

Japan-US Telecommunications Negotiations in A New Phase: States and Markets
- Final Report by the Study Group on US Foreign Economic Policy Making Process –

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Introduction

For more than two decades, Japan and the United States have negotiated over trade in telecommunications equipment and services. Under the changing circumstances, however, Japan-US telecommunications negotiations entered upon a new phase in the late 1990s. The issue of telecommunications equipment is no longer on the table. Instead, the issue of telecommunications services has become a major point of contention, further internationalizing domestic regulatory politics. Last but not least, the World Trade Organizations (WTO) Telecom Pact of 1997 provided the parties with new opportunities and constraints, possibly altering the course of interactions among them.

In this paper, we examine the new phase of Japan-US telecommunications negotiations by analyzing the cases of procurement and interconnection charges of Nippon Telegraph and Telephone (NTT). Our argument is that the bilateral telecommunications talks between Japan and the United States are now conducted within the purview of multilateral institutions, but are characterized by “bilateral twists” to multilateralism.

1. NTT Procurement Negotiations

The negotiations on the procurement of the (then) NTT Public Corporation were the cornerstone of Japan-US telecommunications talks. The NTT procurement talks were derived from the Tokyo Round negotiations (1973-1979) held under the auspices of the General Agreement on Tariffs and Trade (GATT). The Tokyo Round addressed the issue of non-tariff barriers (NTBs) for the first time in the history of multilateral trade negotiations and hammered out a set of codes on NTBs, including a code on government procurement.

Along with other NTB codes, Japan committed to the government procurement code, but it exempted public telecommunications equipment from the commitment. This disappointed the US trade negotiators. Claiming that Japan had not offered sufficient amount, the United States eventually requested that Japan add NTT Public Corporation to the list of government agencies to be covered by the procurement code. So began the first Japan-US telecommunications negotiations.

The NTT procurement talks focused on procedures, rather than the amount, of NTT Public Corporation's procurement. At that time, the state-owned NTT Public Corporation was the sole provider of telecommunications services in Japan. It also was a national research and development (R&D) institution dedicated to promote advances in Japan's telecommunications technologies through a process of procurement based on "voluntary contracts" with manufacturers. Such cooperation in technology and management resulted in close relations between NTT Public Corporation and the contracting equipment suppliers, which was dubbed "the NTT family". Yet the strong tie between NTT Public Corporation and the suppliers was maintained at the expense of foreign as well as domestic manufacturers that did not have contracts with NTT. To open the telecommunication equipment market in Japan, the bidding system of NTT Public Corporation had to be transparent.

After three years of pulling and hauling, the governments of Japan and the United States reached an agreement in December 1980. The NTT Procurement Agreement provided that, in accordance with the nondiscrimination principle of the government procurement code, NTT should ensure transparency in procurement procedures and purchase equipment without regard to the national background of manufacturers. The agreement entered into force in 1981, and promoted foreign participation in NTT Public Corporation's bids for equipment procurement. Over the years, NTT's procurement procedures became open and competitive.

2. Expiration of the NTT Procurement Agreement

NTT Public Corporation was privatized and reorganized into NTT Corporation in 1985, but the NTT Procurement Agreement remained intact and in force. The agreement was extended six times in total, spanning the period before and after the privatization of NTT. During that period of time, the amount of foreign products purchased by NTT increased dramatically in terms of value as well as ratio. The total amount of international procurement was 173 billion yen in FY 1996, which is a 40-fold increase from the 4.4 billion yen in FY 1981. The US government and industry complained less often and even began to appreciate NTT's international procurement activities. It thus can be argued that the NTT Procurement Agreement substantially improved foreign access to Japan's telecommunications equipment market.

The continued existence of the agreement was called into question in 1999, however, when the decision was made to split the mammoth carrier into two regional companies, NTT East and NTT West, and a long-distance services provider, NTT Communications, under a holding company. Should the NTT Procurement Agreement be extended after the restructuring the NTT or should it be allowed to expire? To find an answer to this question, the Japanese and US governments in May 1999 resumed negotiations to discuss the fate of the NTT Procurement Agreement.

At the meetings, the US government insisted that the NTT Procurement Agreement be extended to cover the restructured NTT companies. The Japanese government, on the other hand, insisted that

the restructured NTT companies not be subject to inter-governmental agreements. In spite of the differences in views, however, the negotiators managed to strike a deal in July 1999. It was agreed that the NTT procurement agreement would be laid to rest after a grace period of two years. It was also agreed that, after the restructuring, the holding company, NTT East and NTT West would make procurement rules publicly available and continue efforts to purchase foreign products. Finally, it was agreed that, during the grace period, issues concerning the procurement of NTT companies would be addressed at governmental meetings.

As agreed, the NTT Procurement Agreement expired in July 2001. The expiration meant that the first agreement made at the telecommunications negotiations between Japan and the United States became a thing of the past.

3. The WTO Basic Telecom Pact

While the Japan-US negotiations on telecommunications equipment evolved in connection with the GATT, what few negotiations Japan and the United States had on telecommunications services used to be confined within the bilateral framework. Multilateral institutions simply did not exist. This was the case with the talks over the international value-added network (VAN) in 1990 and the talk over the international leased lines in 1991. The WTO Basic Telecommunications Talks then produced multilateral agreements and changed the framework of reference in the bilateral negotiations.

The WTO Basic Telecommunications Talks is a follow-up of the Uruguay Round negotiations (1986-1994). The Uruguay Round succeeded in crafting an agreement on value-added or computer-enhanced telecommunications services and included it into the General Agreement on Trade in Services (GATS). However, basic telecommunications services such as telephones and facsimiles were carried over to the post-Uruguay Round negotiations.

The WTO negotiations on basic telecommunications began in April 1994 and concluded in February 1997. The purpose of the negotiations was to further the liberalization of telecommunications services trade by improving market access. In other words, the negotiations aimed at removing the barriers against foreign entry to the telecommunications service market, including regulations that restricted opportunities for new entrants. To attain this purpose, the participating countries exchanged offers and requests for commitments on the scope and conditions of liberalization. The commitments were then annexed to the Fourth Protocol of GATS as the Schedule of Specific Commitments.

Another important achievement of the basic telecommunications talks was the Reference Paper, which provides a framework of pro-competitive regulatory policies. The Reference Paper essentially was a safeguard for the market access commitments. Because the commitments could be negated by anti-competitive activities of incumbents or inadequate access to the networks of major suppliers, it

was necessary to establish a set of common regulatory principles that countries would follow to promote liberalization. With regard to interconnection charges, the Reference Paper stipulates that interconnection be provided “at cost-oriented rates that are transparent, reasonably, having regard to economic feasibility, and sufficiently unbundled”. The Reference Paper itself is not legally binding, but it becomes so with additional commitments by the parties. Interestingly enough, it was Japan that took the initiative in drafting the Reference Paper. The paper became a pride of the Japanese negotiators in Geneva.

The WTO telecom deal had different implication for US officials, particularly for the United States Trade Representative (USTR). In effect, the WTO Basic Telecom Pact gave the USTR new clout to pursue the policy objective of opening foreign telecommunications markets. Furthermore, it gave the USTR an additional mandate to fulfill under the Omnibus Trade and Competitiveness Act of 1988.

Section 1377 of the 1988 Act mandates that the USTR annually review foreign compliance with telecommunications trade agreements between the United States and its trading partners and submit a report to Congress. If a trading partner is found to have failed to implement an agreement, the USTR may initiate procedures to retaliate against that country by invoking Section 301 of the Trade Act of 1974. Since the enforcement of the 1988 Act, Section 1377 reviews essentially have set the agenda for Japan-US telecommunications negotiations. In other words, the governments of Japan and the United States have discussed issues or “concerns” identified in the Section 1377 review report.

It should be noted that the USTR is required to review *existing* international agreements. The USTR began the Section 1377 review with bilateral agreements, including the NTT Procurement Agreements and other agreements with Japan. With the entry into force of the WTO Basic Telecom Pact, WTO agreements were also included among the international agreements under the scrutiny of the USTR. In this sense, the conclusion of the WTO Basic Telecom Pact expanded the range of agreements the USTR is to review in pursuance to the US trade law.

However, the incorporation of the WTO Basic Telecom Pact into the Section 1377 review created a twisted situation from the viewpoint of multilateralism. Under Section 1377, the USTR may evaluate foreign compliance and decide to take retaliatory measures *outside the multilateral framework of the WTO*. In other words, it is the USTR, not the WTO, that decides whether the trading partners of the United States have appropriately implemented *multilateral agreements* and punish them in case of noncompliance. This unilateral nature of Section 1377 has given a twist to Japan-US telecommunications talks. It may even be argued that Section 1377, in effect, has provided the USTR with the opportunity to use the multilateral agreements as a means of pursuing its policy objectives through unilateral actions or bilateral negotiations.

4. NTT’s Interconnection Rates

The issue of NTT's interconnection charges came into the spotlight in the Section 1377 review and the subsequent Japan-US telecommunications negotiations in 1998, when the WTO Basic Telecom Pact went into force. Interconnection charges are the fee telecommunications carriers pay for accessing to the networks of a major supplier. Since the 1985 reform, many New Common Carriers (NCC) have entered the various segments of the telecommunications market --- including long distance and international services --- but the local telephone networks have still been dominated by NTT (NTT East and NTT West after 1999). As a result, NCCs have to link their networks to the networks of NTT at a high cost in order to allow their users to communicate with each other and with the users of NTT.

NCCs had long claimed that NTT charged them unreasonably high rates for interconnection. In fact, they had to spend approximately 40% of their revenue on interconnection charges. US carriers operating in Japan, such as AT&T and WorldCom, were no exception to this financial burden. Accordingly, the US carriers urged the USTR to negotiate with the Japanese government for the reduction of interconnection charges. They often did so through industry associations, as is evident from the comments of the Competitive Telecommunications Carriers Association (Comptel) and the United States Council for International Business (USCIB) submitted to the USTR at the time of reviews. The industry and the government of the United States shared the belief that lower interconnection charges would facilitate foreign entry and promote the liberalization of the Japanese telecommunications market.

As mentioned above, the Section 1377 review covered the issue of the interconnection charges of NTT for the first time in 1998. The Section 1377 review of 1998 maintained that the United States had "serious concerns " with the pace of telecommunications liberalization in Japan and suggested that Japan make efforts to ensure cost-oriented interconnection in accordance with the WTO obligations. However, the review did not reveal any specific violation by Japan.

Then, in the review of 1999, the USTR claimed that "over-priced interconnection rates" effectively prevented competition in Japan's local telecommunications market. The USTR urged Japan to take steps to ensure interconnection at cost-based rates within three months, and threatened that it would "consider appropriate options, including initiation of WTO dispute resolution proceedings." The US overture prompted negotiations between the governments of Japan and the United States. The governments eventually agreed that NTT would make maximum efforts to cut interconnection charges and the (then) Ministry of Posts and Telecommunications (MPT) would encourage NTT to do so.

The political tension over the NTT's interconnection charges reached a peak in 2000. The Section 1377 review of 2000 claimed that Japan failed to ensure cost-oriented interconnection in violation of its WTO obligations, allowing NTT to charge the interconnection rates higher than those of any other developed countries. On releasing the review report, the USTR indicated that, depending on the results of the meetings with the Japanese, it might be necessary to take "additional action, including in

the WTO” to ensure Japan’s compliance with its WTO commitments. As was the case with the review in 1999, the USTR set a deadline for the negotiations. It suggested that the decision on whether to take “additional measures” would be made by the end of June, when the summit meetings were scheduled to be held in Okinawa. The negotiations in the next three months were intense, but the two governments managed to reach an agreement before the deadline. It was agreed that NTT would reduce interconnection rates by 22.5% for a nominal period of three years and a substantial period of two years. It was also agreed that the governments would review the implementation cost-oriented methodology in 2002.

The Japan-US negotiations on interconnection charges revolved around the USTR’s claim that Japan had violated WTO agreements because it failed to ensure cost-oriented interconnection rates. More specifically, the USTR claimed that NTT’s interconnection charges were in violation of the Reference Paper, as they had not been properly calculated by the long run incremental costing (LRIC) model.

The US government pressed Japan to adopt the LRIC model as early as 1996. Partly as a response to the US pressure, and partly out of the efforts to be a “policy agency”, the MPT decided to adopt the LRIC model by 1998. The governments of Japan and the United States confirmed the MPT’s intention of adopting the LRIC model in a joint report on deregulation talks (“Enhanced Initiative on Deregulation and Competition Policy”), which was issued on the occasion of the Japan-U.S. summit meeting in May 1998. Therefore, the issue at the interconnection rate talks was not the adoption of the LRIC model *per se*, but the details of the model. The USTR argued that the Japanese version of the LRIC included non-traffic-sensitive costs and were against the principles of cost-orientation provided by the Reference Paper.

However, the Reference Paper merely calls for cost-oriented methodologies of rate calculation and does not require the participating countries to adopt any specific calculation model. In fact, the paper was not intended to be specific or precise. It is a commonly negotiated text that every participant could agree, and its interpretation is wide and open.

Oddly, the Japanese government raised little question about the propriety of the US government to monitor and evaluate Japan’s compliance with the WTO agreements. The Japanese furiously countered the US argument that Japan had violated the commitment to the Reference Paper, but they somehow shied away from questioning the unilateral basis of the claim, not to mention accusing the United States of unilateralism.

Multilateral institutions are intertwined with the Japan-US telecommunications negotiations in another way. The USTR has repeatedly referred to the possibility of filing the case to the WTO, but it never carried out this threat. Indeed, given the rather weak grounds for the claim, it is not certain whether Washington in actuality had the intention to file the case to the WTO. Whether the USTR bluffed or not, it seems that the US trade warriors have ingeniously incorporated the WTO telecom deal into their

negotiations strategy. This probably accounts for the observation that the negotiations over interconnection charges were haunted by the traditional features of the Japan-US trade talks: the United States pressuring for changes and Japan making concessions in the end. Unfortunately, it is doubtful that the acquisition of new leverage on the part of the United States has made the negotiations more productive.

Oddly enough, the Japanese government again gave little consideration to the possibility of redressing the bilateral twists by bringing the case to the WTO, even though it was resentful of the U.S. pressure. Rather than resorting to the WTO dispute settlement procedures, Japan sought to resolve the dispute within the bilateral framework. This negotiation strategy was advocated by top-level policy makers, i.e., senior officials of the Liberal Democratic Party (LDP). With the Okinawa summit meetings approaching, the senior policy makers hastily made compromises to settle economic disputes with the United States for the sake of a “friendly relationship”.

A shortage of time available for consideration tends to result in poor decisions. It turned out that the commitment to adopt the LRIC model and the commitment to lower interconnection charges are not necessarily compatible with each other. Experts in telecommunications now point out that calculation by the agreed-upon LRIC model will actually lead to an increase, not reduction, in the charges. Bound by its own words, the Japanese government has had to pay the price for rushing to a solution and accepting a flawed model that did not fit the reality. The lesson here is not to decide in haste and repent at leisure.

Conclusion

Japan-US telecommunications negotiations in the new phase can be viewed as a set of Chinese boxes. The bilateral negotiations between Japan and the United States are held within a larger framework of multilateral institutions, and are often driven by actual or potential unilateral behavior by the US government. A narrow focus on bilateral negotiations will never lead to a comprehensive understanding of the interconnection rate dispute.

Recent experiences suggest that the United States barely resists the temptation to use multilateral instruments to pursue its own policy objectives unilaterally or bilaterally. While diplomatic maneuver is a fact of life in international political arena, such use of multilateral agreements by the country with the world’s largest telecommunications market could undermine the credibility of the WTO regime on telecommunications services. Now that there exist multilateral institutions that govern telecommunications services trade, it is no longer appropriate or possible to confine telecommunications negotiations within the Japan-US bilateral framework. It should be recognized that the WTO has the ultimate responsibility to monitor compliance of signatory countries with the WTO agreements and that such monitoring does not fall in the jurisdiction of any specific national governments.

Japan, of course, is obliged to comply with its commitments in the WTO telecommunications deal. At present, it is fair to say that Japan has not yet completely implemented all of the principles provided in the Reference Paper. The real problem with Japan's telecommunications policy is not the level of interconnection charges but the lack of an *independent regulatory agency*. The MPT was reorganized into the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) in 2001 as a result of administrative reform, but the MPHPT still performs both regulatory and industrial policy functions. For better governance, the time has come for the MPHPT to vest the regulatory authority in an independent agency.

Compliance with the WTO telecom package is important not only for stable Japan-US economic relations but also for the international regime on telecommunications services that the WTO Basic Telecommunications Talks brought into existence. With the world's second largest telecommunications market, Japan can make a substantial contribution to the development of the multilateral telecommunications regime by proactively enforcing the internationally negotiated rules and principles.