Results of 2004 Section 1377 Review of Telecommunications Trade Agreements

The Office of the United States Trade Representative (USTR) annually reviews the operation and effectiveness of U.S. telecommunications trade agreements pursuant to Section 1377 of the Omnibus Trade and Competitiveness Act of 1988. Its review is based on public comments filed by interested parties. This year, USTR received comments from twelve entities. Comments are posted on the USTR website at http://www.ustr.gov/sectors/industry/Telecom1377/index.htm#2004.

Summary of Findings

Three key areas addressed in this year’s review echoed concerns from previous years: unjustifiably high fixed-to-mobile termination rates (the cost of interconnecting calls to wireless networks); lack of reasonable access to leased lines and submarine cable capacity (including pricing and provisioning times); and lack of an independent regulator to adequately address issues of effective market access in a number of countries. The potential introduction of mandatory single-technology standards that could restrict market access for U.S. technology suppliers was raised as a new area of concern. Finally, some commenters identified country-specific problems, including concerns that Mexico and South Africa have been slow in fully implementing WTO commitments to liberalize resale services.

USTR concluded that these issues raise concerns regarding practices in trade partners’ telecommunications markets. Based on factors including the seriousness of allegations and their impact on U.S. interests, foreign government efforts to resolve issues, and impending decisions that warrant particular vigilance, USTR has identified key countries of concern whose practices it will actively monitor and take additional action against, if necessary.

Key Issues Addressed in the 2004 Section 1377 Review

Discriminatory and/or Unjustified Standards

Key countries of concern: China, Japan, Korea

USTR is seriously concerned about mandatory single-technology standards being considered or proposed for wireless telecommunications services and equipment in China (Wireless LAN Authentication and Privacy Infrastructure or “WAPI”, 3G services, and 450 MHz services); Korea (Wireless Internet Protocol for Interoperability or “WIPI” and 2.3GHz services); and Japan (new 3G services). USTR will continue to urge these countries to refrain from imposing exclusionary standards and will review specific
measures for consistency with trade obligations. Timelines for expected measures by these countries include:

- **June 2004:** China’s enforcement of mandatory WAPI standard; Korea’s decisions in Korea on mandating WIPI and establishing a standard for portable wireless Internet services;
- **Year end 2004** China’s and Japan’s decisions on technical standards for new 3G services.

USTR has succeeded in including additional binding provisions addressing these issues in FTAs with Singapore, Chile, Australia, CAFTA, and Morocco (and has included such provisions in all subsequent FTAs being negotiated.)

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**High Mobile Termination Rates**

**Key countries of concern:** Switzerland, Germany, Japan, Australia, New Zealand

USTR has observed some progress in the movement of mobile termination rates (wholesale rates for connecting to mobile networks) towards more competitive levels, but at the same time, mounting evidence suggests that operators in many countries are attempting to raise rates without justification. In last year’s 1377 Review, USTR urged national regulators to address unreasonably high rates for fixed-to-mobile termination services. Since that time, numerous regulators have initiated or completed reviews, and in some cases proposed measures to remedy rates considered unreasonable (e.g. Australia, Chile, Czech Republic, France, Jordan, Korea, the Netherlands, and Peru). USTR will actively monitor market trends and the results of on-going regulatory reviews, and will encourage countries where regulatory engagement is lacking and where rates are persistently high to justify how this comports with specific trade commitments. In particular, vigilance against rate increases will be heightened.

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**Access to Leased Lines and Submarine Cable Capacity**

**Key countries of concern:** Germany, India, Switzerland, Singapore

USTR is concerned that there still appear to be unreasonable and potentially discriminatory practices and lack of effective legal protection relating to access to wholesale transmission capacity (local leased lines and submarine cable capacity) in several countries. These practices hinder the ability of basic and value-added service suppliers to provide competitive services using these wholesale inputs. Regulatory intervention in Germany, India, and Singapore has helped address problems in the short term, but without clear rules backed up by a regulator with adequate enforcement powers, incumbent operators may succeed in blocking long-term solutions.
Regulatory Independence

Key countries of concern: China, Japan, France, Mexico, South Africa

Efforts to undermine the effectiveness of independent regulators through political interference or legislative proposals limiting regulatory authority remain a serious concern. This weakening of the regulator’s ability to control abusive practices by incumbent operators, many of whom are government-owned, is a serious impediment to effective market access. USTR is encouraging governments to establish regulators fully authorized to make decisions and enforce them without undue interference by incumbent operators or Ministries that control shares in these companies, and to proceed expeditiously with privatization. USTR has succeeded in including additional binding provisions to address these issues in FTAs with Singapore, Chile, Australia, CAFTA, and Morocco (and has included such provisions in all subsequent FTAs being negotiated). In a related matter, USTR is increasingly concerned about inappropriate interference by telecommunications ministries in the commercial decisions of firms, such as ongoing technology royalty negotiations in China.

Liberalization of Services in Accordance with WTO Commitments

Key countries of concern: Mexico, South Africa

USTR continues to be concerned about slow implementation by South Africa and Mexico of their WTO commitments to permit resale of basic telecommunications services. For South Africa, implementing a commitment to allow resale will be pursued in parallel with ongoing FTA negotiations, where the United States has proposed more detailed commitments in this area. For Mexico, USTR is pursuing implementation of this commitment in the context of the current WTO litigation. This WTO process also provides a basis for ensuring that Mexico implements its commitment to ensure competition and cost-based interconnection rates for cross-border services.
Details on Key Issues, and Other Country-Specific Problems

1. Mandatory, Discriminatory Standards

A number of countries have introduced or are considering introducing mandatory, single-technology standards in relation to telecommunications services and equipment that could have the effect of excluding U.S. suppliers. Governmental justification for these policies has, to date, been unconvincing, and in most cases the reason for the mandate appears connected to protecting or promoting local service or equipment suppliers. Potential concerns on these issues relate to services and standards commitments in the WTO.

In China, there are three areas where actual or potential mandates threaten U.S. equipment suppliers: a mandate to use a China-specific encryption standard for wireless LAN products (WAPI, or Wireless LAN Authentication and Privacy Infrastructure) set to be enforced in June; a restriction against the use of CDMA technology in the 450 MHz spectrum band; and uncertainty regarding what technologies will be permitted to be used in conjunction with four new 3G wireless licenses expected to be issued this year. These issues have been raised with Chinese officials on numerous occasions.

WAPI: China announced that it would require all WLAN products (including computers to be connected to WLANs) sold in China to be developed in cooperation with 24 designated Chinese firms, which hold exclusive access to the encryption algorithms needed to comply with WAPI. This appears to be an example of mandating a locally developed standard for protectionist purposes.

U.S. officials have raised this issue at all levels with Chinese officials on at least a dozen occasions in late 2003 and 2004. Most recently, Secretaries Powell and Evans and USTR Zoellick sent a joint letter to China’s Vice Premiers Wu Yi and Zeng Peian regarding their concerns with China’s WAPI regulations. This is an issue for resolution in the upcoming April meeting of the Joint Commission on Commerce and Trade (JCCT).

CDMA 450 MHz: China’s telecommunications ministry, MII, has restricted the use of CDMA technology at 450 MHz and recently issued Document No. 15, which proposes that only SCDMA (a Chinese-developed standard) and other technology incorporating China-controlled IPR be permitted as rural communications solutions. MII’s apparent rejection of CDMA at 450 MHz on technical grounds does not appear justified, given the success this technology has had at this frequency in numerous markets. However, MII ordered the infrastructure to be dismantled in all provinces except Tibet.

3G: China is expected to issue four licenses for 3G services as early as this year, but details on license conditions and informal guidance government officials may be providing remain unclear. There are three 3G standards competing for deployment in

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1 U.S. service suppliers do not yet appear active in China in services relating to these standards but potential service restrictions are also cause for concern.
China: CDMA2000, WCDMA (UMTS), and TD-SCDMA. The United States would like to see operators able to apply for these licenses free of technology constraints.

In Korea, there are two areas where proposals to mandate standards will potentially exclude U.S. equipment and service suppliers: a proposal to mandate a software interface standard for mobile wireless Internet services (WIPI, or wireless internet platform for interoperability); and a mandate to develop a single standard (as yet undefined) for “portable” (i.e. limited mobility) wireless Internet services, licenses for which are expected to be issued this year, in the 2.3 GHz range. Regarding WIPI, the Korean government has postponed any action until at least June 2004 in response to U.S. concerns.

Several U.S. suppliers are interested in supplying equipment for 2.3 GHz services, but it appears that the standards process, under the influence of the government-funded research institute ETRI, is being manipulated to exclude foreign technologies and promote a technology developed by a particular Korean company. USTR will closely monitor developments in both these areas to ensure that Korea’s practices do not run afoul of its trade obligations.

In Japan, the regulator (MPHPT) has announced its intention to license additional spectrum for 3G wireless services at 2010 MHz this year, but so far has refused to issue experimental licenses to certain U.S. companies to test new technologies in this frequency range, potentially limiting their eligibility in upcoming licensing. USTR has formally requested clarification of Japan’s policies in this area. Given the lack of transparency to date, close monitoring of this regulatory proceeding in Japan will be necessary until the licensing process is complete.

2. Fixed-to-Mobile Termination Rates

As in 2003, the high cost of completing calls onto mobile networks in many foreign countries was the source of widespread complaints, a factor identified as negatively impacting U.S. companies both in the U.S. and abroad. With mobile subscribership increasing rapidly worldwide (and now approaching if not exceeding global wireline subscribership), a significant and growing percentage of calls are being terminated on these networks. Some regulators have chosen to ignore the matter in the hope that the marketplace will correct potential distortions, while other regulators have responded with approaches ranging from direct regulation of these rates to simply monitoring the situation. The Administration, through the National Telecommunications and Information Administration, while not advocating regulation specifically for mobile services, has advocated that a principle of cost-orientation be applied to international mobile termination rates. The Federal Communications Commission recently announced that it will issue a Notice of Inquiry to examine the effects of high mobile termination rates on U.S. companies and consumers.

Based on industry submissions, the following countries have particularly high mobile termination rates:

EU Member States (particularly France, Germany, the Netherlands, and Greece), Australia, Japan, New Zealand, Peru, Switzerland, and Venezuela.

WTO members with the relevant commitments (i.e. cross-border voice services) are under a general obligation to ensure access to public telecommunications networks on reasonable terms and conditions, and rates significantly above cost could be construed to be unreasonable. Since last year’s report, more regulators are examining the market for termination on mobile networks, and some have begun to take a more active approach to the issue, including requiring reductions in the termination rate (see Annex).

While many countries have begun to act on this issue (Australia, France, Korea, UK), other countries lag. Where countries have engaged in serious cost analysis (Australia, Italy, UK, France, Korea), the regulators have concluded that market forces do not significantly constrain rates under a calling-party-pays system, and thus rate regulation (based on a cost methodology) may be necessary.

Among major economies with high rates and no regulatory intervention, Switzerland stands out. Although its regulator commissioned a study showing that its rates were among the highest in Europe, its legal authority for acting is constrained. Given the fact that Switzerland’s rates are among the highest in the region, a more active response by the regulator to address this issue appears warranted.

Other countries reluctant to actively engage on the issue include Japan and Germany, which both assert that as long as rates continue to decline, intervention is unjustified. While NTT DoCoMo, the dominant operator in Japan, has been reducing rates annually, the rate of reduction has slowed significantly, to only 3.5 percent this year (down from over 10 percent two years ago). While rates in Japan generally compare favorably with current EU rates, they are almost three times rates in Korea, and EU rates may decline significantly due to regulatory measures.

Germany takes a view similar to Japan, but is required, under an EU directive, to examine whether mobile operators are exerting significant market power (SMP) in the market for termination. Germany’s regulator, RegTP, asserts it will begin this investigation as soon as it obtains authority under the pending telecom law.

With the analysis of this issue in its nascent stages, we will closely monitor developments in countries identified in this review. During the year, as more results of the ongoing reviews emerge, we may revisit this issue to report on any concerns that we may have with the results.

Of particular concern are reports that mobile operators in numerous countries are introducing rate increases for calls to mobile networks. (One U.S. firm reports that thirty-
nine foreign operators have raised mobile termination rates over the past year.) The ability of operators to systematically raise rates in a market typically characterized by falling costs suggests that market forces may not be playing an effective role in constraining rates in such countries, and more active regulatory engagement may be appropriate.

3. Excessive Pricing and Provisioning Delays for Access to Leased Lines and Submarine Cable Capacity

Commenters identified the following countries as not adequately addressing the problems of excessive pricing and lengthy provisioning times for the supply of leased lines to competitive suppliers of telecom services: Australia, Germany, France, China, New Zealand (late filing), Singapore, and Switzerland. In addition, India was cited for inadequately ensuring access to submarine cable capacity. These complaints relate to obligations undertaken in the General Agreement on Trade in Services (GATS) Telecommunications Annex requiring that WTO Members, where they have specific service commitments, ensure that access to and use of public telecommunications networks and services, including leased lines, be provided on reasonable and non-discriminatory terms and conditions.

Provisioning Times

There have been some improvements in the provisioning times of leased lines by incumbent operators, generally as a result of regulatory intervention (or the threat of intervention). Nonetheless, ongoing legal challenges to measures adopted in key markets such as Germany have decreased the predictability of the access regime, and this issue merits ongoing scrutiny.

Pricing

Leased lines are a key wholesale input into many competitively-provided telecommunications services in both the voice and data markets. While leased line rates remain high in many markets, rates appear to be declining in most markets subject to competition. In particular, we note some price reductions in countries such as Australia and Japan. Countries such as Singapore, which have not seen significant declines and have traditionally not regulated these rates, have begun to see reasonably-priced wholesale rates as a necessary complement to facilities-based competition. Although Singapore issued a ruling late last year requiring wholesale rates to be cut by up to 50 percent, this ruling has been stayed due to an appeal by the dominant operator.

Switzerland provides another example where high local access leased line rates of the incumbent carrier prompted regulatory action only to be thwarted by legal challenges. In response to a complaint, the regulator ordered a reduction in the incumbent Swisscom’s leased line tariffs by 25 to 30%, effective January 1, 2004. Swisscom challenged the order and obtained a stay. A court decision may not be issued until 2005.
Country Specific Background: Germany

The German regulator’s lack of authority to impose certain measures (i.e., reporting requirements, filing of service level agreements, issuance of fines, etc.), continues to hamper the development of a fully competitive market in Germany. In 2003, we noted positively the decision made by the German regulator, RegTP, to impose certain deadlines on the incumbent operator, DTAG, pertaining to the provisioning of leased lines. This decision, however, has been mired in lengthy legal appeals, undermining long-term certainty about market rules. While initial reports suggest that real improvements have occurred, DTAG is currently not obligated to implement RegTP’s decision, suggesting that Germany runs the risk of backsliding on its progress.

The lack of regulatory clarity in Germany with respect to leased lines is symptomatic of a larger problem—the failure to implement the European Union’s new regulatory framework for electronic communications, overdue since July 2003, and unlikely to be adopted before July 2004. Although the draft Telecommunications Law has been criticized as providing RegTp insufficient authority to enforce competition, the draft law would authorize RegTP to impose conditions on leased line provisioning, ban market-dominant providers from offering competitors less favorable terms than it offers its subsidiaries, and define unacceptable delays in processing service orders from competitors. Given the importance of these measures, implementation of this law merits close attention.

Country-Specific Background: India

This year USTR received formal complaints regarding a longstanding problem in India, India’s tolerance of actions by its dominant international carrier, VSNL, limiting access to and use of submarine cable capacity it controls through its cable landing station. This raised concerns about India’s compliance with its WTO obligation to ensure reasonable and non-discriminatory access to and use of its public telecommunications network. Given the rapidly growing demand for international bandwidth in India to serve foreign and domestic telecommunications and other businesses, tolerating such restrictive practices hurts a broad range of domestic and international consumer and business interests.

Recently, under threat of regulatory intervention, VSNL has reportedly agreed to activate some of the circuits under dispute, freeing up capacity to meet some of the demand. However, in the absence of clear rules (e.g. on pricing and provisioning), ensuring reasonable and nondiscriminatory access to submarine cable capacity on a long-term basis remains problematic: VSNL has no incentive to allow competitors (whose cable terminates at VSNL’s landing station) to freely activate and market that capacity in India when it could keep prices (and market share) for its own services higher by limiting competitors’ access to additional capacity.

USTR will continue to closely monitor this situation and encourage India’s regulator to introduce long-term rules to prevent similar disputes from arising in the future.
4. Regulatory Independence

The lack of an independent regulator in some WTO member countries to oversee the telecommunications market, or favoritism granted to the incumbent operators (particularly government-owned entities), was again cited as a major problem in this year’s review. This year’s comments highlight problems in China, Colombia, Germany, France, Japan, Mexico, and South Africa.

Limiting the power of the regulator

Legislative action limiting the regulator’s authority is an ongoing threat to the effectiveness of an independent regulator. For example, legislatively transferring regulatory functions (e.g., licensing powers) to a Ministry or Executive Agency can undermine the impartiality of decisions, particularly given the continued presence of government ownership in the incumbent (South Africa), which may then have a conflict of interest relating to licensing competitors. Legislative reversal of prior regulatory decisions (South Africa) or proposed weakening of existing regulatory oversight (France, Germany, Japan) is also cause for concern, often reflecting the disproportionate political influence enjoyed by incumbent operators.

Favoring the incumbent operator – Government ownership and undue influence

In many countries, incumbent operators are perceived as enjoying favorable treatment, either through explicit regulatory decisions, or implicitly through regulatory/Ministry inaction in the face of anticompetitive conduct. This problem is most acute in countries that maintain some level of government ownership in the dominant telecommunications operator (e.g. Germany, France, China, Japan), but cases of fully private incumbents enjoying similar privileges (e.g. Mexico) are not uncommon. A first step to eliminating a perceived or real conflict of interest is to fully privatize operators, which the United States has long advocated.

Failure to institute a structurally separate regulator

In both China and Japan, a single ministry oversees both regulatory and industry promotion functions, in the context of markets dominated by government-owned firms. This confluence of interests calls into question how the MII (China) and MPHPT (Japan) can oversee the market in an impartial manner. In a related matter, USTR has also raised the issue of inappropriate interference by the telecommunications ministry (MII) in commercial negotiations between U.S. telecommunications equipment suppliers and Chinese manufacturers and operators.

One way USTR has sought to address all these issues is to develop criteria for an independent regulator that have become a standard element of bilateral FTAs, and which could form the basis of further initiatives in the WTO.
5. Other Country-Specific Concerns

Austria

Timely management of interconnection disputes in Austria remains a serious problem, with some disputes going back as far as 1998 still unresolved. The lack of effective dispute resolution may also contribute to excessively high interconnection rates, which are among the highest in Europe and nearly two times higher than the EU “best practices.”

China

Telecom law

Delays in finalizing China’s pending Telecom Law are hampering the establishment and enforcement of rules supporting emerging operators, transparent processes for the formulation of new regulations, and the establishment of an independent regulator. China’s standards development process continues to be fraught with overlapping authorities, lack of clear planning, and lack of open, well publicized, and meaningful comment periods. USTR will continue to press for reforms to address these issues.

Capital requirements

China’s capital requirements ($240 million) for Foreign Invested Telecom Enterprises (FITEs) engaged in basic telecommunications services appear unjustifiably high and pose a significant barrier to market entry. USTR will continue to advocate lowering these barriers as in China’s interest to attract foreign investment.

Classification of value-added and basic telecom services

Last year MII classified a range of value-added services as basic telecom services, subjecting any potential suppliers of these services to the high capitalization requirements noted above, and thus effectively restricting market access. The United States has asked China to review this classification to ensure that the scope of value added services comports with international norms, but China has not yet responded.

Japan

As in past years, the high interconnection rates of Japan’s major suppliers, NTT East and West were a subject of complaints. Japan’s regulator is reviewing the model used to set these rates and appears to be trying to move rates to a more rational basis. Nonetheless, NTT’s political influence resulted in rate increases last year (and may do so again this year). NTT has been able to obtain higher rate increases by shifting fixed network costs to its competitors, despite failing to demonstrate that existing fixed subscriber charges do
not already recover such costs. USTR is actively engaged in pressing the regulator to reform its model and will continue to closely monitor these regulatory proceedings.

**South Africa**

In addition to the issue of strengthening South Africa’s regulator, which was discussed earlier, South Africa has not yet fully implemented its WTO commitments to authorize the resale of basic telecommunication services. The on-going negotiation of a free trade agreement with the Southern African Customs Union, where there is an explicit goal of ensuring resale, provides an opportunity to resolve concerns regarding resale.
Annex

Actions to Ensure Reasonable Fixed-to-Mobile Termination Rates (wholesale charges for connecting to mobile networks)

Since the 2003 review, the following developments have occurred in the area of fixed-to-mobile termination:

**Australia:** The Australian regulator, ACCC, has recommended that mobile operators be required to cut their termination rates over 40 percent by 2007 to AUS $0.012 (about $0.09), concluding that the high fixed-to-mobile rate was hurting consumers and impeding competition.

**Chile:** Earlier this year, the government mandated a cut in fixed-to-mobile interconnection fees of nearly 27% over the next 5 years.

**Czech Republic:** The Czech Republic’s regulator announced in March that it would cut fixed-to-mobile rates by 13 percent.

**European Union:** The European Commission identified voice call termination on individual mobile networks as a service market that should be analyzed by Member State regulators to determine whether it requires regulation under the Framework Directive.

**France:** The French regulator, ART, required mobile operators to reduce their termination rates last year, and is expected to further review this market, as recommended by the EC.

**Germany:** The German regulator appears to be finally preparing to examine the market for termination on mobile networks, in response to an EU directive. Significantly, rates of major carriers such as T-Mobile have not declined over the past year. The degree to which the regulator can effectively address this issue will depend on authority granted under the pending Telecommunications Law.

**Hungary:** In July of last year, the competition office imposed fines on mobile operators for anti-competitive practices related to mobile operators’ pricing of termination services.

**Ireland:** O2 Ireland voluntarily reduced rates by 4.5 percent due to potential intervention by the Irish regulator, ComReg.

**Israel:** The Communications Ministry is reviewing Israel’s fixed-to-mobile termination charges.
Japan: This March, NTT DoCoMo cut its mobile termination rates between 3 and 4 percent, retroactive to April 2003 (to around $.11 per minute). Japan’s regulator, MPHPT, refuses to actively analyze whether these rates are reasonable.

Jordan: The telecom regulator announced a new interconnection regime that includes a cut in fixed-to-mobile interconnection fees from $.20 to $.13.

Korea: The government is considering introduction of a Long Run Incremental Cost (LRIC) methodology for interconnection charges for mobile networks. Under the current historical cost criteria, rates have steadily declined over the past three years to around $0.035 per minute, among the lowest in the world.

The Netherlands: In December 2003, OPTA, the Dutch regulator, ordered a cut in fixed-to-mobile rates, from 0.18 Euros to 0.11 Euros per minute over the next two years.

Peru: In January this year, Peru’s regulator, Osiptel, announced plans to cut fixed-to-mobile termination rates by 30% over the next 18 months (from $0.42 to $0.30 per minute).

Sources: World Markets Research Centre, company press releases, totaltele.com, national regulators