

# Corruption in Interventionist Regulation Schemes - A study on the causes of corruption in the privatized telecommunication sector of Brazil, Germany, Italy and Mexico<sup>1</sup>

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## Abstract

Over the past three decades several western countries have passed through intense privatization processes, leading to regulated private entrepreneurs supplying goods as electricity and post services. In this paper we look into the privatized telecommunication sector of Brazil, Germany, Mexico and Italy to identify which variables influenced the presence of corruption in these interventionist regulation schemes. Using a rational choice approach, we verified that neopatrimonialism, our proxy for weak informal institutions, was a strong causal factor of illegal links between private agents and public authorities, as it reduced the costs of corruption, maximizing benefits for the involved parties.

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## **1 Introduction**

Over the past three decades several western countries have passed through intense privatization processes, leading to regulated private entrepreneurs supplying goods as telecommunications, electricity and post services. In many cases it has led to cheaper prices, extended services, new technologies but also to a low-quality supply and corruption scandals. In the following pages we will address which factors had led to latter, specifically in the sector of telecommunications in Brazil, Germany, Mexico and Italy.

It takes into consideration the ideal types of governance suggested by Knill (2004) to narrow its corpus to the telecommunication sector which was heavily impacted in the selected countries since the privatization of the sector took place in the 1990s. Furthermore, Aidt's (2009) approach will be followed, as he formulated a model to differentiate between free and regulated markets in regards of corruption. In addition to that, the theory of neo-patrimonialism needs to be discussed as it will be part of the hypotheses tested in this paper to answer the given research question.

Taking into consideration this structure, which variables influence the cost of corruption in interventionist regulation schemes? As to test the impact of informal and formal institutional framework in the recently privatized telecommunication sector of Brazil, Germany, Italy and Mexico, we start this paper by assessing the current state of the art in the field of causes of corruption. We proceed by presenting our method, based on a process tracing analysis, and the analysis itself, where we have specific sections for informal institutions, formal institutions and evidences of corruption. Finally, after presenting a summary of findings, we point out at potential research questions and policy solutions to be addressed or evaluated in the future.

## **2 Theoretical Framework**

Aidt (2003) defines corruption as the use of public power for individual interest in a universal, complex and multifaceted approach. The definition itself is broad and presents a challenge to studies in the field, as it requires a deeper look into personal motivations, power relations and institutional frameworks.

Researches approaching the individual level benefit from framework proposed by the rational choice theory, which proposes that an individual makes decisions aiming at predetermined outcomes and utility maximization (De Graaf, 2007). Rose-Ackerman (1978) claims that public officials are corrupt because they know that the benefit of corruption exceeds the potential cost.

In the institutional level, other approaches focus on the environment where the agent is working, discussing cultural and structural organizations and the facilitating factors that may contribute to

this causal chain. As De Graaf (2007) states, in these theories there is a causal path from a certain cultural group leading to a mental state that increases the propensity of corrupt behaviors.

In the macro level, there are some studies that concern the culture within public management and society. The focus is to study political and economic structures, observing the public sector reforms under the influence of the New Public Management (NPM), which negatively affected society's structure, leading to higher levels of corruption (De Graaf, 2007). Heywood (1997) refers to it as a "structural approach" to political corruption, in which the key variables are the administrative organization and its efficiency. Doig and Wilson (1997) follow the same argument, affirming that New Public Management, deregulation and privatization may create corrupted structures.

These approaches on the causes of corruption may overlap each other. Taking it into account we advance this discussion in the present paper focusing on New Public Management reforms, what we call interventionist regulation. We are look into formal institutions, as the regulatory framework of privatized telecommunication sectors, and informal institutional frameworks, restricting ourselves to the evidences of a neopatrimonial culture. This way, we aim at perceiving the weight of each of them as the causes of corruption in selected countries.

Knill (2004) delimits the understanding of interventionist regulation in the scope of governance. First, he defines governance as the relations between the market, society and the State. Even though he refers to narrower definitions (cf. Kooiman 1993; cf. Rhodes 1997), he prefers a broader approach, proposing four ideal types of the interaction between those actors. As shown in the table below, they are interventionist regulation, private self-regulation, regulated self-regulation and co-regulation.

**Table 1. Knill's ideal types of governance**

Table 1. Four ideal types of governance.

		Cooperation of public and private actors	
		Low	High
Degree of legal obligation	High	Interventionist regulation	Regulated self-regulation
	Low	Private self-regulation	Co-regulation

**Source: Knill (2004, p. 357).**

As seen in the table, he determines one of the ideal types of governance as Interventionist regulation where he sees a high degree of legal obligation combined with a low cooperation of public and private actors (cf. Knill 2004). As for the working definition of governance within this paper, the concept of interventionist regulation will be the one applied. In this approach, the

obligation for the supplying of public goods is within the hands of government but exercised by the private sector following a process of privatization reform as the ones in most of Europe and the Americas during the 1980s and 1990s. Due to these changes, the state does not supply public goods directly but enables the market to do so. This process, even though it seems paradoxically, strengthens the hierarchical location of the state (cf. Knill 2004). The state is able to intervene *from above* into public and private sectors by enacting requirements, which are legally binding, as this type of governance, as mentioned above, is characterized by a high degree of legal obligation.

Aiming at examining the incidence of corruption in this form of governance, we follow with Aidt's (2009) rational choice approach. He formulates a model to differentiate free and regulated markets in regards of corruption. Based on the microeconomic assumption of Pareto optimality, in free market economic profit tends not to exist, as sectors where profit exists attract newcomers who will bring prices and profits down with increased supply and stagnated demand. The same is not true for regulated markets, where the government is capable of setting licensing schemes restricting the entry of new players. In these markets, economic profit continuously exists, once the government does not allow increases in supply even when an optimal equilibrium was not reached. In these cases, the difference between the profit in a free market and in a regulated market function as a market premium, which is equivalent to the amount of money the newcomer would be willing to spend to join the market.

Aidt (2009) raises some alternatives that could settle the issue, eliminating the risk of a market premium, such as allocating permits randomly. Nonetheless, as he explains, it would generate inefficiencies as untalented entrepreneurs could be granted a market entry. Whereas Aidt's approach is rather pessimistic about regulated sectors, we prefer to suggest an addition to his theoretical assumption.

Considering the institutional design of this given sector or the government as a role, we suggest that when the cost of corruption is higher than the market premium that would be dedicated to corruption, firms are discouraged to behave illegally.

Thus, it is a complex matter to calculate the costs of corruption and the market premium in a given sector. On the other hand, it is possible to suggest some scenarios where the costs of corruption and market premium relationship would be more easily found, such as countries with an informal institutional framework with strong patrimonial bonds and/or weakly designed regulatory schemes. Therefore, we will concentrate on those.

The notion of patrimonialism was introduced by Weber (2008, p. 157), who claimed that legitimacy of rule could be justified by three ideal types of power, namely (a) the traditional rule, explained by

“time immemorial and by habitual observation”, (b) charismatic authority, related to heroism or leadership qualities, and (c) legality, following a rationally created legal statute.

“The administrative staff, which outwardly represents the system of political rule, as well as any other system, is not, naturally, bound to obedience to the holder of power through the idea of legitimacy which has just been mentioned. It is also bound by two means that appeal to personal interest: material reward and social honor. Fiefdoms for vassals, sinecures for patrimonial officials, salaries for modern civil servants, knightly honor, the privileges of the estates, and the honor of the official - these constitute the rewards. The fear of losing them is the final decisive basis for the solidarity of the administrative staff with the holder of power” (Weber 2008, pp. 158-159).

Following this argument, the people, or selected groups of it, are bound to the leader also due to their personal interest, related in some cases to material reward. It was one the reasons why Max Weber advocated for strong bureaucracies where public servants would have their job stability bounded to a strict legal statute, releasing them from the dependency of a leader and allowing a transition from the traditional rule to an impersonal bureaucratic model.

This advocated model also relates to our second variable, the formal institutional framework. In this sense, the hypothesis that strong regulatory frameworks are a potential method for increasing corruption costs and eliminating incentives for its existence also derives from Max Weber. As previously argued, New Public Management reforms created structures that might be corrupted. Nonetheless, it might occur that it is sophisticated enough to inhibit illegal behaviors.

### **3 Methods**

In the following pages we will test our theory by looking through the liberalization reforms in the telecommunication sector of four countries with distinct backgrounds. Our selection included the two largest economies of Latin America, Brazil and Mexico, and two of the largest economies in Western Europe, Italy and Germany. We will test if the influence exercised by neo-patrimonialism and reformed but weak regulations led to an interventionist regulation with evidences of corruption.

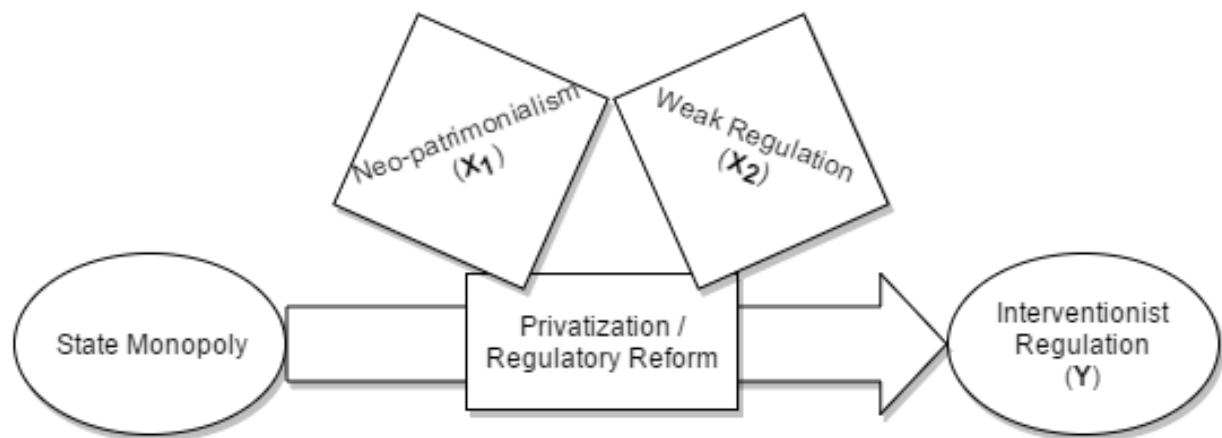
We follow the guidelines proposed by Beach and Pedersen (2013), who affirm that

“In theory-testing process-tracing, a causal mechanism is hypothesized to be present in a population of cases of a phenomenon. The researcher selects a single case where both X and Y are present, and the context allows the mechanism to operate. Here the goal is to evaluate whether evidence shows that the hypothesized causal mechanism linking X and Y was present and that it functioned as theorized. The ambition is to go beyond correlations and associations between X and Y, opening up the black box of causality to study more directly the causal mechanism whereby X contributes to producing Y” (Beach and Pedersen 2013, p. 11).

Our dependent variable Y is the interventionist regulation or, in this case, the privatized but regulated telecommunication sector which might have evidences of corruption or not. Our

independent variables X are the presence of neo-patrimonialism ( $X_1$ ) and the presence of a weak regulatory framework ( $X_2$ ).

**Figure 1. Process-tracing considering neo-patrimonialism ( $X_1$ ), weak regulation ( $X_2$ ) and interventionist regulation (Y)**



**Source: designed by the authors.**

Specific tests are performed to identify the presence or absence of neo-patrimonialism and weak regulation. For the first, we review the literature of the specific country and present descriptive statistics including the Transparency International's Corruption Perception Index and Global Corruption Barometer, and the World Bank's Enterprise Survey. For the latter, we examine the privatization process and the current legal framework of the sector in each country looking for the powers of the regulatory agency and its political and economic independence.

In order to answer the given research question with process tracing, we will look at three different variables in each country, given in table 3. *Neo-patrimonialism* ( $X_1$ ) will be tested by the political and financial independence of the agencies and *Weak Regulation* ( $X_2$ ) by the legislation on regulation.

**Table 3. Variables tested for Brazil, Germany, Italy and Mexico.**

Country	Legislation on Regulation	Politically Independent Agency	Financially Independent Agency
Brazil	yes/no	yes/no	yes/no
Germany	yes/no	yes/no	yes/no
Italy	yes/no	yes/no	yes/no
Mexico	yes/no	yes/no	yes/no

**Source: designed by the authors.**

Firstly, the *Legislation on Regulation* which is defined by the fact, that the agency in charge cannot create regulations, but only enforces them. Secondly, we will look at the *Politically Independence of the*

*Agency*. This is determined by whether politicians are acting as directors and if the president is appointed or approved by politicians. We assume that if the director of the agency is only approved by politicians but appointed due to career's merit, the agency is politically independent. Lastly, the fact whether *the Agency is financially independent* or not will be considered. If the agency receives only money from the government (e.g. from taxes) we assume that it is financially independent. If the agency receives money from private actors and do not have a fixed sum of money but a variable one, we assume it as financially dependent.

## 4 Case Analysis

### 4.1 Informal Institutional Framework

#### 4.1.1 Brazil

Patrimonial bonds between political leaders and the economic elite were identified by Marques and Svoboda (2016), Bresser-Pereira (1998) and Pinho (1998), among others, as the root of corruption throughout history in Brazil. One of the recent scandals regards the ruling party, Partido dos Trabalhadores (PT), and Petrobras, the country's State-owned oiling company.

“The PT and its coalition partners appointed their own candidates to Petrobras' most important executive positions. These figures, led by Paulo Roberto Costa, a former director, secretly diverted funds valued at up to 3 per cent of all contracts to the PT and its coalition partners. This amounted to billions of dollars because of the huge investment in the pre-salt and an accompanying refinery program” (Leahy 2016).

Bresser-Pereira (1998) argues that the patrimonial culture is impregnated in the country's public sector, even if after several trials pursued by different governments to promote a transition from this old mode of governing to impersonal technocratic bureaucracies. Among them are, for instance, the reforms enacted in the 1960s, when a specific ministry was created to modernize the public administration. Whereas it adopted innovative measures such as the decentralization of different processes, budgetary planning and results' control, old traces of patrimonialism remained in the public sector, such as the hiring of new civil servants without a clear selective process and the nomination of politically influential figures for top-management positions.

Bresser-Pereira himself had the opportunity to change this situation as in the 1990s he was nominated minister of a newly-created ministry dedicated to reforming the State. His measures were dedicated to implementing in Brazil the New Public Management model, inspired by Margaret Thatcher and Ronald Reagan. Although modern mechanisms were created, the remaining patrimonial culture in the public sector, merged with the need of building strong coalitions with a large number of parties and political figures, undermined his efforts, creating new forms of neo-patrimonialism (Pinho 1998).

This literature review is supported by data from Transparency International. According to their most recent surveys, Brazil is the 76<sup>th</sup> least corrupt country in the world and its population perceived as the most corrupt institutions in the country political parties (81%) and the legislative (72%) (Transparency International 2016b; 2016c).

#### *4.1.2 Germany*

There are few cases of corruption for Germany evidenced by media vehicles and the academic literature. One of the most prominent regards the former Prime Minister Helmut Kohl who publicly admitted in 1999 to have control over large sums of party money, including over 2 million German Marks (around US\$ 1 million at the time) from undisclosed donors (Maras 2010). Nonetheless, cases as such are not commonly found in the literature, where the country is usually portrayed as a model of transparent governance.

According to Wollmann (1997), its institutional framework was built through an incremental process that included initial modernization reforms in the 1960s and 1970s when the social democratic government combined a Neo-Keynesian economic regime with pragmatic welfare policies. It was followed in the 1970s and 1980s by an alignment with the neo-conservatism of Margaret Thatcher and Ronald Reagan whose main factors were “budgetary entrenchment, cost-reduction and more cost-efficiency” (ibid., p. 79). In the 1990s, these policies were intensified through the New Public Management scheme, including additional cuts and pro-efficiency reforms linked to the general guidelines of the European Union.

Whereas the population perceive the existence of corruption especially among political parties (65%) and private businesses (61%) (Transparency International 2016b), the country’s general index is rather positive, positioning Germany as the 10<sup>th</sup> least corrupt country in the world (Transparency International 2016c).

#### *4.1.3 Italy*

In the early 1990s in Italy, the government started a large initiative to eliminate the mafia's domination over the country's political and social structures, many times involved in public procurement and other typically patrimonial spheres. The economic losses were enormous and represented a large parcel of the country's economy.

“In 1992, the well-known economist, Marco Deaglio appraised that the costs of the “Tangentopoli” system (that is, the so-called “Bribesville”) amounted to around 10,000 billion lire (about to 5.2 billion euro), engendered between 150,000 and 250,000 billion of lire of public debt (between 77.5 billion and 129 billion euro) and resulted in interest on related government bonds (debentures) amounting to 15–25 billion euro. The affair also involved several arrests and sparked the investigation of a range of different actors – from leading figures of the main Socialist, Christian Democratic and Communist political parties



(e.g. Bettino Craxi, leader of the Socialist party) to entrepreneurs and civil servants. Such functionaries were accused of crimes such as extortion, corruption, criminal conspiracy, association with organized crime and the receipt of stolen goods” (Sargiacomo 2015, p. 90).

Whereas new federal reforms have been continuously implemented since then, levels of corruption in Italy continue relatively high when compared to other Western European nations, as it figures as the 61<sup>st</sup> least corrupt country in the world (Transparency International 2016c), with high perception of it especially among political parties (89%) and the legislative (77%) (Transparency International 2016b). According to the European Commission (2014, p. 14), “a new wave of political corruption cases has emerged, involving a number of top regional elected officials and revealing illegal financing of electoral campaigns and political parties, as well as ties with mafia groups”.

Nonetheless, neo-patrimonialism is also found in higher administration levels, such as in the figure of the former Prime Minister Silvio Berlusconi. Barisione (2013) argues that *Berlusconismo*, a political phenomenon, was composed by clear neo-patrimonial features, such as politically benefiting from public licensed media vehicles, the transfer of property ownership (but not real control) to relatives and close collaborators in order to avoid legal restrictions and punishments, and the creation of a political party where all the directive positions were controlled by a kind of 'personal apparatus' of its main leader, Silvio Berlusconi.

#### 4.1.4 Mexico

There is vast evidence in the literature to point out to a culture of neo-patrimonial bonds and corrupt behavior in Mexico. Leaving aside colonial structures and the political disputes taking place in the early XX century, Mexico's recent history evidence a political domination unseen in most democracies: its ruling party, the *Partido Revolucionario Institucional* (PRI) has been in power for around seven decades. In this period, different economic and political regimes were adopted, but one of the major problems faced by most of them in the recent decades was the influence of the narco-guerrilla over the government (Lupsha 1991).

“One typical example is that of Jesus 'Chuy' Murillo. He had been an associate of old-time Sinaloa, Culiacan, plaza holder Pedr Aviles Perez. But by 1979, he had aligned himself loosely with the better connected patronage of ex-Sinaloa state policeman, Miguel Angel Felix Gallardo. That year, he moved to Ciudad Obregon Sonora, where he acquired property and businesses in the valley of the Yaqui. These agricultural and ranching interests even included an aerial crop-dusting firm, at times leased to spray marijuana and poppy fields. To manage these holdings he hired a local but politically well-connected attorney and the local leader of the PRI, Sostenes Valenzuela Miller of Cajeme” (Lupsha 1991, p. 46).

Whereas drug dealers started being weakened especially after the joint efforts of the Mexican and the American government, patrimonial bonds were not eliminated (Lupsha 1991). They take

place, for instance, as forms of subnational undemocratic regimes, or the neo-patrimonialism stimulated by strong bonds and dominances of political and economic elites in certain cities and regions, for instance Oaxaca and Puebla (Hermann 2010; Giraudy 2013).

These arguments are also confirmed by the surveys from the Transparency International. While the country ranks as the 95<sup>th</sup> least corrupt in the world (Transparency International 2016c), its population identifies high levels of corruption in a greater variety of institutions when compared to the other analyzed countries: political parties (91%), the police (90%), public officials and civil servants (87%), the legislative (83%) and the judiciary (80%) (Transparency International 2016b).

#### *4.1.5 Additional Data and Summary of Findings*

Data from the World Bank (2016) and the Transparency International (2016b; 2016c) evidence a large gap separating Germany and the three other countries. The Corruption Perception Index, for instance, presents fairly similar scores for Brazil, Italy and Mexico, which are, in most cases, half of the one achieved by Germany. Similar results are present in the population's perception of corruption on the legislature and among political parties. These statistics confirm the presence of a political culture impregnated with corruption in three out of the four analyzed countries, as also evidenced by the literature review on neo-patrimonialism.

### **4.2 Formal Institutional framework**

#### *4.2.1 Brazil*

In the 1990s the liberalization process inspired by the already mentioned New Public Management reforms of Margaret Thatcher and Ronald Reagan was a global shift from State-owned enterprises to private investors (Megginson et al. 1994). In Brazil these policies were pursued during the governments of Fernando Collor de Mello, Itamar Franco and Fernando Henrique Cardoso, who engaged into several reforms including the privatization of strategic sectors, as the telecommunications one, and the creation of regulatory agencies to supervise their new private actors (Castro 2011; Giambiagi 2011).

The telecommunications sector was controlled by *Telebras*, a State-owned national holding with regional subsidiaries distributed all over the country. The privatization process was initiated in 1995, breaking the State monopoly, and finalized in 1997 when *Telebras'* capital was divided through its subsidiaries into four regional blocks and three sub-sectors (local fixed-lines, long-distance calls and mobile), sold to private operators and a regulatory body, the *Agência Nacional de Telecomunicações* (ANATEL), was established (Lins 2010).

The Law 9.472 of 1997 was enacted to regulate this market – General Telecommunications Law, whose provision verses that the telecommunication service can be transferred from the public to the private sector through concessions, authorizations or permissions and also the creation of the regulatory body.

One the main characteristic of the telecommunications sector is the direct or indirect presence of the federal administration, especially in ANATEL which is an autarchy of the Ministry of Communications. The regulatory body is responsible for regulating and implementing telecommunication policy, monitoring actions and revising tariffs of the rendering services, managing its fund (*Fundo de Fiscalização das Telecomunicações* - FISTEL) and enforcing the legislation (Art. 8, law no. 9.472/1997).

ANATEL has different bodies responsible for its administration: the board of directors, an advisory council, an internal controller, a prosecutor, an ombudsman, and other specialized units responsible for different functions (Art. 8, §1, law n. 9.472/1997).

The most important body is the board of directors, which consists of five directors, which takes decision by absolute majority (Art. 20, law n 9.472/1997). The decisions of ANATEL's administration are concentrated on the hands of these directors, especially the ones regarding regulations (Art. 22, law n. 9.472/1997). Moreover, the composition of ANATEL is not politically independent, because the President appoints these directors and the Senate approves them (Art. 23, law n. 9.472/1997).

The before-mentioned FISTE, which is administered by ANATEL (law n. 5.070, 1966), is the budget that comes from the public sector (federal budget, special credits, income from financial operation) and the private companies (tax, payments for the authorization services, fines, indemnities, donations and any other income) (Arts. 2, 3, 6 and 13, law no. 5.070/1966).

This legal framework still effective until today and regulates the operation of nine players, while only four are licensed to work in all the regions previously controlled by *Telebras* (LCA Consultores 2011). While they are registered in Brazil, most of them are controlled or have part of their shares bought by foreign players. It is the case of *TIM*, a subsidiary of *Telecom Italia* (Italy); *Vivo*, subsidiary from *Telefónica* (Spain) and partly controlled by *Portugal Telecom*; *Oi*, partly owned by *Portugal Telecom*; and *Claro*, controlled by *América Móvil* (Mexico).

#### 4.2.2 Germany

Until the 1990s the telecommunication sector in Germany was a State monopoly held by the German Post. It was not before 1980s when the state started thinking about a new regulation scheme due to new technologies available. Additionally, the European Community as well as the

European Court of Justice speeded up the process of liberalizing the European telecommunication sector.

The European Commission adopted guidelines in May 1988 (88/301/EEC) and June 1990 (90/288/EEC) which enforced the states of the European Community to liberalize telecommunication services as well as to offset the national monopoly on devices (Zolnhöfer 2007). Even though the member states still had to implement the regulations, the decision of the European Community to liberalize the telecommunication market of all member states had been made.

The Telecommunications Act from 1996 regulated the liberalization process of the German telecommunication sector by January 1998. This act stated, and does until now, the process of liberalization and regulation of the sector. Included are next to general provisions (§§1-8 TKG) market regulations such as procedures of the market regulation (§§9-15a TKG), access regulation (§§16-26 TKG) and regulation of fees (§§27-39 TKG). Furthermore, customer protection (§§43a-47 TKG), universal service (§§78-87 TKG) and the Federal Network Agency for Telecommunications (Bundesnetzagentur) (§§116-141 TKG) are part of the Telecommunication Act (cf. TKG - German Telecommunications Act). Aim of the regulatory implementation was on one hand to ensure universal telecommunication services and on the other hand to promote an equal and functional market competition. Therefore, Germany fulfilled the European Commission's obligation on liberalizing the telecommunication sector. As a result, the number of telecommunication provider increased in a massive number by 1999 and prices customer had to pay for services dropped rapidly. Furthermore, at the end of 1999 50% of the large German cities had a competition on the local telecommunication market (Czernich et al. 2008).

During the process of regulative reforms on the telecommunication sector in Germany, the regulatory authority for post and telecommunication (since July 2015 named Federal Network Agency for Telecommunications (Bundesnetzagentur)) was found in 1998. The authority replaced the former federal ministry for telecommunication and post services and assumed the responsibilities of the telecommunication market regulation as even after the liberalization process, the telecommunication sector needed, and still needs a sector specific market regulation (Czernich et al. 2008, Schmidt 1998, Zolnhöfer 2007).

As already mentioned, all (legal) responsibilities and duties of the Federal Network Agency for Telecommunications in Bonn is stated in the Telecommunications Act (§§116-141 TKG). Furthermore, the organisation of the Agency and how they are allowed to operate is written down. The central duty is to control the market power of the biggest provider and to ensure new competitors the necessary equal opportunity to enter the telecommunication market. Such

regulation decisions of the Federal Network Agency for Telecommunications are made by an advisory board with the possibility to be advised by the immediately concerned telecommunication enterprises (Czernich et. al. 2008, Schmidt 1998, Zolnhöfer 2007).

As the Federal Network Agency for Telecommunications is a Federal Authority the Director and Vice- Directors are on the suggestion of the advisory board of the Bundesnetzagentur but needs to be appointed by the federal government (§3(3) BEGTPG) - Gesetz über die Bundesnetzagentur für Elektrizität, Gas, Telekommunikation, Post und Eisenbahnen (Law on the Federal Network Agency of Electricity, Gas, Telecommunications, Post and Trains). Furthermore, this leads to the consequence of the financial independency of the Federal Network Agency for Telecommunications as it is financed by tax revenues due to its position as a federal authority.

#### *4.2.3 Mexico*

After its moratorium in the early 1980s Mexico also passed through an intense liberalization process (Bazdresch and Elizondo, 1993) include features as fiscal adjustment, salaries contraction, commercial opening, re-regulation and profound institutional reform. A major aspect was the privatization of a great number of public firms in the 1990s, whose objective was to improve the general efficiency of the economy.

The challenge was transform a country which had strong patrimonial traces into a modern economy through the adoption of a model of New Public Management. Whereas the central government aimed at this objective, it was a hard path as it demanded central and powerful actors capable of reaching agreements with the local powers while creating a clear and legitimate legal framework (Gault 2000).

The decision of privatizing State-owned companies was made 1989 by the former president of Mexico, Carlos Salinas de Gortari. One of the most attractive sectors was the telecommunication sector, which included a huge potential market combined with deficient infrastructure and pre-existing domestic (Kuhlmann,1997). In 1995 the law for opening the telecommunication sector was adopted and marked the beginning of the possibility of a competitive market. The state owned company *Telefonos de Mexico* (Telmex) was privatized by selling a 20.4 percent controlling stake for US\$1.757 billion to a consortium that included the Mexican company *Grupo Carso*, Southwestern Bell and France Telecom (World Bank, 2003).

As part of the privatization, the concession of Telmex allowed the new company provide voice, data, text, sound and video transmission services for a limited amount of years (OECD, 2012). Once Telemex's exclusivity period expired, the government began to issue concessions for the telecommunications service.

The 1995 Telecommunication Law and the 1996 Presidential Decree implemented an institutional and regulatory framework for the industry (World Bank 2003). The *Comisión Federal de Telecomunicaciones* (Cofetel) was created aiming at regulating telecommunications firms, but in 2014 it was transformed into the *Instituto Federal de Telecomunicaciones* (IFT), an independent government agency through the *Ley Federal de Telecomunicaciones y Radiofusión* (Federal Law of Telecommunications and Broadcasting).

In this new law, IFT become responsible for regulating and monitoring the sector, promoting competition and efficient development, and exploiting radio, satellite and broadcasting services (Art. 7, *Ley Federal de Telecomunicaciones y Radiofusión*).

The Board of IFT consists of seven commissioners, including a president commissioner. They are selected by an evaluation committee, including a resume analysis and evaluation exams, and further approval by both the executive and legislative federal powers (*Estatuto Orgánico del Instituto Federal de Telecomunicaciones*). The Board has a significant power being responsible for planning, developing and regulating the development of telecommunication.

IFT's budget comes from both public and private sectors as the *Ley Federal de Telecomunicaciones y Radiofusión* at its eighth article does not impose barriers to the establishment of new incomes, for instance voluntary contributions from licensed firms. Furthermore, it is also benefited by a specific budget from the federal government.

#### 4.2.4 Italy

The Italian telecommunication sector was decentralized since the early XX century when each region had its own private monopolistic operator. In the 1960s, when the concession contracts expired, a State-owned firm, the *Società Italiana per l'Esercizio Telefonico*, acquired shares from most of these companies but kept its decentralized model (Kornelakis 2012).

The transformations motivated by the European integration since the Single European Act of 1986 led several countries to adjust their economies by liberalizing the State monopoly especially in sectors referred as the network industries, including financial services, transportation and energy (Kornelakis 2012).

The Italian telecommunication sector was affected by these reforms. In the late 1980s, the sector went through a reorganization to boost its competitiveness. In 1992 a new law forced the unification of the operating firms leading to the creation, in 1994, of the Telecom Italia (Kornelakis 2012). In order to the privatization process be finalized in 1997, one prerequisite was the creation of the regulatory body, the *Autorità per le Garanzie nelle Comunicazioni* (AGCOM) through the law no. 249 of July 31, 1997. AGCOM is an independent and autonomous body which is responsible

for the regulation and supervision of the sector, including the organization of communication operators, the control of advertisements, the protection of consumers, and the stimulus to the development of new services and products (law n. 249/1997).

AGCOM is composed by different commissions, internal structures and networks, services and products, and its general Council. Each commission is a collegiate body (Katsura, I., 2008; decree n. 201/2011). The commissioners are appointed by the country's president and approved by the Parliament. The President of AGCOM is appointed by the Prime Minister, approved by the commissions of the Parliament on qualified majority and finally confirmed by the President of the Republic. Specific responsibilities and tasks are assigned to each commission, for instance the one for infrastructure and networks is responsible for ensuring security, regulating the markets defining criteria and objectives of access to telecommunications, setting tariffs and regulating them and verifying the operators' infrastructure, among others (art. 6(a), law n. 249/1997).

The regulatory body is funded by the State annual budget, granted by the a decree of the ministry of economy and finance. Additionally, it receives contributions from telecommunication and broadcasting operators.

Whereas the sector is majorly dominated by four players, Goldstein (2003) argues that it was relatively easy to join the market as seen by the large amount of firms operating in Italy. Government requirements included a license issued by the regulatory agency and the compliance with certain standards defined by it such as the Flat Rate Internet Access Call Origination.

The same reform also opened up the market creating a licensing scheme. The first private player joined the market in 1995. It was the Omnitel, a subsidiary of the manufacturing group Olivetti. In the late 1990s and 2000s other domestic (e.g. Wind and Blu) and foreign companies (e.g. the British Vodafone and the Chinese 3) joined the market under the regulation of the *Autorità per le Garanzie nelle Comunicazioni* (Kornelakis 2012). After a series of mergers and takeovers, four major players currently control the Italian telecommunication sector: the Chinese 3, the British Vodafone and the Italian Wind and Telecom Italia (partly owned by the Spanish *Telefónica*).

#### 4.2.5 Summary of findings

**Table 4. Test results for Brazil, Germany, Italy and Mexico.**

	Legislation on Regulation	Politically Independent Agency	Financially Independent Agency
Brazil	yes	no	no
Germany	yes	no	yes
Italy	yes	no	no
Mexico	yes	yes	no

Source: designed by the authors.

From the description of the four cases and the table we can assume that in all four countries the agencies regulating the telecommunication sector are able to create legislation on regulation as well as enforce them. However, they differ in the legislation process in which other instances have to be included. Therefore, is the mechanism of checks and balances stronger in some countries (Germany) than in others. Nearly the same applies to the political independence of the different agencies. Formally, Mexico has the only politically independent agency. But again, the same mechanism of checks and balances of other governmental institutions applies to the German case.

Lastly, the fact of financial independence only applies to the German agency. Whereas the Bundesnetzagentur gets their only money from the government (tax revenues) and has therefore a fixed income other agencies have a variable one. ANATEL, the Brazilian agency gets its budget from the Union (federal budget, special credits, income from financial operation) and the private companies (tax, payments for the authorization services, fines, indemnities, donations and any other income). The Federal Telecommunications Institute (IFT) of Mexico generates its income from the state, the Union budget but also from private sectors. The same applies for the Italian Communications Agency (AGCOM) which gets its annual budget from the State, granted by the decree of the ministry of economy and finance, and it receives also the contribution from telecom and broadcasting operators.

Therefore, all three agencies receive not only payments from their governments (public sector) but also from the private sector, which is mostly made up by companies from the telecommunication sector. Furthermore, those payments are not fixed as the money which comes from the different private sector is variable.

### ***4.3 Evidence of Corruption***

#### ***4.3.1 Brazil***

Since 1997 different Brazilian congressmen have been trying to start congressional investigations on ANATEL alleging corruption in the privatization process during the 1990s (Rivera and Sardinha 2005) and exaggerated influence of the key private players over the regulatory agency (Capelas 2016).

One of the reasons was the influence exercised by the former minister of communications Luiz Carlos Mendonça de Barros, who was tapped when negotiating easy access to public funds and inside information for major businesses interested in participating into the privatization process (Catanhêde and Vaz 1998).

Furtherly, *GameCorp*, an IT Brazilian company owned by a son of the ex-president Luiz Inácio Lula da Silva, has been investigated since 2006 when it received an investment of 5 million Reais (ca. 1,2



million euro) from *Telemar*, currently *Oi*, during Lula's term (Vasconcelos 2006). Whereas the first investigations didn't lead to any concrete result, the case was re-opened by a new operation that is currently investigating several corruption scandals in the federal government.

De Souza (2016) argues that it was motivated by the economic links between *Andrade Gutierrez*, a major construction firm also involved in other corruption scandals related to Lula's administration (Macedo 2016), and *Oi*. In 2006, when *Andrade Gutierrez* used to be one of *Telemar*'s owners, the telecommunication firm bought 30% of *GameCorp*'s shares.

#### 4.3.2 Germany

Whereas media vehicles as *Der Spiegel* have suggested that German firms, as Siemens, have been involved in bribery scandals to obtain advantages in the Greek telecommunications sector (Schmitt 2010), there is no evidence in the literature concerning corruption cases inside Germany. On the contrary, Deutsche Telekom was identified by Transparency International (2015) as the most transparent among the world's largest telecommunications companies in 2015.

Therefore, we assume that there had not been any corruption cases occurred within the regulative reforms of the telecommunication sector from a monopoly to a free market in Germany. The same applies for the non-occurring of neo-patrimonialism in Germany.

#### 4.3.3 Mexico

The key players on the Mexican telecommunication market are *America Móvil* (Telmex & Telcel) with 66% total market share, *Telefónica* with 7,1%, *Nextel* with 7,2%, *Televisa* 5,7%, and others with 14% (OECD 2012). *America Móvil*, the major player, is owned by one of the richest entrepreneurs in the world, Carlos Slim Helú, and classified below the average (3,8 points against 4,4) of Transparency International's (2015) index of transparency of world's leading companies in the telecommunications sector.

This firm benefited from the concession given to Telmex as it received a temporary monopoly in domestic and international long-distance telephone service. The lack of competitors led to "inefficient telecommunications markets that impose significant cost on the Mexican economy and burden the welfare of its population" (OECD, 2012). It has also heavily benefited from political corruption and back-room alliances during the rapid growth of the telecom sector since the 1990s (Kahn 2013).

#### 4.3.4 Italy

Subsidiaries of Telecom Italia have been involved in corruption scandals and frauds in Italy and abroad, for instance in 2012 in Brazil when operating the local major player TIM (G1 2012). In

2010 another scandal took place due to allegations of tax fraud and money-laundering in Sparkle, also a subsidiary of this company, when over 50 people were arrested due to their connections with the Calabrian Mafia in a corruption scandal involving circa 2 billion euro. The case was also related to high-profile businessmen and politicians, such as the pro-Berlusconi senator Nicola di Girolamo and the Fastweb's founder Silvio Scaglia (Povoledo and Jolly 2010).

In the previous decade the same company was also involved in a scandal when, in cooperation with the Italian military intelligence agency, it ran a surveillance program tapping over 5.000 persons, including politicians, magistrates, journalists and high-level businessmen (Colaprico et al. 2007; La Repubblica 2006).

In the previous decade,

#### *4.3.5 Summary of findings*

Only in Germany, no news or academic research presented evidence of corruption. As for the other countries, even though some cases are still being analyzed by the judiciary, all of them had at least indications of “the abuse of entrusted power for private gain” (Transparency International 2016a). Generally, it was related to private agents bribing or financing politicians to obtain unknown gains, which might be political influence in the licensing and regulatory framework of the telecommunications sector.

## **5 Conclusions**

In the present paper we have reviewed the literature of causes of corruption and assessed the influence of informal and formal institutional frameworks in its costs focusing especially in the telecommunication sectors of Brazil, Germany, Mexico and Italy after their privatizations between the mid-1990s and mid-2000s.

**Table 5. Hypotheses according to the presence or absence of neo-patrimonialism, weak regulation and corruption.**

	Neo-patrimonialism	Weak Regulation	Corruption
Brazil	Yes	Yes	Yes
Germany	No	Medium	No
Mexico	Yes	Yes	Yes
Italy	Yes	Medium	Yes

**Source: designed by the authors.**

As it is described in Table 5, we couldn't identify alleged corruption cases in this sector in Germany but illegal links between private agents and public authorities took place in the other countries. Differently than Germany; Brazil, Mexico and Italy presented weak informal institutional frameworks with clear evidence of neopatrimonialism. This has been exposed in the literature and surveys from international organizations, as the Transparency International.

Whereas we can't argue that any of these countries has strong regulatory frameworks, Germany and Italy featured solid laws promoting the independence of their regulatory agencies. Once Italy also had alleged corruption cases even with a regulatory framework rather similar to Germany in the analyzed aspects, we can't argue the regulatory differences played an important role in the composition of corruption costs.

Based on these results we can argue that the existence of neopatrimonialism is a game-changer regarding corruption, therefore reforms should focus not only in the specific privatized sector but mostly in the political culture's transformation. Alternatively, once the cost of corruption is only afforded when the market premium is higher than it, efficient policies could also be focused on reducing the market premium by deregulating privatized sector.

Further researches should address both possibilities, identifying, for instance, why Germany differs from the other countries in regards of patrimonial bonds or if corruption persisted in countries where privatization and deregulation took place together.

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