

Implementation of the Full Liberalization
of the
Local Fixed Telecommunications Network Services Market
from 1 January 2003

SUBMISSION BY
PACIFIC CENTURY CYBERWORKS LIMITED

Introduction

Pacific Century CyberWorks Limited (PCCW) appreciates the opportunity of sharing with the Panel its views on the Government's Consultation Paper on the Liberalization of Hong Kong's fixed telecommunications network services market.

We would like to emphasize that PCCW fully supports the development of liberalized markets and welcomes the government's initiative in conducting this critically important consultation. We consider OFTA's consultation extremely timely and its liberalization proposal a step in the right direction.

Along with all relevant parties involved in this discussion, it is the desire of PCCW that the consultation will result in a policy decision which allows for a telecommunications market characterized by genuine incentives for increased investment, enhanced infrastructure competition, sustainable growth and substantial job creation.

Such a market, we believe, will benefit users, promote Hong Kong as a telecommunications and business hub, permit all Hong Kong carriers to reach and maintain the critical mass necessary to be regional or even global players, and contribute in a very positive way to Hong Kong's economic future.

Assessment of Proposal

In considering the proposed changes, the obvious first question to be asked is whether the approach being put forward will achieve these very important goals.

The key points for a serious discussion of the proposal include:

- Will the proposals create the right investment incentives, and provide benefits to the community as a whole, and to Hong Kong?
- Is there a possibility that the route being taken may fragment this unique market and produce little long term investment rather than improve and enhance it?
- Is there a danger that existing jobs, and future employment in the industry could be jeopardized?
- What are the likely overall economic benefits?

There can be no doubt that in putting its proposals forward, OFTA is seeking to move forward Hong Kong's telecommunications industry through liberalization.

This is clear from the strong focus in the document on various implementation details of a liberalized market.

While liberalization is a laudable objective, there is, as a number of observers have noted, a need to pursue it not simply as an end in itself, but in the context of the overall situation in the Hong Kong market.

Important considerations before proceeding with liberalization

While the approach to liberalization is fully detailed in the proposal, a number of vital aspects relating to the impact of the move need to be addressed.

These include:

- A cost/benefit analysis on the full liberalization proposal, taking into account the unique size and structure of the Hong Kong market.
- Analysis on the proposal's impact on investment levels and investment incentives.
- Analysis on the impact on job creation
- Review of service quality
- Consideration of prospects for encouraging innovation
- Incentives to ensure infrastructure build outs; and most importantly
- The likely effect on the contribution to the overall economy.

These are important considerations which should not be discounted, or viewed lightly. It cannot automatically be assumed that full liberalization will be beneficial, especially as the liberalization proposal seeks to permit market entry by new facilities based carriers which would *not* be required to commit to investment levels or build outs.

Under the proposal, these new licensees would seemingly enjoy all the same rights as existing FTNS licensees who have made, particularly so in the case of PCCW, substantial commitments to investment levels and build outs. In addition, the newcomers would not be required to pay any more for interconnection than existing FTNS operators even though they may not be infrastructure investors.

This appears to represent a significant change from the existing licensing and interconnection regime, without an accompanying rationale underpinning it. Existing licensees are likely to see such a move as a substantial disincentive to further investment.

Throughout these six years of deregulation, the primary focus of our competitors has always been the central business districts, they being where high-value customers are concentrated. Without active encouragement, this is unlikely to change. The result is likely to be hyper competition in the central business districts, to the detriment of investment, service roll out and expanded consumer choice in other geographic areas.

There is also an additional danger that the liberalization proposal may cause stranded investment and the under recovery of interconnection costs. And most significantly, there would be a very real possibility of substantial employee lay offs.

If resellers and infrastructure licensees are not required to meet investment and build out obligations, but are still enabled to obtain equal interconnection rights, the competitive positioning across the industry will be put off balance. We have already seen the negative results of such policies in other markets.

Providing Balance

The existing interconnection structure successfully used here and in other liberalized markets, should be continued. Such a model is, from experience,

more equitable as it recognizes the contribution of each of the parties, and creates the right incentives for investment and job creation.

Under this approach, the best interconnection rates are provided to FTNS licensees who commit to substantial infrastructure investments and roll outs. There is no policy basis to turn this approach on its head.

In moving forward rapidly to achieve an objective desired by all, there is the real concern that Hong Kong may be “trying to put the roof on a building before the walls have been constructed”.

The OFTA proposal cannot be considered in a vacuum. It must take account of the real situation as it now exists, and any change introduced must be balanced with the ability of existing operators to perform their responsibilities fairly, in support of the consumer.

It is logical that further liberalization should only proceed once a level playing field is established for existing contributors to the Hong Kong telecommunications market.

Concerns still to be addressed

Matters in dispute affect every operator. However, for the purposes of this submission, subjects will be confined to those relating to PCCW only.

For instance, one area OFTA should address prior to full liberalization, involves concerns about existing interconnection charges and practices. While PCCW generally supports the existing rate structure, serious problems exist as to rate levels and certain practices.

An example of the need for reform is the way in which PCCW is required to subsidise all other licensees by having its interconnection charges limited to one quarter to one half of the levels in other developed markets.

This subsidization is also reflected in the provision of interconnection capacity to our competitors. Significant investments made by PCCW to provide interconnection capacity are generally not recoverable because such costs are not paid for until the capacity is fully used over a 15 year period.

Already, due to these shortcomings the existing FTNS operators competing with PCCW are in a position where they are not encouraged to make investment beyond those absolutely required commitments and have thus chosen the low cost option of simply reselling services we have already put in place. If new licensees have even less obligation to invest, this situation would be exacerbated and at the end of the day, the vast majority of residential and rural users are unlikely to receive any real benefits.

The market was first liberalized in 1995, yet PCCW is still required to support competitors by providing wholesale services at price levels which are below cost. No other developed market has such a scheme which so directly disadvantages the incumbent supplier.

There is no indication in the proposal that PCCW will be relieved of the burden of using its own resources to support competitors in the conduct of their businesses. Indeed, the implication is that the Company will be expected to go on giving discounts to newcomers ... who would have no investment requirements ... for well beyond 2003.

A further example is the requirement that PCCW unbundle its services, while competitors are not called upon to similarly unbundle their networks to allow interconnection.

At this point, after many years of having the chance to stand alone, to invest, to expand and compete fairly, the other operators should have reached a stage where they no longer need artificial support.

For a regulator to continue “propping up” a competitor and not creating a level playing field, is unjust, and ultimately against the consumer interest. Interference in market forces is likely, at the end of the day, to put jobs on the line.

Conclusion

PCCW warmly embraces competition, as long as it is fair and equal.

In assessing the OFTA proposal, we believe that while the objective is to be applauded, the full impact needs to be considered in clear and transparent detail and presented to the public so that a careful assessment can be made in the

interests of Hong Kong, the industry, consumers ... and all current and prospective employees in this industry.

It is our belief that Hong Kong deserves to have a comprehensive liberalization plan that continues to require significant infrastructure investment and build out commitments, and one that encourages such investment through a cost based interconnection structure.

To achieve the Government's goal of leading Asia in the communications field, it is vital that we obtain a balanced competitive environment for all participants.

While PCCW fully supports further liberalization, the Company urges that any proposal to achieve this objective takes into account current inequities so that there is a balanced environment into which the newcomers can enter, and that there is a full review of all the possible repercussions of the initiative.

Without a sound, strong and secure foundation in place, full liberalization could serve to hinder the further growth and development of the telecommunications industry, rather than encourage the benefits which OFTA, and the people of Hong Kong, would wish to secure.

In moving ahead, PCCW believes it is in the best interests of all concerned, that liberalization proceed cautiously, in a timely manner, and with great attention given to its impact and to every detail.