TELECOMMUNICATIONS IN MEXICO

MARKET GROWTH OFFERS ATTRACTIVE OPPORTUNITIES

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Mexico represents a significant market for U.S. exporters, with a population of 99 million, a GDP of $581 billion and a shared border of 2,000 miles. In fact, the U.S. Commercial Service in Mexico predicts that Mexico will become the number one trading partner of the United States by 2005. The telecommunications market, in particular, presents attractive opportunities for U.S. companies.

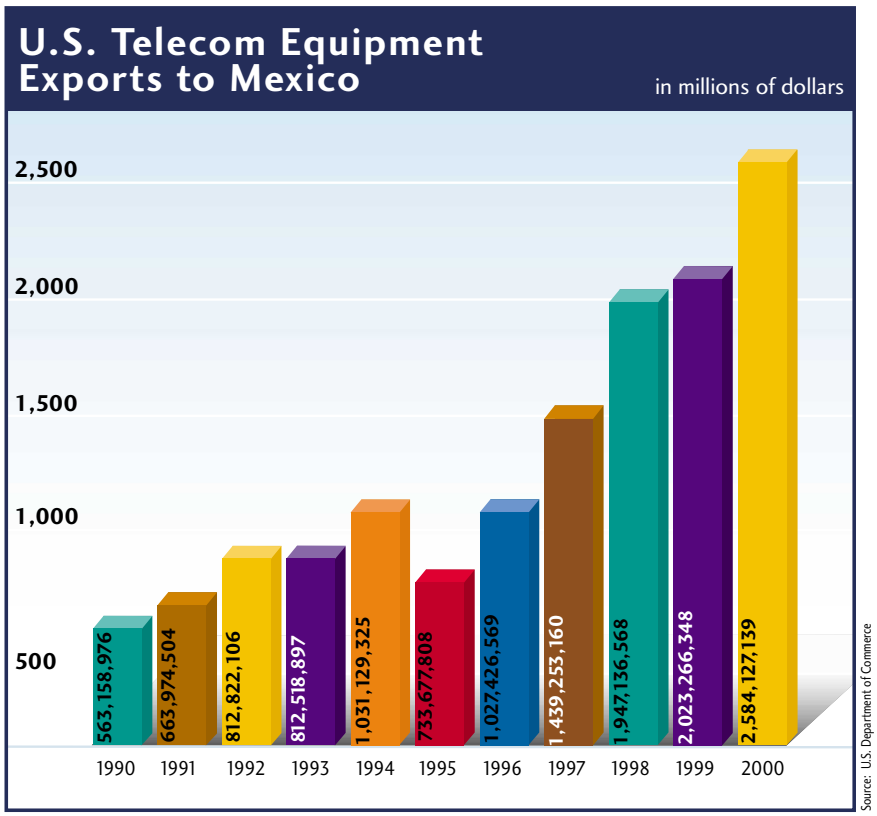
The Mexican telecom market was opened to competition in 1997. Since then, the sector has experienced record growth, with several new competitors entering the market to offer a wide range of services. The combined market for equipment and services is expected to exceed $3.5 billion annually over the next three years.

THE REGULATORY ENVIRONMENT

The Federal Telecommunications Commission (Cofetel), a body within the Ministry of Communications and Transport (SCT), regulates the telecommunications sector in Mexico. Licenses and frequencies are awarded officially by the Ministry (based on the recommendations of Cofetel), while Cofetel oversees the market, regulating network access fees and establishing service standards.

President Vicente Fox's appointment of former Telmex (the Mexican incumbent) and Avantel (partially-owned by U.S. Worldcom) executives to cabinet-level posts, together with his decision to keep Jorge Nicolin at the helm of Cofetel, have led analysts to label him as relatively neutral regarding competition issues in the sector. Analysts also agree that the new administration may look to strengthen Cofetel, perhaps by issuing a clear mandate for the agency and providing it with the legal authority to act and enforce independently.

Foreign investment in most telecommunications services is limited to a 49 percent equity stake. However, in mobile wireless telephony (not including paging), foreign investors may participate up to 100 percent, subject to



approval by the National Foreign Investment Commission. In any case, a foreign investor must participate through a Mexican corporation.

USTR TAKES MEXICO TO THE WTO

Under the World Trade Organization's Agreement on Basic Telecommunications Services, the Government of Mexico committed to market access and national treatment for all services (except satellite-based services) by January 1, 1998. Additionally, Mexico adopted the Reference Paper to the Agreement, a consensus document based upon pro-competitive regulatory principles.

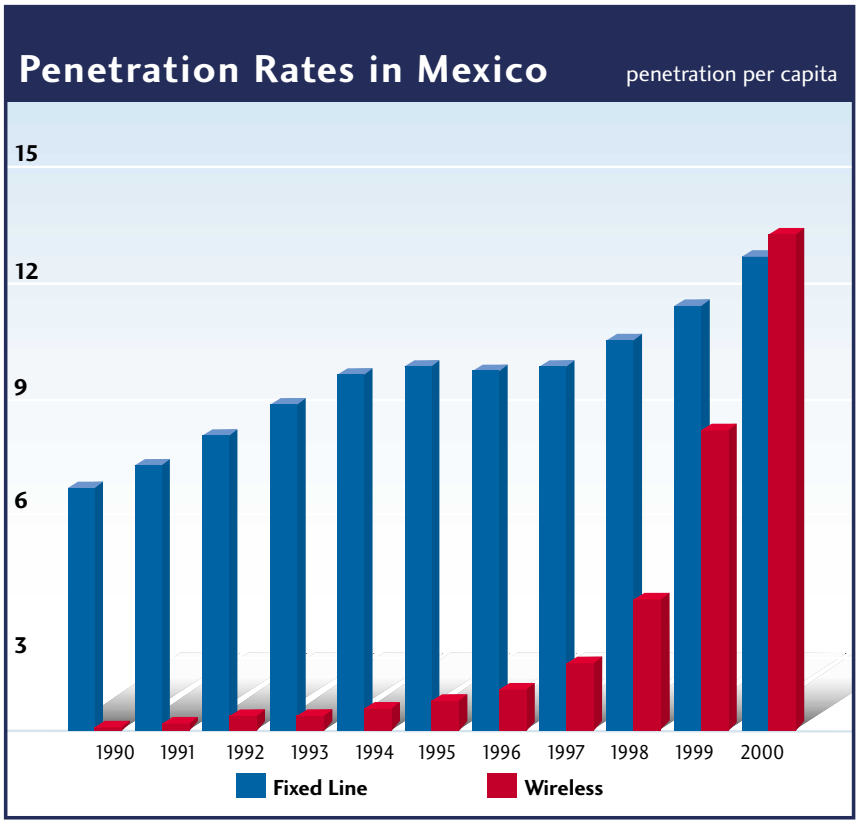
Despite Mexico's substantial progress in opening its telecommunications market, the U.S. Government remains concerned about Mexico's implementation of its WTO commitments. Indeed, on November 10, 2000, the U.S. Trade Representative (USTR) requested that the WTO establish a formal dispute settlement panel to examine its claims that Mexico had failed to comply with its commitments. While Mexico has since taken positive steps to mitigate some of the contentious issues, the international services market remains a critical issue for the United States. On a separate matter, the USTR recently requested a second set of WTO consultations with Mexico regarding Cofetel's failure to enforce recently enacted dominant carrier rules (i.e., its failure to reign in incumbent Telmex) and on the interconnection rates for 2001.

EXPLOSION IN WIRELESS

Wireless services were introduced in Mexico in 1990, when the government issued two cellular service concessions in each of nine geographic regions. In 1998, PCS licenses were awarded in the 1900 MHz band. Presently, five major operators provide mobile services, with only Telcel boasting national coverage. With the exception of Telcel (recently spun off from Telmex into America Movil), the major operators are all partly- or even wholly-owned by multinational operators.

The wireless sector experienced an impressive 68 percent compound growth rate from 1990 to 1999. Wireless penetration during that period increased from 0.1 to 8 percent. With the initiation of the "calling party pays" billing system in 1999, the number of subscribers grew from 3.6 to 9.2 million in less than a year. In September 2000, the number of wireless subscribers surpassed the number of fixed lines in Mexico. More than 13 million Mexicans were using wireless phones by year-end 2000.

The explosive increase in demand has outstripped network capacity, causing a sharp increase in consumer complaints. Although carriers announced significant infrastructure investments in an effort to address the problems, Cofetel has published a set of new measures to address quality of service, including mandatory upgrades in capacity.



THE LAG IN FIXED LINES

At 11 percent, Mexico has one of the lowest fixed line penetration rates in the Americas. Uruguay boasts the highest in Latin America at 28 percent, compared with 66 percent in the United States and 64 percent in Canada. Growth in this sector has been slow, despite declining local and long distance rates (in real terms). Most analysts expect fixed line penetration to reach 18 percent by 2003. Service providers are likely to utilize fixed wireless technologies as quick and cost-effective means to build out their networks and meet pent up consumer demand.

To date, competition in local services has been less intense than in long distance, with Telmex retaining a virtual monopoly in local telephony. However, long distance competitors Alestra and Avantel recently announced their plans to begin providing local service this year.

U.S. TELECOM EXPORTS

The United States continues to be the largest single supplier of telecommunications equipment to Mexico; the U.S. share of Mexican telecom imports was 67 percent in 1999, down from 73 percent in 1998. U.S. telecom equipment exports to Mexico totaled $2.5 billion for the first eleven months of 2000, up 43 percent over the same period in 1999.

However, Mexico's signing of a free trade agreement with the European Union in 2000 means increased competition from European suppliers. European competitors now receive similar tariff considerations and benefits as U.S. producers have enjoyed since the implementation of the North American Free Trade Agreement (NAFTA) in 1994.

The NAFTA eliminated tariffs on 80 percent of U.S. telecommunications equipment exports to Mexico and opened up the value-added services market to North American investment. Prior to the NAFTA, Mexico levied tariffs of 15-20 percent on telecommunications equipment imported from the United States. Remaining tariffs, currently ranging up to 14 percent, are being phased out over 10 years, until 2004.

U.S. companies interested in exporting telecom equipment to Mexico must bear in mind the certification and homologation requirements in Mexico. Homologation is, "the official recognition that the specifications of a product comply with the national technical requirements and can be attached to the network." As agreed in the NAFTA, a pre-approved lab may certify a telecommunications product for sale in any of the three NAFTA countries. Once lingering implementation challenges are overcome, this ability to test telecom equipment destined for export to Mexico in U.S. labs should mean reduced costs for U.S. suppliers.

Second only to Canada, Mexico is a primary trading partner for telecom services as well. In 1999, 11 percent of U.S. incoming traffic originated in Mexico, while 14 percent of U.S.-originated international minutes were to Mexico.

OPPORTUNITIES ABOUND, PROCEED WITH CAUTION

U.S. products have several advantages over those from other countries. Geographical proximity allows for shorter time to market and lower transportation costs. Not to be underestimated, the perception that U.S. manufacturers have a technological edge vis-à-vis competitors provides U.S. sellers with significant marketing leverage.

Low penetration rates mean increased potential business opportunities. Carriers in Mexico will need to install approximately 10 million additional lines if the country is to reach international teledensity levels. The projected growth in local telephony will require the use of fixed wireless technologies to boost penetration quickly. More than one million fixed wireless lines are expected to be installed by new operators during the next couple of years.

Data communications and value-added network services are two of the fastest growing sectors of the Mexican market. The corporate database services segment alone is expected to grow at an annual rate of 35 to 40 percent over the next few years.

The cable TV market in Mexico has grown at an average annual rate of 12 percent over the last four years. As cable TV is utilized increasingly to improve teledensity and Internet penetration, this sector could become one of the hottest opportunities for U.S. manufacturers.

Finally, implementation of the Fox Administration's "E-Mexico Project," to provide Mexico with total telecommunications self-sufficiency through establishing nationwide access to services, will require the continued build out of networks as well as the expertise of international consultants.

While opportunities abound, the Mexican telecommunications market is not for the faint of heart. U.S. companies must overcome certain challenges in entering the market. Some of the biggest issues include the prevailing dominance of Telmex, the lack of competitive conditions in last mile access and the government's need to address weaknesses in the Federal Telecommunications Law. Yet, the Fox Administration's expected introduction of an amendment to the Telecommunications Law, as early as March 2001, signals an auspicious future on the regulatory front

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Upcoming trade events include:

Expo BusinesSolutions
April 25-27, 2000
World Trade Center - Mexico City

"Capitalizing on the Revenue Potential of the Mexican Broadband Market,"
presented by the Institute for International Research.
May 21-23, 2000
Four Seasons Hotel - Mexico City