and the results. It could establish the CFC's credibility, if it produces a number of tangible, credible successes. But if it looks like a retreat from controversy, the shift could confirm, rather than correct, the impression of weakness. Some of that impression stems from public misunderstandings of what is involved in litigating competition issues. Already, because well-financed parties often take the CFC to court, the CFC feels it must move carefully, follow clear procedures, and avoid the appearance of result-driven decision-making.

That care is thought by some, probably unfairly, to be a sign of ineffectiveness. More enforcement may help overcome this misunderstanding in the long run, by educating the businesses and the public about the complexities of competition policy, and along the way working out novel procedural methods and substantive doctrines in the courts so that enforcement will become increasingly efficient.

The notion of an independent decision-making agency is a new phenomenon in Mexico. Whether any of the "independent" agencies can really act independently of the government is yet to be established. The CFC has been bolder than COFETEL. The most independent regulators, such as the energy commission and CFC itself, seem to have a better understanding of competition policy values than ministries such as SCT or agencies with close ties to a ministry such as COFETEL. The CFC's comparative boldness may be explained by the stronger legal basis for its independence of action. Its decision about market power in airlines tends to contradict the policy that the transport ministry would like to pursue, of consolidating the two national airlines into one. And its decision that Telmex has market power requires the communications ministry to take regulatory actions which will be inconsistent with its contention that the Mexican telecommunications industry is already competitive. It would be valuable to review the experiences of these new institutions, to evaluate how their structures impact their effectiveness and to assess whether a single, multi-sector regulator might better implement competition-based policies and resist industry capture (see Chapter 2, Government Capacity to Produce High Quality Regulation, for further discussion of these issues).

### *6.3. Potential benefits and costs of further regulatory reform*

The primary performance objective of competition policy in Mexico is efficiency. In telecommunications and some other sectors subject to economic regulation, protection, or inherited and persistent market power, Mexico still endures inefficiencies. As the regulated and protected sectors are opened to competition, it can be expected that prices and the quality of products and services will move toward competitive levels.

It can also be expected that producing these public benefits will entail some private costs, as competition erodes the security of those who benefit from market power. Thus shareholders and labour interests in these sectors are likely to resist change, in order to avoid those losses to themselves. Efforts to avoid costs to these parties will impose costs on the economy and the consumer, as the competitive benefits of lower prices and greater choice are deferred.

### *6.4. Policy options for consideration*

- *Maintain emphasis on regulatory issues and regulated and privatising sectors, with analysis, publicity, and enforcement, as long as competition is still impaired by controls on entry and by other kinds of official favouritism.*

Focus should be maintained on the sectors where regulation and privatisation are still important issues, despite the difficulty and the political and resource cost, until better outcomes are achieved in the major sectors affected. Analysis and advice should be accompanied by law enforcement in these sectors, too. The CFC can take advantage of the law's comprehensive reach, for few industries, even regulated ones, are technically exempt. This emphasis would have the additional, desirable effect of focusing attention on higher-impact matters concerning collusion and exclusion. If more enforcement is desirable for institutional reasons, it would be better to target the largest economic forces, the largest consumer and market harms, and the most important anti-competitive situations. These are likely to coincide with the subjects of privatisation and deregulation, that is, the same sectors that are now receiving the CFC's regulatory-policy attention.

In trade matters, too, the CFC should play an important role. Some of the remaining competition policy issues in Mexico are the product of still-incomplete opening of its markets. Liberalisation has not yet improved the competitive structure of several major industries. If the law is not amended to add a power to cure monopoly through divestiture, then it should give the CFC more power in the trade law process to prevent achieving or protecting anti-competitive outcomes. At a minimum, the CFC could, through advocacy, ensure that the competitive implications of trade issues are well publicised.

- *Make the CFC part of the Economic Deregulation Council (CDE), to ensure that competition policy issues are regularly considered at the highest levels in regulatory reform efforts.*

The CFC is not regularly involved in the CDE's review process. Although it is consulted on an *ad hoc* basis, the lack of formal, regular ties and responsibilities inevitably diminishes the significance of competition policy issues in this important process. Bringing the CFC into the CDE could lead to a more stable process for resolving disputes among competing policy interests. If promoting market-based approaches is an important goal, then that importance should be represented by high-level participation in this body. Continuing participation will also help ward off regulations that are more anti-competitive than necessary to accomplish their purposes, thus economising on enforcement efforts in the long run.

- *Provide for effective power to ensure that regulations to remedy market power actually achieve that aim, by requiring CFC approval for those regulations or a right of intervention and appeal concerning regulatory decisions that implement its market power findings.*

In form, the method for incorporating competition principles into the regulatory system appears sensible. The CFC applies its general expertise about assessing market competition to determine whether there is a market power problem that needs a solution, and if there is, then a regulatory body that is expert about the particular sector designs and implements that solution. The practice, however, demonstrates that the formal arrangement has weaknesses. In some sectors, capture appears to be a significant problem. Regulators protect "national champions" in communications and transport, and the constitution protects them in energy and petroleum. Competition policy confronts development concerns in telecommunications. In energy, it must compromise with national history. And in many sectors, it is in conflict with financial interests. Regulators who share industry interests in preserving established institutions are unlikely to apply competition policy effectively.

The division of authority in regulated markets needs to be reconsidered. The CFC's finding of market power is merely precatory and insignificant if the relevant ministry's regulation does not actually solve the problem, or if its solution creates new problems and complicates the CFC's ability to deal with them. The CFC should have an oversight role. One option would be to require CFC approval of the proposed regulation before it could become effective. A less intrusive option would be for the CFC to accompany its market power findings with clear, performance-based standards and necessary controls that regulations must include. And the CFC could be more effective if it had the clear power to intervene in actions that apply those regulations, to ensure that the other agency is following through correctly and effectively.

Alternative institutions or additional remedies might be considered to deal with monopoly problems. For deciding about access pricing in network industries that remain regulated, and overcome sectoral regulators' traditional tendency to protect the incumbent, one possibility is a new broad-based agency that would deal with these common questions of "utility" regulation across sectors. That would free the CFC of any duty to compute prices but maintain contact with the CFC for making determinations about competitive conditions and effects. Such a multi-sectoral agency would centralise expertise, promote consistency, and reduce the risk of capture by a particular interested sector. And it is worth considering whether to add provisions to the LFCE to deal more directly with the problem of monopoly as a structural matter. To be sure, relief is difficult to achieve at acceptable costs. But it could be useful to have the tools available, kept in reserve for occasional use in exceptional, but important, cases in which it is difficult to establish clearly illegal monopolising conduct (perhaps because victims are reluctant to come forward), yet structural market power is unacceptably persistent.

- *Broaden the base of support, through greater media exposure and co-ordination with consumer protection activities.*

The CFC should publicise its actions to a wider audience than the business press. To accomplish the goal of wider public understanding of the benefits of competition, it will be necessary that enforcement actions result in consumer benefits that can be clearly and convincingly communicated. And it should develop a structure of co-ordination with consumer protection activities, which could also help build a broader base of understanding and support. It would be consistent with the economic foundation of Mexico's competition policy for the CFC to take on responsibilities for some "consumer protection" issues that are also often treated as matters of unfair competition doctrine, like deceptive advertising, which have direct effects both on consumers and on the health of market competition.

- *Broaden the available enforcement resources by expanding the right of private action.*

As a supplement to the CFC's resources, and a potential corroboration or corrective for its policy positions and decisions, the right to take private action should be expanded. Making all decisions under the LFCE completely dependent on the CFC ensures consistency, but risks leaving problems unaddressed because of resource limitations. Private lawsuits about access and pricing in the context of network monopolies could assist the CFC in overcoming sectoral regulators' resistance to introducing competition. Expanding private actions will require addressing other institutional problems, though. The federal district courts that are most competent to hear these cases do not usually handle private disputes. These would more likely go to the state courts that also hear other kinds of commercial cases. In the state courts, analytical capacities and decisional independence are more variable.

- *Enter international co-operation agreements to improve enforcement efficiency in transnational matters.*

The CFC should enter international co-operation agreements to regularise its relationships with other enforcement bodies and improve its capacity to deal with global problems. Mexico's opening to foreign trade and investment will inevitably produce many enforcement matters with significant international dimensions, and not just with its NAFTA neighbours. Clear prior arrangements for co-operation with other enforcement authorities will improve enforcement efficiency and effectiveness.

### *6.5. Managing regulatory reform*

The CFC needs to be strengthened in stature, and perhaps in resources. It is not clear how to do the latter, when budgets are tight across the government. Other budget-strapped governments, such as Japan's, have found ways to increase funding for competition matters despite cutbacks elsewhere. The CFC may have been short-changed compared to other agencies with narrower jurisdictions. COFETEL has a budget four times larger than the CFC's, and CRE's budget is twice as large. Yet the CFC took on additional responsibilities about regulatory issues despite the decrease in its budget. The Ministry of Finance has authorised a substantial increase in the CFC's 1998 budget as well as an important expansion of its administrative structure. Still, it is not clear that the CFC is being stretched to do the job with the resources it has. The CFC may need to identify particular, compelling enforcement problems it cannot resolve with its current staff and budget, to support the call for greater resources.

As reform proceeds and competition spreads across the economy, problems due to remaining pockets of market power will become even more obvious. Economic distortions will result from trying to sustain monopolies in economically competitive industries. Mexico will have to consider carefully the benefits and costs of the remaining state monopolies.

## NOTES

1. Article 2, Federal Law of Economic Competition (LFCE).

2. Constitution, Article 28.

3. The Competition Law was published in the Official Journal of the Federation on 24 December 1992, and came into force on 22 June 1993.

4. North American Free Trade Agreement, Art. 1501(1).

5. LFCE, Article 10 (vii).

6. These cases are described in the annual reports of the CFC for 1993-94 (p. 34, laundries and dry cleaners), 1994-95 (p. 56, purified water producers, and p. 58, road transport), 1995-96 (p. 64, maritime and airport cargo deconsolidation services, and p. 68, customs brokerage services) and 1997 (p. 64, road transport).

7. OECD Competition Law and Policy Committee (1997), Aide-Memoire of In-Depth Examination of Competition Policy in Mexico.

8. Comision Federal de la Competencia (1998), Annual Report [to OECD Competition Law and Policy Committee] on Competition Policy Developments in Mexico (1997).

9. Comision Federal de la Competencia (1997), In-Depth Examination of Competition Policy in Mexico (1995-96), submitted to OECD Competition Law and Policy Committee, 21 January 1997.

10. This was added in the 1998 Regulations.

11. OECD Competition Law and Policy Committee (1997), Aide-Memoire of In-Depth Examination of Competition Policy in Mexico.

12. *Diario oficial*, 24 July 1998, p. 20.

13. OECD Competition Law and Policy Committee (1997), Aide-Memoire of In-Depth Examination of Competition Policy in Mexico.

14. OECD Competition Law and Policy Committee (1997), Aide-Memoire of In-Depth Examination of Competition Policy in Mexico.

15. Comision Federal de la Competencia (1997), In-Depth Examination of Competition Policy in Mexico (1995-96), submitted to OECD Competition Law and Policy Committee, 21 January 1997.

16. At www.cfc.gob.mx.

17. Article 24(I), LFCE; Article 50, Regulations of the LFCE.

18. See Richard D. Baker (1991), Judicial Review in Mexico: A Study of the Amparo Suit.

19. OECD Competition Law and Policy Committee (1997), Aide-Memoire of In-Depth Examination of Competition Policy in Mexico.

20. OECD Competition Law and Policy Committee (1997), Aide-Memoire of In-Depth Examination of Competition Policy in Mexico, Paris.

21. Comision Federal de la Competencia (1997), In-Depth Examination of Competition Policy in Mexico (1995-96), submitted to OECD Competition Law and Policy Committee, 21 January 1997, Paris.

22. Comision Federal de la Competencia (1998), Annual Report [to OECD Competition Law and Policy Committee] on Competition Policy Developments in Mexico (1997*)*. The data in the table come from the questionnaire response, and do not correspond precisely to the data in the annual report.

23. Comision Federal de la Competencia (1998), Annual Report [to OECD Competition Law and Policy Committee] on Competition Policy Developments in Mexico (1997).

24. Article 14.

25. For an overview see Etienne, Fernando Heftye, "Promoción y protección de la competencia en legislaciones sectoriales y tratados internacionales", in Comision Federal de la Competencia *Report* for the second semester of 1996.

26. The CFC has nonetheless been able to take account of distinctions between fixed and mobile telephony in determining relevant markets. In its decision about Telmex's dominance, the CFC separated local basic telephony from cellular service. Even though they both provide local communications, they differ in price, quality, and mobility. Telmex's market power in basic local service justifies asymmetric regulation under the telecommunications law, and that would in turn emphasise regulatory differences between it and wireless service.