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Telecommunications: Termination Services

Addendum

The attached document, to be read in conjunction with S/NGBT/W/4, is circulated at the request of Australia to Members of the Negotiating Group on Basic Telecommunications.

TERMINATION SERVICES

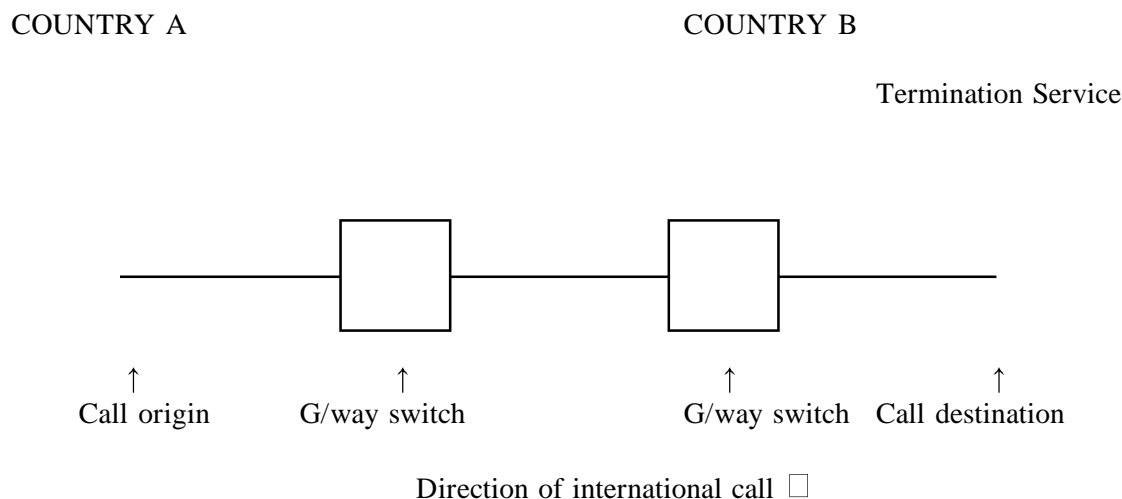
The GATS and Traded Telecommunications Services

1. The General Agreement on Trade in Services (GATS) and the Annex on Telecommunications provide agreed trade disciplines which should be capable of application to any traded telecommunications service sector.
2. These disciplines include MFN (Article II), transparency (Article III), domestic regulation (Article VI), monopolies (Article VIII), business practices (Article IX), market access (Article XVI) and national treatment (Article XVII). The application of such disciplines to traded services in the basic telecommunications sector would yield significant economic welfare gains.
3. It is important that the coverage of such disciplines is comprehensive and that the definition of traded services captures the realities of the modern market place.
4. In the past, trade in the basic telecommunications sector has been masked because until recently most countries regarded basic telecommunications as a service provided by state-owned monopolies. The international telecommunications framework that evolved was intended to facilitate co-operation between these monopolies (usually state-owned) so that services could be delivered. This framework did not anticipate, nor allow for, the competition that has developed with widespread liberalization. The framework resulted in relatively high charges for services and restricted demand.
5. Australia is concerned to ensure that the traded elements of the basic telecommunications are recognized as such and that these elements are subject to agreed trade disciplines. This is in line with ITU recognition that the exchange of basic telecommunications between carriers is trade (Section 2.5 of the World Telecommunications Development Report 1995).

Trade in Termination Services

6. Australia has assessed that one of the major traded services in basic telecommunications is the service provided to deliver (terminate) an international call. Estimates of the annual turnover in trade of such termination services ranged between US\$35 billion and US\$42 billion in 1993.
7. As already described in S/NGBT/W/4, termination services are the services which network operators provide each other when they allow access to their networks through international interconnection. They are the only traded element in the cross border provision of international telephone services.
8. Termination services do not cover the commerce between the customer and the operator in the country of origin or destination country of an international call. Rather, termination services are about operator-to-operator trade.
9. For example, a call which originates in Country A is transported from the originating network to the destination network in Country B. An interconnection point (gateway switch) transfers the call to the terminating network in Country B. This network then delivers (terminates) the call to its final destination.

Figure 1. Termination Services



10. From this description, it is clear that the operator originating the call in Country A (and/or the operator providing gateway to gateway transport in a liberalized environment) is the consumer of the service provided by the operator in Country B in completing (terminating) the call (1). The operator in Country A (and/or the operator providing gateway to gateway transport) could be expected to have some contractual arrangement with the operator in Country B to ensure that these services are provided efficiently and for an agreed charge.

11. An international system has been put in place to facilitate termination services. Bilateral agreements have been reached between operators in accordance with Article 1, paragraph 1.5, of the International Telecommunications Regulations and other recommendations of the International Telecommunications Union (ITU).

12. These agreements set a notional charge (accounting rate) for each minute of bilateral traffic. Total minutes of termination services provided by the operator of one country are offset against the total minutes provided by the other. The settlement rate (i.e. half of the accounting rate) is then applied to the imbalance of minutes and paid periodically.

13. These agreements provide a mechanism for the service user (i.e. operator) in Country A to purchase the termination services of the operator in Country B and to pay for these purchases in a simplified manner. They traditionally have been a reflection of the market power of state-owned monopolies. The element of trade in services (i.e. the termination service) has been obscured by accounting settlement rate structures.

14. With the move away from the monopoly situation in many countries and increased competition, trade in termination services is more clearly identifiable. Using the example above, the operator in Country A may now be able to choose between a number of operators in Country B to terminate the call. (2) This choice should be based on normal trading considerations including transparency, MFN and National Treatment.

Tariff effect of termination services agreements

15. The trade impact of current arrangements for termination services, especially charges for termination services by operators, may be likened to the impact of a tariff on goods. The difference between charges derived from accounting rates and the base charges for domestic termination of calls is the tariff equivalent for termination service charges.

16. For example, in future 1 above, Country B is the destination country. It seems reasonable to assume that the cost of terminating a call from the gateway switch in Country B is the same for domestic subscribers in Country B and the operators of countries originating the call (e.g. Country A).

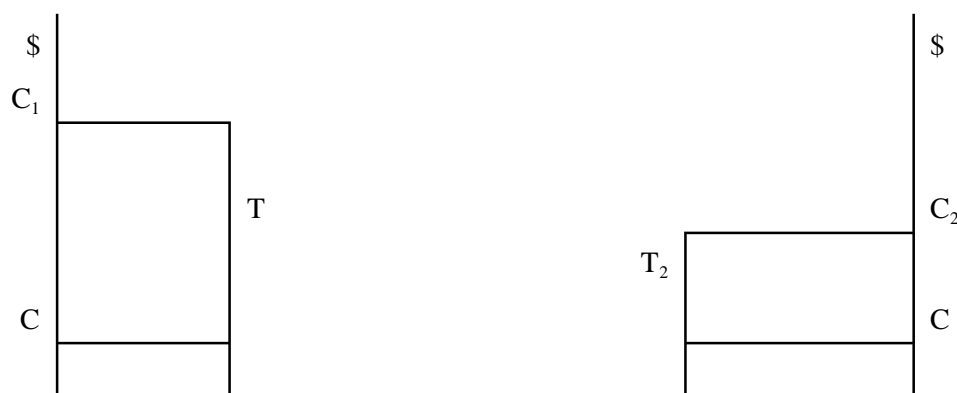
17. There are a number of possible ways to arrive at a measure of the average domestic cost for terminating a call from the gateway switch. One may be a weighted average of all domestic and local long distance call charges. Such a measure would actually exaggerate cost because it would include billing and marketing costs. Another (and even higher) measure would be the charge to domestic subscribers of the longest long-distance calls.

18. If we compare our measurement of the cost of terminating a call from the gateway switch with the charge to foreign operators through accounting rates we could arrive at a tariff equivalent of the effect of accounting rates.

19. In figure 2 below, C represents a measurement of average cost of terminating a call to a domestic subscriber from the gateway in Country B. C_1 represents the charge (as derived from accounting rates) to the international operator in country A for the termination of a call in Country B. The tariff equivalent of the accounting rate is represented by T.

20. Because agreements between operators are made at a bilateral level, these tariff equivalents tend to be MFN-inconsistent. The operator in Country B is able to charge different rates to operators in different countries. For example, in figure 2, C_2 shows the charge imposed by the operator in Country B on an operator in Country C and the corresponding difference is T_2 or the tariff equivalent.

Figure 2: Accounting rates and tariff equivalents



21. Just as the tariffication and eventual reduction of barriers to trade in other sectors are known to result in economic gains, we would expect that any disciplines imposed on tariff equivalents in termination services could be expected similarly to result in economic gains.

Trade distorting features of current system

22. The current international system for facilitating termination services has significant trade distorting effects. The Australian approach to termination services seeks to bring them under GATS disciplines to minimise these distortions.
23. The present accounting and settlement rate systems for payment of termination services results in:
- arbitrary setting of charges well above costs; and
 - bilateral arrangements which are MFN-inconsistent.
24. The current system, where GATS disciplines are not applied, allows monopoly and dominant operators to take their monopoly rent and exercise price discrimination across markets.
25. The accounting rate system locks operators into price distorting behaviour. For example, if an operator were to reduce its charges to subscribers on a unilateral basis it would face the penalty of increased out-payments to foreign operators. This is because the demand stimulated by the price cuts would lead to more minutes of termination services in the country of destination thereby increasing the imbalance of minutes on which the operator would be forced to pay the high settlement rates of foreign operators.
26. The non-MFN nature of accounting rate setting accentuates these distortions. An operator in one country is able to set different accounting rates for the operators in different countries, even though the cost of providing the termination service could be expected to be the same.
27. Increased competition alone, without the application of GATS disciplines to the existing framework, will not force reform of the accounting rate system. Operators losing traffic to value-added services such as call-back, which bypass the agreements between operators and the accounting rate system, have an incentive to increase accounting rates to eliminate the arbitrage opportunity between charges for inwards and outwards call. Current call back and refile regimes are non-transparent and may lead to added distortions.

Applying provisions of the GATS to Termination Services

28. Having described the nature of termination services, the agreements which support them and their trade-distorting effects, it is easier to see the relevance of applying GATS disciplines to this traded service.
29. It is possible to relate the General Provisions of the GATS to different aspects of the trade in termination services. If we adopt an Article by Article approach, we see that the definition of measures by members affecting trade in services as set out in Article I.3(a) would seem to capture the agreements between operators that regulate trade in termination services even when these are negotiated by commercial parties. This is because most operators are either State-owned operators (i.e. "central governments" or "authorities" as per I.3(a)(i) under International Telecommunications Union treaties or privately owned operators exercising "powers delegated by governments or authorities" (as per Article I.3(a)(ii)).
30. Agreements between operators on termination services are unlikely to be consistent with the MFN provisions of Article II. This is because of the differential pricing system entrenched in such agreements. Australia suggests that countries that wish to maintain such agreements would need to

seek MFN exemptions after 30 April 1996 when the suspension of Article II for the basic telecommunications sector ends.

31. Transparency and the free flow of information is important for commercial decision making and the liberalization of trade. Article III explicitly calls for members to publish "all relevant measures of general applications, which pertain to or affect the operation of this Agreement. International agreements pertaining to or affecting trade in services to which a member is a signatory shall also be published".

32. Agreements between operators on termination services (whether commercial or not) are both "measures" and "international agreements" within the meaning of Article I.3(a). As such they should be subject to the transparency provisions of Article III, except where the disclosure of confidential information would be contrary to the public interest or would prejudice legitimate commercial interests (Article III bis). It is difficult to think of grounds on which these legitimate commercial interests would be prejudiced.

33. In view of the monopoly status of many operators of basic telecommunications services, and the joint agreements reached between such operators on the provision of termination services, Article VIII on monopolies and exclusive service suppliers is applicable, particularly paragraph 1 (which appears to direct members to ensure that monopoly operators provide termination services on an MFN basis). In the event that a Member believes that the monopoly supplier of a service of any other Member is acting in a manner inconsistent with provisions of Article VIII.1 and 2 it has the right of recourse to the Council for Trade in Services. The Council may then request the Member establishing, maintaining or authorizing such a supplier to provide specific information concerning the relevant operations. In the case of termination services this could include specific information on agreements between operators.

34. Current agreements on trade in termination services clearly restrict trade in services because of the large difference between cost and charges and the consequent impact of this on demand. Where business practices (not falling within Article VIII), such as those enshrined in termination services agreements, restrain competition and trade in services, Article IX provides for consultations between members with a view to eliminating those practices.

Specific commitments

35. It is clearly possible to list specific commitments for trade in termination services as set out in S/NGBT/W/4. The model schedule in that paper contained comprehensive examples of limitations on market access, limitations on national treatment and additional commitments across modes of supply 1, 3 and 4 for termination services.

36. For example, under limitations on market access for cross-border supply, participants could schedule any limitations on the places of entry to or exit from the market such as the gateway switch or national extension. Similarly, limitations could be scheduled on the number of foreign service providers national service providers can either sell or buy termination services to or from.

37. Under national treatment for cross-border supply participants could schedule preferences given to domestic suppliers such as pricing or conditions of interconnection with or access to networks of national service providers including licensing and regulatory approval.

38. The Secretariat's informal note of 14 February on Modes of Supply and Market Access Limitations also gave some examples of how termination services could be scheduled.

Developing countries

39. Many countries, particularly developing countries, wish to raise development revenue from international telephone services, including the traded element of termination services. Some governments establish monopoly or exclusive international telecommunications service providers so that they can raise revenue by setting charges at a level higher than the cost of providing the service efficiently. However, under the accounting rate system, such development revenue collection can be applied on a discriminatory basis, depending on the market power of other operators. This results in trade distortions.

40. Under a non-discriminatory, transparent and eventually cost-based termination service system, governments in developing countries could replace revenues raised by operators from monopoly pricing with non-discriminatory and transparent taxes on international traffic. This would contribute to the elimination of distortions which create arbitrage opportunities for call-back operators, that reduce the utilization of developing countries telecommunications transport network systems. Over time and consistent with the special and differential needs of developing countries as recognized in GATS Article IV, these taxes could be disciplined to improve competitive markets.

Australian approach

41. The current arrangements for termination services constitute a serious barrier to trade. The effect of these arrangements is to cut demand by as much as one-half according to some research. Australia's proposals on termination services could have a valuable trade-liberalizing effect on basic telecommunications. At the very least, the trade-distorting effect of termination services would be made transparent through the application of general GATS provisions in concert with scheduled commitments.

42. The general provisions which need to be addressed as a matter of priority for termination services are MFN (Article II) and transparency (Article III). Operators in the country of origin of an international telephone call need to have reasonable information on the means, conditions and cost of gaining access to the destination network. Operators also need to know whether they are at any competitive disadvantage vis-a-vis another operator.

43. Operators should be required to publicise termination rates. This would enable competitive forces to operate more effectively to bring down the charges to operators for termination services. It could be expected that this would, over time, have a flow-on effect for subscribers initiating an international telephone call. Publication of terminations services rates strictly speaking need not be a requirement in all cases (e.g. agreements between operators of members where there is genuine open competition), but would be highly desirable in order to assess whether GATS provisions are being observed.

44. The scheduling of specific commitments would impose an added discipline on trade in termination services. Over time the tariff equivalent inherent in accounting rates could be subject to tariffication and reduced.

45. The liberalization of trade in termination services is an integral part of the NGBT's mandate to achieve "the progressive liberalization of trade in telecommunications transport networks and services".

Footnotes

- (1) This ignores other arrangements such as refile and transit.
- (2) However, even in countries where competition is allowed, there are usually measures to restrict choice, e.g. the parallel accounting rate and proportional return requirement.