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PRIVATE AND State Ownership in Telecommunications: A Comparison of São Paulo, Brazil and Manila, Philippines

presented by

Consuelo Campbell

has been accepted towards fulfillment
of the requirements for

Doctorate degree in Telecommunications

Major professor

Date July 7, 1998

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# PRIVATE AND STATE OWNERSHIP IN TELECOMMUNICATIONS: A COMPARATIVE ANALYSIS OF SAO PAULO, BRAZIL AND MANILA, PHILIPPINES

VOLUME 1

By

Consuelo Campbell

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DOCTOR OF PHILOSOPHY

Department of Telecommunications

1998

Professor Joseph Straubhaar

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## ABSTRACT

### PRIVATE AND STATE OWNERSHIP IN TELECOMMUNICATIONS: A COMPARISON OF SAO PAULO, BRAZIL AND MANILA, PHILIPPINES

By

Consuelo Campbell

This study analyzed the structure and Performance of the main regional telecommunications sectors of the Philippines and Brazil under different ownership structures. Poor performance was the common thread between these two companies and was analyzed in the context of three variables: ownership, market structure and regulation at the primary level, and contextual variables such as culture, and political and economic structure at the secondary level.

The study found that institutional idiosyncracies at the state and the firm level in Brazil and the Philippines largely explained the performance of the telecommunications companies in both countries.

Specifically, the historically poor performance and low investment of the Philippine Long Distance phone company in the Philippines can be attributed, for the most part, to profit-maximizing measures that meant the exclusion of non-profitable areas such as the local telephone network; corrupt practices that siphoned and shifted profits elsewhere; and a

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The performance and investment patterns of the Sao Paulo state company, Telesp, can be attributed for the most part, to the political and economic policies at the national and state level and the political/regulatory structure of the Telebras system. Mismanagement and corruption at the ministerial and firm level, while exacerbating the poor performance, played a less crucial role in the firm's overall performance than it did in the case of the Philippine Long Distance Company.

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**ACKNOWLEDGEMENTS**

I would like to extend my gratitutde and gratitude to my committee, Joseph Strauhaar, Chair, Johannes Bauer, Bella Mody, Folu Ogundimu, for their continous support and encouragement. I would also like to thank the many individuals in both the Philippines and Brazil for generously lending their time and support in granting interviews and providing documentation.

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# *INTRODUCTION*

At the most general level, the purpose of this research project is to analyze the factors that underlie the differential performance of the telecommunication sectors in the developing world. More specifically, this study analyzes the structure and performance of the main urban regional telecommunications sectors of the Philippines and Brazil because these two countries provide us with a unique opportunity of comparing an inconsistently performing public system with a weakly regulated private one. Both systems, despite their diametrically opposed ownership structures (public vs. private) exhibited poor performance and flagrant inefficiencies (albeit more inconsistently in Brazil).

The gist of this research lies in the analysis of the processes and forces which, beyond ownership, shaped and constrained the growth and development of telecommunications in Sao Paulo, Brazil and Manila, Philippines from 1973 to 1995. Some common problems include a low telephone penetration ratio when compared to other countries in the region, high installation costs, long waiting time, and poor service quality. While much of the privatization literature in telecommunications focuses on ownership issues as the primary determinant of performance, this dissertation will discuss the interaction of other primary variables such as regulation and market structure as well as their interaction with contextual variables such as politics, economics, and cultural enviro

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Ownership will be defined as either private or public (state). Market structure is the number of firms operating in a sector and regulation is defined as public control of private market related services and regulation by directive, i.e., public enterprises. Performance will be defined both operationally and financially. Operational performance indicators include teledensity ratios, percent growth of local telephone lines, distribution of urban and rural telephone lines, number of public telephone lines, unfilled applications for telephone lines, congestion rate, call completion rate, and restoration time. Financial performance indicators include a company's profitability as measured by the rate of return on equity, investment in the sector, and evolution of urban, interurban and domestic and international long distance tariffs.

Economic conditions include the inflation rate, foreign debt, GDP growth rates, per capita and foreign and domestic investment. Political structure is the existence and relative strength of legislative, executive, and judicial institutions in the country as well as the degree of political corruption within these institutions.

Culture is the ideological climate and environment that surrounds and influences these other variables and which in turn have been influenced by historical phenomenon such as colonialism, nationalism, immigration, linguistic homogeneity, regionalism etc.

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**Telecommunications in Brazil and the Philippines**

The Philippine telecommunications system, for historic reasons, has always been private. As a former colony of the United States, the Philippines inherited the ideology of private ownership, which remained in place even after independence. In theory, telecommunications markets have been open to competition: there are some fifty-four local firms providing telephone service in various regions of the country. In practice, however, one single company controls most of the phone lines. Established in 1928, the PLDT now controls 94% of the phone lines. After more than 65 years of private monopoly power, the quality and extent of the PLDT services have left much to be desired (Sussman, 1992). Existing networks are insufficient to meet basic communication needs, and the telecommunications sector remains uncoordinated, and highly segmented by service, technology and geography. Service coverage represents only about 16% of the total land area of the country with an unbalanced concentration of telephone facilities in Metro Manila. (Benedicto, 1993).

The Brazilian telecommunications sector, on the other hand, has been and is today still run by the state, although privatization plans are changing that reality. While the problems of this state-run system are not identical with the problems of the private monopoly of the Philippines, they are nevertheless as gave. Like the Ph

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grave. Like the Philippines, telephone penetration is low when compared to other countries in the region. Telephone density stands at 7 per 100 which puts Brazil in the position of number 42 in the world and 10th in Latin America. The telephony system serves only 2% of the rural areas, 19.1% of residential areas and 53% of businesses. The waiting period for service in the smaller cities of Brazil has been as long as 14 years. Even in the largest and most industrialized city of Sao Paulo, more than 350,000 people have had to wait 7 years for a line to be installed. It has been estimated that Brazil suffers a telephone deficit of 10,000,000 lines. The average telephone installation cost as of 1993 was $1,200 and has gone as high as $10,000 (Siquiera, 1993).

Given the fact that there has been considerable dissatisfaction with the performance of telecommunications in both countries, a study of the two countries may give us certain clues and shed new light on the factors that affect the development of a modern infrastructure, in general, and of telecommunications in particular. The Brazilian case is characterized by state ownership. In the Philippines, it can be argued that a more free market approach with weak state regulation has been at work.

This research will concern itself with the impact of historical and contemporary contextual variables such as economics, politics, and culture on the ownership structure, the market structure and the regulatory structure of the

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telecommunications sectors of the Philippines and Sao Paulo, Brazil. These interrelationships will then be examined to see how they ultimately affected the performance of the sectors.

An institutional theoretical approach will be employed. Institutions can be defined as the formal and informal organizations created by humans that shape the historical performance of national economies and by extension the sectoral or firm performance (North, 1990). According to institutionalists like Douglas North (1991), history is the story of institutional evolution in which the historical performance of national economies, or on a more micro-level, the firm, can only be understood as part of a sequential story. Institutions provide the incentive structure of an economy, and as the structure evolves, it shapes the direction of economic change towards growth, stagnation or decline, which in turn may effect the performance of the firm.

Hence, this theoretical approach seems to be the optimal one for capturing subtle interrelationships between different institutional organizations and the effect these relationships had on the performance of the sector.

A model has been developed to capture these interrelationships between secondary contextual variables, primary variables such as ownership, market structure and regulatory structures and their impact on the performance of the sectors.

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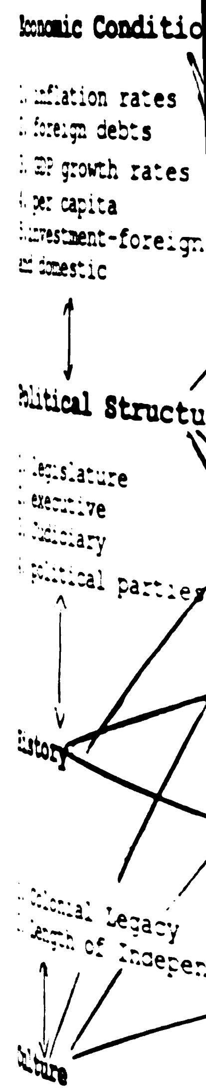
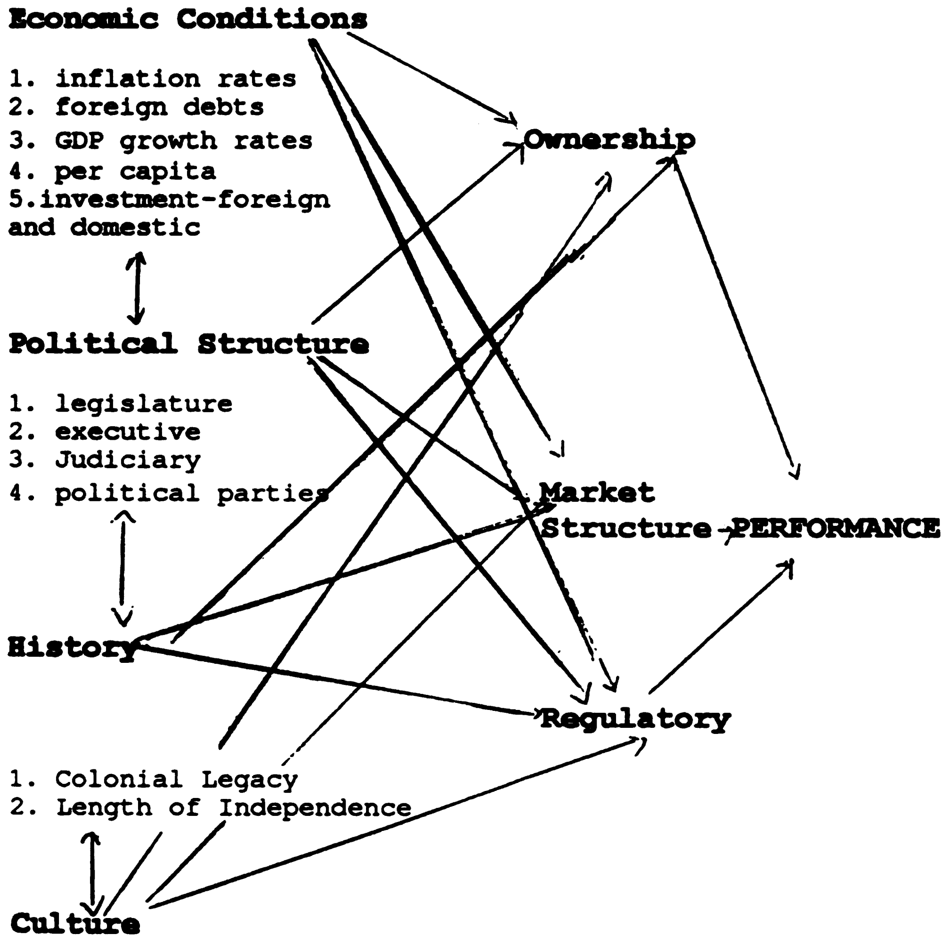


**The interrelationship between contextual variables, ownership, market structure and regulation and its effect on the performance of a telecommunications company**



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Chapter one will be a literature review on the three main variables affecting performance in the sector, the theoretical framework and the questions and propositions derived from the theoretical argument.

Chapter two describes the two-country case study methodology. The qualitative and quantitative techniques used by the researcher are discussed, including the contextual approach to analysis, sources, institutions and questions.

Chapter three is the impact of institutional variables on the primary variables of ownership, market structure and regulation on the Philippines telecommunications sector.

Chapter four is the impact of institutional variables on the primary variables ownership, market structure and regulation on the Sao Paulo telecommunications sector.

Chapter five is an analysis of the impact of the three primary variables on the performance of the company Telesp of Sao Paulo and the Philippine Long Distance Telephone company of the Philippines.

Chapter six will compare the performance of the two companies and analyze their performance. The study will conclude with a theoretical model explaining the nature of these relationships.

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## Review of the Literature and Theoretical Framework

This chapter will discuss performance in telecommunications and review the literature on ownership, market structure, regulation and its relationship to the performance of the telecommunications sectors in various countries.
The theoretical framework will be established and questions and propositions derived from the framework.

### *Performance in Telelecommunications*

The performance of different telecommnunications sectors has been for some (Nellis & Kikeri, 1989; Vogelsang, 1990; Tandem, 1992; Galal, 1994) the ability of a company to function efficiently and to maintain positive growth rates. For others, (Leders, 1993; Harper, 1993; Esfahani, 1993; Stehman, 1995; Petrazzini, 1995) performance of a telecommunications sector has come to mean distributional issues as well as the issue of the quality of services provided.

Factors that may affect the performance of the firm may be external and would tend to be political and economic in nature such as political patronage, political corruption in the case of the Philippines, and macroeconomic and structural adjustment policies of the state such as in the case of Brazil, to name a few. Mody (1987:151) has noted: "the performance of communication technology has freq

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In his analysis of the competitiveness of the Brazilian Telecommunications sector Wohlers (1993) noted that poor performance of the sector in the 1980s was due to the increased politicization of the sector as well as low investment in the sector due to decreasing tariff rates and a reallocation of funding away from the telecommunications sector to other sectors of the economy. Wohlers suggests that the principle challenge of Brazilian telecommunications today is the restructuring of the informatics industry. Telecommunications infrastructure reform can be done only with the complete digitalization and universalization of the basic network; the enlargement of the menu for value-added services; and, promoting the interconnection of the Brazilian telecommunications network with the international global telecommunications network.

While political explanations are those that suggest that the political process and the exercise of power must be essential elements in the ultimate explanation of performance in a sector, these tend, in most cases to be exercised indirectly. More direct determinants of performance of a sector are the ownership, market structure and the regulation of the system. Also, factors that are internal to the firm such as financial, administrative and managerial changes within the companies will also have an inpact on performance. However, it can be argued that in both of these case studies internal changes in the firm were directly related to external changes in the environment.

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This study will look at the impact of contextual variables such as economic /political environment, and social/cultural environment on the market structure, ownership and regulatory structure of the sector. Subsequently, an analysis of the interaction of these variables and their impact on the performance of the firm will be undertaken.

## Ownership

There are good reasons to believe that the ownership of a firm is an important determinant of its performance because changes in property rights will alter the incentive structure faced by those who make the decisions within a firm (Vickers & Yarrow, 1988). Because of this, it is reasonable to expect that the manager of the public enterprise, subject to political pressure, will perform his/her job under a set of incentive constraints that is quite different from the one faced by the manager of a private corporation, who strives to please the private owners (stockholders).

The roots of the belief in the importance of private property as an efficiency-enhancing factor go back to the Austrian approach (Von Mises, 1965). Yet, the separation of ownership from management in the case of modern corporations complicates the connection between ownership, incentives and efficiency. The essence of the Austrian approach is imbedded in the nature of knowledge, with private property seen as a necessary condition for providing the incen

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providing the incentive for discovery and learning. Therefore, private entrepreneurs, motivated by private gains, direct their efforts towards the achievement of potential profits, and by so doing, make use of their knowledge to discover new opportunities. Hence, public enterprises are in a disadvantaged position when it comes to articulating knowledge, which is by definition neither objectifiable nor codifiable (Vicker & Yarrow:1988).

Yet, as hinted above, this argument is far from being convincing when it is directed at explaining the operation of modern corporations. Modern corporations are characterized by the separation of capital ownership (shareholders) from management. Hence, the entrepreneurs, armed with their knowledge are not the managers who control the decision-making process within the firm. Ergo, the problem of principal-agent and corporate governance.

Principal-agent theory addresses the question of the separation of capital ownership and management. It assumes that the principal (owner) and the manager (agent) of the firm do not share the same objectives. While a voluminous literature exists on various principal-agent and monitoring problems, from the perspective of this study it is important to emphasize that private ownership is deemed efficient because first, it is easier to design incentive schemes that would induce the manager of the firm to act in the interest of the owner of the firm.

And second, it is easier for shareholders to monitor and discipline managers. More specifically, under private ownership, it is argued that there are two mechanisms at work that ensure that managers do n

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that managers do not deviate from the efficiency rules. The first one is the shareholders' control-voting rights-over managers and the second is the discipline imposed by capital markets in the form of takeovers. However, the results of empirical research have been inconclusive in terms of supporting the hypothesis that these two mechanisms (capital markets and monitoring of management) are instrumental in enhancing efficiency in private corporations.

As to public ownership, one can say that the two major criticisms of public enterprises have been in the area of financial performance and economic efficiency (Nellis & Kikeri, 1989). The standard inefficiency claims attributed to public ownership is said to be caused by the lack of capital market incentives to monitor managers. Furthermore, the "agency" problem is claimed to be more complex because of the structure of the polity itself: the general public elects a government; the government supervises civil servant; they in turn monitor the managers, who monitor the employees and workers of the state-owned enterprises (Singh, 1975).

Equally complicated is the issue of financial performance because public enterprises may post profits despite their production inefficiencies . In many cases profitable performance will be due to competent, hardworking managers, or because the managers are capable of resisting production-reducing or cost-increasing demands of the government. In other cases, however, profitable performance may not rest with the efforts of management but may be due to the exploitation of monopoly powers. Moreover,

public enterprises make a short-run profit, obtained at the expense of an inappropriate long-term investment or depreciation policy, which goes unnoticed or uncorrected by government reviewers (Nellis, 1986).

While the case for inefficiency in the public sector may have some empirical support there is also evidence of public institutions that have, in many cases, outperformed private institutions. For instance, Bauer (1993) has noted that the performance of some Eastern European countries' public telecommunications sectors was superior to that of the United States when one looked at the countries' base or starting points.

In a series of studies done by the World Bank on the impact of divestitures in twelve countries, Vogelsang argues that in the case of British Telecom the main winners were the consumers and those who purchased the stock, including employees (Galal & Shirley, p.36) However, Vogelsang (1990) believes that public pressure would eventually have forced the British government to boost its investments in British Telecom had it remained in public hands. In a commentary on Vogelsang's article, John Moore takes issue with Vogelsang's assumption that public pressure would eventually have forced the British government to invest in the company and says relaxing that assumption would push the substantial gains from privatizing British Telecom even higher because privatization would be assumed to make an even bigger difference.

In a factual and statistical analysis performed by J.M. Harper (1993) on BT efficiency, the researcher concludes that the

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1984 UK telecommunications regime has had little beneficial effect on BT efficiency and has been accompanied by a serious decline in UK telecoms manufacturing. The paper proposed radical changes in structure to unleash the real potential of competition and to retrieve Britain's place in manufacturing. Stehman (1995) has argued that privatization has actually stood in the way of more competition by preventing a restructuring of BT and encouraging the government to put off further liberalization until the second tranche of BT shares was sold.

In the case of Japan's own privatization attempts Yoshiro Takano (1992) has noted that while there was some operational and administrative problems with the privatization process, the overall result has been beneficial. This is particularly true in the area of improved managerial efficiency, of a substantial rate reduction in long distance services by NTT in response to competition, a restructuring of public finances as a result of reduced dependency on government bonds, increased productivity of workers, a reduction of non-operating costs, resulting in a savings of 2.1 billion dollars and some improvement in service quality.

Galal (1994), in his analysis of the privatization of three firms (Chile Telecom, Enersis and Chilegener) in the late 1980s, noted positive performance gains for all three companies. The biggest gains, however, were made by Chile Telecom. Following privatization in 1988, the company increased the number of lines in service in the next four years by 72 percent, the largest increase in the company's history. The principal variable in the improved performance of the company was the relaxation of investment const

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While consumers benefitted from the divestiture of Chile Telecom, Tandom (1992) points out that this was not the case in Telmex's divestiture. In fact, consumers were the only losers, which were worse of by thirty-three billion dollars (Tandom, 1992:35). The loss was due mainly to the price increases. All the other players (Government, employees, domestic shareholders, domestic buyer, foreign shareholders and foreign buyers) were winners.

In general, while the changeover from state to private enterprise may have contributed to improvements in the sector Leders (1993) has argued that real improvement has not come from a change of ownership but to administrative, financial and managerial changes within the companies, to a relaxation of political constraints that have impeded investment, and to the establishment of a competitive environment. Petrazzini has noted (1995) that in the short run and under certain market, management and organizational conditions, ownership has less impact on firm efficiency and performance than has been widely argued.

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*Market Structure*

A second determinant that interacts with ownership and has an impact on a firm's performance, is the market structure. Market structure is defined as the number of entities operating in a market which include the size of the entities as well as the entry and exit conditions (Snow, 1986).

While it is recognized that the extremes of monopoly or pure competition do not exist in an environment, industries that tend to either of these extremes generally reflect the performance characteristics of these polar cases. The most obvious of these effects is that monopoly pricing results in a deadweight loss to society. This loss has at least three sources. First, because too little is produced there is allocative inefficiency. This represents a loss of value from monopoly pricing, a loss that is not gained from any group in the economy, thus a net loss to society. However, it must be noted that this does not hold if a monopolist can price discriminate. Second, a lack of incentives to hold down costs may cause technical inefficiency. In a competitive environment cost minimization is a necessity. However, a monopolist may not be under the same constraint. If costs increase, the survival of the firm will not be in jeopardy, because the business has a cushion of economic profits. However, a trade-off exists. Any increase in costs resulting from waste will reduce economic profits earned by the firm. Managers will typically sacrifice profits by allowing the firm to operate inefficiently because cost

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Labor contracts are another source of technical inefficiency. When workers are hired, the agreement is usually concerned with inputs-the number of hours to be worked rather than a specified level of effort. A primary task of management is to monitor performance. However, this is not a costless task so, consequently, in most organizations there is considerable slack. Although managers may permit technical inefficiency, it is not consistent with the objectives of the stockholders. To the extent that the firm's stockholders can constrain the behavior of managers, the problem of technical inefficiency will be reduced. However, monitoring of managers by stockholders is extremely difficult in today's economic system because of the large number of stockholders and the lack of control of a large portion of the stock by any single group or individual. Thus we again come to the problem of principal-agent. This separation of ownership and control provides opportunities for technical inefficiency where monopoly power exists.

Another problem of monopoly is the tendency for rent-seeking behavior. This is the payment to factors of production in excess of the minimum amount required to bring them to productive use. Rent-seeking behavior does not increase the amount of goods and services, and leads to the dissipation of monopoly profits. Rent-seeking can take many forms and often involves government officials. The choices of policy-makers can affect the distribution of income and the changes of tax laws can increase or decrease profits by huge am

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profits by huge amounts.

Another impact of rent-seeking is the incentive to engage in corrupt behavior. Because the stakes are so high, bribes for favorable legislation or agency treatment may be offered (Buchanan, 1980).

Normally, the existence of a monopoly should encourage other firms to enter the market. This is particularly true when the performance of the monopoly is poor. However, because of the huge potential for profits the monopoly will often create strategic barriers to entry. These include: government policies by the granting of monopoly patents and restrictions on entry or licensing; single ownership of an essential input as when a single firm owns the entire supply of a nonproducible input; lack of technical information by potential competitors inhibits their entry; economies of scale as with a natural monopoly; and market strategies which include policies such as predatory pricing, excess capacity and limit pricing (Stiglitz, 1989).

The theoretical debate concerning the trade-off between dynamic efficiency and scale economies in a natural monopoly is of great importance in the field of telecommunications. An argument that is often advanced for restricting entry into industries with economies of scale is that entry of additional competitors leads to undesirable duplication of fixed costs and it is better to have one, or at most, a few large firms than to have many smaller ones. This leads to increases in allocative inefficiencies (Vicker & Yarrow, 1988 p. 48). However, Yarrow later argues that the cost efficiency\ competition trade-off is not inevitable. He claims that

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the empirical literature equating the degree of competition with the number of firms operating in the market suggest a weak linkage. For example, collusion rather than competition may occur where a number of firms exist and there is a dominant carrier.

In the telecommunications industry several distinct economic activities are required to supply the final product. A long-distance phone call consists of a trunk line and local links. The supply of a private branch exchange (PBX) telephone exchange involves both manufacture and distribution and in such industries it is often the case that effective competition is more feasible in some activities than it is in others. For example, competition in long-distance telecommunications is possible, whereas in the local networks typically there is natural monopoly and inevitable market power (However, as the recent deregulation of the Regional Bell operating companies has shown, this may be changing).
The question for policy in these circumstances is how to promote and maintain effective competition in activities where it is feasible while monopoly exists in the related areas. More importantly, can the problems of dominance be confined to those activities in which competition cannot exist, or can the dominant firm thwart competition throughout the industry (Vickers & Yarrow, 1988, p.69)? Both Brazil and the Philippines have recently tried to liberalize their telecommunications environments partly in recognition of the trade-off between scale economies and allocative efficiency. The question then is could competition have existed in manufacturing related areas (like telephones) or long distance phone calls during this period thereby increasing allocative

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Secondly, if competition could co-exist with a monopoly, what might the dominant firm do to thwart competition in related areas? One thing might be to charge high prices to the new firm for the section that the incumbent firm controls, like the access fees charged to competitors for interconnection. Local competitors of the PLDT have claimed the company is charging exorbitant access fees for interconnecting to the PLDT trunk line.

While the charging of high access fees may serve as an important barrier to entry, another thing would be a cross-subsidization of the dominant firms local phone service. The excess profits from the long distance part of the company would allow this to occur. This would be a barrier to entry for a new company who might have to charge a higher price for their local service. This would be a form of limit pricing. In fact, the PLDT's argument against the government allowing new entrants is that the new entrants could not possibly afford to subsidize the local phone calls and still remain profitable.

An examination of the relationship between market structure and performance is also important because economic theory postulates that private firms seek to maximize profits while bureaucratic theory posits the maximization of bureau size and authority (Downs, 1969; Wildavsky, 1964). The desire to increase bureau size and authority is derived from the incentives of bureau managers whose power and rewards are positively related to the importance of the bureau.

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The profit motive, on the other hand, is derived from the objectives of private sources of capital to the firm, which are transmitted through the incentive structure of the firm to employees at all levels of the firm. However, a regulatory agency generally puts a constraint on a monopoly's unfettered inclinations toward profit maximization at the expense of distribution.

*Regulation*

This leads us the final and third determinant of performance, which is the regulatory arena of the sector. While the importance of regulation has been explored (Snow, 1986; Brock, 1981) and the reasons regulation has assumed its present forms (see Jaskow & Noel, 1981; Pelzman, 1976; Stigler, 1971) been analyzed, most of these theoretical analyses have been concerned with the traditional definitions of regulation, i.e. an institution regulating a private monopoly. For instance, the public interest school holds that regulation is a public trust to keep monopolistically structured industries from earning supranormal profits by "contriving a scarcity and charging higher prices" (see Cushman, 1941; Bernstein, 1955). The capture theory (Redford, 1952) sees regulators as manipulated by their client industries and therefore serving the interests of the regulated party instead of the public interest.

These perspectives, valuable as they are, tend to be narrow in their approach and confine themselves to traditional notions of regulation. This analysis necessitates a more "generic relation

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extending outside the traditional context of public control of private economic activities" (Mitnick, 1981: p). Hence, a broader approach to regulation will be employed. That is, regulation as public control of private market related services, which is the Philippine case, and the most extreme form of regulation identified by Mitnick as regulation by directive, i.e. public enterprise, which is the case of Sao Paulo.

Other subcategories of regulation such as "capture are

considered in the analysis. Capture can be understood as a kind of reverse regulation. Regulatory outputs tend to correspond to the interests of the regulated parties rather than the public interest or those specified in legislation.

Hulsink (1993), in analyzing the effect of Dutch regulatory reform, illustrates "the paradox of regulatory reform". That is, he has noted that liberalization of significant parts of the telecommunications markets and the withdrawal of government intervention has not yet fully contributed to fair competition in the domestic marketplace. A new institutional framework was developed to combat the inefficiency and ineffectiveness of traditional government intervention as well as to reinforce the position of the marketplace. However, the newly established regulatory framework was not able to manage the domestic and institutional expansion of the former PTT administration. Privatization and liberalization, on the one hand, have led to less government interference in general. They have, on the other hand, created a need for more precise and specific rules to balance the

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the interests of consumers, business users, PTTs and national and foreign service providers. Thus, the "paradox of regulatory reform" requires re-regulation to guarantee the universal provision of dedicated services, reasonable tariffs, fair competition and interconnectivity.

Spiller & Sampson (1994) looked at the relationship between regulation, institutions and economic performance in the Jamaican telecommunications sector. They concluded that Jamaica's parliamentary system with two strong parties, with very little independence of individual members of parliament, and a decentralized decision-making process based on strong statutory based procedural requirements may not provide the necessary regulatory stability to promote private sector investment in sectors characterized by sunk investments and domestic consumption. They contend that the regulatory reform of the late 1980s could have been handled better. The maintenance of a strong monopoly over all telecommunications segments was not necessary to support the development of the network based on private ownership. While breaking the monopoly might have reduced the extensive cross-subsidy towards the domestic segment and reduced public support towards privatization, competition could have been encouraged in other areas that would have promoted the development of a whole array of new products and increased the competitiveness of Jamaica's export-oriented sectors. Spiller and Sampson feel that this clearly articulates a need for a more careful design of regulatory institutions that take into account both the political structure of the country and the economic and technological issues telecommunications

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In a comparative study of telecommunications regulations, institutions and commitment, Levy and Spiller (1996) establish a framework for resolving the regulatory problems of a country and argue that credibility and effectiveness of a regulatory framework, and thus its ability to support efficiency in the production and use of services, vary with a country's political and social institutions.

A country's ability to commit to particular regulatory processes and institutions is based on its regulatory governance and regulatory incentives. While the governance structure incorporates the mechanisms a society uses to restrain the discretionary scope of regulators and to resolve the conflicts to which these restraints give rise, the regulatory incentive structure comprises the rules governing pricing, competition, entry and interconnection. The decisions of regulatory bodies on who will be allowed to enter an industry or procedures to be followed in conducting business can have an enormous impact on profitability.

In the process of matching regulatory systems to a country's institutions, Levy and Spiller (1996) assert that the first and most important distinction to be drawn is between countries that have domestic institutions that engage in arbitrary administrative actions and countries that do not. An independent judiciary with a reputation for impartiality, and whose decisions are enforced is a necessary condition for making credible commitments. The authors note that domestic institutions in the Philippines have historically provided an inadequate foundation for a regulatory system capable of re

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A comparison of the privatization attempts in Trinidad and Jamaica by McCormick (1995) reveals that in both Jamaica and Trinidad the predominant factor prompting divestment of telecommunications was the acquisition of foreign exchange to service external debt obligations and build their international net reserves. She notes that while a private telecommunications monopoly seems to offer more services than a public telecommunications monopoly, neither country adequately addressed effective regulatory mechanisms prior to the divestment of the sector. McCormick believes that had this been done both countries would have garnered greater benefits from the divestiture. Dmytrachenko (1994), in her analysis of the performance of Brazilian telecommunications, looked at the structural adjustment policies during the years 1975-1989 and its effect on the microeconomic performance of Brazilian long-distance telecommunications. The study focused on the effect of regulatory changes on productivity growth and concluded that regulatory reform had a significant and negative impact on firm performance starting in 1980.

*The Theoretical Framework*

While nations may differ in their economic and political structure, they all exercise considerable political control over the communications sector. One potentially valuable use of

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international comparative studies is to provide a more comprehensive analysis of the relationship between the performance of policies and the institutional and political environment in which they are imbedded. This can provide some basis for constructing reasonable, informed expectations about the likely consequences of changes in domestic policies. To the extent that the performance of the communications sector depends in subtle ways on the interactions between political institutions and market organization, these factors must be taken into account in a comparative analysis.

Hence, a general conceptual framework is needed for examining the role of political and institutional structures in shaping the performance of the communications sector. The overall objective would be an enhancement of our understanding of the factors that affect the growth and direction of change in the sector.

Understanding the process driving the performance of the sector requires an accurate characterization of this environment and a theory for relating these characteristics to performance.

Several theoretical approaches have been used by research scholars to describe this relationship. Some theorists have emphasized the role of ideology in the crafting of regulatory policy (Quirk, 1977). From this perspective policy outcomes options and outcomes are strongly shaped by the ideological framework of those political parties in power. Electoral and representational mechanisms have been used as a tool to explain the existence of certain regulation in the telecom market. Roger Noll (1983), for example, argues that narrow economic interest coalitions- such as

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those pressing for the liberalization of the telecommunications market-are more likely to succeed in political systems with single-member districts elected by plurality vote and a fairly autonomous legislature than in countries with nationwide proportional representation.

Another approach explaining this relationship has been a statist approach. While much of statist theory is primarily political philosophy with essentially normative criteria, other statist approaches (Mody, 1995) view the state as allocating power within the society for the purpose of serving the interests of a particular class or group,as say, Marxist or elitist theories (Lukes 1974). A similar approach by North (1981) posits that the state is analogous to a business in that it seeks to maximize the wealth & power of state officials.

The most common approach historically, however, is to assume that the state pursues the national interest. Political scientists adopt a broad definition of national interest, incorporating internal and external stability and the positive assertion of national power in the international community (Aron, 1966).
The states' power lies in its superiority in largely non-economic domains such as power, security & stability (Gilpin, 1981). As such, constant trade-offs are being made between economic values (e.g. efficiency and distribution) and political values. Hence, the state, in order to maintain its power and sovereignty, must cut deals with potentially threatening groups of constituents that, in the short run, detract from economic objectives but are essential to retaining internal stability.

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To explain developments in the area of micro-economic policy, such as communications, statist theory indicates that the relevant facts are the linkages between the sector and policy, on the one hand, and the purpose of the state, on the other. Policy will favor the enhancement of groups and sectors viewed as essential to the maintenance of state power, internal stability, and the structure that supports it, as well as of national wealth. Hence, an industry that is an important source of political stability will be protected even if it is inefficient, while an industry seen as potentially threatening to the established state structure will be constrained or even prohibited, regardless of the economic growth potential it provides.

Telecommunications and broadcasting are important to the state because of the role communications systems and technologies play in national security and their importance in the overall economic system. Therefore, statists, such as the Brazilian military, view as natural a persistent government policy to promote the sector, including its protection against domination by foreigners or potentially disruptive internal groups.

The purpose of government policy will, therefore, be three-fold:

1) To assure that the sector does not become a barrier to the development of other favored economic activities.

2) To promote development that supports the states' overall economic & political objectives.

3) To make sure that the use of the communications network is consistent with goal of promoting state social and cultural interests.

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A statist approach, however, is made difficult by the multiplicity of definitions and typologies. Held (1989) claims that the ubiquity and complexity of the state makes it difficult to comprehend. This is because discussion of the state tends to mix levels of analysis, as when the state and the international arena are co-mingled. The uniqueness of historical experience makes it difficult to generalize, and appropriate and useful data are difficult to find (Braman, 1995).

A third theoretical approach used and the choice of the researcher is an institutionalist approach. While the institutionalist school of thought can be divided into liberal institutionalists in the Veblen-Ayres or commons tradition; new institutionalist in the Oliver Williamson and Douglas North approach; and radical institutionalism in the Dugger and Waller school (Dugger, 1992), all of these approaches emphasize the matrix of the cultural and social factors and the political and economic institutional structures that determine the performance of an economy and by extension the performance of a sector of an economy. Institutional structures are primarily economic, political, cultural and social in nature. As Eggertson (1990) points out "they are the humanly devised constraints that structure economic and social interaction". They consist of both informal constraints (sanctions, taboos, customs, traditions and codes of conduct) and formal rules (constitutions, laws, property rights).

According to institutionalists, history then, is the story of institutional evolution in which the historical performance of national economies, or on a more micro-level, the firm, can only

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be understood as part of a sequential story. Institutions provide the incentive structure of an economy, and as the structure evolves, it shapes the direction of economic change towards growth, stagnation or decline (North, 1991).

In the same article North points out that divergent paths established by England and Spain in the New World have not converged despite the mediating factors of common ideological influences. In the case of England, an institutional framework evolved that permitted the complex impersonal exchange necessary for political stability as well as to capture the potential economic benefits of modern technology. In the case of Spain and Portugal, personalistic relationships were the key element to the political and economic exchange (p.34)

While independence in the Portuguese and Spanish colonies brought about U.S. inspired constitutions, the results were radically different than what occurred in the United States. Latin-American schemes and efforts at decentralization all failed and the gradual country-by-country reversion to centralized bureaucracy control characterized Latin America in the nineteenth century (Veliz, 1980). This was true for the Philippines as well. For while American colonialism help develop a system that moderately empowered regional elites, the power of the executive consistently undermined regional interests.

What developed from this system was the structuring of property rights in favor of an elite minority, rather than the more decentralized structuring of property rights in North America (North, 1991).

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One of the results of this skewed structuring of property rights in favor of an elite minority in many developing countries was the creation of the rent-seeking state. As defined by James Buchanan (1980:7-8), "rents are created when a state gives an entrepreneur an artificial advantage by restricting freedom of entry into the market. When extreme restriction creates a monopoly, the consequences for the economy, as a whole, are decidedly negative". Also, a rent-seeking incentive structure is extremely conducive to the development of corruption.

The importance and centrality of oligarchic families in both the Philippines and Latin America can be attributed, in large part, to the rise of rents as a significant share of their nations' economy (McCoy, 1993:10).

The role of corruption has played a significant role in the development of institutions in all countries. However, in some countries it has played a more significant role than in others. The interaction between corruption and political institutionalization has played a significant role in affecting sectoral performance.

In light of the above theoretical framework, the following propositions are aimed at providing the general framework of empirical inquiry for the research.

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*PROPOSITION 1*

*The institutional features that directly affected the primary variables: ownership, market structure and regulatory structure, were the relative strength of the state and the level of political institutionalization. Contextual features that indirectly affected the three primary variables were the level of industrialization; culture and size of the national bourgoisie; autonomy, strength & culture of the military; and autonomy from core countries.*

*Proposition 2*

*The poor performance of the Philippine Long Distance Telephone Company can be attributed to low levels of investment caused by an ownership structure with strong ties to the administration, a monopoly that focused soley on profit maximization to the exclusion of nonprofitable areas, and a weak regulatory structure that was unable to enforce compliance.*

*The inconsistent performance of Telefonos de Sao Paulo can be attributed to levels of investment that depended on political and economic policies at the national and state level. The ownership/management structure was, on the whole, largely responsive to the current polity, a monopoly structure that successfully centralized and established a national telecommunications infrastructure and a regulatory structure that was subservient to and tied to political and economic agendas.*

*Proposition 3*

*Low levels of political institutionalisation combined with a monopolist model of corruption in the Philippines resulting in a performance that was largely unresponsive to political, economic and regulatory incentives.*

*Moderate levels of political institutionalisation combined with a nonmonopolist model of corruption in Sao Paulo resulting in a performance that was largely responsive to political, economic and regulatory incentives.*

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# Methodology

## *Comparative Analysis in the Social Sciences*

The analytic strategy used in this comparison is an explanation building strategy whose goal is to analyze the case studies by building explanations about the phenomenon in the cases (Yin, 1992). To explain a phenomenon is to stipulate a set of causal or correlational links about it. Proving causality in case studies may be complex and difficult to measure, therefore it may be more appropriate to speak of correlational links (Yin, 1994).

This study has chosen two countries that are neither extremely similar or extremely different. They were chosen because they were good representatives of two countries that had a state system and a private system that had both performed poorly and because of easy access to data.

In this study we propose to investigate a well-defined and well-observed phenomenon, namely, the poor performance of two telecommunications companies in two countries under different ownership arrangements. Poor performance, therefore, is the common thread between these two countries and will be analyzed in the context of three major variables: ownership, market structure and regulation at the primary level, and contextual variables such as culture, and political and economic structure at the secondary level.

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*Data Collection*

The study required quantitative data as well as qualitative data based on interviews and articles. While aggregate country data was available from international financial organizations such as the World Bank, specific regional data was sought from local sources.

Partial data collection for the Philippines section was done in the summer of 1993. The researcher conducted interviews with academics, professionals in the industry and government officials. Archival and library research was also performed. The researcher continued this data collection during the summer of 1996 and conducted similar types of data collection for Sao Paulo in the fall of 1996.

In the Philippines interviews were conducted with the following academics: Dr. Onofre Corpus, who has written extensively about Philippine political history; Dr. Thomas Aquino and Jonathan Chua, both communication researchers. Interviews were also conducted withthe following officials ; Pedro Balanga, and Jose Carrera, who was very helpful in locating data not contained in the annual reports; Abelardo Sabino (Vice-president PLDT) and Ricardo Zarate (senior Vive-president of the PLDT) Richard Pratte, vice-president of Eastern Communications, a competitor of the PLDT was also conducted. Interviews with people in the government included Simeon Quintanar, the present commissioner of the National Communications Commission; Luiz Alcuaz

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(Commissioner NTC, 1987-1989); Rufino Bomasang (Acting Executive Directoor, Office of Energy Affairs); Jose Dans (Minister of Transportation and Communication, 1979-1986); Cathy Heceta(Chief of Legal Division, NTC); Josefina Lichauco (Undersecretary of Communications, DOTC) Industry watchers, such as Thomas Aquino and Jonathan Chua, both of whom work for the Center for Communication Research were also conducted.

In Sao Paulo, interviews with Dr. Mauricio Barrato, professor of international trade and business, were conducted. Professor Barrato has a keen interest in telecommunications development in Brazil and especially helpful in giving me a broad overview of the development of para-statal organizations like Telebras, Petrobras etc. and the historical rationale for their relative autonomy. Also interviewed was Ethevaldo Siquiera, editor of Revista Nacional De Telecommunicacoes. Dr. Siquiera is considered one of the most knowledgeable people about the telecommunications industry in Brazil. He discussed the historical development of the telecommunications industry in Brazil and provided a political analysis of investment by the military during the period in question. He also provided me with written materials in the form of books, magazines, and company (TELESP) documents.

Dr. Jose Gordiano, who is working with Dr. Roberto Venosa on TELESP financial portfolio and is the president of Consultores Gestao & Negocios, supplemented what Dr. Siquiera said and also spoke of the various models for Brazilian telecommunications in the event of restructuring the sector. He was also helpful in putting me in contact with people in TELESP. An interview with the inancial director c

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financial director of TELESP, Dr. Adoaldo Wolf, proved critical in the acquisition of the annual reports of TELESP as well as other financial and performance data on the company.

Both general and specific questions asked are listed below. General questions concerned the socio-political and economic environment and specific questions were about the sector. The general questions asked were:

1. What was the role of the state in the development of both telecommunications systems? How much emphasis was put on the "national Interest" in the development of policy?

2. Has a strong executive contributed to nondistributive policies in the telecommunications sector?

3. In the Philippines, what were the social forces and class alliances that fostered the development of a private system? How did this class articulation collaborate with American colonialism to give rise to a private weakly regulated system?

4. In Brazil, what were the social forces that fostered the development of state system? What pressures were put upon the bureaucracy to improve the sector? What role did the military play?

Specific questions were the following:

1.How much disatisfaction with the system was there? Who was most affected?

2.What are the telephone penetration ratios in both states? What are they in the major cities?

3. What was the price of local telphony service for the urban areas and rural areas? What was the price of domestic and local long distance?

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3. How did the monopoly structure affect the performance of the system?

4. Was the ownership/management structure an important factor in the firm's performance?

5. What were the dynamics in the Philippine regulatory system and how did they interact with the polity?

6. What were the dynamics of the Brazilian regulatory system and how did the economic/political environment interact with the system?

7. In both countries, how much local innovation occurred? How much money was spent on research and development over the years?

8. What was the share of telecommunications investment in relation to both countries' GDP? What were the investment patterns of different administrations during this time period?

9. Who were the principal users of telecommunications equipment? Was it the military? Was it foreign firms?

10. How would one characterize the relationship between Telebras of Brazil and Telesp of Sao Paulo? Did the centralized hierarchical structure of the system lead to a loss of financial and operational control?

11. Was Telesp able to focus its efforts on specific regional development projects based on welfare and social interest goals?

12. Was there any attempt by the regulatory authorities in the Philippines to encourage development projects based on the social interest and welfare of the region?

13.Has Telesp engaged in unprofitable activities that it has been unable to abandon because these activities have been attached to ational policy goa

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14. How have legislative controls over appropriations affected long term planning?

15. How is the authority of the NTC (National Telecommunications Commission) of the Philippines defined? How tranparent are the laws? What are the mechanisms for implementation?

16.Who runs the NTC and how are the leaders appointed? Do they serve the interests of political leaders or private groups, or are they long-term, secure employees, such as career civil servants or judges?

17. What procedures must the organization follow for reaching decisions? Are its processes open to participation by anyone, or are they closed to groups strongly affected by them? What resources does the agency possess relative to the scope of its authority?

Data on the socio-political-economic environment of both countries was based on documentary and archival material gathered in the United States, Manila and Sao Paulo. In Manila, sources such as the library of the University of the Philippines as well as the Philippine National library were used. In Sao Paulo, information on the State of Sao Paulo was gathered from the business library of the University of Sao Paulo, the Instituto Brasileiro Geografica e economia (IBGE) and the Fundacao Sistema Estadual de Analise de Dados (SEADE).

Data on the both telecommunications sectors and the companies under investigation were gathered from the company libraries and research institutes such as SEADE and IBGE in Sao Paulo and the National telecommunications Commission (NTC) and the Department of transportation and

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The actual analysis and comparison of the performance of TELESP and the PLDT was performed with data extracted from the annual reports of both companies and information from research institutes like SEADE and IBGE in the case of Brazil, and the Communication Research Center of the Philippines, the National Telecommunications Commission, the Department of Transportation and Communication and other departments of the PLDT in the case of the Philippines. It might be interesting to note here the kinds of data available in the different annual reports. In the case of the private firm, the PLDT, the information was almost exclusively financial (a brief mention was made at the the beginning of each of the reports about the number of lines the company had laid down that year). All other performance information had to be extracted individually from various departments of the firm, the NTC and the DOTC. In the Telesp annual reports, however, both financial as well as operational performance data was available. The researcher was able to almost exclusively rely on the annual reports for the necessary information.

The specific areas of comparison included:

1. A qualitative assessment of both systems made from the media of both states, which was comprised of critical articles and books as well as interviews with academics, people in the industry and people in government. Articles on TELESP came from trade journals such as <u>Revista Nacional de Telecommunicacoes</u> and <u>Telebrasil</u>, and newspapers such as <u>Estado do Sao Paulo</u> and <u>Folha</u>

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2. Quantitative comparisons involving a time-series analysis of performance indicators taken from the company annual reports and country research institutes. The years ranged from 1965 to 1995 in the case of the PLDT and 1973 to 1995 in the case of TELESP. Performance indicators included urban and rural penetration ratios in both countries; the price of telephony service for the urban areas and the rural areas from 1965 to 1995 in the case of the Philippines and 1973 to 1995 in the case of Brazil; a comparison of the quality of services was also made. These included waiting time, existence of a dial tone, party lines, interference, service response time, rate of completed time for local service and congestion.

Comparisons were also made on number of public telephones, annual growth of telephones in service, investments in long distance and local lines.

Financial comparisons were made on the companies' growth or profitability as measured by the annual rate of return on equity.

All financial information was expressed in U.S. dollars for the sake of clarity and expediency. While the devaluation of the currency was a problem this researcher confronted in both countries, Brazil had the added complexity of currency changes that occurred throughout the period of investigation. The first change occurred in 1983, w

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In summary, this study investigated the poor performance of two telecommunications companies in two countries under different ownership arrangements. The study required quantitative and qualitative data. Qualitative data was based on interviews and articles. Interviews were conducted with academics, industry analysts, officials of the companies and government officials. Quantitative comparisons involving a time-series analysis of performance indicators was taken from company annual reports and country research institutes.

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**Socio-political and economic environment**
***and its impact on the ownership, market structure and regulatory structure of the Philippine Telecommunications sector***

While an indepth analysis of the political, economic and social histories of is beyond the scope of this dissertation, a discussion of important historical, social, political, and economic developments in the countries and their impact on the development of the ownership, market structure and regulatory structure of the sector will provide a framework for the analysis of the performance of the Philippine Long Distance Company. Also, a history of the sector provides us with the sectoral context as well as the interrelationships and interactions between the social, political and economic events occurring in the country and the specific sectoral issues and politics.

The central question and concern that underlies the choice of topics and subtopics in this chapter is: What were the historical, political, social and economic conditions that led to the creation of a private, monopolist and weakly regulated system in the Philippines?

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### *Philippines*

#### *Development of the Philippine State*

Interest in the Philippine state has recently been pursued by Anderson, 1988; Hawes, 1987; and Stauffer 1985. Judged against conventional standards of autonomy, which implies independence from dominant elites, and the capacity or ability of the state to implement policies that are independent of elite interests, this dissertation will argue that the Philippines is a weak state. That, ultimately, the process of state-building has been a function of both external forces (Spanish and American colonial rule) and internal forces (weak national bourgeoisie and elite penetration of the state).

The transformation of Philippine society by Spanish and American colonial policies, and the penetration of the state by different regional elites unleashed powerful centrifugal forces that have fostered fragmented social control and reinforced regional identities at the expense of a strong, national identity (Riedinger, 1993).

While it is recognized that geography and linguistic diversity play an important role in the centralization of social control, a primary reason for the historical weakness of the Philippine state and its institutions have been colonial policies that encouraged and supported elite penetration of the state and the institutional structures of power.

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***Spanish and American Colonial Legacy***

The Philippine state is a product of many factors. Especially important is the way in which the colonial experience shaped and organized economic activities, political institutions, and religious and social practices (Hawes, 1987:2). Under the Spanish Hapsburgs, the colonial bureaucracy was a broker between local elites, the different native groups and the Spanish crown (Phelan, 1960:47).

In both Spanish America and the Philippines, the crown created an elaborate bureaucratic structure that balanced the fiscal concerns of the crown, the religious mission of the church, and the economic interest of the colonist (Lang, 1979:210). While Peru and Mexico provided Spain with silver, neither precious metals nor spices were available in any great quantity in the Philippines. Hence, subsidies from Mexican silver were continually needed to prop up the Filipino economy (Burley, 1973:234).

The political hierarchy established by the Spaniards set the pattern for the structure of society. Power rested with the administration, church, and the military, and as a result their leaders became leaders of society (Burley, 1973:236).

The Spanish colonial administration consisted of a centralized authority( which by definition was almost exclusively Spanish) and the appointments of local bureaucrats as heads of barrios and towns. These individuals functioned as willing middlemen between the colonizers and the townspeople (De Guzman &

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Reforma, 1988: 27). As Phelan notes, "Political office was monopolized by a small group of bosses in each community. Venality, widespread but petty flourished. In the hispanic world this system has come to be known as caciquism" (Phelan, 1959).

The native magistrates gained prestige and influence by the confirmation of their political authority. This was achieved by providing the masses with some modest protection against the worst excesses of colonial exploitation. However, at the same time they also oppressed their subordinates for their own personal gain (Phelan, 1959 p.159). Continued prosperity, in addition to the isolation of the Filipinos from the Spanish community, strengthened the political and societal leadership of the magistrates (Phelan, p.133). Gradually, some magistrates gained entrance into the upper-level bureaucracy, chiefly as a consequence of status acquired through landownership.

Landholding in the Philippines first became important as a source of wealth and prestige in the late 1700's, when the Spanish colony began to export agricultural crops. Following liberal reforms in the 1790's, Spain and the Spanish colonial administration in the Philippines began to open the economy to new, more dynamic foreign merchant houses which were primarily British and American.

This event stimulated rapid growth in the production and export of sugar and hemp. The advent of large-scale agricultural exports made land a source of prestige and tremendous wealth (Bauzon, 1975). As Bauzon indicates there was an element of ethnic diversity among the members of the landholding elite which

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consisted largely of the Spaniards and Chinese mestizos and upper-class Filipinos. Because of the small number of Spanish administrators and settlers, and because of a law that until 1768, prohibited Spanish civilians from living in the provinces (largely at the instigation of the religious orders, who wanted to concentrate on converting the natives) most land was held by a group collectively known as the principalia. These were primarily the leading native-Filipino families and the mestizos, most often offspring of the union of Chinese fathers and native-Filipina mothers (Wickberg, 1964). Many elite landholding families became the economic equals of the Spanish colonialists.

Unlike Spanish colonialism, which denied any political participation to most Filipinos above the magisterial level, American colonial policy granted formal political concessions to Filipino nationalism, which diffused both the Philippine and American opposition to U.S. imperial policy, while at the same time strengthened U.S. economic and political controlling mechanisms. This was achieved through trade policies that tied the Philippine economy to the U.S. and a political system that paid lip-service to democratic principles through the electoral process, which in reality, reinforced the economic and political base of the landed oligarchy through whom the U.S. ruled (Schirmer & Shalom, 1987 p.35).

American rule had three major impacts. The first was the development of free trade relations between the U.S. and the Philippines; the second, the establishment of a free enterprise system based on liberal values of free trade and private

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interests; and the third was the evolution of a democratic system of government dominated by the landholding elite (Hawes, 1987 p.24). Owens (1971: 29) states "that by 1899 the United States was already looking for Filipino leaders with whom a modus vivendus could be arranged, a means of saving not only the cost of repression and local administration, but also what was left of her ideals and self-image".

Creation of civilian governments by way of municipal elections began as early as 1901. In 1907, the first elections for national office were held, and by 1916, legislative control of the colony, by way of the Philippine Autonomy Act of 1916 (also known as the Jones Law) was completely in the hands of Filipinos (Hawes, p.27). So in an unprecedented way, the U.S. government established colonial rule in the Philippines with the declared purpose of self-liquidation of that rule role and enlisted the collaboration of the Philippine elite to this end.

These policies of concession had the effect of consolidating a social base for U.S. rule among the Philippine elite. In 1909 the passage of the Payne-Aldrich Tarriff law opened the markets of the U.S. to wealthy Philippine landowners. This resulted in increased wealth and prosperity for this group from the sale of raw products, as well as completely winning over the Filipino elite to U.S. rule (Schirmer & Shalom, 1987: 35-36)

As markets for Philippine products opened in America, the effects of capitalism on the feudal agrarian society sharpened. The Americans had gradually enlarged the sphere of local government, so that landlords started giving more time to politics and public life.

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and public life. Participation in government by a few leading elite families gradually led to a near monopoly of power by this group (Constantino, 1978: 146). The passage of the Payne-Aldrich tariff Act also had the impact of increasing Philippine economic dependence on the U.S. For example, American exports came to dominate the Philippine market, rising from one-tenth of total imports in 1899 to more than six-tenths by 1929 (Brandt, 1993: 153-154).

Tariff policy ensured the profitable development of agricultural products for export in exchange for American manufactures. American land policy, which perpetuated the concentration of land ownership, favored the traditional landed elite, who in turn became the brokers for the continuation of American colonial control. The elite used their influence with American colonial officials to shape policy in their favor. American investments produced increasing control of extractive, public utility and commercial sectors (Constantino, 1975:312).

However, it is not enough to look at colonial policies as the only causal agent for the past and present conditions. As Onorato (1972: 9-10) notes: " As we have seen, the granting of self-rule is not enough. The indigenous elite must be honest, efficient and competent. They must assume the responsibility of answering the legitimate demands of the people. The Filipino leaders did not take up their obligations".

During the colonial period two important figures emerged, Manuel Quezon and Sergio Osmena, as the foremost leaders of the ruling elite. In an interview with Frank McIntyre as early as

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1913, Quezon admitted privately that both he and Osmena opposed independence because of fears of Japanese expansionism. However, given his economic interests, the prospect of the loss of the colonial free trade access to the U.S. domestic market was perhaps an even more immediate concern (Schirmer & Shalom, 1987: 202)

In the U.S., the move to grant independence to the Philippines was supported by interest groups with varying motives. The major pressure came from the American farm lobby, whose members saw in continued Philippine preferences a threat to domestic agricultural production, which was exacerbated during the depression years.

Largely in response to these pressures, the Tydings-McDuffie Act was enacted on March 24, 1934, inaugurating the commonwealth. The Tydings-McDuffie Act included both political and economic provisions. On the political side it defined the steps to independence which was to be granted after a ten year period (Schirmer & Shalom, p.57). These provisions provided that the Filipinos elect delegates to a convention that drafted a constitution which would subsequently be approved by president Franklin Roosevelt. The results were the election of Manuel Quezon as president and Sergio Osmena as vice-president under one party, the Nacionalista Party. With the all-powerful Nacionalista party leading and with no effective opposition, a virtual one-party system became entrenched under Quezon's leadership.

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social and moral aspects of postwar national development creating dissonance in all of them" (Steinberg et al, 1971 p.373). Japan had been able to obtain the cooperation of the majority of the elite. For much of the elite, collaboration with their new conquerors provided a means of maintaining their political and economic power (Schirmer & Shalom, 1987 p.69).

The question of what to do with the collaborators was one of the pressing issues Washington faced upon the return of the U.S. to the Philippines. In July of 1944, Roosevelt announced that "those who collaborated with the enemy must be removed from authority and influence". However, the administration neglected to formulate concrete plans for putting the president's declaration into practice (Brandt, 1993).

In the end, the collaboration issue was resolved in favor of the collaborators. They assumed their strategic positions in congress. By and large congress was dominated by the wealthy, who were intent on promoting their own economic interests. Thus, the pre-war elite, many of whom had served the Japanese, were firmly in control as the Philippines was about to achieve its independence (Brandt, 1993). The Manuel Roxas administration was committed to both the economic and military aspects of U.S. intervention. A neo-colonialist policy of special relations, in the form of the Bell Trade Act and the Philippine Rehabilitation Act, made war damage compensation conditional upon the Roxas' government's approval of the parity provision for American investors (Sussman, 1993).

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The parliamentary machinations and the U.S. pressure that led to the passage of the Bell Trade Act provoked considerable opposition from Philippine nationalists. Washington responded, in part, to mollify the opposition to a new treaty. In 1955, the Laurel-Langley treaty was signed, which was to govern economic relations between the two countries for the next twenty years. The parity agreement provision of 1946 was recast to establish reciprocity. This agreement gave Philippine investors the same right to invest in the U.S., as U.S. investors had in the Philippines. However, a new clause was added that actually strengthened U.S. interests in the country. It stated that U.S. investors would now be granted equal treatment with Filipinos in all areas of the economy, not just the area of natural resources and public utilities. The question of why public utilities was emphasized along with natural resources in the Bell Trade Act was, perhaps, a recognition on the part of the U.S. government that the primary sources of profit in a war-torn economy lay in these areas.

Specifically, in the area of public utilities, there was a substantial demand on the part of the elites of the country, as a result of war damage, for access to public utilities.

By the end of 1946, the elite, with the help of American politicians, had set up a party system of politics, had drawn up a U.S. style constitution, and had held a number of national elections. Ingrained in these institutions were the objectives of the U.S. government and the elite's desire to maintain their privileges. (Esfahani, 1992). In particular, the following mportant featur

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important features were the consequences of these forces at work:

**A. Competitive politics**- To gain legitimacy among the population a system of competitive politics was established. For this purpose, the constitution envisioned the separation of powers and stipulated that elections be held for the positions of the executive and legislative branches of government. To restrict political competition to members of the elite, the qualifications of the members of congress were made subject to approval by an electoral tribunal consisting of three members of the Supreme Court, and three members of the first and second parties with the largest number of votes in the congress. This set-up was quite effective in undermining third parties and especially in keeping non-political entrepreneurs out (Wurful, 1988 p.92).

**B. Dominant executive and weak legislative and judiciary**- To maximize the control of the government by the elite, a great deal of power was concentrated in the hands of the president. The potency of the presidential office was embedded in a number of constitutional provisions (Esfahani, 1993). As far back as the first Philippine constitution (Malolos Constitution of 1935) the executive office was invested with considerable power (De Guzman & Reforma, 1988). The president could legislate in certain areas by issuing decrees, veto legislation subject to overrule only by a two-thirds majority in both houses of congress, and appoint a variety of municipal officials or suspend the elected ones for

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elected ones for a just cause (Wurfel, 1988 pp.76, 77, & 90). The president could also declare martial law without the consent of congress. Finally, the budget items proposed by the president could not be increased by the congress, while the president could treat the budget approved by the congress as fungible (Esfahani, 1993).

The weak legislature of the Philippines, like the strong executive, also has historical roots. The definition of politics that emerged under American colonial rule tended to emphasize pragmatism and a complete commitment to the ideology of non-ideological politics. It was the politics appropriate to the support of a narrow elite. A system that would have supported greater ideological heterogeneity would have threatened the elite political hegemonic structure as well as American interests.The political style that developed was one that relied heavily on eloquent rhetoric while carefully eschewing any commitment to any ideological position. The pork barrel system of American politics was also adapted and as Stauffer notes " seems to have been perfectly designed to bring about the modernization of traditional clientelism" (1975, p.15).

Stauffer (1975), in his study of Philippine legislative roles and the behavior of house members (based on interview data) found that "Philippine legislators tended to see the purpose of their jobs as being much more particularistic and non-legislation oriented than their counterparts in the United States". His study consistently pointed to legislator perceptions of constituent demands that were centered on having the congressman perform personal service

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The judiciary's weakness is manifested mainly in the control of its resources by the congress and by the president. Traditionally, the president has appointed, with the approval of congress, judges at all levels. Congress is responsible for setting the budgets of the courts and the salaries of the judges. This system seriously impedes the judiciary but serves the interests of the elites well because it allows them to control the judicial process vis-a-vis the non-elite, who are frustrated by the inordinate delays and costs of pursuing justice. The system also gives the president a relatively free hand in issuing executive orders and taking arbitrary action without being challenged (Wurful, 1988 p.77).

**C. Two-Party system with weak indistinguishable parties alternating in power.**

As a result of the immense power invested in the executive, competition for the presidency was intense. Those in the elite who were in power, could channel enormous resources to themselves and their clients. As a result, the elite groups outside the ruling coalition were constantly looking for ways of replacing those inside (Esfahani, 1993).

After the Second World War, a two party system emerged (the Nacionalista party and the liberal party) which were indistinguishabl

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indistinguishable by their platforms and programs and played no serious role in policy-making (Tancangco, 1988). Belonging to a party essentially meant declaring allegiance to the patronage system of a particular leader and benefitting from the spoils of that relationship. Members switched parties, and took most of their clients with them to better position themselves for gaining political office. As a result, parties alternated in power every four to eight years. The main purpose of the winning coalition was the distribution of political talents in each generation of the elites.

### D. Economic parity rights for U.S. citizens

As mentioned in the previous section, the U.S. intended to maintain its political, economic and military influence in the Philippines after independence. Agreements such as the Bell Trade Act and later the Laurel-langley agreement ensured that the economic and political ties would remain intact. The U.S. offered substantial foreign aid, credit, trade, and investment opportunities for the elite and used these resources to preserve its interest in the country. In the economic arena, this meant that American investors had a sense of relative safety in the Philippines. The leverages also allowed American politicians the chance to mediate among the Filipino elite and, thus, contribute to the long-term stability of the system (Sussman, 1992).

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alliance between U.S. economic interests and an strong executive dominated by elites during the early post-war years and the collusion between the executive and particular elite groups favored by the executive during the later years of the post-war era.

***Post-war Political and Economic Change***

In the period immediately after World War 11, economic factors began to break down the tight collaboration which had characterized U.S. -Philippine relations. Economic crises forced the Philippine government and the elite that dominated it to implement policies they would never have accepted in normal circumstances. By the late 1940's the Philippines began to suffer from growing balance of payments deficits caused by declines in U.S. governmental spending in the Philippines. The government responded by imposing import and exchange controls in 1950. These policies, plus a high tariff enacted in 1957, resulted in a period of import substitution industrialization that lasted for more than a decade (Hawes, 1987).

Baldwin (1985) argues that the major beneficiaries of the government's development policies during the 1950's and early 1960's were those who owned or controlled business in the industrial sector which were then exploited by a vigorous Philippine entrepreneurial group. It must be emphasized, however, that these Philippine entrepreneurs were joined by a rapidly growing number c

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growing number of foreign investors-primarily Americans protected by parity rights (Cheetham & Hawkins, 1976). Among the significant things that occurred were a rise in nationalism, a growing centralization of political power in the executive branch, and the diversification of the economic interests of the political elite.

***Traditional Elite Culture***

The strength and locus of traditional elite culture in the Philippines is the family. What the church and state cannot provide, the family meets. It does not only provide economic security and social identity for its members but also provides the emotional security of immediate personal relationships. These personal relationships define morally committing obligations and locate self-identity and conscience in concrete relationships, ethical action thus becoming self-centered and very concrete (Cordero & Pampio, 1967:272). Not only does Filipino culture articulate strong beliefs about the family in the abstract, but individuals, as both leaders and followers, are influenced by kinship concerns in making political decisions (Wurfel, 1988:34).

Consequently, the idea of a common weal, a shared responsibility, or a transcendent national interest can never be the product of the class position and world view of the traditional elite. The idea of the culture of the nation, that transcends particular, private interests, cannot develop when a country is seen as a family backyard.

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From this political vision follow ideas about the state and the role it should play. The state, above all, should serve the interests of the elite as a collectivity, yet should not interfere too much in the pursuit of free enterprise which it may protect and stimulate but should not thwart. Basically the state should be kept weak and provide the arena in which factions of the elite fight their battles. Organized on a regional basis and in clan-like families, exponents of the elite see to it that they get elected to the various halls of power where they defend their individual and family interests. It is by dominating the legislative process that they can exert their hold over the executive administrative branch of government. By emasculating the executive and manipulating the judiciary, the elite tries to create its own free room of action and to make these branches instrumental to its purposes and concerns (Mulder, 1991).

### *The Breakdown of Elite Cohesion*

During the 1960s elite cohesion broke down. Jonathan Fast (1973) has argued (p.93) that " until the late 1960s the Philippine oligarchy had been remarkable in its homogeneity as a class". What terminated the elite cohesion that had characterized Philippine society after independence for twenty-five years was the growing power of import-substituting industrialists and the influx of foreign investors. The strength of family ties and the small size and homogeneity of the elite were no longer sufficient to maintain coh

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to maintain cohesiveness. Also important was the desire on the part of president Marcos to free the executive from the stranglehold of the old oligarchy. Emasculating the latter allowed him to build a strong centralized state (Constantino, 1978:189).

One segment of the new elite was broadly nationalist in character, favored protection for domestically-owned industry & curbs on foreign investment. The other segment of the elite favored a rapid end to government protection of local industry coupled with new support for agricultural exports, policies to attract foreign investors, and a foreign policy closely tied to the U.S. President Marcos was widely believed to be firmly in the camp of the elite segment favoring an open economy.

Guillermo O'Donnell (1973:292) has noted that the sequence of industrialization by import substitution with a broadening of the political spectrum in support of a strengthening of the domestic market was typical of South America.

Under the import substitution plan, the Philippine experience was closer to the Latin American experience than to the experience of other Asian countries, like Taiwan and South Korea. As Cummings has noted (1984, p.27) "Taiwan and South Korea did not have the political characteristics that existed in Brazil and elsewhere. Politics did not stretch to include workers, peasants or plural competition for power. Labor was excluded in the 1950s and remained excluded in the 1960's. Neither the squeezed middle class of bureaucrats nor the small businessmen achieve representation in either Taiwan or South Korea".

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broader. This was so not just domestically, but also in the sense that international investors had stronger links to local capitalists and through them more influence in shaping the local path to development. Also, because the political sphere was broader in the Philippines, the state had less relative autonomy. The transition to export-led development consequently involved greater conflict.

New foreign investment was sought in the 1960's, but most of it went into the agricultural export sector, not into new manufacturing for export. The power of the import-substitution sector of the economy was curbed, but there was no easy transition to export-oriented industrialization. In this the Philippines was again more like Latin America than Taiwan and South Korea. It went through a decade of economic stagnation and political conflict during the 1960's, before it made a sharp break with the past with the declaration of martial law (Cheetham & Hawkins, p.12).

### *Marcos, Martial law and the Strengthening of the Executive*

Within the first few months of the establishment of martial law in 1972 by President Marcos, massive changes were made in the Philippine political economy. Nationalistic rulings by the Supreme Court were severely restricted in their implementation or contradicted by presidential decrees. The president strengthened his hand against the landholding elite that dominated provincial politics by closing congress. The power and scope of the executive branch expanded

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branch expanded substantially and perhaps, more important is the fact that the military got bigger, and its role in maintaining civil order and opportunities to participate directly and indirectly in the economy were all vastly enhanced (Hawes, 1987).

As part of a shift to development based on export-oriented industrialization, wages were repressed and the power of unions to organize and bargain collectively was sharply curtailed. The political sphere, which had expanded in the 1960s, now contracted with the strict implementation of exclusionary politics. In the first full year of martial law (1973) foreign investment reached 55 million dollars and in 1974 140 million dollars (BOI report, 1979).

What began to emerge in the early years of martial law, therefore, was a triple alliance of multi-national, state and local capital (similar to what Evans (1979) describes in Brazil) rather than a clearly dominant state that controlled the local and multinational capital, as in South Korea and Taiwan (Hawes, 1987).

With congress closed and the Supreme Court subservient to the executive, domestic politics was radically different after 1972. The power of local politicians to control followers became largely superfluous because there were no elections to participate in. The president no longer needed local support for his own election. He now depended on his power as commander-in-chief of the armed forces to remain in office, and votes were no longer a valuable commodity (Machado, 1981).

Philippine politics under martial law were unlike the politics of the pre-martial law period, when a stable, elite politics was

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politics was based on regular alternation of office-holding between two very similar political parties. These parties were pyramidal arrangements of political factions tied together by patron-clients. The leaders of the elite faction were most often landowners and had the economic and political resources to resist controls from the national level. It was not until Marcos declared martial law that a Philippine president was able to assert national, executive-branch control over local factions led by a landowning elite (Hawes, 1987)

Prior to the declaration of martial law in 1972, field research in the late 1960's and early 1970's began to suggest that significant changes were taking place in Philippine politics. The greatly enhanced economic role of the government made control of the central organs of government vital. The greater intensity of elections, along with the expansion of suffrage, resulted in greater mobilization. In many areas of the country the political leadership of the old leading families was overthrown by professional career politicians (Machado, 1974).

The decades of the 1960's and the 1970's was characterized by a growing recognition that the easy phase of Import Substitution Industrialization (ISI) was over, and a debate over what policies should be followed to restore rapid economic growth broke out. The executive branch of government, with its economic planning offices dominated by technocrats was leading the nation toward a more open economy in which foreign capital would play a larger role. The legislative and judicial branches were more responsive to nationalist, populist pressures, both from the

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public and from certain segments of the import-substituting industrial bourgeoisie. The declaration of martial law broke the policy stalemate. By choosing to declare martial law, Marcos cleared the way for the nation to shift its path towards export-led industrialization (Machado, 1979). At the same time, Marcos enhanced his own role in the political system, which allowed him to reward his loyal family and friends, i.e. his cronies, leading to a category of capitalism known in the modern parlance as crony capitalism (Girling, 1985).

In most countries of the region, being a high-ranking official in the military or civilian bureaucracy opens tremendous opportunities for joint-venture participation or more direct economic pay-offs. What distinguished the Philippine variant under Marcos was that most of the cronies were not government officials but private citizens. A Crony was, as Newman & Ratliff (1989:59) point out, "a relatively distinct position in the social process of production and, consequently, its own specific political economic requirements". The position they occupied in the social process of production was right next to the first family's. They all served as important officials in the presidents ruling political party. Their specific political-economic requirements included the maintenance of a capitalist, class divided economy but also, and even more important, the continuation in office of president Marcos.

Although Marcos posed as a social reformer, his regime rested upon a coalition of rent-seeking families not unlike those that had dominated electoral politics before martial law. Backed by an expanding mil

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expanding military and an influx of foreign capital, Marcos effectively centralized political power in the archipelago for the first time since the late 1930's. (McCoy, 1993:17).

Marcos effectively stripped the old political elite of their power, while simultaneously providing his cronies with extraordinary opportunities, creating unprecedented wealth among the chosen few (Manapat, 1991:12).

Instead of using his broad martial-law powers to promote development, Marcos expanded the role of rents within the economy, increasing the political corruption that he once promised to eradicate. Since the basis of crony wealth was accidental personal ties to the president, rather than economic acumen, many of the family-based conglomerates proved unstable. Plagued by mismanagement and corruption, these corporations collapsed when the economy began to contract after 1981. As Marcos provincial machinery withered, he sharped reverses in the 1984 and 1986 elections, producing a crises of legitimacy eventually leading to his ouster (McCoy:18).

***Post Marcos Regimes***

The fall of Marcos and the assumption of the presidency by Corazon Aquino in 1986, represented a change of regime but did nothing to alter the basic pact of domination in the Philippines. It was a continuation of essentially the same coalition of dominant class segments and of the same pattern of class domination. (H

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domination. (Hawes, 1987:52). The only segment to have suffered immediate damage because of the fall of Marcos were the crony capitalists. Aquino immediately embarked on a campaign to decentralize the political structure that Marcos had so carefully created, thereby reestablishing the relative strength of the legislature and the former landed elites.

Under the Aquino administration the business dealings of her relatives and their cronies were the target of frequent criticism. Shortly after Marcos' ouster, one Aquino relative obtained, at a fraction of their market value, controlling interests in thirty-six companies previously owned by Marcos' brother-in-law (Reidinger, 1993). Therefore, competition in the Philippines under Aquino was still constrained by the concentration of wealth and the domination of a relatively limited number of family-based economic empires (Tiglao, 1991).

While the positive growth rates from 1986 to 1990 were a turn-around from the negative growth rates during the last few years of the Marcos administration, the Aquino government suffered from severe economic setbacks. By the end of Aquino's term, in June of 1992, her personal popularity had waned as the reform hopes of the early days had not been realized. The land reform program was bogged down in bureaucratic delay and landlord opposition. Widespread corruption continued and the government was perceived as ineffectual (the Economist Intelligence Unit, 1994-1995).

However, on a number of economic fronts the Aquino government made progress such as the liberalization of foreign investment rules, the de

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rules, the deregulation of some sectors of the economy, and the broadening of the tax base and the collection of taxes. After being derailed for an extended period by the opposition within the Aquino cabinet, efforts to overhaul the tariff structure moved ahead. Maximum tariff rates for many items were substantially reduced from Marcos-era levels (Tiglao, 1991: 48-51).

The election of Fidel Ramos on May 11, 1992 ensured the maintenance of the political and economic policies pursued by the Aquino administration and was well received by the country's major foreign creditors and the local business community. Although deep-rooted economic and social problems remain largely unresolved, the resumption of economic growth, particularly since late 1993, and the prospect of its maintenance at more robust levels through the rest of the Ramos administration, has enhanced the president's popularity (EIU, 1995-1996).

Ramos campaigned, in part, with a platform to privatize inefficient government enterprises and a plan to break the power of inefficient private monopolies. Privatization has become a core element of economic policy for the 1990's. By the end of 1992, the sale of two hundred ninety-three government assets and the sale of seventy-five companies brought in two billion dollars. (Far Eastern Economic Review, April 27, 1995).

The present government of Fidel Ramos has undertaken a number of initiatives that promise to create an environment more conducive to market competition and export-oriented economic growth. Ramos' election was widely viewed as a backlash against the passive leadership of Aquino (Reidinger, 1992:2). During his campaign Ramos

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campaign Ramos pledged to restore the authority of the Philippine state in order to govern effectively within a democratic framework. Ramos has largely restored political stability, streamlined the bureaucracy, alleviated chronic shortages, successfully challenged entrenched monopolies, and promoted export-oriented growth while minimizing the state's economic role (Tiglao, 1995: 27).

As Reidinger (1992) has noted the key challenges in promoting market competition and economic growth concern the nature of the private sector and the weakness of the state, both in an administrative and organizational sense and in terms of the structure of the political system.

The new government of Fidel Ramos central tasks is to establish the authority of the Philippine state in order to govern effectively within a democratic framework. In the recent privatization efforts by the Ramos government, the concerns center on the balance of power between the private sector and the public sector, as well as the distribution of wealth among firms and individuals seeking access to public assets (Reidinger, 1992).

Critics of the Ramos regime claim that the president must build a broader coalition of social forces-urban workers, small farmers, students and NGOs-to initiate national development policies that foster democracy as well as growth (FEER, August 7, 1995) In fact, while Ramos' rhetoric has been a stinging attack on the pervasive system of rent-seeking familial politics, his actions have not always been consistent with his rhetoric.
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## *The Military in the Philippines*

As an institution, the Philippine military has played an important role in supporting the political structure of the country and has been used by various political leaders of the country to establish and maintain power and has also been used as a tool to frustrate genuine social reform.

Historically, the Philippine Military has lacked legitimacy. This lack of legitimacy can be traced to its collaborationist character (Sturtevant, 1976). During the Second World War only two senior generals out of nine remained loyal to the U.S. and an estimated 80% of army officers were said to have collaborated with the Japanese (Kessler, 1989). The charges of collaboration constituted a major issue in the post-war Philippines and had a direct impact on the military.

After the Second World war the military became involved in politics as a means to assuage the collaborationist taint and restore some legitimacy. The victory of a presidential candidate, who was also charged with collaboration would mean amnesty for military collaborators. Hence, the military backed the candidacy of Manuel Roxas, thus establishing a pattern for military involvement in future elections (Goldberg, 1976).

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charge of the judicial system in October 1950 when Habeas Corpus was briefly suspended (Berlin, 1982). Throughout the 1950s and early 1960s, military involvement in political and social affairs grew. However, the military's power really expanded with the election of President Ferdinand Marcos in 1965. Marcos undertook the most thorough reorganization of the military's structure and supervised the largest personnel shake-ups in the military's history (Kessler, 1989). Both the structural and personnel changes had the purpose of imposing Marcos' personal control over the military. Marcos played to the military's inherent factional weakness under the guise of strengthening it. Marcos feared that a strong, autonomous and professional army might ultimately overthrow him. However, control over the military meant also extending rewards. Thus began military involvement in development programs. During the martial law period (1972-1983), the military continuously used their official positions for personal gain (FEER, March 1983). They became involved in numerous kinds of legal and illegal business activities for themselves as well as for Marcos and his cronies.

However, during the 1980's, a reform movement within the military started to form and was one of the elements that supported the overthrow of the Marcos administration. The military's role in restoring democracy was seen in a positive light by the public and increased their legitimacy. However, an unintended consequence of the Marcos era was the encouragement of the involvement of the military in development projects. The Marcos regime, by corrupting the integrity og the military's ranks, strengt

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The Marcos years took their toll on the military's self-perception and on society's perception of them. However, after having participated in the overthrow of Marcos, they saw themselves more as a coequal partner with civilians in government affairs and finally as the ultimate guardians of the state.

***The International Context of Philippine Politics***

For the Philippines, the overriding factor in the international context during the twentieth century has been its relationship with the United States. Dominant segments of the elites have been able to extract resources from the domestic Philippine economy as well as legitimacy, economic aid, military assistance, prestige and ideological support from the United States (Hawes, 1987).

While the import-substituting sector was dominant throughout the 1950's and the 1960's, it was not completely Filipino. Large parts of the ISI sector were under the ownership or control of foreign investors (Kurth, 1979).

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Fund and the World Bank to support a reopening of the Philippine economy. The Philippines was to become another export platform for low-wage manufactured goods. Ideological and intellectual support for this effort came primarily from the World Bank (World Bank, 1976).

The strengthening of the state through increased international assistance and the use of martial law powers to quell domestic opposition, was important to the technocrats within the state elite. It increased their insulation from the demands of civil society, allowing them to speak for the interests of international donors and those segments of the elite interested in manufacturing for export (Hawes, 1987).

## *History of the Philippine Long Distance Telephone Company*

### *Inception to Filipinization*

As early as the 1870's, communication links within the Philippines and the outside world were well established. Starting in 1867, the Spanish colonial government installed telegraph lines linking several provinces in Luzon, the biggest island of the archipelago where manila is located. In 1878 the first overseas connection, linking Hongkong and Manila, was established (Aquino, 1989: 23).

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In 1898, admiral Dewey cut this connection, which had the effect of severing communication with Madrid and establishing the political, military and commercial presence of the United States of America (Sussman, 1992:20). During this period, mail service was expanded and a new telegraph network was established by the occupation forces (Sussman, 1992: 21).

In 1903, the Philippines-San Francisco submarine telegraph cable started operations. It was also in this year that a new American regime allowed a private telephone company to operate in Cebu city, the second largest city in the Philippines. Numerous small provincial companies developed until in 1905 an American, J.B. Stevenot, set up the Philippine Long Distance Telephone Company (Aquino, 1989:3).

In 1928, the PLDT was given a fifty year franchise by the Philippine legislature. During the 1930's, the PLDT acquired assets and franchises of other telephone companies and started long distance services to various parts of the country. By the late 1930's close to 30,000 telephones were installed by the PLDT. However, many of these lines were destroyed during the Second World War (Aquino, 1989:4).

Under colonial rule, the administration depended primarily on American colonial institutions for the regulation of the sector. These institutions were primarily influenced by the strategic interests of the United States in the

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Philippines (Esfahani, 1993). The basis for the regulation of the telecommunications sector during this period was a law that simply mandated the regulators to approve investments that contributed to public welfare and to set tariffs so that utility companies would receive a fair rate of return on their investments. The franchise stipulated a 1 percent tax on the companies gross receipts in lieu of all taxes.

The regulation of all public utilities (which included telecommunications) was assigned to one agency, the Public Service Commission (PSC). The PSC was a highly centralized organization where all the decisions had to be made by the commissioner(interview with Onofre Corpus, 1993). This regulation placed the regulatory decisions of the PLDT in firm control of the existing administration as it is easier to control one man as opposed to a group.

After independence in 1946, no attempts at regulatory reform were made, even though economic nationalism was a pervasive Philippine policy objective of the 1950s and the early 1960s. While there were no prohibitions against state ownership, most economic assets in the Philippines continued to be private. This was due, in large part, to legislation that allowed continued ownership of public utilities by American companies for a period of twenty-five years.

In the years following the Second World War, Laws such as the Bell Trade A

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the Bell Trade Act and the Philippine Rehabilitation Act, guaranteed the continuity of pre-independence institutions as well as providing a predictable and safe investment environment for both Filipino and U.S. businesses. In the telecommunications sector, PLDT realized high profits and performed well under foreign ownership ( Morales, p.20).

In 1945, the U.S. army, as a result of war devastation, took control of PLDT's network. In 1947, the control of the company was transferred to an American enterprise, the General Telephone and Electronics corporation (GTE), which acquired approximately 28% of PLDT's common stocks. The rest of the stocks were mostly owned by a large number of American corporations, each of which held a small share. The Filipino elite also acquired a small share of the company. While numerous independent companies existed in the provincial areas and supplied the local exchanges, the PLDT controlled the main trunk line and did not allow the smaller companies to interconnect. By the 1950s, the PLDT had come to dominate 95% of telephone service (Interview with Richard Pratte, 1993). This refusal on the part of an American-owned company to allow for interconnection and the government's acquiescence to these demands was a clear example of American influence over the country's domestic policy. A more politically and economically independent state might have given more support to the smaller

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companies and demanded that they be allowed interconnection. (Morales, 1990, p.22).

Five years after the war, PLDT's pre-war system was completely restored, and between 1950 and 1959 the number of telephones in service grew by 14.4% per year. Telephone tariffs had been set at relatively high levels to make the task of rebuilding the system profitable at the beginning of this period but were kept nominally constant throughout the 1950s (PLDT Commemorative issue, 1978).

During the decades of the 1940s and the 1950s, a number of factors assured the PLDT that it would receive a reasonable rate of return on its investments. This was primarily due to the assurance of the fixed exchange rate stipulation in the Bell Trade Act that kept the peso pegged to the dollar. A currency devaluation would have had a negative impact on the profits of the company. The other reason was the fact that the PLDT's customers were mainly the Filipino elite and foreigners, who were concerned about availability and quality of service and did not seek a confrontation with the PLDT. A confrontation which could have jeopardized the expansion and improvement of service at a time when there was still a great deal of excess demand.(Esfahani, 1993).

By the late 1940's foreign reserves started to dwindle as a result of industrialization policies and limited U.S.

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investment. The latter was particularly meaningful, as part of the rationale for passing the Bell Trade Act was an expectation of increased American investment in the country which would accelerate rehabilitation and economic development. However, this did not occur. American investment in the post-war Philippines was modest compared to its investment in other countries (Benedicto, 1993).

As a result, the government installed import and exchange controls in 1950. Balance of payments difficulties forced the government to ration the foreign exchange demands of many businesses. However, the government's attitude towards the PLDT was clearly more favorable. While the government did impose some restrictions on the remittance of dividends to the foreign shareholders of the PLDT, they did not restrict debt amortization. The PLDT could easily circumvent remittance restrictions by increasing its foreign exchange debt, especially the amount owed GTE (Esfahani, p.23).
During this period of time telephone service grew. This has been primarily attributed to the presence of excess demand for telephones among the elite (Esfahani, p.24).

By the late 1950's, the role of the United States in the Philippines had changed. Economic nationalism was a pervasive Philippine policy objective in the late 1950's to early 1960's with President Garcia's Filipino-first policy, and was discernable thr

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discernable throughout legislative, executive, and judicial activity. This was reflected in the use of the powers of the government to ensure that international trade was in the national interest(Benedicto, 1993). As a result, the United States government lost some of its power over domestic policies.

These new policies resulted in a major conflict between the PLDT and the PSC following a devaluation in 1962, whereby PLDT was not given any preferential treatment like it had been accustomed to receiving in the past. The IMF had recommended a major devaluation and a decontrol of the foreign exchange market, which the U.S. approved. The devaluation would be very costly for the company because the PLDT depended on foreign equipment and foreign capital and its controlling shareholders evaluated their profits in terms of U.S. dollars. PLDT suggested that the PSC allow for an adjustment of telephone tariffs in conjunction with the devaluation, so that the company could go forward with its expansion program. However, keeping the prices of the public utilities low was a way of controlling inflation, and the government needed to keep inflation down to avoid further devaluations that could put the stabilization plan in trouble.

Given the political environment of the time, the PLDT could not count on the U.S. government to intervene (interview with Minister G

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The PLDT managers decided to postpone their expansion plan despite the fact that the peso had not yet been devalued. The rationale behind such a move, as explained by Minister Dans (interview 1993) was "had the PLDT continued their expansion plans, the government would have had much less of an incentive to approve a rate increase. This was perceived by the company management at the time as an important leverage to pressure the government into allowing for an eventual rate increase".

In 1961, the Central Intelligence Agency (CIA) threw its weight and money behind Diosdado Macapagal for the presidency, a proven pro-American with established CIA credentials and a free trade enthusiast. His election led to a rigorous enactment of World Bank and International Monetary Fund policies (Sussman, 1993). On January 21, 1962, three weeks after his inauguration, the new administration announced a 95 percent devaluation of the peso. The PLDT and other public utilities immediately filed rate increase applications with the PSC. Public utility owners argued that without a rate increase they would have difficulty financing their expansion projects. The PLDT management publicly announced that it would not invest in expansion until the requested rate increase was approved (Ronquillo, 1993).

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The PLDT's slow growth during this period had increased unmet demand and the company hoped that further delays in investment would induce the elite in need of telephones to press the government to grant a rate increase. The government, however, was more concerned about the failure of the stabilization plan than about elite demands, and found the cost of satisfying the demands of the public utility companies too high. Thus, they instructed the PSC to take no action on rate increase applications until further notice (interview with Minister Dans).

The government's policies had the desired effect of keeping inflation low, increasing exports and keeping a steady GDP growth rate for a short period. However, soon after, the decline of import substitution industries together with the shortages in infrastructure reversed the GDP growth trend (interview with Onofre Corpuz, 1993). Thus, the weakening economy, the pressures generated by the shortages, and the confidence in the stability of prices prepared the stage for the approval of a public utility tariff increase. In June of 1964, the PLDT received a 40% rate increase for all its local services and immediately launched its expansion plan (interview with Minister Dans, 1993).

An important aspect of the PLDT's withholding strategy during 1960-1963 was its focus on the domestic side of the operations.

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While local investment dropped during the period between 1960-1963, the PLDT continued to invest heavily in its international ventures such as a joint venture to build a submarine cable from the Philippines to Guam, with links to Hawaii and the U.S. mainland. The Guam submarine project, which was finished in 1964, boosted the profitability of the PLDT far more than the 40% rate increase approved for local services (Esfahani, 1993). One notes that even in a time of less favorable treatment by the Philippine government and a period of decreasing influence by the U.S. government, the company was able to pursue a policy that eventually forced the hand of the government. The State's inability to force the company to expand in the face of unmet demand and company profitability underlines the weakness of the regulatory institutions as well as the government's ability to resist the political manipulations of the company. Had a stronger regulatory regimen been in place the government might have been able to force the company to cross-subsidize its local expansion from its lucrative international profits.

In conclusion, during the American colonial period regulatory policy was dictated by U.S. institutions who ,in turn, were governed by U.S. economic and political interests. Immediately after the Second World War until 1959, the continuing

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continuing American economic hegemony (with its implied political leverages), in the form of the Bell Trade Act and the Philippine Rehabilitation Act, guaranteed a profitable and safe investment haven for Americans. Pro-American national governments, more concerned with rehabilitation and economic development in the form of U.S.investments, made little attempts to introduce legislation that might jeopardize those investments. Therefore, the PLDT was routinely exempt from legislation (for example, foreign exchange rationing) that other businesses were subject to. In addition, the presence of excess demand for telephones among the elite assured GTE that confrontation with the government was a remote possibility.

During the late 1950's and the early 1960's, a new political wind in the country, in the form of nationalism, gave rise to a lessening of U.S. commitment capability and the absence of a friendly relationship between the company and the administration. Conflict between the company and the government reached a peak when a devaluation of the peso occurred and no concomitant price increase was granted. The government felt a rise in public utility tariffs would have detrimental inflationary effects, undermining its stabilization policies, which far outweighed the costs of shortages in the service. However, when the economy stabilized and the shortages grew, the government gave in and finally approved a rate

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approved a rate increase. Throughout this period, however, the PLDT continued to invest in its international operations and garner lucrative profits.

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With the parity amendment set to expire, GTE would soon have to divest its PLDT assets. Under the Philippine political structure allies of the president were able to outbid others for the divested assets.

In the mid-1960s GTE was negotiating to sell its shares in PLDT (GTE, 1976; U.S. SEC, 1977). A group of Investors headed by Jose Cojuangco, Jr. (father of Corazon Aquino) approached GTE in 1966 and GTE seriously considered the bid. However, soon after President Ferdinand Marcos was elected president of the country, high-level government officials urged GTE for political and security reasons not to sell its interests to the Jose Cojuangco group (Jose Cojuangco had supported the opposition party which lost in the 1965 elections). (Interview with Thomas Aquino, 1993).

The group which took over the PLDT were all well-known associates of Marcos. The group was led by Ramon Cojuangco (Jose Cojuangco's cousin who had supported Marcos in the 1965 elections). Luis Tirso Revilla (Ramon's brother-in-law)

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Alfonso Yuchengco (a banker) and Antonio M. Meer (a lawyer) (Esfahani, 1993). Other Filipinos involved in the PLDT takeover were friends and associates of the group such as Leonardo Siguion-Reyna, a lawyer who up to that point had exercised an important role in the Philippine Telecommunications industry; Leonides Virata, an executive of Philamlife; Gregorio Romulo, a financial director of ITT, Philippines and Alberto Meer, Antonio Meer's brother and close business advisor and lawyer of Alfonso Yuchengco (Manapat, 1993).

A plan was devised to transfer the controlling interests of GTE to PTIC, a corporation which served as a holding company for the PLDT shares of the four owners. GTE, under pressure to sell its interest in PLDT due to the impending expiration of the Laurel-Langley agreement got extremely favorable terms. The Cojuangco led PTIC group purchased GTE's PLDT shares for $11.00 a share, 30 percent over the list price on the American Stock Exchange. (Manapat, 1993)(On the surface, it would seem to make more sense for the Cojuangco group to have bought the shares through the stock exchange where it was selling for $8.50 a share. However, this was just another incentive on the part of the Cojuangco group to sell the shares to them).

GTE also received 22.5% stake in the holding company that

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enabled it to appoint one director to the board of PLDT. Furthermore, GTE also obliged the PTIC group of Cojuangco to require PLDT to enter into a fifteen year contract with GTE for the purchase of telephone equipment. The terms of the contract provided that GTE's shares in the company would be bought for approximately $7,000,000 in cash and $7,000,000 in promissory notes (GTE, 1976; U.S. SEC 1977).

According to Meer (Tiglao, 1993) the loan was guaranteed by the Development bank of the Philippines. The notes were to be written off through a five to seven percent commission on PLDT's purchases of GTE equipment. A further sweetener for GTE was an exclusive long-term contract to publish the yellow pages telephone directory.

What made the deal particularly attractive to the Cojuangco group were the enticements GTE provided. Apart from the extremely liberal incentives of paying half the price of the shares with only promissory notes, GTE made direct payments to the group as well. The money came in the form of secret commissions, credits and uncollected loans over a ten year period. The group netted one million in personal loans, which were never expected to be paid back. In defense against an SEC charge in 1977 claiming illegal payments were made, the Cojuangco group argued that the loans were part of a plan to refinance the company. However, the group was not able to prove

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able to prove that the loans were made to the PTIC. The loans were clearly personal transfers to the four individuals (Manapat, 1993). GTE also agreed to pay an additional $2,000,000 fee to Stamford Trading Co., a Bahamian firm used as a conduit for the secret payments. The deals were clearly beneficial to PTIC and damaging to PLDT. According to the Wall Street Journal (1977) "GTE executives have testified that one of the factors in setting the price for equipment purchase by PLDT was the amount of commissions GTE paid or credited through the Bahamian company. When the U.S. SEC filed suit in 1977 against the PTIC group, they had no difficulty getting the defendants to agree to the court injunction of $1,000,000 transfer from PTIC to PLDT".

After the GTE-PTIC deal, other U.S. and Filipino shareholders in PLDT remained by-and-large passive investors. The PTIC group dominated the PLDT board and business was directed to enterprises held directly or indirectly by the PTIC group. Insurance, construction and many financing contracts went to related companies. This system created the possibility for directors and management to transfer the company's profits to their own accounts rather than sharing them with other stockholders. The Philippine SEC and the Public Service Commission never questioned these practices (Manapat, 1993).

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In 1969 PLDTs franchise was extended for twenty-five years beyond its 1978 expiration date. Debate in the Congress ensued about whether the company should be subject to corporate income tax. There were those who believed that the franchise tax was insufficient and a final compromise raised the company's franchise taxes to 2 percent of its gross receipts (Esfahani, 1993).

During the 1970s PLDTs overall profitability was low and it had little incentive to invest. The company's third expansion plan (X-3), which it was implementing between 1973 and 1978 was a very small project. Specifically it was less than half of the previous expansion plan in terms of installations. This was curious because the mid-1970's were boom years for the Philippine economy. Yet the company made no attempt to expedite or enlarge the expansion plan.

In fact the expansion plan was largely completely by 1976 and it was not until two years later that the PLDT started its next project (Manapat, 1993). It was also during this time that the governments support was clearly demonstrated in the form of rate increases, the foreign exchange indexation of local rates and the mandatory subscriber investment plan (Esfahani, 193) In fact, the administrations favorable treatment was in marked contrast to its treatment of Meralco, the electric company owned by the Lopez family. After martial

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law (1973) President Marcos was wary of the ambitions of the Lopez family and after martial law appropriated a large part of their assets. First were the newspapers owned by the Lopez family, which were closed down after martial law and were not reopened until they were sold to one of the presidents relatives. Next, in a measure that the president called "popular", electricity tariffs were reduced. In reality this was a measure to force the sale of Meralco to one of Marcos' cronies. When this tactic did not work, Eugenio Lopez's son was taken into custody and accused of trying to assassinate the president, forcing the older Lopez to sell Meralco to the Meralco foundation, Inc., a non-stock firm set up by Marcos' brother-in-law (Tiglao, 1989).

The favorable treatment of the PLDT by the Marcos administration raises the question of the relationship of Marcos to the company. Although president Marcos had no interest in the PLDT under his own name, revelations after his departure in 1986 show that he must have had a major stake in PTIC, represented by the Cojuangco family. Attorney's investigating the case found that in May 1978, Ramon Cojuangco and Luis Revilla had transferred forty-six percent of PTIC shares, with a value of P 170,000,000 to Prime Holdings company, at the price of P 6.5,000,000, five percent of the market value (Sison, 1986). Prime holdings had been formed by two Marcos f

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by two Marcos financial advisors, one of whom admitted in 1986 to have acted as a Marcos front. The attorneys concluded that the sale had not been forced but had belonged to Marcos all along. The reasons for the transfer are not clear. Some have speculated that the transfer may have been prompted by Marcos' disease, as his family became concerned over securing his fronted assets after his death (Jonathan Chua, 1996).

Interestingly, there was no change in PLDT's board of directors between 1977 and 1981, suggesting that the 1978 transaction was not intended to shift control of the company (Esfahani, 1993).

During the mid-1970's the U.S. SEC began investigating business misconduct and asked publicly traded corporations to carry out internal audits about inappropriate trading practices. GTE's audit uncovered its shady deals with the PTIC and in February 1976 GTE halted its arrangements with the Cojuangco group, informing them that commission payments would stop.(Manapat, 1993).

It also refused to pay some $1.7 million that the group had earned under the existing arrangements (GTE, 1976 p.22). However, GTE maintained its stake in PTIC. In January 1977, the U.S.SEC filed a complaint against PTIC group. PLDT would find it difficult to borrow and invest while its contracts with GTE were being terminated and the U.S. SEC was preparing

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an indictment against it. Although the case was quickly settled out of court, the conflict with GTE continued until December 1977, when GTE abandoned its PTIC shares. This freed PLDT to resume its investments. However, the only visible improvements during these years were in the number of domestic and long-distance circuits. Many of the circuits were rented from related telecommunications companies-firms that were franchised as carriers. An important supplier for domestic long-distance was Domestic Satellite Philippine Inc. (DOMSAT), a company owned by Ramon Cojuangco and directed by a number of Marcos cronies (De Luna, 1986). The main suppliers on the international side were Philcomsat, Philippine Global Communications (Philcom) and Eastern Telecommunications Philippine Inc. (Eastern Telecom). This interrelated structure of enterprise provided an important channel for directing PLDTs profits. For example, Philcomsat's profits over the 1966-1989 period were far larger than those of the PLDTs (Isberto, 1986).

After the martial law period entry of other competitors into the telecommunications sector increased. Previously, entry had been restricted because obtaining a franchise from the congress was politically costly. Under martial law President Marcos could grant franchises at will, and he used this power to arrange for entry into the growing long-distance

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telecommunications market for firms to which he had ties. To avoid conflict among his associates, particularly between PLDT and the newly established firms, Marcos restricted the new franchises to message or data communications (Esfahani, 1993).

The last years of the Marcos era, particularly the period of 1978 to 1985, clearly exposed the fundamental flaw in the country's underlying institutional structure. The government's inability to commit itself to anything other than individuals meant that members of the ruling elite would be compelled to sharply cut back on investments inside the country as soon as anything threatened the political balance, even though they had ample supplies of foreign credits, and could ensure profitability in their businesses. Favorable treatment from the government helped boost real telephone tariffs and provide access to large foreign loans, yet PLDT's net investment in local service was modest, and its real rates of return were negative (Esfahani, 1993).

As the Marcos regime continued to wane cronies lost interest in investments and used every arm of the government to squeeze as much as possible from the economy. The economy slowed, inflation mounted and foreign debt and capital flight soared (Interview with minister Dans, 1993).

The picture that emerges for the period 1978-83 is a telecommunications company with friendly ties to the

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administration that is given the opportunity to earn high profits, take over the assets of other companies and borrow heavily. Since the company was concerned with the stability of the administration, it hesitated to expand the local network, except in the area of long-distance services. As the disintegration of the Marcos regime accelerated in the 1984-1985 period and the economy collapsed, PLDT's investment came to a complete halt(Sison, 1986). Capital flight increased and the PLDT managers failed to remit foreign exchange earnings in 1985 (Friedland, 1988).

### *Aquino, Political Turmoil, and Regulatory Activism*

The ushering of a new coalition of forces represented by the Aquino administration increased regulatory conflicts between the PLDT and the new government. The Presidential Commission on Good Government (PCGG) sequestered PLDT's assets and appointed a supervisory committee, headed by attorney Luis F. Sison, to oversee its management. The task of the committee was to investigate the connections with Marcos and its business practices. Numerous allegations were leveled against those in control of the company. The PCGG particularly identified and expropriated the Marcos holdings in the PTIC. (Tiglao, 1988). The committee was presented with deeds of

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assignment showing that in 1981 Ramon Cojuangco and Oscar Africa had attempted to buy the shares of Prime Holdings in PTIC. However, the deeds were not notarized, did not specify any payments, and were not recorded in the books of Prime Holdings. Therefore on May 2, 1986 the sequestration was lifted (Sison, 1986).

The following month PLDT shareholders elected new members to the board of directors. Oscar Africa, from a prominent family with significant interests in other Philippine telecommunications firms, retired as president and was replaced by Antonio Cojuangco, Ramon's young son and relative of President Aquino. PCGG placed two of its members to the Board of directors. Over the following months, they reexamined the company's business practices and issued a more positive report about its management. The commission eventually dropped the case against the PLDT (Esfahani, 1993).

The first few chaotic years of the Aquino administration were dominated by a wide range of represented interests which impeded the development of clear policy objectives and left individual government officials with broad discretionary authority. The new government seemed to prefer expropriating PLDTs assets through tax increases rather than rate reductions. The main interest in these actions was to increase government resources (Tiglao, 1988).

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Another policy initiative during the Aquino administration was the National Telecommunications Plan developed by the Department of Transportation and Communications. Under the plan the government would use official development assistance funds to build telecommunications facilities in areas where they would not be in competition with private sector. After the projects were established they would be transferred to the private sector in a competitive process. PLDT would be eligible to participate in the competitive process, but it would have to compete with other firms. (Friedland, 1988)

In addition to its problems with the new regulatory environment, PLDT faced difficult foreign borrowing conditions because of its own accumulated debt and because of debt rescheduling negotiations between the government and foreign creditors. This resulted in the PTIC group allowing the domestic network to stagnate while investment in international circuits continued (Esfahani, 1993).

By 1990 the new competitive political system had weathered several crises and become more settled. The "old" elite regained control and reestablished the institutions through which they exercised control, although now non-elite groups, particularly the middle class, had more influence than in the past. The PTIC group managed to improve its political standing

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standing with the elite groups that won out in the leadership struggle. The influence of the Cojuangco family in the legislature and the bureaucracy and its control of a major newspaper turned government policies more favorable toward PLDT and ensured that the PCGG representatives on the boards of PTIC and PLDT remain inactive (Tiglao, 1993) .

Although PLDT had gained strong support within all the branches of government, it invested slowly. This did not make sense as profitability in the company was on the rise. PLDT even fought to reserve underdeveloped regions and services for which it had no plans to invest any time soon, clearly showing that highly profitable investment opportunities existed in the sector. Industry observers have speculated that their company must have been concerned about the government's inability to guarantee them a competitive rate of return beyond the end of the Aquino Administration (Jonathan Chua, 1996).

***Ramos, Monopoly Breakup, Competition, and Interconnection***

Under the administration of Fidel Ramos who took office in 1992 events took a different turn. Ramos decided to support the entry of new firms into the telecommunications market and dismantle PLDT's monopoly (Tiglao 1993a). In February 1993 he

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presided at the signing ceremony for a joint-venture between Globe Telecom of the Philippines and Singapore Telecom International, which hoped to take over a big part of the market from PLDT (Tiglao, 1993b). At the same time president's office also reversed the decision by the previous administration on rebidding the disputed privatization projects and allowed Digitel to operate them (Tiglao, 1993c)

By the end of 1993 PLDT, in response to administration pressure, undertook an ambitious "zero-backlog" program. Its backlog had reached 800,000 lines. It was also in 1993 when effective deregulation of the industry was initiated. New players included Globe Telecom, owned by the Ayalas ( one of the most prominent families in the Philippines); a company by Eugenio Lopez called Communication International corporation (CIC); Digital communications owned by shopping-mall and manufacturing magnate John Gokongwie and Cable and Wireless of Britain; Smart Information technologies, 63% controlled by a group of Filipinos and 37% held by a local subsidiary of the Indonesian-owned, Hongkong based First Pacific Group (Tiglao, 1993d).

Nineteen ninety-four was the year the NTC decided to divide the country into eleven service areas which would then be assigned to the different telecommunications firms existing in the country. Under the new rules no single operator could control Metro

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control Metro Manila's telecommunications needs since the NTC had required each company to develop both an urban area and a rural area that had been matched to it (Business World, 1994).

The government also broadened access to international satellite systems by creating policy that would allow local telecommunications operators direct access to international satellite organizations. Up to that point Philcomsat was the country's sole signatory to two international satellite consortia-Intelsat and Inmarsat. The administration's broadening of NTC powers during this period augured well with its plans of liberalization and de-monopolization of the industry (Clifford, 1994).

PLDT's response to the new regulatory environment and to the increased competition was initially introverted and defensive. However, a poor public image coupled with the inevitability of increased competition pushed the PLDT to reassess its tactics.

Gradually, the PLDT substituted its weaker defensive posture for a decidedly more aggressive one. The zero-backlog program was one response. Another was the strengthening of Piltel, a once obscure subsidiary of PLDT. Investment in Piltel (the cellular mobile arm of PLDT) catapulted the company to leadership in the cellular mobile market, claiming eighty percent of the country's users(Tiglao,1994).

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Ironically, the Ramos government's campaign to dismantle the monopoly of PLDT enhanced its shares value. The PLDT was not only awakened from its inertia, prompting it to embark on a crash program to fill unmet demand but also awakened the interests of investors in the company, both foreign and local (Perez, 1994). By 1995 the PLDT stock was trading at six times what it was before the Ramos government was inaugurated in June 1992 (Tiglao, 1995). In October 1995 a new telecommunications bill was passed-the Public Telecommunications Policy Act of 1995 (or Republic Act 7925). Weeks after the new implementing and regulations were released, the new players accused the PLDT of monopolistic conduct, sparking a battle over exclusivity arrangements. At about the same , negotiations for interconnection arrangements were underway and many of the new players complained that the arrangements tended to favor the PLDT.

Under the new regulatory environment telecommunications firms are no longer subject to a multitude of regulations. Many of the latter have been either done away or replaced with market-oriented ones. Industry players can now take numerous initiatives previously reserved for government (Chua, 1995).

Critics of the new telecommunications Act argue that the bill has effectively weakened the power of the regulator by allowing more decisions to be decided by the marketplace, thus tacitly

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tacitly undermining the new entrants in an already uneven playing field and empowering the dominant player (Interview with Jonathan Chua, 1996). A good example would be the access charges that the PLDT charges for interconnection. Companies have complained the access charges are too high and that the cost could effectively put the competitors out of business (Interview with Richard Pratte, 1996).

In a case like this the NTC can not directly intervene because the new Telecommunications Bill limits the NTCs power in this regard. The dispute must be resolved at the industry level (interview with Jonathan Chua).

Apart from the cost of interconnection, companies like ICC (International Communications Corporation are complaining about the quality of interconnection the PLDT has provided the companies with. The ICC is complaining of customer dissatisfaction because of a lack of circuits to PLDT lines. While ICC has fared better than many of the other companies in its phone installation requirement (40 percent of its 1996 target), its lack of connecting circuits to the PLDT network has hampered Bayantel (ICCs service) subscribers from making calls and has been responsible for confidence erosion. ICC prodded the NTC to require PLDT to submit its provisioning schedule till year end and to penalize PLDT if it fails to comply with its obligations (Pano, 1996). A week after the

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complaint the NTC responded with a memorandum requiring all carriers to undertake traffic studies to determine interconnection trunking with the PLDT as well as with inter-service area operators. (Marcelo, 1996).

As for compliance to the roll-outs or installation mandates by the government, the president chided the DOTC and the NTC for not remedying the situation of the poor performers in the industry. President Ramos was reacting to reports that 10 carriers had so far installed in the first half of 1996 only 20 percent of the combined commitments of 1.35 million lines for 1996. This represents only 3.75 percent of the 7.2 million lines targeted during the three year implementation of the Service Area Scheme (SAS) according to statistics released by the DOTC (Pano, 1996). Local Exchange Carriers (LECs) which are suffering from slippage in telephone line installation would be in danger of losing their contracts if they did not meet the 1998 deadline (Philippine Star, 1996).

Meanwhile the PLDT surpassed its target for the installation of telephone lines for the first half of the year. Investment in service improvement and expansion continued to grow. The additional plant investment for the period brought the net value of PLDT's property, plant and equipment to P82.8 billion at the end of the years first half (Star, September, 2 1996). The PLDT earlier in 1996 reported

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a 25.3 percent rise in net income for the first half of the year to 2.92 billion pesos from 2.33 billion posted in the same period in 1995 with operating revenues increasing by 15.6 percent to 13.77 billion pesos from 11.91 billion pesos in the comparative period. Combined local network and National Long distance network revenues went up to 21.8 percent compared to the same period in 1995 primarily because of an increase in the number of telephone lines in service and higher volume of national long distance calls (Star, August 27, 1996).

In summary, under Spanish colonialism the political hierarchy set the pattern for the structure of the society. Power was vested in the church, the administration and the military, with the "principales" acting as intermediaries between the Spaniards and the local population. The power of the principales was strenghthened by the isolation of the Filipino community from the Spanish community and their continued prosperity through landholding.

American colonial policy continued to court the elites of the country as mediators between the colonial administration and the local population. After the Second World War, when many of these prominant elites were brought up on collaboration charges, they were given favorable treatment by the American war tribunal and allowed to enter and dominate the political arena for much of the Republic's history.

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American colonialism had three major effects on the development of Philippine society and its institutions. The first was a democratic system of government dominated by landholdng elites; the second was a free enterprise system based on liberal values of free trade and private interests, and the third was the presence of the United States after independence and its continued influence on the economic life the of the country through free trade relations between the two countries and parity rights for U.S. citizens. This established the private ownership framework that was to dominate all public utilities in the country.

Under the Republic (1946-1972) the Philippine Presidents used the states' licensing powers as bargaining chips in their dealings with national and local elites, thereby favoring and supporting the dominant political families. From the paradigm of rent-seeking politics, the Philippine system was based not so much on the extraction of surplus from the production of new wealth but on a redistribution of existing resources and the artificial creation of rents, thereby rewarding favored families by manipulating regulations to effect a reallocation of existing wealth, or a redistribution of resources produced by others (Scott, 1982: 97-98).

The clientilistic networks of the landowning elite served as a foundation for national political alliances. These alliances c

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alliances created a system that focused in responding to the needs of particular individuals or groups as opposed to the task of creating legislation that serve the national interest.

Under the doctrines of economic nationalism and national development of the 1950's and the 1960's, the republic eventually extended its influence into every sector of the economy. However, although the state had broad economic powers under the law, the republic's record of implementing its development schemes was erratic. Elected with the support of rent-seeking political brokers, successive presidents were forced to pay-off powerful politicians with local and national benefices, thereby compromising the states integrity and diminishing its resources. The republic thus developed as a state with both substantial economic resources and a weak bureaucratic capacity (Corpus, 195-248; de la Torre, 1986: 92-96). It is precisely this pairing of wealth and weakness that opened the state to predatory rent-seeking by politicians (Hutchcroft, 1992:4). Granting monopoly priveleges to select elite families became a way of ensuring political loyalty and perpetuating executive interests in the private sector. The existence of a strong executive and the maintenance of a weak judiciary and legislature secured this relationship. The existence of a strong executive implies that any coalition or company that has friendly relations with the executive will be created favorab

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treated favorably. The existence of a weak regulatory agencies are favored by the elite groups within the president's coalition because their interests are protected by those in charge of regulation.

The PLDT became the giant that it was for the most part because it was nurtured and pampered by the Marcos and to a lesser extent, the Aquino administrations. The Marcos government helped Cojuanco and his associates acquire control over the company, legislated competitors out of the market, mandated private subscriptions to boost its capital, and gave it liberal financial help. The Aquino government, on the other hand, while initially increasing the regulatory activism against the firm, continued and nurtured this monopoly by placing individuals in charge who placed the interests of the Cojuangco family above the welfare of the country (Chua, 1996).

### *Ownership Structure of the PLDT from 1967 to 1995*

In 1967, when the PLDT became a Filipino corporation, there were some people who hailed this as a triumph of Philippine economic nationalism (FEER, 1988). However, an analysis of the composition of the tightly knit group which took-over the telephone company as well as the history of the management of

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management of the firm questions this assertion.

As mentioned in an earlier section, Ramon Cojuangco's family enjoyed close ties with president Marcos. Ramon Cojuangco was also chairman of Domestic Satellite Philippine Inc., a company which deals with satellite communication facilities. The company was registered under Cojuangco's name with the SEC in 1975 with an authorized capitalization of $2.8 million. Included in the board of directors of Domestic Satellite was Manuel Nieto Jr., another Marcos crony. Cojuanco had numerous other interests as diverse as banking, mining, manufacturing, insurance, printing, realty and medical equipment (Manapat, 1991).

Yuchengco, apart from his interests in a large commercial bank, a major investment house, and a string of insurance companies, also worked closely with Harry Stonehill, an american millionaire involved in many dubious Philippine deals after the Second World War, who later became famous in the popular folklore for his corrupting influence on Filipino politicians. Most of the members of the "Stonehill gang" (individuals who managed Stonehill's vast properties) later became Marcos cronies (Manapat, 1993).

After the SEC suit of 1977 and the penalties that ensued, the Cojuango group was found on numerous occasions to be in blatant violation of the SEC directives. As will be

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subsequently shown, instead of protecting the interests of the PLDT, the group abandoned the position of trust it occupied within the firm. It seriously victimized PLDT stockholders by systematically bleeding the firm of its resources (Manapat, 1991).

The claim of the U.S. SEC that officials at the highest levels of the government of the Philippines had a financial stake in the transactions was later proven correct. Subsequent research showed that several shell corporations and front men had been organized to enable Marcos to secure his interests in PLDT (Manapat, 1993 p.8).

The first layer was through Philippine Telecommunications Investment Corp. (PTIC), the corporation Cojuanco and his associates had organized to purchase PLDT from GTE. The original list of PTIC directors was later expanded to include Prime Holdings Inc. (PHI), a shell corporation Marcos used to control both PLDT, the money-maker, and the PTIC, the holding company. The second company, PHI, was organized by Rolando Gapud and Jose Campos Yao on October 5, 1977. Yao was a Marcos associate who controlled the Pharmaceutical industry and had extensive holdings both in the Philippines and overseas. Gapud was a finance manager used by Marcos to manage a great part of his financial empire as well as organize front corporations. PhI ultimately became the major stockholder of PTIC, with members of

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members of the Cojuangco family a close second (Manapat, 1991).

The following list, which shows greater concentration after the nominees transferred the shares to their real owners, gives the relative breakdown of PTIC shares by the time Marcos was ousted in 1986 (Far Eastern Economic Review, Oct. 6, 1988):

Table 3.1
Breakdown of PTIC shares

| Owner | shares |
|---|---|
| Prime holdings | 46% |
| Cojuangco Family | 43% |
| Yuchengco | 7% |
| Antonio Meer | 4% |

This highly concentrated ownership of PTIC meant substantial revenues or benefits for Marcos, Cojuangco, and their associates since the telephone monopoly was an extremely profitable venture. Since 26.9% of PLDT was owned by PTIC, and since 46% of PTIC was held by PHI, this meant that Marcos actually owned 12.5% of PLDT by the time he was ousted from office in 1986 (Manapat, 1991). These shares then had a market value of $7.4 million (Tordecillas, 1986). Marcos acquired his PLDT shares through a series of gratuitous transfers from GTE, PTIC, the Cojuangco group, and PHI.

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Substantial amounts of PLDT stocks were transferred for free or merely at token prices from GTE to PTIC, passing through Cojuangco and Revilla, amd ultimately ending as the property of PHI and Marcos (Manapat, 1993 p.10).

While Marcos enjoyed owning the majority of PLDT voting stocks through these shell corporations, Cojuangco, Yuchengco, and their associates concentrated on controlling the management of PLDT. By participating in Marcos' plans, Cojuangco, Yuchengco, and their associates assured themselves not only of ownership of a substantial portion of the shares but also control of its management. This arrangement permitted Cojuangco and Yuchengco as well as their friends to reap considerable benefits such as large directors fees, lucrative contracts from a captive corporation, and other money-making schemes (interview with Jonathan Chua, 1996).

One of the money-making schemes to raise further capitalization for the PLDT was through a plan devised by the Marcos dictatorship. Marcos imposed a controversial presidential order in 1973 which required all those who received new telephone lines to acquire preferred shares in PLDT. The scheme. formally called the Subscriber Investment Plan (SIP),had the effect of dramatically increasing PLDT's capital through forced subscriptions. But since the presidential order required subscriptions to preferred shares that did

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that did not carry voting rights, telephone subscribers did not have any power to vote for company directors or choose its officers. Thus, while PLDT was theoretically a company owned by all subscribers to the telephone service, it was really controlled by a small favored group (Manapat, 1993 p.15).

The following table summarizes the stock ownership of the PLDT and the voting associated with the shares (Henares, 1989):

Table 3.2
Stock ownership and Voting Rights

| | |
|---|---|
| Investors Equity | 100% |
| Voting common | 14.79% |
| non-voting preferred | 85.21% |

Only 14.79% of total shares have voting rights. The rest of the stockholders, representing 85.21% of total equity, have no voting rights and therefore no say with regard to the management of the company. A closer look at the 14.79% common shares which have voting rights reveals far tighter control than what appears at first glance. The majority of the common stock, comprising 75% of all voting shares or 11.10% of total equity, is scattered, largely spread over different U.S.institutional investors. This diffused ownership of the voting stock is the key to the tight management control exerted by the PLDT clique. This clique, holding only 25% of

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the voting shares or merely 3.39% of total equity, controls the management of PLDT through their holding company, the PTIC. The following table lists the shareholders of PTIC, their percentage ownership of the holding company, and the corresponding percentage of the total equity of the telephone monopoly:

Table 3.3

| shareholder | % of PTIC | % of total PLDT equity |
|---|---|---|
| PHI | 46% | 1.725 |
| Cojuangco | 44% | 1.65 |
| Yuchengco | 7% | 0.2525 |
| Meer | 3% | 0.1107 |

Source:Manapat, 1996

The chart below graphically shows the breakdown of the ownership of PLDT. It shows how Cojuangco and Yuchengco are able to exercise management control over the PLDT even when they own only a very small percentage of the total shares (Henares, 1989).

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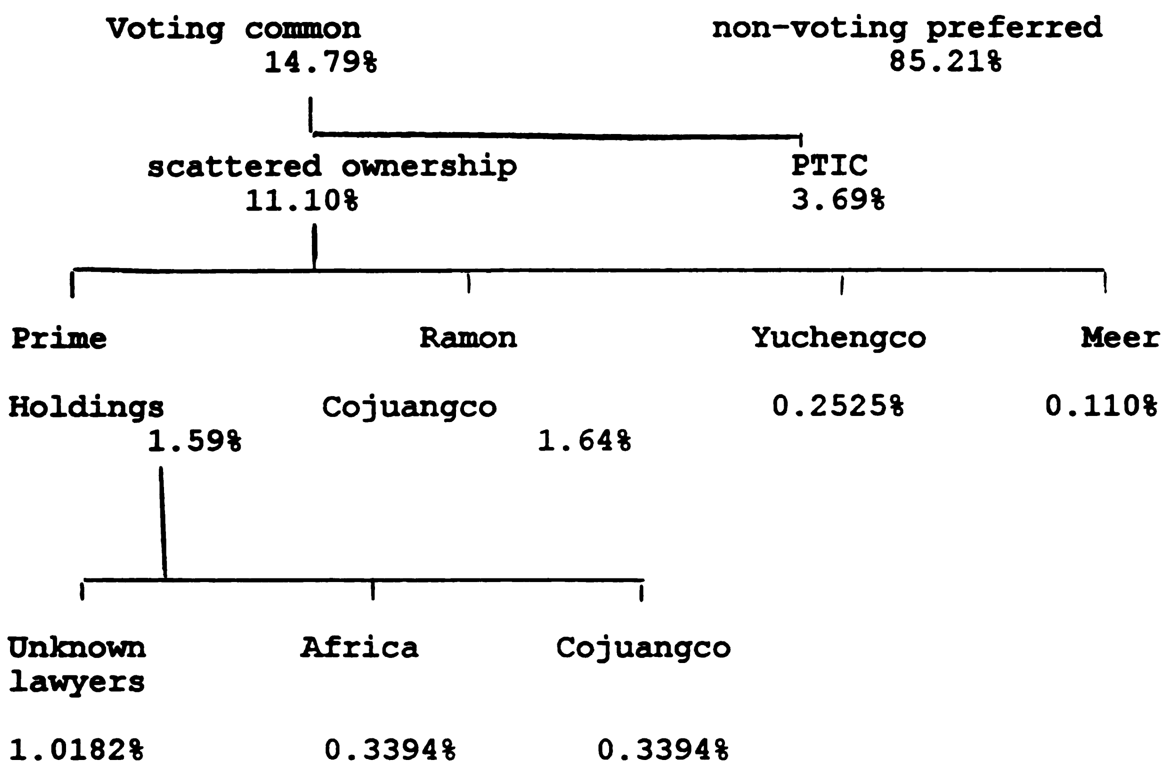


Source:Manapat, 1996

This figure clearly illustrates the partiality involved in the management structure of the PLDT. Since voting stocks are 14.9% of the entire equity, and since, further, the voting stocks are largely diluted amongst different US institutional invest

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investors, this permits a small group to exert complete management over the firm. Also, Ramon Cojuangco and family own only 1.624% of the entire PLDT but enjoys six seats in the 11-person board. Yuchengco owns only 0.2525% but enjoys three seats and sits as its chairman. PHI, on the other hand, while owning the single biggest block in PTIC, representing 1.725% of total PLDT equity, only had two directors, less than Cojuangco or Yuchengco, and no representative in the management of the firm (Henares, 1989). This implies that Marcos and PHI were primarily interested in merely owning the firm and relegated the details of management to Cojuangco and Yuchengco. This arrangement had the effect of totaling disenfranchising the majority of owners of PLDT. Individual subscribers to the telephone service, comprising 85.21% of the total equity, did not possess any voting rights, had no representatives or participation in management, and did not in any way share in the huge profits of the company because company profits were consistently underepresented (FEER, 1986). They were forced by the Marcos-imposed SIP subscriptions to provide the bulk of PLDT's capital but did not get any of the benefits. (Henares, 1989).

There was a further injustice. The voting common shares had a par value of $0.23 but selling at $12.00 per share in 1989, while the non-voting preferred shares had a par value of

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$0.46 but sold for the same price, leading to the comment that the PLDT forcibly raised "cheap money from its subscribers while providing an insufficient return on investment" (FEER, 1986).

Apart from the SIP, the Marcos government also shored up the capital base of the PLDT in other ways. Some came in the way of direct infusion of money from government financial institutions, such as the purchase of $38.5 million worth of preferred shares of PLDT by the DBP(Development Bank of the Philippines), a move Cesar Virata, Marcos' Prime Minister, justified by appealing to the idea that foreign investors needed to be attracted (FEER, 1982).

Once the management structure was in placeby the mid-1970s, the PLDT continued to engage in many projects that were of dubious legality Among these practices were the awarding of lucrative contracts to companies owned by members of the PLDT clique, the purchase of overpriced equipment, extremely high executive compensation, the non-repatriation of foreign exchange earnings and insider trading (Interview with Jonathan Chua).

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**Captive Corporate Contracts**

The PLDT group organized a network of front companies to methodically corner the supplies bought by the telephone company. Only those firms in the select list of suppliers were allowed to do business with the PLDT. These suppliers all had very similar lists of stockholders and officers, all of whom were relatives or friends of the members of the PLDT board and management. This proved to be an extremely lucrative undertaking for Cojuangco and his associates. Since the PLDT was classified as a public utility and therefore under government regulation, ownership and control over the exclusive network of suppliers gave Cojuangco and his associates the opportunity to milk the telephone company. Cojuangco, for example, was able to circumvent rules regulating public utilities. A case in point is the government rule limiting the rates of return of public utilities to a maximum of twelve percent of total invested capital. Cojuangco and his associates simply increased the expenses of PLDT through expensive contracts with the network of suppliers he controlled. This would in effect lower the rate of return of the PLDT while benefitting Cojuangco's front companies. Control over the network of PLDT suppliers was described by some as "single biggest source of graft and corruption" in the telephone mon

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telephone monopoly (Manapat, 1993).

A select list of companies was formulated and no company could break into the substantial PLDT market if they were not part of this list. Among the favored PLDT suppliers were corporations which were owned or controlled by Cojuangco or his relatives. These companies formed part of the South East Asia Development Corporation (SEA), an umbrella company organized to manage the twelve or so affiliate companies, most of whom were the equipment suppliers. A System of interlocking directors and officers between the PLDT and SEA and its affiliates was instituted. Directors and officers in these corporations were often found in the board of management of the PLDT and vice-versa. Individuals previously associated with SEA were eventually appointed to key positions in PLDT. The companies had the same directors with the key positions rotated amongst themselves (Philippine Daily Inquirer, 1986).

These director and officer interlocks were in clear violation of Philippine and American securities laws. However, they were introduced to ensure that the PLDT purchased its supplies only through companies owned by Cojuangco or his relatives and his associates. With such a management and purchasing set-up, abuses easily occurred (Far Eastern Economic Review, 1988).

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These arrangements prejudiced the PLDT, the telephone subscribers who financed the company and the general public who suffered because of poor service. (Manapat, 1993, p.26).

**OVERSEAS REMITTANCES**

Another crime by the PLDT group was in the area of foreign earnings. Foreign exchange earned from overseas correspondent telephone companies was not immediately remitted to the Philippines. This was practice was in direct violation of Central Bank Circular No. 1028 which required the remittance of foreign exchange earnings within fifteen days. The PLDT systematically deposited foreign exchange earnings in overseas time deposits for between three to six months without being recorded in Philippine books (Torsedillas, 1986). The idea of retaining the dollar deposits overseas in the hope of maximizing interest income on these funds must have generated a large amount of money given substantial foreign exchange earnings of the PLDT. For example, in 1984, a year in which these foreign accounts were studied with closer scrutiny, the average monthly balance was $11.4 million (Militante, 1986). Given an average 12% interest rate in the U.S. during this period this earnings should have been substantial.

However, no interest earnings were ever registered in the accounting

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accounting ledgers of PLDT (Manapat, 1993).

**EXECUTIVE COMPENSATION**

Another area where the PLDT has received criticism is executive compensation. The salaries and allowances of PLDT officers were found to be extremely high when compared to comparable companies (Philippine Daily Inquirer, 1992). Moreover, there were no written policies or guidelines which limited the amount of compensation top PLDT officials could received. Furthermore, there were no corporate guidelines which required PLDT officials to explain or indicate in their receipts the purposes of the expenses charged to the company. In some instances investigators found that many expenses were done through personal credit cards for items with clearly no connections to the legitimate business of the firm. Investigators found that for 1984 alone questionable expenses charged to the company amounted to $3.7 million (Militante, 1986).

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**PLDT AND ITS ACCOUNTING PRACTICES**

Apart from captive corporate contracts, overseas remittances and high executive compensation the PLDT systematically distorted accounting record (Manapat, 1993). Provisions of the Public Service Law require that return on investments be limited to twelve percent. The PLDT gets around this limitation by engaging in transactions that increase the operating expenses of the company. Should these practices b stopped then the Rate of return of the PLDT would exceed the legal cap of twelve percent. This means that rates charged customers would have to be adjusted downwards (interview with Jonathan Chua, 1996).

The key therefore to maintaining the present rate structure of PLDT is to hide these anomalies from any serious audit. Dr.John Ure, associated with the Center of Asian Studies at the University of Hongkong, claimed in a study that the PLDT employed questionable accounting practices (Philippine Daily Inquirer, 1992). Since the time Cojuangco and his associates took over the firm from GTE, the PLDT has never been subject to a serious financial audit. Neither has the NTC, mandated by law to oversee the firm's operations, conducted any management or performance audit to see if the PLDT meets the requirements of its franchise (Manapat, 1993).

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PLDT officials have historically used SGV, one of Asia's biggest accounting and auditing firms. However, a seal of approval from the SGV is suspect since the accounting firm was the accounting and auditing firm of Marcos and his cronies for most of their corporations (Philippine Daily Inquirer, 1992).

The SGV thus consistently gave the PLDT a clean bill of health. It certified the books of PLDT as balanced despite the huge amounts overseas that remained unremitted. Finally, it gave the PLDT its seal of approval even when the company was in clear violation not only of established accounting and auditing procedures but also of Philippine law (Manapat, 1993).

**MARCOS AND SIEMENS**

In 1977, the PLDT, with the help of the Marcos government, embarked on an ambitious expansion program called X-4 expansion program (Interview with Minister Dan, 1993). The program's aim was the modernization of the company's antiquated telephone system by delivering between 200,000 to 222,500 new lines by 1982.

However, persistent charges by the press and telecommunications industry watchers were levied against the PLDT its contract with Siemens Aktiengeselschaft, the German telecommunicat

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telecommunications company. Charges were of gross overpricing, illegal commissions and kickbacks, the provision of non-working or obsolete technology, and violation of the technical requirements of the loan agreements (Velasquez, 1986).

There was neither public explanation of how and why Siemens was chosen as the equipment supplier nor were there disclosures if there were other contractors who participated in the selection process. Given the historical relationship with GTE, the question arises as to why PLDT did not contract the American company instead, particularly given the equipment compatibility issue. It was later claimed that Siemens got the contract because Marcos was angry with GTE after bribery schemes between PLDT and the American firm had been disclosed (Business Day, 1986). Investigators also later charged that Siemens acquired the project "by entering into arrangements profitable to Marcos" (FEER, 1988).

Two loans were arranged with an international consortium of banks led by the Germany-based European-Asian Bank. The loans were the single largest supply contract in the history of the PLDT totaling $412.3 million. However, the terms of the two loans caused great concern. On the first loan the interest rate charged was twenty-five percent( interview with Minister Dan, 1993). This rate was way above the international libor rates prevailing at the time. Interest rates were fifteen percent over t

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percent over the prevailing market rates. The rates were felt to be a way to charge kickbacks and divert funds to secret funds (interview with Jonathan Chua, 1996).

Both loans covered the installation of 200,000 lines. The first loan was to be for 60,000 lines and the second for 140,000 lines. What is interesting with the second loan is despite the a substantial increase in the volume of phone lines covered, there was a considerable increase in the unit price per line. The unit price from the first loan was $1,750.00 per phone. The second loan had a unit price of $2,195.00 per phone. This represents an increase of 25% in the price per unit of the phones. By the end of the project, the unit cost of a line had skyrocketed to $6,023 per line (Philippine Daily Enquirer, 1990).

Also the contract required that Siemens install an all-digital telephone switching and dialing system in Metro-Manila by 1986. However, the actual equipment fell far short of the state-of-the-art equipment that the agreement stipulated. Instead of delivering and installing modern equipment, Siemens subcontracted different corporations connected with Marcos and the PLDT group and delivered substandard and obsolete technology. The SEA Development Corporation and its affiliates and another corporation, Electronic Telephone Systems Industries, Inc. (ETSI), a company Marcos owned, became the subcontractors

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subcontractors of Siemens in the Philippines, thus assuring substantial earnings for these front corporations, particularly from 1980 through 1983 when the purchases were at their peak. The result of this pyramid of Subcontractors was higher costs and poorer equipment quality (Manapat, 1993).

Also, another problem with the Siemen equipment was its incompatibility with existing PLDT lines. There were impedance differences between the equipment supplied by Siemens and the North American standard which GTE had introduced to the PLDT phone system. Furthermore, the equipment delivered by Siemens were electromechanical devices (EMD) rather than the electronic switching systems (ESS) required by the contract. Apart from the interface compatibilities, the switching equipment presented installation problems as well. The outdated EMDs required three times as much space as the electronic switching system (Philippine daily Inquirer, 1992:5)

The substitution in equipment was technically a violation of the contract. Even if top PLDT officials were not inclined to object to the PLDT being shortchanged because of their financial interest in the project, the consortium of banks funding the expansion program could have called the loan. The loan agreements covering the project prohibited any equipment substitution unless expressly approved by the lending banks

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(Philippine Daily Enquirer, 1992:6). This, however, did not occur and as a result the country was stuck with a multimillion dollar debt and an antiquated phone system .

**THE FIVE YEAR DEVELOPMENT PLAN**

While the contract between Siemens and PLDT was clearly disadvantageous to the country, another project seemed to indicate that the Siemens agreement was merely a part of a concerted effort by Marcos and Cojuangco to gain control over the country's telecommunications industry.

Under the guise of upgrading the nation's communication's infrastructure, the Marcos government embarked on an ambitious five-year development plan, covering 1978 through 1982, where the country's telecommunications facilities would be improved. The plan included telegraphy, where telegrams were to reach all towns and municipalities in the archipelago, and an improvement of the country's telephone density ratio. However, it was clear that the only part of the plan that was implemented with any vigor was the privatization of telecommunications facilities. The policy of privatizing the telecommunications industry and the selective implementation of the five-year development provided the platform
for delivering the telecommunications field under the monopoly

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Government entities, such as the Government Telephone Service which supplied phone services to Metro-Manila, several major cities, and all government offices in the country, were dismantled. The importance of the GTS lay in the fact that, like PLDT and unlike other telecommunications operators in the country, it maintained a national telecommunication trunkline. The GTS and the trunkline it maintained was then supervised by the Bureau of Telecommunications (Butel) (Interview with Minister Dan, 1996).

Marcos then assigned Ceferino Carreon to currently head all the major government offices dealing with telecommunications such as the Board of Communication (BOC), Bureau of Telecommunications (Butel) and the Telecommunications Control Bureau (TCB). The BOC and TCB were later merged into the National Telecommunications Commission (NTC).

Carreon's primary function was to dismantle the GTS telephone system. At the simplest level, this meant that PLDT would have access to the large market of government offices and major cities vacated by GTS. More importantly, though, the move also had the long-term effect of eliminating all future competition for PLDT.

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With the GTS trunkline gone, only PLDT would have "the communications highway" essential for telecommunications. Cojuangco could therefore easily kill any potential or actual competitor by denying it the use of the telecommunications trunkline. This was the state of affairs until President Ramos, in 1993, with Executive Order 59, ordered the company to interconnect (Interview with Jonathan Chua, 1996).

## The Philippine Telecommunications Industry

### Structure of the Telecommunications Sector

The telecommunications sector in the Philippines is comprised by a wide range of services and manufacturing activities involving government agencies, private and public telecommunications network operators, equipment manufacturers and suppliers, users of telecommunications services and local industry associations. The structure of the sector and their interrelationships is shown in Figure 3.2

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Figure 3.2

Telecommunications Industry Structure

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**NTC**
**Regulatory body**

**voice carrier**

**international Domestic operators record carrier**

**carriers Paging carrier operators**

**Cellular Mobile Telephone System**

**VSAT**

**PLDT**

**Source: NTC**

***Government Agencies***

The telephone industry is governed by Congress which is responsible for legislation and franchise awards. Local governments also have the authority to issue a franchise to a local telephone company. Government agencies involved in policy-making are:

1. The Department of Transportation and Communication (DOTC)
The DOTC was created in July, 1979 by President Ferdinand

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Marcos with Executive order No. 546. The main function of this department is the formulation of national policies for telecommunications which include telephony, telegraphy and satellite communications. It is also responsible for regulating and policing private ownership, control and operations of the print and broadcast media (DOTC, 1987).

2. The National Telecommunications Commission (NTC)

The NTC is an arm of the DOTC that has regulatory and quasi-judicial powers. Also established under EO no. 546., its functions most closely resemble those of the FCC in the United States. Its primary mandate is the issuance of Certificates of Public Convenience for the operation of communication utilities and services; the establishment and regulation of areas of operation of public service communication; the granting of permits for the use of radio frequencies for wireless telephone or telegraph service; and the sub-allocation of a series of frequencies of bands allocated by the International Telecommunications Union. A Commissioner heads the NTC, aided by two deputy commissioners.

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3. The National Telecommunications Development Committee (NTDC) The NTDC is a group, created in 1988, composed of high ranking government officials overseeing telecommunications concerns as well as top level leaders in the industry representing private entrepreneurs and telematics users. Their main task is the job of appropriate policies and programs for the telecommunications industry in order to hasten infrastructure development. The NTDC was later changed to the Telecommunications Action Group (TAG), a task force that the NTC in conjunction with TAG convenes.

4. The Office of Telecommunications (TELOF)

Originally the Bureau of Telecommunications (BUTEL) TELOF is directly under the DOTC and is considered the operating arm of the government. Presently, it undertakes BOT projects, most of them involving the installation and upgrading of telephony in the provinces. TELOF builds the infrastructure and operates it in areas that are under-served. These areas are non-attractive to profit-oriented telecommunications firms yet need the basic services in order to be competitive with neighboring provinces in the consumer goods market.

Criticism of TELOF is they take away the challenge and responsibility of the telecommunications operators for expanding their network and expanding their services.

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However, TELOF presently operates less than five percent of telephony as its main area has been in telegraphy.

**4. The national Economic Development Authority (NEDA); the Department of Trade and Industry (DTI); and, the Board of Investments (BOI).**

These government offices are relevant to the telecommunications industry only in that they oversee the funds that the national government has allotted for this industry and, thus help ensure the most efficient use of these resources. Moreover, they are responsible for providing a stable and thriving economy for all industries to operate in. (Magsaysay, 1993)

The DOTC policies are integrated in the NEDA development framework. Policies on economic investments is formulated by the Department of Trade and Industry (DTI) and the Board of Investment (BOI), an agency of DTI.

***Private Sector***

The private sector accounts for the bulk of telecommunications investment and handles most of the country's telecommunications needs. PLDT is the largest of the 45 entities providing telephone services in the Philippines, han

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handling about 94 percent of total telephone operations in the Philippines. Among the notable services being offered at present under government regulation are:

1. Telephone service
   a. Local Exchange Telephone Service
   b. Long Distance Telephone Service
      - Domestic Services
      - International Services
2. Mobile Telecommunications Services
   a. Cellular Mobile Telephone Service
   b. Radio Paging Services
   c. Public Mobile Radio Communication Services
   d. Maritime Mobile Services
   e. Aeronautical Mobile Telephone Services
3. Record Carrier Service
   a. Domestic Record Services
   b. International Record Services
4. Carrier's Carrier Service
   a. International Satellite Service
   b. Domestic Satellite Service
   c. Terrestrial Radio Service
5. Leased line Service

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Since the analysis is concerned with the provision of basic telephone service the description below will limit itself to the telephone sector.

Telephone Service in the Philippines is offered by both the private sector and the government, although the recent move of the government was to privatize its operations. PLDT dominates the industry and accounts for 94% of local telephone connections to date. However, since 1993, new entrants have challenged the PLDT's hegemony in the international arena.

Table 3.4 describes the market structure of the telephone service industry.

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TABLE 3.4

MARKET STRUCTURE FOR TELEPHONE SERVICE INDUSTRY

| TYPE OF SERVICE AND FACILITIES | FRANCHISED OPERATIONS | MARKET STRUCTURE |
|---|---|---|
| local exchange | PLDT<br>PILTEL<br>Government<br>Carriers<br>Small Private Operators | regulated monopoly in each franchised area. |
| Domestic Long-distance Network | PLDT<br>TELOF | Regulated |
| International gateway | PLDT<br>Philcom<br>ETPI<br>Globe Telecom<br>ICC | Regulated competition |
| Cellular Mobile Telephone System | PILTEL<br>EXTELCOM<br>Isla Com<br>Smart<br>Globe Telecom | Regulated Competition |

Source: DOTC, NTC

Despite the recent competition, PLDT's position as the dominant operator has not significantly been challenged to

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date. The extensiveness of PLDT's network and the magnitude of its investment cannot easily be matched by any of the current operators.

In summary, the PLDT has a strong competitive edge in all segments of the telephone sector (local, domestic long distance and International long distance).

### *Regulatory Structure in the Philippine Political System*

Policy-making and regulation of the industry is vested in the Executive branch, the Legislative branch and the local government Units. The Executive, through the DOTC and the NTC, sets the development goals, policies and Strategies and strategies on telecommunications and regulates the industry. The Legislative branch and Local government units are empowered to grant national and local franchises respectively.

DOTC implements its plans and policies on telecommunications through the NTC. Decisions of the NTC, a quasi-judicial body attached to the DOTC, are appealable only to the Supreme Court.

Private operators who intend to provide commercial telephone services are required to secure a franchise either from Congress for a national franchise or from local government units for a local franchise. Government-owned s

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systems, however, are not required to obtain legislative franchise nor do they operate under the supervision of the NTC.

After getting a franchise, the enfranchised operator should obtain a CPCN from the NTC. A CPCN specifies the period, area of operation, type of service to be provided, rates to be charged, and other service commitments from the operators. Amendments to the original CPCN is needed for every expansion, extension or modernization of facilities and services, and changes in rates.

Applicants for a CPCN are subjected to hearings by the NTC where competitors are given a chance to oppose the application.

The NTC also regulates the rates charged by telecommunication companies, and any request for rate adjustments has to be approved by the commission. The NTC sets the rates based on a 12 percent rate of return ceiling imposed on public utilities, which is computed based on the net book value of property, plant and equipment plus working capital equivalent to months' average operating expenses (Carrera, 1994).

Historically in the Philippines, the political structure has created regulatory bodies that were weak and inefficient. While the initial form of regulatory institutions were borrowed from the United States during the colonial period, s

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some key aspects, such as the tenure and the selection procedure of regulators, were chosen in ways to ensure full control by the president. (Esfahani, 1993).

A country's regulatory structure reflects the country's basic institutional endowment. The establishment of an independent and expert regulatory agency has historically been perceived as a threat to the interests of the elite. This is because the professionals running the agency could use their control over elite-owned businesses to redistribute rents either to themselves or to their constituents. Such a redistribution is most likely to benefit the non-elite, therefore regulatory agencies have been consistently deprived of independence and resources.

Some of the characteristics of the Philippine regulatory system include: Lack of independence; Congressional Control over the Budget; Limited resources of Regulatory Agencies; Ambiguous regulation; Shared Entry Regulation in Public Utilities (Esfahani, 1993).

Recently, however, the new telecommunications Act of 1995 has sought to strengthen the power of the regulator. However, many of the weaknesses persist.

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***Recent Policy and Regulatory Developments affecting the Sector***

The government's recent policy has been increased intervention in a free enterprise system. The broad policy outline of the DOTC is embodied in Circular 87-188 (see Appendix). The policies set forth were mainly directed toward the provision of an interconnected, efficient telecommunications network and to provide the public with universal access to services (Magsaysay, 1993).

Executive Order 59 and 109, were specifically designed to address the inequities in the sector.

<u>Interconnection Policy (EO 59)(1993)-</u> This involved mandatory interconnection of all telecommunications firms. This order was designed to streamline the procedures for network interconnection of the different telecommunications service providers operating on the country.

<u>Universal Service Policy (EO 109)(1993)</u>- This order pertained to the provision of Local Exchange Service Lines accelerating the sectors' goal towards universal service. Under EO 109, operators are required to install a minimum of 300,000 local exchange lines and an additional 300 lines for every international circuit addition. Likewise, CMTS operators are

required to install a minimum of 400,000 local exchange lines.

## Implementing guidelines for EO 109

The implementing guidelines for EO 109, prepared by the NTC in 1994 divides the Philippines into eleven (11) telecommunications operating areas. The rationale is to combine "high value" areas with "low value" ones in order to permit cross-subsidy.

The PLDT will be restricted to its present service areas and in areas already included in its previously approved expansion projects. Eight other interested operators have been assigned areas to serve. Table 3.5 presents the summary of service areas allocation by operator.

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TABLE 3.5

SUMMARY OF SERVICE AREAS ALLOCATION BY OPERATOR

| AREA | COVERAGE | OPERATOR |
|---|---|---|
| 1 | Region 1 and Metro Manila D (Pasay, Las Pinas, Paranaque, Pateros, Taguig and Muntinlupa) | Smart |
| 2 | Region 2 and Metro Manila A (Caloocan, Manila and Navotas) | ETPI |
| 3 | Region 3 | Smart |
| 4 | Region 4-A (Aurora, Laguna, Marinduque, Quezon, Rizal and Romblon) | CAPWIRE |
| 5 | Region 4-B (Batangas, Cavite, Mindoro Occidental, Mindoro Oriental, Palawan) | Globe Telecom |
| 6 | Region 5 and Metro Manila B (Malabon, Quezon City, and Valenzuela) | ICC |
| 7 | Region 6 and Region 7-A (Negros Oriental, Siquijor) | ISLA |
| 8 | Region 7-B (Bohol and Cebu) and Region 8 | ISLA |
| 9 | Region 9-A (Zamboanga del Norte and Zamboanga del Sur), Region 10 and Region 11-B (Davao Oriental and Surigao del Sur) | PILTEL Philcom |
| 10 | Region 11-A (Davao del Norte, Davao del Sur and South Cotobato) and Region 9-B (Basilan, Sulu and Tawi-Tawi) | PILTEL Philcom |
| 11 | Region 12 and Metro Manila C (Makati, Mandaluyong, Marikina, Pasig and San Juan) | Globe Telecom |

Source: NTC

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Some of the more important provisions of EO 109 are:

1. All operators shall be required to provide a minimum of 300,000 lines within a period of 3 years from the date of authority to install, operate and maintain a LEC service. Thereafter, 300 lines shall be added for every international circuit addition.

2.Authorized nationwide CMTS operators shall be required to provide a minimum of 400,000 local exchange lines while regional CMTS operators a minimum of 40,000 local exchange lines.

3. Authorized operators of non-basic telecommunications services plow back their profit in excess of the total company's 12% ROI into the local exchange service.

4. In local exchange service areas where there are more one authorized LEC, the LEC network shall be interconnected in such a manner that would ensure efficient and effective conveyance of traffic from the subscriber of one LEC to those of the other.

The entry into the market of several service providers augurs well for the industry. While telephone service is expected to improve, government and business must ensure an efficient system free of redundancy and poor interconnection by actively involving the NTC in decisions that have so far been left to the private sector (Magsaysay, 1994).

### *Market Structure, Regulation, Ownership & Political Structure*

The political structure in the Philippines has been shaped by a small group of elites who have maintained power through the privatization of public resources, thereby weakening the state's resources and its bureaucratic apparatus. Rent-seeking on the part of a small number of families has been achieved through the concentration of power in the executive, at the expense of a weak legislature and judiciary (McCoy, 1993:12).

Since the president can modify or reinterpret laws secure in the knowledge that the judiciary is unlikely to rule to the contrary, specific regulations to limit rent-extraction are not very effective and have little political pay-off.

The PLDT became the giant that it was for the most part because it was nurtured and pampered by the Marcos, and to a lesser extent, Aquino administrations. The Marcos government helped Cojuangco and his associates acquire control over the company, legislated competitors out of the market, mandated private subscriptions to boost its capital and gave it liberal financial help. The Aquino administration, on the other hand, while initially increasing the regulatory activism against the firm, continued to nurture the monopoly by placing the interests of the Cojuangco family above the welfare of the country.

The National Telecommunications Commission (NTC), under both the Marcos and Aquino administrations, was manned by individuals who were perceived to be PLDT puppets (Richard Pratte, 1993). Any attempt on the part of the commissioners to challenge the company was eliminated. For example, in 1989, when commissioner Jose Luis Alcuaz tried to break the PLDT monopoly by permitting all international carriers to operate as international gateways for telephone services, he was promptly fired. Alcuaz' moves were quickly assailed by the well-funded PLDT media campaign.

Alcuaz was fired a few days after he granted the gateway permission, on November 14, 1989, and a few days before he was about to denounce the interference of President Aquino's relatives in NTC affairs (Manapat, 1993:44-45).

The Ramos administration has successfully challenged the monopoly and allowed for new entrants into the sector. However, in the context of the Philippine political economy, a greater number of firms does not necessarily mean increased competition. Indeed, collusion rather than competition may be the outcome of freer entry. For example, upon a close examination of the ownership's of the various telecommunication's companies presently operating in the country, one notes intricate and subtle relationships linking almost all the firms together (O'bien, 1997:93).

Hence, while the Ramos administration has successfully increased the number of firms in the sector, the powerful political forces that encourage collusion and cooperation rather than competition among firms have remained in place.

**SUMMARY**

While the telecommunications sector in the Philippines is comprised of a wide range of services and manufacturing activities involving government agencies, and private and public telecommunications network operators, the private sector accounts for the bulk of telecommunications investment and handles most of the country's telecommunications needs. Despite the recent competition, PLDT's position as the dominant carrier has not been significantly challenged. The PLDT still retains a strong competitive edge in all the segments of the telephone sector.

The two most important regulatory agencies are the Department of Transportation and Communication (DOTC) and the National Telecommunications Commission (NTC). Policy-making and regulation of the industry is vested in the Executive branch, the Legislative branch and the Local Government Units. The Executive, through the DOTC and the NTC, sets the development goals, policies and strategies in telecommunications and regulates the industry. The legislative branch and Local Government Units (LGU) are empowered to grant national franchises respectively.

Historically, in the Philippines, the political structure has created regulatory bodies that were weak and inefficient.

However, two recent Executive Orders (59 and 109) have increased the government's intervention in the weekly regulated sector.

Ownership and management of the firm was dominated by a group of Marcos cronies and shell companies representing Marcos' interests. While Marcos owned the majority of PLDT voting stocks through these shell corporations, Ramon Cojuangco and his associates controlled the management of the firm.

One of the ways the company raised revenues was through an investment scheme known as the Subscriber Investment Plan (SIP) initiated in 1973. These were forced subcriptions of stocks in the company to all new recipients of telephone lines and which carried no voting rights.

The collusion of management and ownership encouraged further corruption through captive corporate contracts, overseas remittances, very large executive compensation, dubious accounting practices and insider trading.

While the Ramos administration has successfully challenged the monopoly and allowed for new entrants in the sector, powerful political forces that encourage collusion rather than competition among firms continue to be present.

**PRIVATE AND STATE OWNERSHIP IN TELECOMMUNICATIONS: A COMPARATIVE ANALYSIS OF SAO PAULO, BRAZIL AND MANILA, PHILIPPINES**

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By

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# 1V

## The Socio-political, economic environments and its impact on the Ownership, market structure and regulatory structure of the Sao Paulo Telecommunications sector

A discussion of the important historical political, economic developments in the country and state and their impact on the ownership, market structure and regulatory structure of the sector will be undertaken. Also, the history of the sector in Brazil and Sao Paulo will also be undertaken so as to provide a context and framework for the interactions of the secondary variables with the primary variables: ownership, market structure and regulation.

The central question that underlies the choice of topics and sub-topics is: What were the historical socio-political and economic conditions that led to the creation of a state monopoly in Brazil and Sao Paulo and how did these conditions interact to produce the ownership, market structures and regulatory structures of the sector?

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### *Colonial and Imperial Brazil*

Portuguese explorers, led by Pedro Alvares Cabral, reached Brazil in 1500 on their way to India. Brazil was considered Portuguese territory as a result of the treaty of Torsedillas of 1494 which recognized the separate spheres of Portuguese and Spanish imperialism ( da Silva Rego, 1972:223). While the Spanish were taking over the skilled South American peasantry in Peru and Mexico and sought to establish settlements in these regions, the Portuguese, in contrast, were setting up a string of trading stations that extended from the African coast to India to the Far East (Lang, 1979:3). For Spain, America formed the core of a land-based empire, whereas for Portugal, Brazil was a minor partner in a commercial system organized around the spice fleets (Eisenstadt, 1968:41-49). A distinctive feature of Portuguese expansion, in contrast to Spanish expansion, was the energy the crown devoted to organizing trade, as opposed to territorial administration. It was not until the seventeenth century that Portugal initiated a true settlement policy which involved large-scale commercial agriculture, the control of extensive territories and the subjugation of the local population. As opposed to Spanish America's more diversified economies, seventeenth century Brazil had an economy based on a single crop, sugar. While the Spanish crown needed a bureaucracy to tax silver and collect sales taxes in the great interior cities of hispanic America, such a strategy was largely irrelevant to Brazil's less diversified export economy (Lynch, 1964-1969:28-29). Except in the ports, bishops and bureaucrats were scarce, and neither the crown's authority nor the institutional authority of the church reached the countryside. The crown commissioned powerful landowners to raise militia units, while Brazil's royal government rarely challenged entrenched colonial interests. (lang, 1979:227).

Brazil's export economy thus contributed to the slow development of urban life which was confined to a few coastal ports. This impeded the spread of ecclesiastical and cultural institutions such as universities that would have depended on a city for support (Ricard, 1958:444-453).

By the eighteenth century Brazil's export economy had expanded to include other products, the most important of these being gold. While Luso-Brazilian trade flourished, most of the Brazilian gold sent to Portugal ended up in London banks to pay for English manufactured goods (Manchester, 1933:38). In 1758, the king's chief minister of state, Sebastiao Jose de Carvallo e Melo, the Marquis of Pombal, using the state's fiscal and institutional powers, started to promote the interests of the empire's wealthy

Businessmen (Lang: 73). Thus, in 1755, Pombal established a Board of Trade responsible for all commercial affairs. Membership was restricted to a group of state-subsidized businessmen who were guaranteed a steady supply of capital by the state (Manchester, 1933:40).

While Pombal's program was unsystematic and largely based on traditional methods, it yielded important new industries, an entrenched Lisbon business elite, and the beginnings of an import-substitution tradition that was to endure both in Portugal and Brazil (Lang, 168-169). However, Pombal's reforms did little to transform the political bureaucratic structure in Brazil. Aside from the treasury boards, the most significant bureaucratic reforms consisted in transferring the title of the viceroy from Bahia to Rio de Janeiro (Lang,1979: 229).

Napoleon's invasion of Portugal in 1808 led to the transference of the Portuguese throne from Lisbon to Rio de Janeiro. Brazil now had a central government, albeit one controlled by the Portuguese and paid for by the Brazilians (Manchester, 172-173). While the French and American revolutions had inspired some Brazilians with ideas of revolution, constitutionalism became the rallying cry of conservative Brazilians disenchanted with absolutism. Constitutionalists argued that a national assembly with legislative powers could restrain royal authority without abandoning the historic legitimacy that monarchy conferred on the central government. Constitutionalism provided an escape from the revolutionary dilemma, a path between the old regime and the apparent disaster that republicanism had inflicted upon Spanish America in the 1800s (lang,1979:201).

From 1822, the date of Brazilian independence from Portugal, until 1889, the date of the proclamation of the republic, Brazil was ruled by a constitutional monarchy. The emperor acted as a head of state and assumed all the prerogatives associated with that office (Baaklini, 1992:1). The throne became the means used by centralists to preserve Brazilian unity and a strong state. Political parties, in the modern sense, were non-existent and legislatures acted merely as advisory councils. The way the government trained, selected and appointed its bureaucrats, particularly its magistrates, consciously built on colonial precedents, and Rio de Janeiro continued to court the powerful rural clans (Flory, 1975:664-692). Participation in elections was limited to the nobility and to the few members of the propertied class (Baaklini, 1992:2).

Under the empire, secessionist movements ended and the onset of modernization began. Relative to other periods in Brazilian history, the imperial period was characterized by a relatively high degree of institutional stability (Iglesias, 1986:4). A strong state took shape in Brazil sooner than in the hispanic republics and endured for most of the century (Lang, 204). This relative stability was broken, however, in 1889 with the establishment of a presidential system of government modeled after the United States (Iglesias, 1986:5).

### *Post-colonial and Imperial Governments*

### *The First Republic (1889-1930)*

During the First Republic, the landed classes, the church and senior military officers continued to dominate the political scene (Bello, 1966:25). Presidential elections were highly influenced by the state governors, in particular the governors of the states of Rio de Janeiro, Sao Paulo, Minas Gerais who exercised great influence in choosing the president (Skidmore, 1966:187).

The constitution of 1891 endorsed liberal positivist ideals, giving the government a very limited role in the social and economic realms, thus encouraging a movement towards decentralization. Whatever limited powers the government possessed were exercised by the state and local governments rather than the federal governments. In the absence of organized political parties, landed local classes dominated the electoral process ( Fliescher, 1981: 201-202).

Because of the restrictive electoral laws, less than five percent of the total population participated in the elections. The coffee barons emerged as the economic elite in the late 1800s and the early 1900s, and immigrant labor began to supplant slave labor. During this time political conflict under the presidential system of government was not between the president and the legislature, or the president and the political parties, but between the president and the state governors (Baaklini, 1993: 2).

During the First Republic, the limited role of government, and its decentralized feature, prevented the emergence of a strong president. The winning of the presidency by one group of elites did not prevent the defeated group from continuing to secure its interest either at the state level or in the private domain. Those who lost kept their political basis intact and were later able to wage a campaign for the next presidential election (Flynn, 1978:32).

From an economic standpoint it was the period of Primary Product Export (PPE). Although manufacturing grew in sectors tied to foreign trade, Brazil did experience substantial industrial growth in the 1920s (Haggard, 1990:165). However, war and depression caused what structuralist claimed to be a worsening of trade, which contributed to chronic balance of payment problems in the major PPE countries in Latin America. The depression thus forced reorientation of the Brazilian economy away from PPE toward industrial production for the domestic market (Wang, 1995:277).

### *The New State Period (1930-1945)*

Between 1930 and 1945, Brazil witnessed extreme institutional and political instabilities, representing fundamental changes in the role of government and the nature of the federal system. In 1930, a military coup led by dissatisfied governors and the military brought to power Getulio Vargas. He was in office constitutionally until 1937, when he declared the Estado Novo, which lasted till 1945, assumed dictatorial power (Skidmore, 1968:3).

The new state period witnessed legislation in the economic and social spheres initiated by Vargas, which transformed the federal government's role in the socio-economic realm. The federal government became the center of society and of the economy. The role of state and local governments was diminished and the decentralized federal system of government gave way to a more centralized system.

The governor's role as a counterbalance to the president during the old republic was undermined. From then on, the presidency became the undisputed power center of the entire political system (Furtado, 1963:28).

Another way the Vargas era changed Brazil's political system was with the emergence of the institution of the armed forces as the arbiter of political succession and the guardian of the constitution (Stephan, 1975:201). Prior to the Estado Novo, the federal military establishment as an institution was weak, and until 1930 each state had its own militia. Vargas's Estado Novo weakened the state militia and strengthened the central armed forces.

Another change brought about by the Vargas era was the emergence of the urban masses as a major force in presidential elections. They became the target of populist politicians seeking office. Vargas himself, in addition to using the military to ward off challengers, resorted to populist programs to mobilize the support of the urban masses (Baaklini, 1992:3-4).

Vargas, who combined a centralizing modernization drive and populist urban nationalism, began using selective state economic intervention as a tool to speed Brazil's transition to an industrial economy. The conventional wisdom, therefore, dates ISI policies to the Estado Novo (Haggard, 1990: 166).

Hirschman (1968) labeled the period of 1930-1950, usually considered the first stage of ISI in Latin America "growth via the domestic market" The emphasis on the domestic market was to have an enduring impact on Latin American development strategy in general, and Brazil in particular. Perhaps the most important legacy of this easy phase of ISI in Brazil was its expansion of income and employment, and its inclusion of a previously excluded populist sector in the political scene, and a nationalist government using state enterprises.

***The Competitive Period or Second Republic (1946-1964)***

The return to competitive politics after World War 11 was an attempt by certain forces within the military and civilian bureaucracies, in alliance with political parties, to democratize the government and open it to more participation by the expanding middle class. Public bureaucracy continued to expand during this period with a total 191 ministeries serving a total of 219 months, indicating a high degree of government instability and transient turnover (Baaklini, 1992:10).

Clientilism in appointments continued unabated and corruption was pervasive. However, what was most politically notable during this period was the rapid growth in the size and power of the bureaucracy and its penetration to all spheres of Brazilian life (Riggs, 1988: 343-79).

During the competitive period ISI took a permanent form. This was because the Brazilian social order had changed fundamentally, with the shift of economic and political supremacy from agro-exporting groups to urban industrial centers (Frieden, 1981:100).

However, further ISI strategies would require investment in new areas such as consumer durables, intermediate and capital goods. This called for an expanded role of the state in terms of planning, creating para-statals, strengthening industrial financing, protecting domestic industries and soliciting foreign capital. These tendencies culminated in the Juscelino Kubitschek administration (1956-61) which vowed to achieve modernization during his tenure (Wang, 1994:279).

Successive regimes in the Second Republic, from the second Vargas presidency (1950-1954) to Kubitchek, Janio Quadros (1961) and Joao Goulart (1961-1964) relied on variants of the populist coalition of the 1930s and its nationalistic, developmentalist consensus. However, this strategy had also sowed the seeds of destruction for ISI. That is, the government and the privileged industrialists habitually receiving government protection and subsidies had developed a patron-client relationship. Rent-seeking activities, social programs, and tax evasions drained the state coffer and created constant budget deficits. Further, the anti-export bias of industrial policy, especially chronic currency overvaluation, led to recurring balance of payments crises (Hirschman, 1987:26).

The vicious cycle was completed when constant budget deficits and chronic balance-of payments difficulties joined forces to create inertial inflation, a fundamental problem that has plagued Brazil for most of the post-war era (Bresser Pereira, 1987).

### *Bureaucratic Authoritarianism (1964-1985)*

The multitude of economic problems centered on ISI as practiced in Brazil triggered a profound political crisis. In 1964 a group in the military led by general Humberto Castello Branco overthrew Goulart and seized power, ushering in the infamous period of bureaucratic authoritarianism. The coup also marked the first time that the military was used as a ruling institution. The military strived to guarantee the stability of burearaucratic authoritarianism's dominant coalition: the state, foreign capital and the domestic bourgeoisie (Schamis, 1991:204).

In order to maintain an attractive environment for foreign investment, the military depoliticized the popular sector previously mobilized under populist governments, by freezing wages and prices, controlling inflation, and suppressing labor movements.

From 1964 to 1985 Brazil was governed by a succession of authoritarian regimes, each headed by a four-star general. Despite variations in structure and personnel, all were coalitions of military officers, technocratic administrators and old-line politicians (Skidmore & Smith, 1992:179).

It was during this period that the utmost political repression occurred. It was also the period when Brazil achieved rapid economic growth. In fact, the combination of political and industrial growth, prompted some scholars to question the major canon of the modernization school that posits a positive relationship between economic development and democratic politics.

The Castello Branco regime (1964-1967) considered economic stabilization to be its top priority. Roberto Campos was the dominant economic aide to bring inflation under control and improve the balance of payments. (Wang, 1995:281).

The period from 1968 through 1973 is considered the "Brazilian Miracle". Industrial output rose 109%, GDP 90%, and per capita 62%, average annual rates of increase for these indicators were 13.1, 11.3 and 18.4 respectively (Frieden, 1981:117). However, rapid growth was achieved at the expense of increased political repression. Key economic technocrats like Antonio Delfim Netto, a chief architect of the "Brazilian Miracle", enjoyed substantial autonomy under general Artur da Costa e Silva (1967-69) and Emilio Garratazu Medici (1969-1973). Much of that spurt was related to Brazil's decision to complete the ISI cycle by moving into capital and intermediate goods (Hirschman, 1987:19-20). Leading the way were the big projects such as metallurgy, machinery, chemicals, electrical equipment and transportation equipment. In short, it was a growth strategy based on repression of labor unions, amid recruiting of foreign investment and high reward for economic managers.

The regime of general Ernesto Geisel (1974-79) used active state intervention and heavy borrowing to implement the big projects and also began the long process of redemocratization. This was the period of the first energy crises when lending institutions, like the IMF, were encouraging developing countries to borrow in support of their development projects. Brazil, with a fast growing economy became an ideal candidate for the international lending institutions (Wang, 1995:283).

However, the changes in the international political economy caused by the second energy crises turned this blessing into a curse almost overnight. The world recession depressed the value of Brazilian exports, while high interest rates kept the cost of servicing the debt at extremely high levels. By 1982, Brazil had become the largest debtor nation in the world (87 billion). To get further loans Brazil had to accept IMF-imposed conditionalities that involved draconian austerity policies at home leading to economic depressions in most of the 1980s (Bresser Pereira, Maravall & Prezeworski, 1993:321).

Brazil's last military regime, that of Joao Figuereido (1979-85), started out in a deep and multinational crisis, with foreign debt, recession, inflation and redemocratization eventually engulfing it. Pressures by the international community and from national groups pushed the military government to accept an indirectly elected civilian as a transition to democratization (Wang, 1995:285).

**DEMOCRACY (1985 TO PRESENT)**

The redemocratization period (1985-present) began when Tancredo Neves, the president elect from the PMDB, fell ill on the eve of his inauguration and never recovered. Succeeding him was Jose Sarney, the vice-president-elect who defected from military controlled PSD party. The Sarney government

(1985-90) presided over Brazil's lost decade. None of the economic indicators showed any improvement (Skidmore & Smith, 1992:183). This was, in large part, due to mismanagement by elected and appointed officials.

The government of Fernando Collor de Melo (1990-92) promised to fight inflation, clean the government, and open the economy to foreign investors. It succeeded in little except to enter into a liberalization discourse vis-a-vis the long-protected domestic enterprises. Collor left the office in financial scandals and faced criminal charges. The Itamar Franco government (1992-94) was basically a care-taker government. However, one of the positive achievements during both the Collor and Franco regimes was the acceleration of the privatization debate.

In the fall of 1994 Fernando Henrique Cardoso, the dependentista academic and the architect of Brazil's latest inflation killer, the Real plan, was elected president. His pro-business environment and opening of Brazil to foreign investors has started the country slowly moving away from protectionism where once impressive industrialization had now been eclipsed by the high growth rates and greater social equity of economies such as Taiwan and South Korea (Wang, 1995:286).

***The Military in Brazil***

The degree to which a military apparatus is identified with the state varies. At the opposite end of state identification are irregular and private armies that are totally societal in character, as are also some national armies that have been deeply penetrated by society (Rouquie, 1987). While the Philippine army had historically been the tool of the oligarchs throughout the second half of the twentieth century, the Brazilian army had developed an ideology that was strongly identified with the state.
Much of this can be traced to its historical roots.

Joining the military as an officer in nineteenth century Brazil carried great status and was limited to the upper classes of society. Howver, during the empire the army in Brazil was a second-rank military organization that did not possess a monopoly of arms. The 1891 constitution gave a great deal of autonomy to the states and limited the possibilities of federal control. Regional landed oligarchs, who did not want to lose their power, supported the National Guard which was controlled by the regional oligarchs (Skidmore, 1988). The states also had their own public forces. These militarized police forces did not depend on the federal government. However, under the Estado Novo of 1937 and later in the 1964

Military coup, these military police were placed under the command of army officers.

In order to establish the superiority of the army, the Brazilian officers demanded the strict application of the law requiring universal obligatory service which they had finally obtained in 1916 as a delayed compensation for having participated in the overthrow of the empire (Stephan, 1971).

Besides demanding a military institution that was numerically and technically strong, they also expressed a desire for autonomy, which is the mark of increasing professionalization. Modernization of the military gave the institution a certain prestige and authority in the state and society. Furthermore, the meritocratic procedures used in the selection and promotion of officers gave them a priveleged place in the state apparatus. This was in contrast with the interchangeable civilian bureaucrats who were more closely associated with political elite (Rouquie, 1987)

Modernization and professionalization, however, also meant a greater inclination towards involvement in public affairs. The importance of internal defense in a country that was rarely involved in international conflicts made internal political intervention appear a more normal and less dramatic process. Instead of suggesting the excessive politization of the institution, political activity by the military seemed to be an extension of the armies' routine activities.

In the absence of war, therefore, the armies were transformed into bureaucratic bodies in which institutional rather than heroic values predominated. The codification of promotions as a major bureaucratic mechanism framed the mentality of the military officers and distinguished them from the civilian bureaucrats of the same period. Henceforth, officers who were evaluated by their superiors throughout their period of active service no longer depended in principle upon the capriciousness of political authorities (Stepan, 1971).

The feeling of superiority that was produced among the military officers by their consciousness of being an elite group in the state was reinforced by other factors. The creation of a system of high level technical and scientific education in order to produce certified arms experts and military engineers, as well as acess to the modern technology, gave the military a clear awareness of their competence. Moreover, the procedures of recruitment and promotion, based on universal criteria, made the army an ideal counter society, where in the eyes of its members, justice legitimated heirarchy and organic solidarity ruled.

The historical importance of the Brazilian army laid in its continued presence at all the turning points in the history of the nation and as a determining force in periods of crises. For instance, it was the the army that established the Republic in 1889 before handing it over to civilians. Likewise, in 1937 it permitted the establishement by coup of the centralizing dictatorship of Vargas' Estado Novo. At the same time, the army that had supported Vargas in 1930 deposed him in 1945 and established a democratic system. However, by the late 1950s, the politically conservative and economically liberal faction of the military, was dominant. This group had close ties to the United States, were anti-Vargas and attached to free enterprise. They also espoused the doctrine of National Security (Rouquie, 1987)

This doctrine was based on the internalization of the cold war of the 1950's, linked development and security, and gave the army the function of defining permanent national objectives while also justifying its usurpation of power.

The victors of the 1964 military coup, led by Castello Branco, were liberals who wished to strengthen and protect the state by purifying the democratic system without actually abolishing it. The continued idealistic attachments to the representative institutions of the west meant that the coup, in the eyes of the Castellistas, was a necessary measure for the defense of the 1946 constitution against leftest elements out to subvert it (Skidmore, 1988).

However, this moderate program of protected democracy soon proved to be inoperable, and with pressure from the hardliners in the military moved towards an increasingly autocratic system. This was embodied by the numerous institutional acts passed between 1966 and 1968, which granted greater dictatorial powers to the executive. From 1969 until 1974 in particular, the important decisions of the regime were based on essentially military criteria. Decisions in the areas of natural resources, energy and telecommunications seemed to have depended more on strategic concerns than simple economic rationality. The development of a powerful telecommunications sector was seen as one of the cornerstones of that strategy (Rouquie, 1987).

The election of Geisel in 1974 signified the opening up and the liberalization of the government. Geisel's strategy was to maintain support within the military while eventually reducing the role of the hard line and restoring the military's more professional role. This opening up increased throughout the figuereido government, which saw itself as a transition government to democratically elected civil government.

What can be noted throughout this military period is the was the ideological commitment to the belief that the military's role was only a temporary one. Even under the most authoritarian administration of Medici, where pressure to extend his rule was being made by civilian and military hard-liners, the military kept to the timetable of presidential successions. The military had agreed that they must not allow a dictator or caudillo to emerge in Brazil. Medici honored this principle and passed the baton to a different general with different allies and a different agenda.

### *The State in a Federalist Society*

Despite the fact that the formal organization of the state in Brazil follows federalist precepts, the dynamics of Brazilian governance defies such a precept. For even at the apex of centralized authoritarian controls during the 1970s, the large states continued to exercise a substantial degree of autonomy (Graham, 1990:73).

However, as the economy grew worse during the late 1970s and approached crises proportions in the 1980s, it proved to be more of a case where national gains equaled state and local losses. When one examines the Brazilian popular press and the scholarly literature at the time, there is a common complaint that the states and municipalities had become dependencies on the federal government ( Barata, interview, 1995).

Nevertheless, some very important trade-offs were achieved in tax reform during this period. While authority patterns clearly advanced the values of heirarchy in state and federal relations and undercut the authority to which the states had become accustomed, the financial position of the municipalities improved through federal-tax-sharing and transfers through the state governments (Graham, 1990:78-79).

The 1967 tax reforms both simplified existing tax legislation and concentrated resources at the federal level. The primary arguments behind these reforms were two-fold. By increasing federal revenues, federal deficits would be reduced, thus removing one of the main causes of inflation. In concentrating resources at the center, more rational decisions could be made over the allocation of public moneys among regions and sectors, thereby promoting overall economic development. The fact that these reforms increased the regressiveness of the tax structure and undercut tax structures previously accorded to state and local authorities, was justified by the increased capacity to plan more rationally and by revenue sharing provisions (Graham: 80).

A decade later it became clear that only a few of these objectives had been achieved. Acute inflation had returned, and it grew progressively worse each year as internal and external public sector indebtedness increased. Unrestrained public sector expansion at the federal and state level in the

1960's and the 1970's, through the creation of hundreds of new public enterprises, had made the problems of coordination and control even greater (Stephan, 1988:201).

When the growing indebtedness of state governments was added in, because of their need to provide certain basic services despite inadequate revenues, the surplus generated at the national level through the tax reform quickly disappeared. This situation was further aggravated by the pressures on state governments to hire new employees. In the period immediately preceding the 1982 direct election of governors, for example, it was estimated that 500,000 employees were added to the public payroll (Skidmore, 1989)

As the crises grew in the early 1980s, the shortage of funds at the national level meant cutbacks at the state level in nearly every category. The financial squeeze on state government, was not a new story, rather a part of an old problem in Brazilian history.

Throughout the first Republic (1889-1930) the state taxing authority was also limited and the recourse to the federal government was constant. The most important new departure in the 1967 tax reform was the commitment of the federal government to the redistribution of public moneys through tax sharing, conditional grants and interregional transfers. In terms of amount of transfers from federal to state the north and northeast regions respectively were the first and second greatest beneficiaries in revenue sharing, followed by the center-west. The region which continually subsidized these operations was the Southeast, the center of which was the Sao Paulo, Rio de Janeiro and Minas Gerais triangle, with Sao Paulo constituting the most highly developed region in all of Latin America (Veda, 1982:20-24). However, one cannot generalize easily by simply saying that the poorest states automatically received the most federal support and the richest the least, for the patterns varied greatly from state to state. Those states depending on the federal government for more than seventy percent of their revenues -Ceara, Rio Grande do Norte and Pernambuco- are among the poorest, but Rio De Janeiro was also included in this list. Nevertheless, the converse is true when applied to Sao Paulo, which received more than fifty percent of its revenues from state sources (Graham, 1990:83).

During this era it became common practice to use a holding company structure whereby the national organization would oversee investment policy in a given sector and set priorities for state-owned companies within the sector. Thus state companies in utilities, communications, and industry, for example, would function autonomously in their routine operations, while questions of finance and development strategy were decided at the federal level (Rezende, 1982:492).

***Brazilian Public Policy towards State-owned Enterprises***

Historically, Brazil's initial attempts at state ownership resulted from an attempt to increase private participation in the economy.As early as 1858, in order to attract foreign investment, the government offered guaranteed rates of return on investment and provided the physical and financial infrastructure for these investments to take place. Thus was born the railroad and shipping companies (Dmytrachengko, 1993:32).

However, by the time of the Estado Novo (1937-1945), planned economic intervention became an integral part of public policy (Dmytachengko, 1993:34).

During the Second World War, shortages and dwindling foreign investment, hastened the creation of a number of state-owned enterprises. It was during this period that a distinct category of state-owned enterprise was established under the auspices of a much broader public policy scheme which would have lasting consequences for the politico-economic structure of Brazil in the future. The policies underlying the creation of these new state enterprises had an ideological undercurrent that sought to protect all aspects of the country's sovereignty, not just its territorial boundaries. This was part of a redefined National Security Strategy that viewed economic dependency as a threat to national security. Hence, its elimination became a public policy target. The creation of public enterprises and import substitution policies were some of the measures adopted in sectors designated too strategically important to be in foreign hands.(Rezende, 1982:494)

During the 1950's, the first coherent industrial development strategies emerged with the Salte plan in 1950 and later President Juscelino's Kubitschek's 1956 Programa de Metas (Program of Goals). Kubitschek's strategy, unlike the Salte plan, had a solid financial foundation. A state-owned bank, the Banco Nacional de Desenvolvimento Economico e social (BNDES) had been created in 1952 and charged with the mission of financing both private and public industrialization efforts in energy, transportation and steel (Dmytrachengco, 1993:35).

After the military take-over in 1964 the autonomous and expansionary character of public enterprises became especially pronounced. In its attempt to alleviate development bottlenecks, the government created stabilization measures which included structural reforms in the productive public sector. As a result, two measures were taken that affected the fate of state-owned enterprises in the country. First, the state financial system became broader in scope, permitting public sector investment in sectors other than energy, transportation and steel. As a direct consequence of these policies, the state ventured into new areas such as housing and telecommunications. Second, a law was passed in 1967 which granted public enterprises permission to diversify and create subsidiaries. The effect of this law had an impact on steel, mining and public utility sectors where existing state-owned enterprises expanded vertically and horizontally and became giant industrial conglomerates (Rezende, 1982:501).

Until the mid-1970's state-owned enterprises were able to achieve their macro-economic goals of minimizing foreign dependency, alleviating development bottlenecks and fostering rapid economic growth, while maintaining, for the most part, an acceptable degree of micro-efficiency . This was largely due to the government's commitment to invest in the public sector as part of a national security strategy and liberal lending policies by international lending institutions like the IMF(Carrera-Fernandez, 1988; Trebat, 1983).

However, towards the end of the decade public enterprises started to experience a sharp decrease in economic efficiency. Trebat (1988:168) has argued that the absence of a cohesive public policy strategy is one reason that explained the worsening performance of the public sector. Another reason attributes it to the adjustment lag between public policy and the world economic situation which was still feeling the effects of the oil shock of 1973.

However, the public sector continued to experience steady growth in a period of worldwide recession. It was also during this period that public enterprises experienced increasing autonomy and holding companies such as Telebras, created in 1972, were created to oversee the newly created state enterprises (Dmytachengko:43).

Throughout the 1980's the Brazilian economy experienced a period of prolonged recession, aggravated by record inflation rates and astronomical public service debt. By 1986, debt service consumed 33.2% of the revenue generated from the export of goods and services (World Bank, 1988).

During the early 1980's, international lending institutions, such as the IMF and the World Bank, recognized the importance of the productive public sector as an important variable in the global economic policy equation. Emphasis was placed on the alignment of public enterprise action with macro-economic policies concerning inflation, deficit reduction, debt management, and balance of payment adjustments. In Brazil, the Secretaria de Controle das Empresas Estatais (Control Secretary for State Enterprises-

SEST), which had been created in 1979, was the organ selected to carry out the task price indexing and was used as a means to control inflation, import restrictions were imposed in an attempt to reduce balance of payment discrepancies, and investment was drastically reduced in order to slow down the escalation of foreign debt (Dmytrachengko:45).

While the government attempts to harmonize public enterprise policy with overall public policy was certainly a significant transformation from the pre-existing system of decentralization and relative autonomy of state enterprises, perhaps the most radical changes occurred in the transformation in ideology surrounding state ownership. It is worth noting that up until the mid-1970's, the developmentalist or statist model encountered virtually no opposition from either political or industrialist group. This lack of protest by entrepreneurs has been attributed to the non-confrontational position of the state, where public ventures complemented rather than competed with private interests, as well as the elite reconciliation model in politics (Dmytrachengko :40).

However, as the public sector began diversifying its activities and penetrating areas traditionally reserved for private ventures, opposition to state intervention grew (Gomes, 1986:348).

The campaign against "estatizacao" (Statism) was fueled by the debt crises. Increasingly, different sections of the population came to the realization that the public sector played an important role in contracting foreign debt, which led to their being assessed for the bulk of readjustment costs. The current support for privatization is attributed by some to be a natural response to the problems associated with state ownership of the past fifteen years.

In summary, the history of direct state involvement in Brazil draws several conclusions. First, while the state's participation in the public enterprises was an active and conscious effort, a lack of planning resulted in ad hoc policies which were designed to foster rapid economic growth and to fulfill specific necessities at various times. Second, as a result of inadequate planning, cohesive guidelines by which to judge public enterprise performance or their effectiveness as vehicles of macro-economic policies, were never created. Hence, the public sector continued to operate unchecked, despite its size and impact on the overall health of the economy.

***Performance of the State governments***

When Brazilian commentators speak of the role of the state government after 1967, they usually make a contrast between political economy, on the one hand, and fiscal dependency on the central government, on the other hand. (Graham, 1990: 87).

An article by Fernando Rezende (1982:489-540) emphasizes the decline in the percentage of state activities funded out of the states' resources after 1967 and the expansion in economic and public service activities at the state level through autonomous agencies and public enterprises. In other words, while the federal government was allocating less money to the states, there was a concomitant expansion in state activities that had to be paid for. This, he asserts, caused states to increase their foreign borrowing which thus led to the increased indebtedness of state governments. By 1981, state governments had contracted an estimated one-third of the country's external indebtedness (491). More notable, perhaps, is the fact that this indebtedness was centered primarily in the most developed part of the country-the southeast. Within that region, two states stand out: Sao Paulo with $ 8.1 billion and Minas Gerais with $ 4.8 billion (509-510).

Contrasting this indebtedness with the percent of state income derived from federal government transfers demonstrates quite dramatically the failures of the 1967 tax reform to meet the needs of state government. Yet this was a time of overall sector expansion, and the defense of revenue sharing schemes was only one aspect of the technocratic elite's overall development strategy for Brazil. Generally, those states which were the most developed found it easiest to barrow abroad. In contrast the poorer states had the least capacity to secure foreign loans but were able to expand their resource base through federal transfers already weighted in their direction.

While the central government tried to concentrate public sector investment at the top, multiple jurisdictions, overlapping authority and divided responsibilities were more often the case. On the one hand, while the larger state governments became rivals of the federal governments in institutional complexity, they were often bypassed on key developmental decisions. On the other hand, as policy moved from the planning stage into operation, and investments were made and allocated in a specific spatial context, the primacy of governors as the key political actors within the states reappeared and influenced policy outcomes. (Wright, 1982:29-30). In a discussion of the importance of distinguishing between viable and nonviable state governments in their capacity to function autonomously of the federal government, Graham (1990: 220) notes that by the 1990's some of the states are proving to be more successful than others in carving out and defining separate spheres of action. Whatever particular mix of intergovernmental relations emerges as a consequence of these new developments, a redefinition of the jurisdictions, the powers and the responsibilities of the three levels of governments (federal, state and municipal) that have characterized Brazilian federalism since its inception in 1891 is underway. Much, of course, will depend on the extent to which the states and key metropolitan areas are able to consolidate their positions as relatively autonomous institutional actors capable of defending and representing regional and local interests vis-a-vis those articulated in the federal government.

**Sao Paulo-State and City**

Sao Paulo was originally settled by Jesuit priests in 1532, and, during much of Portugal's 300 years rule in Brazil, was a modest trading post (Feldman-Bianco:20). During the eighteenth century, the city of Sao Paulo was turned into an intermediate redistribution center for regions as distant from each other as Rio Grande do Sul in the south and Mato Grosso in the central west. The state of Sao Paulo became, toward the end of the eighteenth century, the center of a modest sugar exporting economy (Singer, 1968). However, it was not until the second half of the nineteenth century that a major transformation occurred in Sao Paulo, built on the foundation of a coffee-exporting economy (Feldman-Bianco: 23).

Brazil's coffee revolution in the late nineteenth century, when coffee cultivation greatly increased, shifted the locus of growth within Sao Paulo towards the west. (Little, 1960). While coffee was being cultivated in the state at the beginning of the century, it was only after the spread of the coffee plantations to the western region, and the construction on 1868 of a railroad between Sao Paulo and the port of Santos, that the city turned into an important marketplace for capital and labor (De Sylos, 1973).

**Industrial Development in Sao Paulo**

Sao Paulo began its rapid industrialization during the first decades of the twentieth century, when Rio de Janeiro still dominated Brazil's economy. In 1907, Rio produced 44% of the national industrial output, While Sao Paulo's share was 17%. By 1920, Sao Paulo's share had reached 32%, while Rio de Janeiro had dropped to 28% (Quandt, 1993: 113).

The historical process of industrial concentration in Sao Paulo has been related to a variety of factors (see Cano, 1977). In contrast with the stagnant subsistence agrarian structure of Rio de Janeiro, Sao Paulo had Brazil's highest concentration of top quality agricultural land, allowing it to become the world's leading region for coffee production early in the century. This enabled the state to generate huge capital resources and develop a transportation and energy infrastructure which had no parallel in South America. The replacement of slave labor with abundant free immigrant labor, the growing prosperity of the Sao Paulo agro-industrial bourgeoisie and the demand for industrial raw materials propelled Sao Paulo and its capital city into a dominant position (Quandt, 1993:114).

The Getulio Vargas administration's support for the industrialization of the country and his historical ties with the Sao Paulo polity through the tenente revolts of the 1920's, was an opportunity for the Sao Paulo elite to expand their influence at the national level, and consequently, direct national economic resources towards Sao Paulo. For example, Brazil established a program in the 1950's to encourage foreign investors to create leading industries in Brazil. Those investments were highly concentrated in Sao Paulo, with 76% of the total, against 13% for Rio de Janeiro and 6% for Minas Gerais. The remainder was distributed among three states (Lima, 1967:32).

During the bureaucratic-authoritarian regimes of the 1960 and the 1970's, the industry of Sao Paulo began to attract an international market. By virtue of its leading industrial position and the gradual improvement of inter-regional highways, the city, together with the state of Sao Paulo, became the center of a process of national integration of formerly almost self-sufficient regional markets (Singer, 1968).

The disparity between the extreme concentration of industry, infrastructure and services in Sao Paulo and the rest of Brazil continued to grow so that by 1975 45.9% of the country's capital and 35.6% of its internal income was concentrated in the state of Sao Paulo . In that same year, 26 of the 50 major multinational corporations operating in Brazil were concentrated in the state (Camargo et. al 1976: 128).

Centralization of Brazil's economic and industrial activity in Sao Paulo was exacerbated by a large urban labor surplus, intensified by the growing impoverishment of regions such as Brazil's northeast and the modernization of agriculture in the south. For lack of both rural and industrial employment opportunities in those regions, they became the major sources of migratory flows to Sao Paulo. As a consequence, employers were able to preserve a largely unilateral power to control labor and determine wages (Storper, 1984).

Sao Paulo's industrial dominance peaked in the early 1970's. From then on, its shares of national manufacturing output and employment started to decline. A neo-classical interpretation of the rise and relative decline of Sao Paulo argues that concentration of wealth occurred in Sao Paulo due to the efficient concentration of infrastructure and resources in Sao Paulo. However, when cost-minimization strategies (tax breaks, subsidies etc.) were abandoned by the government, the increasing cost of infrastructure provision increased labor costs in the metropolis, thus increasing the cost of doing business (Townroe & Hamer, 1984). Thus, according to this view, decentralization will occur when the state no longer is willing to publicly subsidize the core area's increasingly inefficient infrastructure and services.

In contrast to this essentially ahistorical view, Storper (1984) takes a more institutionalist approach and claims that infrastructure investments are rarely motivated by rational cost-minimizing strategies, or by an assessment of the potential economic output of different alternatives. He claims that the rise of Sao Paulo was more a function of a shifting of power between regions and different factions of the ruling class. For the rise of power in Sao Paulo implied sacrificing pre-existing infrastructure and human resources in Rio de Janeiro. In this sense investment in Sao Paulo was not rational or efficient.

Quandt (1993:191) notes that "the protracted concentration of production was possible because of low labor absorption techniques, an abundant labor supply, wage repression, and the characteristics of labor". Labor laws in Brazil have historically been paternalistic and highly regulated by the state, which arbitrated directly all capital-labor disputes. The weak bargaining power of labor started to change in the 1970's when the authoritarian regime began to falter. Simultaneously, the concentration of the auto industry in Sao Paulo enabled the creation of strong sindicatos (unions), like the metalworkers union and the party representing its interest-the PT (Partido de Trabalhadores) or Workers Party.

Hence, the decentralization of production out of Sao Paulo since the 1970's, may be seen, in large part, as a management strategy to cope with the changing labor environment. In addition to labor markets, the rapid industrial growth in Sao Paulo put pressure on the market for industrial land, on the availability of infrastructure, housing & services, as well as on local ability to cope with mounting environmental problems. Thus it was becoming evident that the Greater Sao Paulo region was unable to sustain the previous rates of industrial growth. The federal government also encouraged decentralization by making it an explicit goal of the Second National Development Plan (1974-1979). This plan reinforced the already existing incentives for industrial investment in the less developed regions of the country, such as the North and Northeast. The government's fiscal plan was also a means of directing resources away from Sao paulo. For example, the distribution of federal expenditures per capita in Northeastern Brazil in 1991 was seven times higher than Sao Paulo state, although the latter generated around 60% of the total federal revenues. This amounts to a massive transfer of resources, because the federal government collects more than two-thirds of all taxes; states and municipalities get 29% and 3% respectively.

At present, albeit the decline in the past twenty years, the city of Sao Paulo is still the center for the most dynamic sectors of the Brazilian economy. The Sao Paulo hinterlands also stands out as an unusually dynamic region. Its growth rates have been among Brazil's highest throughout the century.

Sao Paulo state's urban system is highly developed in relation to the rest of Brazil. The origins of Sao Paulo's urban network can be traced back principally to the rapid expansion of the coffee plantations in the late nineteenth century. As a result of coffee exports, the port of Santos emerged as the states' second urban center on the beginning of the century, While Campinas and Sorocaba became major industrial areas outside of GSP, specializing in agro-industries and textiles.

Today more than 30 million Paulistas (people coming from the state of Sao Paulo as opposed to Paulistanos who come from the city of Sao Paulo) out of a total of 32, 821,933 are urban (IBGE/PNAD, 1993). The city of Sao Paulo is by far the largest in Sao Paulo and in Brazil with a population of more than ten million inhabitants. Campinas is a distant second with approximately one million people.

There are only four other cities in the state with more 500,000 inhabitants, with all of them located within the Greater Sao Paulo (GSP). Another 18 cities have between 250,000 and 500,000 people and 25 cities are in the 100,000 to 200,000 range. Sixty-nine cities have more than 75,000 inhabitants in Sao Paulo.

Besides population, the city of Campinas also ranks second to Greater Sao Paulo (GSP) in the areas of microelectronics, computers and telecommunications equipment (Quandt, 1993:158). The telecommunications sector is the outstanding feature of Campinas where nearly half of all technology based workers are in the telecommunications equipment producers (Quandt, 1993:163).

### *Family and Class in Sao Paulo Culture*

Just as a discussion of elites, in the context of family and class in the Philippines, illustrated the primacy of private interests over public interests in elite society, a discussion of class and family in Sao Paulo will elucidate the particular ideological framework that promoted the identification of regionalism with nationalism in the state.

At the apex of the urban social pyramid of Sao Paulo were the elite families. The Parentela, or extended family, was traditionally an important part of the lives of all social groups. However, by the 1960s, lower-class families tended to be organized in nuclear units while the extended family continued to thrive among the upper classes (de Silos, 1976).

The urban middle sectors in Sao Paulo were increasingly composed of immigrant families, both European and Japanese. Many of these immigrants joined the elite ranks and invigorated the class and its leadership with a greater sense of ambition and purpose. The dynamism of the new entrants was accompanied by a work ethic that was not a salient feature of the older, leisurely elite groups (Hutchinson, 1960 ).

All the sectors of the bourgeoisie tended to share a civic pride in their city. This pride was unique to Sao Paulo whose elites preferred their city to the federal capital, Rio, unlike the elites of other states like Pernambuco and Minas Gerais (Love, 1980:210).

The dynamism and uniqueness of Sao Paulo culture in the twentieth century were related to a moving frontier, European immigration and the rise of a new metropolis that challenged the federal capital for national leadership, both culturally and economically. Sao Paulo's importance in culture and economic affairs grew throughout the twentieth century, so that some considered it a state within a state (Hutchinson:15).

The Paulistas' ambivalence toward the authority of the central government had to an extent always conditioned their behavior toward the federal government. The support of the Vargas administration for the Paulista coffee growers further strengthened their position within the national polity (Weffert, 1968:73).

The economic elite and its political representatives developed an ideology that identified their interests with those of Sao Paulo's and Sao Paulo's interest with Brazil's. Hence, the compatibility of regionalism with nationalism was articulated in a unique way. If national integration can be defined as the intensification of linkages across state lines and the strengthening of loyalties to the nation-state rather than its component units, Paulista leaders felt that their state formed the growth pole around which the nation should organize itself (Love:213).

# BRAZILIAN TELECOMMUNICATIONS INDUSTRY

## *Early History of the Telecommunications Industry*

The history of Telecommunications in Brazil dates back to May 11, 1852, when the first Brazilian telegraph line was installed in Rio de Janeiro (Molano, 1995). Telephone service arrived in 1876, when Alexander Graham Bell offered Emperor Pedro II, a technology aficionado, a telephone as a gift. Two years later, a concession for the installation of telephone services between Rio de Janeiro and Niteroi (it's twin city across the bay) was granted to an American citizen, Charles Paul Mackie. The firm, called the Telephone Company of Brazil, consisted of U.S. investors and was located in New York. While foreign-owned telephone companies spread to other urban areas, Brazilian businessmen would lead expansion of the networks into the interior regions of the country. In Sao Paulo the first eleven commercial and residential telephones were installed on january 8, 1884 by the Companhia de Telegrafos Urbanos (Nogueira, 1978:13).

As telephone use increased, the government granted individual states and municipalities control of telephone concessions. However, in 1890, the Brazilian government reversed itself and established a national agency to grant service concessions. (Dmytrachengko, 1993:25)

By 1922, Rio de Janeiro had thirty thousand telephones for a population of 1,200,000 inhabitants, while Sao Paulo had twenty-two thousand telephones for a population of 630,000 people, giving Sao Paulo a higher telephone density (3.4 per 100 persons) than the capital, Rio (2.5 per 100 persons). (Nogueira, 1978:15).

Development of the industry, however, came to a standstill with the start of the First World War. The war broke off access to American and European technology and equipment, and the departure of the emperor removed a strong guiding force and ally of the industry. Hence, the industry entered into a prolonged period of decay and decline (Noguiera:17).

In the 1930's, however, the Brazilian telephone network again started to grow. For example, the Rio de Janeiro network surged to over 99,000 lines. As the world entered into the Second World War, however, investment and development ceased. The system decayed during this period because it was unable to get access to new equipment and replacement parts. Up to this point, control of the larger firms was mostly in the hands of foreign capital. However, towards the end of the 1950's and the beginning of the 1960's, the government began to increase its level of intervention as the Brazilian state began to play a more interventionist role in the private sector (Nelson, 1994).

The deepening of industrialization in the second half of the 1950's increased the rate of urbanization in the country and accelerated the expansion of a unified internal market. Breaking the isolated regions to build the necessary infrastructural highway required a telecommunications system that was inclusive and efficient (Wohlers, 1996:23).

Private companies, however, became concerned by the growing interference of government in the industry and, in 1960, they started reducing their level of investment, thus plunging the Brazilian telecommunications sector into a period of contraction.

By 1960, only four cities were connected by microwave interfaces (all other cities were connected by high fidelity radio signals). In the interior of the country, the situation was even more precarious. There were 800 telephone companies and concessions operating in Brazil. Due to the number of firms, there was a wide range of technologies and a high level of incompatibility between systems. There were also only a few long-distance lines and no central planning. Development of a uniform, modern system was hindered by the fact that power to grant concessions was divided between the central government,

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the states, and towns, resulting in the implementation of disparate technologies and rates which often did not cover the cost of providing services (Dmytrachenko, 1994). The result of the fragmentation and disorganization was a chaotic system with a penetration ratio of 1 per 100 in 1960, and a high unmet demand for telephone lines of poor quality (Wohlers, 1996).

To increase coordination between the different telephone companies and systems, the government decided to take a role that was more pro-active than the simple rate setting that it was responsible for. On March 31, 1962, the Brazilian government passed legislation that first, nationalized all telecommunications companies in the country and second, instituted uniform tariffs, provided for new investments, and assured telephone service in vital areas of the economy, such as banking and manufacturing (Dmytrachengko, 1993). The Brazilian telecommunications code instituted the bases for the formation of a Brazilian telecommunications system with normative, technical and financial components. The normative-technical component established the beginning of a national system which unified all the telephone networks in the country and instituted a federal organ with planning and fiscal functions called CONTEL (Conselho Nacional de Telecommunicacoes- National Telecommunications Council).

In the financial plane the code allowed for the creation of the FNT (Fundo Nacional de Telecommunicacoes-National Telecommunications Fund) whose purpose was the obtainment of extra budget resources that would put at the disposal of the future state company (Wohlers, 1996).

Part of this legislation also included a blueprint for the creation of the Empresa Brasileira de Telecommunicacoes (Embratel), which was to be funded by a 30 percent increase in telephone rates. Embratel eventually began its operations in 1965. The company's objectives, as stated in its charter, were to implement, expand and operate: 1) more advanced automatic telephone exchanges for long-distance calls in each state; 2) interstate trunk lines; 3) satellite stations 4) international telephone exchanges; 5) a national telex and data communication network; and 6) stations for the transmission of television and offshore signals. It was also given the task of providing administrative and operational assistance to interstate telephone companies, and engaging in research and development aimed at stimulating the domestic telecommunications industry. Embratel's objectives underscore the fact the organization placed more of an emphasis on infrastructure buildup and technological progress than by a more social welfare role in promoting employment and more equitable distribution of the service.

In 1966, the government decided to continue its expansion into the rest of the telecommunications sector and authorized Embratel to acquire a majority share in Compania Telefonica Brasileira (CTB). CTB was a subsidiary of the Canadian-owned Brazilian Traction Light & Power and the largest telephone company in Brazil. With the acquisition of CTB, Embratel gained control of the six largest telephone operations in Brazil, including Sao Paulo, Minas Gerais, and Espirito Santo. Nonetheless, there still remained almost 1,000 small operators that provided services to small villages, towns, and rural regions. Therefore in 1972, the government decided to create a federal holding company that would integrate all of the Brazilian regions under a single public owner and technological format while providing a uniform plan of investment. The new company was called Telebras and was divided into 30 regional subsidiaries or units corresponding to state units. Later Telebras was given control over Embratel, raising the number of subsidiaries to 31.

Table 4.1: telecommunication Units of Telebras

| | | | | |
|---|---|---|---|---|
| Bambui | Teleron | Teleamazon | Teleacre | Telaima |
| Telepara | Telma | Telepisa | Teleceara | Telern |
| Telpa | Telpe | Telasa | Telergipe | Telebahia |
| Telemig | Telest | Telerj | Cetel | Telebrasilia |
| Telegoias | Telemat | Telesp | Telespar | Telesc |
| CRT | CTBC | CTMR | Cotelpa | Teleamapa |
| Embratel | | | | |

Source: Telesp, 1996

Telebras planned and coordinated the growth of the telephony system, the acquisition of equipment, the application of resources, and the promotion of technological development via the CPqD (Wohlers, 1996). Until Telebras, Embratel was under the direct control of the Ministry of Communications and like most state-owned enterprises enjoyed considerable autonomy. Regulations affecting EMBRATEL were, until recently, largely limited to price controls and requirements that the firm satisfy certain levels of service demanded. These controls were aimed at making telecommunications affordable to the general public and allowing for a competitive rate of return. This practice was in keeping with the philosophy that state-owned enterprises, by fostering growth through self-financed investments, be instruments through which economic development is stimulated (Dmytrachengko, 1993).

***Telebras under the Military***

Telebras was designed to minimize political meddling by creating a buffer zone between the political leadership located in Brasilia and the managers of the individual companies in the group (Dmytraczenko, 1993). The holding company structure allowed telephone operations to be decentralized with most operating decisions delegated to the local level. The Ministry of Communication in Brasilia was in charge of the firm at a general level, but local managers were able to operate in a manner that allowed them to maximize efficiency while enjoying many of the benefits and resources of centralized technology and investment.

In other words, the individual units were allowed to operate as if they were private companies. There was very little actual regulation, and ministries rarely interfered in company affairs. Nonetheless, there was significant political control at the local level over employment issues. Many politicians allocated positions in Telebras operating units as forms of political patronage. Company employees were also considered public-sector employees, making them eligible for public-sector wage policies and constitutional guarantees. Therefore, the company had a mix of political interference. The holding company was relatively independent at a national level, but the operating units had a fairly high level of interference at the local level.( Wohlers, 1996)

The period of the 1970's was known as the "golden age" of the Telebras system, when investment averaged 1.3 billion dollars annually (Siqueira, 1996). During the earlier part of the decade the strategy was to concentrate forces on the growth and modernization of the system. It was during this time that Embratel created a modern and efficient system of interconnection via microwaves (Wohler, 1996). Once this was completed, the focus was on the existing urban networks which used cross-subsidies from the profitable long-distance market for financing local lines and public phones. This caused a tremendous expansion in the urban networks, so much so, that between 1972 and 1980, the number of terminals installed by Telebras went from 1.4 million to 5.1 million, representing an average installation rate of 17.3% (Revista Nacional de Telecommunicacoes, October, 1981).

However, in the 1980's the environment described above changed dramatically. Price controls were used to restrain inflation and, consequently, not only did they cease to allow for a reasonable rate of return, but they also lagged well behind inflated production costs. Moreover, borrowing restrictions were imposed in an attempt to reduce the size of the public debt and limits were placed on imports as a means to ease the balance of payment pressures (Wohlers, 1996). Also, the government of Figereido was attempting to improve the popularity of the government party and used low tariffs as one of the means to do this.

### *Telebras and Democracy (1985-1996)*

After two decades of authoritarian government in the country, Brazil embraced democracy in 1985 with the election by Congress of Tancredo Neves and Jose Sarney. From an economic standpoint this government was not very successful in stabilizing the monetary system and controlling inflation. Politically, however, the country experienced the consolidation of democracy with the approval of the 1988 constitution (Wohlers interview, 1996).

Article 21 of the constitution defined the public model as the exclusive model in the provision of basic telecommunications needs in the areas of telephony, telegraphy and data processing. The charter, however, did not touch the regulation of the industry which was left virtually unchanged from the 1962 constitution.

At the end of the last decade, while other Latin-American countries (Mexico, Argentina and Chile) were preparing to privatize their systems, Brazil constitutionally reaffirmed the public monopoly of telecommunications. Telecommunications was seen as part of the country's patrimony as well as a source of employment for an increasingly agitated labor sector. However, the 1988 constitution, while maintaining the public monopoly for basic services, also guaranteed a wide area for private initiatives in value-added services and the exploration of the UHF and VHF bands (RNT, 1989).

One important contribution made by the Sarney government to the privatization movement in the country was the sale of Telebras stocks in 1989 which were publicly offered in the stockmarkets across the country. This sale was extremely important in generating finances for the Telebras system. For example, in 1990 the value of the Telebras stock was $5.00 a share and rose to $35.00 a share in 1991, representing a seven-fold increase in one year (Wohlers, 1996).

While the Collor government started a serious debate on the deregulation and privatization of the sector, they were unsuccessful in articulating a politically consistent policy in the area of telecommunications. The proliferation of deregulatory measures occurred without having defined a consistent competitive model and adequate mechanisms for regulation. All this ended with the political paralysis of the sector (RNT, 1993).

The government of Itamar Franco was able to continue the debate on the deregulation an liberalization of the sector. However, it was not until the government of Fernando Enrique Cardoso that a new institutional model organizing the telecommunications sector was realized. On February 1995 the government presented the congress with a proposal to break the public model as framed by the 1988 constitution. This was approved in the middle of that year and the constitution was subsequently emended (Revista Nacional de Telecommunicacoes, 1995). In an interview with Sergio Motta, the present minister of Communications, by RNT magazine, Motta outlined several points discussed in the proposal. One of the points was the subdivision of Telebras into five or six mini-holdings. Each of these holdings would represent a macro-area with authority over the operating companies in that area. The macroarea would not be defined by geographic contiguousness, but rather by the joining of rich and poor areas (For example Sao Paulo and Amazonia) thereby ensuring against the likelihood of private capital only serving the richer areas (RNT, March 1996:30).

Apart from breaking the monopoly at the end of 1995, the government of Cardoso created other important measures. These were:

1. PASTE -Plano de Metas (plansof goals) which is a plan for the growth and recuperation of the sector.

2. The overhauling of the tariff system- In 1995 the federal government promoted tariff readjustment rates in telecommunications, reducing cross-subsidies, increasing basic subscription rates by 517%, local calls by 57% and interurban calls by 213% (Wohlers, 1996: 30). This was implemented to readjust the historically low tariffs that had existed in the country over the last twenty years.

3. Minimum Law (Lei 9.295)- This law passed in July of 1996 whose primary purpose was the facilitation of cellular telephony into the private sector. This law supports the exploration of cellular by Brazilian companies owning at least 51% of voting capital and 83% of total capital. The law also provided for the creation of a regulatory body, the CNC (Comissao Nacional de Communicacoes) and would be operational upon the approval of both houses of Congress (Wohlers, interview, 1996).

***Technological Development in the Telebras System***

Government investment in Telebras had as its driving force the development of Brazil's technology base. The cycles of growth and decay that had characterized Brazilian development in the sector during the first half of the twentieth century was the argument for a strong, self-sufficient technological base.

The construction of the domestic telecommunications industrial base was accelerated in 1974, after the severe shock of the oil crises and the surge in commodity prices. Brazil's complete dependence on foreign oil and high energy costs absorbed much of the foreign exchange allocations. Therefore, the government immediately began exploring ways of reducing non-oil import costs through import substitution programs. In 1974, the government established Grupo Ejecutivo Interministerial de Componenetes y Materiales (GEICOM) to lead the task. GEICOM identified telecommunications equipment as a good candidate for import-substitution and in 1976 the government established the national telecommunications lab, CPqD.

CPqD was a telecommunications research and manufacturing complex in Campinas, a city outside Sao Paulo. CPqD telephone laboratories were the most advanced outside the industrialized world and the only ones of their kind in Latin America. While laboratories in the U.S. and France set the standard for telecommunications technology in the industrialized world, CPqD was chartered to do the same for Brazil. CPqD improved and refined Telebras' standard electromechanical equipment, it also spearheaded the country's push into microelectronic technology (Hobday, 1990).

However, inspite of the Brazilian effort, its R&D expenditures could not match spending in the U.S. and Europe. For example, in 1991, Telebras channeled about $2.4 billion in scarce resources to establish a Brazilian telephone standard, while the Japanese, Americans and Europeans spent four to five times more (Siquiera, 1994).

As the CPqD facilities matured during the late 1970s and early 1980s, the government began to require that equipment manufacturers perform a larger part of their technology intensive manufacturing process in Brazil. General Jose Antonio Alencastro e Silva, the head of Telebras during the late 1970s, sought to create spillover effects, such as technician training and subcontracting activities, that would have a greater impact on Brazil's technological base (Latin American Newsletter, July 18, 1978).

However, other problems were not foreseen came to haunt the industry as it matured. For example, the CPqD complex designed an indigenous telephone system called Tropico. Tropico was, and continues to be, a viable system that uses digital, satellite, and fiber optic technology but has a high level of incompatibility with telephone systems used in the rest of the world. This divergence between Tropico and international standards increases as time goes on, thus isolating Brazil from the rest of the world. Telebras has also been left with the high costs of performing original research that has already been performed in the major telephone laboratories, thus burdening the country with the continued funding of a redundant system. Political considerations, such as national pride and employment, and the logic of sunk costs, however, prevented Brazil from returning to international technology (Haggard, 1992).

Another problem associated with this policy was the creation of large and powerful interests groups. Since manufacturers of domestic telephone equipment had a captured client in Telebras and the country had cut itself off from trade competition through import substitution, the manufacturers sold telephone equipment to Telebras at prices that were higher than international rates.

A domestic lobby was spawned with the high rents from these exclusive markets and soon became a powerful force against privatization. Not only did the privatization of Telebras mean increased competition from external sources for equipment and a reduction in rents, it also implied the transformation of the Tropico technology to international standards. Therefore, the manufacturers would have to make large investments to retool their industry international standards.

The effect of all this on Brazil's telecommunications technological level was not good. When comparing the level of digitalization with its neighboring countries, Beca (1991) noted the low level of digitalization compared to other countries in the Southern cone, lagging behind by four or five years. The primary source for Telebras' expansion programs was self-financing, which meant the use of internal resources, such as tariff rates and installation fees. The money was used primarily to purchase equipment, perform research and development (R&D), manage the operating system, and expand the network.

By the middle of the 1980's, Telebras and its subsidiaries shifted their focus of funding from internal sources to domestic and international capital markets. Because of the large size of its revenue base and assets, the company was able to tap into Brazilian capital markets, as well as international ones. The ownership structure was also altered to allow minority equity participation by private investors, with control remaining in the hands of the state. Telebras and the subsidiaries for Sao Paulo and Rio de Janeiro, Telesp and Telerj, used the Sao Paulo stock market (Bovespa) to float shares. Telebras was also able to raise money in the international capital markets. On several occasions the company floated bonds in the international capital markets, something that no other state-owned telephone company in Latin America had been able to achieve. Investors were especially attracted by the enormous size of Telebras. The company's total investment was much higher than any other Latin American country's investment. Its rate of return was also quite good, which stood at 10% for 1988 and 6% for 1989 (RNT, 1990).

### *The Growth of Cellular telephony*

While some Latin American countries (Argentina, Mexico) were privatizing their state-owned companies and introducing cellular technology in the late 1980s, Brazil introduced cellular telephony only in 1990. Up through 1992, only five operators of the Telebras system were offering cellular telehony. During this period, important regional companies, such as Telesp and Telemig, still did not offer the service. This was said to be because these two large companies needed more time to evaluate the potential of their markets. The Paulista market, alone, had a potential in the hundreds of millions of dollars. This was because of the huge unmet demand in the area of basic telephony, and because it was the last great metropolis in the world that still did not have cellular telephony (Interview with Wohlers, 1996).

While private companies, both foreign and domestic, wanted to enter the market they were prevented by Article 21 of the 1988 constitution which reaffirmed the power of the monopoly. However, starting in 1990, the government of Fernando Collor encouraged the deregulation of telecommunications services by trying to stimulate the entrance of the private sector in the areas of data communication and cellular telephony.

To bypass the constitutional monopoly, the government of Collor interpreted cellular telephony as a restricted public service. This classification put it as a type of mobile telephony, which then allowed for the entrance of private initiative according to the Brazilian Code of 1962.

However, the participation of the private sector was really established during the government of Fernando Enrique Cardoso, with the approval of Constitutional Amendment no. 8, which broke the constitutional monopoly and provided for the participation of private companies in cellular telephony. The Minimum law, promulgated in 1996, permits the privatization of band A, which had previously been exclusive to the public sector. The law obliges that the public concessionaires, in a time frame of twenty-four months, create independent companies for the purpose of providing cellular telephony. The government has authorized ten concession areas with six of them in the riches regions of the country and four of them in the poorest. it was also established that the same company or consortium could operate in two areas of concession, a rich region and a poor one.

***Telefonos de Sao Paulo- TELESP***

In the context of TELEBRAS, the TELESP system is the largest of the twenty-eight state operating companies. TELESP presently accounts for 27% of TELEBRAS investment; 34% of net operating revenue excluding EMBRATEL; 33% of all telephone lines; 37% of all domestic long-distance traffic; 47% of all international traffic; 24% of all employees (30% excluding EMBRATEL) (TELESP annual report, 1996).

***History of the Company***

In 1973, there existed in the state of Sao Paulo, more than 200 telephone companies with 694,000 telephone terminals distributed in 200 municipalities out of a total 571 municipalities in the entire state of Sao Paulo (10 year TELESP summary report, 1973-1983).

In accordance with the mandate of Telebras that it create an operating company in each state, Telesp was inaugurated on April 12, 1973. However, the process of preparing for the creation of the company had already started three years earlier, under the guidance of the CTB (Companhia Telefonica Brazileira) (RNT, April, 1993: 38).

The CTB was bought by the Brazilian government in 1966 from the Canadian company which had been operating in Brazil since 1923. The constitution of 1967 nationalized all the private telecommunications companies and outlined new ideas for the recuperation of the sector. After the acquisition of the CTB (which operated in the states of Sao Paulo, Guanabera, Rio de Janeiro, Minas Gerais and Espirito Santo), the Brazilian government, represented by the newly created Embratel, assumed control of the old CTB (RNT, April, 1993: 39).

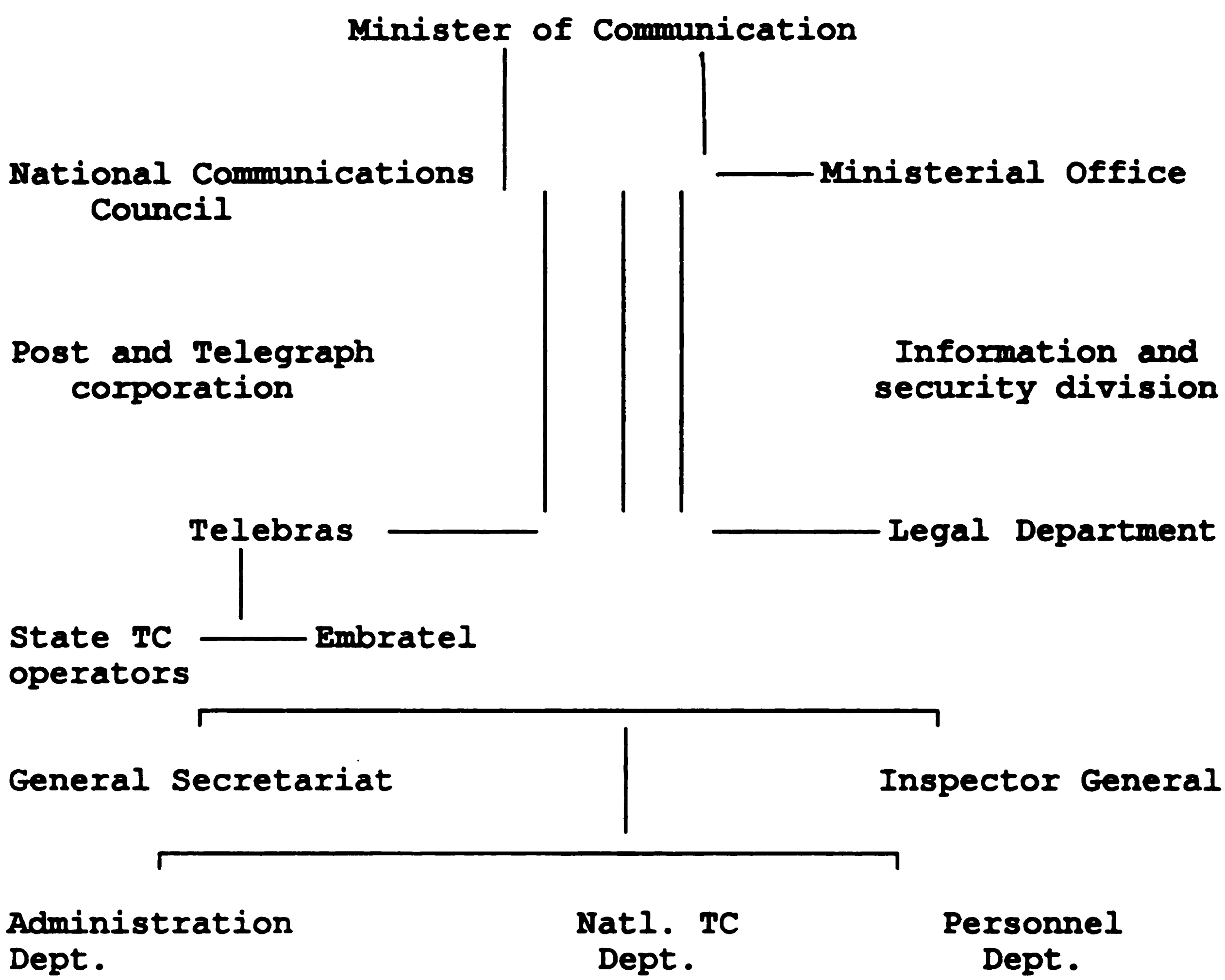
The most dynamic period of recuperation started with the leadership of Jose de Siqueira Meneses Filho, in January of 1970, under the administration of Hygino Corsetti, the Minister of Communications. Siquiera brought numerous engineers and other technicians to the company with the intention of reversing the stagnation that had occurred in the five states where the CTB was operating. One of the first actions taken by the new company was the establishment of direct dialing (DDD) between the cities of Porto Alegre and Sao Paulo (RNT, April, 1993:39).

At the end of 1971, with more than three hundred engineers and an emergency plan executed throughout the entire state, the company announced an installation plan for 1 million telephone lines over a five year period. This plan was the first great national push for the recuperation of local telephony in the country. The plan was a success and the process of recuperation accelerated. The birth of Telebras in 1972 facilitated this process even more (RNT, April, 1993: 40).

After Telesp was created in 1973, the company put all its efforts into the expansion and modernization of the state telephone system ( ten year annual report, Telesp, 1973-83: 3). The organizational structure, the revenue and ownership structures were as follows:

***Structure of the Brazilian Telecommunications sector from 1967-1990***

Figure 4.1

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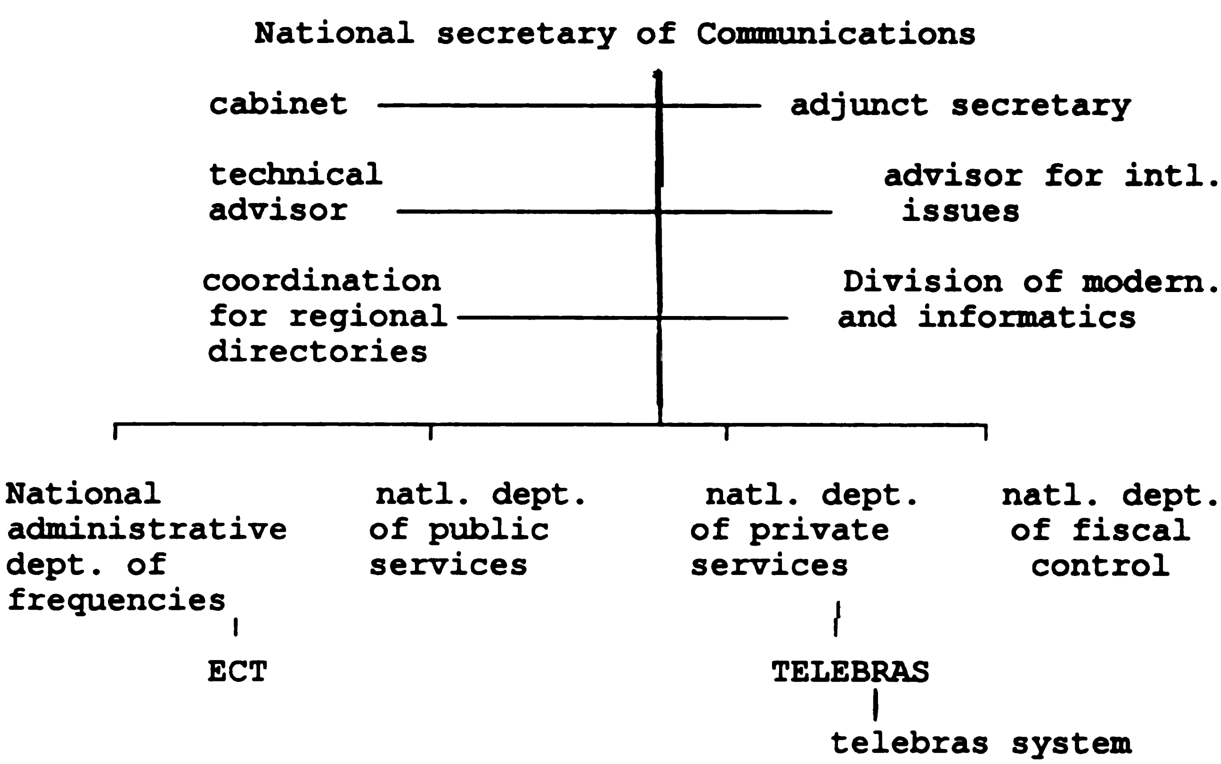
source: Revista Nacional de Telecommunicacoes, August, 1979 :88

As illustrated by the above graph, the Ministry of Communications was made up of the National Communications council, responsible for advising the minister, the secretary-general and the National Department of Communications. Also under the Ministry of Communications was a publicly-owned corporation, the Brazilian Post and Telegraph and the Telecommunications Brasileiras S.A.-Telebras (Quandt de Oliveira, 1992)

The objectives of the Ministry of Communications included the laying down of directives and targets in connection with the National Communications System and the promotion of the installation of means of Communication aimed at ensuring national unity and security. Also included was the promotion of research; the development of human resources for the area; ensuring the operational efficiency of communications services at all levels; supporting Brazilian enterprises and contributing to the consolidation, the updating and complementing of the relevant legislation. The national council was presided over by the ministry and was responsible for advising the minister in matters concerning the postal services and telecommunications. The Secretary- General's responsibilities include planning, the preparation of the budget, administrative modernization and reform, financial programming, the carrying-out of studies aimed at establishing targets and working out directives of Communications policy, supervising, coordinating and controlling the activities of postal services, telecommunications information and international matters of interest to the Ministry of Communications. The National Telecommunications Department's (Dentel) mandate was to guide, coordinate, control and supervise the application of the laws, regulations and practices related to telecommunications activities (Revista Nacional de Telecommunicacoes, August, 1979:87). In April of 1990, Congress approved the reorganization of the telecommunications sector and the restructuring of Telebras.

The new structure as seen in figure 4.2 was as follows:

Figure 4.2




--Source: RNT, May 1990: 8

In this new system the National Secretary of Communications substitutes the old Minister of Communication. The National Secretary of Communications has four new departments which are: The National Administrative Department of Frequencies whose functions are the administration of the frequencies of the Spectrum and the proposal of norms to optimize their utilization.

The National Department of Public Services, elaborates norms and coordinates, formulates and evaluates the objectives and goals relative to public services in telecommunications and postal services. The National Department of Private Services controls and directs all limited services and special services like cellular telephony. The National Department of Fiscal Control plans, coordinates, controls the application of fiscal policy, laws, regulations and norms relative to the communications industry. The old DENTEL was divided into the Department of the Administration of Frequencies and the Department of Fiscal control.

***Investments and Sources of Funding for the Sector***

The telecommunications Sector can count on four sources of funding for its investments: tariffs, autofinancing, Third party sources, fiscal sources (until the beginning of the

1980's a large part of this consisted of funds from the Fundo Nacional de Telecommunicacoes) (Wohlers, 1993:26).

1. Tariffs- The levying of tariffs on public services is a vital and important characteristic of the public sector. The pricing of tariffs should be calculated according to certain fundamental concepts. These include: the coverage of all operational costs; the depreciation, during the life of the equipment, of the applied value; and a just financial remuneration of invested capital.
(Quandt de Oliveira, 1992:169-170).

These concepts constituted the foundation of the norms for fixed tariffs that were in Article 151 of the Constitution of 1946. It was determined that tariffs should be established and revised in such a way, that a fair return on investment permit the concessionaires to expand and improve their services. Article 151 was later regulated by Articles 101 and 102 of the Brazilian Telecommunications Code of 1962, that established the direction fixing of tariffs by Contel (Quandt de Oliveira, 1992: 172).

Requests for tariff adjustments were also approved by Contel and decreed by decision no.20 in 1964, which established the procedure that concessionaires had to follow for their requests.

Decision no. 87 defined what was considered remunerable capital, introduced the possibility of applying monetary corrections, and fixed the remuneration of this capital at 12%.

While tariffs for all companies were circumscibed by the criteria set by Contel, Embratel's tariffs differed from other companies in that the fixed remuneration of 12% did not apply to the Company. Embratel's mandate to modernize and expand the Brazilian telecommunications system exempted it from this requirement (Quandt de Oliveira, 1992:173).

Throughout the 1960's and until the end of the 1970s, tariff rates were effective. However, during the 1980s the Brazilian government started to readjust tariff rates below the rate of inflation. It was one of the policies used by the Brazilian government to contain inflation. Since the resources generated by tariffs could not keep up with demand, other investment resources were created to finance the sector. One of these sources was autofinancing.

2. Autofinancing- During the 1950's, concessionaires of telephone companies started to complain that low tariff rates as mandated by the government could not keep up with the cost of expansion. Furthermore, they were also arguing that potential stockholders were unmotivated to buy stocks because of the low rates of return, and that financial institutions

such as banks were hesitant to provide loans for fear of non payment due to a lack of profits (Alencastro e Silva,1990:153).

The unmet demand that existed needed much higher investments than the resources generated by tariffs could supply. Among a number of solutions discussed arose the idea of obtaining the resources directly from subscribers of the service. Pedro Renault Castaneira was one of the pioneers of the system called autofinancing.(Quandt de Oliveira:180). The method was to divide the actual total cost of expansion of an area by the number of terminals requested by subscribers. Subscribers would then receive stocks from both the holding company, Telebras and the operating company (Wolhers, 1996).

With the passage of the Brazilian Telecommunications Code of 1962, autofinancing was institutionalized and regulated by Contel. Supporters of autofinancing argued that it allowed for the expansion of the system as well as democratizing the capital. Critics, however, felt that while it was a legitimate resource for the expansion of the system, autofinancing had a number of weaknesses and should only be used as a temporary solution. The most important criticism was that it masked the real existing demand because only those who could afford the high cost of installing a telephone line could receive one (Quandt de Oliveira:181).

Autofinancing, with perhaps the exception of Japan in the 1950s and Korea in the 1980s, is peculiar to Brazil and continues to be applied (Wohlers, 1996). During the 1970s, the cost of autofinancing was progressively reduced in relation to the cost of installation with the idea of eventually transforming it into a simple installation fee. However, during the 1980's this idea was abandoned and autofinancing became again one of the principle sources of financing.

3. Fundo Nacional de Telecommunicacoes-During the early years of the expansion plan the government decided, as a result of the inadequate generation of resources because of low telephone penetrations, to temporarily establish an extra tariff that would be specific to telecommunications. This resulted in the creation of the Fundo Nacional de Telecommunicacoes (FNT) which existed until 1983 (Quandt de Oliveira: 183).

4.Third party resources (recursos de terceiros)- These were loans that Telebras or any of the operating companies received from banks, suppliers or other financial institutions (Wohlers, 1996).

Table 4.2 below demonstrates the share that each of these sources of funding had in telecommunications investment from 1974 to 1995.

Table 4.2

INVESTMENT AND FINANCING OF THE BRAZILIAN TELECOMMUNICATIONS SYSTEM FROM 1974 TO 1995

| YEAR | INVEST (US MIL) | FINANCIAL PARTICIPATION (%) | | | | |
|---|---|---|---|---|---|---|
| | | TARIFFS | AUTOFINANCING | FISCAL | OTHER | TOTAL |
| 1974 | 796 | 13 | 23 | 17 | 47 | 100 |
| 1975 | 1220 | 4 | 23 | 15 | 60 | 100 |
| 1976 | 1648 | 9 | 19 | 11 | 61 | 100 |
| 1977 | 1566 | 17 | 20 | 13 | 50 | 100 |
| 1978 | 1454 | 24 | 26 | 20 | 30 | 100 |
| 1979 | 1358 | 20 | 25 | 13 | 42 | 100 |
| 1980 | 932 | 9 | 32 | 17 | 42 | 100 |
| 1981 | 1330 | 29 | 24 | 24 | 23 | 100 |
| 1982 | 1523 | 36 | 23 | 19 | 22 | 100 |
| 1983 | 992 | 55 | 21 | 12 | 12 | 100 |
| 1984 | 864 | 69 | 21 | 5 | 5 | 100 |
| 1985 | 918 | 67 | 24 | 2 | 7 | 100 |
| 1986 | 1245 | 49 | 24 | 13 | 14 | 100 |
| 1987 | 1448 | 45 | 46 | 7 | 2 | 100 |
| 1988 | 1977 | 55 | 18 | 4 | 23 | 100 |
| 1989 | 2559 | 24 | 33 | 1 | 42 | 100 |
| 1990 | 2121 | 69 | 25 | 1 | 6 | 100 |
| 1991 | 2311 | 52 | 26 | 0 | 22 | 100 |
| 1992 | 3063 | 64 | 13 | 0 | 23 | 100 |
| 1993 | 2935 | 55 | 12 | 0 | 33 | 100 |
| 1994 | 4261 | 64 | 17 | 0 | 20 | 100 |
| 1995 | 4660 | 58 | 15 | 0 | 27 | 100 |

source: Wohlers, 1993:26 and Wohlers, 1996:191

***Regulation of the Brazilian Telecommunications Sector***

Regulation of the Brazilian telecommunications sector has its origins in the senatorial debates that occurred in the 1950's. During this period certain Brazilian senators started to be concerned with the lack of legislative control in the telecommunications sector (Nogueira, 1978:38). In 1953, Senator Marcondes Filho, who was the Minister of Labor during the presidency of Getulio Vargas in the previous decade, presented and passed a law instituting the Brazilian Code of Radiodiffusion (Quandt de Oliveira, 1993:57). This initiated a movement in the senate to create a legal instrument that would codify the exploration of telecommunications services in the country. It ended in the passage of the Brazilian Telecommunications Code of 1962 (Noguiera, 1978:39). The Brazilian code contained three important points. These were:(Quandt de Oliveira, 1993:58).

1. The creation of a central organ, Contel (Conselho Nacional de telecommunicacoes), which was responsible for the overall execution of the law.

2. The elaboration of the first national telecommunications plan.

3. The authorization and creation of a company responsible for interstate and international telecommunications. That company was called Embratel (Empresa Brasileira de Telecommunicacoes).

While the Brazilian Telcommunications Code established the foundation of a national telcommunications regulatory environment, it was not until the military government of Castelo Branco, two years later, that measures established in the code started two years earlier started to take serious form. Some of the measures instituted by Branco's administration were:

-the creation and regulation of the FNT (Fundo Nacional de Telecommunicacoes), a body that was responsible for the collection of a telecommunications tax levied on the sector until 1982.

-The acquisition and control of the stocks of the CTB (Companhia Telefonica Brasileira) and the CTN (Companhia Telefonica Nacional), which were companies that were largely capitalized by foreign money and had which concessions in the richest and most developed regions of the country.

-Membership in Intelsat

-creation of the Ministry of Communication through the administration reform established in Decree no. 200, passed on march 15, 1953. (Quandt de Oliveira, 1993: 59).

During the government of Medici (1969-1974), the Minister of Communication launched an emergency plan for a million telephones in the old areas of the CTB and proceeded with the total restructuring of the sector which was characterized by:

a. The passage of law no. 5.792 on July 11, 1972, authorizing the creation of the holding company, Telebras (Telecommunicacoes Brasileiras S/A). The first president was the Minister of Communications at the time, Euclides Quandt de Oliveira.

b. The creation of subsidiary companies in each state of the federation which were responsible for the implementation and exploration of public telecommunications in their respective jurisdictions.

c. The transformation of Embratel into a subsidiary of Telebras.

d. The authorization for the application of FNT funds for local and interstate services and its administration by Telebras (Alencastro e Silva, 1990:67).

***Telephone Infrastructure in Sao Paulo State***

The state of Sao Paulo has the most developed telecommunications infrastructure in Brazil. However, Sao Paulo's share of Brazilian telephony, while still dominant, declined from 1980 to 1994. Table 4.3 illustrates the percentage of telephony as a share of total Brazilian telephony.

Table 4.3

| | 1980 | 1994 |
|---|---|---|
| # of terminals | 43.72 % | 35.72% |
| Residential terminals | 44.05 | 36.00 |
| non residential term. | 40.24 | 35.48 |
| Trunk capacity | 52.51 | 43.26 |
| Public Terminals | 42.08 | 30.84 |
| long-distance calls completed thru TELESP/ Telebras | - | 34.86 |
| International minutes | | 48.00 |
| long-distance calls completed thru Embratel | - | 29.72 |
| Net operating revenue | | 34.00 |
| investments | | 37.5 |
| employees | | 29.6 |

Source: SEADE, IBGE

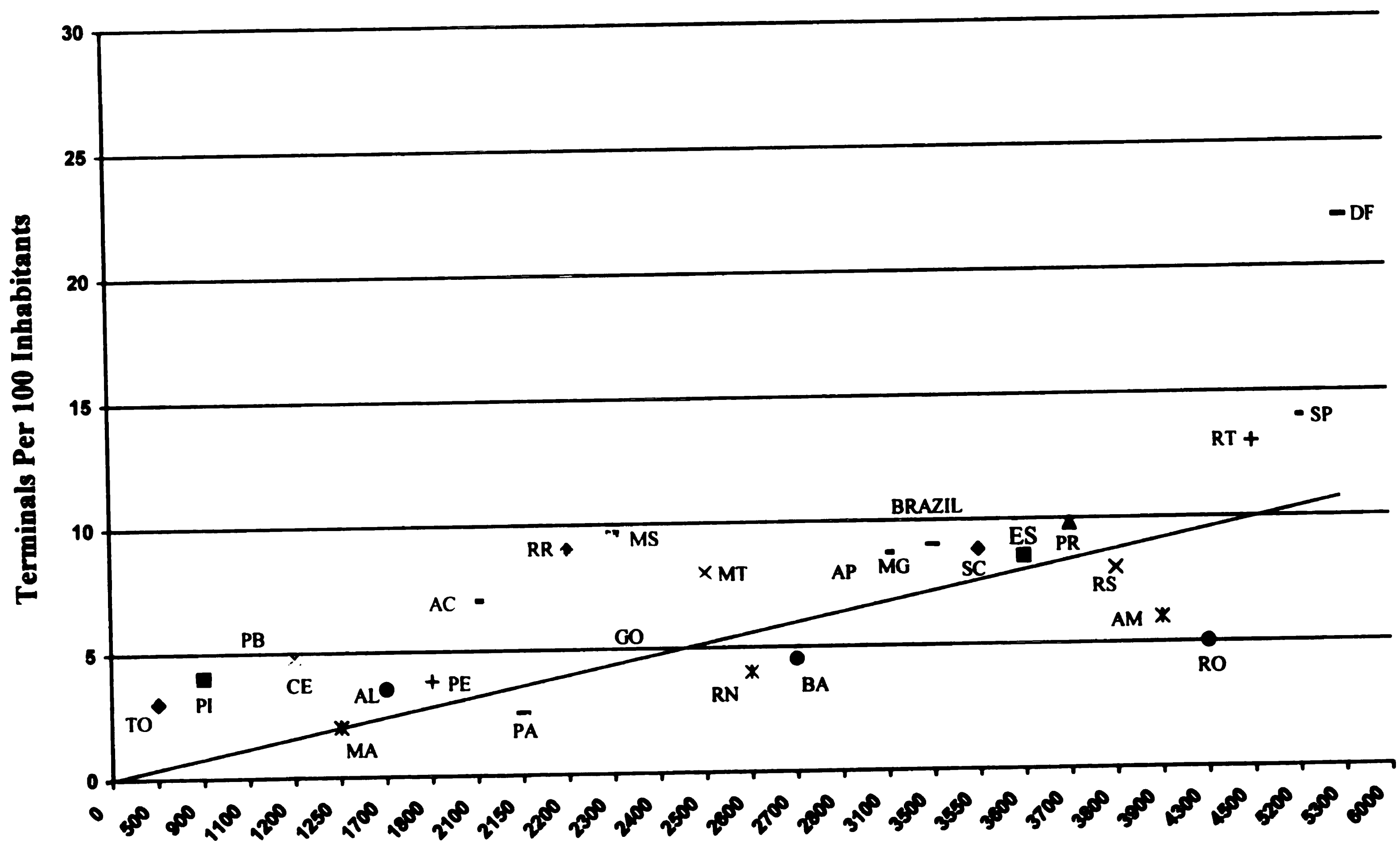
This decline in share can be attributed to both the growth of other telecommunications companies in Brazil, as well as the growth of the operators in the State of Sao Paulo. TELESP remained the monopoly operator until 1981, when private companies like Etusa, Ceterp and teleoesp started offering local services. However, TELESP controls 96 percent of all lines in the state, as well as the main trunk line for access to long-distance calling. Telesp owns 88% of all access lines, Companhia Telefonica Da Borda Do Campo (CTBC), a subsidiary of Telesp, holds 8%, while two other companies, Companhia Telefonica Do Brasil Central (private) and CETERP (belonging to the municipality of Riberao Preto) own the remaining 4%.

In 1991, the private sector was allowed to participate in an expansion program called the Community Telephone Program. Private companies were licensed to provide telephones in some towns in the state of Sao Paulo. However, the companies were supervised and controlled by Telesp who was responsible for the initial installation of the telephones and the connection of these systems to the public telecommunications network. Since the start of the program up till December of 1994, 202,651 lines were contracted and 98,176 were installed. In 1994 alone, 409,000 new telephone lines were installed in the state of Sao Paulo. Thirty thousand of those lines were installed by the Community Telephone Program and the rest by Telesp (Telesp Corporate Information, 1994:8)

A regression (see figure 4.3) of state per capita income on telephone density of the telebras subsidiaries clearly shows TELESP to be at the top of the regression line (SEADE, 1996). Similarly, a similar regression (figure 4.4) of 28 countries and the state of Sao Paulo locates Sao Paulo closer to Argentina than to Brazil (Telesp, 1996).

FIGURE 4.3

Brazil: Telephone Density x Per Capita Income of the Brazilian States (1994)

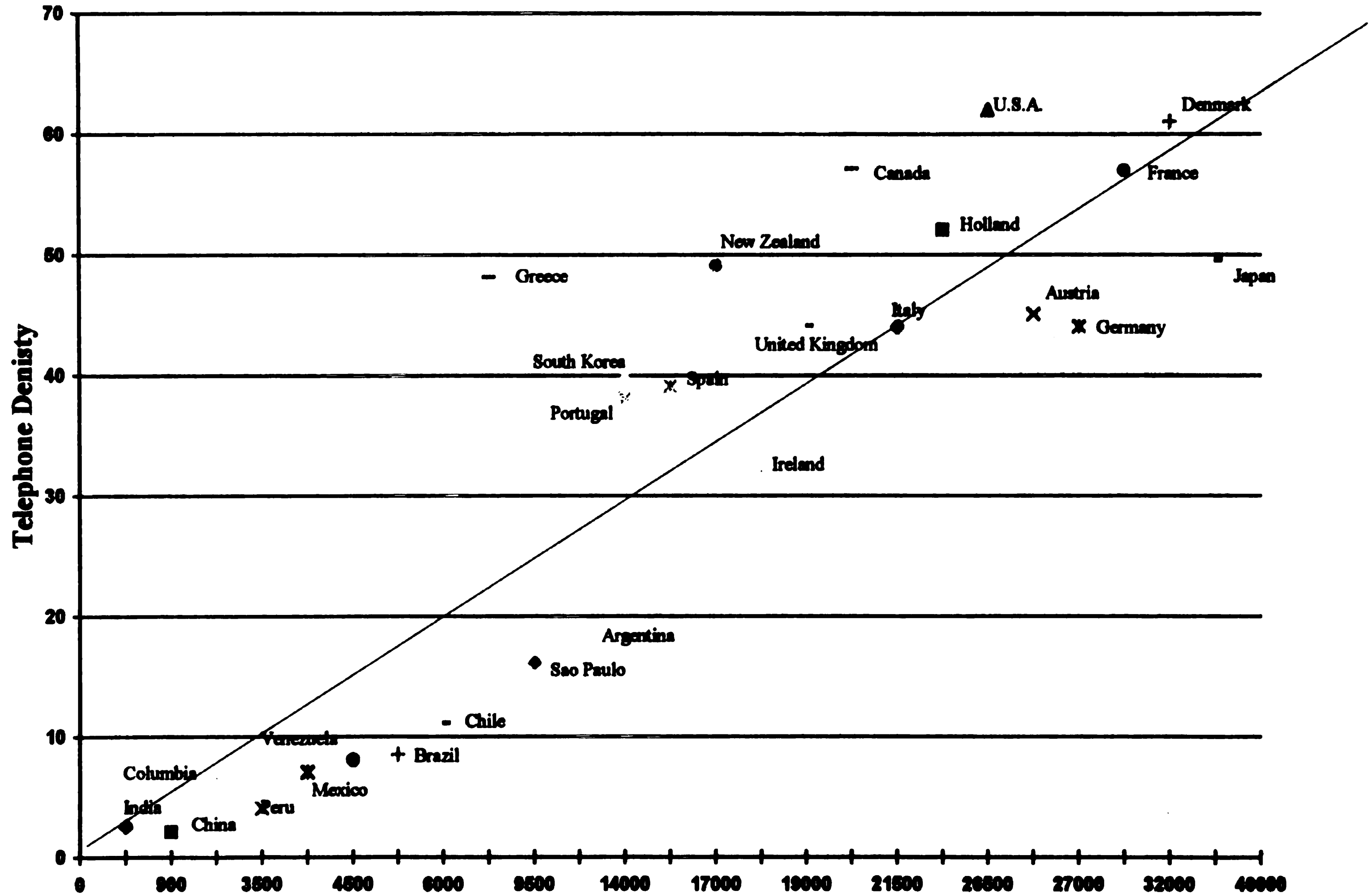



Per Capita (U.S. $)

Source: Wolhers, 1996

## FIGURE 4.5

### Telephone Density Per 100 Persons x Per Capita Income




Source: Merill Lynch
TELESP

### TELESP MISSION STATEMENT

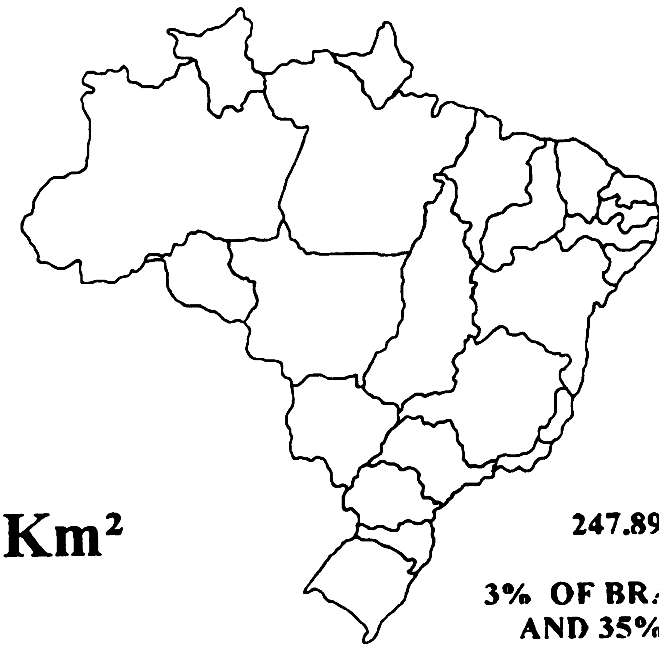
" To Stimulate the development of society by providing communications in voice, text, data and image through the integration of services, systems, and state-of-the-art technology" (Telesp Corporate Information, 1994:cover).

## TELESP NETWORK

Telesp telecommunications network consists of subscriber equipment, the local plant (switching equipment, fiber optic cables and digital transmission systems) and the long distance plant (Toll switching equipment, microwave and multiplex equipment, coaxial and fiber optic cables).

In the last seven years the proportion of Telesp lines connected to digital exchanges has increased. By the end of 1995 37.5% of all access lines were digital (Telesp Corporate Information, 1995). The cellular service switching equipment is fully digitalized. Plans to switch from the analog transmission system to a digital transmission system are now in the works with Telesp considering its use in the next Metropolitan Sao Paulo expansion plan.

# TELESP OPERATIONS AREA



8.511.965 Km²

247.898 Km²

3% OF BRAZIL AREA AND 35% OF GDP)

## ACCESS LINES IN SERVICE

DISTRIBUTION BY OPERATION REGION DEC /94

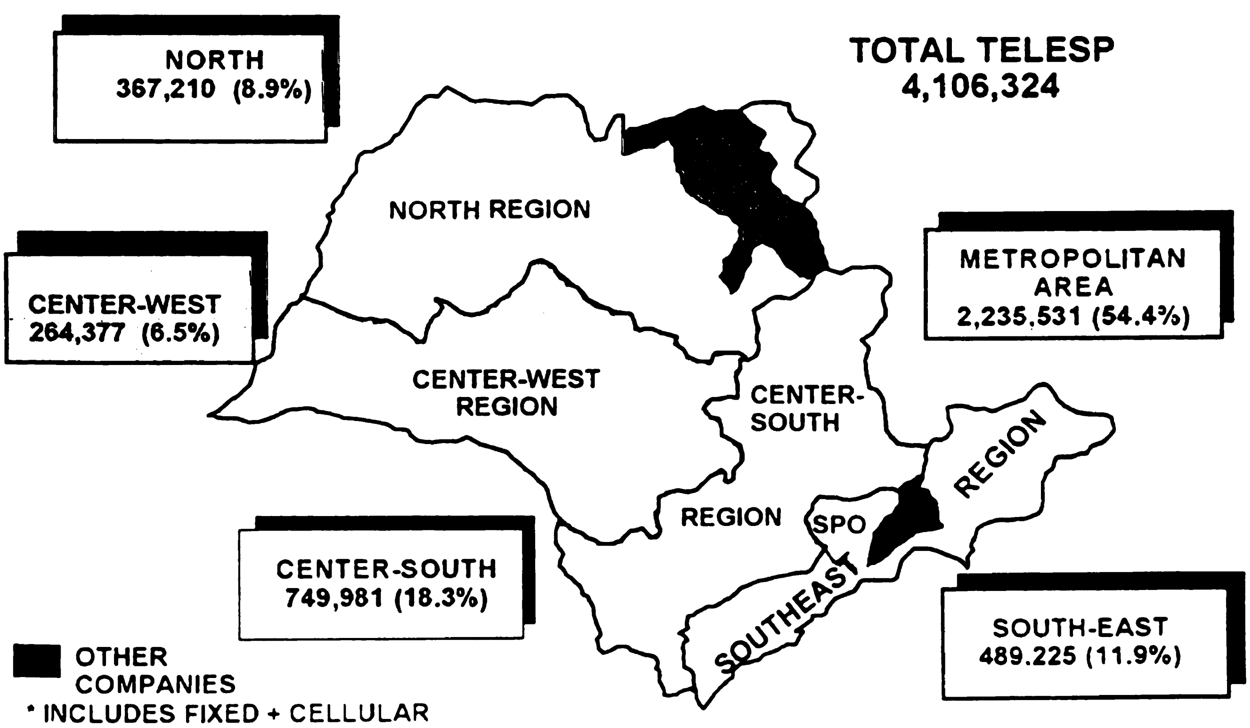
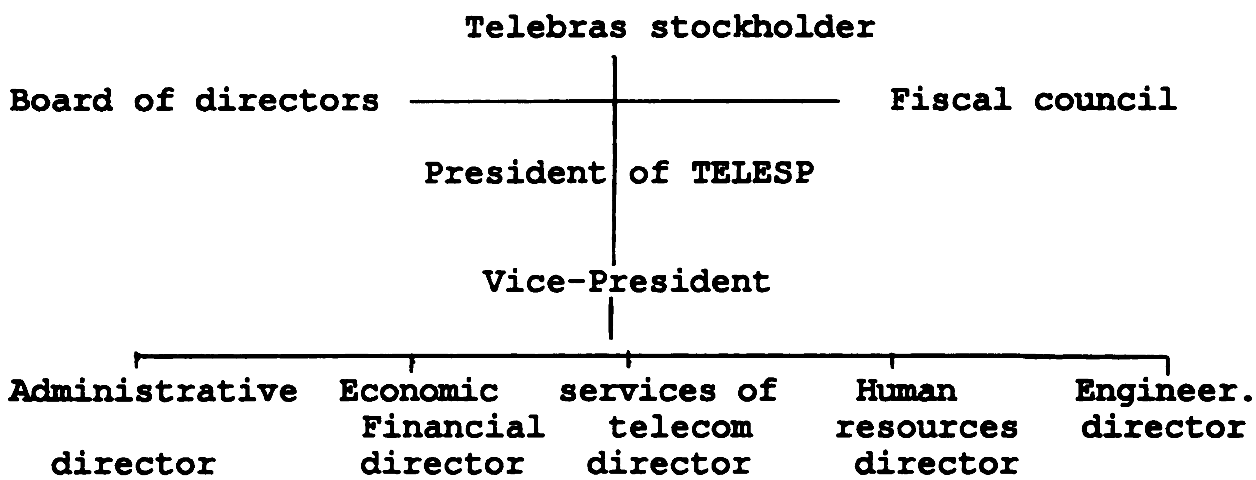


Figure 4.5

TELESP Organization




## REVENUES

Telesp's sources of revenue come from local services, domestic and international long distance services, cellular, data, telex and others. In addition to revenues derived from telecommunications services, funds for investment were also generated from autofinancing. Under the autofinancing procedure, the customer pays the price established by Telebras to Telesp. Telesp then issues its own stock to Telebras in the amount equivalent to 80% of the subcription price and pays the remaining 20% to Telebras in cash.

The customer then receives 100% of the price paid in Telebras stocks. The only exception is when the customer is the State Government, which receives Telesp stocks. (Telesp

Corporate Information, 1994:18-19)

## CAPITAL STOCK AND OWNERSHIP

Telesp's capital stock is divided into common or voting shares and preferred or non-voting shares. On December 31, 1994, 75.6% of Telesp total issued capital stock was owned by Telebras; 0.4% by the Sao Paulo Government; and the remainder by the public. Under Brazilian corporation law, a company is annually required to allocate 5% of the net income to a legal reserve, until this reserve is equal to 20% of its capital stock. The law also requires a minimum compulsory dividend of 25% of the net income to be paid to holders of preferred shares. Subject to these requirements, the dividend policy of a company is determined by its stockholders.

Hence, since Telebras is the primary stockholder of Telesp it determines dividend policy. Table 5.4 illustrates the breakdown shares controlled by each group IN 1994.

TABLE 4.4
EQUITY OWNERSHIP
(millions)

| | NO. OF SHARES | % | %COMM. | PREF |
|---|---|---|---|---|
| TELEBRAS | 37,017 | 75.6 | 87.1 | 61.6 |
| SAO PAULO GVT. | 187 | 0.4 | 0.3 | 0.4 |
| PUBLIC | 11,728 | 24 | 12.6 | 38 |
| TOTAL | 48,932 | 100 | 100 | 100 |

Source: Telesp

The performance of Telesp throughout its twenty-four year history can be attributed, in large part, to certain national and state administrations and their commitment to growth in the sector through investment in the sector and fair tariff policies, the unique position of Telesp in the Telebras system, and the commitment of management in the company to their clients and the company's growth.

Before Telesp was created in 1973, five states, including the State of Sao Paulo, had their telephone systems operated by the CTB, which represented two-thirds of the Brazilian telecommunications network.(RNT, 1993, October).

By the late 1960's, under the guidance of Delson Siffert, a commitment to professionalize the sector existed and by 1971 the CTB was showing signs of recovery from the earlier stagnancy of the 1960's. This professionalization consisted of the hiring of three-hundred engineers and the execution of an emergency plan called "Plan for a Million Telephones" in the CTB areas (RNT, 1993: October) The plan was successful and Telesp and the state of Sao Paulo were major beneficiaries of the push of the telecommunications building and experimentation in Brazil.

In 1979, at the end of the Giesal administration and under the Telesp presidency of Salles Leite, the company had acquired new submarine cables, direct dialing and the use of intelsat via domestic satelites. professionalism and fair tariff rates established by the Minster of Communication, Euclides Quandt de Oliveira, and the Telebras leadership of Jose Antonio de Alencastro e Silva created impressive rates for the years from 1973 to 1979. For example, the number of telephone lines went from 580,000 in 1973 to 1.7 million by 1979 (RNT, 1993: 12).

From 1979 to 1985, under the Telesp presidency of Carlos de Paiva Lopes, the company started its period of consolidation. It was during this period that the company reached its highest point professionalism. The quality of service and the attainment of the goals set up by the expansion plans were points of pride for the Telebras system (RNT, 1990).

During the government of President Sarney, conditions in the sector throughout the country and in Sao Paulo in particular, started to deteriorate. This was due to the entrance of political bosses like Antonio Carlos Magalhaes (Minister of Communication, 1985-1990), the substitution of competent, high-level professionals for people with little technical ability and sparse managerial experience but who were politically connected to the administration, and the political demands exerted by a newly politically open system to keep inflation rates down. This caused marked deteriorations in the qualitative as well as quantitative performance of the company (Telebrasil, 1995).

Under the Telesp presidency of Antonio Ignacio de Jesus, the expansion plans were not completed, with people having to wait five to seven years for a telephone, suffer the worst congestion rates in the company's history and pay exorbitant prices in the black market for a telephone line (RNT, 1993, October).

Moreover, the company president was accused of corruption in the form of bribe-taking and favoritism. Journalist and editor of the most important Trade journal <u>Revista Nacional de Telecommunicacoes</u> Ethevaldo Siquiera notes that the cost of a telephone line during the Ignacio de Jesus tenure was forty percent higher than after his presidency, implying that the cost of corruption was passed on to consumers in the form of greater costs per line (Ethevaldo Siquiera, 1996).

In 1990, an independent non-profit consumer group by the name of Instituto Brasileiro defesa do Consumidor-IDEC (Brazilian Institute for the Defense of the Consumer) brought a number of complaints from Telesp consumers to the state courts. An analysis made by IDEC of the contracts that Telesp made with its subscribers showed that the company had not kept faith with their clients. One clause, in particular, stated "Barring any Technical impediments, the longest waiting period for a telephone is twenty-four months" (RNT, 1990). However, when customers complained of the poor service, the company attributed it to anything but a technical nature. The standard reply tended to attribute the company's poor performance to the economic policies of the former governments. Specifically, this meant the Cruzado, Bresser and Verao plans, which interfered with the company's planning and in the negotiation with suppliers. However, IDEC established that the suppliers of telecommunications equipment never confirmed these allegations (RNT, 1990, June).

With the new presidency of Waldemar Fernandez Neves the Telesp management appears to be improving the quality and quantity of its services. However, some of the structural problems associated with the telecommunications sector, in general, remain and continue to pose barriers and problems for the Telesp system. The recent political changes in the sector and the push to liberalize and privatize the sector is welcomed by a majority of people in the sector and a majority of Telesp customers as well (Telesp, 1995).

## Summary

Brazil's colonial and imperial period was marked by an export economy and a political bureaucratic structure that, when compared to Spanish America, was much more underdeveloped and deemphasized. This resulted in a more decentralized political structure and a greater degree of autonomy for most regions of the country. However, after independence in 1822 and during the constitutionalist monarchy, the first movements towards centralization of the government were taken. It was a period characterized by relatively high political and economic stability, the end of secessionists movements, and the beginnings of modernization.

Under the leadership of Getulio Vargas, the new state period (1930-1945) was characterized by the transformation of the federal governments role in the socio-economic sphere. The role of state and local governments was diminished, giving way to a more centralized form of government. It was also the period of the "Estado Novo", initiating the first stage of ISI policies.

While Brazil's initial attempt at state ownership dates back to the middle of the nineteenth century, it was not until the Estado Novo (1937) when planned economic intervention became an integral part of public policy.

The bureaucratic-authoritarian regimes of 1964-1985 were characterized by extreme political repression, on the one hand, and rapid economic growth on the other hand. Planned economic intervention became a part of a national security strategy. State-owned enterprises were effective in achieving their macro-economic goals of minimizing foreign dependency, alleviating government bottlenecks and fostering rapid economic growth while maintaining a certain level of micro-efficiency until the late 1970's. It was during this period the private system of telecommunications was abandoned in favor of a state monopoly.

Since the nationalization of the telecommunications industry in 1966, the public sector has accounted for the bulk of Brazil's telecommunications investments and needs. The holding company structure involved decentralized telephone operations with most operating decisions delegated to the lower level.

Ministries rarely interfered with company affairs and there was little regulatory control at the operating level. Regulation of the Brazilian Telecommunications sector in the last thirty-five years has its origins in the Brazilian code of 1962, which allowed for the creation of Contel, the

First National Telecommunications Plan and the creation of Embratel.

Throughout the 1980's, the Brazilian economy experienced a period of prolonged recession, aggravated by record inflation rates and an astronomical public service debt. Price controls were used to restrain inflation and borrowing restrictions were imposed in an attempt to reduce the size of the public debt.

While the Collor and Franco governments started the debate on the privatization of telecommunications in Brazil, it was not until the government of Fernando Enrique Cardoso that a new institutional model organizing the telecommunications sector was achieved. Cardoso introduced legislation at the end of 1995, which was approved in 1996, that ended the public model as framed by the 1988 constitution. The government also created important measures such as PASTE, the overhauling of the tariff system and the Minimum Law, which provided for the entrance of private initiative in the area of cellular telephony.

Telefonos de Sao Paulo (Telesp) was a major beneficiary of the Brazilian government's emphasis on investment in the telecommunications sector throughout the 1970's. Telesp remained the monopoly operator in the state of Sao Paulo until

1981 when private companies started offering local services. However, Telesp still controls 88% of all access lines.

From 1979 to 1985 the company reached its highest point of professionalism. However, from 1985 to 1990, under the company presidency of Antonio Ignacio de Jesus, a marked deterioration was noted on the qualitative and quantitative performance of the company. With the company presidency of Waldemar Neves, Telesp management seemed to be improving despite persistent structural problems inherent to the telecommunications sector in general.

# V

# Analysis of the impact of Market structure, Regulation and Ownership on the Performance of the PLDT and TelESP 1973-1995

This chapter will look at the impact of the three primary variables, regulation, market structure and ownership on the performance of the two firms. It is recognized that the relationship between these variables and performance is not a simple linear one but interactive involving the secondary contextual variables as well. The focus will be on the firms' performance in terms of investment in the sector, profitability as measured by the company's rate of return on equity and the quality of service as measured through congestion, call completion rates etc. Investment by Telesp will be expressed in straightforward dollar amounts. However, investment in the case of the PLDT, where specific monetary amounts could not be obtained, will be inferred from the number of local lines installed. Also, in the case of the PLDT, as actual numbers for the demand for the telephone lines were only available from 1985-1995 (see figure 5, appendix), prior to 1985 unfulfilled applications (figure 4, appendix) will be used to estimate demand. The comparative performance of the PLDT and Telesp will be analyzed for the years 1973 to 1995.

### *The Philippine Long Distance Telephone Company*

The analysis of the PLDT's performance will distinguish five periods: The first period will cover the years 1967 to 1972, the filipinization of the company and the democratic period of the Marcos administration; the second period will span the early years of martial law between 1973 to 1979; the third period will cover the last half of the martial law period and the Marcos dictatorship; the fourth will span the Aquino period and the fifth will cover the first three years of the Ramos government.

The analysis was periodized in this way because these dates seemed to reflect different political periods in the country, each of which had a unique impact on the performance of the firm.

### *Marcos Democratic period and the Filipinization of the Company (1967-1972)*

The PLDT's transfer to Filipino ownership in 1967 was marked by a flurry of excitement from both the old owners and the new ones. Indeed, from 1967 to 1972 the PLDT experienced one of its fastest periods of growth. The average growth rate in telephony expansion averaged 14.83% for this period (see figure 2), while the company's rate of return had also risen substantially (see figure 7) as a result of the rise in local residential rates, and the expansion in domestic and long-distance revenues (see figures 2, 16).

GTE's interest in the company was clearly a result of its desire to start the expansion of the company early, not only for the immediate profits it would gain but also for the fact that a larger network and an ongoing expansion project would secure larger and longer term equipment supply contracts (Pratte, 1996).

PTIC's incentive to invest was quite clear. After 1967, the PLDT could count on supportive government policy at least as long as Marcos remained in office. Investment was also spurred by the fact that as the economy and middle class expanded, overall consumer demand grew, with the growth in the demand for telephony heightened by the investment stagnation of the early 1960's. Most of the telephones installed were in the metropolitan Manila area, where demand was growing fastest and subscribers were more likely to use international long-distance services. However, local tariff rates were not raised during this period. This may have been due to the political unpopularity of the move, which might have alienated middle-class voters in an increasingly politically competitive environment (Aquino, 1993).

At the end of the Marcos' second term (1970-1972), investment (figure 2) declined and capital flight picked up. The country experienced a 65% devaluation of its currency in 1970 ( 3.90 pesos to 6.44 pesos to the dollar) thereby increasing the PLDT's equipment cost. The company also had borrowed heavily in foreign markets and the higher value of the dollar made repayment difficult (Balanga, 1996). In addition, the tighter labor markets of the late 1960's and greater labor militancy had substantially increased real wages and PLDT's labor cost (Esfahani, 1993).

However, in contrast to events following a 1962 devaluation during the Macapapagal government when the regulatory agency did not approve a tariff increase, the NTC immediately gave an approval for rate increases for public utilities after the devaluation of 1970 (Manapat, 1993).

Moreover, the treatment of the electric company (Meralco) was significantly different from the treatment received by the PLDT. Meralco, the electric company owned by the Lopez family only received a 5% rate of adjustment, while the PLDT received a 40% rate increase on all its local telephone services. While there was opposition to the rate increases by consumer groups and certain members of congress, they only managed to postpone consideration of additional increases in the following two years.

This generous attitude towards the PLDT was not accidental as the company had patrons in the administration. The Lopez family, on the other hand, had aligned themseleves with the opposition liberal party (Esfahani, 1993).

Although the increase in telephone tariffs in 1970 enabled the PLDT to remain profitable for the year, this did not last long. The real rate of return on equity fell significantly, becoming negative in 1971-1972 (figure 7) and investment in expansion dropped sharply (figure 2).

The PLDT's explanation for the decline in profitability has been to point to higher inflation rates following the 1970 devaluation, while slow investment has been attributed to the higher cost of foreign exchange, causing difficulties for foreign financing (Carreon, 1996). However, in its 1971 annual report the PLDT makes no such claims. This above explanation is questionable because the relative stability of the peso after the 1970 devaluation suggest that the sudden drop in profitability could not just have been due to cost increases.

An explanation based on adversarial political relations with a potentially unsympathetic administration seems to fit the picture more. The opposing political party (liberal party) had been gaining ground and was predicted to win the elections of 1973. Had the liberal party won, this would have meant an adversarial regulatory environment for the company. In this situation it makes sense for a business that is friendly with an incumbent regime and uncertain about the next one to transfer its assets abroad.

Corroborating this idea, it is also important to note that during this period the PLDT signed a twenty million dollar contract with GTE for equipment and received an immediate 1 million dollars in U.S. bank accounts (U.S. SEC, 1977).

***First half of Martial Law 1973-1979***

During the early years of martial law, nationwide investment increased as GDP increased (figure 9). The expectation during the first years of martial law would be increased investment for sectors controlled by government cronies. This, however, did not occur with the PLDT. While the PLDT received tariff increases and regulatory support, investment in local telephone lines, while increasing slightly for the years 1974-1975, started to decline and reached their lowest point for this period in 1979 (figure 2). While the behavior of the company seems to be contradictory, two factors may explain its actions. First was the decline in the demand for telephones in the years 1973-1975 (see figure 5), and second was the U.S. SEC's suit against the PLDT, which implied a termination of the company's relationship with GTE.

While decreased demand for telephony explains the reason for a lack of investment, the more important question is: what factors lowered the demand for telephones during a healthy economy (figure 8)? A possible explanation may lie in the income distribution of the country and how economic booms have traditionally affected different classes in the society. Economic booms in the country have historically been enjoyed by only the few who controlled the economy and enjoyed monopoly profits. For nearly everyone else real income was falling (FEER, 1986). In fact, between 1970 and 1980, the average real wage rate steadily declined by eight percent a year. Hence, increasingly fewer households could afford a telephone. PLDT customers essentially continued to be the elite and the upper-middle class, and most of them already had telephones (Esfahani,1993). Another explanation is the Subscriber Investment Plan (SIP) imposed by the Marcos administration in 1973. This artificially lowered the demand in the country for telephony by increasing the cost of a telephone line through the forced subscriptions of PLDT preferred stock.

However, this does not explain the increase in demand starting in 1976 (figure 5) and the continued lag in investment by the company. Demand picked up as the performance of the economy improved, more people entered the ranks of the middle class and new businesses started to request more lines. The lack of investment during this period can be traced to the SEC suit which closed of the PLDT's main channels of barowing for equipment and supplies. The 1976-1978 lag was critical because it accounted for telephone shortages and quality deterioration of the late 1970's and early 1980's.

While low demand during the 1973-1975 period affected local telephone services, the number of domestic and long-distance circuits continued to improve (see figure 6.6). Many of the circuits were rented from carriers' carriers such as Domestic Satellite Philippines Inc. (Domsat), a company chaired by Ramon Cojuangco and directed by a number of well-known Marcos cronies (de Luna, 1986). On the international side the suppliers included Philippine Communications Satellite (Philcomsat), Philippine Global Communications (Philcom) and Eastern Telecommunications Philippines Inc. (Eastern Telecom). These were all highly profitable firms, owned by the same groups of Marcos associates and front companies, and who also had close interlocking ties and interests with the PLDT (De Luna, 1986).

This interrelated structure of enterprises provided an important channel for directing PLDT's profits. For example, Philcomsat's profits over the 1966-1989 period were far larger than those of the PLDT (Isberto, 1986).

### *Last half of Martial law (1980-1985)*

As the Marcos government started to decline in the latter part of the 1970's, a commensurate decline in investment occurred even though companies such as the PLDT had ample supplies of foreign credit and could ensure profitability for their business. The waiting time for a phone increased from one year in the previous period to between two to three years during this period. The quality of services in terms of congestion, party lines and call completion rates also saw a marked deterioration.

During this period the government helped boost real tariffs, encouraged take-overs, and provided access to enormous domestic and foreign loans. For example, in the case of tariff increases, the National Communications Commission (NTC) approved two major tariff increases in 1980 and 1984. These increases, along with the automatic adjustment provision, turned around the downward trend in the local and domestic long-distance tariffs. Take-overs occurred under a policy of sectoral integration and rationalization, where the PLDT was encouraged to take over several smaller telephone companies. These companies had been denied access to PLDT's network and with real local tariffs falling, had become losing propositions. However, soon after the take-over agreement in early 1981, local rates were increased by 35%. (Esfahani, 1993).

The government provided easy access to loans by directing state-owned banks to purchase non-convertible, non-voting preferred shares in PLDT, to enable the company to borrow in international markets than existing equity permitted (Gonzaga, 1992). Yet the company's net investment for the period was lower than the previous period. The number of lines during this period grew an average of only 6.67% while the company's real rates of return were negative (see figures 2, 7) except in 1986. The investments of this period went mainly into expanding domestic and international long-distance networks and improving the quality of service, especially for long-distance related services such as direct dialing and digitalization (Esfahani, 1993). This increased the gap even more between investments in local services and those in long-distance services.

The negative rates of return during this period has been explained by the PLDT to be due to the increase in the franchise tax from one to two percent of gross revenues which occurred in 1978, and the increase in interest rates during the late 1970's and early 1980's (Carreon, 1996). However, this does not explain the company's borrowing during 1979-1983 despite consistently negative rates of return. As Manapat (1993) has pointed out, given the interlocking relationships between the PLDT, the service/equipment suppliers and the carriers' carriers, it is highly probable that the profits emerged elsewhere. As the Marcos economy disintegrated, PLDT's investment stopped and capital flight was extensive (Sison, 1986).

*The Aquino Administration*

In the early years of the Aquino administration government agencies such as the Presidential Commission on Good Government (PCGG) attacked the PLDT as one of the many Marcos-associated companies under investigation. The commission sequestered PLDT's assets and leveled numerous allegations against the company. One of the first acts to be taken was the identification and expropriation of Marcos' holdings in the PTIC. While the company was able to avoid the expropriation of its assets (one may speculate because he was the presidents' newphew), it was unable to escape Executive Order 27 that assessed a 35% corporate income tax on all franchise holders and increased the franchise tax from 2 to 4 percent of gross revenues (Aquino, 1993). It was also during this period that the NTC ordered a 10 percent cut in the PLDT's local residential rates (Friedland, 1988). This was probably due to the combination of the popularity of lower rates on the part of the voting populace, as well as the popularity of punitive actions against any Marcos-related company. The result of all this new regulatory conflict was almost a complete halt in investment in the local networks (figure 2 ).

During the latter years of the Aquino administration (1990-1992), the PLDT managed to improve its political standing with the elite groups in power, due primarily to the influence of the Cojuangco family in the legislature (Tiglao, 1993). However, because of the unwillingness of the administration to raise tariffs in an election year and the uncertainty of the friendliness of a post-Aquino administration, PLDT slowed its investment in the local network and the number of unfilled applications for the new lines soared (see figures 4, 5).

While the Aquino government made an attempt to introduce competition into the sector, it was hampered by the weakness of the regulatory institutions and the strong anti-entry bias of the franchise system. By the end of the Aquino presidency, the PLDT had managed to penetrate and gain support within all branches of the government. However, investment continued to be low. The company could not claim that a lack of profits was the reason, for profitability was on the rise. Rather, a more plausible explanation seems to be the company did not want to risk their investment resources given the uncertainty of the next regime's friendliness. Some political candidates (Ramos among them), as part of their political platform, had vowed to break the monopolies in the country and introduce competition

(Chua, 1996).

### *The Ramos Administration*

The election of Fidel Ramos to the presidency in June 1992 ushered a new era of reform and competition. The administration was committed to breaking the power of the monopolies, and PLDT was one of the first companies singled out by the President. One of the first things the president did was ask the Supreme Court to reconsider its ruling against Eastern Telecommunication's bid for a franchise to operate in certain regions of the country (Tiglao, 1993). In another move the president replaced the representatives of the Presidential Commission on Good Government (PCGG) boards of directors of the PTIC, who had been accused of failing to vigorously represent the government's interest (Panaligan, 1993).

Executive Order 109, which mandated that the PLDT allow interconnection with other companies, while initially causing the company to assume a defensive posture, later proved to be a new source of revenue for the company through access fees. Since the PLDT is the largest fixed operator in the country, charges had to rely on PLDT's cost data. While PLDT's competitors vigorously claimed the company's rates were too high, the NTC could do nothing as the Telecommunications Act of 1995 mandated that interconnection and access fee disputes between operators be solved through private negotiations (Pratte, 1996).

Responding to the increased competition, the PLDT in 1993 tripled its investment from the previous year and continued investing aggressively through 1995 (see figure 2) By the middle of 1995 the PLDT's stock was trading at six times what it was before the current government was inaugurated in the middle of 1992(FEER, 1995, August), and the return on equity was at 19.2% (figure 7).

Although the liberalization of the industry has brought in ten new franchises, the PLDT will likely retain its dominant position in the industry, where it currently controls 90 percent of fixed lines and, up until now, the only nationwide backbone network in the country. In the first half of 1995, trunk traffic increased by 20 percent over the previous year (Deutsche Morgan Grenfell, 1995).

While the Ramos administration's government policy was initially threatening to the company, the current regulatory environment is favorable to the PLDT. For example, the country's present interconnection structure provides no initial subsidy to the newcomer. Thus, the new policy, if implemented, will result in the local exchange carriers being subsidized by the profitable international gateway and cellular operators (Pratte, 1996).

However, if the company is to maintain its dominant position over the long haul, it must improve its ability to control operating expenses and increase its employee and equipment efficiency ratios which have historically been the lowest in the region (Interview, Chua).

***Telefonos de Sao Paulo , Brazil***

***TELESP--Establishment of the Firm and the Development of the Infrastructure (1973-1979)***

The late 1960's and early 1970's was characterized as the most autocratic period of the military regimes rule. The ideological foundations of the military's usurpation of power and its justification for increased political repression was the doctrine of National Security, which linked development to security and defined the military's role as the guardians of the state.

Part of this strategy involved the nationalization, modernization and expansion of sectors that were deemed crucial to the maintenance of national security. Telecommunications was considered an example of such a sector.

The period between 1973 to 1979 was the period of expansion and modernization of the Sao Paulo state telephone system. Investment was high (see figure 23) and growth in telephone lines averaged 15.74% over this period. The company's rate of return on equity averaged 9.82% reaching its highest growth year ever in 1978 with a growth rate of 24.27% (see figure 25). The expansion of services in the state of Sao

Paulo was impressive. The number of telephone lines grew from 570,000 in 1973 to 1.7 million in 1979 (Revista Nacional de Telecommunicacoes, 1978).

It was also the period when the company established the state of Sao Paulo's interurban network which connected the principal fifty-seven municipalities of the state (Telesp, 10 years of Telesp, 1983). However, the company was not only concerned with increasing the number of residential and commercial telephone lines but also aggressively establishing a public telephone system which grew at an average of 19.5% for this period (see figure 6.22).

In 1978, the company embarked on a decentralization program with the objective of improving its efficiency. Until 1978, the service sector of Telesp was centralized. In the meantime, the company was growing and it became increasingly difficult to coordinate its services. Hence, Telesp decided to create a separate department of services. Digitalization of services was also introduced, which improved the overall quality of services. For example, the number of complaints for every 100 telephones went from 12.6 in 1973 to 7.4 in 1979 (Telesp annual report, 1979).

It was also during this period when the company started to become less dependent on foreign equipment. As a result of a national policy to "buy Brazilian", the company's purchases of foreign equipment were reduced from twenty-four million dollars in 1975 to eleven million dollars in 1976 (Telesp annual report, 1976).

The growth of the system in these first six years were due to a number of reasons. First, under the leadership of President Geisel, Sao Paulo benefitted from the national push for telecommunications development and experimentation, which recognized telecommunications as one of the key components in the modernization and industrialization of the economy. Hence, the commitment at the national level to the development of a viable telecommunications infrastructure was even more accentuated in the most important industrial sector of Brazil, namely, Sao Paulo.

Second, it was the period when the company started to professionalize its workforce. Political bureaucrats of the old system were replaced by professional technocrats.

***Country Presidency of General Figuerido and Company leadership of Paiva de Lopez (1980-1985)***

While the presidency general Geisel (1974-1978) has been credited with the beginning of the "abertura" (opening) of the country, it is really under the leadership of General Figuereido (1978-1985) when the standard of democratization is raised. Part of this process involved the increased politization of the public enterprises. That is, replacing the former technocracy of public enterprises with political appointees.

In the case of Telesp, however, political appointees were not made until the civilian government of Sarney in 1985. Performance-wise, the period under the leadership of the company Presidency of Paiva de Lopez, was a "mixed-bag" . On the one hand, it was during these years when professionalism reached its apex. On the other hand, it was also the period when investment in the sector began to decline (See figure 23). It also marked the beginning of the steady decline in Tariffs (figure 24).

However, the company's rate of return on equity averaged 14.52% for the period, which was only slightly less than the previous period (figure 25).

This seeming contradiction between a high rate of return and lower investments can be explained as the lag that may occur between investment and its manifestation in the system. In other words, the effects of the company's high rates of investment of the previous period were still generating

genuine profitability in the company by increasing the overall productivity of the company, particularly since investment were focused on infrastructure development and improvements in technology.

However, while growth of the company continued to be positive, the growth rate of telephone lines started to decline reaching their nadir in 1983 (see figure 19) corresponding to the lowest year of investment by the company (see figure 23). The quality of service, which was consistently improving during the first period, also started to stagnate (see figures 26, 27).

The low levels of investment in the sector during this period can be attributed, in large part, to the decreased commitment on the national government's part to support the telecommunications sector because of larger macro-economic issues that dominated the national agenda such as the "debt crises" and a spiraling rate of inflation. Lower tariff rates were part of its overall macro-economic policy to control inflation, which began to rear its ugly head (see figure 29). It is during this period when tariff rates are consistently adjusted below the rate of inflation.

It was also a period of recession and slower growth for the country as a whole, and for the state of Sao Paulo as well. This is true particularly between the years of 1981-1984, where GDP for the state was at negative levels for two out of the three years (see figure 28).

The decreasing commitment on the part of the government for a strong telecommunications sector was also manifested in its abolition of the Fundo Nacional de Telecommunicacoes (National Telecommuncations Fund) in 1982. Under the FNT, funds were specifically earmarked for the telecommunications sector. However, its absorption by the Fundo Nacional de Desenvolvimento (National Development Fund) meant that telecommunications would now have to compete with other sectors of the economy.

### *Company Presidency of Antonio Ignacio de Jesus (1986-1990)*

During the company Presidency of Antonio Ignacio de Jesus Telesp's performance continued to deteriorate. While investment increased when compared to the previous period, the company only averaged a 6.5% growth rate for the entire period. Much of the investment increase was due the shift by Telebras and its subsidiaries from a focus on internal sources of funding to domestic and international capital markets.

Telebras and its subsidiaries for Sao Paulo and Rio, Telesp and Telerj, used the Sao Paulo stock market (Bovespa) to float shares.

This slowing down of growth again reflected the low investment in the sector during the previous period. The growth rates for telephone lines continued to expand in 1986 but from 1987 to 1990, they steadily declined (see figure 19).

More importantly, the quality of services declined dramatically, making it the worst period in the company' history. In 1989, congestion peaked at 40% (see figure 27). Waiting time for a telephone line during this period went from two years in the previous period to five to seven years during the De Jesus years (RNT, June, 1990).

Much of the gain in investment was eaten away by an inflation rate that reached 1800% in 1989. The Sao Paulo economy also registered a negative GDP growth rate for the years 1988 and 1990 (see figures 28, 29). While a slow economy may explain the slow growth in telephone lines due a decrease in the demand for telephony, a more plausible explanation is a combination of macro-economic factors like the high rate of inflation and slow economic growth, government policies supporting low tariffs, and mismanagement at the sectoral and the firm level.

Mismanagement at the national level was largely due to the appointment of Antonio Carlos Magalhaes as the Minister of Communication. Magalhaes attempted to raise more money for the Telebras system by selling more lines for the period 1986-1989. However, when the first of these lines were supposed to come due in 1988, the various operating companies had insufficient budgets for the allocation of these lines, and explained their budget depletions as the result of inflation, thus waiting times increased (Wohlers interview, 1996).

At the firm level, accusations of mismanagement and corruption were levied against the President, Antonio Ignacio de Jesus. Charges included favoritism, padding the cost of the installation of telephone lines and other equipment, and giving contracts to companies that were not the most competitive but favored by the president. While the president was never actually convicted of bribery or corruption, sources who were close to the man claimed that de Jesus received numerous kickbacks during his tenure (interview, Ethevaldo Siquiera, 1996).

***The Company Presidency of Waldemar Neves (1990-1995)***

In the years 1991 and 1992, investment by the company in the sector peaked, doubling from 1990 to 1991 and growing by

45% in 1992. However, it was the slowest period of growth for the company with a rate of .03% and .06% for 1991 and 1992 respectively (see figures 23, 25).

This can be explained by the mismanagement during the previous years at the national and firm level, a continued high rate of inflation, and a negative GDP for the state of Sao Paulo (see figures 28, 29).

While investment levels were high when compared to the previous period, the company still had a large back-log of unmet demand and claimed that bureaucratic largesse at the national level hindered the company's ability to invest. For example, in the middle of March, 1993, the company still did not know the revenues it could count on to implement its "action plan of 1993" (RNT, April, 1993).

The President of the company, Waldemar Neves, commented that to eliminate the deficit of the expansion plan, (PEX), at the end of the year, Telesp was obligated to spend more than it was authorized to spend. The company claimed that money invested during this period was spent improving the deplorable quality of services. With a peak of 40% in 1989, the congestion rate fell to 13% by the the end of 1993 (see figure 27). In fact, in 1991 Telesp ranked twenty-second in performance quality out of the twenty-seven Telebras operating companies. However, in 1992, it placed seventh within the Telebras system (RNT, April, 1993).

Telesp was able to increase its investment resources during these years, in part, because it was able to convince Telebras that the best thing for the country in 1991-1992 was to invest in the state of Sao Paulo, because the extreme congestion and its poor performance contributed to the loss of revenues in the whole system. The Paulista operator reached an agreement with Embratel and Telebras for an added 200 million dollars over 1991-1992 for the sole purpose of improving the quality of service (RNT, April, 1993).

In 1993, investments continued to be high. This was, in large part, because of the unfreezing of the Tariff rates by Brasilia, which conceded a readjustment of 36.63% for interurban rates (RNT, 1993, October). This move was extremely important for Telesp, for the company must share 33% of its interurban revenues with Embratel while other operating companies only give between five and ten percent of their interurban revenues. In the area of international calls, where 50% of all international calls are generated in Sao Paulo, the situation is the same.

At the end of 1993, all the indicators for the sector had shown improvement over the previous two years. Investment in the sector by Telebras and Telesp continued to be high in the 1994-95 period (see figure 23) and the company's growth was modestly high (see figure 25).

A new commitment was made by the government of Fernando Enrique Cardoso to invest and modernize the sector. Part of this strategy involved the eventual privatization and liberalization of the sector. Cardoso's "Real Plan" and his control of inflation created an atmosphere of stability and confidence in the country. During the years 1994-95, the state of Sao Paulo experienced real GDP growth rates of 5.41% and 6.45% respectively. Telesp also had positive growth rates (see figure 25).

While telephone terminals grew for the entire state at a rate of 8% and 11% respectively, they grew at a much higher for the municipality of Sao Paulo, registering 14% for 1994 and 17% for 1995. However, they grew at a much slower rate for the interior of the state than either the municipality or the entire state (see figure 21).

In 1996, the company guaranteed the 330,000 people in the state, who were part of Telesp's expansion plan of 1994 (Cipex-94), that they would be attended to within a period of eighteen months. This was also valid for the 470,000 people who had won the lottery for a telephone in early 1996. In that year, the company, under the Presidency of Waldemar Neves, and with the blessings of the present Communication's Minister, Sergio Motta, held a raffle that gave people who were not part of the expansion plan a chance for a telephone line (RNT, April, 1996).

However, the basic problem of a limited budget still remains. Adoaldo Wolf, who is the present finance director of Telesp, noted that this budget limitation was the greatest impediment for the expansion of its investments (Interview with Adoaldo Wolf, 1996).

In trying to overcome these budget limitations and continue offering new services to its customers, the company has entered into partnerships with private initiative. For example, the 1994 Expansion Plan cost the company $1,117,630,000 and was financed by a network of banks that have had a historical relationship with the company.

Today Telesp is at the crossroads of the privatization of its system. While the president of the company has stated that Telesp is ready for competition, he acknowledged that the present regulatory environment puts the company at a disadvantage and must be changed before the company can compete successfully. For example, every project and plan that the company has is directly tied to the budget of the union. Because the allocation of resources is dependent upon various political and economic factors, planning on a large scale is stifled, and investments, on the whole, tend to be modest. These relatively modest rates of investment in a state that continues to grow and prosper has, in fact, been responsible for the increase in the growth of demand from one million in 1990 to five million in 1995 (Telebrasil, March/April, 1995).

***Comparison of the Performance of the PLDT and TELESP***

This section compares the performance of the PLDT and Telesp from the years 1973-1995.

***Dictatorship and Military rule in both the Philippines and Brazil (1973-1979)***

During the early years of martial law in the Philippines nationwide investment increased as GDP increased. The PLDT was controlled by Marcos cronies, received tariff increases and regulatory support. However, no net investment occurred.

It has been noted (North, 1996) that when corruption and rent-seeking are pervasive in a country, economic investment will not occur. Since the rent-seeking economy is tied to the political stability of the executive, i.e. the rent-giver, any indication of political weakness on the part of the rent-giver will create disincentives to invest.

In contrast to the Philippines, this was the period of the expansion and modernization of the Telesp system in Sao Paulo. Overall investment was high and the growth rate in telephone lines continued to expand. The state established its interurban network, connecting the principle municipalities of the state to each other. The quality of services also improved.

Low levels of investment by the PLDT during this time can be attributed to several factors. These include: the SEC suit against the company, and a decreased demand for telephony due to a saturated middle class and the Subcriber Investment Plan (SIP) introduced by Marcos in 1973. While the government's ostensible rationale in the implementation of the SIP was to raise money for the improvement and expansion of the system, no such improvement occurred except in the most profitable areas of domestic and long-distance circuits. In contrast, the Brazilian autofinancing plan, which had similar characteristics, was genuinely used for the modernization and expansion of the system (Siqueirra, interview). This was particularly noted in Sao Paulo (see figure 19), which was recognized by the government as the locus around which growth and modernization would occur.

It was also during this period that the dependency on foreign companies for equipment and services accelerated in the PLDT in the form of contracts with foreign companies such as Siemens. However, while dependency was nothing new and was historically consistent in terms of the company's behavior, what was new was the extreme corruption and waste associated with this relationship.

However, unlike the PLDT, Telesp actually reduced its dependency on foreign equipment manufacturers and suppliers during this period. This was, in large part, because of the establishment of telecommunications research institutes like the CPqD in Campinas, Sao Paulo, and government subsidies for equipment manufacturers as part of its overall policy of Import Substitution Industrialization.

***Decline of Marcos Dictatorship and the last Military president of Brazil (1980-1985).***

During the last years of the Marcos dictatorship investment in all sectors of the economy declined. While companies such as the PLDT had access to enormous domestic and foreign loans, a boosting of real tariff rates in 1980 and 1984, investment by the company continued to decline even more so than in the previous period. Government support for the company did not correlate positively with investment in local lines. However, growth did occur in domestic and long-distance circuits. Apart from the obvious lucrative profits generated from long-distance lines, one can also argue that the lack of investment in local telephony can be attributed to a loss of confidence by Marcos cronies in a disintegrating economic and political environment. Even though government policies were favorable towards the company, the historical inability of the government to commit itself as an institution transcending individuals was a reflection of the fundamental weakness in the country's underlying institutional structure. This meant that members of the elite, while receiving favorable treatment by the existing regime, would not invest in a politically unstable environment where future profits could not be assured.

In contrast, one notes that low investment in Telesp is directly correlated with the national government's commitment to invest in the sector. A decreasing commitment on the part of the national government to support the sector was a primary cause of the poor performance of Telesp during this period. The government's shift in priorities was more a function of the debt crises, a spiraling rate of inflation and IMF imposed sanctions on the Brazilian economy, that were external to the institutional structure, and which created the political decisions that affected the sector.

The relationship between the PLDT and the Aquino administration during the early years (1986-1988) was marked by a tremendous increase in regulatory conflict which resulted in an almost complete halt in investment in the local networks. However, during the latter years of the Aquino presidency (1989-1992), the relationship between the company and the government improved.

Investment in the local networks, however, still did not improve and the number of unfilled applications increased tremendously. The increasing profitability of the firm did not act as an incentive for investment. A political explanation rather than an economic one thus provides a clearer understanding of this conundrum. That is, the company did not want to risk their investment resources given the uncertainty of the next regime's friendliness. Again, one notes, that investing in local telephony seems to be tied more to the company's long-term security within a politically stable environment, than purely economic rationales such as high profitability and growth.

While investment by the PLDT came to an almost complete halt during the Aquino years, investment by Telesp started to increase relative to the previous period. However, the increased investment was not tied to the improved performance of the company. In fact, from 1987-1990 growth in telephone lines steadily declined and the quality of services reached their nadir.

Also, while performance and low investment by the PLDT was primarily tied to a lack of confidence in a possible future unfriendly political environment, performance by Telesp was tied to a combination of factors such as: high inflation rates for the country and government policies supporting low tariff rates for the sector, slow GDP growth rates for the state, the deprofessionalization and mismanagement of the sector at the national level, and the deprofessionalization, mismanagement and corruption at the firm level.

During 1991-1992, Telesp was able to increase its investment because Telebras invested more in the state of Sao Paulo for these two years. However, rates of return were their lowest point in the company's history. This again can be explained as the result of mismanagement during the previous period.

The poor performance of both companies may also be attributed to the fact that both countries were undergoing periods of political transition. In the Philippines this meant a lack of confidence in a potentially unfriendly political and regulatory environment, and in Brazil it meant the lack of a cohesive and long-term telecommunications policy for the sector.

### *Competition under Ramos and restructuring under Cardoso*

Fidel Ramos' election to the Presidency in 1993 marked the beginning of competition in the sector. While initially defensive, the PLDT tripled its investments in 1993 and continued investing aggressively through 1995. While the competition may have spurred the company to invest to retain its market share, the PLDT also realized that it could also increase its profitability by charging interconnection fees to the new entrants. Some of the competitors, like Eastern Telecommunications and Globe telecommunications, have complained that the PLDT has been unable to justify its access fees when pressed to do so by the companies. However, when these companies pressed the national Telecommunications Commission to intervene, the NTC responded by saying that under the Telecommunications Act of 1995 the government could not intervene in this process. Under the current law the regulatory structure is still favorable to the incumbent. Some industry analysts have noted that during the deliberation and formulation of the law the PLDT were allowed to have representatives present while other company's were not allowed to have representatives present during the final deliberation of the law (Interview with Jonathan Chua, 1996).

Richard Pratte, Vice-president of the International Division of Eastern Telecommunications, has argued that the overcharging of access fees by the PLDT may be a deliberate strategy on the part of the company to eliminate some of the competition.

While high levels of investment starting in 1993 can be directly attributed to competition and the loss of market share by the PLDT, increased investment by Telesp during this period is largely attributed to a new commitment on the part of the national government to invest in the sector. The regulatory environment, through laws such as the Minimum Law and PASTE and the increase of tariffs by the Cardoso government, has started to create more favorable conditions for growth in the sector.

***Summary***

Throughout the History of these two companies one notes differences in investment patterns that are a reflection of the political and economic environments existing in both countries. For example, the distributional differences between municipality and country (figure 1, 17) can be said to be a reflection of the concentration of economic activity in Metropolitan area versus country. The increasing gap in the case of the Philippines and the relatively consistent one in Sao Paulo is a reflection of the high concentration of economic activity in the city of Manila versus a more dispersed one in the city and state of Sao Paulo.

In comparing the two systems, one notes that the most striking difference, was the relationship between government policies, on the one hand, and investment, on the other hand. Even under the most favorable regulatory, economic and political conditions during the Marcos and Aquino administrations, investment by the company was low. This was not the case with Telesp.

Telesp's performance was very tied to the overall health of the Brazilian economy, the state of Sao Paulo and the policies set forth by the executive. The organizational features of the firm, such as the leadership and management, while having a definite impact on firm performance, were indelibly tied to the economic and political environment in the country. In the case of Telesp, economic factors, to a large extent, determined political decision-making at the national and firm level. In the case of the Philippines, the economic conditions were less a factor for decisions made at the firm level regarding investment.

# VI
# CONCLUSION

It has been argued (Weston, 1990) that malfunctioning or weak government institutions constitute a severe obstacle to investment, entrepreneurship and innovation. The relative strength or weakness of government institutions may, therefore, indirectly have an effect on the micro-economic performance of firms. A theoretical model has been developed to explain the relationship between various contextual and primary variables and their impact on the performance of the firm and responsiveness to political, regulatory and economic incentives. All subsequent propositions are derived from the model.

Figure 6.1

Level of industrialization → strength of state-<br>
culture & size of national → levels of political<br>
bourgeoisie institutionalization<br>
strength & culture of military →<br>
relative autonomy from core countries → model of corruption

→ownership → Performance of sector<br>
→market structure → performance responsiveness<br>
→regulatory structure → to political, regulatory<br>
& economic incentives

Proposition 1

***The institutional features that directly affected the primary variables: ownership, market structure and regulatory structure, were the relative strength of the state and the level of political institutionalization. Contextual features that indirectly affected the three primary variables were level of industrialization; culture and size of the national bourgeoisie; autonomy, strength & culture of the military; and autonomy from core countries.***

***Primary institutional features***

***1. Relative strength of the state***

Judged against conventional standards of autonomy, which implies independence from dominant elites and the capacity and ability of the state to implement policies that are independent of elite interests, the Philippines is a weak state. That is, the process of state building has been a function of both external forces (Spanish & American colonialism) and internal forces (weak national bourgoeisie & elite penetration of the state).

The transformation of Philippine society by Spanish and American colonial policies, and the penetration of the state by different regional elites unleashed powerful centrifugal forces that have fostered fragmented social control and reinforced regional identities at the expense of a strong national identity.

In contrast, the Brazilian state can be judged to be a moderately strong state, having both a military and a civilian bureaucracy that possess a certain degree of autonomy from social classes and interest groups. Selective state intervention has been used at various points in the country's history to speed Brazil's transition to an industrial economy. The strengthening of the federal government, starting with the Vargas regime, centralized social control and reinforced a strong nationalist identity.

The commitment to building a strong state underlay the Brazilianization and nationalization of many foreign controlled companies in the 1960's. Telebras' stellar performance during its early years was the result of the executive's commitment to the development of a strong federalist state, and the recognition of telecommunications development as an important component in this equation. Its later periods of low investment in the telecommunications sector was the result of the shifting away of priorities from telecommunications development to other sectors that were in greater need, and as a crises strategy to curb inflation. Telesp's performance, with some minor differences, reflects the pattern of Telebras' performance.

## 2. *Level of Political institutionalization*

Institutions are defined as the formal and informal organizations created by humans that shape the historical performance of national economies and by extension the sectoral or firm performance. Political institutions are sections of the modern polity that include the executive, the legislature, the judiciary and political parties. High levels of political institutionalization imply a balance between the three branches of government, elections, strong, autonomous and differentiated parties and respect for constitutional law. Conversely, low levels of political institutionalization imply a dominance of one of the three branches of government, absence of elections, weak undifferentiated political parties and a disrespect for constitutional law. Moderate levels of political institutionalization have some of the features of high and low political institutionalization.

this dissertation will argue that the Philippines has low levels of political institutionalization, while Brazil has moderate levels of political institutionalization. Features of both systems are as follows.

***a. Dominant Executive and weak legislature in a competitive system of Politics in the Philippines; Strong Executive and Weak Legislature in an authoritarian system in Brazil***

One of the important features of the Philippine political scene was the control of the government by a small group of people. The political structure of the country has been shaped by the desire of a small elite to maintain political and economic power. This was done by maximizing the concentration of power in the executive, while impeding the functions of the legislature and judiciary. Since members of the legislature were numerous and from local districts, members of the non-elite had a greater chance of exploiting rivalries among candidates and influencing those elected Thus a congress that was too strong was considered too risky for policy setting and resource allocation.

The president's power was embodied in a number of constitutional and legal provisions. The president could legislate in certain areas by issuing decrees, veto legislation subject to overrule by a two-thirds majority in both houses of congress, appoint a variety of municipal officials and suspend elected ones (Wurfel, 1988:76,77 & 90). The president could also declare martial law without the consent of the congress, and finally, while the budget items proposed by the president could not be increased by the congress, the president could treat the budget approved by the congress as fungible. These powers, especially the control over local governments and release of funds, left the congressmen at the mercy of the executive for the support of their patronage systems.

The concentration of power in the executive increased even more with the presidency of Marcos, particularly after the declaration of martial law. While a strong executive and weak legislature increased the likelihood of rent-extractions by the elite with ties to the executive, the system of competitive politics, however undifferentiated and weak the political parties were, increased the probabilities of those in power being on the losing side at some point in the future. Hence, its members had to devise mechanisms for protecting their assets when the "friendly executive" was out of office. One of the ways was the shifting of assets away from firms such as public utilities to more secure investments out of the country. Thus, as the probability of turnover in the executive increased, real investment tended to fall. This was a recurring and consistent pattern in the PLDT's investment behavior.

Historically, the Brazilian political structure during the republic has shifted between periods of strong and weak executives. The roots of the strong executive during the republic really begin during the presidency of Getulio Vargas (1930-1945). Legislation in the economic and social spheres was very much influenced by the personality and power of Getulio Vargas, who, along with his political party, transformed the federal government's role in the socio-economic realm. From then on the presidency became the undisputed power center of the entire political system (Furtado, 1963:28). The legislature and the judiciary in Brazil have generally been subordinate to the power of the executive. However, this has tended to vary during various time periods.

While the strength of the executive was enhanced during the Vargas period, it was not until the Bureaucratic Authoritarian regimes (1964-1985) that authority patterns, both constitutionally and pragmatically, clearly advanced the values of hierarchy in state and federal relations and the importance of a strong executive.

A strong executive in the Brazilian context meant that support for telecommunications investment and development would not be stalled and undermined by legislative infighting.

In the Philippine context, however, a strong executive resulted in the interests of the executive and his cronies being served to the detriment of the development of a viable national telecommunications system.

*b. Weak regulatory Mechanisms in both the Philippines and Brazil*

The institutional mechanisms for market governance in the form of regulatory bodies were weakened by an executive in the Philippines that could dismiss regulators unilaterally, congressional control over agency budgets that were consistently low, low salaries for regulatory officials that prevented them from performing their mandated duties and encouraged corruption and "capture" by the private industry, and the vagueness and nonspecificity of regulators that left a great deal of room for discretion. This discretion and dominance by the president kept regulations subject to easy change and hence limits their long-term credibility.

Similarly, weak regulatory mechanisms in the telecommunications sector in Brazil have exposed the system to greater political influencing. This was especially evident in the decade of the 1980's when the political commitment by the government to the sector declined. Furthermore, weak regulatory mechanisms in Brazil have created amorphous distinctions in an increasingly complex telecommunications sector between political sectoral levels, regulatory levels and the operational execution of telecommunications services. This is especially true in the last ten years when the development of new technologies in telecommunications has clouded the "public goods" nature of telecommunications services.

***Secondary contextual features***

***1. Philippine economic dependency with the United States perpetuated an agrarian economy run by a small elite whose interests paralled U.S. interests, while political and economic independence in Brazil and in particular Sao Paulo allowed for the development of industrialization.***

After Philippine independence in 1946, the U.S maintained political, economic and military influence in the country. This was part of a package that included independence for the country and future american assistance for the imposition of decades long restrictions on Philippine government policies (Wurfel, 1988:14).

Specifically, this took the form of the Bell Trade Act of

1946 which guaranteed a fixed exchange rate, free trade with the U.S. and parity rights with Filipinos in the ownership and exploitation of natural resources and public utilities.

The U.S. presence in the economic sphere created a system that encouraged the use of politics by the elite for economic gain. Taylor (1966) asserts that the prevalence of foreign business in a country tends to promote corruption because their presence and control of important economic avenues to economic well-being forces potential native entrepreneurs to attempt to make their fortunes through politics. The U.S. presence in almost every sphere of economic life after the Second World War encouraged the local elites to pursue politics as the main avenue of wealth and power.

The use of political power as a way to wealth implies a subordination of political values and institutions to economic ones. The principle purpose of politics becomes not the achievement of public goals but the promotion of private interests. Though there were no prohibitions against state ownership, economic assets remained largely private which served the interests of GTE until 1967 and the Cojuangco ownership thereafter. Public ownership would have meant the total loss of the profits once the ruling group was out of power. Thus, many foreign-owned enterprises were "Filipinized" but not nationalized, as similar enterprises in other developing countries had been.

In the colonial experience of the Philippines, one notes a link between Spanish and American colonial administrations on the one hand, and the evolution of the Philippine social structure and choice of development models, on the other hand. Spanish and American ambitions in the Philippines were limited primarily to agricultural exports. Railroads and industry did not develop like they did in Brazil, and the processing and export of agricultural crops was dominated by foreigners. Low levels of industrial development, therefore, put a low priority on telecommunications development which tended to be extremely narrow, confining itself, by and large, to urban centers. Even after the Filipinization of the telecommunications system in 1967, it was still not perceived as vital to national development and expansion.

In contrast, early independence in Brazil allowed for the country to move from classic dependence to what Peter Evan's (1979) describes as dependent development. Classic dependence was broken in Brazil at a relatively early date because the chief export, coffee, was in local hands, not those of foreigners; because coffee money built railroads; because railroads built for the coffee industry also linked together a national economy; and because of the existence of local entrepreneurs. Evans argues that the combination of factors that allowed Brazil to move out of the coffee exporting economy in the direction of industrialization was very special and was not the same with other crops such as sugar.

Industrial growth during the Vargas years coexisted with a trend toward less dependence of the Brazilian economy on the advanced capitalist countries (Gomes, 1986:175-177). During the period between 1930-1945 external dependency as represented by the volume of outstanding debt was reduced. Starting in 1933 the Brazilian economy started to experience significant growth, particularly in the industrial sector. This industrial growth was basically oriented towards the expansion of the internal market.

The relevance of all this is that a less significant presence of foreign capital in Brazil meant that the interests of the local dominant classes were less connected than they had been in the past to the interests of foreign capital. It is also important to note, however, that this trend towards less dependency in Brazil was also tied to the trends occurring in advanced capitalist societies at the time. That is, capital movements during the 1930's were significantly curtailed. The advanced capitalist countries were steeped in depression and there was little capital to be exported from the center economies.

When private foreign capital started to reappear after the Second World War the situation to be faced in Brazil was no longer the same as it was in the 1920's. The old patterns of dependency could not be restored, unlike they could in other Latin American countries who had not undergone similar industrialization.

The acceptance of Brazilian industrialization by the United States (the prime source of foreign capital) and the subsequent decision of multinational corporations to join in and lead Brazil's industrial growth was reached as an outcome of a bilateral game: a game in which the interests that counted were not only those of U.S. capital, but also those of Brazilian capital.

Sao Paulo, began its rapid industrialization during the first decades of the twentieth century. The Getulio Vargas administration's support for the industrialization of the country directed many economic resources towards Sao Paulo. During the Bureaucratic Authoritarian regimes of the 1960's and the 1970's, the industry of Sao Paulo began to attract an international market.

The importance of Sao Paulo as the center of industrial development in the country was the foundation for the rapid expansion of the Telesp system during the 1970's. As Sao Paulo's share of national manufacturing output started to decline in the 1980's and as other industrial centers started to emerge, Telesp's share of resources from Telebras, relative to its earlier period, also declined.

Rapid industrialization demanded a telecommunications infrastructure that could support it. The best way to achieve this, according to the generals of the bureaucratic period, was through a state monopoly that was regulated through the Ministry of Communication. While the Telebras system had a certain degree of autonomy from the state, it was still deemed the only structure where the the leaders could exert maximum control over the process of telecommunications infrastructure development.

### *2. Culture and strength of the Military in the Philippines and in Brazil*

The degree of military identification with the state apparatus varies from one society to the next. As an institution, the Philippine military has played an important role in supporting the political structure of the country and historically has been the tool of the oligarchy throughout the second half of the twentieth century. The Philippine military has historically lacked legitimacy primarily because of its collaborationist character, first with the colonial powers, and then with the ruling elite, who have used it for both the establishment and maintenance of power as well as a tool for the frustration of genuine social reform.

The army's inability to act autonomously from the interest of the ruling political group ensured that it would function as a tool for the maintenance of a political structure dominated by a small political elite. This group had a fundamental interest in maintaining a private system of monopoly that meant minimum government interference and maximum profits with the minimum amount of investments, and a regulatory structure that was "captured" by the executive branch which ensured, for the most part, continuous favorable treatment.

The Brazilian army, on the other hand, developed an ideology that was strongly identified with the state. During the Vargas era the military emerged as the arbiter of political succession and the guardian of the constitution (Stephan, 1975:201).

While Vargas weakened the state militias and strengthened the central armed forces, it was not until the military coup of 1964 when the military was used as an institution to guarantee the stability of bureaucratic authoritarianism's dominant coalition: the state, foreign capital, and the domestic bourgeoisie.

In the absence of war, the Brazilian army was transformed into bureaucratic bodies in which institutional rather than heroic values predominated. The historical importance of the Brazilian army laid in its continued presence at all the turning points in the history of the nation and as a determining force in periods of crises. The doctrine of National Security that was espoused by the military regimes of the bureaucratic-authoritarian period linked development with security, and gave the army the function of defining permanent national objectives while also justifying its usurpation of power.

One of the crowning achievements heralded by the military government was in telecommunications. The autonomous character of the military allowed it to develop and implement policies and realize developmental goals that might have been more difficult to achieve in a more liberal environment, where private interests dominated and which may have incapacitated national goals.

### 3. The Culture and Strength of the National Bourgeoisie

While the traditional agrarian elite cohesion in the Philippines was briefly challenged in the early 1960's by an emerging industrial elite, they were summarily quashed by the Marcos administration. Traditional elite interests required a weak state which provided the arena in which factions of the elite fought their battle. Since private interests dominate elite activity, it would make sense that ownership of most enterprises remain in private hands. Likewise, the weakly regulated private monopoly structure is the perfect vehicle where minimum investments result in maximum profits.

In contrast, the emergence of an industrial elite in Sao Paulo that challenged the traditional agrarian elite allowed for the development of an ideology that identified its interests with those of Sao Paulo and Sao Paulo's with those of Brazil. Hence, it was in the interests of the industrial elites of Sao Paulo that a modern telecommunications infrastructure be established. Centralization of the system was deemed an important first step, and it was only through a state monopoly where this could be achieved. Thus, elite support for a state monopoly was given.

*Proposition 2*

***The poor performance of the Philippine Long Distance Telephone Company can be attributed to low levels of investment caused by an ownership structure with strong ties to the administration and that colluded with ownership in perpetuating corrupt practices, a monopoly that focused soley on profit maximization to the exclusion of nonprofitable areas, and a weak regulatory structure that was unable to enforce compliance.***

***The inconsistent performance of Telefonos de Sao Paulo can be attributed to levels of investment that depended on political and economic policies at the national and state level. The ownership/management structure was, on the whole, largely responsive to the current polity, a monopoly structure that successfully centralized and established a national telecommunications infrastructure and a regulatory structure that was subservient to and tied to political and economic agendas.***

Low levels of investment in the PLDT can largely be attributed to ineffective political institutions which encouraged rent-seeking and corruption. Even under favorable conditions when the company was given the opportunity to earn high profits, takeover assets of other companies and borrow heavily, investment was low. Concern about the stability of the administration superseded any of the incentives to invest, causing the company to suppress the expansion of the local network, except where it facilitated long-distance calls. Also, because it is a publicly traded company controlled by minority stockholders, its profits were channeled to more exclusive accounts.

In contrast low levels of investment in the telecommunications sector can be attributed to specific government policies at the national level.

The upward trend of investment that began at the end of the 1960's showed signs of weakening in the 1980's. Although the 1982 debt crises had devastating effects on capital formation, the slackening of investment activity predated 1982.

In 1980, the sectoral composition of Brazilian investment changed significantly when Delfim Netto became the chief economic policy-maker in the Figuereido government. His economic strategy was in some respects a Brazilian version of the supply-side arguments made in the U.S. at that time. State enterprise investment was scaled back and replaced by private investment.

The pressure on state enterprises was also intensified by the governments use of state enterprise pricing policy to reduce inflation. The policy of controlling these prices to combat inflation had important consequences. First, it decapitalized those enterprises, forcing them to reduce their future investment plans. Second, the resulting deficit added to the public sector deficit.

Third, real investment in a number of Brazil's most important state enterprises fell dramatically throughout the 1980's.

Investments in telecommunications by the Brazilian government started to fall at the end of the 1970's and continued to decline throughout much of the 1980's. For example, in the period 1974-1982, average annual investment in the sector was 1.4 billion dollars; between 1983-1987, investment in the sector averaged 1.1 billion dollars. This decrease in investment by Telebras meant a decrease of funds allocated to Telesp. Specifically, low investments in the sector in general and to Telesp specifically can be attributed to government policies that encouraged and included:

a. **low tariff rates**- During the early 1980s international lending institutions such as the IMF and the World Bank, insisted that countries like Brazil align public enterprise action with macro-economic policies concerning inflation deficit reduction, debt management and balance of payment adjustments. Hence, price indexing was used as a means to control inflation and investment was drastically reduced in order to slow down the escalation of foreign debt (Dmytrachengko).

As result of this price indexing, tariffs for the telecommunications sector as well as other public services were continuously kept below the level of inflation between the years 1979 to 1992. This had an extremely detrimental effect on all the Telebras operating companies.

### *3. Decreased Revenues from Third Party Sources*

Between 1983-1987, investment from institutions such as banks and other lending institutions, both foreign and domestic, declined dramatically. This was, in large part, because of the large debt that states had contracted over the years, making state enterprises unattractive investment avenues.

State debt increased because of the expansion of state services during the decade of the 1970's and 1980's while the federal government started to allocate less money to the states. These services had to paid for, and so states started to increase their domestic and foreign borrowing, thus increasing their indebtedness.

By 1981, for example, state governments had contracted an estimated one-third of the country's external indebtedness. This indebtedness was centered primarily in the most developed part of the country, namely in the states of Sao Paulo and

Minas Gerais.

### *c. The Loss of other Fiscal Revenues from institutions like the FNT*

Until the beginning of the 1980's, a major source of funding for the telecommunications sector came from the National Telecommunications Fund. However, beginning in 1982 this fund, which was specifically designated for the telecommunications sector, was absorbed by the more general National Development Fund.

This meant that telecommunications would have to share revenues with other sectors of the economy. By 1989, funding from this source had declined to zero. Apart from low investment levels, other features can account for the poor performance of the sector. These include:

### 1. The absence of a middle and long term planning system

After the military takeover in 1964 and until the late 1970's, state-owned enterprises in Brazil were able to achieve their macro-economic goals of minimizing foreign dependency, alleviating development bottlenecks and fostering rapid economic growth, while maintaining, for the most part, an acceptable degree of micro-efficiency (Carrera-Fernandez, 1988, Trebat, 1983). Their later poor performance has been attributed to the absence of a cohesive public policy strategy and the adjustment lag between public policy and a depressed world economic situation in the late 1970's and the early 1980's. Telebras, and by extension Telesp, suffered from the lack of cohesiveness of government public policy by consistently acting for the short term. Telesp was consistently frustrated from engaging in middle and long-term planning.

## 2. Political/regulatory structure of the holding company system

The holding company structure, which included Telebras, meant that the national organization would oversee investment policy in a given sector and set priorities for state-owned companies within the sector. Hence, state-operating companies such as Telesp would would function autonomously in their routine operations, while questions of finance and development strategy were decided at the federal level. The present regulatory environment and the lack of autonomy at the financial and development level has meant generally moderate levels of investment. The fact that every project and plan that the company has is directly tied to the union means that the allocation of resources is tied to various economic and political forces which inhibits planning on a large scale and higher levels of investment.

### 3. deprofessionalization of the sector

One of the first measures implemented under the state system was the manning of the telecommunications sector with technical and managerial expertise. This, however, started to change in the early 1980's for the Telebras system and in the mid-1980's for Telesp. Both at the federal and the firm level experienced technicians and managers were replaced by political individuals. Technicians and managers also left for the private sector because state companies could not pay them adequately enough to retain them.

Thus, political interests dominated policy-making resulting in increasing mismanagement in many cases and corruption in some cases. It is important to note, however, that corruption was not endemic throughout the whole Telebras system.

***Proposition 3***

***Low levels of political institutionalization combined with a monopolist model of corruption in the Philippines resulting in a performance that was largely unresponsive to political, economic and regulatory incentives.***
***Moderate levels of Political institutionalization combined with a nonmonopolist model of corruption in Sao Paulo resulting in a performance that was largely responsive to political, economic and regulatory incentives.***

This comparison has revealed that while the ownership, the regulatory environment and market structure all played a role in the performance of the telecommunications companies, the PLDT and Telesp, the political structure that framed these variables was ultimately a greater determinant of the performance of these two companies. For example, the state-run company, Telesp, performed well when the government commitment to the sector was high and performed poorly when it was not. In the case of the PLDT, the consistently poor performance of the company was, in large part, the result of weak political institutions that lacked credibility and that ultimately created an environment of political uncertainty adversely affecting the companies' desire to commit itself.

What differed between these two scenarios, however, was the strength of the political institutions and their ability to effect the performance through policies. While political institutions in Brazil may be underdeveloped relative to the advanced capitalist democracies, their relative strength was revealed in the authoritarian government's continued commitment to a constitutional form of government by allowing for the existence of an opposition party (albeit much more narrowly defined than previously) and the holding of elections; the belief that the military government solution was only a temporary one; and, finally, by the refusal of the military leaders, even during the peak of its authoritarian existence, to allow the System to sink into "caudillismo" or dictatorship (Skidmore, 1988).

The direct correlation between government policies, on the one hand, and firm performance, on the other revealed the relative strength of the political institutions in Brazil which affected the performance of Telesp. The lack of any correlation between government policies and firm performance in the case of the PLDT revealed the weakness of the political institutions.

The deeper question of why institutions were more developed in one context than in another is a large and complex one. Modernization theorists have posited that one of the important factors for the development of political institutions in a country is the level of economic development. Economic development, while perhaps not a sufficient condition to the development of strong political institutions, is a necessary one. Historically, in western countries the rise of a strong national bourgeoisie occurred before the advent of mass democracy (Huntington, 1984). In the case of the Philippines, the superficial assumption of democratic principles and institutions in an economically underdeveloped environment assured that these institutions would remain weak and would be controlled by a small elite.

One of the measures of weak political institutionalization is the amount of corruption that a system will tolerate. Huntington further notes (1988:384) that corruption is most prevalent when countries are modernizing and industrializing, when the interests of family, the clique or the clan predominates, and when mobility outside politics does not exist. Modernization breeds corruption because it involves a change in the basic values of a society. What may be considered perfectly acceptable in a traditional society, like gift-giving, for example, is considered corrupt under the new standards and norms of a modernizing society. It also contributes to corruption by creating new sources of wealth and power. Corruption, in this sense, is a direct product of the rise of new groups with new resources and the efforts of these groups to make themselves effective within the political sphere.

However, if corruption is a measure of weak political institutionalization, and if the development of political institutions is dependent on modernization and industrialization, doesn't this create a paradox?

One might explain this seeming contradiction by discussing the type of corruption that may arise in different contexts.

In many political systems the incidence of corruption is high at the lower levels of bureaucratic and political authority. However, in some societies, the incidence of corruption seems to remain constant or to increase as one goes up the political hierarchy. In terms of frequency as well as scale, national legislators are more corrupt than local officials; high level bureaucrats are more corrupt than the low level ones; cabinet ministers are even more corrupt and the president or top leader i.e., Trujillo of the Dominican Republic, Somoza in Nicaragua and Marcos in the Philippines, is the most corrupt among them.

Such patterns of top-heavy corruption implies very low levels of political institutionalization since the political institutions in the society, which should be most independent of outside influences are, in fact, the most susceptible to such influences. Economists like Mauro (1993) describe this as a monopolist model of corruption which is highly correlated with low levels of investment and economic growth. This model can be used to describe what occurred in the Philippines during the Marcos regime. The general economic underdevelopment of the country never allowed for the development of a national bourgeoisie with interests beyond the individual or the clan. The creation of strong political institutions was not in the interest of the elite nor the dictator. Therefore a monopolist model of corruption could emerge.

In a nonmonopolist model of corruption, where corruption tends to proliferate at lower levels, the leaders of the society generally remain true to the stated norms of the political culture and accept political power, and sometimes military power, as substitutes for economic gain. This acts as an insulating force for the top political institutions which have the responsibility of setting the political agenda. Economic independence and industrialization allowed for the development of credible political institutions in Brazil. Moderately high levels of political credibility combined with a political ideology that saw Brazil as the potential economic superpower of Latin America allowed for the development of institutions that had national development and national security at the top of its political agenda.

Therefore, while modernization and industrialization may create the conditions for the proliferation of corruption, the type of corruption that will occur will generally be of a nonmonopolist type. Conversely, low economic development and low political institutionalization will create the conditions for a monopolist model of corruption.

One might argue that any form of rent-seeking is distortionary. However, it is also true that distortion is greater when top level leaders are corrupt.

The stellar performance of the Telebras system, and by extension Telesp, during its early years, is a reflection of the relative structural soundness of the system. Incidences of corruption were isolated and not endemic to the system like they were for the PLDT. While it is true that Telesp's performance was affected by the distortionary effects of corruption during the Ignacio de Jesus years, other factors were more important to the overall performance of the firm. The consistency of performance responsiveness to incentives is what is most notable in the Sao Paulo system, while the opposite is true for the PLDT.

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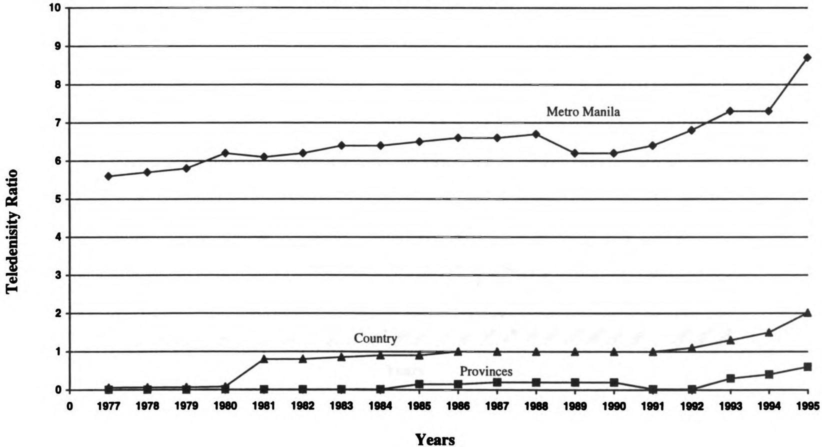
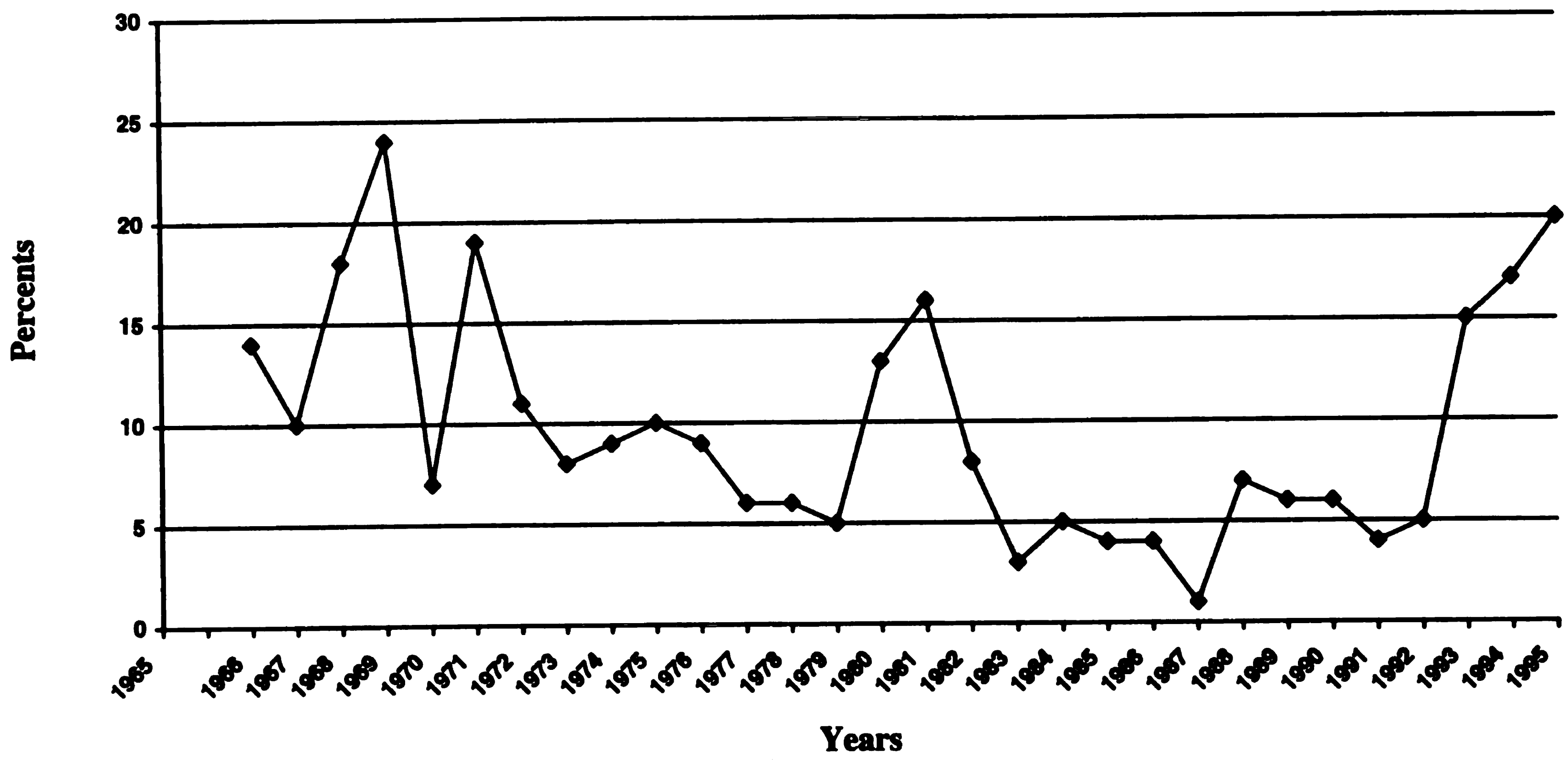
APPENDIX

**FIGURE 1**
**Philippines**
**Teledensity Ratio Per 100**
**(Manila, Province, Country)**




Source: PLDT

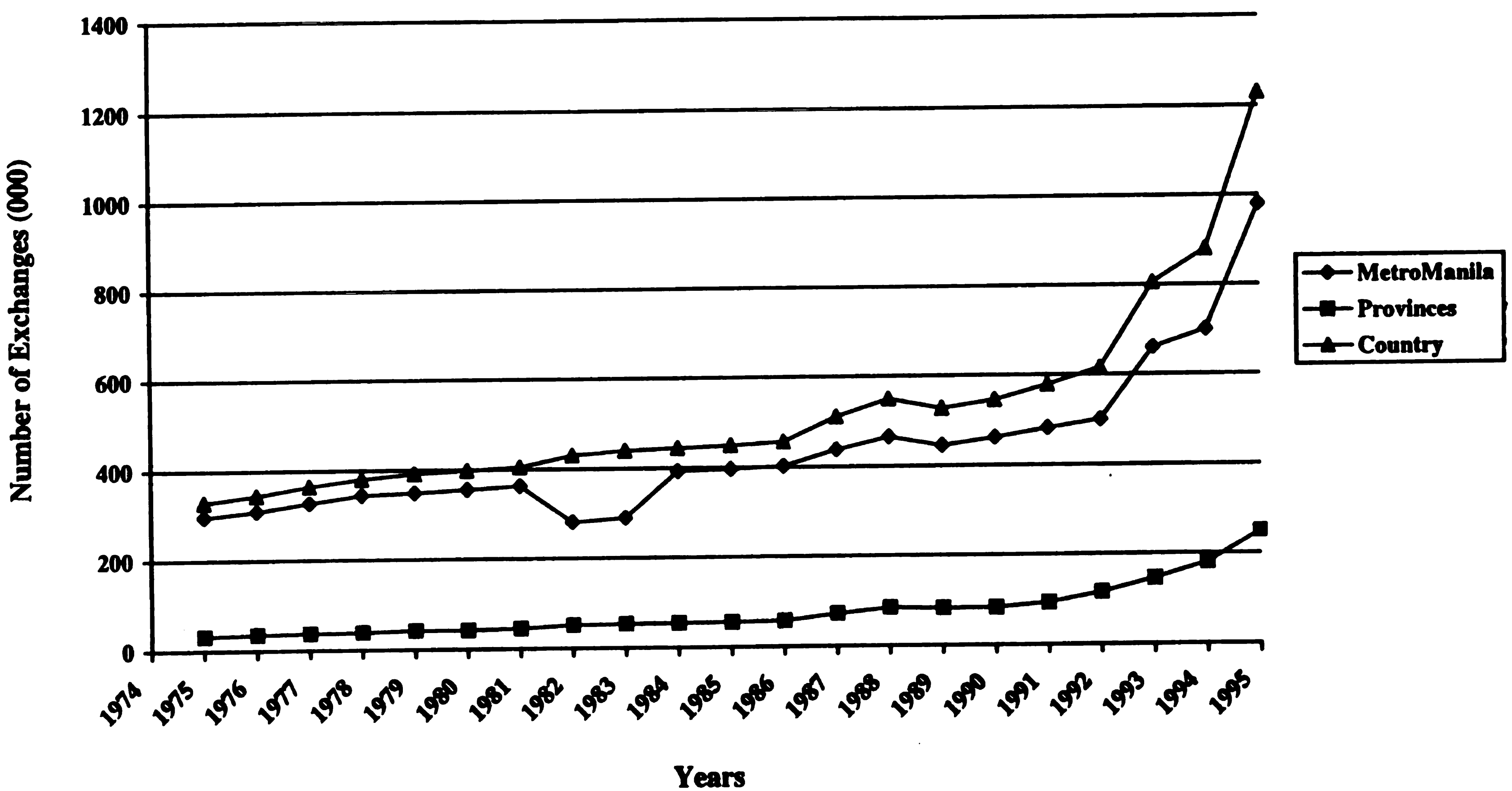
**FIGURE 2**
**Philippines**
**Percent Growth of Local Telephone Lines in Country**




**Average Growth Rates**
1966-1973: 14.83
1974-1986: 7.57
1987-1992: 4.83
1993-1995: 17.33

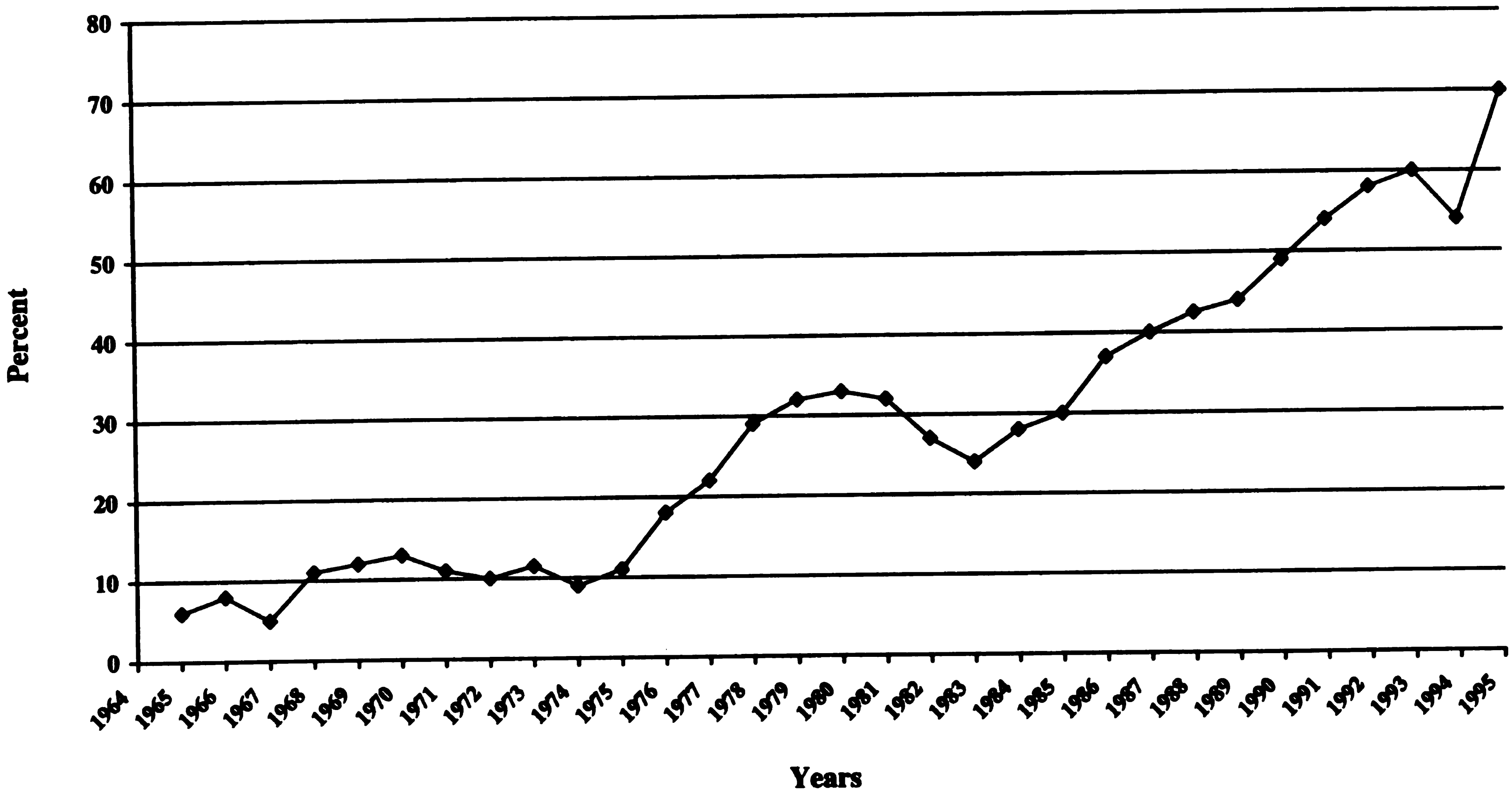
**Source: PLDT Annual Reports**

**FIGURE 3**
**Philippines**
**Number of Telephones Working in Metro Manila, Country, Areas and Provinces**



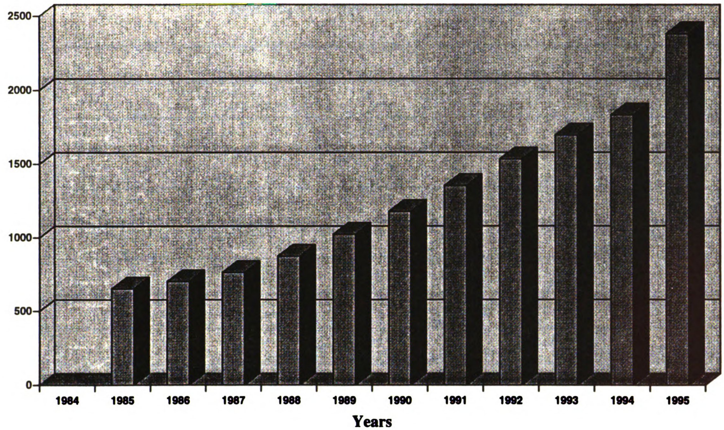

**Source: PLDT Annual reports**

**FIGURE 4**
**Philippines**
**Unfilled Applications For Telephones**



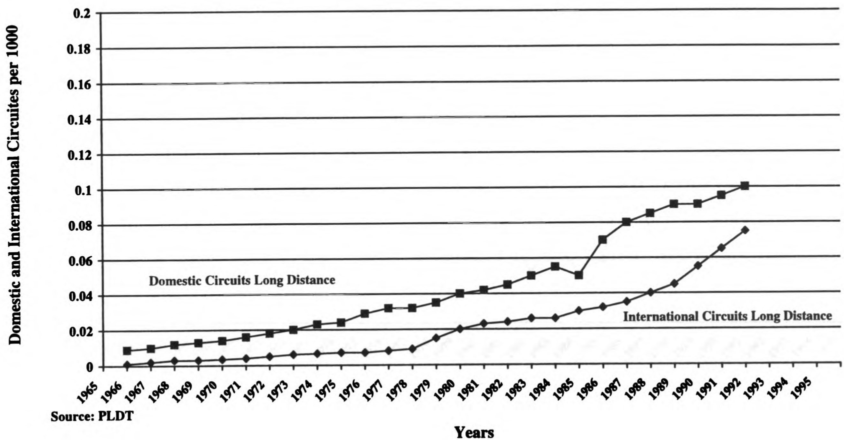

Source: NTC

**FIGURE 5**
**Philippines**
**Estimated Demand in Country (000)**



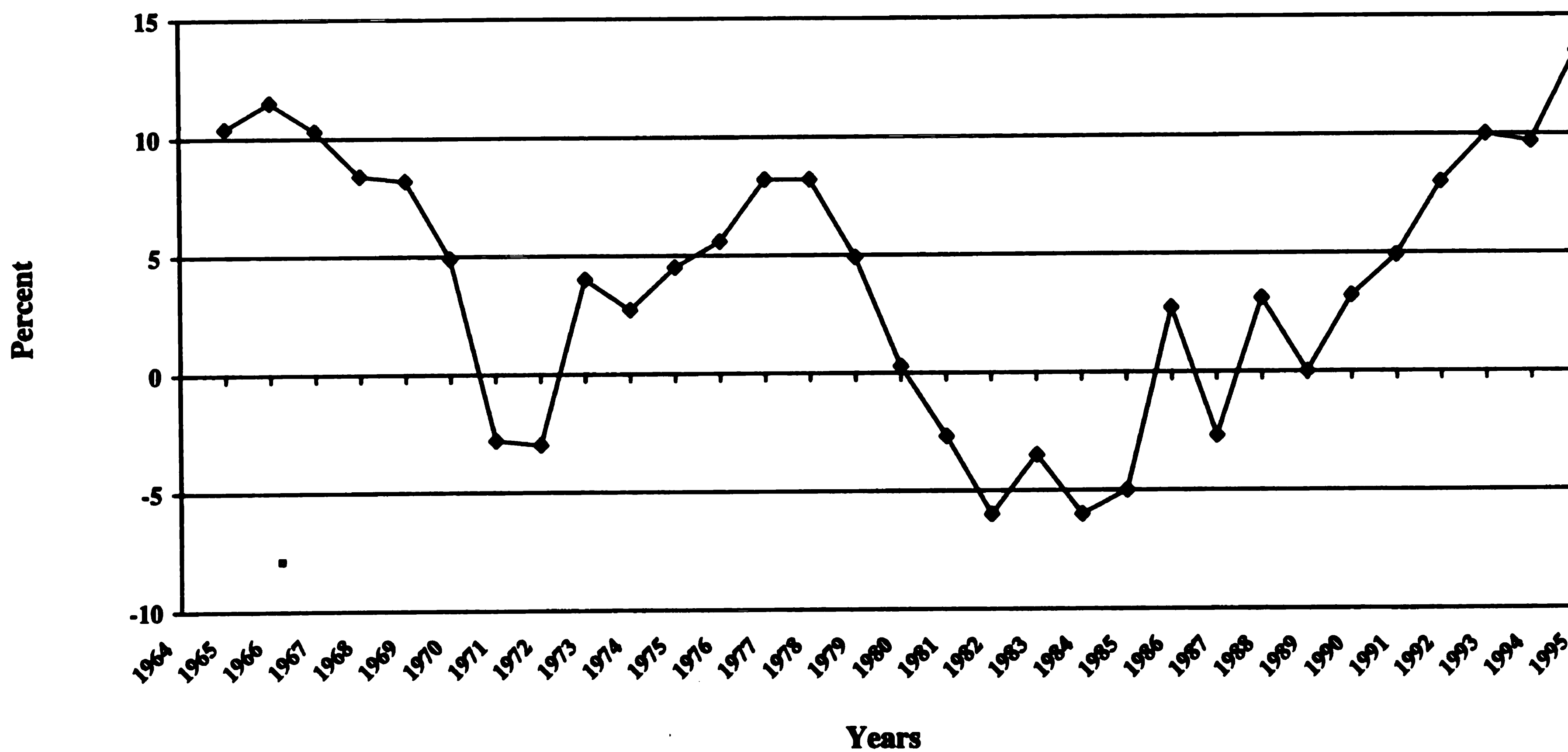

Source: NTC

**FIGURE 6**
**Philippines**
**Telecommunication Facilties of PLDT per 1000 Population (Domestic and Internal Circuit)**




Source: PLDT

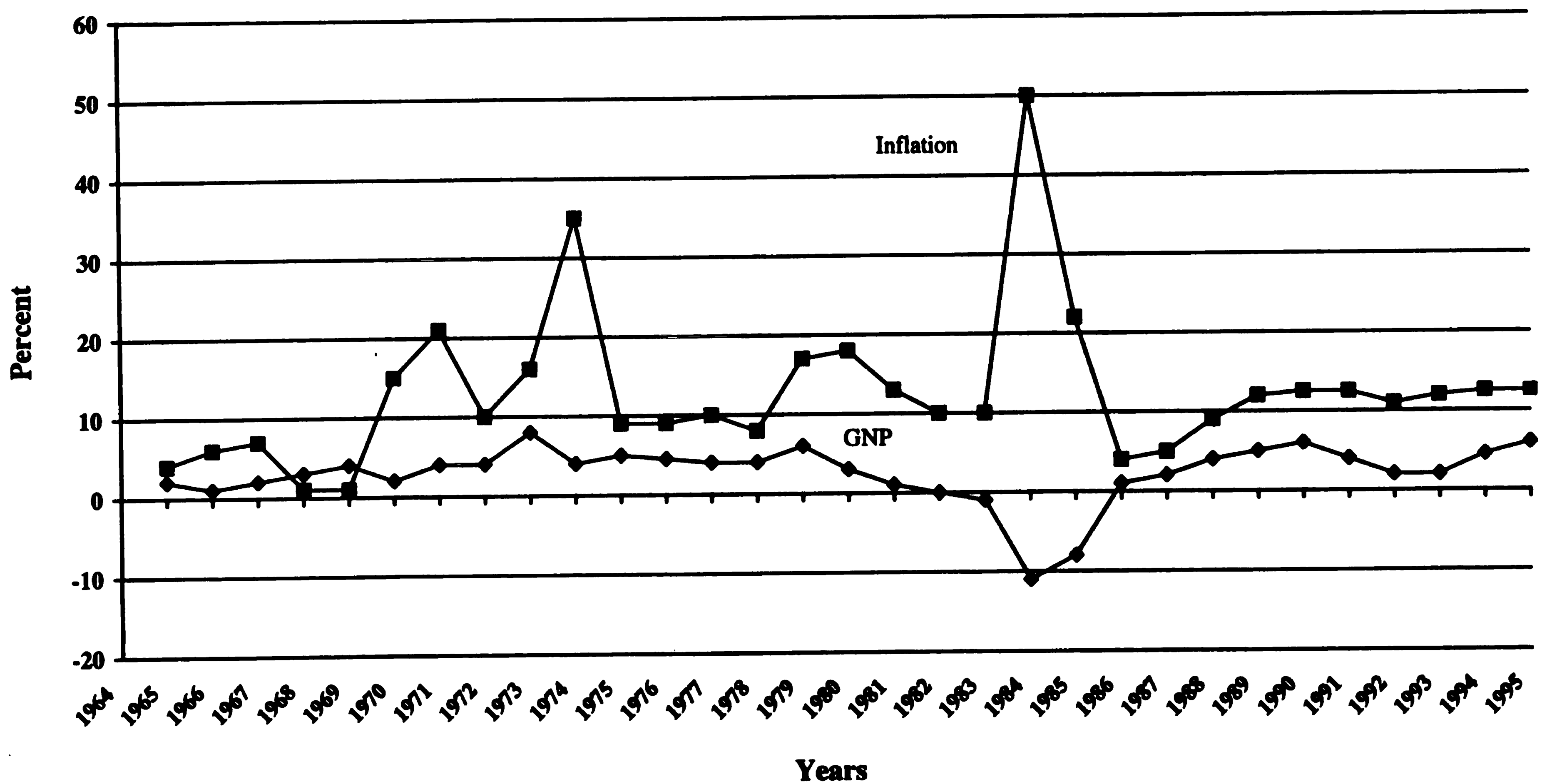
**FIGURE 7**
**Philippines**
**Real After Tax Rate of Return on Equity**




1965-1972: 6.00
1973-1979: 5.44
1980-1986: -2.53
1987-1992: 2.75
1993-1996: 9.00

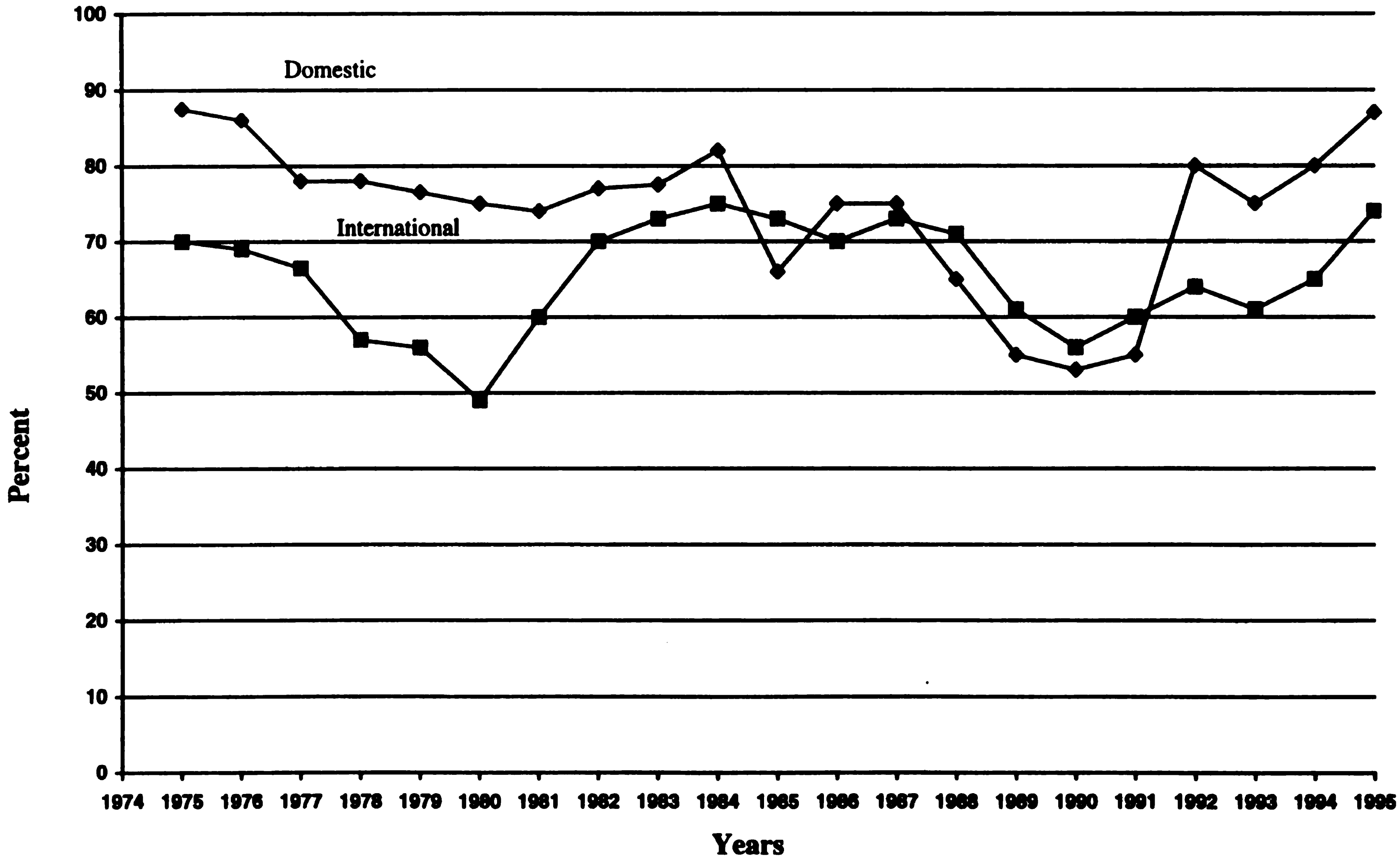
Source: PLDT Annual Reports

**FIGURE 8**
**Philippines**
**Real GNP per Capita Growth Rate and Inflation**



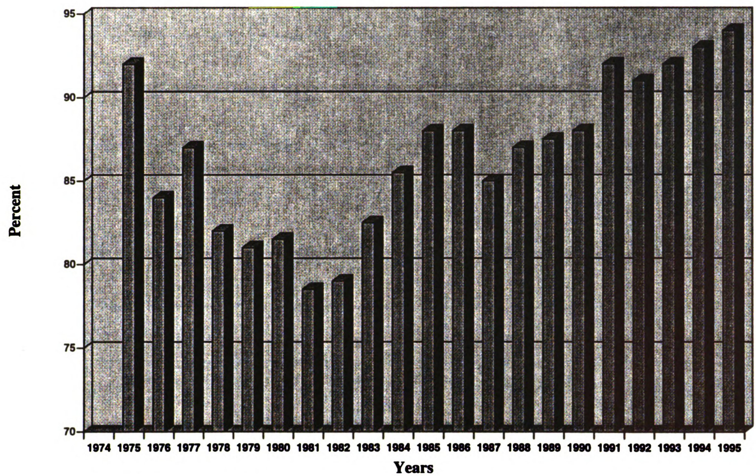

Source: International Financial Statistics

**FIGURE 9**
**Philippines**
**Call Completion Rates**



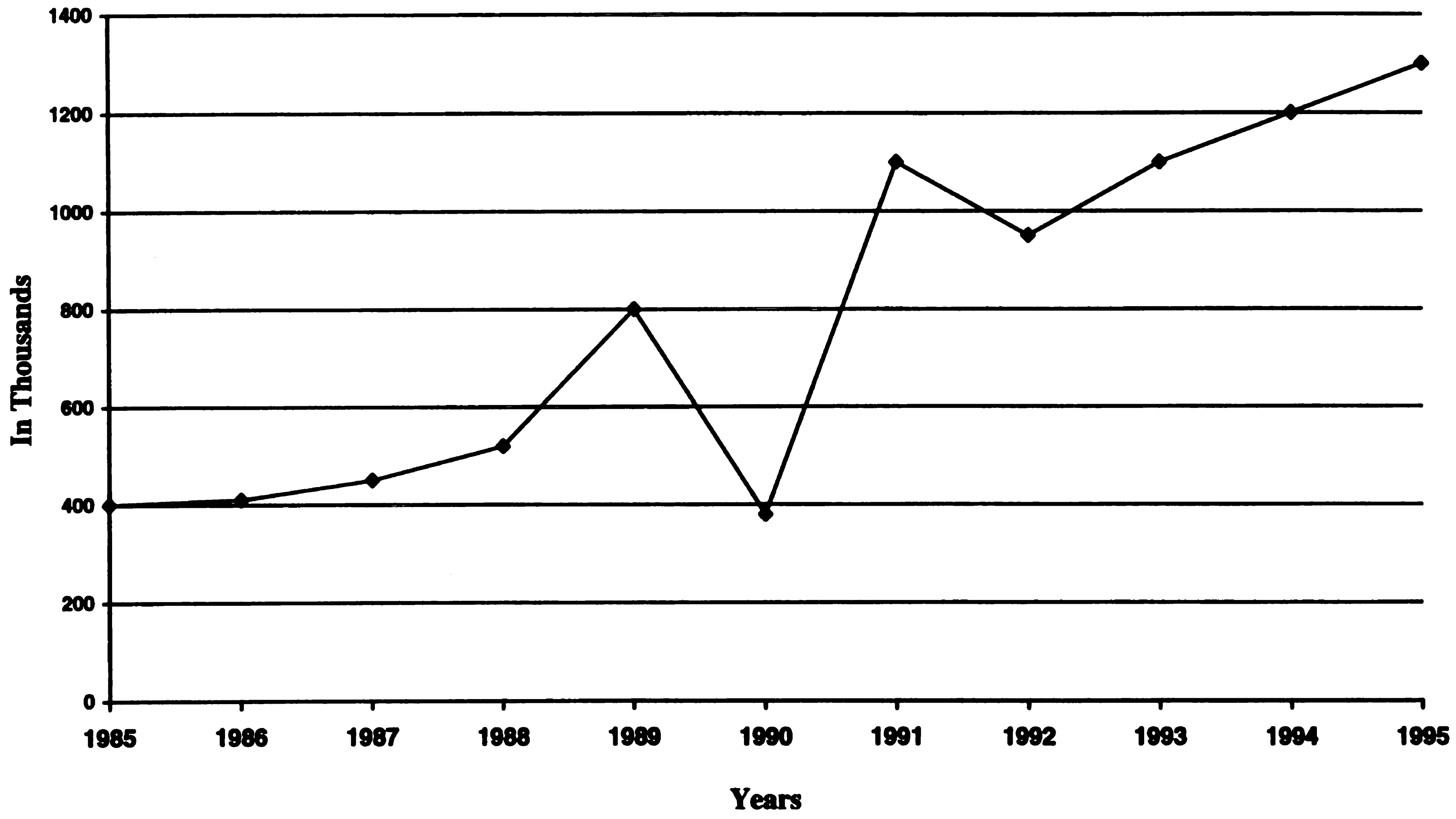

Source: PLDT

**FIGURE 10**
**Philippines**
**Restoration Time - Percent of Total Troubles Restored Within 48 Hours in Manila**



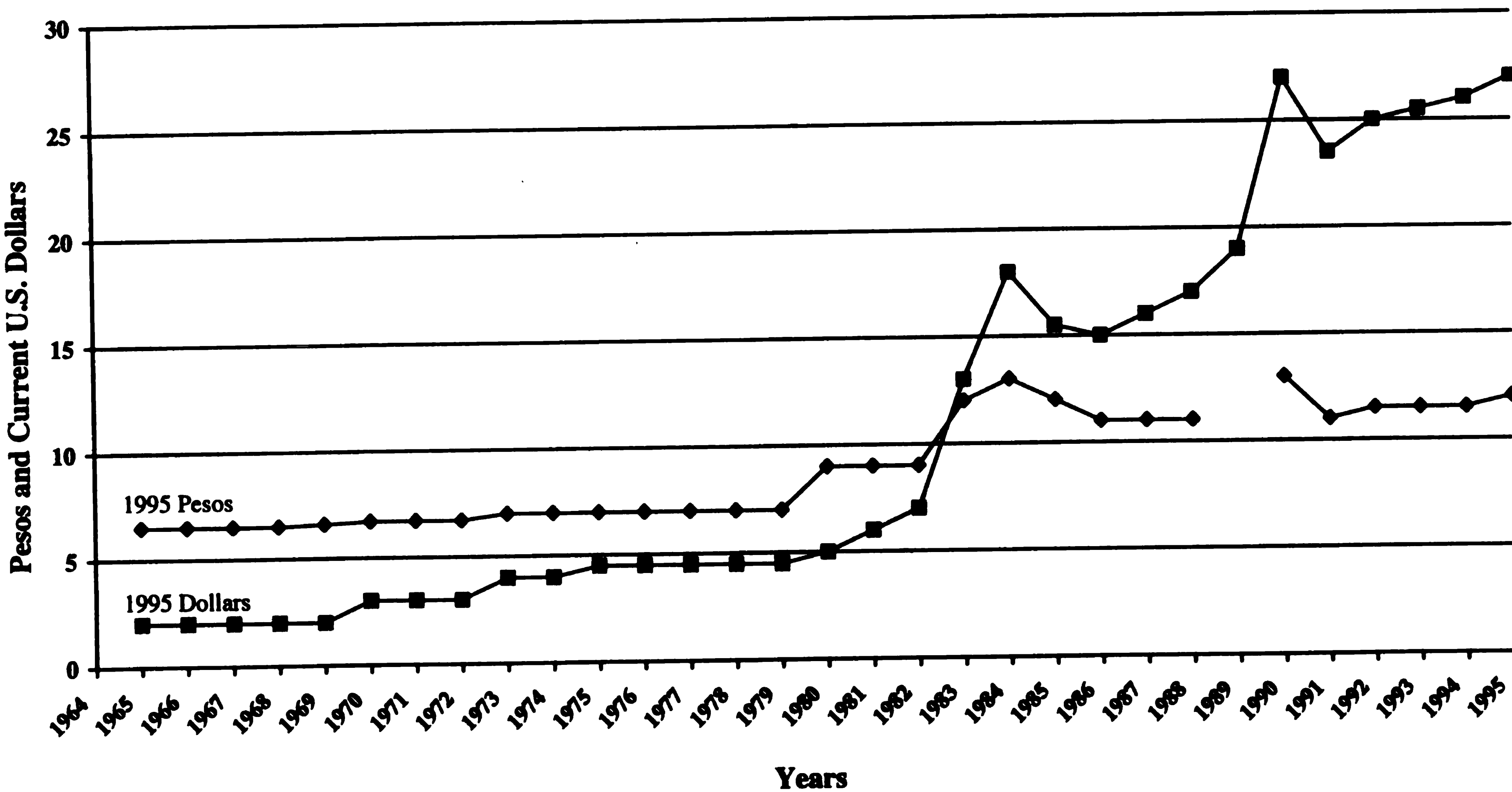

Source: NTC

**FIGURE 11**
**Philippines**
**Number of Public Telephones Working in the Country**



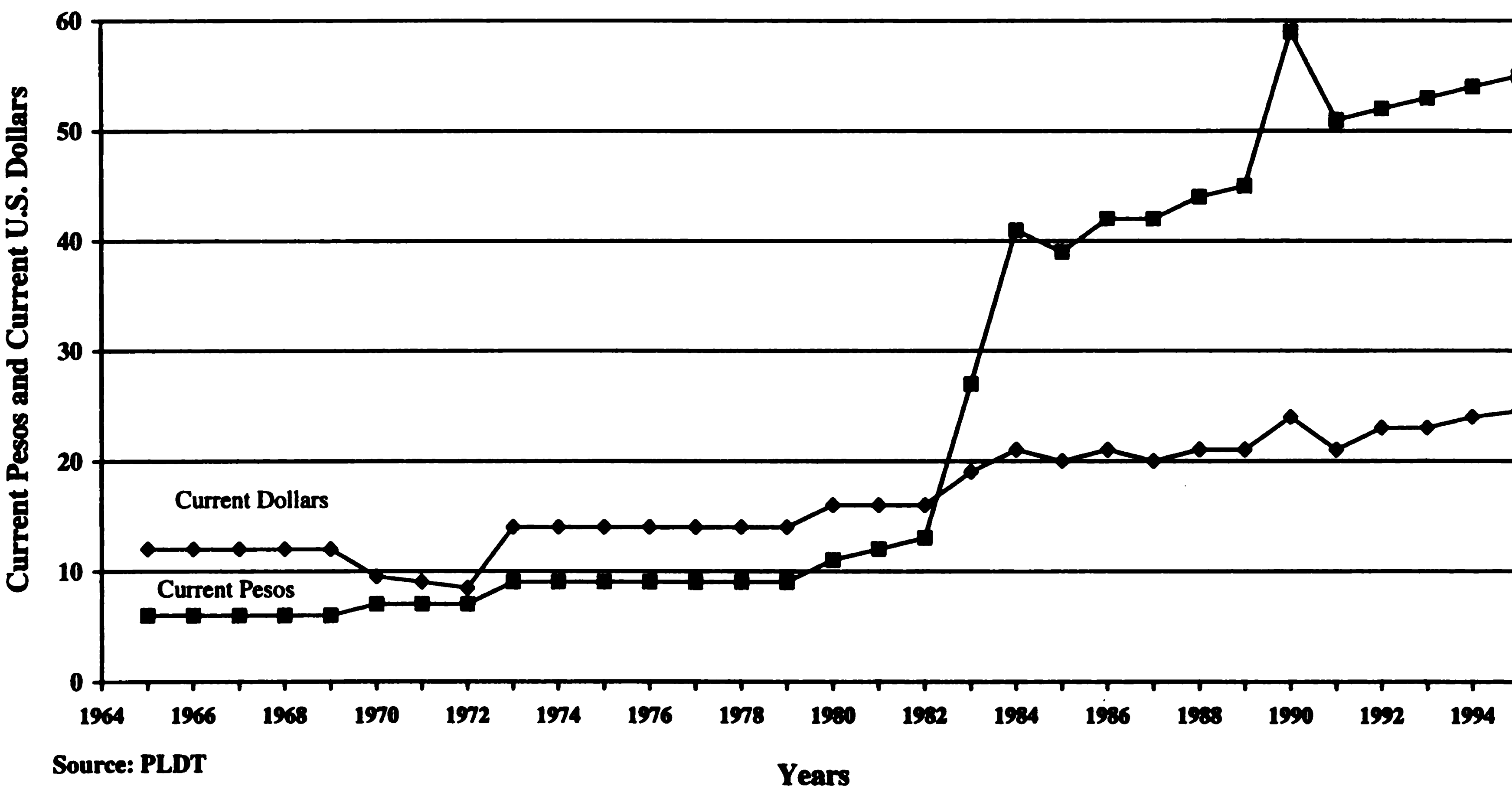

Source: NTC

**FIGURE 12**
**Philippines**
**Local Residential Rates in 1995 Dollars**



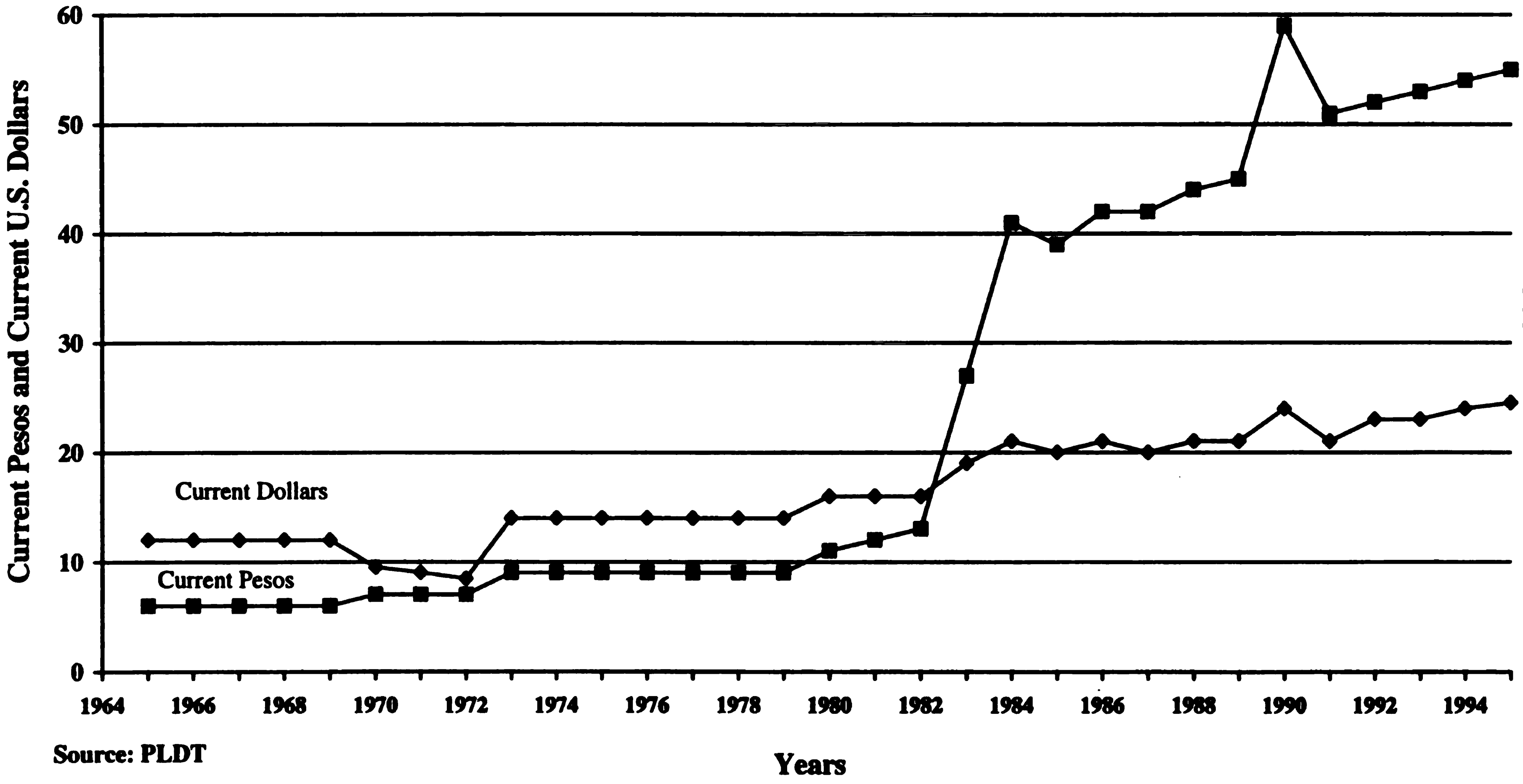

Source: PLDT

**FIGURE 13**
**Philippines**
**Local Business Flat Rates**



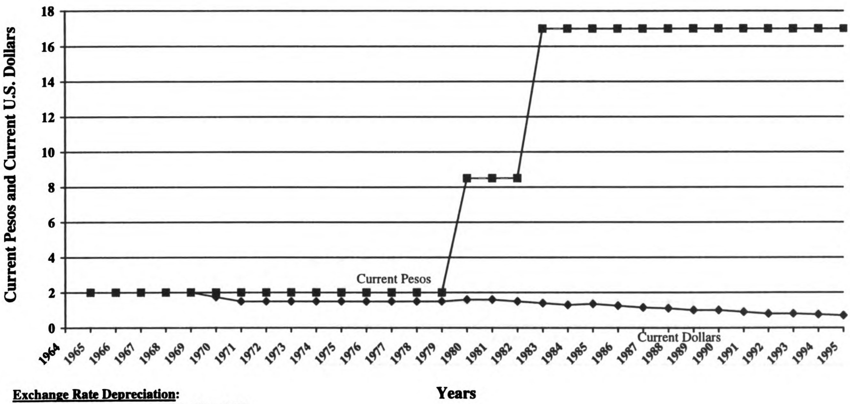

Source: PLDT

**FIGURE 13**
**Philippines**
**Local Business Flat Rates**




Source: PLDT

**FIGURE 14**
**Philippines**
**Domestic Long Distance Rates**
**(Manila to Cebu, Sation-to-Station, Initial 3 Minutes, Day Time)**

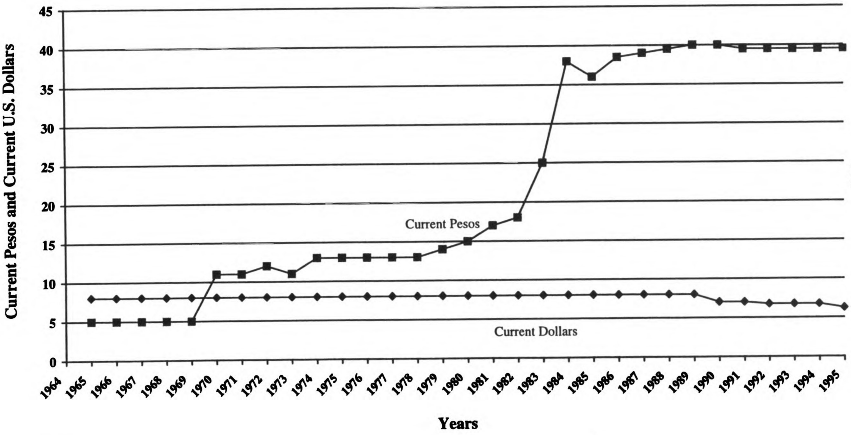



**Exchange Rate Depreciation:**

| | |
|---|---|
| 1965 - 4.00 = 1.00 | 1983 - 20 = 1.00 |
| 1970 - 6.00 = 1.00 | 1986 - 22 = 1.000 |
| 1979 - 10.00 = 1.00 | 1988 - 24 = 1.000 |
| | 1990 - 26 = 1.000 |

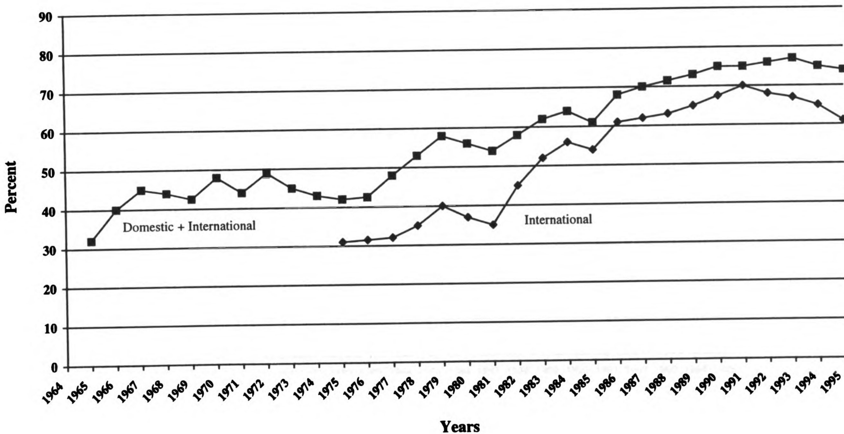
Source: PLDT

**FIGURE 15**
**Phhilippines**
**International Long Distance Rates**
**(Philippines to the U.S., Station-to-Station, Initial 3 Minutes, Day Time)**




Source: PLDT

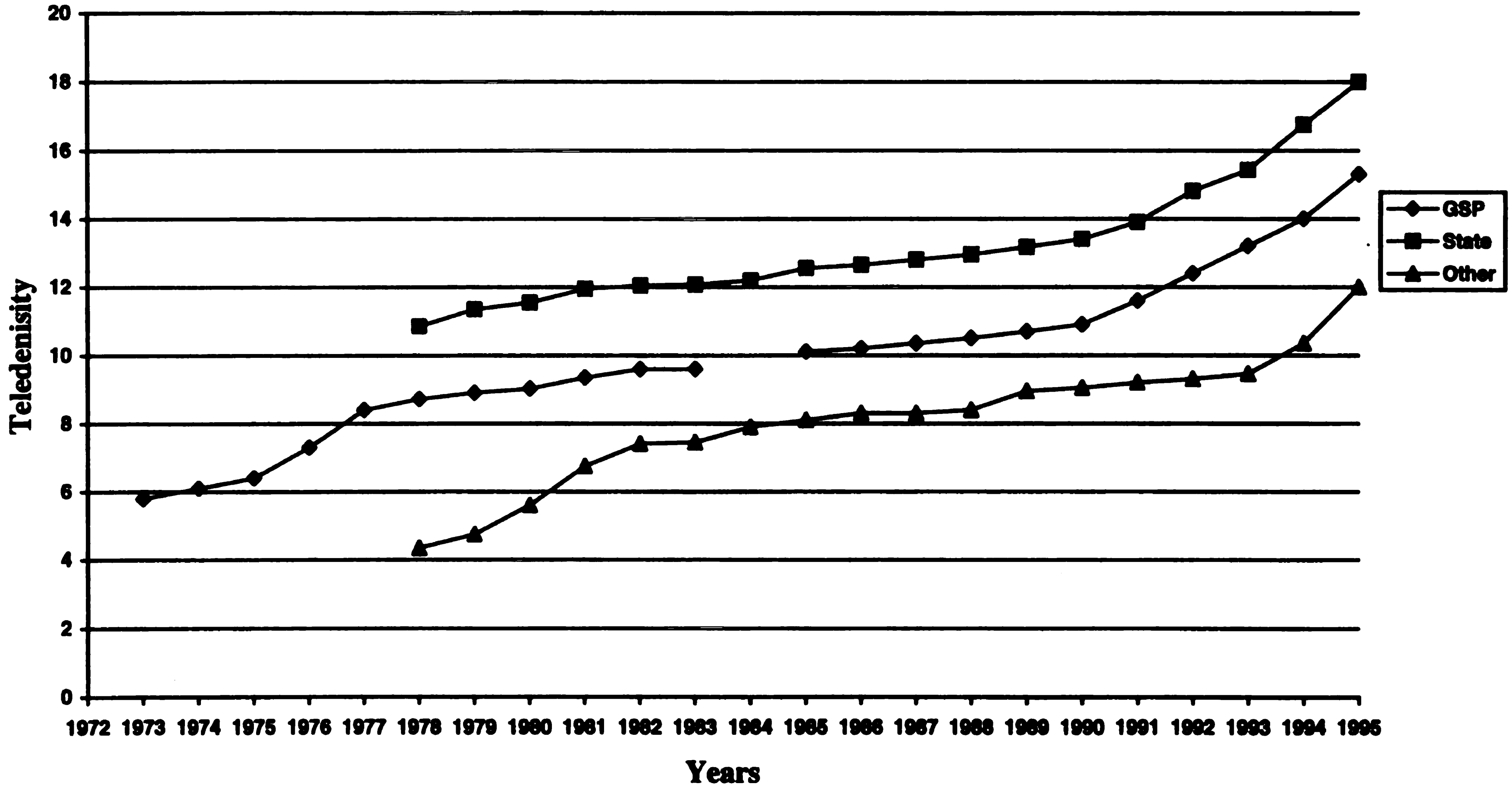
**FIGURE 16**
**Philippines**
**The Share of Long Distance Revenues in Total Operating Revenues**




Source: PLDT Annual Reports

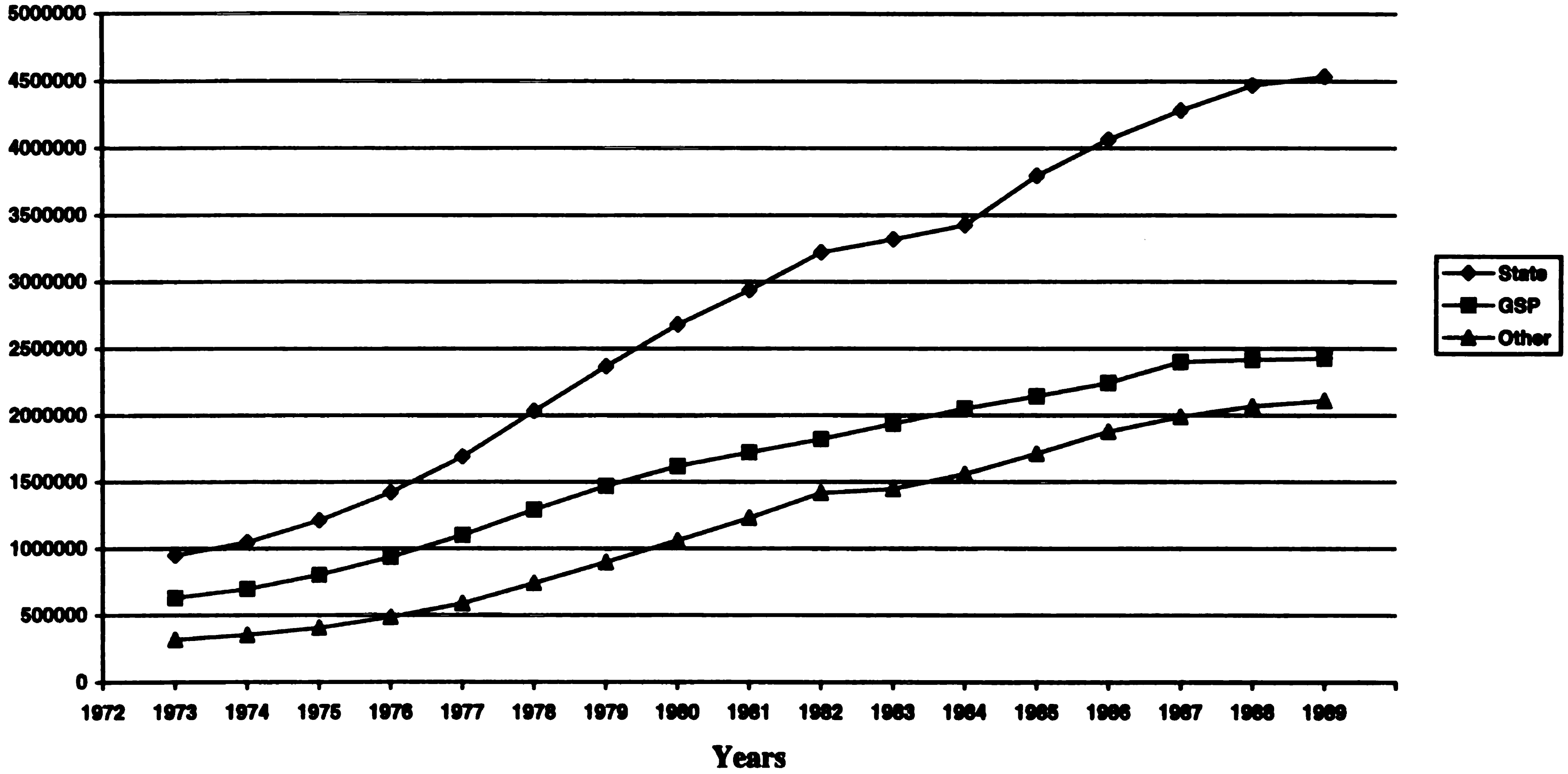
## FIGURE 17

**Teledensity Ratios**
**For Greater Sao Paulo, State and Other**




Source: Telesp Annual Reports

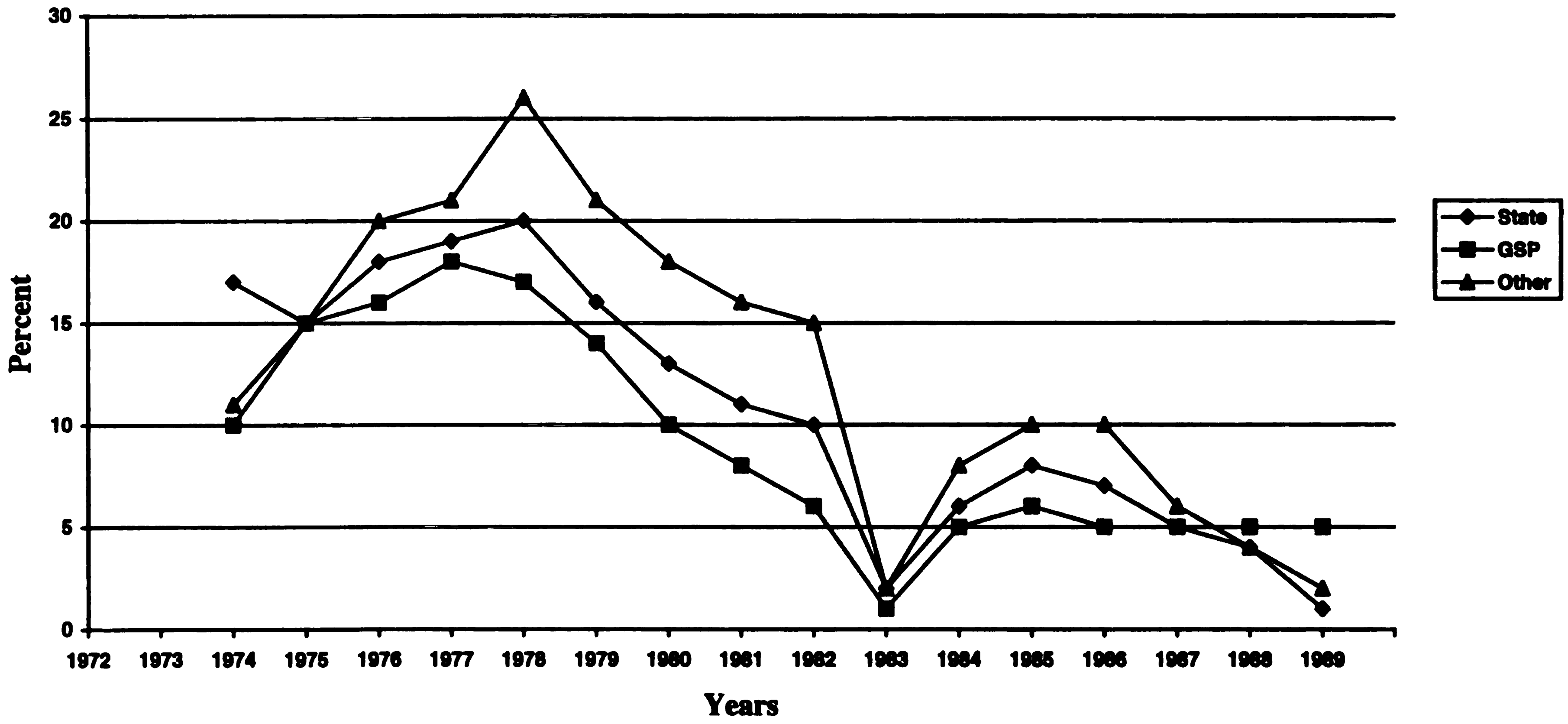
**FIGURE 18**
**Sao Paulo**
**Telephones in Service**




Source: Telesp Annual Reports

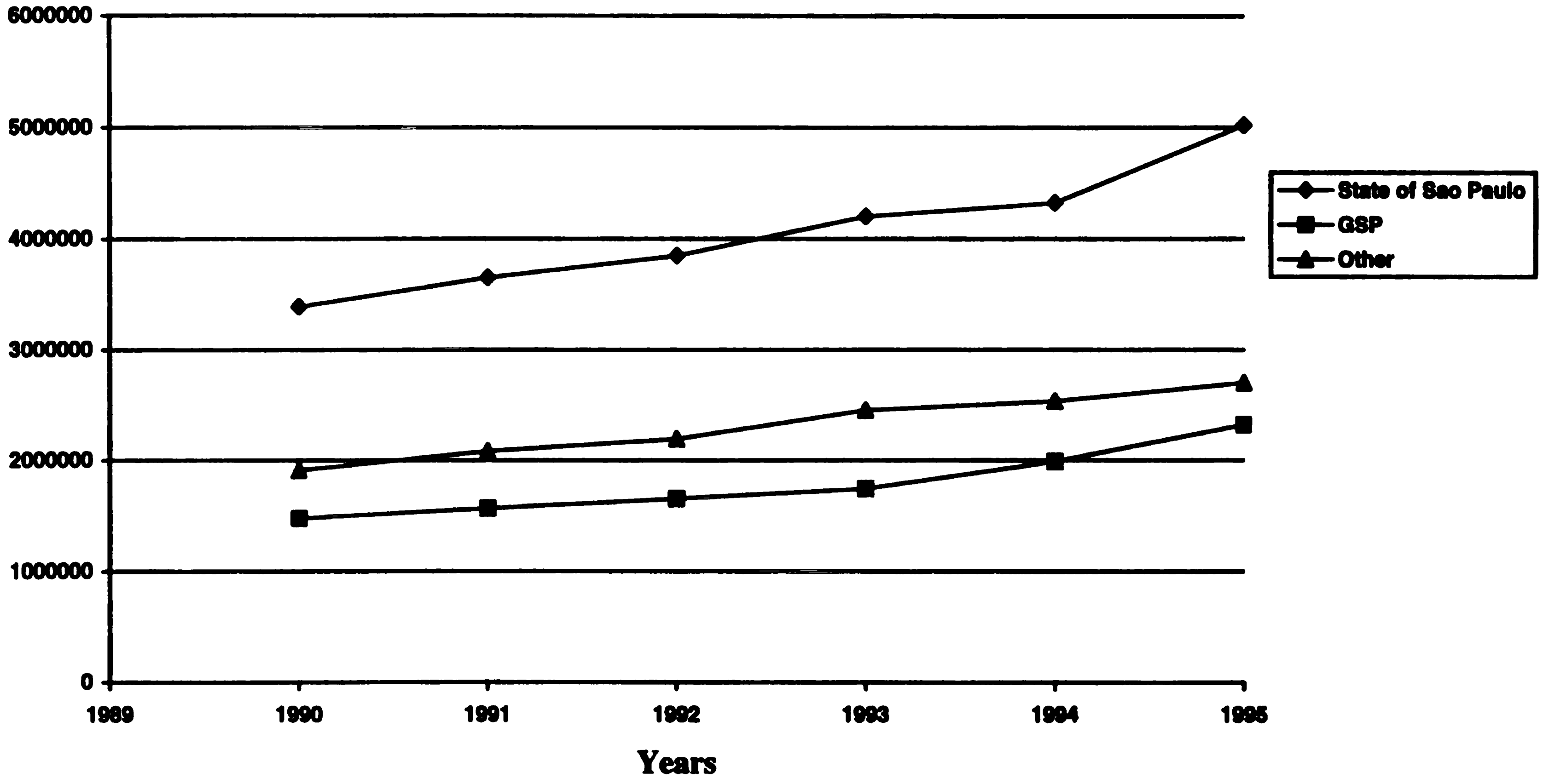
**FIGURE 19**

**Sao Paulo**
**Growth Rate of Telephones**



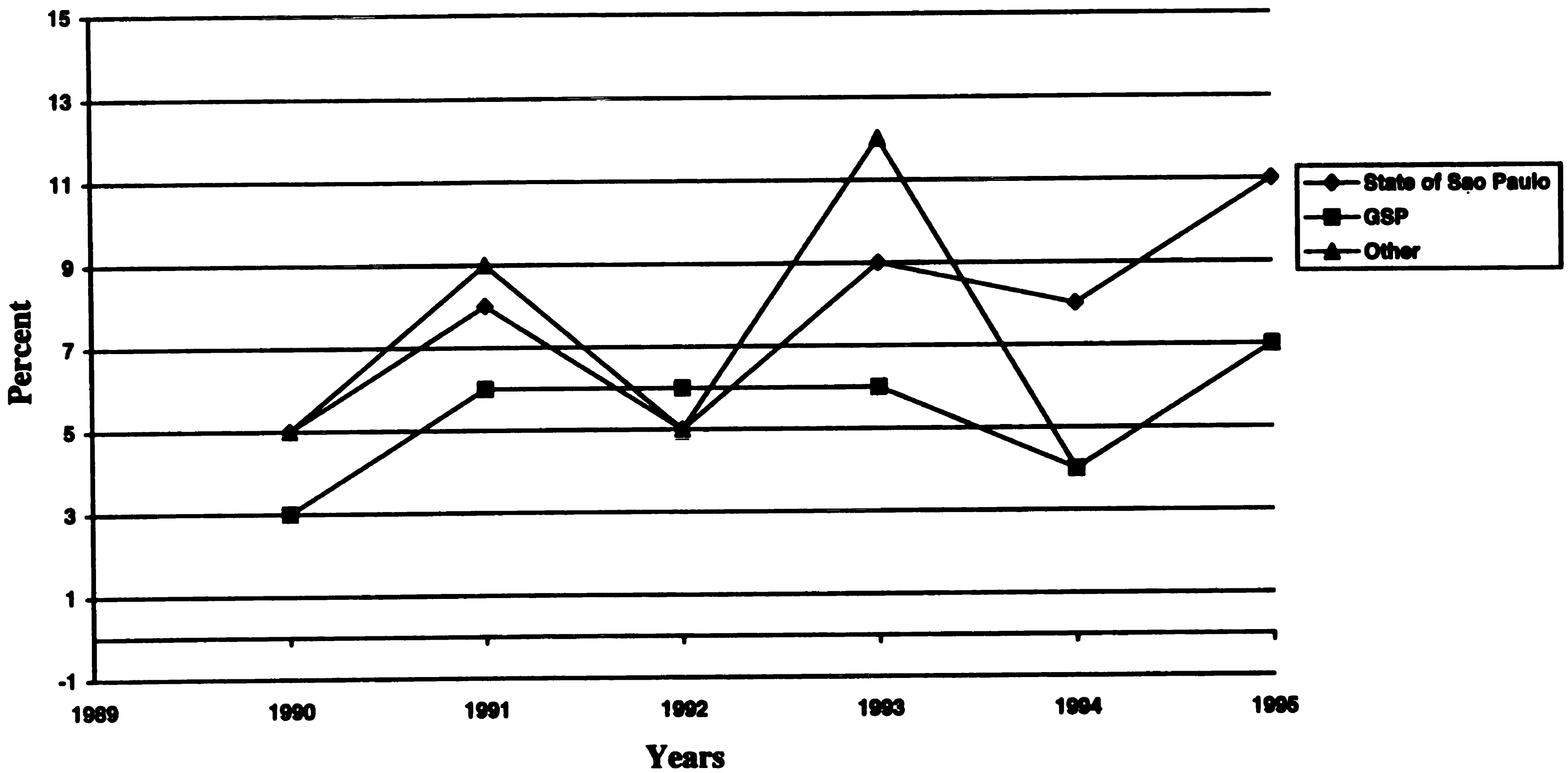

Source: Telesp Annual Reports

**FIGURE 20**
**Sao Paulo**
**Terminals in Service**



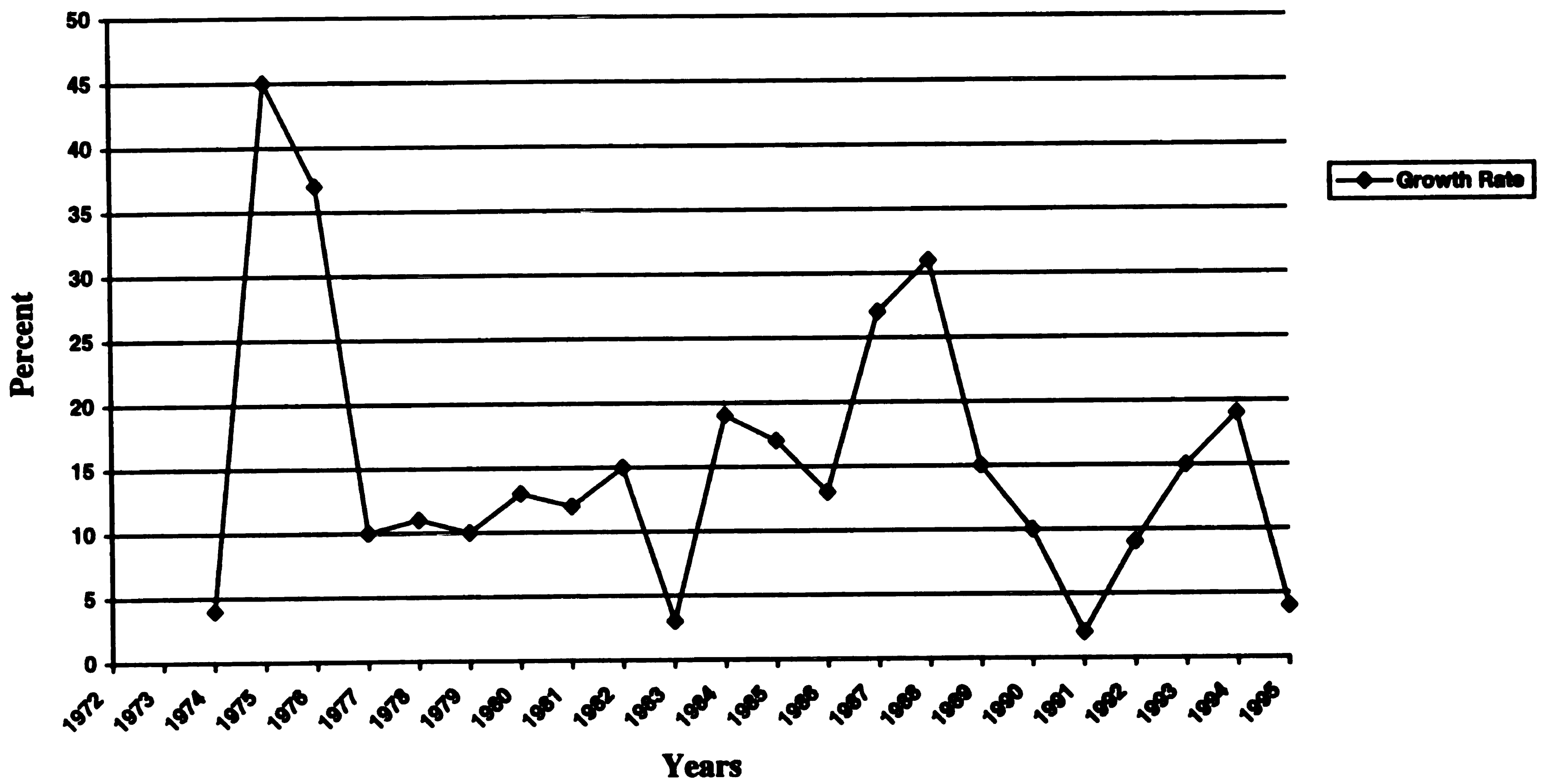

Source: Telesp Annual Reports

**FIGURE 21**
**Sao Paulo**
**Growth Rate of Terminals in Service**




Source: Telesp Annual Reports

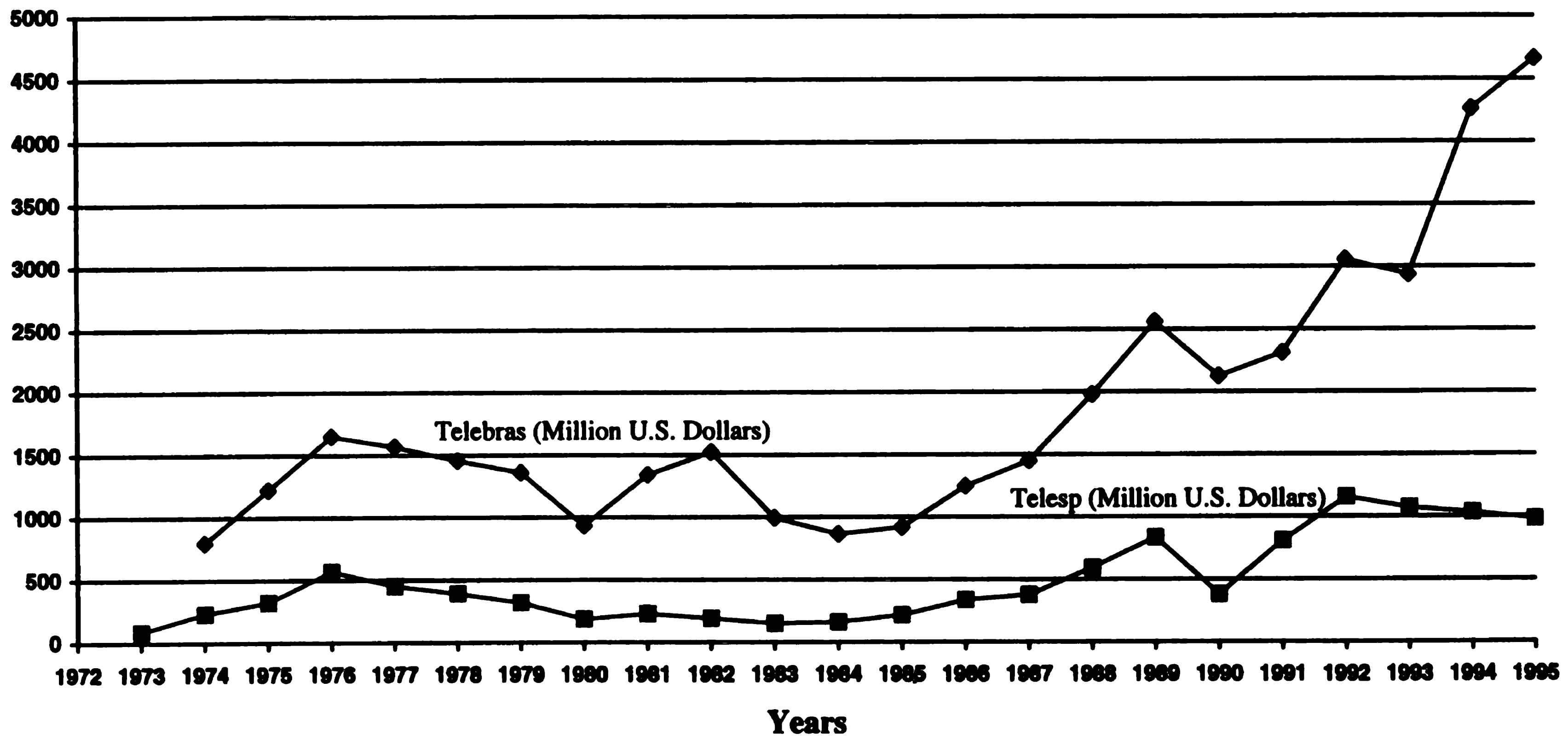
**FIGURE 22**
**Sao Paulo**
**Growth Rate of Public Telephones**




Source: Telesp Annual Reports

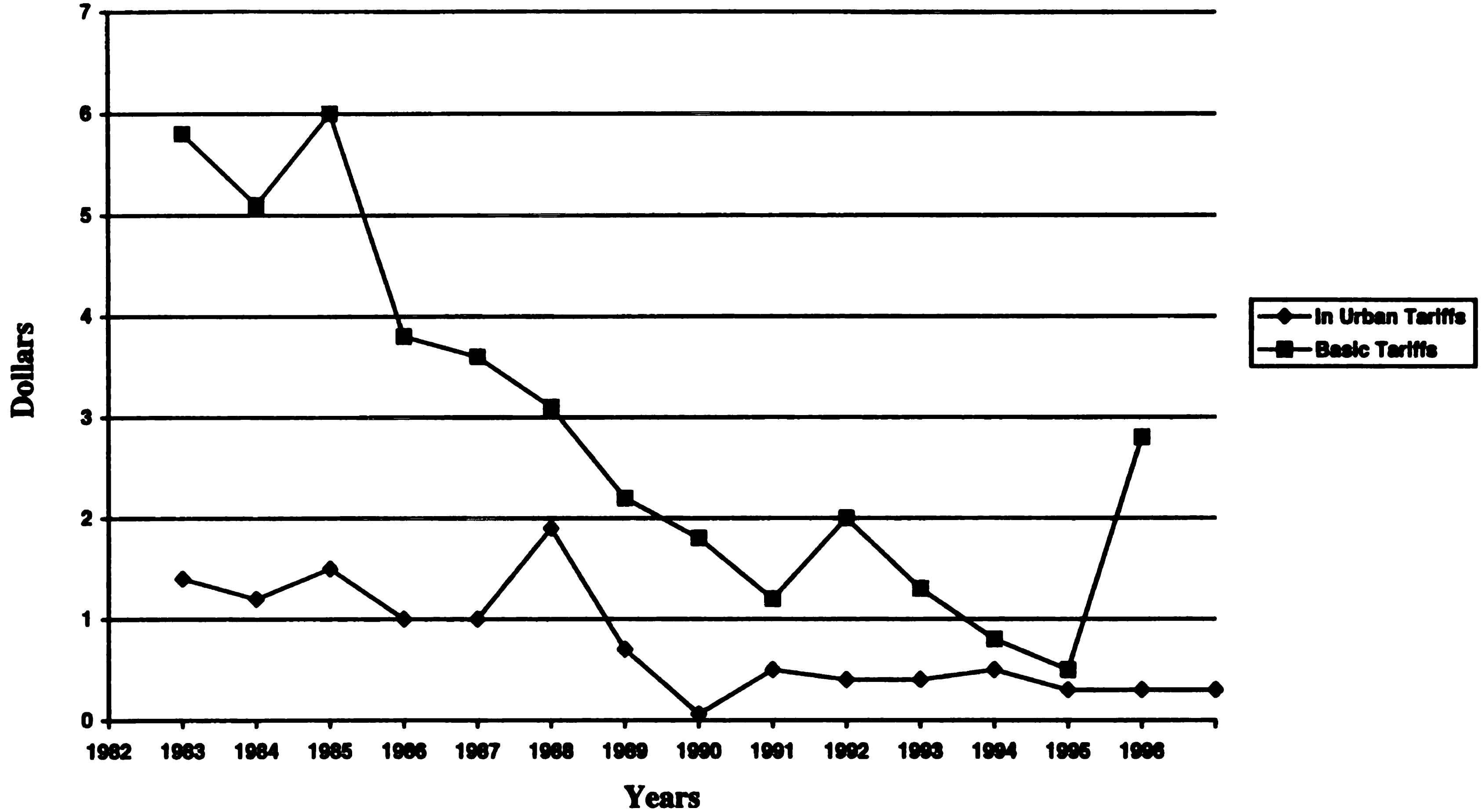
**FIGURE 23**

**Investments by Telesp (Million U.S. Dollars) and Telebras (Million U.S. Dollars)**



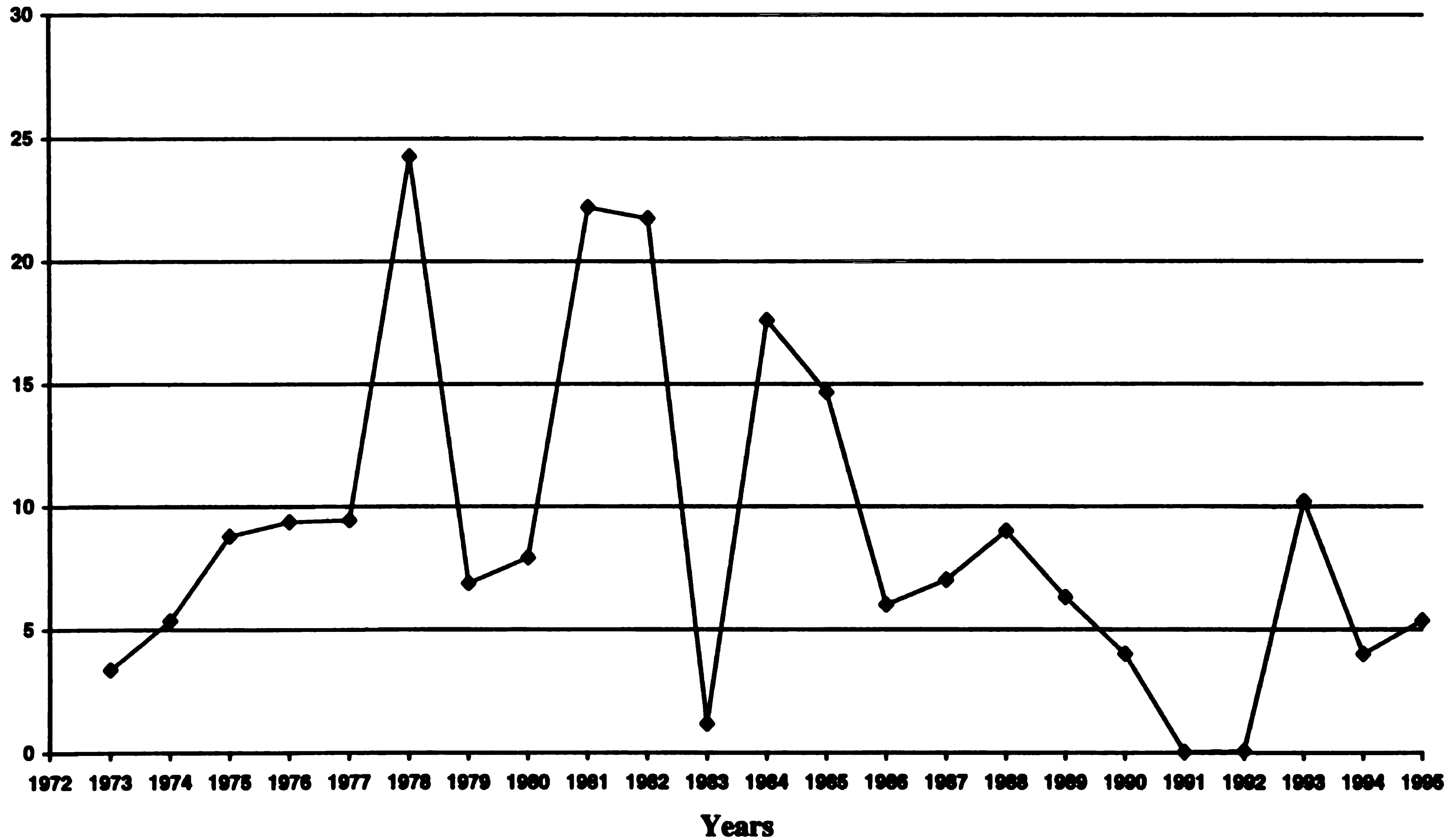

Source: Wohlers 1996, Telesp Annual Reports

FIGURE 24
Sao Paulo
Evolution of Telebras Tariffs: Basic and In Urban



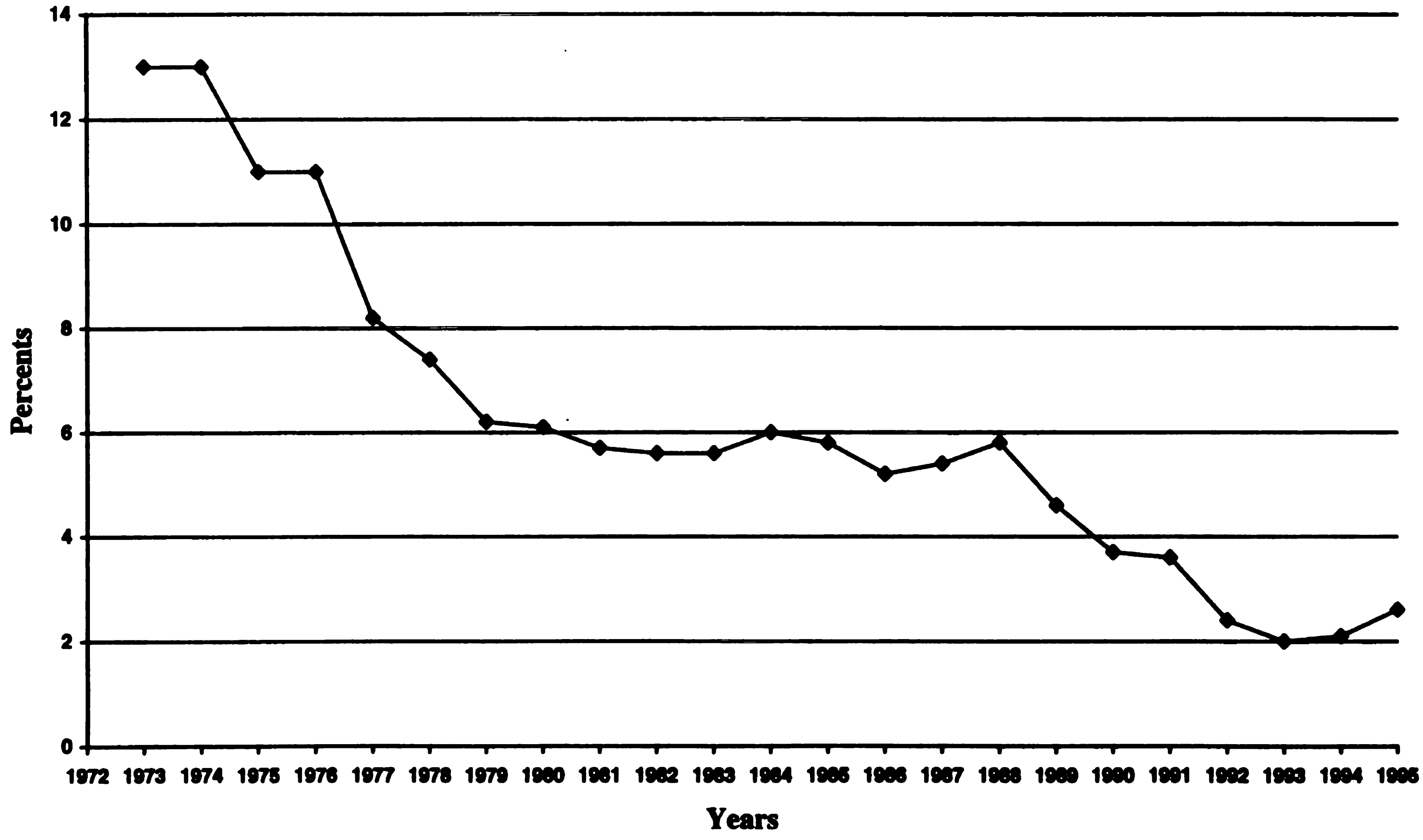

Source: Wohlers, 1995

**FIGURE 25**
**Sao Paulo**
**Rate of Return on Equity**



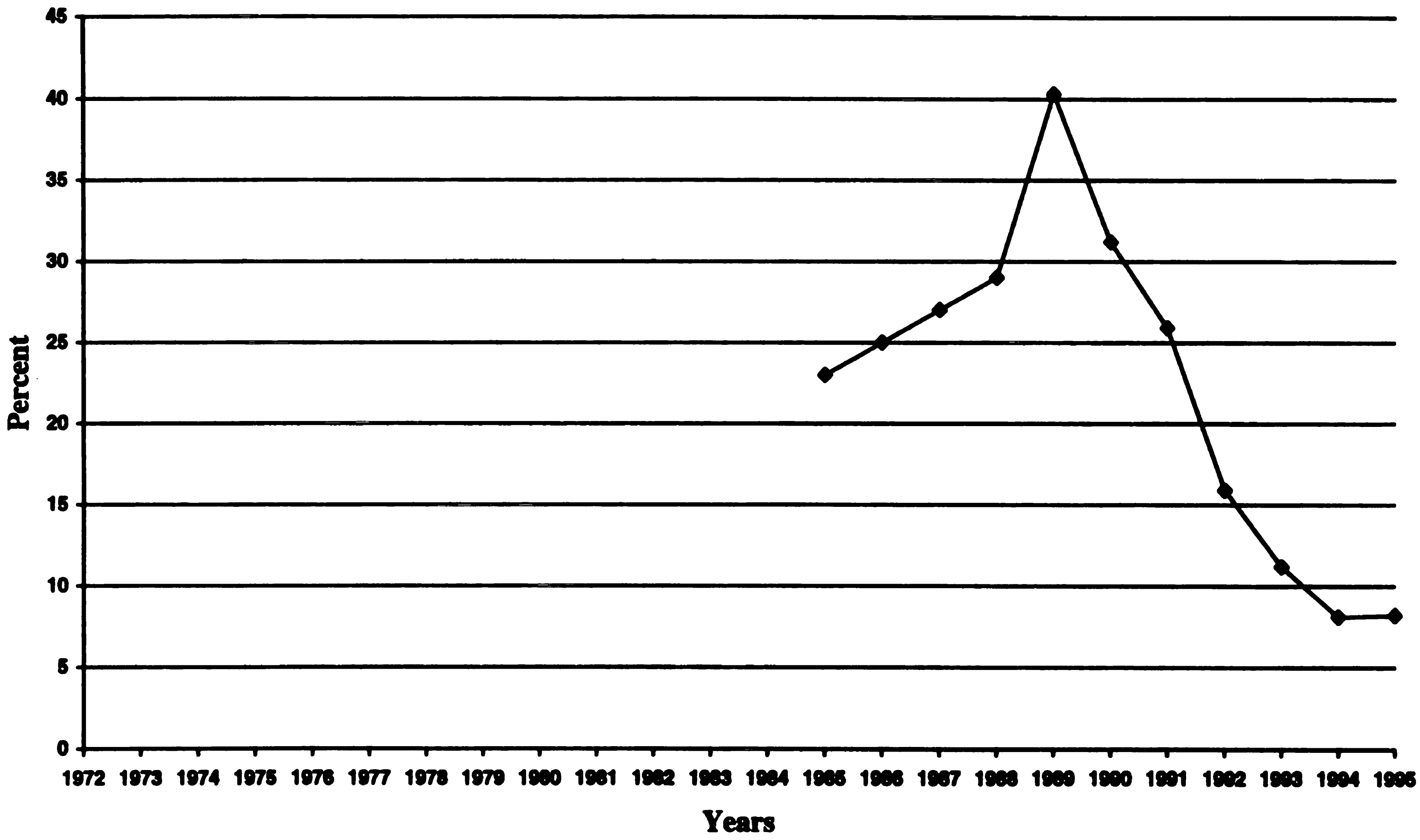

Source: Telesp Annual Reports

**FIGURE 26**
**Sao Paulo**
**Service Requests for Every 100 Telephones**




Source: Telesp Annual Reports

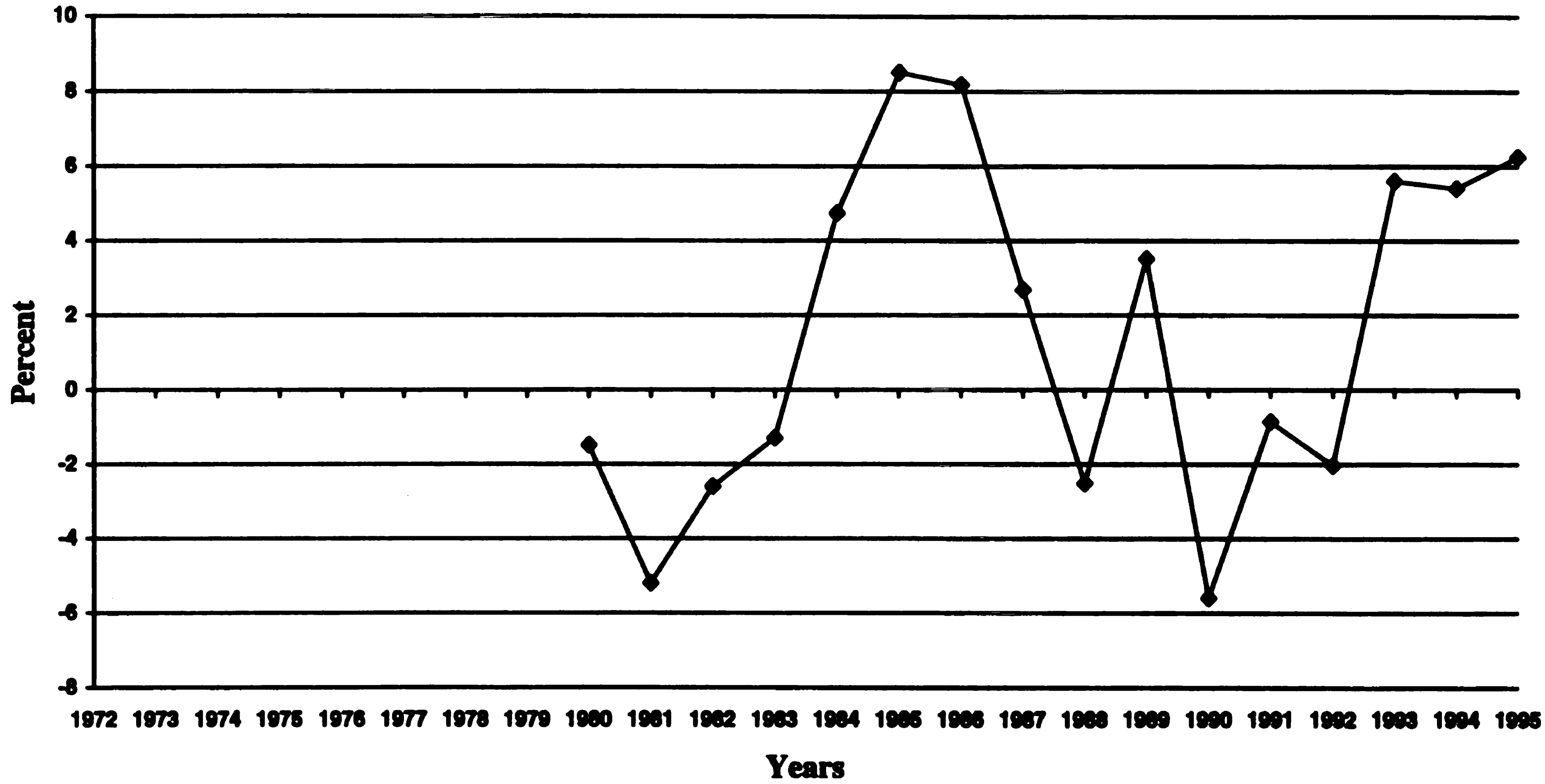
**FIGURE 27**
**Sao Paulo**
**Congestion Rate**




Source: Telesp Annual Reports

FIGURE 28

GDP Growth Rate for State of Sao Paulo

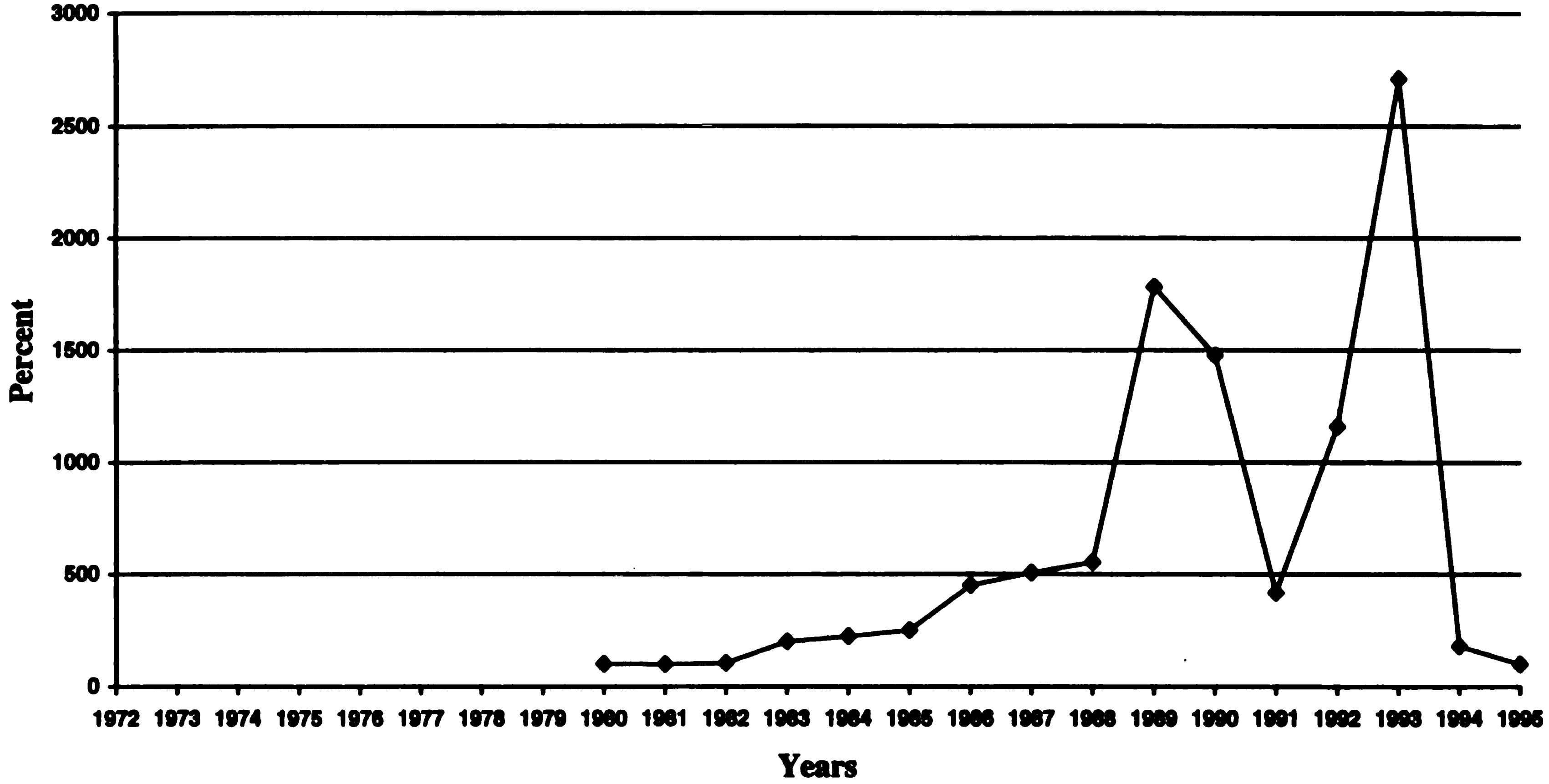



**Average Growth Rate of Real GDP per Capita:**
1980 - 1990 = .81
1990 - 1995 = 2.80

Source: SEADE

**FIGURE 29**

**Inflation Rate for Brazil**




Source: International Financial Statistics