

# Future EU Trade Policy

Response by British Telecommunications PLC to the  
2010 European Commission consultation

## 1 Introduction and Key Points

BT activities outside the UK are focused on the provision of networked IT services to multisite corporations and public-sector agencies. We work to meet the needs of our customers in more than 170 countries. We are consequently keen to achieve open markets both for our own activities and for those of our customers.

Against this background, BT remains committed to the WTO multilateral system and hopes that, despite the many missed deadlines in the Doha Round, a deal will still be possible. Such a deal should include substantive commitments in the services sector.

We are equally supportive of further Free Trade Agreements, and other plans to deepen economic integration with the EU's main commercial partners such as India, Brazil and Japan. Development of the TEC with the United States is also key. All those initiatives should offer opportunities to go beyond what could possibly be achieved in the Doha Round.

Finally, we consider compliance with existing trade commitments to be at least as important as the negotiation of new agreements. The EU and WTO both need to allocate significant resources to the mitigation of protectionist tendencies and enforcement of existing obligations.

As far as sectoral trade priorities are concerned, BT believes that opening of markets for electronic communications services merits high ranking for two reasons:

- Cross-border provision of such services is critical to development of trade and cross-border investment in other sectors.
- Open third country markets are needed to ensure development of an indigenous EU cloud computing industry.

With regard to the trade priorities *within* the electronic communications sector, forthcoming international trade negotiations and regulatory dialogues should give greater emphasis to four points:

- opening of third country markets for Virtual Private Network (VPN) services
- lifting the non-tariff barriers (NTBs) which result from inadequate application of the WTO Telecommunications Reference Paper
- lifting of restrictions on Foreign Direct Investment (FDI)
- lifting the NTBs which derive from national requirements relating to encryption and customer premises equipment.

In relation to the first two of these points, we would underline the critical role of third country domestic regulation. This needs to be considered not only as a potential source of non-tariff barriers. As the EU's own Electronic Communications Framework demonstrates, it is also vital to get the right regime in place so that regulation of enduring bottlenecks is ensured.

The remainder of the present paper sets out the rationale for prioritisation of electronic communications services in the EU's future trade policy and for selection of the above-mentioned issues *within* the electronic communications sector.

BT has global first-hand experience of all the points raised, and would be pleased to share this experience in further discussion with the European Commission.

## 2 Sectoral priorities for EU trade policy

Electronic communications services merit high ranking in the EU's trade policy priorities for two reasons.

### 2.1 Electronic communications services support trade and cross-border investment in other sectors

This fact was widely noted when the WTO Telecommunications Agreement was signed in 1997. Since then the global spread of interconnected networks based on Internet Protocol (IP) technology has led to a “death of distance” in data transmission costs, and enabled the interoperability of computers located anywhere on the surface of the planet.

This development has accelerated the “Second Great Unbundling” of economic activity. Whereas nineteenth century railways and steamships created a situation in which it was no longer necessary for production and consumption of goods to take place in same location, firms are now able to segment business processes and locate each element – both component manufacture and knowledge-based activities - in the most appropriate geographic site. Trade in finished products is consequently being supplemented by “trade in tasks.”<sup>1</sup> This expands opportunities for all countries to raise living standards by taking advantage of their respective sources of comparative advantage.

### 2.2 Open third country markets are needed to ensure development of an indigenous EU cloud computing industry

A variety of reports have highlighted the opportunity that cloud computing represents for the EU as a whole with regard to economic growth, government cost-cutting and climate change objectives.<sup>2</sup> Other studies have underlined the opportunities for EU firms, particularly those with a background in the telecommunications sector.<sup>3</sup> It is nevertheless vital to recognise that economies of scale and scope will be key sources of competitive advantage in the “all-IP” environment where (a) computer servers and software have already become the principal engines for production of electronic communications services and (b) data transport, data storage, and data processing will increasingly be offered as a single package.

With these points in mind, attention must be drawn to the remarkable openness of the EU market. For example, in contrast to the United States, the EU seeks to ensure that the bottleneck regulation defined in the WTO Telecommunications Reference Paper is applied to IP data transport services.<sup>4</sup> And an apparent determination to avoid situations where domestic regulation creates non-tariff barriers to trade is demonstrated by continued imports of cloud services worth many millions of dollars, even though some major services may not be compliant with EU law.<sup>5</sup> US providers are consequently able to use their access to the EU market to enhance the economies of scale already offered by a large home market. On the other hand, a large part of Europe's potential cloud service exports to the US remains blocked for reasons which are explained in section 3.2.1 below.

### 3 Priorities within the electronic communications sector

In order to maximise the welfare gains associated with growth of “trade in tasks” and foster development of an indigenous cloud computing industry, EU trade policy in the electronic communications sector would benefit from greater focus on four things:

- opening of third country markets for Virtual Private Network (VPN) services
- lifting the non-tariff barriers (NTBs) which result from inadequate application of the WTO Telecommunications Reference Paper
- lifting restrictions on Foreign Direct Investment (FDI)
- lifting the NTBs which derive from national requirements relating to encryption and customer premises equipment.

#### 3.1 Opening global VPN markets

##### 3.1.1 *The critical role of VPN services and their position within the existing GATS framework*

VPN services do not figure in the outdated classification of telecommunications services, which provide the basis for most existing commitments by WTO Members.<sup>6</sup> They nevertheless represent an important input for almost all the major corporations which once used dedicated leased lines to connect their own sites and exchange data with customers and suppliers. VPNs are defined by software platforms which function together with basic IP infrastructure in order to provide a data transmission service which is more reliable and more secure than the “best efforts” public internet. Taking account of their essential role in ensuring interoperability of business-critical IT applications in different geographic locations, these cloud services can be considered a vital facilitator for evolution of the above-mentioned “trade in tasks” paradigm.

VPN services sit across the dividing line in the GATS classification which separates Basic Telecommunications from Value-Added Services. On the one hand, they have the simple transport of electromagnetic signals from A to B as their *raison d’être*. They therefore share the common characteristic of the Basic Telecommunications services which are listed in the existing classification and which mostly consist in the “making available” of physical transport infrastructure. On the other hand, VPN services are among those produced by computers attached to transport infrastructure. They therefore share the common characteristic of the Value-Added Services in the other half of the GATS list.

Two other aspects of global VPN service provision need to be recognised. Firstly, the computers used to supply a VPN service in a specific country can in many scenarios be located anywhere in the world (and even where a local physical presence is desirable, this may often be limited an MPLS router enclosed in an outwardly unassuming tin box). Secondly, taking account of the geographic dispersion of customer sites, a VPN provider cannot normally achieve the economies of scale needed to justify investment in its own transport infrastructure at the local access level. It must therefore rely on facilities leased from national operators. To sum up in terms of the GATS services taxonomy, global VPN provision is essentially a Mode 1 service (ie, often based largely on cross-border supply).

### 3.1.2 *Obtaining new market access commitments on VPN*

An emphasis on the Value-Added Service, Mode 1 features of global VPN supply should help the EU to obtain new market opening commitments from its trade partners – particularly among emerging economies. It will be clearer that, rather than undermining incentives for local investors by competing in the same zero-sum game, global VPN providers deliver incremental traffic and revenues that can help to pay for development of physical transport infrastructure. It will also be clearer that an open VPN market will help ensure availability of low-cost, high-quality data transmission services with global reach which can in turn help third countries to attract foreign direct investment and grow their exports in other sectors.

Emphasis on the same points should, in addition, help to avoid situations in which global VPN providers are confronted with the restrictions which the governments of emerging economies typically use to bind their WTO commitments having assumed that facilities-based provision must necessarily be the principal mode of supply for Basic Telecommunications services. It will be clearer that conditions which are applied to licence holders with view to avoiding cherry-picking of the most profitable customers and raising teledensity rates (FDI ceilings, VOIP ban, requirements for licence holders to deploy infrastructure in all national regions and contribute to universal service funds etc) make no sense in a VPN context.<sup>7</sup>

### 3.1.3 *Ensuring that the WTO Telecommunications Reference Paper applies to new market opening commitments on VPN*

EU negotiators must nevertheless continue to insist on the Basic Telecommunications aspects of VPN provision since undertakings outlined in the WTO Telecommunications Reference Paper are typically applied only to services in this category.<sup>8</sup> This point is addressed in more detail in the next sub-section.

## 3.2 **Improving application of the WTO Telecommunications Reference Paper**

Electronic communications remains the only sector in which national commitments can be underpinned by adherence to a set of independent regulatory principles designed to avoid non-tariff barriers to trade in services. The European Commission needs to use all means at its disposal – specific provisions in FTAs, exchange of best practice and experience in regulatory dialogues, etc – in order to ensure that Reference Paper is properly applied. With regard to global VPN services, rigorous enforcement is particularly important for two reasons.

### 3.2.1 *Avoiding price discrimination*

As noted above, a VPN provider cannot normally achieve the economies of scale needed to justify investment in its own transport infrastructure at the local access level. In most cases local access links must therefore be considered as an “essential facility” which, under the terms of the Reference Paper, should be made available under non-discriminatory wholesale terms and conditions.

In countries where regulation does not ensure this, imports of VPN services will be blocked in scenarios where (a) the local market is characterised by the presence of vertically-integrated incumbent operators which are themselves suppliers of global VPN services and (b) a draft contract specification requires connection of a number of sites and the majority of these sites are located in the country in question.

Such scenarios occur frequently in the United States where profit margins on the supply of so-called “Special Access” are estimated in many cases to exceed 100%.<sup>9</sup> As already noted in Section 2.2 above, this fact severely limits the size of the addressable global market for European exporters of cloud services.

### 3.2.2 *Avoiding non-price discrimination*

The second reason for insistence on rigorous application of the Reference Paper relates to reliability as the “Unique Selling Point” of VPN services. Since wholesale local access is a critical input for such services and the overall reliability of any system cannot exceed the reliability of its weakest link, it can be impossible to offer a retail service which is in line with customer expectations in those countries where standard Service Level Agreements (SLAs) for such links are absent, inadequate or un-enforced. And the same countries’ imports of VPN services to can be blocked if a vertically-integrated incumbent operator offers premium SLAs to its own customer-facing business units which are not matched in its wholesale offer. To sum up, it is vital to ensure that the principle of non-discrimination is applied not only to the pricing and technical configuration of wholesale local links, but also to such mundane matters as delivery and repair times.<sup>10</sup>

### 3.3 **Lifting of restrictions on Foreign Direct Investment**

Notwithstanding the possible opportunity to sidestep FDI ceilings which has been described in Section 3.1.2 above, the EU should continue aiming for the reduction of such restrictions which are still common in the electronic communications sector. Even when the restrictions are consistent with a State’s commitments, they limit competition and stifle innovation. In practice, they often appear to benefit only a small percentage of the local population while at the same time creating a significant barrier to entry. And even in cases where foreign companies can own majority shareholding, there are significant costs to setting up joint ventures which often result in business inefficiencies

### 3.4 **Encryption requirements and customer premises equipment**

The final issue meriting a higher profile in electronic communications trade policy relates to the restrictions which a number of countries impose on imports of customer premises equipment with encryption capabilities. This is a significant barrier to the supply of electronic communications *services* to the extent that VPNs are typically sold as part of a contract package which includes provision of customer premises equipment. Since the issue has already been explained in detail by manufacturers of the equipment in question, it is mentioned here only as a “placeholder”.

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<sup>1</sup> eg, “The rise of offshoring: it’s not wine for cloth anymore”, Grossman and Rossi-Hansberg, 2006:  
[http://www.princeton.edu/~pcglobal/research/papers/grossman\\_rise\\_offshoring\\_0602.pdf](http://www.princeton.edu/~pcglobal/research/papers/grossman_rise_offshoring_0602.pdf)

<sup>2</sup> eg, “The economic consequences of the diffusion of cloud computing”, Etro, 2010: Chapter 1.9 in WEF 2010 Global Information Technology Report:  
<http://www.networkedreadiness.com/gitr/main/fullreport/index.html>

<sup>3</sup> eg, “The future of cloud computing: opportunities for European cloud computing beyond 2010”, European Commission, 2010  
<http://cordis.europa.eu/fp7/ict/ssai/docs/cloud-report-final.pdf>

<sup>4</sup> Although the definitions in Article 2 of the Electronic Communications Framework Directive 2002/21/EC cover all services consisting in transport of signals by electromagnetic means, BT does not consider that fully effective regulation of IP access bottlenecks has yet been achieved in all Member States. Equally noteworthy is the fact that the FCC is currently seeking powers to regulate IP transmission services as part of its efforts to solve the “net neutrality” issue.

<sup>5</sup> eg, letter from the Chair of the Article 29 Working Group to the CEO of Google, May 2010  
[http://ec.europa.eu/justice\\_home/fsj/privacy/docs/wpdocs/others/2010\\_05\\_26\\_letter\\_wp\\_google.pdf](http://ec.europa.eu/justice_home/fsj/privacy/docs/wpdocs/others/2010_05_26_letter_wp_google.pdf)

<sup>6</sup> This problem applies not only in relation to long-standing commitments. The 2009 EU-Korea FTA is based on the same classification, modified only by the addition of specified mobile services.

<sup>7</sup> Revival of the EU’s 2005 WTO submission – viz, its proposal to reclassify electronic communications services under a single generic heading – might not achieve the same result. Although third country markets for VPN services would be liberalised in principle, the proposal’s lack of “granularity” could obstruct clear appreciation of the distinct character of these services.

<sup>8</sup> The schedules of the three states which have joined the WTO most recently – Tonga (2007), Vietnam (2007) and Ukraine (2008) – represent a mixed precedent. Tonga and Ukraine have based their telecoms commitments on a simple copy and paste of the antiquated GATS classification. But Vietnam has departed from this scheme in order to include specific commitments on VPN and classified these commitments under the Basic Telecoms heading.

<sup>9</sup> eg, Longstanding regulatory tools confirming BOC market power: a defense of ARMIS, prepared for the Ad-Hoc Telecommunications User Committee, Economics and Technology Inc, Boston, January 2010 <http://www.econtech.com/ETILongstandingregulatorytools.pdf>

<sup>10</sup> Although the UK has successfully solved this problem with the introduction of Functional Separation, less drastic measures can achieve the same outcome with regard to competitive supply of VPN services. Such measures include publication and independent audit of comparative Key Performance Indicators.

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