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PERSPECTIVE: THERE'S NOT AN AWFUL LOT OF TELECOMS IN BRAZIL

Lawrence Spiwak[*]

Frank Sinatra loved to sing that "they've got an awful lot of coffee in Brazil," but the big question is whether there is going to be any meaningful telecoms competition in Brazil when the local markets are open to competition on 1 January 2002. The burgeoning Brazilian telecoms market has tremendous potential for investors - indeed, what investor wouldn't want to take a first crack at a market with a population of over 165 million potential untapped customers? Unfortunately, it appears that legitimate concerns remain about whether Brazil has a sufficient legal and regulatory framework to allow competition to take hold.

For example, Anatel – the Brazilian telecoms regulator – has yet to implement meaningfully many of the major pro-competitive provisions of the Brazilian 1997 telecoms law (*e.g.,* collocation rules, numbering allocation distribution plans). And for those items Anatel has started to implement – like interconnection rules and dispute resolution mechanisms – there is much room for improvement if these rules are to have a material effect on the incumbents' strategic behavior.

Second, the Brazilian licensing regime – either by omission or by design – constitutes a major barrier to entry. On 30 August 2001, Anatel proposed several rules to allow firms to apply for a fixed switched telephone (STFC) license.

While firms can enter under other licensing regimes, the STFC regime is the only one that guarantees interconnection to the PSTN and a numbering allocation distribution plan. An STFC license is required if a

[*] *Lawrence J. Spiwak is president of the Phoenix Center for Advanced Legal and Economic Public Policy Studies (www.phoenix-center.org), an international think-tank based in Washington DC. The views expressed in this article do not represent the views of the Phoenix Center, its adjunct fellows, or any of its individual editorial advisory board members.*

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firm wants to grow its business over the long-term. Rather than make the licensing regime a *pro forma* process, however, Anatel is using it as a mechanism to mandate investment into the local market: if firms want to enter the long-distance or international markets in Brazil, they must enter the local market first, even though these markets have radically different economics.

Exacerbating this problem is Anatel's desire to impose stringent build-out requirements for local service. But as demonstrated from the U.S. experience, build-out requirements – even if promulgated with the best of intentions to ensure some sort of universal service – impose significant asymmetrical economic burdens on new entrants.

To illustrate this point, a new Phoenix Center policy paper reveals that a conservative estimate of construction costs for new local loop facilities comes to around $2,500 per line. Applying this number to the build-out requirements contained in the proposed Brazilian licensing regime, a new entrant seeking to pursue a pan-Brazilian (eight major business locations) entry strategy would be required to sink nearly $1 billion within three years just to achieve a 1% market share - regardless of economic feasibility.

And just as the CLECs in the U.S. and European markets are discovering, no amount of regulatory alchemy can convince an investment house to risk capital to fund Brazilian CLECs under such conditions either.

The net result of these policies is predictable: unless there is fundamental change, there is little prospect for telecoms competition in Brazil, investment attractiveness and the maximization of consumer welfare. Instead, the Brazilian telecoms markets will continue to be dominated by the three major companies that came out of the old Telebras system – Telefonica, Brazil Telecom and Telemar – with little or nothing to constrain their ability to exercise their market power. As experience shows, however, without a vigorous telecoms sector, Brazil – or any other country, for that matter – will always remain on the short end of the digital divide.