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Japan's Telecommunications Deregulation: NTT's Access Fees and Worldwide Expansion

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Summary

In July 2000, the United States and Japan reach a negotiated settlement on Japan's costly rates for telecommunications companies to hook into the telephone network owned by the Nippon Telegraph and Telephone Company (NTT), Japan's dominant provider of telecom services. Japan agreed that NTT would lower its rates for regional access by 50% and local access by 20% over two years. NTT also is attempting to acquire Verio, an Internet service provider in the United States.

Nippon Telegraph and Telephone (NTT), Japan's former domestic telephone monopoly, is being privatized, but it still is majority owned (53%) by the government and charges high rates for foreign telecommunications suppliers (including U.S. Internet providers) to connect to its telephone network. The United States claims that Japan's expensive interconnection fees violate that country's commitments under the World Trade Organization¹ and disadvantage non-NTT Internet suppliers. As part of U.S.-Japan deregulation talks, the U.S. Trade Representative and others have been discussing the issue with Japan. Japan had proposed that interconnection charges by NTT be reduced a total of 22% by 2004, while the United States has pressed for a cut in rates of 41% by 2002. On July 18, 2000, the two sides agreed that Japan would lower its rates for regional access by 50% and for local access by 20% over two years.²

On July 5, 2000, ten U.S. senators sent a letter to the Ambassador of Japan to urge a resolution of the telecommunications trade issue before the Group of Eight (G-8) Economic Summit in Okinawa on July 21-23, 2000. In the 106th Congress, Senate Resolution 275 (Sense of the Senate Regarding Fair Access to Japanese

¹ The annex on telecommunications to the WTO's General Agreement on Trade in Services relates to measures which affect access to and use of public telecommunications services and networks. It requires that such access be accorded to another party, on reasonable and non-discriminatory terms, to permit the supply of a service included in its schedule.

² U.S. Trade Representative. United States and Japan Agree on Interconnection Rates. Press Release 00-55, July 18, 2000. On Internet at [<http://www.ustr.gov>].

Telecommunications Facilities and Services) was passed and engrossed in H.R. 434 (Section 709, P.L. 106-200, signed May 18, 2000).

NTT's majority owned mobile telephone unit DoCoMo also has been building an international network primarily by purchasing shares of foreign telecommunications companies. The company already is moving into Europe and is attempting to purchase a controlling share of the Englewood, Colorado based Verio, Inc. for \$5.5 billion. Verio is a major provider of Internet services to corporations. The FBI has raised national security concerns about this planned acquisition.³ Under section 721 (the Exon-Florio provision) of the Defense Production Act of 1950 (enacted in 1988), the President is authorized to suspend or prohibit any foreign acquisition, merger, or takeover of a U.S. corporation that is determined to threaten the national security of the United States.⁴ The committee reviewing the case has until August 14, 2000, to either have the FBI and NTT's DoCoMo reach a satisfactory compromise or to report its decision to the President who then has 15 days to take action. On May 25, 2000, seven Republican members of the House Commerce Telecommunications subcommittee sent a letter to the USTR citing NTT's failure to institute "fair cost based interconnection rates" and criticizing the proposed Verio purchase.⁵ It is unclear whether the provisions of S. 2793 (Hollings), which strengthens the limits on the holding of and transfer of broadcast licenses and other telecommunications media to foreign persons or governments, would apply to the NTT-Verio case, since Internet service providers do not need a telecommunications license.

Both NTT and NTT DoCoMo are huge companies. According to a *Business Week* ranking of global corporations, as of May 31, 2000, NTT DoCoMo was valued at \$247.24 billion which made it the world's eighth largest company (up from 27th in 1999) by market value. NTT was fifteenth (down from thirteenth in 1999) at a market value of \$189.16 billion. Both NTT and NTT DoCoMo are larger than Deutsche Telekom (\$187.25 billion), France Telecom (\$148.71 billion), AT&T (\$109.10 billion), and British Telecommunications (\$93.70 billion).⁶ If combined, the two NTT companies would rank as the second largest company (in terms of market value) in the world behind General Electric and ahead of Intel, Cisco Systems, and Microsoft.

³ The FBI reportedly is concerned that its ability to enforce wiretap laws would be compromised by foreign ownership of Internet service providers. Schwartz, John. FBI Intervenes in Planned Sale of Internet Service to Japanese. *Washington Post*, July 7, 2000. P. E4.

⁴ The security review is conducted by the Committee on Foreign Investment in the United States (CFIUS), which consists of eleven members from various executive branch departments and is headed by the Secretary of the Treasury. Once CFIUS has received a complete notification, it begins a thorough review of the notified transaction. If an extended review or investigation is necessary, CFIUS must begin it no later than 30 days after receipt of a notice and end within 45 days. For details on the operations of CFIUS, see its Internet site at [<http://www.ustreas.gov/oasia/oii.html>].

⁵ Pressure Mounts on Japan on Telecommunications Competition. *Inside U.S. Trade*, June 9, 2000. Internet edition.

⁶ The Global 1000. Special Report. *Business Week*, July 10, 2000. p. 107ff.

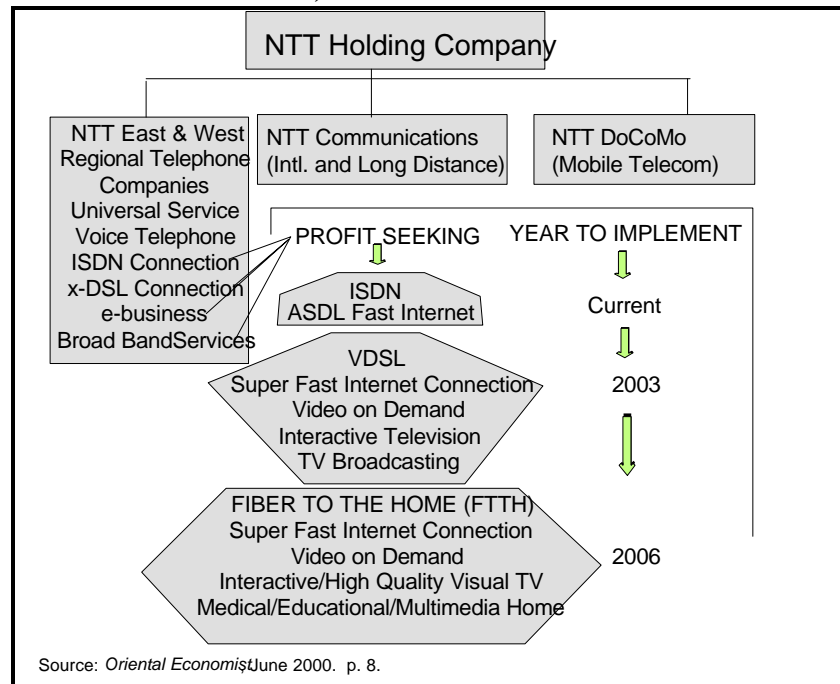
Background

In U.S. economic relations with Japan, the United States has pursued a multi-faceted approach that has included encouraging major structural reform in Japan to open more sectors to competition. The global Internet revolution has pushed Internet access and the provision of Internet service in Japan to the forefront of concerns by U.S. companies. This is an area in which U.S. providers are competitive and offer leading technologies.

Since the Denver G-7 summit on June 19, 1997, the United States and Japan have been negotiating over various issues under the framework of the Enhanced Initiative on Deregulation and Competition Policy. With respect to the telecommunications sector under this initiative, Japan is to undertake specific new measures to introduce more competition into its \$130 billion telecommunications market. Specifically, Japan is to ensure that interconnection rates – the rates charged competitors of NTT to access the majority of Japanese customers – are set below retail rates; define measures that will assure NTT DoCoMo’s (mobile/cellular service provider) interconnection rates are more fairly priced by being purely based on costs; authorize an inter-connection “clearing-house” for new entrants in the Japanese market which will dramatically speed market entry and liberalize the use of flexible network arrangements, thus allowing businesses to build out their networks more rapidly and efficiently.⁷

Over the more than two years that the United States and Japan have been negotiating over NTT’s inter-connection rates, the Japanese position has been that NTT’s pricing policies are justified by its costs. The U.S. side, however, has pointed out that NTT’s method of calculating costs includes too many fixed costs that have already been incurred rather than using a methodology (Long Run Incremental Cost

Figure 1. NTT’s Organization and Plans for Future Internet, TV, and Other Services



model) scheduled to be implemented by NTT by the end of 2000 that uses only future

⁷ U.S. Trade Representative, Government of Japan. Second Joint Status Report under the U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy. May 3, 1999. On the Internet at [<http://www.ustr.gov/releases/1999/05/index.html>].

costs in calculating rates.⁸ NTT's argument that it requires more costly interconnection rates has been weakened considerably by the high rate of profit reported by its East regional telephone company.⁹

The cost question also is muddled by NTT's role as a provider of universal telephone service in Japan. As shown in Figure 1, the NTT Holding Company is organized into NTT East and NTT West regional telecommunications companies, NTT Communications (long-distance and International), and NTT DoCoMo (mobile/ cellular telecommunications). Under the regional telecom companies, NTT plans to offer Internet service, e-business, and TV broadcasting as profit seeking-activities. An important question is to what extent NTT should have to provide services to customers in remote areas at the same price charged those in cities as it has traditionally done for telephone services. The amount NTT charges other companies to connect to its lines in urban areas determines, to some extent, the funds it will have available to subsidize high-cost remote connections.

Figure 1 also shows NTT's plans for future provision of profit-seeking activities in the Internet and in broadband services (TV broadcasting). This is where interconnection fees would become critical for foreign companies hooking into NTT's transmission system. The company currently offers ISDN (Integrated Services Digital Network) at 128 kilobits per second, a relatively slow Internet connection. NTT also offers ADSL (Asymmetric Digital Subscriber Lines) at a few megabits per second, a fast Internet connection that can handle video on demand. By the year 2003, NTT plans to offer VDSL (Very-high-bit-rate Digital Subscriber Lines at about 52 megabits per second) technology. VDSL allows a super-fast Internet connection, video on demand, interactive TV, and TV broadcasting. By 2006, NTT plans to offer FTTH (Fiber To The Home) technology with transmission speeds of 1 gigabit per second. It would carry services provided under VDSL, but at a much faster rate, as well as high-quality visual television broadcasting, medical care and educational programming delivered to an individual subscriber and other services of a future multimedia-capable home.¹⁰ The market for these telecommunications services in Japan is large and growing. The U.S. contention is that foreign firms should have access to this market on an equitable basis and in accord with Japan's obligations under the World Trade Organization.

As part of the deregulation of Japanese companies, government-mandated divisions and government-sanctioned monopolies have been disappearing. In the case of NTT, it had held a domestic monopoly on the provision of telephone services, but it also had been barred from doing international business (done by KDD, Kokusai Denshin Denwa). Among the major carriers in the world, it is the only one that has not developed international operations. NTT now is attempting to become a global power – hence its recent deals to acquire foreign telecommunications companies.

⁸ U.S., Japan Fail to Agree on Telecom Deregulation, Expect New Try. *Inside U.S. Trade*, March 24, 2000. Internet Edition.

⁹ Landers, Peter. Japan Signals a Truce in U.S. Phone Spat – To Resolve Trade Impasse Tokyo Seeks to Speed Cut in Charges by NTT. *Wall Street Journal*, July 3, 2000. P. A9.

¹⁰ For a discussion of these issues in terms of the U.S. market, see CRS Issue Brief IB10045, *Broadband Internet Access: Background and Issues*, by (name redacted) and (name redacted).

Table 1 lists foreign acquisitions and the establishment of overseas subsidiaries by NTT. As is apparent, NTT is attempting to establish a world-wide network through focusing on Asia and on the more industrialized economies of the world. It is in the U.S. interest to ensure that U.S. and other companies have comparable access to Japan's home telecommunications market as NTT has in U.S. and other telecommunications markets in the world. Monitoring Japan's compliance with the July 2000 agreement, pressure on Japan to further deregulate its telecommunications sector, and if necessary for the United States to take unsettled issues before the dispute resolution mechanism of the World Trade Organization is the strategy the United States is now pursuing.

Table 1. Nippon Telegraph and Telephone's Major Equity Investments in Overseas Corporations

Country	Company
U.S.	Verio (\$5.5 billion acquisition, pending) NTT America (subsidiary)
U.K.	NTT Europe (subsidiary)
Netherlands	Royal KPN NV (15% stake, pending)
France	DoCoMo Europe S.A. (subsidiary) NTT France (subsidiary)
Germany	NTT Deutschland (subsidiary)
Australia	Davnet Telecommunications Pty Ltd.
Brazil	NTT do Brasil (subsidiary)
Hong Kong	HKNet Co. Ltd. (pending) Hutchison Telecommunications (19% stake, \$410 million) NTT Hong Kong (subsidiary)
Korea	NTT Korea (subsidiary)
Malaysia	Telekom Malaysia Bhd. (pending) NTT MSC (subsidiary)
Philippines	Philippine Long Distance Telephone Co.
Sri Lanka	Sri Lanka Telecom Ltd.
Singapore	StarHub Ltd. NTT Singapore (subsidiary)
Taiwan	NTT Taiwan (subsidiary)
Thailand	NTT (Thailand) (subsidiary)

Sources: NTT on Internet at [<http://www.ntt.co.jp>]. Guth, Robert A. NTT Takes on the Big Boys. *Asian Wall Street Journal*, June 5-11, 2000. P. 1, 8.

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