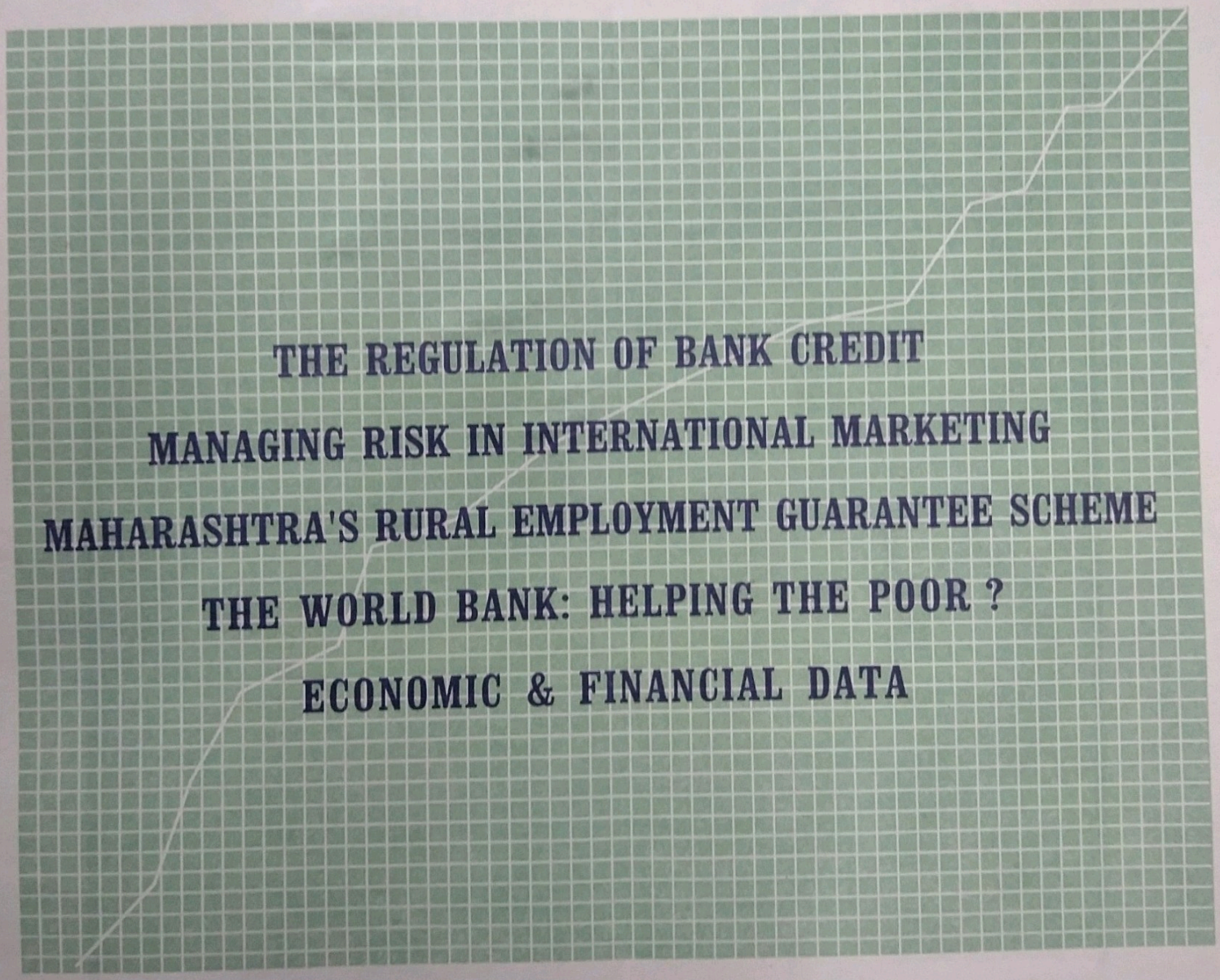
ISSN 0038-4046

SOUTHERN ECONOMIST

44th Year of Publication

Volume 44 Number 10 Rs. 20



THE REGULATION OF BANK CREDIT

MANAGING RISK IN INTERNATIONAL MARKETING

MAHARASHTRA'S RURAL EMPLOYMENT GUARANTEE SCHEME

THE WORLD BANK: HELPING THE POOR ?

ECONOMIC & FINANCIAL DATA

SEPTEMBER 15, 2005

FDI in Telecom in India: A Study

By D. Chennappa*

With the liberalization in the Indian telecom industry, the industry is subjected to an intense competition, especially within the cellular services. Competition is likely to keep subscription growth high and pressure on prices. It also requires operators to increase capital investment to expand services. The government has also increased the limit on Foreign Direct Investment (FDI) in telecom providers from 49% to 74%[1]. This change may also give many players access to more capital in general and foreign capital in particular for expansion of their networks, thus, increasing competition.

The Indian telecom service sector is becoming one of the fastest growing sectors in the world. As such India has become the fifth largest network in the world in terms of number of telephones after China, USA, Japan and Germany, crossing more than 100 million telephone subscriptions by April 13, 2005. Two chief factors are responsible for this great growth are: One, the availability of cheaper handsets with better functionality, which lowered the entry barrier and perfectly suited to Indian conditions such as dust resistance, battery capacity, etc., and the second, a significant dip in tariffs from a level of around Rs 16 a call and chargeable incoming calls to a low tariff regime of Rs 1 a call and handsets too have undergone a sea change, that is, when mobile services were launched in 1994, mobile handsets cost upward of Rs 40,000. Today, one can acquire one for as low as Rs 2,500[2].

Above all, the main issues pertain to a) the strategic nature of the telecom sector, b) the reason for similar caps in other countries c) whether there is a need for FDIs of this magnitude in view of the healthy balance sheets of the telecom companies d) the need for indigenous equipment manufacturing capabilities to bring down equipment costs. This study based on secondary data, which is collected from Department of Telecommunication, Government of India, Telecom Regulatory Authority of India (TRAI), Annual reports, Journals and Newspapers. And suitable suggestions have been made. The details are as follow:

> Among the listed countries, most of them allow FDI after the tele-density and the per capita incomes have gone up to certain levels, when compared to them, India lags behind on both tele-density and per capita income levels. India, therefore, needs to strengthen domestic manufacturing units and niche market first of all and increasing FDI cap is not sufficient for increasing higher rural tele-density.

The main criticism on the raising the limits of FDI ceiling beyond 49% is that once foreign capital wrests control over our telecom companies, there would be no control whatsoever on the hardware equipments imported by them. Information security of our Defense system as well as sensitive economic entities like the stock market or banks can, therefore, get undermined[3]. Historically almost all countries regarded telecom as a strategic sector. The telecom companies were either state owned or under strict regulatory controls regarding foreign ownership. The US and Canada were among the few countries that had private ownership of telecom and both had strict limits on foreign ownership.

The Europeans and most other countries had state owned telecom companies. Therefore, they did not need any official caps on foreign ownership. However, the Indian security agencies have already put forward their positions that the telecom sector is a strategic one and foreign control of telecom companies need to be carefully circumscribed. Further, Department of Telecommunication, Government of India received replies from the Intelligence Bureau and the Directorate of Revenue Intelligence, both of which emphasized that the 49 per cent limit should be retained, as communication is a vital national infrastructure with a critical role in the security of the nation[4].

In this context, it may also be noted that the security agencies have restrictions on people using cell phones in border areas. It would be suspicious if owning of cell phones in border areas by interests inimical to India is considered a security threat by the intrusion of foreign interests owning telecom networks in India.

If there were reasons why telecom sector's strategic nature needs to be overridden, then we could consider the same. But we see no such overriding concern. And the other side, India is generating enough to finance the growth of the telecom sector without impacting other sectors. If this is so, is there any reason why we should compromise with our security and hand over two-thirds of the existing GSM mobile subscribers to foreign companies?

Restrictions on Foreign Ownership In Other Countries: The issue here is not that some countries allow unrestricted FDIs. The more important issue is why do countries such as US restricts foreign ownership at all? If th

* Dr. D. Chennappa is Associate Professor of Commerce, Nizam College, Osmania University, Hyderabad.

US has foreign ownership restrictions in cellular area, it has no such restriction in fixed landlines. Here we need to remember an elementary fact that Telecom fixed-line services in the US were a monopoly, and a regulated monopoly of AT&T (Bell), a US company. The issue of restricting foreign ownership, therefore, did not arise for the Bell system. In the US, the restriction on foreign ownership on radio licenses came in 20s when telegraph and wireless were recognised to be of strategic importance. In the US, Marconi, who was a British citizen owned radio licenses.

The US thought that this was not in its strategic interest. It forced Marconi to disinvest its share and this led to the formation of RCA under the US government's stewardship. RCA was also given Marconi's US patents. The question of similar restrictions on fixed landline telephony did not arise, as this was already a home-grown Bell monopoly.

As long as this scenario continues, there is no need for the US to look at foreign ownership restrictions for landlines. In any case, they have other laws. These are anti-monopoly provisions; sizeable foreign investments in sensitive sectors need Treasury clearances. In telecom, a Committee on Foreign Investments in the US (CFIUS), an intergovernmental agency consisting of the Federal Communications Commission (FCC), Homeland Security, Central Intelligence Agency (CIA), the Federal Bureau of Investigation (FBI) and the Department of Justice, etc., examines all such investments.

Foreign equity caps are only one mechanism for restricting foreign control. Countries with higher FDI limits in telecom companies had put in place security mechanisms long before raising the limits. India is not an exception. The issue for us is that this is the only one we have currently in place and relaxing, imposing no restrictions on foreign control on Indian telecom companies. In Canada, where US companies were seen to be foreigners, such restrictions applied to both fixed and radio licenses.

In case of China, is yet to allow FDI limits of 49 per cent, which would allow only by 2007. It might be noted that in China, Internet services are also covered by the above restrictions unlike India where 100 per cent FDI is allowed in Internet and other data services. China Unicom and China Mobile — the mobile telephony operators are "State-Owned Enterprises" with more than 70 per cent of their shares owned by unlisted parent companies and ultimately the Ministry of Finance.

China Mobile is the country's most valuable enterprise and is ranked in the Fortune 500 list. China has more than 300 million subscribers against approximately 45 million in India at present and accounts for 30 per cent of the world's net addition in subscribers. And this growth has taken place without any FDI in areas such as mobile, fixed telephony or long distance services5. Hence, country wise foreign capital restrictions in telecom sector have been presented in table-1.

The key reason for restricting foreign ownership in telecom is that the telecom sector is related to country's security needs and, therefore, domestic control is unavoidable. The security or economic communication passes through public communication networks using encryption, if secrecy is desired. NSA's key role in communication intelligence comes in here6. If the intelligence agencies know the telephone numbers of key government officials, tapping their conversation is a routine matter.

The need for larger capital investments

The finance ministry has claimed that unless FDI limits are lifted, huge investments of Rs 1,60,000 crore cannot be made. However, this is clear that the internal resources generated by the telephone companies are quite adequate to meet the needs of the sector. Therefore, the resources and surplus of telecom companies have been presented in Table-2.

Table-2 shows that the current annual surplus and reserves of six telecom companies — BSNL, MTNL, Bharati Televentures, Tata Telecom, Reliance Infocom and VSNL are in the excess of Rs 57,000 crore in the financial year of 2003 and Rs 65,834 crore in 2004. It shows that Indian telecom sector has been largely self-financing; the entire expansion carried out by the erstwhile DoT was from internal resources. BSNL alone has made investments of Rs 66,372 crore in the last five years, largely from internal resources. It has a cumulative outlay in Grass Fixed Assets of Rs 1,30,000 crore (March 2004)[7], which is growing at an annual rate of 15 per cent. If we take this 15 per cent figures projected for next five years, the investment reaches to Rs 1,30,000 crore. If MTNL surplus included the total investment will obviously cross Rs 1,60, 000 crore.

Apart from BSNL & MTNL, the private sector is put their investment in this sector. And private telecom companies are projected to generate about Rs.10,000 crore per annum for their internal resources, and, therefore, do not require such large infusions from outside. And that FDI limits have no relevance in either attracting foreign capital or in expansion of the telecom network.

The biggest proof of this can be found if we contrast the mobile and Internet services in the country. In Internet services, 100 per cent FDI is permitted. We not only have yet to attract foreign capital, our broadband services are 60 times more costly than Korea' s where 30 per cent FDI is allowed. Our Internet growth rates are stagnant with VSNL concentrating after privatisation on the more lucrative international long distance telephony. In the same period, with a 49 per cent cap in FDI, we have grown at a phenomenal pace in mobile services. China, with an even more stringent FDI policy, also has grown at a staggering pace.

Experience shows that a blind faith in the market, coupled with relaxing FDI limits, will not lead to increased telecom penetration or expand telecom-manufacturing base. The key here is not FDI limits but the cost of services and the thrust that the government is willing to put into these sectors.

Table-1 — Country-wise FDI Limits in Telecom

Country	Foreign Ownership limit
USA	FCC Act: 25 per cent for direct, indirect stakes in FCC licence; check on national security, public interest and effect of such entry on degree of competition
Canada	Foreign ownership for facility based services: 20 per cent directly and 33.3 per cent indirectly using a holding company route, i.e., 46.7 per cent
France	20 per cent for outside EU
Japan	Foreign ownership in NTT, the dominant telecom carrier restricted to 20 per cent
Korea	33 per cent for facility based service providers; 20 per cent for Korea Telecom, the dominant telecom carrier
Mexico	Concessions granted to individuals or corporations of Mexican nationality only. Foreign investment less than 49 per cent except for cellular telephony services where permission is required from the commission of foreign investment
Turkey	After the monopoly has ended in 2004, new licenses will require not less than 51 per cent equity by Turkish citizens
Malaysia	30 per cent, can start with less than 50 per cent but has to be reduced within 3 years
Philippines	40 per cent
Thailand	49 per cent
Taiwan	49 per cent
Singapore	49 per cent
Australia	FDI is limited to 35 % of Telstra's 49.9% equity; individual foreign investments limited to 5 % of the 49.9%. Approval required for FDI in other entities
Indonesia	35 per cent
India	74 per cent

Source: World Bank publications, retrieved through websites.

Table-2: Reserve & Surplus of Indian Telephone Companies (Rs in crore)

Company	FY 2003 (Rs)	FY 2004 (Rs)	FY 2005* (Rs)
BSNL	8,400	9,500	10,500
MTNL	8,867	9,861	10,306
Bharati Televentures	1,803	2,400	3,350
VSNL	5,265	7,004	9,860
Tata Teleservices	3,701	4013	5021
Reliance Infocom	28,978	33,056	Not available
TOTAL	57014	65834	—

Source: Websites of all companies. * Estimated.

Table-3 — Countrywise Per Capita Income and Tele-density

Countries	Per capita Income (US $)	Fixed Line teledensity	Mobile teledensity	(%) Total Tele-density
USA	36,233	52.13	54.3	116.43
UK	26,309	59.06	84.07	143.13
Germany	24,122	65.87	78.54	144.41
Argentina	11,180	27.88	17.76	39.64
Brazil	2,693	22.32	26.36	42.38
India	550	4.67	4.5	9.17
Mexico	6,252	14.67	25.45	40.12
Poland	4,502	31.07	45.09	76.16
Indonesia	850	3.65	5.52	9.17
The Philippines	969	4.17	19.13	23.29
China	963	20.92	21.4	42.32
Pakistan	429	2.66	1.76	4.42
South Korea	10,014	47.24	60.37	116.43

Source: Business Line, November 10, 2004.

Indigenous Manufacture

Unless equipment manufacturing is indigenised, the cost of equipment will not come down, impinging ultimately on the cost of telecom services. India has higher duties for raw materials than for finished goods, leading to the destruction of the indigenous telecom industry.

The Chinese example is quite paradoxical. They have used their very large internal market to develop a manufacturing base which is now one of the largest manufacturer in the world, the biggest player in the global cellular market. It manufactures the largest number of handsets in the world, and is giving global competition and they are investing their money in procuring the more sophisticated equipment such as switches and routers, etc. China has secured very substantial FDIs in manufacturing with the presence of almost all the major telecom equipment manufacturing companies such as Nokia, Ericsson, Alcatel, etc.

The manufacturing sector in China is growing enormously and it is likely to be major supplier of telecom equipment internationally — from mobile handsets to more sophisticated network equipment. This has been possible due to a holistic view of the telecom sector, it took from manufacturing to services. This has not only helped China in building manufacturing capabilities, but also resulted in cheaper telecom equipment and, thus, cheaper expansion of the telecom network.

In India, in contrast, we are providing negative protection to indigenous industry. We have higher duties on raw materials and intermediate goods than on the finished products. No wonder Indian industry is in the doldrums while huge amounts flow out of the country for import of almost everything in the telecom sector from mobile switches to handsets. The premier switch manufacturing company, BPL is now sick. There is no manufacture of mobile handsets taking place in spite of the huge cellular market. These policies of continuing discrimination against Indian industry must be rectified if Indian industry has to grow and bring down prices of telecom services.

Apart from the issue of manufacturing protection or the infant industry argument, we need to be clear about certain fundamentals. We believe that unless telecom equipment costs are brought down, the telecom services costs will remain high. We look upon domestic manufacture as a means of lowering costs. This is the Chinese model. If India has a market for 150 million new subscribers, then this must be a larger market for new subscribers than that of the US and the EU put together, and at least to the Chinese market in size. Considerably, if we do not strengthen this market to build our manufacturing strength, not only the cost of telecom services will come down but it also leads to huge outflows of foreign exchange.

Let us take a quick look at the foreign exchange outflows that would take place if we do not build up telecom equipment manufacture. Out of the 150 million additional lines, about 120 million is expected to be cellular. For handsets alone, there is an outflow of $24 billion, if we add to this the 50 per cent of the $28 billion towards the cost of equipment; we are talking of another $14 billion. In other words, we are showing about an outflow of the order of $38 billion for not having telecom equipment manufacturing sector of the type that China has built.

Telecom giant Nokia was established manufacturing plant in India on April 1,2005 at Chenai in Tamil Nadu. By the next year, the plant go to the stream says Nokia President Pekka Ala-Pietila. Nokia has been in Indian market for the ten years but it has decided to manufacture here only now. And Elcoteq, President and CEO of Nokia, has promised to establish a research centre in India. For this, the government of India expects huge FDI to India in telecom manufacturing sector. Horrendously, it has forgotten the outflow of the Forex reserves[8].

Per Capita Income and Tele-Density

A comparison between India and developed countries in terms of their per capita incomes and tele-density levels is presented in Table-3.

Table-3 shows there is no relationship between per capita income and tele-density. Many of the countries listed have high levels of telephone penetration with tele-density levels that are many times higher than that of India's[9]. Most of these countries have invited FDI not for building basic infrastructure, but to augment competition or improve the quality of telecom services. The objectives that guided these countries to invite foreign investments were entirely different from those that have been mentioned by the Indian government.

Moreover, many of the countries listed allowed FDI only after the tele-density and the per capita incomes had gone up to certain levels. India lags behind most of the other countries on both tele-density levels and per capita incomes. Not one among the countries listed has allowed foreign investors to hold majority shares in their telecom firms at per capita income and tele-density levels that prevail in India. Each of these countries had significantly well-established domestic telecom companies before FDI was introduced and the attempt was to bring in FDI to introduce greater competition. Many of the developed countries in the list are the very ones the government on other occasions avoids comparisons with, citing incompatibility on socio-economic grounds.

Suggestions

1. Foreign Investment Implementation Authority (FIIA) mechanism has been activated to ensure speedy resolution of investment related problems, which has been widely acknowledged as an effective problem-solving platform.

2. Liberal entry policy of FDI can go a long way in encouraging foreign investment in infrastructure but not hacking the FDI cap from 74% to 100%.

3. No remote access should be provided to any equipment manufacturer or any other agency outside the country for any maintenance / repairs by the licensee.

4. India needs not as much an export or FDI target as first where with all to instill confidence among investors and buyers.

5. India needs to strengthen domestic manufacturing units and niche market. Hence, increasing FDI cap is not a panacea for increasing higher rural tele-density, etc., it is sturdily suggested that Indian government should concentrate on basic needs such as water, electricity and work rather than telephones and foreign participation.

6. Experience shows that a blind faith in the market, coupled with relaxing FDI limits, will not lead to increased telecom penetration or expand telecom-manufacturing base. The key here is not FDI limits but the cost of services and the thrust that the government is willing to put into these sectors.

Conclusion

The finance ministry has claimed in his budget 2005-2006 speech that unless FDI limits are lifted, huge investments of Rs 1,60,000 crore cannot be made. Whereas, it is clear that the internal resources generated by the Indian telephone companies (Public and Private) are quite adequate to meet the needs of the sector. Even, private telecom companies are alone projected to generate about Rs.10,000 crore per annum for their internal resources, and, therefore, do not require such large infusions from outside. And that FDI limits have no relevance in either attracting foreign capital or in expansion of the telecom network. Hence, the main criticism on raising FDI ceiling beyond 49 % is that once foreign capital wrests control over our telecom companies, there would be no control whatsoever on the hardware equipments imported by them. Moreover, the security agencies like the Intelligence Bureau insisted on retaining the 49% ceiling on FDI in the interest of national security.

Among the listed countries, most of them allow FDI after the tele-density and the per capita incomes have gone up to certain levels, when compared to them, India lags behind on both tele-density and per capita income levels. India, therefore, needs to strengthen domestic manufacturing units and niche market first of all and increasing FDI cap is not sufficient for increasing higher rural tele-density. It is, therefore, suggested that Indian government should concentrate on basic needs such as water, electricity and work rather than telephones and foreign participation.

References

1. Ministry of communication and information Technology, government of India, Apil14, 2005.

2. *The Economic Times*, 15th Feb. 2005. P.1.

3. Editorial, "Left parties rejoinder to the Finance Ministry's note on FDI in telecom, People's Democracy -Weekly organ of the Communist Party of India — (Marxist), Vol.no.XXVII, No.47, P.2.

4. *The Hindu*, 14th April, 2005

5. Editorial, op cit. 3.

6. A note on FDI regulation in Telecom (submitted by the left parties to the UPA government) retrieved thorough internet.

7. *TRAI*, July 2004

8. Department of Telecommunication, Government of India, March 2004

9. *Business line*. November 10,2004. ❑