

# **The Report of the SG 3 Focus Group**

## **(Annex E to Recommendation D.140)**

**Ambassador Anthony Hill,  
Chair, SG3 Focus Group,  
3rd Plenary Meeting,  
7th December 1998, Geneva**



Note: The views expressed in this presentation are those of the author and do not necessarily reflect the opinions of the ITU or its membership.

Ladies and Gentlemen,

It gives me great pleasure to welcome you back to Geneva to participate in the third and final Plenary meeting of the ITU-T Study Group 3 Focus Group. There is only one item on the agenda for this meeting -- a review of the Final Report of the Focus Group which was completed on 6th November 1998. That Report is available as document COM 3-65 and is entitled "Transitional arrangements towards cost-orientation, beyond 1998". The purpose of this presentation is to describe the main recommendations in the report and to explain how the Focus Group arrived at them.

The meeting today is followed by the meeting of Study Group 3 which will run from tomorrow, 8th December, until next Tuesday, 15th December. Study Group 3 is invited to recommend the Focus Group Final Report text for adoption as a new Annex E to Recommendation D.140. In so doing, it would mark a multilateral accord on the transition to cost-orientation, and thus would go a long way towards implementing this Recommendation. I consider it no exaggeration to say that if Study Group 3 fails to come up with a credible follow-on to the current transitional arrangements (Annex D), which end in less than four weeks, then we would be faced with the potential collapse of the accounting rate system and a descent into uncharted waters. The choice which Study Group 3 faces is stark. On the one hand it could choose an orderly and smooth transition, based on a multilateral accord, towards a cost-oriented regime, in a manner which will allow time to develop new remuneration options, such as termination charges which are under discussion in Study Group 3. The Focus Group Report provides the best available basis for that multilateral accord. On the other hand, if there is no agreement on the terms of the transition, then it implies that Study Group 3 is unable to implement its own Recommendation. Consequently, certain countries may choose to impose, unilaterally, their own interpretation of cost-oriented rates. That alternative path is likely to be disruptive for all Administrations/ROAs, but with much more severe consequences for ROAs and consumers in many middle-income and developing countries than the transition path proposed by the Focus Group.



## **Agenda**

- **Mission and Objectives of the Focus Group**
- **Recommendations (Annex E)**
  - ⇒ **Indicative target rates, direct and transit**
  - ⇒ **Transition path towards cost-orientation**
  - ⇒ **Universal Service Obligations**
- **Comparisons: Focus Group indicative target rates and FCC benchmarks**
- **Context:**
  - ⇒ **ITU-T D-series Recommendations**
  - ⇒ **BDT Work Programme (Valletta Resolution 12)**
- **Next steps**

In this presentation, I will cover:

- first, the Mission and Objectives of the Focus Group;
- second, the outline of the main Recommendations of the Final Report as they relate to indicative target rates, the transition path and Universal Service Obligations;
- third, a comparison of the likely outcomes of implementing the Focus Group's Recommendations with those of the alternative transition path proposed in the FCC's Benchmark Order, the provisions of which come into force on 1st January 1999;
- fourth, a consideration of the work of the Focus Group in the wider context of the ITU-T D-series Recommendations, and the work programme established by the ITU/BDT following the Valletta World Telecommunication Development Conference in March/April 1998,
- finally, a consideration of the next steps in this process.



## **Focus Group Origins and Timetable**

- **ITU-T Recommendation D.140**
  - ⇒ **Staged reductions to achieve cost-orientated rates over 1-5 years**
- **World Telecommunication Policy Forum, 98**
  - ⇒ **Opinion C on evolution of accounting rates establishes terms of reference of Focus Group**
- **June SG3 meeting/1st Focus Group Plenary**
- **2nd Focus Group Plenary, 1-3 Sept**
  - ⇒ **2nd draft, Chair's Working Document, 25 Aug**
  - ⇒ **3rd draft, Chair's Working Document 16 Oct**
  - ⇒ **Minneapolis Plenipot., Res PLEN/6**
- **Final report (Annex E), 6th November 1998**

The origins of the Focus Group can be traced back in the work of Study Group 3 to at least 1992, which is when Recommendation D.140 was approved. That Recommendation proposed that Administrations/ROAs should seek to achieve accounting rates which are cost-orientated by scheduled reductions within a period of one to five years. In 1995, Annex C was added to the Recommendation which sets out two possible approaches to negotiation:

- by applying a common cost model;
- where there is no agreement on a common cost model, or where cost data is unavailable, then the Administrations should follow underlying cost trends and accounting rate trends.

This time last year, a new Annex D was debated which, for the first time, gave explicit direction on market trends by proposing a ceiling on the total accounting rate of one SDR per minute (excluding transit charges).

However, it is widely felt that the accounting rate reductions have not moved fast enough to catch up with declining cost trends and that most rates remain significantly above costs. The World Trade Organisation's Agreement on Basic Telecommunications, which came into force on 5th February 1998 and which was discussed at the ITU World Telecommunication Policy Forum, held 16-18 March, makes accounting rate reform all the more urgent. The 600 or so participants in the Policy Forum acknowledged the need to accelerate the work of Study Group 3 in implementing Recommendation D.140, and to that end they established the Focus Group, with myself as the Chair and Tony Wong as Vice-Chair. The terms of reference for the Group were confirmed by Study Group 3, at its June meeting.

The Focus Group held a half day Plenary meeting in June, followed by a three day meeting at the start of September when a second draft of the Chairman's Working Document was discussed. That draft was subsequently revised and a third draft was submitted to members on 16th October. It did not prove possible to hold a meeting before the final report was due, because of the clash with the Plenipotentiary Conference in Minneapolis. Nevertheless, the many comments received were taken into account in drafting the Final Report, which was posted to members on 6th November. On that same day, the Plenipotentiary Conference approved the Final Acts which include a Resolution (PLEN/6) which calls upon Study Group 3 to "agree on transitional arrangements" and to reach "an early resolution of the issue of accounting rate reform". Thus, we have direct instructions from the Plenipotentiary Conference, the highest decision-making body in the Union, to complete our work on time.



## **Focus Group Terms of Reference**

- **Open membership**
- **Working methods**
  - ⇒ **E-mail reflector & website**
  - ⇒ **Plenary meetings\* as necessary**
  - ⇒ **Report to Director of TSB by 6th November**
- **Objectives**
  - ⇒ ***“development of proposals for solutions for transitional arrangements towards cost orientation beyond 1998, including ranges of indicative target rates” taking into account country case studies and other existing market analyses/data.***

\* Plenary meetings funded in part by a voluntary contribution from MPT, Japan

The terms of reference for the Focus Group require open membership. I believe this has been achieved in that the 139 Focus Group Members, coming from 64 different Member States, represent a broad cross-section of the interests of the membership.

Second, the Focus Group was requested to use electronic working methods to the fullest extent possible. During the period between April and the end of October, some 73 formal contributions were posted to the e-mail reflector, including 8 Methodological Notes prepared by the Secretariat and one Information Note prepared by the ITU/BDT.

The principal objective set out in the terms of reference was to develop proposals for *“solutions for transitional arrangements towards cost-orientation beyond 1998, including ranges of indicative target rates”*. Again, I feel this objective has been met in the Final Report which was delivered to the Director of the TSB and the Chair of Study Group 3, on 6th November.



## **Defining “indicative target rates” for direct relations**

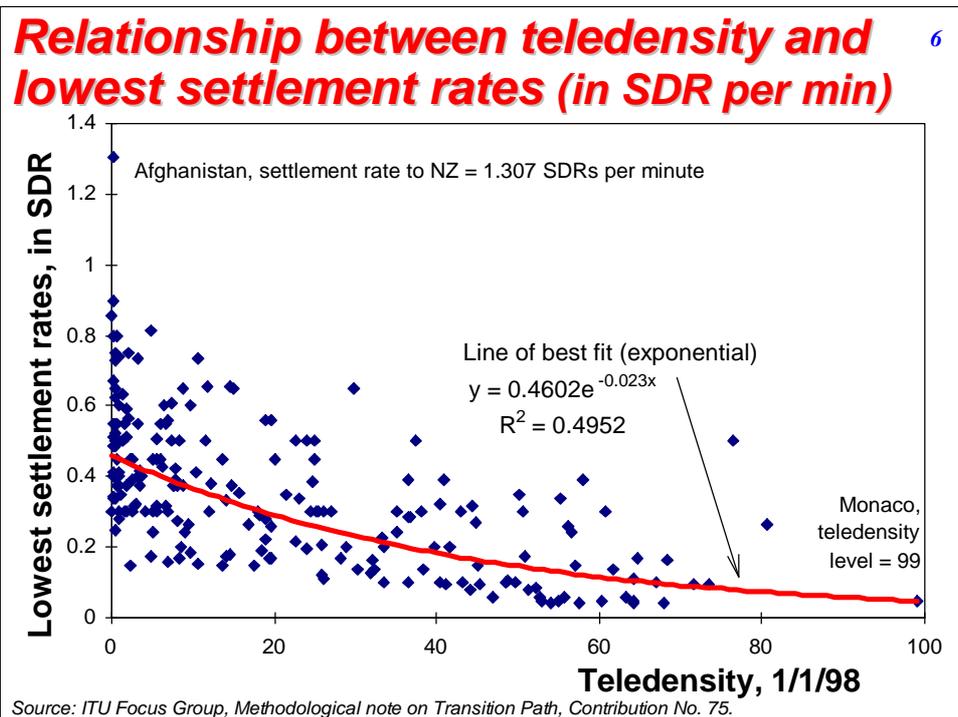
- **Interim transitional mechanisms (4 options)**
  - 1 **Price caps**
  - 2 **Designated target ranges**
  - 3 **Case study cost components**
  - 4 **“Best practice” rates existing in the market**
- **Agreement to use 4th option**
  - ⇒ **Primarily based on teledensity groups (income groups also considered)**
- **Choice of indicative target rates**
  - ⇒ **Initially based on average of lowest 5 published settlement rates (2nd Chairman’s Work. Doc.)**
  - ⇒ **Revised to average of lowest 20 per cent**

The work of the Group has followed a logical progression.

The initial Working Document of June 1998, which was revised and endorsed at the first Plenary meeting on June 8th, set out four possible options for “interim transitional mechanisms”. These were:

- the use of price caps, derived from cost models or cost proxies, such as those developed within the TAS Group or in the FCC Benchmark Order;
- the application of designated target ranges;
- the estimated cost components derived from the nine country case studies commissioned by the ITU and the Commonwealth Telecommunication Organisation;
- finally, what were termed “best practice rates”, based on an analysis of existing published settlement rates in the market.

At the second Plenary meeting, held 1-3 September, it was agreed to follow this fourth option, though the term “best practice” was dropped as there was no agreed definition. In addition, it was agreed that the countries and territories under consideration would need to be categorised into different groups. Initially, it was considered that this might be done on the basis of income groups, related to GDP per capita. But ultimately the Group agreed to work on bands defined by teledensity. It was also necessary to choose a mechanism for determining the level of the indicative target rate within each band. Initially, this was proposed as the average of the lowest five settlement rates. This was later revised to the average of the lowest 20 per cent. In addition, a data-gathering exercise was conducted in September 1998 to increase the coverage of data on lowest settlement rates available for the analysis.



The work of the Focus Group has been supported by a series of methodological notes prepared by the Secretariat of the Focus Group, which has been provided by staff of the TSB, and BDT and the SPU. This chart for instance, which is taken from the Methodological Note on the transitional path, shows the close statistical relationship between teledensity (telephone lines per 100 inhabitants) at the start of this year, and the lowest published settlement rates of the 224 countries and territories for which data was available. The  $R^2$  correlation co-efficient is close to 0.5 where 1 would represent perfect correlation. In other words, where teledensity is high, settlement rates are generally low.

This relationship is statistically significant and confirms the use of teledensity as a platform for the analysis and categorisation of countries. Not only is teledensity, in itself, a significant factor in explaining variations in cost-causation between different countries, it is also significantly correlated with other factors which might be inferred to cause cost variations, such as differences in traffic volume, GDP per capita, disposable income, etc.

**Final Report Recommendations on “indicative target rates” by Teledensity (T) Band, in SDR (and US cents) per minute.**

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T<1	1<T>5	5<T<10	10<T<20	20<T<35	35<T<50	T>50
<b>0.327 SDR</b>	<b>0.251 SDR</b>	<b>0.210 SDR</b>	<b>0.162 SDR</b>	<b>0.118 SDR</b>	<b>0.088 SDR</b>	<b>0.043 SDR</b>
43.7¢	33.5¢	28.0¢	21.6¢	15.8¢	11.8¢	5.7¢
<i>Low income</i>		<i>Lower middle</i>		<i>Upper middle</i>	<i>High income</i>	

*Note: The correspondence between teledensity band and income group shown in the bottom row is intended to be approximate, not precise. Source: ITU Focus Group Report. 1 SDR = US\$1.39.*

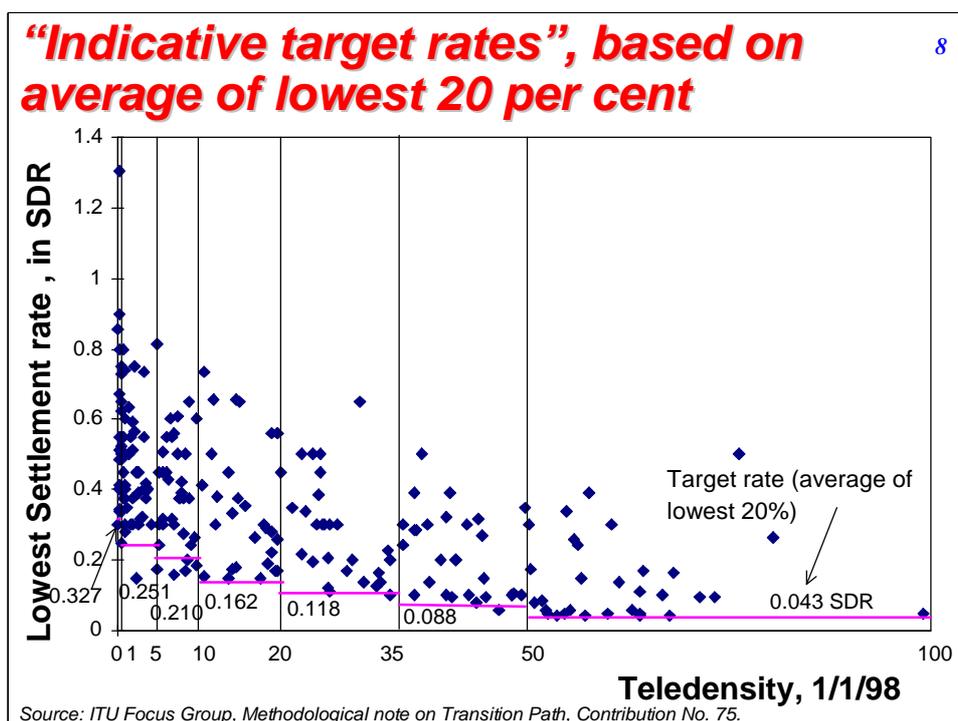
After the September meeting, considerable attention was focused on gathering additional data, refining the teledensity bands, and establishing the target levels. The process was carried out in two stages:

- First, for each country, the lowest settlement rate was identified. Where there were multiple operators in a particular country, the average was taken;
- Second, for each teledensity band, the average of the lowest 20 per cent of published settlement rates was taken.

The data which was used in establishing the indicative target rates is available on the Focus Group website (<http://www.itu.int/intset/focus/>) and is also shown, in summary form, in the Annexed Tables in the Final Report.

Some seven teledensity bands were defined, each containing around 30 countries or territories (up to a maximum of 42 in the “below 1” teledensity band). The indicative target rates range from 0.327 SDR per minute in the lowest teledensity band to 0.043 SDR in the “above 50” band.

The slide also shows the approximate mapping of income groups to teledensity bands.



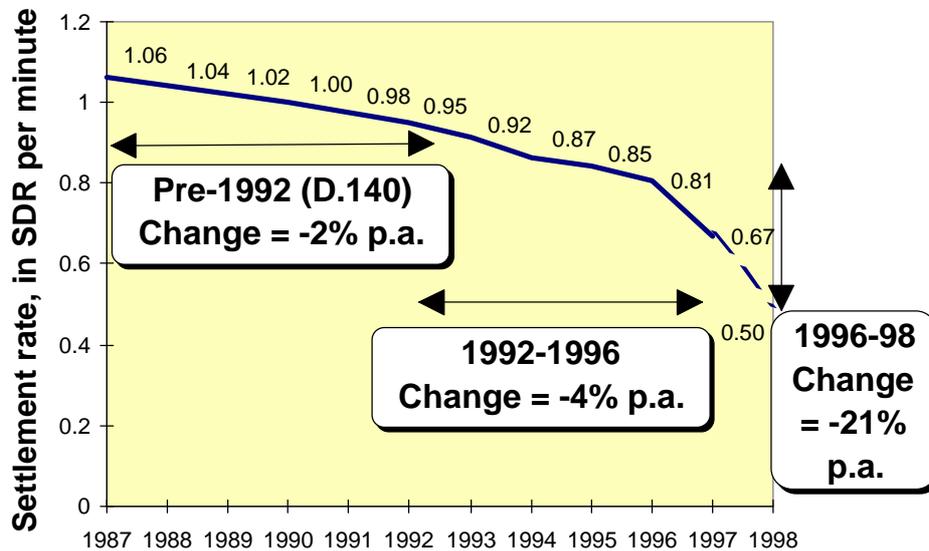
This slide shows the distribution of the indicative target rates for direct relations relative to existing lowest settlement rates plotted against teledensity.

Annex Table 1 of the Final Report shows that the list of countries and territories which have the lowest current published settlement rates includes representatives from all regions. For instance:

- from Africa, the list includes countries like Ghana and Uganda;
- from Asia, it includes Bhutan and Azerbaijan;
- from Latin America and the Caribbean, it includes Mexico and Brazil;
- from the Pacific, it includes Solomon Islands and Vanuatu;
- from Central and Eastern Europe, it includes Poland and Hungary;
- from the Arab States, it includes Tunisia and Morocco;
- from Western and Central Europe, it includes the Netherlands and Switzerland.

These are neither exceptional nor unusual countries. And they have very different market structures.

## Global average settlement rates, in SDR<sup>9</sup> per minute, 1987-98

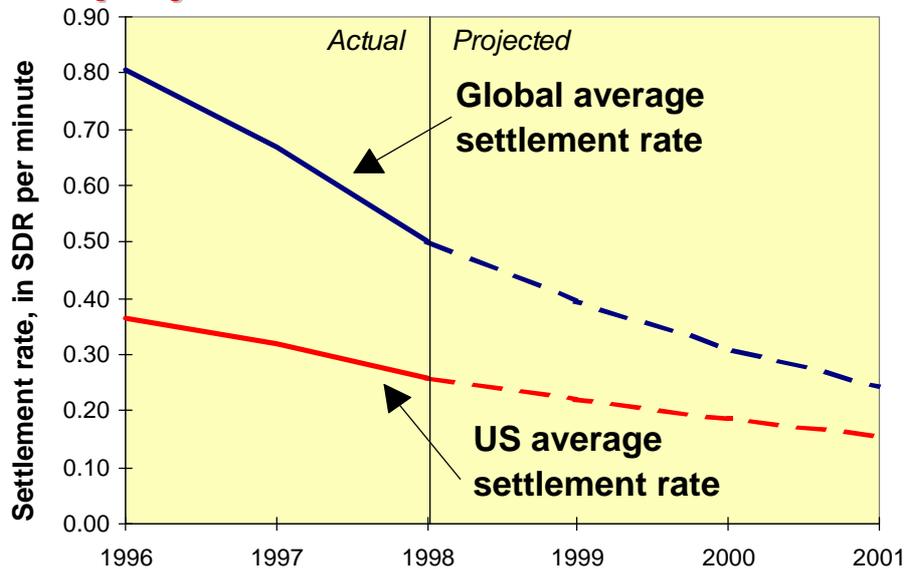


Source: ITU-T Study Group 3 (COM 3-53). 1998 estimate is a minimum projection based on D.140 Annex D.

All 44 countries which figure in the list of those with the lowest published settlement rates are below the level of 0.5 SDR, which corresponds to the existing recommended transitional arrangements in D.140 Annex D. However, in other countries, rates at the cut-off date of 28th September were sometimes significantly above this. Research carried out by the TSB Secretariat shows that average global settlement rate in 1997 was 0.67 SDR.

In the period up to 1992, when the Recommendation D.140 was approved, settlement rates worldwide were falling by an average of just 2 per cent per year. This rate doubled in the four years following the approval of the Recommendation. However, between 1996 and 1997, the rate of reduction rose to be in excess of 20 per cent. This acceleration is expected to have continued during 1998 as Annex D to Recommendation D.140 is implemented.

## Global and US average settlement rates, and projections to 2001



Source: ITU-T SG 3 (COM 3-53), and FCC. Projections based on average change, 1996-98.

Projecting forward this accelerating rate of reduction, it can be seen that the global average settlement rate will continue to fall and should approach that of the US average settlement rates which is currently falling by more than 15 per cent per year. Consequently, the three year timetable recommended in Paragraph E5.2 of the Focus group Final Report appears to be realistic. While, in some cases and on some routes, it may be necessary to reduce settlement rates at a faster rate, on the vast majority of routes it should be possible to achieve the target rates within the three year transition period just by continuing recent trends. For those 20 per cent of countries which have already achieved, or are close to achieving, the target rates, it is suggested, in paragraph E5.3 that they continue to take positive steps towards achieving cost-oriented levels, in co-operation with their correspondent partners.

## **“Optional” indicative target rates for small island states and LDCs**

<b>Category</b>	<b>Small island states (pop&lt;200'000)</b>	<b>LDCs and “as if” LDCs</b>
<b>Indicative target rate in SDRs per minute</b>	<b>0.292 SDR</b>	<b>0.312 SDR</b>
<b>In US cents per minute</b>	<b>39.0¢</b>	<b>41.7¢</b>

Source: ITU Focus Group Report. 1 SDR = US\$1.39.

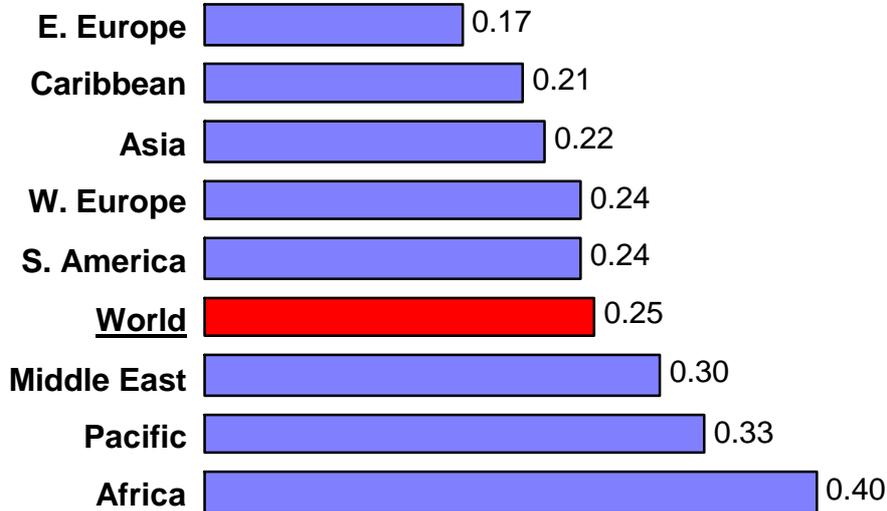
In the research carried out for the Focus Group -- in the country case study programme, and also in the work funded by the BDT in the Pacific Islands -- it has been shown that teledensity is generally a good indicator of cost variations. However, there remain a number of very small, tourism-oriented or economically vulnerable countries and territories, for which a different approach seems sensible.

In the Focus Group Final Report, two particular categories are recognised:

- small island states, which are defined as the 30 countries and territories which have less than 200'000 inhabitants, are distant from a continental mainland, off the main cable route and are therefore reliant on satellite communications;
- the 48 Least Developed Countries, and 3 “as if” LDCs recognised by the United Nations General Assembly.

Applying the same methodology of defining the average of the lowest 20 per cent of published settlement rates for these two groups produces an indicative target rate which, in some cases, may be higher than that which is relevant to their teledensity. It is proposed therefore that these countries and territories should be accorded the free choice of which target rate to apply.

**Estimated average transit shares from US to other regions, in US\$ per minute <sup>12</sup>**



*Note:* These rates are based on the average revenue per minute derived from transit operations.  
*Source:* Methodological note on transit (contribution 28). Data adapted from FCC.

For transit relations, it proved difficult to apply the same methodology for determining indicative target rates for two reasons:

- First, there is a disparity between the “official” transit rates, which exist on paper only in the contract between the origin country, the destination country and the transit operator, and the “confidential rates” which are actually paid.
- Second, even for official rates, there is very little published data. OFTEL is the sole regulatory agency to publish transit rates, The confidential rate carries a significant discount from the “official rate”, and is proprietary information, confidential to the transit operator and the country of origin.

To estimate the level of the “confidential rates”, the revenues received by US transit carriers from each region were analysed. From this was subtracted the amount that US carriers paid out, and then the remaining revenue was divided by the number of minutes carried in each region. This methodology gives an approximate cost per minute which, while not precisely accurate, at least shows the orders of magnitude involved. On this approximation, the global average for transit service from the United States was around 25 US cents per minute in 1996 -- a rather high price for a service that should probably cost less than a tenth of that amount.

The wall of silence that surrounds transit works very much against the interests of developing countries. A system which is based on differences between “official” and “confidential” rates means that the receiving country may be deprived of at least part of their fair share of the accounting rate. And the fact that there are few published rates means that developing country officials cannot compare the rates they are really being charged with any internationally comparative level. The work carried out by the Focus Group on transit relations marks an attempt to shine some light on this opaque set of transactions.

## **Final Report Recommendations on target rates for transit shares, in SDR (and US cents) per minute, by route**

<i>Routes with &lt;350 K mins</i>	<i>350K - 1.5m mins</i>	<i>Routes with &gt;1.5m mins</i>
(64 kbit/s)	(256 kbit/s)	(1.5/2.0 Mbit/s)
<b>0.06 SDR</b>	<b>0.05 SDR</b>	<b>0.03 SDR</b>
8.3¢	6.9¢	4.2¢

*Source: ITU Focus Group Report and methodological note No. 28. 1 SDR = US\$1.39.*

The Focus Group used a methodology based on cost proxies derived from international private line costs to derive a series of indicative target rates for transit shares, as a function of the volume of traffic on different routes. These rates are between 0.03 and 0.06 SDR per minute. This result was verified by applying a methodology based on an average of the lowest 20 per cent to the transit rate data published by OFTEL. That produced a target rate of 0.045 SDR per minute.

These target rates are intended to be upper limits and not set any lower limit. As has been recognised by many contributions to the Focus Group, on competitive routes, one would expect to find rates which are considerably below these targets. Nevertheless, if these target rates are implemented, they will exert a significant downward pressure on accounting rates which, on some routes, are being artificially sustained by inflated “official” prices for transit. They would also greatly assist those developing countries and remote islands which are currently paying far too much for transit service.



## **Final Report Recommendations on transition path**

- **Apply indicative target rate for direct relations within three years (year-end 2001)**
  - ⇒ **Extended transition period (to year-end 2004) for LDCs and low teledensity countries, as a function of dependence on net settlements**
- **Apply indicative target rate for transit shares within two years (year-end 2000)**
- **Indicative target rates could be applied:**
  - ⇒ **Symmetrically, with both Administrations/ROAs applying the same rate which is at or below the target of the lower teledensity country**
  - ⇒ **Asymmetrically, applying different rates below the target of the lower teledensity country**

How would the indicative target rates for direct and indirect relations be implemented?

The Focus Group report recommends a transition path for most countries of up to three years. That would begin in 1999 and end in 2001. It is recognised that many countries may wish to go much faster than this in order to avoid the loss of traffic to alternative systems, such as the Internet, which do not use “settlements”. That is certainly possible, by bilateral agreement, and all countries are encouraged to move towards cost-oriented rates at the earliest opportunity.

For some countries, particularly those with low teledensity or a high level of dependence on net settlements, it is recognised that this transition path might actually be too fast. For these countries, a longer transition path, up to the year 2004, is recommended.

For transit shares, it is recommended that the target rates be attained within two years, that is, before year end 2000, if not sooner.

The Final Report outlines two main ways in which the indicative target rates for direct relations could be applied, through bilateral agreement:

- First, they could be applied symmetrically, with both Administrations/ROAs applying the same target rate, but which would be set at or below the indicative target rate of the lower teledensity country;
- Alternatively, they could be applied in an asymmetric manner, with the Administration/ROA in the higher teledensity country applying a lower rate than the Administration/ROA in the lower teledensity country. In this case, both rates would be set below the target rate of the lower teledensity country.

The transition path is explored in more detail in later slides.



## **Focus Group recommendations on Universal Service / Access**

- **Defining USOs is the right of each Member State:**
  - ⇒ **transparent, non-discriminatory and competitively neutral**
- **In order to enhance Universal Access:**
  - ⇒ **Administrations/ROAs with high teledensity “may give favourable consideration to terminating incoming calls at their own cost-oriented rates without requiring reciprocal treatment. Such favourable consideration would be voluntary and based on mutual agreement.”**

In the Focus Group, we were fully aware of the continuing telecommunication development “gap” and the commitment in the ITU Constitution to “extend the benefits of telecommunications technology to all the world’s inhabitants”; in other words, to achieve Universal Access.

The approach taken to this issue was:

- First, to acknowledge the sovereign right of each Member to define Universal Service Obligations (USOs) in the way it chooses. In line with WTO commitments, USOs should be applied in a manner which is transparent, non-discriminatory and competitively neutral.
- But going beyond this, it is recognised that some Administrations/ROAs may choose, or be obliged by their regulator, to apply the same cost-oriented “interconnect fee” to all incoming calls. In this case, the interconnect fee might take the form of an unbundled termination charge. In such a case, Administrations/ROAs may choose to offer this cost-oriented interconnect fee without requiring reciprocal treatment from other Administrations/ROAs. This possibility is recognised in Paragraph E6.2 of the Final Report. If implemented, it would go a long way towards enhancing Universal Access.

## Worked examples of different transitional arrangements (year 2001)

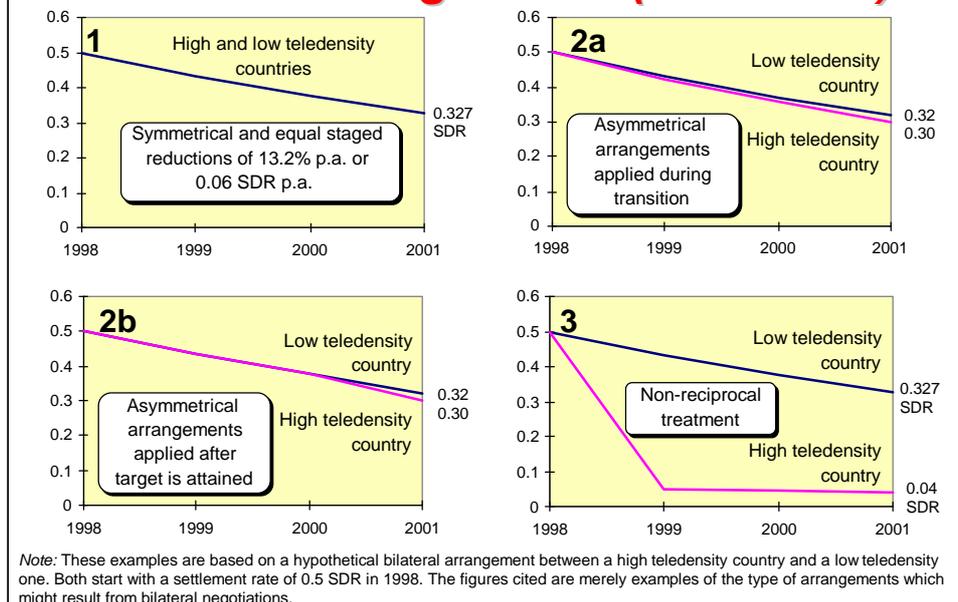
<i>Option</i>	<i>High teledensity (T&gt;50)</i>	<i>Low teledensity (T&lt;1)</i>	<i>Total Accounting Rate</i>	<i>% Split</i>
<b>1. Symmetry (Para 5.1a)</b>	<b>0.327 SDR</b>	<b>0.327 SDR</b>	<b>0.654 SDR</b>	<b>50/50</b>
<b>2. Asymmetry (Para 5.1b)</b>	<b>e.g., 0.30 SDR</b>	<b>e.g., 0.32 SDR</b>	<b>0.62 SDR</b>	<b>48/52</b>
<b>3. Non-reciprocal (Para 6.2)</b>	<b>e.g., 0.04 SDR</b>	<b>e.g., 0.327 SDR</b>	<b>0.367 SDR</b>	<b>11/89</b>

Note: This example is based on a hypothetical bilateral arrangement between a high teledensity country and a low teledensity one. The figures cited are merely examples of the type of arrangements which might result from bilateral negotiations.

This slide shows a worked example of how the three possible transition paths identified in the Report might be implemented. The numbers are hypothetical and should not be interpreted as limiting in any way the scope for bilateral negotiation; hence it is indicated that the figures shown are only examples:

- In the first case, both Administrations/ROAs apply the same target rate by the end of the transition period (2001) which is at or below the indicative target rate of the lower teledensity economy, in this case 0.327 SDR per minute. This option implies continuing with the traditional accounting rate system.
- In the second case, the Administration/ROA from the higher teledensity country applies a lower rate than the other Administration/ROA, though both rates are below the target rate of the lower teledensity country. In the example shown, an asymmetric split of 48/52 is derived and the total accounting rate is lower than it would have been if symmetry had been applied.
- In the third case, the Administration/ROA in the lower teledensity country benefits from non-reciprocal treatment in that the Administration/ROA in the higher teledensity country charges a cost-oriented "interconnect fee" of, say, 0.04 SDR per minute, while still continuing to pay the other Administration/ROA some 0.327 SDR per minute. It may prove difficult to sustain this degree of asymmetry for more than a very short period because of the scope it provides for arbitrage and reverse call-back. However, it could be used to assist the low teledensity country in the event of a sudden fall in the net settlement payment.

## Worked examples of possible different transitional arrangements (1998-2001) <sup>17</sup>



These worked examples are further amplified in the graphs shown in this slide. All the examples start from the same point, namely that Administrations/ROAs from a high and low teledensity country are applying a total accounting rate of 1 SDR per minute (in line with D.140 Annex D) at the end of 1998. This is split symmetrically.

- In graph 1, both Administrations/ROAs apply the same target rate of 0.327 SDR and achieve this by staged reductions over the three year period to year-end 2001. The reductions could, for instance, be the same amount each year (0.06 SDR) or the same percentage (13.2% cut).
- In graph 2a, both Administrations/ROAs apply different target rates during the transition period. In this case, the Administration/ROA in the higher teledensity country will apply a slightly faster rate of reduction than the Administration/ROA in the lower teledensity country. For instance, the former may move towards a target rate of 0.3 SDR while the latter might move towards 0.32 SDR.
- In graph 2b, both Administrations/ROAs apply different target rates, but only after the target of the lower teledensity country is attained, between the years 2000 and 2001.
- Finally, in graph 3, the Administration/ROA in the high teledensity country offers a cost-oriented “interconnect fee” without requiring reciprocal treatment from other Administrations/ROAs.

Of course, these examples represent only a small fraction of the range of options that could theoretically be achieved through bilateral negotiation.

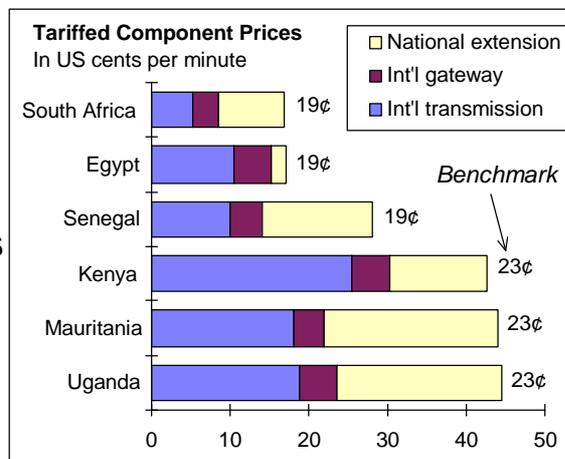
## Alternative proposals: FCC Benchmarks

- **3 elements:**

- ⇒ **international transmission;**
- ⇒ **int'l gateway;**
- ⇒ **national extension**

- **Based on operator's tariffs and FCC estimates**

- **For each income level, an average of the tariff rates for countries in that category were used to set the benchmark**



*NB: Many smaller countries were excluded from the analysis but are nonetheless included in income group averages*

It is instructive to compare the Recommendations of the Focus Group with those of the FCC Benchmark Order. The FCC Benchmark Order, which was passed in August 1997 and entered into force in January 1998, sets out a range of benchmarks between 15 and 23 US cents per minute (0.11 to 0.16 SDR per minute). The range is much narrower than that proposed in the Focus Group Final Report and the implementation periods, which range between year-end 1998 and year-end 2002, are somewhat tighter.

The FCC's benchmarks were derived from a methodology based on cost proxies in which actual, or supposed, price data was used as a surrogate for costs for each of the three components. The analysis was based on just 72 countries, chosen because they had major traffic streams with the United States. Only three countries from the continent of Africa were included in the survey (Egypt, Kenya and South Africa) and their traffic patterns are not representative of Africa as a whole. Furthermore, the FCC's analysis excludes, for instance, most LDCs and small island states. The case studies carried out on LDC African countries indicate very different results from those obtained by the FCC.

The FCC methodology derives benchmarks by averaging the Tariffed Component Prices (TCPs) in each income group. These TCPs are not representative and the process of averaging TCPs within each income group makes the results even less representative.

## Focus Group Final Report and FCC Benchmarks compared

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	<i>FCC Benchmarks</i>	<i>ITU Focus Group</i>
<b>Coverage of analysis</b>	<b>72 countries</b>	<b>224 countries / territories</b>
<b>Range of rates (direct relations)</b>	<b>0.11-0.16 SDR</b>	<b>0.043-0.327 SDR</b>
<b>Transit shares</b>	<b>Not covered</b>	<b>0.03-0.06 SDR</b>
<b>Groups</b>	<b>4 by income + 1 by teledensity</b>	<b>7 by teledensity + 2 others</b>
<b>Target years</b>	<b>Multi-year: 1998, -99, 2000, -01, -02</b>	<b>Year-end 2001 (2004)</b>
<b>Dependency on net settlements</b>	<b>Not covered</b>	<b>Extended transition</b>

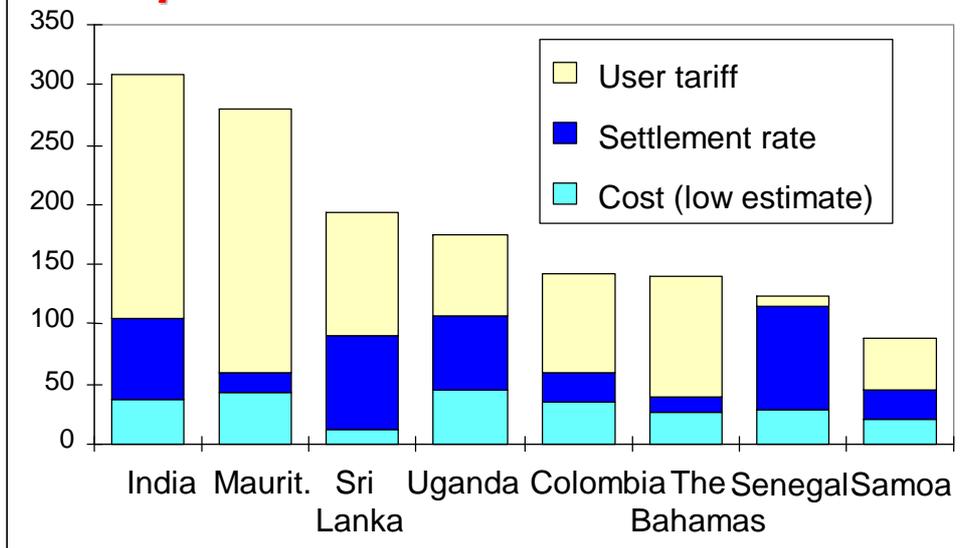
This slide provides a comparison between the FCC Benchmarks and the approach adopted by the Focus Group. The Focus Group data covers three times more countries and territories, which are categorised among a larger number of groups. The Focus Group's range of indicative target rates is also wider, at each end.

On the other hand, the FCC benchmark Order is based on an unrepresentative sample of just 72 countries, which are categorised between four income groups (low, lower-middle, upper middle and high) with the low income category being further subdivided into above and below a teledensity of one.

The majority of the world's users of telephone services live in the high income / high teledensity countries. They generate traffic mainly to other users in high income countries. The net effect of the recommendations in the Focus Group Final Report would be a steeper reduction in prices to consumers. The majority of the world's potential telephone users live in low income / low teledensity countries. For these potential consumers, the availability and accessibility of telephone service is more important, in the short term, than the price of international calls. The Focus Group's recommendations would result in a more gradual reduction in net settlements, which should ensure that those future consumers receive telephone access at an earlier date than would otherwise occur.

Additionally, the Focus Group's approach is far more realistic than that of the FCC, especially with regard to the market realities in the developing countries where it has been shown that, in a number of cases, transit rates exceed even the FCC's own benchmarks. The FCC Order does not address the issue of transit. Also, the Focus Group approach recognises the specific problems of high-cost small island states and LDCs which are excluded from the FCC analysis.

**Case study countries, average costs, settlement rates and user tariffs, in US cents per minute** 20



In order to compare the effects of the two alternatives (the Focus Group Final Report and the FCC Benchmarks Order) in real situations, it is useful to consider the country case study countries which were selected because they were considered to be among the most vulnerable to changes in the international telecommunications environment. The case studies were intended to show the impact of the changing international telecommunications environment rather than to provide rigorous cost studies.

## Potential impact of Final Report Targets & FCC Benchmarks on Case Study Countries <sup>21</sup>

Country	Lowest settlement rate	Target rate/year	FR % change	FCC % change
<b>Bahamas</b>	<b>0.225</b>	0.118 (2001)	<b>-18.1%</b>	<b>-93.9%</b>
<b>Colombia</b>	<b>0.375</b>	0.162 (2001)	<b>-22.7%</b>	<b>-35.1%</b>
<b>India</b>	<b>0.592</b>	0.251 (2002)	<b>-18.3%</b>	<b>-31.5%</b>
<b>Lesotho</b>	<b>0.300</b>	0.327 (2001)	<b>-5.0%</b>	<b>-12.2%</b>
<b>Mauritania</b>	<b>0.622</b>	0.327 (2001)	<b>-17.9%</b>	<b>-26.0%</b>
<b>Samoa</b>	<b>0.300</b>	0.312 (2001)	<b>-5.0%</b>	<b>-28.3%</b>
<b>Senegal</b>	<b>0.633</b>	0.312 (2003)	<b>-12.6%</b>	<b>-48.5%</b>
<b>Sri Lanka</b>	<b>0.550</b>	0.251 (2004)	<b>-11.8%</b>	<b>-29.9%</b>
<b>Uganda</b>	<b>0.337</b>	0.327 (2001)	<b>-5.0%</b>	<b>-14.5%</b>

Source: ITU Focus Group Methodological Note on Transition Path towards Cost-Oriented, contribution 75.  
 Note: The cost components shown show the lower estimates where multiple cost estimates were provided.  
 All of the case studies have been validated by the regions concerned except Uganda and Lesotho.

- In three of the country cases (Lesotho, Samoa and Uganda), their lowest settlement rates are already below, or close to, the indicative target rate. These countries may wish to make further reductions in order to ensure that they continue to reduce their rates towards cost-orientation, as indicated in paragraph E5.3. They would also need to reduce their other settlement rates into line with their current lowest rate.
- In three other cases (India, Senegal and Sri Lanka), their lowest settlement rates are higher than the applicable indicative target rates. An extended transition period is recommended, in paragraph E5.2, as these are low teledensity countries with a high dependence on net settlements.
- In the three other cases, (Bahamas, Colombia and Mauritania), their lowest settlement rates are significantly higher than the indicative target rates. A rate of reduction of between 18-22 per cent per year would be necessary to attain the target rates.

It is instructive to note that, in every single case, the rate of reduction required by the FCC is higher than the implied by the Focus Group's transitional arrangements. Significantly, the three case study countries with the highest dependence on net settlements (Samoa, Senegal and Sri Lanka) would need to make reductions of between 28 and 48 per cent per year to meet the FCC's targets.

## **Potential impact of Final Report Targets & FCC Benchmarks on Pacific Islands**

<i>Country</i>	<i>1996/97 TAS cost model</i>	<i>Lowest settlement rate</i>	<i>Target rate/year</i>	<i>FR % change</i>	<i>FCC % change</i>
<b>Island 1</b>	<b>0.712</b>	<b>0.300</b>	0.292 (2004)	<b>-5.0%</b>	<b>-23.0%</b>
<b>Island 2</b>	<b>0.489</b>	<b>0.449</b>	0.292 (2001)	<b>-13.3%</b>	<b>-32.7%</b>
<b>Island 3</b>	<b>0.396</b>	<b>0.375</b>	0.292 (2001)	<b>-7.9%</b>	<b>-28.5%</b>
<b>Island 4</b>	<b>0.381</b>	<b>0.387</b>	0.327 (2001)	<b>-8.9%</b>	<b>-40.5%</b>

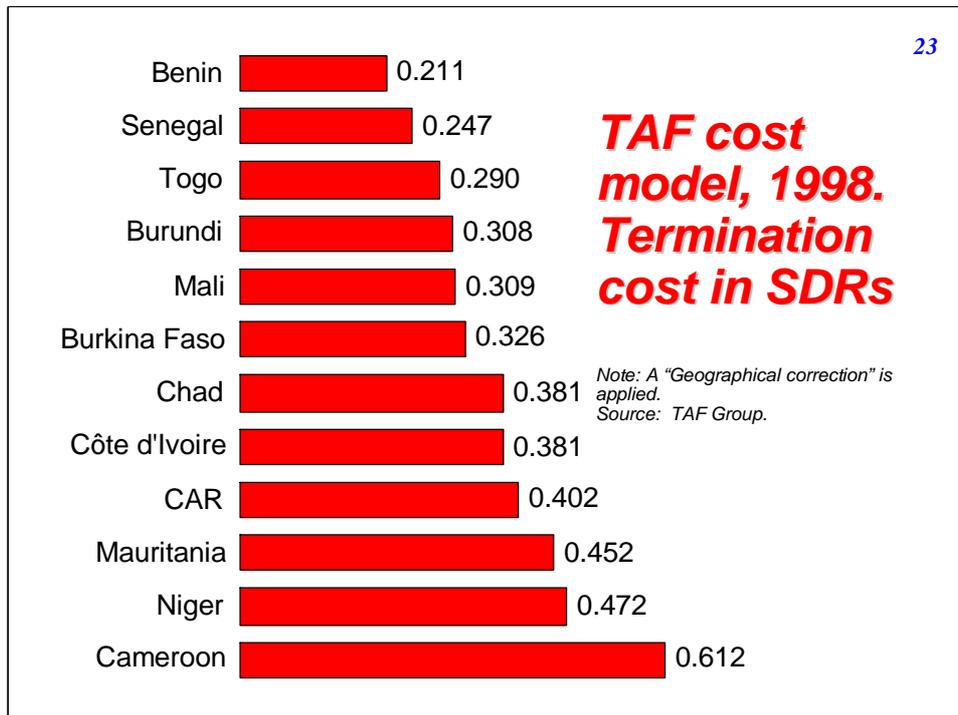
*Source:* Adapted from Pacific Resolutions, contribution 59.

*Note:* The cost components show the estimated costs obtained from applying the TAS model.

It is possible to test the two different scenarios (Focus Group Final Report and FCC Benchmarks) also on the Pacific Islands which were studied in a project financed by the ITU/BDT. The consultants applied the TAS methodology in these countries and derived estimated cost components, in 1996/97, of between 0.38 and 0.71 SDR per minute. The Focus Group methodology would imply applying an indicative target rate of 0.292 for target years of between 2001 and 2004. This would require a rate of reduction of between 5 and 13 per cent per year.

By contrast, the FCC methodology would imply a rate of reduction of between 23 and 40 per cent per year for these small island states with high cost of call termination, for which telecommunication net settlements represents one of their main sources of income.

These islands would benefit greatly from the recommended upper limits for transit shares in the Focus Group Final Report. On the issue of transit shares, however, the FCC methodology is silent.



In addition to the work in the Pacific Islands, a number of cost studies were also carried out in Francophone West Africa, again financed by the ITU/BDT. These studies applied a variation of the costing methodology that was used in the Senegal and Mauritania case studies. As can be seen in this slide, while the results showed a wide variation in the existing cost structures of the region, the results are not out of line with the figures obtained by using the methodology of the average of the lowest 20 per cent of published settlement rates which, for low teledensity countries, produces a target rate of 0.327 SDR per minute.



## **Context of Focus Group proposals**

- **ITU-T Recommendation D.140**
  - ⇒ **Implements transition towards cost-orientation agreed in 1992**
  - ⇒ **Complements existing transitional arrangements to year-end 1998 (Annex D)**
- **ITU-T Recommendation D.150**
  - ⇒ **Will facilitate expanded menu of remuneration options (e.g., termination charges)**
- **Recommendations D.300R, 500R, 600R**
  - ⇒ **Provides indications of cost trends where cost data, or agreed cost model, unavailable**

Where do the Recommendations of the Focus Group sit in relation with other Recommendations in the ITU-T D-Series?

The proposed text would form a new Annex E of Recommendation D.140, complementing the existing Annex D which is valid until the end of 1998. If the text is adopted at this meeting, it could be approved formally by Member States under the accelerated procedures, by June 1999 at the latest. It could be implemented in bilateral negotiations straight away.

There is a linkage with other proposals under discussion in Study Group 3, namely the expanded menu of remuneration options, including “termination charges” and “settlement rates”. With a focus on asymmetric arrangements, Annex E anticipates the new flexibility which will be introduced if Recommendation D.150 is revised.

Finally, it is important to state that Annex E does not, in any way, supersede or replace the regional tariff Recommendations contained in D.300R, D.500R and D.600R. As is clearly stated in paragraph E3.4 of Annex E, where a regional cost model which has been recognised by ITU-T Study Group 3 and is used within a region, the results obtained from the regional model could be applied within the region and, by bilateral agreement, with countries outside the region. The value of the Focus Group’s target rates is in cases where there is no agreed cost model, or where cost data is unavailable, in accordance with Approach 2 of Annex C of Recommendation D.140.



## **BDT Programme (Valletta, Res. 12)**

- **Regional programme**
  - ⇒ **Seminars in Colombia, Dakar, Barbados, Bangkok, Nairobi, Oman**
  - ⇒ **“Mini cost studies” in Pacific, Francophone Africa, Caribbean/Latin America**
  - ⇒ **Fellowships for LDCs to participate in work of Focus Group and ITU-T Study Group 3**
- **Assistance to Regional Tariff Groups (TAF, TAL, TAS)**
- **Assistance with analytical cost accounting**
- **Valletta Action Plan (WTDC), Programme 4**

In this presentation, I have made a number of references to the work of the BDT. During the course of the Focus Group's work, some six regional seminars have been held to help Member States and Sector Members to learn about and discuss the implications of the Focus Group's work for their regions. In particular, these meetings have been aimed at validating the country case studies. Two regional meetings have been held since the Focus Group report was published, in Nairobi and Oman. The declarations from those meetings will be available in an Information document prepared by the BDT.

In addition, the BDT has helped to finance a series of mini cost studies in Africa, the Pacific and the Latin America/Caribbean region. This work is still ongoing. This is in line with paragraphs E3.4 and E3.5 of Annex E which call upon Administrations/ROAs to utilise an appropriate costing methodology as soon as possible.

The BDT has also provided fellowships for representatives from the LDCs to participate in the work of the Focus Group and Study Group 3. This work will no go on during the implementation phase of the Focus Group's work, under the auspices of programme 4 of the Valletta Action Plan.



## Conclusions

- Focus Group proposals would create new Annex E to Recommendation D.140 for **transitional arrangements** beyond 1998
- This would mark a significant step towards rates which are **cost-orientated, non-discriminatory** and **transparent** (D.140)
- Provides “**smooth transition**” for countries most dependent on net settlements
- Recommendations proposed are based on extensive research and represent a **possible consensus**
- Presents **multilateral** alternative to imposition on US carriers of US/FCC Benchmarks Order

This presentation has sought to clarify the scope and nature of the package of Recommendations contained in the Focus Group's Final Report which, we agreed, should be simple, practical, and at the same time flexible enough to cover all likely cases. I hope it has achieved this end. This is essentially our report for which we have worked diligently over the past several months, and fast-tracked a process which had been stalled for six years. The process has been stimulated in recent times by technological applications in the industry which created new market realities. This has been reflected in the major negotiations at the WTO, in national legislation in the United States (the Benchmarks Order), the European Union Directives, and the United Nations' recognition of the “right to communicate”. In a brief summary, the following are the likely positive outcomes, should we agree upon the proposals in Annex E as transitional arrangements beyond 1998:

1. We will have succeeded to build upon the positive outcome achieved this time last year when Study Group 3 debated the transitional arrangements to 1998, that were implemented as Annex D of Recommendation D.140.
2. Annex E marks a significant step towards implementing Recommendation D.140 and achieving rates which are cost-oriented, non-discriminatory and transparent. If Study Group 3 fails to take steps to implement this Recommendation, which is now more than six years old, then credibility of Study Group 3, and indeed of the ITU, must be seriously questioned. We have, in this meeting, a chance to show that the accounting rate system can be reformed through a voluntary and multilateral process without recourse to unilateral action.
3. It would mark a further stimulus to the work of Study Group 3 on Recommendation D.150, on the expanded menu of remuneration options, including termination charges.
4. It would lend credibility and confidence to the introduction of cost analytical frameworks being undertaken in developing countries and to which the Focus Group has contributed.
5. It would meet the Plenipotentiary Resolution commitment to reach “an early resolution to the issue of accounting rate reform”.

I regret that we were not able, in the course of the Focus Group's work, to respond to the calls voiced from several quarters for the development of a dispute resolution mechanism. It was felt that that was outside the mandate of the Focus Group and could be better handled in the ITU Plenipotentiary and Council.

I am aware that the Focus Group did not have chance reach a final consensus before the report was issued, but I strongly feel that the text we have before us is the best available consensus which the Group is able to achieve. Indeed, I doubt if a better result could have been achieved even if more time were available given the sensitive and politicised nature of this issue.

I would contend that the Focus Group's recommendations take due account of the very difficult situations faced by developing countries and, by focussing on the needs of the very poorest and most dependent of those countries, it comes up with a transition path which is likely to be the smoothest that could be envisaged.

Finally, in closing, I would ask to consider what the consequences of failure to reach an agreement by next week would bring. It would mean that there is no multilateral basis for the transition to a cost-oriented regime. That would imply that individual countries will almost certainly decide to follow their own path and those countries which are net payers, may take unilateral action to achieve their own purposes. The FCC Benchmark Order is already in force, and the axe will begin to fall in less than four weeks. The European Union is preparing a similar action and will undoubtedly go ahead if Study Group 3 fails to act. The choice is yours.