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The Breakup of the Brazilian Telecommunications Monopoly:

Fasten Your Seat Belts!

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"Information technology has become the fundamental tool for the development of the economy and of society itself. This means that our nation will have to overcome the existing gap in order to continue its development process. This does not just involve expanding the already existing services for the purpose of restoring justice and balance. It is a matter of investing heavily in communications to build a sound and strong infrastructure, essential to create the wealth needed for the country to invest in social areas."

"As a fundamental strategy to reach this objective, the government will introduce competition in the exploitation of telecommunication services. It will also implement a judicious but decisive privatization of state owned companies, with the ultimate purpose of bringing benefits to end users and of increasing the productivity of the Brazilian economy."

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Foreword

This paper is mainly concerned with telecommunications privatization as a means of fostering the Brazilian economy.

What this paper does not attempt is an evaluation of the impact of Telebrás privatization on Brazil's rate of GDP growth. Such an effort, to be dependable, would have to quantify, as much as possible, the impact of the intense levels of interdependence among different sectors of Brazil's economy. Moreover, such an assessment may still be premature.

This paper begins by considering Brazil's strength. Then it attempts to judge the value of the Brazilian telecommunications monopoly. The paper then discusses how Brazil, since the implementation of the Real Plan, has had an extraordinary opportunity to benefit from a privatization of its telecommunications companies. Then it seeks to evaluate the arguments that favor and oppose alternative implementation scenarios of the irreversible process of change with private monopolies or full competition. The paper also reflects on how the enhanced efficiency of privatized companies and the higher level of investments are likely to affect Brazil's economic growth. The conclusion assesses how important it is for Brazil to maintain the pace towards privatization of its telecommunications.

Acronyms and Abbreviations

BACEN	Brazilian Central Bank
BOVESPA	São Paulo's Stock Market
CPqD	Telebrás Research and Development Center
FGV	Fundação Getulio Vargas
GDP	Gross Domestic Product
IBGE	Brazilian Geography and Statistics Institute
IBOVESPA	São Paulo's Stock Market Index
IGP-M	General Market Price Index
INPC	National Price Index

IPC	Consumer Prices Index
ITU-T	International Telecommunications Union
MINICOM	Ministry of Communications
MP	Temporary Law
NYSE	New York Stock Exchange
PASTE	Program for Recovery and Expansion of the Telecommunications and Postal System
TELEBRÁS	Brazilian State Telecommunications Company
URV	Real Value Unit

Introduction

The macroeconomic scenario shows signs of a clear and exciting future, reinforcing the optimistic expectations regarding the stability of the Brazilian economy. In fact, with low inflation rates and democracy taking firm root, the social, economic and political climates have never been better in the country.

In this environment, the Brazilian telecommunications market has been growing significantly, with net profits expanding by as much as 240% in 1996.

Telecommunications have become one of the most important factors in today's economic world. More than the exchange of information, they serve as a barometer of a country's strength. The highly interconnected world is deepening international trade and changing the structure of a globalized economy. The globalization of business activities has also globalized customer needs for telecommunications services. Without a shadow of a doubt, telecommunications will be the backbone of tomorrow's information society.

Everyone agrees that demand for telecommunications services in Brazil is spreading like wild fire. The Brazilian telecommunications market is under-exploited - telephone services are sparse and the demand sky high.

In spite of the facts shown above, until recently, Brazil remained stubbornly isolated from the global movement towards opening the telecommunications sector.

However, during recent years, the serious intent of the government to privatize telecommunications in Brazil has been attracting huge foreign capital inflows. If the government maintains its intent, foreign capital inflows will continue increasing and the growing pressure for privatization will sustain investments in this sector.

These trends point to more capital inflows in the coming years. Thus, the telecommunications market will certainly be a booming investment opportunity and its impact on Brazil's economy will be significant.

As a result, Brazil is becoming the most important telecommunications market in Latin-America.

Understanding what happened, what is happening and what is likely to happen in Brazilian telecommunications, and the affect on the nation's economy, is the major subject of this paper.

1. General Country Information

1.1 - Surface and Location

In terms of surface area, Brazil stands in fourth place among the nations of the world, after Canada, China and the USA. Brazil is a continent-sized country with 8.5 million square kilometers. Located in central and eastern South America, Brazil possesses an area equivalent to 20.8% of the Americas, and 47.9% of the South American land mass.

Brazil's boundary extends over 23,086 kilometers, of which 7,367 kilometers are coastline on the Atlantic Ocean. The coast goes from the estuary of the Chuí River, which forms the border between Uruguay and Rio Grande do Sul, to the mouth of the Orange River, on the border between French Guiana and Amapá. To the West, North and South, Brazil has 15,719 kilometers of shared borders with all the South American countries except Ecuador and Chile.

1.2 - Population

Brazil is the world's sixth largest country in terms of the size of its population, i.e., approximately 160 million people (40 million families). Its population density is around 18 people per square kilometer. In the 1990s, the rate of population growth has fallen to 1.4% per year. Based on the above figures, forecasts are that the population will be close to 200 million by the year 2020.

1.3 - Administrative Organization

The nation is a democratic republic, divided into 26 States, the Federal District (Brasília) and around 5,000 Municipalities. Brazil's constitutional organization consists of three independents branches of Government: the Executive, the Legislative and the Judicial branches.

The current President of Brazil, Mr. Fernando Henrique Cardoso, took office in January 1995.

The Legislative branch is comprised of a two-chamber Congressional system - the Senate and the Chamber of Deputies, all of them elected by universal direct suffrage. The President and the Chamber of Deputies function for a period of four years whereas the Senate functions for a period of 8 years.

The Federative Republic of Brazil is divided into five regions. The smallest of these is the Southern region, which covers 6.7% of the nation's land area and encompasses the States of Paraná, Santa Catarina and Rio Grande do Sul. The Southeast covers 10.8% of the nation's land surface, and consists of the States of Espírito Santo, Minas Gerais, Rio de Janeiro and São Paulo. The Central-West region covers 18.8% of the nation's land area and is comprised of the States of Goiás, Mato Grosso, Mato Grosso do Sul and the Federal District. The Northeast covers 18.2% of the nation's land area and consists of the States of Bahia, Sergipe, Alagoas, Pernambuco, Paraíba, Rio Grande do Norte, Piauí and Maranhão. The North is the country's largest region, covering 45.5% of the nation's land surface, and is comprised of the States of Acre, Amapá, Amazonas, Pará, Rondônia, Roraima and Tocantins.

Brazil - Basic Data and Social Indicators

Surface Area	8.5 million square kilometers
Population (1995)	155.9 million inhabitants

Population Density (1995)	18.1 people per sq. km.
Labor Force (1990)	64.5 million people
Unemployment Rate (12/96)	14.2%
Illiteracy (1991 as a % of the population)	
Population Aged	15 to 39 - 10.97%
	40 and over - 30.8%
Life Expectancy at Birth	65 years
Infant Mortality Rate (1991)	45/1000
Estimated Housing Deficit (1991)	10 million units

Table 1: Sources: Central Bank of Brazil / BACEN

2. The Brazilian Telecommunications Monopoly

In the 1960s, Brazil was served by a number of small private companies. Telephone service was scarce and poor : most lines were very noisy, callers were frequently connected to wrong numbers, interoperability was difficult, and long-distance calls were painful. It was next to impossible to an operator to place a long-distance call manually. Hours could pass before a call be completed at the time.

Whether expecting to be nationalized or just benefiting from the monopoly, and from the black market, for many years the companies did not invest enough in upgrading the infrastructure or expanding the system.

Within this chaotic scenario, after 1964, nationalization became the word of the day, just as privatization prevails nowadays. Thus, Brazil's military government sent a wave of nationalizations down on the private telecommunications companies. Except for a very few well-connected companies, such as CTBC, virtually all the telephone companies were nationalized.

This year marks the 25th anniversary of Telebrás's creation . To begin with, it is important to take a closer look at its history. The Telebrás System was founded in 1972 to be the instrument for executing telecommunications policy and for consolidating the Brazilian Telecommunications sector. In 1974, a federal decree granted Telebrás the monopoly to explore public telecommunications services in the country.

Telebrás, which still has a *de facto* monopoly on public telecommunications networks and on basic telephone service, is the holding company responsible for operating and regulating telecommunications in the country. The Telebrás System is made up of a holding company which controls the system, a long distance and international operating company (Embratel) and 27 state operating companies - local exchange carriers, such as Telebahia and Telesp. The local exchange companies are also responsible for intrastate communications.

Since the beginning, the top positions at Telebrás and Embratel have been occupied by highly qualified personnel, and services have been enhanced country-wide. During Brazil's economic boom of the mid-'70s, call-completion rates rose and long-distance calls became possible. According to

Table A - Appendix, the government made substantial investments in 1976/77, expanding the infrastructure and upgrading the system.

However, since 1978 investment has not kept pace with needs. To make things worse, billion of dollars collected in taxes by the national telecommunications fund (FNT) from 1967 to 1984, were diverted to other governmental expenses.

Despite the above picture, today Telebrás is the third largest Brazilian company in terms of employees with around 100,000. It has achieved a record of impressive growth over its short twenty-five-year history. It is one of the largest open capital companies in Latin America, with over 6 million stockholders. It is also the second largest Brazilian company in net assets, market value and revenue.

According to ITU-T, there were some 633 million main telephone lines in the world at the end of 1994, an increase of 54% over 1984, an average growth of 5% per year. The number of lines added in Brazil grew at over 15 per cent a year during the last quarter of century. One can see that the country experienced one of the highest growth rate in the world. Network growth during the last decade of the 1980s, though not spectacular, was fairly consistent.

In 1995, Telebrás was registered by the United States Securities and Exchange Commission and at the New York Stock Exchange - the second Brazilian company to be registered (the first one was Aracruz Celulose).

Taken together, the Telebrás System was valued on May 15, 1996 at over US\$ 16 billion dollars - based upon the average quoted price of its shares negotiated on stock exchanges (see graph 1, p.15).

As a self-sustained company, its profits have been reinvested into ever larger assets every year. Over the past quarter of century, the Brazilian Telecommunications System has invested over US\$ 60 billion in expanding and enhancing the plant, making it one of the biggest investors in the world (see table A - Appendix, p.40,41 and 42).

For instance, in 1996 alone, the Telebrás System installed 1.581 million telephones, 1.286 million cellular phones with automatic roaming, and 39 thousand public pay telephones.

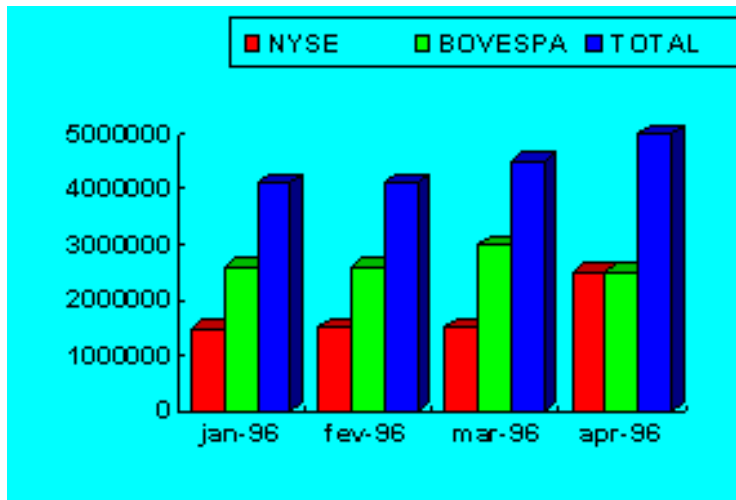
The consolidated net profits for the Telebrás System amounted to R\$ 2.756 billion (approximately US\$ 2.6 billion) in 1996 and its revenue was R\$ 12.487 billion (approximately US\$ 11.8 billion).

In spite of the distorted Brazilian telecommunications tariffs, with levels unheard of anywhere else in the world, revenues from telecommunication services form a substantial part of the Brazilian GDP, about 2.6%.

When it comes to spending, Telebrás has taken the lead during the 1990s among Latin American and Caribbean countries with investments reaching the impressive rate of 64.5% of revenues. According to ITU-T, a ratio over 60% is necessary for fast-track increases in teledensity (see tables 2 and 3, p.15 and p.16).

Telebrás Stock Negotiations

NYSE and São Paulo Stock Exchange



Graph 1: Source : Telebrás. A Company Ready for The Future Pp. 8

Telebrás' Investment

Table 2

Source: Telebrás US\$ billion

	1976-1980	1981-1985	1986-1990	1991-1995
Annual Average Investment	1,4	1,1	1,9	3,1
Annual Bigger Investment	1,6	1,5	2,6	4,1

Latin American and Caribbean Big Spenders

Country	Investments (US\$m) '90-94	Revenue (US\$m) '90-94	Invest. % as of revenue '90-94	Subscribers lines /1994 (x1000)	Tele-density
1. Brazil	18,546.00	30,335.00	64.5	12,927.5	8.12
2. Mexico	11,500.35	38,010.01	37.3	8,492.5	9.25
3. Argentina	6,640.02	15,105.00	40.2	4,834.1	14.14
4. Chile	2,031.55	4,615.51	47.0	1,545.1	11.0
5. Venezuela	1,903.88	4,314.78	38.9	2,324.2	10.92
6. Puerto Rico	1,258.76	4,254.01	30.0	1,314.8	36.07
7. Colombia	833.82	3,647.23	26.4	3,518.0	9.68
8. Jamaica	592.91	1,004.66	60.0	250.5	10.04

Country	1991	1992	1993	1994	1995
9. Ecuador	446.19	829.34	53.4	658.1	5.87
10. Uruguay	424.58	1,627.66	25.7	582.1	18.38
11. Peru	395.32	2,138.40	17.8	772.4	3.31
12. Honduras	362.57	480.40	75.0	131.2	2.39
13. Paraguay	274.86	588.64	57.8	173.0	3.58
14. El Salvador	186.65	640.77	35.7	235.7	4.18
15. Cuba	179.30	1,427.00	16.3	359.0	3.20
16. Panama	158.36	985.19	15.3	287.3	11.11
17. Costa Rica	131.09	829.84	28.5	430.0	13.01
18. Nicaragua	120.23	237.82	38.0	85.3	1.99
19. Trinidad T.	110.03	737.84	14.4	203.8	15.78
20. Guatemala	85.27	807.88	18.3	245.1	2.37
21. Barbados	83.64	518.58	16.1	87.0	33.35
22. Surinam	70.67	955.81	22.7	50.1	11.99
23. Bermuda	56.38	244.36	23.0	47.0	75.02

Table 3: Source : ITU/BDT, Geneva

3. Brazilian Economic Performance

3.1 - The Lost Decade

In the 1980s and the early 1990s, Brazil occasionally experienced one of the most harmful combinations of economic conditions thinkable - incessant inflation and low economic growth. In such an atmosphere of economic stagnation, the economic model in vogue worsened income inequality and impoverished a substantial part of the population.

In 1993 Brazil's annual inflation reached its highest level ever: 2,489%, measured according to the National Consumer Price Index (INPC). Thus, the country had one of the highest rates of inflation in the world. In May 1994, just preceding the launching of the Real Plan, monthly inflation reached 50%, from where it dropped to under 2% by the latter half of the year. In 1994 Brazil had two different currencies - Cruzeiro Real and Real.

Macroeconomic stability, with fiscal discipline is a necessary precondition for rapid growth.

3.2 - The Real Plan

The Real Plan is almost three years old. It has proven to be quite successful in reducing inflation, and its main consequence has been a rise in the purchasing power of the lowest-income segments of the population. As a result, these segments of society have become a significant part of aggregate demand, expanding significantly the market for consumer durable goods.

It is important to point out that the sharp drop in inflation rates does not result from any price freezing program. In fact, the success of the Real Plan has resulted in a prolonged period of price stability.

The benefits of price stability cannot be overemphasized, be it in terms of its social impact or of its importance in fostering an environment for economic development.

However, macroeconomic stability cannot be an end in itself, it has to be combined with rapid and sustained growth, with reasonable income distribution.

Moreover, there is some worry in the air about the accumulated deficit in the international trade balance.

Then, to equilibrate the trade balance, to keep a modest economic growth, the government has been attracting foreign capital with high interest rates.

Of course, the massive capital inflow has increased dramatically the internal public debt.

Indeed, foreign accounts can be a problem concerning the Brazilian international reserves and its international liquidity, taking into consideration that foreign and domestic savings can leave the country suddenly.

For this reason, the government is struggling to reduce the domestic demand so that imports decrease and exports increase. It is important to point out that the high interest rate path must be abandoned as soon as the foreign trade balance shows clear signs of recovery. In fact, the government has been lowering interest rates gradually.

Within this context, privatization is important not only because of the proceeds it produces, but also because of the gains in efficiency.

As *Suma Econômica* - May/95 put it, "To accelerate the operation of the privatization program is no doubt the best way to contain liquidity, as consumption will be turned into investment. As an extra push, it also causes a more efficient economy."

But Brazil still needs to reduce or even eliminate the cost of red tape. To achieve this goal, the Brazilian government need to simplify the bureaucratic steps that investors need to jump through to set up their businesses.

4. The Breakup of Telebrás - An Irreversible Process of Change

4.1 - Motivations

The interest of Brazil in privatizing its telecommunications companies could be divided into two types: rhetorical and real.

The rhetorical interest has instantaneous political objectives and public approval, defending privatization as an element of pressure from the government against the scarce supply of telephone lines and the current high prices of services. Aside from the rhetorical interest, employed as elements of impression in internal negotiations, there are real interests that account for privatization. Among the real interests of Brazil's government in privatizing its telecommunications companies I may point out :

4.1.1 - Interest in minimizing the debt problem : The weight of the domestic debt, and the pressure for the adoption of firm actions to reduce it, have a significant importance. In additional, the macroeconomic consequences of public sector debt depend upon how it has been financed. Exorbitant monetary financing of debt led Brazil to inflation.

Besides that, Brazil still lacks the flexibility to deal efficiently with its budget deficit due to its commitment to funding colossal privilege programs such as loss-making public enterprises, exorbitant public employment, and non targeted subsidies.

Within this framework, an inflow of capital resulting from privatizations would help Brazil to buy back its debt on the market, meet the demand for services and foster its economy as a whole, increasing efficiency and encouraging investments. Such investments are needed to push forward the economy, stimulating growth and employment.

4.1.2 - Impossibility of affording the necessary investment : Although the Brazilian Telecommunications Sector has performed well since its creation, it obviously that did not satisfy the sharply increasing national demand for telecommunications services. It means that, despite the historical growth, we still have a long way to go to meet market needs.

Taking into consideration that **the funds from the State will not be enough** to foster the sector, the Ministry of Communications (MINICOM) has been striving to deregulate, liberalize, privatize and stimulate competition in the Brazilian telecommunications market.

Unlike many other countries that are obliged to offer tax incentives to foreign investors, Brazil has a large consumer market of approximately 160 million people, 40 million families, 5 million companies, thousands of government agencies and many other organizations that demand massive telecommunications services (see Table 5). These opportunities have not been exploited fully; the nation can sustain a growth rate that is much higher than currently levels.

As regards financial investments, in the new scenario, private companies will be able to get long term and low interest rate loans abroad.

4.1.3 - Interest in dealing with health, education, and sanitation: Privatization, when properly executed, frees state funds for social programs.

4.1.4 - Need to enhance Brazil's image abroad: Most economists agree that Brazil's biggest attraction for foreign investment capital is a privatization process supported by a stable and democratic political climate. The combination of these factors reduces uncertainties, providing the confidence necessary for new investment. A huge privatization program generates immediate policy credibility abroad by providing a firm signal of the government's commitment to investors. If this scenario predominates, Brazil's credibility will come to reflect its economic strengthen. For this reason, President Fernando Henrique has felt a compelling need to establish his medium-term political viability before focusing on major economic issues.

4.1.5 - Need for augmenting the level of foreign direct investment:

From the government's point of view, the foreign current account deficit could be financed by the privatization program. The later would bring long-term foreign capital inflows, and would turn much domestic consumption into domestic savings.

The government wants to encourage foreign-private cooperation through deregulation, privatization and infusions of foreign capital as way to invigorate the Brazilian economy.

All these factors contribute in a synergistic way towards accelerating the pace of economic development

Evolution of the Brazilian Market

Table 5

	1994	1999	2000
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	Unit	1994	1999	2003
População	million	154,8	164,8	172,3
Urban	million	116,1	128,5	139,6
Rural	million	38,7	36,2	32,7
Families	million	40,3	43,1	45,3
Urban	million	31,5	35,0	38,2
Rural	million	9,2	8,7	7,9
Average Monthly Family Income				
r < R\$ 300	%	50,0	45,0	41,0
R\$ 300 < r < R\$ 1000	%	34,0	35,0	36,0
R\$ 1000 < r < R\$ 3000	%	13,0	16,0	19,0
R\$ 3000 < r	%	3,0	4,0	4,0
Companies	million	4,4	5,3	7,5
Primary Sector	%	0,7	0,7	0,7
Secondary Sector	%	16,6	16,6	16,6
Tertiary Sector	%	82,6	82,6	82,6

4.2 - Constitutional Telecommunications Reform

There are many driving reasons for the change of the telecommunications sector in Brazil. However, many of these changes had to go through Congress because they affected the national constitution. The manner of privatizing of the Telebrás System and the future of all state-owned companies are currently under discussion.

The Brazilian constitution of 1988 established some new rules concerning market regulations. Even though, at the time, the monopoly of the telecommunications market remained unchanged, some advances have been implemented in order to liberalize the Brazilian telecommunications sector.

The newly promulgated 8th Constitutional Amendment, which modifies line "a" of indent Article 21 of the nation's constitution, provided a starting point for such liberalization. The amendment change the basic conditions for granting concessions and licenses, allowing for the participation of private capital and, consequently, making it possible to attract much higher levels of investment to the sector.

On May 14, 1996, the Specific Law for Telecommunications was approved by the Chamber of Deputies and later on by the Senate. This bill introduced competition into existing services.

In other words, the National Congress approved complimentary legislation on concessions to private companies for the exploitation of value-added services, as well as of satellite communications and cellular mobile service on Band B. (The Telebrás subsidiary companies have explored mobile services on Band A since 1992). These changes enabled the government to launch bids for private companies to operate in these areas in direct competition with existing public carriers.

In the second half of 1996 the government submitted to the National Congress a bill for the General Law of Telecommunications. This bill was designed to provide a competitive market for all telecommunications services, and to establish a regulatory body.

The regulatory body will likely be composed of members from the executive branch, the legislative and civil society. The process of rewriting the regulations for the new telecommunications environment will take some time.

Michael Denmead of Analysys, the Cambridge, UK-based consultancy, said in a published report : "There is certain to be a great deal of confusion as inexperienced regulators try to deal with the problems which will arise, particularly in relation to interconnect, licensing, universal service and price controls."

With an eye on this new group of laws that promises telecommunications deregulation , liberalization and privatization, formidable and powerful groups of players recently joined forces to seize a share of Brazil's billion dollars telecommunications market. Those groups included Victori Communications - Bradesco, AT&T and Globo; OTL (Odebrecht Telecommunications); AG Telecom - Andrade Gutierrez, the Machiline Group and US West; and many others are waiting in the wings (see table 6).

CONSORTIUM			
National Group	Foreign Investor	Operator	Consortium Status
AG Telecom/ Monteiro Aranha	GE Capital (USA)	SouthWestern Bell (USA) / Mannesmann (Germany)	OK
Brasilinvest/Cowan/ Grendene	Banco Espirito Santo (Portugal)	Nynex (USA) / BellAtlantic (USA)	OK
Camargo Correa	-	Stet (Italy)	NOT OK
Cia. Suzano de Papeis/Inepar	Motorola (USA)	Korean Mobile Telecom	OK
Erline/Grupo Senna	-	Telia (Sweden)	OK
Globopar/Bradesco	Victori International	AT&T (USA)	OK
Grupos de Amazonas e do Maranhao	Millicom (USA)/ Portugal	Telecom (Portugal) Sercomtel (Brazil)	OK
Itamarati/Splice/SBT	-	GTE (USA)	OK
Lightel	-	CTRC (Brazil)	NOT OK

Empresa		OTDR (Brazil)	NOT OK
Metodo Engenharia	-	CCII (USA)	OK
Odebrecht/Unibanco/ Folha da Manhã	-	AirTouch (USA)	OK
RBS/OESP/Arbi/Safra	-	Bell South (USA)	OK
Rural/Encap/Telemont/Set	-	Millicom (USA)	OK
Teldin	-	-	-
Vicunha/Grupo Bezerra de Menezes/Grupo Tacito Pimentel	Netcom/Conviq (Suecia)	Portugal Telecom	OK
-		Deutsche Telekom (Germany)	-
-		France Telecom	-
-		Hutchison (Hong Kong)	-
-		Telesystem (Canada)/Bell Canada	-

Table 6

Source: TELECOM - Jornal de Telecomunicações. August 1996

4.3 - Alternative Implementation Scenarios

Prompted by different motivations and historical circumstances, new trends in telecommunications have created a sense that privatization is the order of the day. One could think of privatization as permitting a practical route to the universal competition that the Brazilian government favored as its final goal, that is, going all the way down to freedom of telecommunications services and prices.

Two major questions must be answered : will the immediate impact of privatization increase Brazil's welfare or will privatization itself be the end of the process ? Will privatization get us closer to the goal of full competition ?

Given the limits of foreign' s interest in full competition, rules are likely to grant a period of private monopoly. In fact, the "*short-term private monopoly*" will be permitted for new companies. However, protection will need to be reduced in the medium-run. This approach seems to preclude the chance that this *temporary monopoly* would persist, returning the Brazilian telecommunications sector to the fragmented, inefficient, and discriminatory private monopolist-infested situation of the 1960s.

The dynamic path that privatization offers is to reach full competition in the Brazilian telecommunications sector. Those who think that having private monopolies in Brazil's telecommunications sector is a better alternative are enslaved by old ways of thinking, based upon the days when protection was in vogue.

One can ask what do Brazilians really expect to gain by going through the hassle of exchanging public monopolies for private monopolies ?

Even though economists from the World Bank assert that "*private ownership itself makes a difference*" , Brazil intends to make the change deeper, which means opening up the telecommunications sector.

Privatization is a useful supplement, not an alternative, to full competition. However, privatization will not merely supplement full competition. If correctly done, it will also stimulate the whole Brazilian economy. One could call the final result as "outcome-privatization".

As a matter of fact, whether Brazil will open up its telecommunications or not in order to expand the number of actors competing with each other will depend to some extent on the disposition of its authorities to do so. Their attitude will certainly be affected by ideas, ideologies and interests. In Brazil, many people fear that the government will be pressured not to grant free access to all companies willing to operate in Brazil. Thus, the government needs to be aware of such pressure in order to ensure free access after the *short-term monopoly*.

4.4 - Domestic Support

It is worthwhile to point out that in order to get domestic support for this important reform, some significant results and benefits have to be visible in the short run, such as lower prices, much higher density of telephone lines and better quality.

In addition, Brazil's officials have to embrace the concept of the so-called **shared growth**, which has been the model adopted by the *Asian Tigers*. The government should make every effort to realize this goal. It must play the role of intermediary, catalyst and honest broker.

In other words, to bring legitimacy and public approval, Brazil's government needs to ensure that the improvements in economic welfare will be widely shared. Without a doubt, few politicians would deny either the value of growth or that the benefits of growth should be shared. This will enable Brazil to reach national consensus as the nation moves toward this goal.

With this commitment and opening to the future, the Telecommunications System and Postal System Recovery and Expansion Program (PASTE) wonders what concepts and values should guide telecommunications policy and try to shape the future that awaits us in the next millennium.

5. The Impact of the New Scenario

In a climate of uncertainty, the new scenario shows exciting signs of good winds coming in the near future.

In order to leverage sustainable growth, the country needs to eliminate bottlenecks in the key areas of critical weakness in the economy, such as telecommunications.

Every change in telecommunications policy has multiple impacts on the Brazilian economy. However, some people have not yet fully realized amplitude of the impact of better telecommunications services on the socioeconomic development, and their significant and rapid cross-sectorial benefits, leveraging Brazil's economic development.

Privatization of Brazil's telecommunications system is likely to have impressive positive results. Efficiency will be improved in the companies, the government will receive considerable proceeds from the sale of assets and, if new owners make essential investments, the outcome will be outstanding.

This is not to say that privatization always provides only positive outcomes. Mistakes are bound to occur, so some negative effects are possible.

The main question is how Brazilians can be convinced that it is in their interest to open the country to foreign investment in the telecommunications sector.

In reality, this sector has been one of the locomotives and of the Brazilian economy. As a result, Brazilians have become accustomed to phenomenal growth rates in the telecommunications sector, but Telebrás has not kept pace with the demand. Nowadays, this demand has a basic reason, which is the high level of economic activity as a consequence of the Real Plan.

5.1 - PASTE

If the goals of the PASTE program are achieved, financed either by the State or by the private sector, the profile of Brazilian telecommunications will be drastically changed.

According to this program, the amount of money that would go to the telecommunications field is respectable - US\$ 77 billion dollars investment from 1995 to 2003. Besides that, PASTE also presents a list of regulatory decisions that must be taken.

Due to the above picture, the Brazilian government believes that the implementation of the privatization program is the best path to foster the economy.

5.2 - Impact on Tariffs

Taking a look at the European deregulation experience, one can see that over the past years competition has reduced tariffs, but also has bitten into the profits of operators. Chileans, on the other hand, may be facing predatory competition: after the first battles, as profits and revenues fell, operators have began merging. At the same time, in Argentina privatization has harmed consumers by raising prices of telecommunications services. However, because of the sale of the system is complete, the government has no room to negotiate further changes.

5.3 - The Transition Period

In the beginning of the privatization process, Brazil's telecommunications will have some competitive areas and foreign ownership in marginal areas ,such as mobile and satellite services. Local companies will need to keep working hard to make themselves much more attractive to investors.

Increased competition also means greater risks for investments in development. Time is a crucial factor in the competitive market. Everybody knows that a competitive marketplace is not a friendly environment at all and every company will have to be efficient in order to make ends meet.

To keep on the business will be their first priority, as opposed to just having to watch profitability. It is a matter of survival: if one can make money even before doing any work, then so much the better.

Existing public carriers, such as Telebahia, are seeking to prepare themselves as quickly as possible to face the new competitive market. "Survival" will be the name of the game in tomorrow's competitive telecommunications environment.

5.4 - Impact on Employment

In theory, the improvement of efficiency would lead to a large number of layoffs but in practice, the employment-reducing effects of the new telecommunications environment will be offset by its employment-creating effects, thanks to higher investments.

Indeed, it is expected that the competitive telecommunications sector alone will create approximately 50 thousand new job opportunities in the short run. This figure is quite impressive when one considers the current employment level in this field - around 150 thousand.

In any case, a transitional adjustment assistance program may have to be implemented to assist those few workers displaced because of restructuring. Such a program should provide affected workers with job search assistance, and the chance of long-term training while receiving non-wage compensation.

5.5 - Impact of Grouping State Owned Companies

The following analysis embodies a policy-framework to minimize investment diversion and to maximize prosperity throughout the country.

The Brazilian government is likely to establish that neighboring states will form "*baby-bells*". This arrangement is not exactly Brazil's crowning achievement. Einstein once claimed that "imagination is more important than knowledge."

Formulas to bind the Brazilian "*baby-bells*" based only upon geographically near states and the population are not easily defensible because they can concentrate investment and its welfare impact on the richest states which, not by coincidence are near each other and discourage those who want to establish more links among the richer and poorer states.

By ruling out unions between non-neighboring companies, Brazil can create some new *baby-bells* that are unlikely to have enough capital to stimulate their regional economies, undermining the rapid move towards the shared objective of full competition and increased welfare for all in Brazil. That can be catastrophic indeed.

The tangible welfare effects will depend not only on the process of privatization, but also on the level of expenditures of the newly privatized companies.

Thus, a desirable pre-condition for selling the current telecommunications companies would be to require that the new owners invest as much as is necessary to reach, in each region, a pre-established set of national standards. The targets could be, for example, density of telephone lines and public pay phones. In addition, bids will likely set rights and obligations in the area of services and investment. But present rules are doing little *in practice* to avoid investment concentration.

6. Conclusion

The predicted worldwide implications of globalization are so important that the Brazilian government is playing a pivotal role in the deregulation and liberalization of the telecommunications market.

The government may have defined the goal but not the process and it is up to the Brazilian public to find the best way. Many different paths can be taken to achieve this goal. However, it is important to keep in mind that, whichever route Brazil takes, it will face many unknowns, such as unpredictable socioeconomic and political behavior.

In the negotiations currently underway nationwide, the forces are formidable. Efforts to frustrate the intent of deregulation may delay the pace of competition in the short term, however, the direction is firmly established. Sooner or later, huge market shifts are certain to happen.

Without guessing what will occur, I will even go so far as to affirm what should not happen. As far as a liberalized market is concerned, the first thing any of us should not want is to see power concentrated once again in a few hands - whether they are the hands of the government (today's situation) or the hands of the private sector (tomorrow's environment).

Besides that, we must help ensure that customers will be the chief beneficiaries of these changes. The payoff : higher investments, "more job opportunities", lower prices and access to voice, data and video services available to millions of additional customers. These changes will enhance the quality of life for society and the competitiveness of Brazilian companies, and of the country itself.

By pursuing this goal, we are contributing to the establishment of a richer nation. With this objective in mind, step by step we must help turn this dream into reality. Should this come true, the telecommunication reform could be better called the official turn of the Brazilian economy towards the twenty-first century. "Buckle up" will likely be the order of the day. However, it is too early to call for "champagne".

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