Memo on the General Policy of the Telecommunications Sector for the coming stage approved by the Council of Ministers at its session No. 18/2003 held on Nov 4, 2003

In accordance with the provisions of Article (3) of the Telecommunications regulatory Act issued by the Royal Decree No. 30/2002, the Minister of Transport and Communications is entrusted to set the general policy for the telecommunications sector and present it to the Council of Ministers so as to endeavour the following:

i. Developing the telecommunications sector with the object to expand the scope of provision of telecommunications services to cater for the needs of economic and social development.

ii. Preparing the telecommunications universal service requirements pursuant to Article (38) of this Act, and in accordance with the Government's economic and social policy.

iii. Encouraging investment in telecommunications industry in coordination with the competent bodies.

iv. Introducing competition in telecommunications services in accordance with the exigencies of the state general policy.

v. Safeguard and developing the Sultanate's interest in the field of telecommunications at the international level.

According to Article (11) of the said Act, the Authority members are to propose the general policy of the telecommunications sector, and to prepare programs and plans necessary for its development. A Provisional Committee was established to perform the duties and functions of these members pending the issuance of the Royal Decree appointing the members of the authority.

Executive Summary:

The Telecommunications Regulatory Authority (TRA) has appointed PwC Consulting to develop recommendations on:
Telecommunications sector policy to achieve the targeted socio-economic objectives.
Preparing for the introduction of competition.

This document addresses telecommunications sector policy, most importantly recommendations on the structure and timing of the liberalisation of the telecom sector in Oman. The liberalisation approach to be adopted is a critical component of sector policy and it influences all areas of regulation.

The document took into consideration the analysis of the government objectives as well as the current market situation in order to understand the status of the market and the challenges facing the Government. The analysis in the Paper draws upon international examples of the liberalisation approach taken in other countries and relates them to proposals for the Strategy and Approach for Oman, developed on the basis of analysis of the market situation, Government plans and sector objectives. The key challenges that the Government and TRA will face in reforming the telecommunications sector have been identified and a range of options for liberalisation which seek to address these challenges has been proposed.

1. Current situation and context for liberalisation

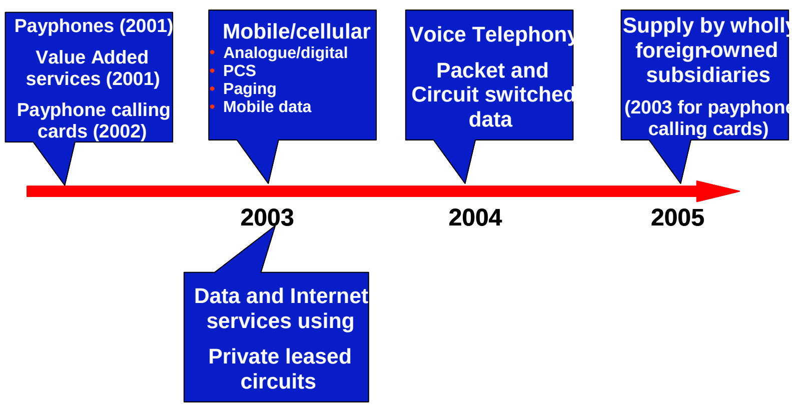
Oman has a relatively low teledensity for fixed and mobile services compared to countries of similar income. It has also a low population density and inhabitants of rural areas are under served. Fixed line teledensity, is below 10%, and household teledensity is 48%, are the lowest in the GCC countries, and much lower than international standards.

The fixed line teledensity of less than 10% and the household teledensity of 48% is the lowest among GCC in contrast to more than 20% and above 100% respectively. Teledensity varies across regions, from 17% in urban Muscat, to under 1% in thinly populated Al-Wusta. Service availability follows a similar pattern, with lower availability in more remote regions as there are several villages of less than 500 inhabitants and most of these are still not covered. Oman's terrain is mainly a combination of mountains, particularly in the most densely populated North East region, and desert. Whilst infrastructure costs for rural and interior areas in Oman are greater than international averages.

As part of its accession to the World Trade Organisation (WTO), the Sultanate has committed to progressive opening of the telecommunications market to competition, with no limitations on market access for certain services and at specific dates.

The precise interpretation of the extent of market opening implied by the commitments, and their applicability in the Oman context, is still open. However, some of these commitments are likely to entail a major shift in the structure and underlying economics of the telecommunications sector. For example, the commitment to allow cross-border supply of voice telephony from 2004 means that providers based outside Oman may be able to offer services such as international calling cards, without requiring commercial presence in Oman

Market opening: Commitments to WTO



Government plans for the partial privatisation of Omantel have been postponed in light of the global slowdown, particularly in the telecommunications sector. It is a requirement of the Telecommunications Law (the Telecoms Law) passed in March 2002 that licensing must be in place within one year. The draft licence, including for roll-out and quality of service obligations, is being reviewed and updated.

2. Three key challenges were identified for Government and TRA as a result of liberalisation, based on the need to:

- Enable universal service in a competitive environment.
- Encourage introduction of advanced services.
- Establish a robust approach to economic regulation of the sector, based on transparent service costing and accounting.

The introduction of competition complicates the task of sector regulation in the short to medium term. In a monopoly, where the sole operator is owned and operated by Government, the operator is typically directed by Government to implement socio-economic policy on its behalf, as part of the Government development initiatives. In the competitive environment, the rights and duties of individual operators need to be developed and imposed in a coordinated way, through balanced obligations, to avoid distortion of competition. Government will also need to establish an effective system of regulation that limits the potential for anti-competitive practices and gives commercial freedom to sector players while supporting the achievement of Government socio-economic objectives.

3. Overall strategy and approach to liberalisation

As identified in the market analysis, there is a real need to increase rural connectivity as well as speeding up connections in served areas. Rural demand is not being met and Omantel has not done much in the past to increase rural penetration, despite being allocated funds to do so. There is a significant risk this will continue and we recommend TRA not to oblige Omantel to serve all rural areas but instead create a separate scheme for rural projects. Omantel will still have national rollout target and be obliged to serve any customer within areas where the network is already available or will be available within the next three years according to Omantel's expansion plans and targets. This will serve to "ring fence" Omantel's obligations to a well defined area, make its targets manageable to meet and give the Government ability to immediately go ahead with alternative methods of providing rural connectivity.

The TRA and Omantel will need to work together to define the extent of Omantel's served areas. Omantel network presence will not be uniform across a given geographic area. Omantel will have an obligation of universal service within the boundaries of a served area, so it will be important to clearly establish these.

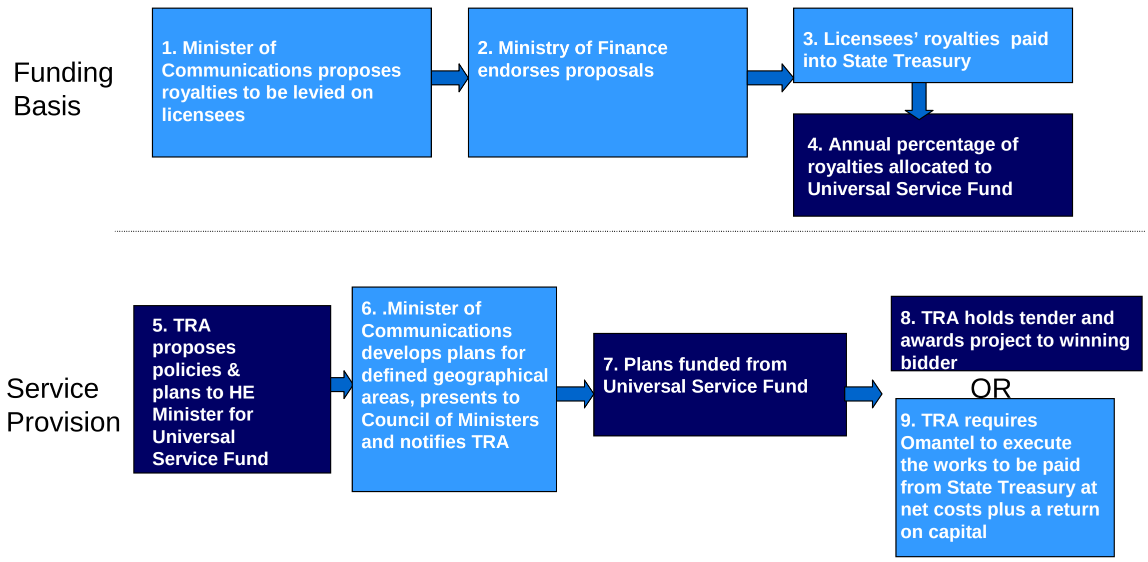
International experience and current trends show that a rural project structure is a cost efficient way of increasing rural connectivity. Increasing rural connectivity is a long-term plan and it would bring significant cost implications on Omantel, which is not compatible with the short-term goal of part privatisation of Omantel and introduction of competition in the sector. By addressing the need for increase in rural connectivity separately via the rural projects scheme, the Government could simultaneously:

- Limit Omantel's obligation to served areas.
- Control the negative impact on Omantel's value prior to sale of an equity stake.
- Limit burdens on Omantel and thereby remove impediments to introduction of competition.
- Encourage initiatives to increase rural connectivity immediately.

4. Funding of Universal Service

It is recommended that the funding of Universal Service, including the rural projects in particular, should be shared between operators in the market by establishing a Universal Service Fund (USF). The Regulatory Authority would assess the cost of universal service and based on this funding requirement allot a percentage of royalties to the USF pursuant to Article 4(2) of the Telecom Law, i.e. operators pay according to their market share. Operators undertaking supply of unprofitable connections may then be given a subsidy from the fund towards the arising deficit. This framework is based on the principles envisaged in the Telecom Law, where operators would pay royalties or licence proceeds to the State Treasury, and the Treasury would then decide on certain expansion of the network, which it can fund to put out to tender or to Omantel. However, the royalties would go into the general Government budget and therefore subject to changing political priorities. The USF mechanism is advantageous because the contributions are earmarked solely to rural expansion and administered independently in a transparent manner.

Diagram 3.4 Suggested approach to funding of universal service



5. Summary of recommendations for liberalisation:

The table below summarises, service by service, the key features of the Strategy and Approach for Oman discussed in the previous section.

The options discussed are assumed to cover a five-year period and would be subject to periodic review. In particular, it is expected that, at a minimum, there would be an interim review stage three years into liberalisation to assess developments and, where deemed necessary, to make adjustments needed to maintain progress towards sector objectives and adapt to new developments in the marketplace.

Summary Views (1)

	IBM Recommendations
Value Added Services and ISP	▪ Start 2003 ▪ Open entry (must meet qualifying financial and technical criteria)
Voice services and Fixed and Mobile Calling cards	▪ Start 2003 ▪ Open entry (must meet qualifying financial and technical criteria)
Payphones	▪ See rural
Rural Services	▪ Include payphones in rural services ▪ Set up structure for rural projects and funding (Universal Service Fund) 2003 ▪ Competitive bidding for rural projects ▪ Projects launch 2004/2005
Leased lines and private data networks	▪ Operators can provide end to end links (full transmission path between customer sites) ▪ Potential for operators to transition to voice and international data (to be considered at 3 year review stage) ▪ Open entry (must meet qualifying financial and technical criteria) ▪ Start 2003
Public data networks (packet & circuit switched)	▪ As for private data networks ▪ Start 2004
Mobile network	▪ One additional national operator ▪ Right to provide own fixed links ▪ Right and obligation for infrastructure sharing in rural areas ▪ Obligation to contribute to Universal Service Fund ▪ Start licensing process 2003
Fixed network (PSTN)	▪ One new entrant with full service rights (local, long distance, international) ▪ Optional roll-out obligations ▪ Obligation to contribute to Universal Service Fund ▪ Start licensing process 2004

The government needs to adopt a set of national targets for the telecommunications sector to express the aspirations to develop the sector within the few coming years. Teledensity is ambitiously forecasted to reach 19% by 2007 compared to 9.6% at present, mobile teledensity to reach 40% by 2007 compared to 18% now and Internet users to reach 200 per 1.000 by 2007. The targets were derived from the analysis of demand and other comparative analysis carried out in the Sultanate.

Summary of recommendations for Omantel

The recommended scheme for rural connectivity is put forward as an alternative to placing a universal service target upon Omantel. Omantel will have five year roll-out targets under its fixed licence, in order to ensure continuity of network build while rural projects are being developed and piloted. For the time being, Omantel would not be eligible for universal subsidy for its served areas. However, the situation would be open for review at a later date, as part of TRA's regular five year review. Omantel would, however, be able to compete for subsidised rural projects which are put out to tender, on the same basis as other applicants.