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Oversight Hearing
Foreign Government Ownership of American Telecommunications Companies
Subcommittee on Telecommunications Trade & Consumer Protection
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Panel 2, Witness 4

Mr. Chairman, Members of the Subcommittee, thank you for inviting me to testify on our international telecommunications policy.

With the dramatic changes the telecommunications industry is undergoing domestically and abroad, this is a timely topic. Given the time that has elapsed since the passage of 1996 Telecom Act and the WTO Basic Telecommunications Agreement, which went into effect in February 1998, this is a useful opportunity to reflect on the policy choices the United States has made and how they have affected U.S. interests.

WTO AGREEMENT ON BASIC TELECOMMUNICATIONS

American telecommunications trade policy rests on simple and familiar principles. An open and competitive telecommunications market promotes innovation and technological progress; rewards the most efficient and well-run business; and reduces the price of services for families and other consumers. The telecommunications sector is a dynamic example of the value of our open investment policy and our leadership in liberalizing markets. This is the type of world market we seek to foster through trade policy, and the reason is very clear in America's experience at home.

Once dominated by monopolies, the deregulation of our local telecommunications markets has fostered competition and innovation. We now host over 300 new competitive local providers, who have attracted tens of billions of dollars in new capital and are bringing advanced services to millions of Americans, from cell phones and satellite service to video-conferencing, high-speed Internet access, and much more. The direct value of this to our economy is vast; and the associated benefits of reduced costs for businesses, greater convenience in daily life, and national competitiveness still greater.

However, as the United States pioneered deregulation in the telecom sector, in the 1980s and through the 1996 Telecom Act, many of the world's major markets remained dominated by traditional monopolies. This not only

posed an obstacle to their technological development, but was a significant barrier to exports of some of America's most competitive businesses, whether across borders or through investment by American firms. Our trade initiatives have thus sought to open world telecommunications markets to competition. In this we have used a variety of policy tools, including bilateral negotiations, Section 1377 of our domestic trade law, and negotiations at the WTO. And central to the advances of the past years was conclusion of the WTO's Basic Telecom Agreement in 1998.

This agreement, joining most of the world's major telecommunications markets in binding commitments to market access and pro-competitive regulatory policies, is one of the major trade policy accomplishments of the past decade. Before it went into force, only 17% of the world's top 20 global markets were open to U.S. firms; with it, measured by annual sales, U.S. companies gained access to over 95% of global telecommunications markets.

Since 1998, we have made still more progress. Singapore, Canada, Korea, Japan, and India have all unilaterally improved market access. As China, Taiwan and other economies enter the WTO, each of them will implement market-opening commitments in telecommunications. Given the momentum we have established, we have been able to replicate this standard even outside the WTO - for example, in our recent bilateral trade agreement with Vietnam.

The value of these market-opening commitments is growing in step with the growth of global markets, stimulated in great part by the emerging competition the agreement unleashed. With sales at $650 billion in 1997, the global telecommunications market is now rapidly approaching one trillion dollars in annual sales.

As expected, U.S. firms have taken full advantage of these opportunities. U.S. firms hold substantial investments in operators in over three dozen countries and on every inhabited continent (e.g., SBC alone has stakes in 22 countries, and MCI Worldcom has facilities-based operations in over 20 countries as well (Source: Hoovers Online)). U.S. operators (such as Qwest, Viatel, GTS, and MCI Worldcom) now operate the most extensive pan-European networks and are global leaders in deploying technologies such as cable telephony and internet telephony. U.S. firms are the largest investors in almost every international submarine cable consortium and global satellite system (e.g., U.S. firms have ownership interest in over 70% of the capacity on the recently-laid U.S.-Japan cable, which will provide a quantum increase in trans-Pacific connectivity) and have invested heavily in overseas wireless operations (e.g., Bellsouth has over 6 million cellular customers in ten Latin American countries, and its international operations account for almost 10% of its revenues (Source: Forbes, March 2000)). Following in the wake of telecom liberalization, U.S. firms are also taking the lead in moving globally

into value-added and Internet services (e.g., PSINet provides facilities-based Internet access in 29 countries on five continents).

The benefits of the WTO agreements extend far beyond U.S. telecommunications firms. U.S. and foreign consumers and businesses are major beneficiaries of the dramatic competition that has resulted from increased market opening: some retail calls across the Atlantic now can cost little more than a domestic long-distance phone call, and even calls to Japan, recently as high as one dollar a minute, are now available from major carriers for at little as 15 cents a minute. With end-to-end investment in submarine cables now possible, and massive investment led by U.S. firms now underway, the price of international connectivity has plummeted by as much as 80% over the past 4 years (source: ING Barings) - a key factor that is fueling the growth of the global Internet.

In addition to securing investment opportunities, the WTO Basic Telecom Agreement put into place binding regulatory principles to ensure that regulators enforce pro-competitive rules. These commitments - ranging from cost-oriented interconnection rates to transparent licensing procedures - are an essential framework for effective regulation and have provided a basis for addressing problems faced by U.S. carriers in Canada, Mexico, Japan, Peru, Israel, the United Kingdom, and Germany, affecting investments worth billions of dollars. Most recently, we have taken advantage of these commitments to reach an agreement with Japan that will lower interconnection payments for U.S. and other competitive carriers by over one billion dollars; and we have initiated proceedings in the WTO to enforce rights of U.S. telecom service providers relating to over one billion dollars of U.S. investments in Mexico and affecting the second largest international services market for the U.S. service providers and consumers.

Despite this progress, barriers continue to exist in these and other markets, and competition has not yet fully developed in all WTO markets, just as it has not yet fully developed in the United States. But as we make the global transition from monopoly to competitive markets, the WTO commitments provide one of the most important sets of competitive safeguards on which we can now rely to open foreign markets and ensure that our trading partners abide by their commitments. Furthermore, the impact of WTO commitments extends far beyond the WTO members which have undertaken them. These commitments are widely seen as goals for a much broader range of countries and are a major focus of attention in the International Telecommunications Union (ITU), the Asia-Pacific Economic Cooperation (APEC), and the World Bank.

To date, success has bred more success. Peer pressure by liberalizing countries has created a virtuous circle where countries now compete for global investment by offering more attractive investment opportunities and more

effective regulatory regimes. For example, even after entry into force of the WTO Basic Telecom Agreement, Singapore, Korea, Japan and India have unilaterally decided to improve foreign investment and telecom regimes, and many EU and Latin American countries are substantially reducing interconnection rates. Preserving this momentum is essential if the WTO is to provide a forum for further progress - through implementation of existing commitments and expansion of new commitments.

CURRENT PROPOSALS CAN UNDERMINE THESE BENEFITS

New proposals are under consideration to limit foreign investment in the U.S. telecom markets by preventing the Federal Communications Commission (FCC) from licensing certain telecom carriers based on their level of government ownership. Currently, foreign investment in the telecommunications sector is governed by Section 310 of the Communications Act of 1934. This statute (section 310(a)) prohibits *direct* ownership of certain categories of telecom licenses by a foreign government or its representative; however, section 310(b)(4) authorizes *indirect* ownership of certain telecom licenses by a foreign person, a foreign corporation, or a foreign government to exceed 25 percent unless the FCC finds that the public interest will be served by the refusal or revocation of such license. By placing an absolute bar on certain types of licenses, the legislative proposals seek to remove the discretion that this statute currently provides the FCC to determine whether an award of a particular license or authorization is in the public interest.

Competition and national security concerns have been cited as justification for imposing an absolute bar on the participation of such foreign government-owned carriers in the U.S. market. For instance, there have been assertions that foreign government-owned competitors have special privileges in their home market which can be exploited to distort competition in our market. Questions have also been raised concerning the desirability of allowing foreign government ownership of U.S. telecommunications assets, which are vital to U.S. national security.

These arguments merit careful review and analysis. The FCC and other Executive Branch agencies must carefully scrutinize all transactions involving government-owned carriers to ensure that they do not distort competition in the U.S. market or undermine critical U.S. national security, law enforcement, and related interests.

However, the Administration does not believe that these concerns justify changing existing law to prevent a telecom company from participating in the U.S. market purely based on its level of government ownership. We believe that such proposals risk undermining the benefits the United States has reaped in the past few years in the international telecom market. Moreover,

the evidence casts doubt on the assumptions underlying proposals to ban government-owned carriers, particularly assumptions that government-owned carriers enjoy special advantages.

Finally and most importantly, the U.S. Government already possesses effective tools to address the competition and national security concerns raised by any foreign government-owned carrier wishing to participate in the U.S. telecom market. These tools are more than adequate to address the concerns that have been raised and do not create the risks that the proposed initiatives are certain to engender. We will continue to use these tools to address competition, national security, and other concerns that foreign investment in our market may raise.

BACKTRACK FROM INTERNATIONAL LIBERALIZATION

The United States has been the leader in worldwide liberalization of telecom markets, producing tangible benefits for both us and our trading partners. Proposals to ban government-owned telecom firms from our market would likely diminish our leadership role in this effort and could cause other countries to believe they could limit foreign investment in the telecom and possibly other sectors, either in retaliation or for protectionist goals. We would, therefore, be putting at risk the significant benefits we have derived from years of hard work in opening up these markets.

We are facing many of the same questions that framed policy discussions in the lead-up to telecommunications negotiations in the WTO in the mid-1990s. At that time, there was considerable debate over whether the United States could better affect foreign market opening through a unilateral, reciprocity-based approach or through a multilateral framework in the WTO. The stakes for the United States were enormous. With approximately one third of the value of the entire global telecommunications market at the time, the United States needed to ensure major concessions from its trading partners in return for offering access to the biggest domestic market in the world.

In the end, the calculus was clear: any broad-based agreement that rapidly opened up global markets to U.S. firms clearly played to our advantages. While we were offering other countries access to a market no other country individually could match, a critical mass of market opening offers would provide opportunities that U.S. firms were uniquely positioned to exploit, given our broad-based experience with competition.

As I already discussed, we have fared extremely well. So far, we have led the world trend in market liberalization and a commitment to competition. Others have followed, particularly in light of the increased productivity, investment, growth and consumer welfare that deregulation and competition have produced in the United States. But any perception that the United States

is turning back on that approach risks reversing the incentives of our trading partners to compete in liberalizing their own markets, and possibly bolstering pressure to protect vested telecommunications interests. We have already received strong expressions of concern from the European Union (EU) and other trading partners regarding the compatibility of these proposals with our international obligations in the WTO.

We expect the telecommunications sector to be a major focus of recently launched WTO services negotiations, and, as in the last round, we can best take advantage of these negotiations by demonstrating leadership. Much work remains to be done to liberalize further global markets, particularly in fast-growing developing and newly-industrialized country markets such as India, South Africa, Korea, Malaysia, and Mexico.

If the United States enters these negotiations having instituted measures most countries will perceive as protectionist, it is possible that many countries will be tempted to restrict existing opportunities offered to U.S. carriers and resist any further opening in the WTO process. This could affect billions of dollars in current U.S. investment abroad, and even more future investment. In short, efforts to restrict our market now could curtail the virtuous cycle of liberalization and growth that we have experienced in telecom markets around the world.

ASSUMPTIONS REGARDING GOVERNMENT-OWNED TELECOM FIRMS

Much of the concern with foreign government-owned telecom firms stems from the belief that a government-owned company would enjoy significant advantages in competing with U.S. rivals in the U.S. market. At first blush, this appears to be a compelling concern. However, there is evidence that casts doubt on the assumptions underlying this belief.

Assumption 1: Government-owned firms are able to raise capital more easily than private firms.

Market data do not demonstrate a conclusive link between government ownership and access to capital. Although some government-owned firms have accumulated large cash reserves, presumably to finance acquisitions, any large firm can accumulate cash. What matters is not cash holdings *per se*, but the ability to finance acquisitions.

Companies raise capital primarily by issuing equity and debt. Most of the major players in telecom use close to an even split between equity and debt financing. A review of corporate bond ratings for large telecom firms (privately and government owned) demonstrates that there is no systematic

relationship between bond rating and the extent of government ownership in a firm.(1)(2)

Telecom companies - including DT - have recently issued unprecedented levels of corporate bonds to finance acquisitions and expansions. Given these high levels of debt, investors have become cautious, demanding higher yields that have translated into higher financing costs for companies, both government and privately owned. At the same time, many of these telecom companies are under threat of credit rating downgrades. For instance, Moody's has placed DT under review for a possible downgrade to its credit rating, growing out of its $7 billion pledge for a third-generation wireless license in Germany, and its $50 billion offer for Voice Stream.(3) Such downgrades could have a major impact on certain companies. For example, to secure financing, DT agreed that it would add an extra one-half percentage point to the coupon of its recent $14.6 billion bond issue if its credit rating were downgraded to below single A. If the interest rate adjustment were triggered, it would cost DT an additional $73 million a year. As this example suggests, the market is focusing on the business risks associated with DT's actions, not its government ownership, as it determines DT's cost of capital.

This is not meant to suggest that these government-owned telecom operators do not enjoy high credit ratings and ready access to debt capital. But, as discussed above, the reasons do not appear to have a direct relationship to government ownership. Rather, while government involvement may be *a* factor in credit analysis, so are other factors, including the competitive environment, the regulatory environment, management strength, management strategy, diversification strategy, funding strategy, network quality, foreign acquisitions, and a range of financial measures. In some instances, government ownership is specifically cited by credit rating agencies as a negative factor.(4) Moreover, in the context of diversification strategy, foreign acquisitions may also be a negative factor in a credit rating due to political, currency, or other risks. Accordingly, one could argue that the high credit rating for firms like NTT derives principally from the dominant position in the domestic market combined with the fact that it has not ventured aggressively outside its home market.

On the equity side of the balance sheet, companies that earn superior returns on equity are usually assigned higher price and earnings multiples than are less efficient companies, thus lowering the cost of stock issuance. Looking at the cost of equity alone, Bellsouth, SBC, Verizon, and AT&T (with a cost of equity of 6.82%, 7.42%, 7.10%, and 7.67% respectively) enjoy a lower cost of capital than DT and FT (with a cost of equity of 7.78% and 7.70% respectively) (source: Bloomberg).

There are other reasons why government ownership might put foreign government-owned companies at a competitive disadvantage in the eyes of equity investors. Government-owned firms are typically less efficient and less profitable than private firms.(5) Government-owned firms are often burdened with high labor costs, extensive universal service requirements, and poor management. Management is often less prepared to operate in a market-oriented environment, putting such firms at a disadvantage in responding quickly to growth areas such as data services.

Governments may also have found it easier, as owner of the operator, to use the operator as an instrument of flawed industrial policy, imposing long-term burdens on these firms (e.g., NTT remains burdened with a cost structure in its local exchange markets that is three times higher than that of a typical U.S. Regional Bell Operating Company, while carrying far less traffic). These inefficiencies can be absorbed where a company is dominant in its domestic market, and that market remains its focus; but such a legacy is likely to be a comparative disadvantage for a firm looking to expand abroad into competitive markets like the U.S., where efficiency is such a key determinant of success.

Combining the cost of debt and the cost of equity to determine the overall cost of capital, it is not clear that companies with significant government investment have a comparative advantage. The evidence is mixed: DT has one of the lowest weighted average costs of capital (5.32%), but DT's rate is not significantly lower than that of Verizon, (5.46%) or Bellsouth (5.55%). Furthermore, these U.S. firms, along with SBC, have a lower weighted average cost of capital than France Telecom (which is 54% government owned) (source: Bloomberg).

In sum, the assumption that government-owned firms have privileged access to capital may initially seem compelling. However, as discussed above, the relationship between government ownership and access to capital is inconclusive, and government ownership can impose significant costs on a firm.

Assumption 2: Government-owned firms are more likely to have monopoly privileges in domestic markets and can subsidize their U.S. operations with revenues generated at home to engage more easily in anti-competitive behavior.

Allegations of monopoly privileges and anti-competitive cross-subsidization are common in markets with dominant telecom providers. However, just as there is no systematic relationship between government ownership and access to external finance, there is no certain connection between government ownership and monopoly privilege and anti-competitive cross-subsidization. The problem that U.S. carriers face in foreign markets

involving issues stems less from government ownership than from monopoly legacy, and allegations of anti-competitive abuses arise in foreign markets dominated by a government-owned entity (such as DT in Germany or NTT in Japan) or a completely privately-owned company (such as Telmex in Mexico). One could argue that Germany (which owns a substantial stake in Deutsche Telekom) has a more independent and effective regulator than Mexico (which has no government stake in the dominant operator).

As a result, the relevant question may not be present levels of government ownership but whether the foreign market is more or less open to competition. We have made tremendous progress in this regard over the past few years, particularly since the entry into force of the WTO Basic Telecom Agreement. Where this is not the case and our carriers still face anti-competitive barriers in foreign markets, we have been vigilant in using our remedies in the WTO and under U.S. trade law (such as under Section 1377 of the 1988 Omnibus Trade and Competitiveness Act) to encourage our trading partners to open their markets to meaningful competition. Our recently initiated WTO case against Mexico and our actions under Section 1377 with respect to Germany, Israel, South Africa, and other countries underscore this resolve.

Finally, U.S. telecommunications firms are already operating - in many cases, quite successfully - in overseas markets. For example:

- SBC holds 50 percent of AUREC (Israel), 42 percent of Tele Danmark (Denmark), 20 percent of Bell Canada, 19 percent of TransAsia (Taiwan), 18 percent of Belgacom (Belgium), 18 percent of Telkom South Africa, and 15 percent of Cegetel (France). Through Tele Danmark, SBC holds a 42 percent stake in Talkline, a German cellular service provider and reseller.
- Bellsouth, through various alliances, holds wireless licenses in Argentina, Brazil, Chile, Denmark, Ecuador, Germany, Guatemala, India, Israel, Nicaragua, Panama, Peru, Uruguay and Venezuela. Through an alliance with KPN (Netherlands), Bellsouth holds 100 percent of E-Plus, a German mobile operator.
- Verizon has substantial wireless interests in Mexico, Italy, Greece, the Czech Republic, Slovakia, Indonesia, New Zealand, the United Kingdom, Thailand, and the Philippines.
- AT&T is involved in joint ventures and alliances in, among other places, Canada, Britain, Mexico, India, Japan, Taiwan, and Latin America.
- MCI-Worldcom has facilities-based operations throughout Asia, Europe, and Latin America.

- Viatel has a fiber-optic network of 4,700 kilometers designed to link 59 cities and is currently licensed in Austria, Belgium, Canada, France, Germany, Italy, the Netherlands, Spain, Switzerland, and the United Kingdom.
- Qwest, in alliance with KPN, is building a European network designed to extend 11,800 miles and reach 46 European cities.
- Level 3 is building submarine links to Asia and Europe, and is building an inter-city network in Europe linking at least 13 European cities.
- Global Crossing has submarine cables to Europe and Asia and is building gateways for data operations.
- Primus has operations in Japan and Germany.
- Global Telesystems operates the largest European Internet backbone.
- PSINet owns Internet service providers in 29 countries and five continents.

Assumption 3: Competition in the U.S. market has weakened the U.S. industry, making U.S. firms vulnerable to foreign takeover.

The evolution of the U.S. telecom market over the past several years has contributed to an environment that has allowed U.S. telecom companies to flourish. For example, new Competitive Local Exchange Carriers ("CLECs") have thrived due to competition and deregulation. Their market capitalization of about $85 billion at the end of 1999 was up from $3.1 billion in 1996. Between 1993 and 1998, overall market capitalization of U.S. telecom firms increased by $800 billion, doubling in value (source: CEA). Furthermore, stocks of U.S. telecom firms are generally trading today at earnings multiples similar to those of their European counterparts. As of September 1, the average ratio of stock price to EBITDA (i.e., Earnings Before Interest, Taxes, Depreciation, and Amortization) (the most commonly used valuation measure in telecom to measure cash flow) for all U.S. telecommunications firms with market values exceeding $20 billion was 10.5. The average of the same ratio for BT, FT, DT, and Telecom Italia was the identical 10.5. Thus it does not appear that U.S. firms are undervalued relative to their European counterparts.

Assumption 4: Government ownership provides a competitive advantage, particularly given the favorable regulatory treatment they receive.

The evidence suggests that government-owned firms view *privatization* as providing the competitive advantage that they currently may lack. For instance, one of the many incentives to privatize is to better tap global capital markets given large-scale investment needs that the government cannot meet. This is supported by evidence that firms are able to increase their capital expenditures significantly following privatization (Source: D'Souza, 2000).

The evidence also does not demonstrate a conclusive link between government ownership and regulatory favoritism. Rather, regulatory favoritism can exist wherever an incumbent telecom company wields considerable power and influence. In fact, we are currently investigating allegations of biased regulation in Mexico of Mexico's dominant carrier, Telmex, which is 100% privately-owned. Mexico, like many of our WTO trading partners, has undertaken obligations in the WTO to ensure impartial regulation. We continue to be vigilant in ensuring that countries live by these and related obligations regardless of whether their incumbent telecom supplier is government or privately-owned.

If companies truly saw government ownership as a competitive advantage for regulatory or other reasons, there would be significant resistance to privatization by operators. NTT management's current campaign to eliminate Japanese government ownership from its company reinforces this point, as do current privatization efforts in Finland, Egypt, Austria, Algeria, the Czech Republic, Kenya, Kuwait, Morocco, Norway, Turkey, etc. Between 1984 and 1996, over $140 billion worth of privatizations occurred, some of which resulted in firms which are 100% privately-owned (such as BT). From the beginning of 1997 to the end of July in 1999, an additional $104 billion worth of privatizations were completed. As of 1999, of the 189 members of the ITU, 90 had wholly or partially privatized their incumbent telecom operators; and 18 of these were privatized completely. Of non-privatized operators, over 30 are currently planning to privatize.

However, it is unrealistic to expect firms to privatize overnight. At the beginning of most privatization programs, national telecom firms in smaller countries have a potential market capitalization larger than the entire stock market, so it is impractical to sell shares all at once. Even in larger countries, the relative scale of privatization is enormous. For example, three NTT offerings in 1987-88 raised about $80 billion, yet this represented less than 25 percent of NTT's total equity. Likewise, DT's initial first round of privatization occurred in November 1996 with an initial share offering of about $13 billion, and reduced the government's ownership stake from 100 percent to 76 percent. A subsequent offering reduced this stake to the present 58 percent. For NTT and DT to suddenly meet the levels specified by current legislative proposals to be able to participate in the U.S. market, they would be required to sell $54 billion and $39 billion worth of stock, respectively, based on current market capitalization. To put these amounts in perspective, the U.S. market last year absorbed $51.2 billion in Initial Public Offerings.

TOOLS AVAILABLE TO ADDRESS COMPETITION AND NATIONAL SECURITY CONCERNS POSED BY FOREIGN GOVERNMENT OWNERSHIP

Proposals to bar telecom companies owned in excess of 25 percent by a foreign government from the U.S. market seek to address the competition and national security concerns presented by transactions involving such companies. However, current law already provides powerful tools that enable the FCC and other Executive Branch agencies to scrutinize proposed foreign investment to ensure that it in no way undermines national security or competition in the U.S. market. Although my colleagues will go into more detail on the role of their agencies in this review process, let me give you a brief overview of these tools and then focus on the activity of USTR in ensuring that U.S. companies can compete in foreign markets on meaningful terms.

1. Public Interest Test

The FCC's public interest test allows the FCC - with input from other Executive Branch agencies - to scrutinize carefully the competition, national security, and other concerns posed by foreign investment in the U.S. telecom market. The Communications Act of 1934 requires the FCC to conduct this analysis in several contexts related to foreign entry. For instance, section 310(b)(4) of the Act permits a foreign firm or government to acquire or maintain a greater than a 25 percent indirect ownership of certain telecom licenses unless the FCC finds that the public interest will be served by the refusal or revocation of such license. The FCC applies its public interest test by examining, through public proceedings, whether a particular transaction threatens competition in the U.S. market or implicates national security, law enforcement, foreign policy, or trade policy concerns.

With respect to competition issues, the public interest test establishes a presumption in favor of entry into the U.S. market by an applicant affiliated with a foreign telecommunications carrier from a WTO member country. However, contrary to certain claims, *this presumption is not automatic; it is rebuttable*. As part of its public interest test, the FCC is empowered to ensure, among other things, that a foreign carrier does not undermine competition in the U.S. market by virtue of its ability to exercise dominant power in its home or other third-country markets.

In fact, the FCC has put in place a series of competitive safeguards designed to curb anti-competitive behavior that could result in harm to the U.S. telecom market. For example, the FCC prohibits any U.S. international carrier from accepting "special concessions" (such as exclusive arrangements) from a foreign dominant carrier. The FCC also requires certain operators to produce quarterly reports on traffic and revenues and maintenance of basic service and facilities. The FCC can also require the U.S. carrier and its dominant foreign affiliate to maintain structural separation in order to prevent foreign-affiliates from miallocating costs.

In instances where these safeguards would be insufficient to prevent anticompetitive conduct in the U.S. market, the FCC has the authority to impose additional conditions on the grant of authority tailored to the

competitive concerns raised in a particular transaction, such as applying the "no special concessions rule" or dominant carrier safeguards where the foreign carrier is not dominant in its home market. And where an application poses a very high risk to competition in the U.S. market, and where the FCC's competitive safeguards or other conditions would be ineffective, the FCC can deny the application.

The FCC's public interest test also addresses the national security and law enforcement concerns raised by the entry of a particular foreign carrier into the U.S. market. The FCC specifically accords deference to other Executive Branch agencies in this and other areas to ensure that national security and law enforcement concerns are adequately addressed. Agencies charged with law enforcement and national security responsibilities will better explain how they have raised these issues with the FCC and how those issues have been resolved.

Accordingly, the Administration believes that the FCC's public interest test can address the concerns raised by an application by a foreign government-owned carrier to participate in the U.S. market. The public interest test ensures that foreign entry into the U.S. market does not harm competition in the U.S. market and addresses concerns that may arise in foreign markets - such as those relating to unfair cross-subsidies or unfair home-market advantages - to the extent that they give a foreign carrier an anti-competitive advantage in the U.S. market. In addition, the public interest test - as well as the Exon-Florio review discussed in the following section - ensures that entry of a foreign carrier into the U.S. market will not compromise our national security.

2. Exon-Florio National Security Review of Foreign Investment

The Exon-Florio provision (Section 721 of the Defense Production Act of 1950) provides for a national security review of foreign acquisitions of U.S. companies. Under the statute, the President may suspend or prohibit an acquisition if he finds that:

a) there is credible evidence to believe that the foreign investor might take action that threatens to impair the national security; and

b) existing laws, other than the International Emergency Economic Powers Act and the Exon-Florio provision itself, do not provide adequate and appropriate authority to protect the national security.

The President alone retains the power to suspend or prohibit a foreign acquisition of a U.S. company, but the President delegated the review and investigation aspects of the Exon-Florio provision to the Committee on Foreign Investment in the United States (CFIUS). CFIUS was established by Executive Order in 1975 to monitor the impact of foreign investment in the United States and to coordinate the implementation of U.S. policy on such investment. CFIUS is an interagency committee chaired by the Secretary of the Treasury with ten other agencies including Defense, State, Justice, Commerce, USTR, the NSC and the NEC. In addition, when CFIUS reviews a

foreign acquisition of a U.S. company with businesses of interest to a non-CFIUS member agency, such as Energy or NASA, CFIUS invites that agency to participate in the particular review.

Over the last twelve years, CFIUS has established a record of implementing Exon-Florio to protect the national security. The prevailing judgment is that Exon-Florio has raised the awareness of foreign investors contemplating acquisitions of U.S. companies of the importance of national security considerations and has helped to ensure that foreign investments, including in the telecommunications sector, are structured in ways to address any of the government's national security concerns. In fact, a number of transactions have been restructured precisely to respond to national security concerns that CFIUS has raised.

3. Antitrust Review

Telecommunications mergers are subject to antitrust review by the Department of Justice under section 7 of the Clayton Act, which prohibits any merger that is likely to substantially lessen competition in any market in the United States. The standards for review are the same for all mergers, including those involving foreign firms or firms owned in whole or in part by foreign governments.

As in a merger of domestic firms, whether a firm involved in a merger has market power in any given market can be a relevant antitrust issue, and could, depending on the facts, raise antitrust concerns. If a foreign firm involved in a merger with a U.S. firm has market power in its home market, and if that market power could have an effect on a U.S. market as a result of the merger, then that market power in the home market could raise antitrust issues. It is the existence of the market power, and the effect on competition in a given market, not necessarily the source of the market power, that gives rise to the antitrust problem. The source of the market power could flow from any number of factors, such as historical developments, local regulations, intellectual property rights, government mandates, scale economies, first-mover advantages, or the like. Foreign government ownership of a firm that is a party to a U.S. telecom merger could be relevant if it implicates the nature or durability of any market power that creates an antitrust concern. Exactly how or whether market power in the foreign firm's home market creates an antitrust problem in the United States depends on the facts of any particular case.

If the Justice Department concludes that a merger would cause competitive problems in the United States because of market power in a foreign market, antitrust law provides for a range of possible remedies. These can include blocking the merger, or imposing alterations, restrictions, or other safeguards that enable U.S. markets to realize the benefits offered by the merger while

guarding against possible competitive harms. Determination of an appropriate remedy depends on the facts of the particular case.

For example, in British Telecom/MCI, the parties entered into a consent decree that tied approval of the merger to opening the British market to International Simple Resale on transatlantic calls, including interconnection in the United Kingdom for ISR carriers, and also imposed a number of disclosure requirements and restrictions on the sharing of competitively sensitive information to ensure that British Telecom would not use its market power abroad to injure competition in U.S. or international markets by discriminating against other competitors. In Sprint/France Telecom/Deutsche Telekom, the parties entered into a two-phase consent decree, in which a Phase II similar to BT/MCI was preceded by a Phase I with even more extensive oversight to address discrimination and cross-subsidy concerns until all legal prohibitions on competitive entry were removed in France and Germany, and competitors were licensed to compete in those markets.

4. U.S. and International Trade Laws

One of the primary missions of USTR is to ensure - by enforcing our domestic laws and our rights in the WTO - that U.S. services and service suppliers can compete robustly in foreign telecom markets. At the heart of the trade policy of this Administration has been a firm determination to enforce U.S. trade laws and ensure that other governments implement the commitments they made to us under international trade agreements. Vigorous enforcement enhances our ability to get the maximum benefit from our trade agreements, ensures that we can continue to open markets, and builds confidence in the trading system.

Under Section 1377 of the Omnibus Trade and Competitiveness Act of 1988, USTR solicits public comment as part of its annual review of the operation and effectiveness of U.S. telecommunications trade agreements and takes action where U.S. trading partners are not in compliance with their international obligations. In the past three years alone, USTR has undertaken major initiatives to encourage our trading partners to implement their telecom trade commitments and open their markets to competition from U.S. carriers. The annual Section 1377 review process has led foreign governments in most cases to quickly address complains we have had regarding implementation of the WTO Basic Telecom Agreement. Some recent highlights include:

Canada: During the 1998 Section 1377 review, Canada eliminated restrictions that prevented U.S.-based carriers from enjoying the same opportunities for transmitting Canadian international long distance traffic as enjoyed by carriers based in third countries.

European Union: U.S. government advocacy, including during the 1999 review, prevented unnecessary and potentially discriminatory

standards-setting and licensing activities by the European Union and its Member States with regard to third-generation mobile telecommunications services, allowing U.S. suppliers of competing technologies greater access to European and global markets.

Germany: During the 1999 and 2000 reviews, the Administration maintained an intense focus on action by the German regulator (Reg-TP) to ensure that Deutsche Telekom provide non-discriminatory and cost-oriented interconnection rates to competitive carriers. Certain Reg-TP decisions in 1999 helped to curb anticompetitive abuses by the Deutsche Telekom. However, we continue to monitor issues identified in the 2000 review related to a backlog of interconnection requests and concerns about excessive license fees and insufficient regulatory transparency.

Israel: During this year's section 1377 review, Israel committed to remove its discriminatory access fee on calls to and from the United States and Canada by December 31, 2001.

Japan: The Administration has successfully ensured more timely and effective implementation of Japan's WTO telecom commitments in three reviews since those commitments came into force. In 1998, we worked to ensure that new Japanese rules for international service resulted in lower retail prices on the bilateral route of 50 percent or more. In 1999, Japan eliminated restrictions on the use of leased lines by new entrants, lowering costs dramatically for NTT's competitors in the Japanese domestic and international long-distance and business-services markets, and agreed to eliminate a premium that NTT charged to competitors for calls to NTT's ISDN customers that was distorting competition. And most significantly, in July 2000, Japan agreed to slash its interconnection rates up to 50% over two years, saving competitive carriers over one billion dollars in above-cost interconnection fees; and to make its local network accessible for ensure competition in the provision of high-speed Internet services.

Mexico: Last month, the United States initiated WTO dispute settlement proceedings against Mexico regarding barriers to competition in Mexico's $12 billion telecommunications market including: (1) a lack of effective disciplines on Telmex, which is able to use its dominant position in the market to thwart competition; (2) the failure to ensure timely, cost-oriented interconnection that would permit competing carriers to provide local, long-distance, and international service; and (3) the failure to permit alternatives to an outmoded system of charging U.S. carriers above-cost rates for completing international calls into Mexico. Mexican officials have recently been quoted as stating that they intend to cut interconnection rates substantially and issue dominant carrier regulations. The Administration will examine any concrete steps taken in Mexico to ensure satisfactory resolution of the problems our firms have encountered.

Peru: During the 2000 review, the Administration identified high interconnection charges in Peru as a barrier to market access. The Peruvian telecom regulator (Osiptel) is currently taking steps to ensure that these charges are cost-oriented, consistent with WTO regulatory principles.

South Africa: This year, the Administration successfully encouraged South Africa's dominant carrier, Telkom, to restore access to facilities that competitive U.S. value-added telecommunications services need to compete with Telkom in the South African market.

Taiwan: During the 1998 review, the United States and Taiwan reached an agreement mandating a three-year transition to cost-based interconnection rates for wireless service suppliers, strengthening implementation of a 1996 agreement. In discussions under the 2000 Section 1377 review, Taiwan eliminated certain exclusivity rights from three licenses eventually issued to new entrants for fixed-network services.

United Kingdom: As part of the 2000 review, the Administration urged the United Kingdom to open its telecommunications market to competition in advanced data services that make high-speed Internet access possible. We continue to monitor the UK's progress in introducing competition in the advanced data services market.

These examples highlight our continuing commitment to vigorously utilize our trade tools - including in the WTO and through domestic trade law - to open foreign telecommunications markets and ensure that our trading partners abide by their commitments in this vital and rapidly expanding services sector.

CONCLUSION

In summary, we are now enjoying the benefits of a remarkable era of innovation and growth in the telecommunications revolution. The United States is the leader in this field; and we have every reason to believe that by sustaining and deepening our commitment to an open and competitive world market, American families and businesses can draw still greater benefits from the telecommunications revolution than we have to date.

We do not need new legislation to deal with concerns raised by foreign investment in our telecom market - whether by government-owned privately-owned firms. Our laws and review standards provide us with strong protection against threats to national security or anti-competitive behavior. At the same time, they ensure that we remain fully in accord with our own commitments under the Basic Telecom Agreement, enabling us to maintain our leadership in developing a more open international market.

Thank you again for this opportunity to testify.

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2. Standard & Poor's gives an AAA rating to the government bonds of France, Germany, Japan, and the Netherlands, but gives the bonds of FT, DT, Nippon Telegraph and Telephone (NTT), and Royal KPN a rating of A, AA-, AA+, and A- respectively. An analysis of recently issued bonds of these firms shows that their trading values imply yields of between 25 and 125 basis points above the government bonds in their respective countries. On average, they trade with yields 50 basis points higher than government bonds with comparable maturities.

3. NTT was subject to a similar review arising out of its acquisition of Verio, as were many other European government-owned carriers, relating to their third-generation wireless bids. Telenor (100% owned by Government of Norway) is subject to a possible downgrade arising out of its investments in Thai carriers.

4. For example, Moody's recent rating of the Australian government-owned carrier Telstra bases its ratings, in part, on limitations associated with being 50.1% government-owned including inability to access equity markets and intense public scrutiny of cost initiatives.

5. For extensive reviews, *see*, Boardman, Anthony, and Aidan R. Vining, "Ownership and Performance in Competitive Environments: A Comparison of the Performance of Private, Mixed, and State-Owned Enterprises," *Journal of Law and Economics* 32: 133 (1989); Vining, Aidan R., and Anthony E. Boardman, "Ownership versus Competition: Efficiency in Public Enterprise," *Public Choice* 73: 205–39 (1992); and Dewenter, Kathrin, and Paul H. Malatesta, "State-Owned and Privately-Owned Firms: An Empirical Analysis of Profitability, Leverage, and Labor Intensity.*American Economic Review,* forthcoming.