United States Council for International Business

Thomas M.T. Niles, President

1212 Avenue of the Americas, New York, NY 10036-1689
tel: 212-354-4480 ~ fax: 212-575-0327
e-mail: info@uscib.org ~ Internet: www.uscib.org

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January 12, 2004

Ms. Gloria Blue
Executive Secretary
Trade Policy Staff Committee
ATTN: Section 1377 Comments
Office of the United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20508

VIA ELECTRONIC TRANSMISSION

Re: USTR Section 1377 Request for Comments Concerning Compliance with Telecommunications Trade Agreements

Dear Ms. Blue:

The United States Council for International Business (USCIB) is pleased to have this opportunity to submit comments on the operation and effectiveness of U.S. telecommunications trade agreements pursuant to Section 1377 of the Omnibus Trade and Competitiveness Act of 1998 (19 U.S. C. Section 3106). The effective implementation of telecommunications trade agreements is of concern to all of our members.

USCIB has worked closely with the Office of the U.S. Trade Representative and others in the Executive Branch on many U.S. trade initiatives addressing telecommunications, and we greatly appreciate your efforts on behalf of U.S. industry. USCIB is unique in that it represents all facets of the telecommunications and information services industry – including international carriers, long distance carriers, incumbent local exchange carriers, competitive local exchange carriers, Internet and value-added service providers, satellite service providers and manufacturers, equipment manufacturers, software companies and business users. The Comments submitted herein represent common concerns in the effective implementation of the WTO Basic Telecoms Agreement, the GATS Telecommunications Annex, and the GATS schedule of commitments on value-added services.

As stated in your notice, the purpose of the review is to "determine whether any act, policy, or practice of a country that has entered into a telecommunications trade agreement with the United States is consistent with the terms of such agreement, or otherwise denies to U.S. firms, within the context of the terms of such agreements, mutually advantageous market opportunities." With regard to the WTO Basic Telecoms Agreement, you seek comments on whether any WTO member is acting inconsistently with its commitments, including the Reference Paper, or with other obligations, including the Annex on Telecommunications, in a manner that affects market opportunities for U.S. telecommunications products and services.

Several general issues should be noted at the outset of these comments. The first is the importance that our members place on the establishment of a strong independent regulator with effective enforcement powers. The second is the importance of ensuring compliance with the WTO Reference Paper requirements for cost-oriented interconnection.

USCIB submits comments on China, the European Union, France, Germany, India and Mexico. Our members continue to review our 2003 submission on Canada and Japan and will convey the results of that review to USTR, if necessary, once it is complete. Our specific comments follow:

CHINA

China's WTO commitments to liberalize telecommunications services became effective upon its accession to the WTO on December 11, 2001. These commitments include a six-year schedule for phasing in direct foreign participation in value-added network services and basic telecommunications. China also agreed to be bound by the obligations in the Reference Paper to establish an independent, impartial regulatory authority and a pro-competitive regulatory regime. USCIB recognizes and appreciates the positive steps China has taken to implement its WTO commitments. However, China's overly narrow interpretation of market access opportunities for foreign participants and a lack of an independent regulator have negatively impacted market opportunities for U.S. telecommunications companies contrary to China's WTO commitments. We are especially concerned by China's unreasonably high capitalization requirements for basic services, which will greatly limit market access.

High Capitalization Requirements: China's regulator, the Ministry of Information Industries (MII), recently reclassified several international value-added services as basic services. This action has the undesirable effects of both delaying until December of 2004 the ability of foreign entrants to offer these services, and of subjecting any would-be entrant to the excessively high capitalization requirements placed on new basic services providers. This reclassification has an unwelcome market constraining effect. A basic services license, when available for application by foreign invested joint ventures in late 2004, will be subject to a 2 billion RMB (US$250 million) capitalization requirement, or 100 times the capital requirement for value added service licensees. USCIB considers the existing capitalization requirement in basic services an excessively burdensome and unjustified restriction that violates Article VI of the GATS. The requirement was effected by State Council Order No. 333 of December 11, 2001, the day of China's accession to the WTO, and "could not reasonably have been expected" when China made its commitments, as stipulated by Article VI 5 (a)(ii). A narrowly tailored performance bond would be sufficient to address any existing concerns. In addition, the approval process for equity joint ventures is cumbersome and lengthy: four separate government authorities are required to approve such ventures pursuant to a lengthy and complicated process.

Market Access: Presently, market entry is being delayed by the Ministry of Information Industry's ("MII") extremely narrow views of what constitutes a value-added service for purposes of international value added network service licensing. The regulator has construed the meaning of value-added services in its WTO commitment schedule so narrowly that any

meaningful offerings, such as IP-VPN services demanded by global enterprises, are excluded. Recent changes to the Catalogue of Telecommunication Services redefined basic and value-added services in a manner that discourages and severely limits new providers from entering China's telecommunications market. The narrowing of the scope for value added services represents a counter-liberalization trend inconsistent with China's WTO commitments. For example, it limits virtual private networks to "domestic" services, and deletes "resale" services. The June 2001 Catalogue had listed VPNs under Internet and data transmission value added services, but the latest revision allows value added service providers to offer only "domestic" VPN services. By contrast, China's WTO commitment makes no distinction in treatment between domestic and international services with value added service characteristics, such as VPN applications. Foreign investors are not only precluded from offering basic telecom services until December 2004, at unreasonably high pre-qualification market entry costs, but they are also allowed to do so only in partnership with a licensed basic services carrier. China has entered its third year of WTO membership, yet no foreign companies have been licensed to provide value added services in the areas identified in the schedule of commitments. According to the schedule, by 2003 China is obliged to permit joint ventures in 17 metropolitan areas, but has failed to license any foreign carriers to do so. It is imperative that China phase out its geographical and ownership restrictions strictly according to its schedule of commitments.

Independent and Impartial Regulator: China is far from achieving its Reference Paper Section 5 commitment to establish an independent regulator. The Chinese Government owns and controls all of the major operators in the telecommunications industry, and the MII still occupies dual roles as protector of state enterprise operators and as industry regulator. The pending Telecom Law could improve this situation by mandating a regulatory body that is organizationally separate from government agencies that are focused on developing the state-owned telecommunications industry. Because this new law has been pending for a long time, finalizing and adopting this should be a top priority for the government. Interested parties must also be provided a reasonable period for review and comment on the Ministry's regulations and decisions as required by China's accession documents. Virtually no notice was given, and no comments invited, before the recently revised Telecom Catalog went into effect.

USCIB encourages USTR and others in the U.S. Government to place a high priority on working with China to establish a regulatory body that is separate from, and not accountable to, any basic telecoms supplier, and that is capable of issuing impartial decisions and regulations affecting the telecoms sector. In this context, it is important that the regulatory body adopts the following:

- transparent processes for drafting, finalizing, implementing and applying telecom regulations and decisions;
- appropriate measures, consistent with the Reference Paper, for the purpose of preventing major suppliers from engaging in or continuing anti-competitive practices;
- a defined procedure – as it has done for interconnection -- to resolve commercial disputes in an efficient and fair manner between public telecom suppliers that are not able to reach mutually acceptable agreements;
- an independent and objective process for administrative reconsideration of its decisions; and

- appropriate procedures and authority to enforce China's WTO telecom commitments, such as the ability to impose fines, order injunctive relief, and modify, suspend, or revoke a license.

At present the regulatory environment in China is discouraging new entrants from participating. This will continue until foreign investors have confidence that China has a clear intention and a demonstrated plan to implement its WTO commitments.

Geographic Restrictions: Notwithstanding the business model of the Internet, MII had taken the position that the WTO accession agreement limited the customers that could be served by a value-added telecommunications provider to, initially, three cities and subsequently 17 cities. At times they have also suggested that a commercial presence must be established in each city where customers will be located, and that an inter-regional service, based in one city but serving customers in another, is not permitted. Such an interpretation is inconsistent with the global model of how value-added, non-facilities based Internet service providers are structured, and imposes geographical restrictions that make an inter-regional, or national scaled business model non-viable. The impact of this interpretation is to negate the benefits accorded to foreign value-added telecommunications providers under the WTO agreement.

THE EUROPEAN UNION

In its 2003 Comments, USCIB recognized the strides that the E.U. was taking to ensure effective enforcement of its rules regarding telecommunications services. In 2003, the E.U. issued Directives and Recommendations establishing a new Telecom Framework. The Telecom Framework contains many principles that ensure consistency with the E.U.'s WTO Reference Paper commitments. Despite the E.U.'s requirement that its Member States implement the new Framework by no later than July 15, 2003, several Member States have not done so. Most notably, Germany and France are unlikely to adopt new national legislation implementing the new E.U. regulations until the second quarter of 2004 at the earliest. Not coincidentally, the governments of Germany and France maintain significant ownership in their respective incumbents, and therefore have an incentive to delay transposition of the new E.U. regulations as long as possible. The European Commission announced on December 17, 2003, that it had warned Germany, France, Belgium, Greece, Luxembourg, the Netherlands and Portugal that it would challenge those Member States in the European Court of Justice if they did not implement new legislation soon. While the E.C.'s warning is a positive step, USCIB remains concerned that the warning is not being taken seriously by Member States, further delaying the implementation of laws consistent with the E.U.'s WTO commitments.

Moreover, enforcement of existing rules has been far from uniform, resulting in a net negative impact on investment through this area. In particular, there are substantial failings in the implementation of the rules on cost and accounting information that underpin the workings of the entire regime. In addition, the E.U. has demonstrated its inability to secure compliance in the long term. While various Member States have been taken to the European Court for failure to implement these rules, this process has proven to be quite lengthy, and it can take upwards of 4 years to secure a final determination. These problems are particularly evident in France, Belgium and Germany. However, with the exception of the United Kingdom and Ireland, no effective

regime is in place to ensure the WTO obligations on cost orientated pricing for interconnection and non-discrimination can be met. USCIB urges USTR to monitor very closely any progress in this area and maintain appropriate pressure on the relevant national authorities in this regard.

IV. FRANCE

New entrants continue to face multiple barriers in France that affect market opportunities for U.S. telecommunications companies. These barriers are in clear violation of the WTO Reference Paper and GATS Telecommunications Annex.

Independent and Impartial Regulator: Section 5 of the Reference Paper requires that the regulatory body be separate from, and not accountable to, any supplier of basic telecommunications services. However, the regulator established by the French Government to oversee telecommunications policy ("ART") effectively shares oversight with the Finance Ministry, which also is the majority owner of the major supplier, France Telecom ("FT"). This arrangement results in confusion and a lack of transparency, in violation of Section 5 of the Reference Paper. For example, in a recent decision the Finance Ministry ignored the ART's recommendation to investigate price squeeze concerns regarding a France Telecom tariff related to broadband Internet access. Despite the ART's concern, the Ministry approved the tariff. This decision, and the French Government's decision in 2002 to make available a 9 Billion Euros loan facility to FT, have increased concerns about the prospects of impartial regulation of FT and such subsidies further raise questions about distortion of competition and consistency with the national treatment obligation under the GATS. Rather than address these concerns, however, the French government appears set to *weaken* ART's already minimal powers. In a January 8, 2004, debate regarding the new telecommunications legislation, the French National Assembly with support from the government agreed to diminish the ART's powers to regulate France Telcom's prices. USCIB urges USTR to ensure that France does not use its legislative process to further undermine its WTO commitment to establish an independent regulator.

Interconnection and Local Access Leased Lines: In comments submitted in last year's 1377 review, USCIB raised concerns about the provisioning of local access leased lines in France. One year later, USCIB member companies are continuing to experience obstacles in France with respect to discriminatory pricing and provisioning delays. France has not fully implemented the Section 2 Interconnection provisions in the Reference Paper.

The ART has issued decisions in an effort to improve FT's Reference Interconnection Offer (RIO), including a decision in February 2002 and successive decisions for 2003-2004, addressing a number of leased line issues. While these decisions required FT to address leased lines in its RIO and to modify conditions for delivery, including applicable penalty clauses in order to end the discriminatory treatment harming FT's competitors, the conditions have not been implemented by FT, which continues to engage in discriminatory pricing and provisioning delays. Additionally, FT continues to stonewall on provision of interconnection at its ATM switch consistent with the Reference Paper.

The E.U.'s 8th Implementation Report corroborates the claims of new entrants and in particular states that "tariffs for most retail leased lines have remained unchanged from last year with the result that France remains above the E.U. average for most types and lengths of leased lines, with the exception of short distance high capacity lines (140/155 Mbits/s)."[1]

With regard to provisioning of leased lines, FT unilaterally has degraded the quality of service commitments contained in its local access leased line contracts with new entrants, and substantially stiffened the terms of such contracts. Such actions are highly detrimental to the businesses of emerging carriers. In particular, FT gives preferential treatment to its retail arm in the "premium" service that FT offers to its own clients covering repair times and guarantees on downtime, and which is not available for other operators. Such discrimination, lack of transparency and unreasonable delays in provisioning clearly violate Sections 2.2(a) and (b) of the Reference Paper.

In addition to the Reference Paper, Section 5(a) of the GATS Telecommunications Annex requires France to ensure that service suppliers of other WTO members have access to and use of public telecommunications transport networks and services on reasonable and non-discriminatory terms and conditions for their provisioning of value-added services.

GERMANY

USCIB members continue to face barriers in the German telecommunications market that constitute clear violations of the WTO Reference Paper and the GATS Telecommunications Annex. Indeed, the situation described in the comments submitted in last year's Section 1377 review has deteriorated over the past year.

Independent Regulator: RegTP remains incapable of enforcing its rulings in a timely and effective manner. RegTP lacks basic tools, such as the ability to levy meaningful fines for violations of its orders. Moreover, German law gives competitors no opportunity to examine the evidence presented by Deutsch Telekom (DT) to RegTP to justify telecommunications rates, and RegTP lacks the resources or institutional capacity to scrutinize this information with appropriate rigor. In addition, the absence of effective pro-competitive regulatory authority severely limits RegTP's ability to order DT to offer circuit capacity and leased lines in a manner consistent with the Reference Paper.

USCIB is concerned that the German Government continues to hold a direct and indirect ownership interest of 43% in the incumbent DTAG, which has resulted in more political pressure on RegTP in 2003. The proposed Amendments to the German Telecommunications Act ("Draft Act") that are currently being considered by the German legislature threaten to undermine even further the independence of RegTP. For example, the Draft Act would enable the Economics Ministry to appoint RegTP's board, which is charged with making key decisions regarding regulation of markets and effective remedies. This is likely to invite significant political influence over RegTP.

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[1] 8th Implementation Report, Annex 3, Country Report, France, p. 76

This influence is getting worse under the new proposed law, not better. Several provisions in the Draft Act severely curtail the independence of RegTP. These provisions allow the Ministry of Economics to replace RegTP decisions, and drastically extend the scope of potential governmental influence over decisions that should be taken by an independent regulator. For example, provisions of the Draft Act allow the Minister to effectively by-pass both the rights of competitors to be heard and the mandatory public consultation on fundamental regulatory questions laid down in Article 6 of the European Framework Directive (FD). In addition, the Draft Act allocates all basic decisions such as market definition, market analysis, and imposition of obligations to RegTP's "President's Chamber". Unlike the other chambers (so-called "Ruling Chambers"), which have technical, economic and legal expertise on board, the President's Chamber is made up exclusively of Board members who are political appointees. Not only does this lift everyday proceedings to management level, but under the Draft Act virtually all core elements of regulation are assigned to the chamber which arguably is subject to direct political influence.

It is essential that:

1. RegTP be free from influence from the political Ministries;
2. RegTP is granted the statutory authority to implement and enforce Germany's trade commitments; and
3. the courts have the statutory authority to hear appeals in a timely manner and to enforce Germany's trade commitments.

Other Violations: Germany has also failed to ensure non-discriminatory and reasonable terms and conditions in compliance with the GATS Telecommunications Annex and the interconnection provisions of the Reference Paper. This failure has resulted in high prices and lengthy provisioning delays for leased lines and the refusal to provide interconnection services in basic telecommunications. The Draft Act however, appears to eliminate any possibility for RegTP to address these problems by establishing impossible pre-conditions for regulatory intervention to address the conduct of operators that maintain significant market power in critical markets.

Specifically, the Draft Act introduces a new threshold for regulatory intervention that goes beyond the European rules: the absence in a given market of so-called "functioning competition". By using the term "functioning competition," the Draft Act adds an additional – and undefined -- test for ex ante regulation above and beyond the absence of "effective" competition that must also be ascertained before RegTP can take any action.[2]

Finally, the Draft Act reduces the number of remedies available to RegTP – from seven to three. Taken in combination with the additional requisite tests and preconditions, this reduction significantly curtails the ability of RegTP to address discrimination and other anti-competitive behavior, and prevents Germany from fulfilling its commitments to ensure non-discriminatory and reasonable terms and conditions with the Annex and interconnection provisions of the Reference Paper.

[2] Not only is this in breach of EU law, but it results in leaving operators and regulators with legal uncertainty -- guessing as to how the "functioning" of competition in a market should be established.

As USCIB noted in its comments last year, it is important that the Draft Act be modified to provide for stronger and more efficient enforcement vis-à-vis those basic wholesale interconnection products covered by and consistent with Germany's trade agreements, including the GATS Telecoms Annex and the Reference Paper. These products are essential for competing providers to introduce innovative services, particularly where the incumbent provides no similar retail service to end-users.

INDIA

Interconnection Usage Charge/Access Deficit Charge: In October 2003 the TRAI, India's telecommunications regulator, issued an Access Deficit Charge ("ADC") Regulation in connection with its Telecommunications Interconnection Usage Charge (IUC) Regulation, 2003. The new regulation relies on an imprecise calculation of the access deficit to be recovered and places a heavy recovery burden on international service providers and their customers. Accordingly, the regime remains inconsistent with India's WTO Commitment. The higher ADC charge on international traffic is inherently discriminatory against international operators, because international calls impose the same costs on the local network as do domestic calls, yet the international operators must pay a higher rate than domestic operators, and one that is clearly above-cost. Pressure should remain on the TRAI to eliminate the ADC and to encourage implementation of a transparent and non-discriminatory universal service policy. This will enhance competition in India and improve trade between the US and India.

Access to Submarine Cable Capacity: The Indian Government is violating its GATS Telecommunications Annex commitment by not ensuring reasonable and non-discriminatory access to and use of the submarine cable station controlled by VSNL, India's international carrier. VSNL has severely limited access to spare submarine cable capacity by refusing to allow access at reasonable rates. These actions have created an artificial shortage of submarine cable capacity, preventing competitive operators from meeting the full bandwidth demands of their customers and driving bandwidth prices for the capacity that is available to much higher levels than the prices for similar capacity on routes where the market is more competitive. VSNL's restrictions on access to submarine cable capacity are clearly inconsistent with India's GATS Telecommunications Annex commitment to provide access to and use of the public telecommunications network on reasonable and non-discriminatory terms and conditions.

MEXICO

The telecommunications market in Mexico is a major market for U.S. telecommunications companies and constitutes the second largest U.S. international route. Overall, the telecommunications market in Mexico is worth an estimated US$14 billion. U.S. companies continue to be harmed by Mexico's failure to implement its WTO obligations, which, if fully implemented, would allow effective competition to flourish. Such competition would provide benefits to customers, service providers and carriers in both countries bringing market growth, lower prices and the introduction of new and innovative services.

USCIB commends USTR's efforts to bring Mexico into compliance with its WTO commitments for basic telecommunications services, including a formal WTO complaint filed in February 2002 concerning international services that is currently before a panel established by the WTO Dispute Resolution Body. Press reports indicate that the panel has ruled that Mexico has failed to comply with its WTO obligations. However, major problems concerning Mexico's failure to allow fully open markets in domestic services also must be addressed as well as the lack of an effective and independent regulator.

Lack of Effective Regulation and Anti-Competitive Practices: The telecommunications regulator, Cofetel, was established under Mexico's New Federal Telecommunications Law in 1995, and reports to the Mexican Ministry of Communications and Transport (SCT). Cofetel repeatedly has failed to effectively regulate and enforce its regulations. U.S. telecommunications operators have voiced concerns about the problems inherent in Mexico's telecommunications regulatory environment and USCIB addressed these concerns in comments submitted in last year's 1377 review. The current regulatory climate continues to serve to sustain market dominance by Telmex and its subsidiaries, while offering potential competitors only limited opportunities to serve the market. The absence of an independent and effective regulator has had a negative impact on the development of competition. For example, Mexico has failed to maintain appropriate measures to prevent anti-competitive practices by Telmex, as required by Mexico's commitments under Section 1.1 of the Reference Paper. Although Mexico's Competition Commission, the CFC, has again found that Telmex possesses market power, Cofetel has failed to promulgate new dominant carrier rules to prevent Telmex from engaging in anti-competitive conduct.

Enforcement of dominant carrier safeguards is long overdue in Mexico. Telmex has denied competitors phone lines needed to provide service, priced its own services at predatory rates, refused to allow other carriers to interconnect to its network, and has withheld fees it owes competitors.

Cofetel's authority and enforcement powers need to be addressed. Cofetel's regulatory authority is limited to issuing recommendations to the SCT for the imposition of sanctions in instances in which telecommunications operators violate the telecommunications law or fail to comply with regulatory obligations. Upon receipt of Cofetel's recommendations, the SCT has the sole authority to implement or reject the sanctions. This regulatory structure has not been effective.

Interconnection: Mexico has failed to ensure the availability of cost-oriented interconnection arrangements with Telmex, its major supplier, as required by Section 2.2 of the Reference Paper.

On-Net Interconnection: For interconnection of domestic long distance calls to Telmex's network in a city where a new competitive carrier has a network, Cofetel allows Telmex to charge competitive carriers 0.975 cents per minute for 2002 interconnection, without any cost justification. In addition, long distance carriers must pay a "call attempts" surcharge (2.85% of the interconnection charge) and 0.53 cents per interconnection minute for special projects, resulting in a net payment of 1.53 cents per minute. By comparison, long-distance

interconnection in countries with effective competition is routinely available for about one cent per minute.

Off-Net Interconnection: For interconnection of long distance calls to areas of Mexico where equal access interconnection arrangements are not available, or where a new competitive carrier does not have a network, Telmex charges competitive carriers a "resale" tariff rate. The resale rate is currently about 8 cents per minute, about four times the level of a cost-oriented rate. The resale rate is based, without cost justification, on a 25% discount from Telmex's commercial rates to customers. Similar regional interconnection is routinely available in countries with effective competition for approximately 2 cents per minute.

Local Interconnection: Mexico has also failed to ensure timely, non-discriminatory, cost-based interconnection for local competitors. Although Telmex has recently provided interconnection to several carriers, Telmex has imposed several restraints to prevent full and fair competition. While USCIB does not have a position on "bill and keep" we do have concerns about discriminatory practices in the application of Telmex' "bill and keep" system that selectively benefits only Telmex. Additionally, the lack of interconnection quality standards results in routing and programming failures for competitors' local service traffic. Furthermore, Telmex imposes several restrictions on the provision of transit services between local service providers and long distance networks that increases competitors' costs and results in degraded service levels.

<u>Prohibition on Foreign Ownership and Control:</u> Mexico should eliminate its prohibition on foreign control of Mexican "concessionaires" (carriers authorized to own and operate basic telecommunications facilities), which is also contrary to Mexico's WTO obligations.

Lastly, USCIB is concerned about the impact of various tax measures on the telecommunications business. For example, effective January 1, 2002, the Mexican government imposed a new 10% luxury tax on certain categories of mobile telecommunications. The newly adopted tax unjustly burdens the mobile communications sector, particularly considering that it has been levied in addition to an existing 15% value added tax. The revenue benefits that the Mexican Government hopes to gain through the implementation of the mobile tax are likely to be largely offset as a result of its detrimental effect on users and on investment in mobile communications facilities and services.

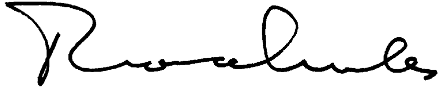
CONCLUSION

USCIB would like to close by emphasizing the importance of a strong and effective regulatory authority with the powers necessary to ensure compliance with its decisions. Such regulatory authorities will enhance compliance with trade commitments and minimize barriers in telecommunications markets.

We appreciate this opportunity to provide our views and look forward to continuing to work with you on telecommunications trade matters.

We would be pleased to provide additional information if necessary.

Sincerely,



Thomas M.T. Niles