

A Note on FDI Regulations in Telecom  
(Submitted by the Left Parties to the UPA)

The Finance Minister, while presenting the Union Budget has proposed that the FDI caps for Insurance and Civil Aviation be raised to 49 per cent and the FDI cap in the telecom sector be raised from the existing 49% to 74%. The issue here is not one of FDI caps per se, but the specificity of these sectors and whether there are reasons why there should be continuing restrictions on foreign ownership here.

We recognise that foreign capital and technology may be required for upgrading Indian industry and making it globally competitive. However, in the above areas, there were specific reasons why such caps were put there in the first place. India is not unique in imposing such caps and therefore those who are arguing for no restrictions on foreign ownership in sectors like telecom, insurance and civil aviation are refusing to recognise the specificity of these sectors. Even countries such as the US, who have argued for free capital movement to other countries, maintain restrictions on telecom and civil aviation. Similar restrictions are also in place for the telecom sector in countries such as Canada, France, Taiwan, Korea, Indonesia, etc., who otherwise have very few restrictions in other sectors. We will examine here the telecom issue in some detail.

In India, like in most other countries, telecom was originally the exclusive preserve of the Government. Foreign ownership in telecom in India came in with the 1994 tender for basic and cellular services through which the private parties were to be given licenses for various telecom circles. The tender conditions specified that only companies registered in India could quote. However, it allowed companies to be joint ventures with a cap of 49% for foreign ownership. It might be noted that the license condition also specifies this cap and it is not a cap on direct foreign equity but on total foreign equity, therefore is a cap on both direct and indirect foreign equity.

From the beginning, some of the private operators and financial interests have been arguing for lifting this cap. International agencies such as IMF and the World Bank have also advocated the removal of such restrictions. The other voices in favour of lifting the foreign ownership cap have been the cellular operators and also various foreign financial institutions. However, in spite of repeated attempts, the Indian Government has till date resisted such moves, mainly on security considerations.

The U.S. officials have also been adding to the pressure for further deregulation of the telecom sector in India in recent times. David Gross, U.S. coordinator for international communications and information policy, and another senior official, Michael Gallagher, strongly argued the "need" for raising the current limits on FDI in telecom, during their visit to India in February this year (see The Hindu, February 6, 2004). Their reasoning was that the world telecom industry was entering a new phase of growth after a difficult three-year period and the demand for funds was high and that capital would flow to the country with the most favourable investment policy. According to them, India stood to lose investment opportunities if it persisted with the current limits on FDI in telecom.

It was during the end of the tenure of the NDA government that the Union Communications Minister Arun Shourie had publicly expressed his desire to hike the FDI cap in telecom. However, it became clear from Mr. Shourie's speech in Parliament on the Budget (see news on rediff.com, July 20, 2004) that the ceiling could not be raised earlier because of serious objections from the Intelligence Bureau. The main objection to the raising of the FDI ceiling beyond 49% centres on the fact 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 Defence as well as sensitive economic entities like the stock market or banks can therefore get undermined. This is all the more germane in the Indian case because of the low level of development of our hardware manufacturing sector, which makes the telecom companies highly import intensive. As almost all government communications also take place through the public telecom network, opening a part of the public telecom network to foreign ownership will carry unacceptable risks.

India is not the only country, which has such a cap on foreign ownership. It is because of this strategic importance that foreign capital in the telecom sector is strictly regulated in most advanced and developing countries. Only recently European countries have been lowering some of these, permitting EU countries to enter each other's telecom markets. The FDI cap in most East and South East Asian countries including China, which have experienced rapid growth of the telecom sector in the recent past, continue to have a 49% or lower caps on FDI in telecom. These are also the countries that are singled out by various agencies as having registered much higher telecom growth and penetration than India. Obviously, such foreign ownership caps have not prevented investment and growth in the telecom sector in these countries.

#### Telecom Ownership Limits in the US

The US still maintains a 25 per cent foreign ownership limit, as also a carrier radio license limit of 20% (applicable for all mobile carriers). The Communications Act of 1934 limits foreign investment in a company with a radio license to 20 percent ownership and in a holding company with a radio license to 25 percent ownership. The statutory language mandates the 20 percent limit, but allows a waiver of the 25 percent limit by the Federal Communications Commission (FCC) if the given investment is determined to be in the public interest. These investment restrictions are invoked whenever a company uses radio technology to offer common carrier, broadcast, or aeronautical services. The slice of the electromagnetic spectrum covered by radio technology includes cellular, microwave and satellite services. The U.S. Congress recently overhauled the 1934 Act in the Telecommunications Act of 1996. The 1996 Act does not, however, alter the restrictions on foreign investment in radio licenses under Section 310(b). Fixed line competition in the US is still in its infancy and all such companies are under the control of fully owned US companies. So the foreign ownership issue is relevant largely for mobile and long distance players, both of which come under the foreign ownership restrictions noted above.

Though no change in the Act has taken place with regards to the FCC discretionary powers if indirect foreign ownership beyond 25% is sought,

FCC has substantially changed the way it deals with such applications in the past. From 1934 to 1994, the FCC accepted not a single such application: all such applications were rejected. In 1994, the British Telecom was allowed substantial stake in MCI and the merger of BT and MCI was subsequently approved in 1997, though the final merger fell through for other reasons. This was the first ever waiver by FCC of the 25% limit on foreign ownership. Though companies such as Deutsche Telekom have been allowed majority ownership of telecom companies, the route is by no means easy or simple. Any foreign ownership in the US has to still cross the following regulatory hurdles:

- The limit of direct ownership for all radio-license (including cellular) is still capped at 20%.
- Holding companies with foreign ownership can apply for exemption from the 25% cap that exists for them. FCC approval is on a case-by-case basis and based on the following guideline: "The current FCC regulations evaluate the effect of a merger on national security, public interest, and the competition in the marketplace. The national security concern requires the FCC to determine that mergers with government interests do not allow foreign governments access to American military or technological secrets. When examining the public good, the FCC balances national security concerns against the advantages to consumers that the additional competitor could provide. Finally, the FCC determines whether the merger would benefit the marketplace by adding competition and lowering prices, or harm the market by eliminating American companies." (2001 Duke L. & Tech. Review, 2004).
- In addition, investments in sensitive sectors such as telecom need clearance from the Committee on Foreign Investments in the US (CFIUS) for the purpose of national security. CFIUS is an inter-governmental agency, which functions under the purview of the US Treasury. CFIUS can also initiate investigations on its own if it feels that there are security issues involved in such foreign investments.

For those who believe that the US allows unfettered access to its telecom markets, need to take a closer look at the regulatory structure of the US. Other countries that also maintain FDI caps are China, Korea, Canada, Mexico, Turkey and many others. A partial list of such countries is given in the accompanying table.

Countries With Foreign Ownership Restrictions in Telecom

Country	Foreign Ownership Limit
USA	FCC Act, 25 per cent for direct; indirect subject to FCC approval based on national security, public interest and effect of such entry (or merger) on 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
Poland	Foreign ownership restriction for national and local telecommunication services, mobile services and cable television services: shares of foreign equity in company cannot exceed 49 per cent, share of votes of the foreign organisation and of the organisations controlled by foreign equity at the general shareholders meeting shall not exceed 49 per cent; Polish citizens residing in Poland shall have the majority on the management and the supervisory boards.
Turkey	After the monopoly has ended in 2004, new licences will require not less than 51 per cent equity by Turkish citizens.
Malaysia	30 per cent, can start with >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 investors limited to 5% of the 49.9%. Approval required for FDI in other entities.
Indonesia	35 per cent

*Note: These figures have been collected from World Bank Publications, websites of different countries and the FCC website.*

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. We will take up this argument in the next section.

#### Security Issues in Telecom

Is there a need to restrict foreign ownership in telecom? If we look at the US, it is clear why they still insist upon restrictions on foreign ownership. They know exactly how eavesdropping electronically on telephone and other conversation leads to "hard intelligence". The national security agency (NSA) has been listening to such conversations for decades. The information is filtered through a bank of computers using sophisticated

search patterns by which some of such conversation of email is selected for human analysis.

Much of this monitoring takes place by picking up the communications from satellite traffic, using submarines to listen in to undersea cables, and radio communications. In today's world, if one country can own a telecom company in another, it makes all this easier as also the added ability to listen to the fixed line communications as well. Owning the physical telecom network in a country gives these agencies thus access to another slice of telecom traffic. It can "mine" this information remotely, without the knowledge of even the operating company personnel by appropriate selection of hardware. The security agencies in India have pointed this out earlier.

All networks and exchanges are really computer banks; planting a backdoor for either remote intelligence gathering or taking the telecom network down from a remote location during a crisis is child's play with today's technology. It is because the US knows this and its intelligence agencies are involved in this business, that they will not allow unrestricted foreign ownership of their domestic telecom companies.

For those who believe that Security concerns in telecom is a myth needs to look at some of the debates that have taken place in the European Union on the role of the US and UK in collecting communications intelligence. One of the better-known examples is that of project Echelon, (details given here as annexure) borne out of a US-UK joint agreement on sharing communications intelligence. Australia, Canada and New Zealand are also currently partners in the Echelon project. Echelon is a global electronic surveillance network which is designed and coordinated by the National Security Agency (deals with cryptography and code breaking) of the US Government and has been in operation since decades. It is a global network, which can intercept all Telephone, Telex, Satellite, Fax and E-mail communications. It has also been monitoring Indian telecommunications for decades, the evidence of which is also given here in the annexure on Project Echelon.

The NSA and similar agencies use voice recognition, word recognition and also monitoring known numbers (such as Government phones, etc.) of the high-density telecom traffic. Satellites, radio communications and under sea telecom cables have also been used by intelligence agencies to tap into security and even commercial information. The US agencies routinely monitor foreign delegations in trade and other international negotiations in order to know the fall back positions of various crucial delegations. In fact the European Union's anger on the use of such communication intelligence was that it was being used to help US companies, which were in competition with European ones.

Earlier, there were proprietary networks that were used by Government security agencies. However, such separate networks have been given up and almost all sensitive information -- either security or economic -- all pass through public communication networks, using encryption if secrecy is desired. NSA's key role in communications intelligence comes in here; it uses the dominant US position in the software and hardware world to routinely access master keys in the standard commercially available

encryption software. If the intelligence agencies know the telephone numbers of key Government officials, tapping their conversation is a routine matter. It is from this consideration that Indian security agencies have opposed lifting of FDI caps.

#### India's Security Concerns

This also explains why the security agencies of India had strong reservations on passing on the management control of the telecom service companies in favour of foreign promoters, when NDA tried to enhance this limit in 2003. DoT had then invited security agencies' views on increasing FDI ceiling to 74 per cent from 49 per cent in respect of basic and cellular services. DoT received replies from the Intelligence Bureau and the Directorate of Revenue Intelligence, both emphasising 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.

Public reports indicate that the Indian security agencies have disagreed that foreign ownership of the telecom network poses no security risks to the country. They have argued, as reported in the papers at the time of NDA's proposal to lift FDI limits that various safeguards need to be taken before such a measure is allowed. The Intelligence Bureau, we understand had argued that as security doctrine, communications is vital for the country and the control of telecom companies should remain in Indian hands. Among the suggestions that IB had made then to the Government included security clearance of the foreign companies, 26% mandatory Indian holdings, foreign equity either through direct or indirect holding company route to be restricted to 49% and various other measures. The security agencies also wanted this exemption for only 7 years with progressive dilution of foreign equity to be carried out within these 7 years. This left the FII route for increasing the FDI beyond 49% as the only possible one, a course which was not favoured by Hutch and Singtel, as it would mean a weaker position than they enjoy currently. This was the reason that finally the NDA Government did not carry through the proposal to lift the 49% FDI cap.

If the security agencies objections were so clear a year earlier, we are unable to understand why they have ceased to have validity within one-year span. To our mind, the earlier objections are in tune with the security concerns that most countries have and that is why almost all countries in the region with security concerns have similar FDI caps.

#### Need of FDI for Improving Teledensity: A Reality Check

Before we get into the details regarding FDI ownership in telecom, let us see why and from whom the pressure is coming for lifting such caps. With the initial opening up of the sector to private capital, a large number of international telecom majors were interested in entering the Indian market. There was the belief that the telecom sector was set to take off, and there was a worldwide scramble for telecom licenses. This led to gross overbidding by the companies, or perhaps strategic bidding — high prices to keep out others and subsequently petitioning the government for lowering license fees. This in India led to the revenue sharing arrangement decided by the lame duck Vajpayee government after it had lost its

mandate in the Lok Sabha. Similar concessions were also offered in Europe. None of the foreign players made much of the 49 per cent FDI cap during that time, knowing that a demand for outright foreign ownership would probably run the risk of derailing their entry itself. They were quite happy to get a 49 per cent ownership, well beyond what the US offers. The foreign investors ran into a crisis when their parent companies got into red. Companies such as Worldcom went spectacularly bust; AT&T has recently withdrawn from the domestic market segment in the US and many other telecom companies found themselves in deep trouble. The exodus of firms from the Indian market had little to do with the problems here and much more to the state of the finances of those firms. And the bigger problem here was not FDI caps but the regulatory mess that TRAI and the Government had jointly created.

The "market friendly" analysts have been campaigning for quite some time that all FDI caps should be lifted and such a measure will help in boosting the FDI flows into infrastructure. To many of them, without such lifting of FDI caps, Indian telecom sector will be languishing in the doldrums. This is the argument that Cellular Operators Association of India (COAI) has been repeatedly advancing for the last five years. They had claimed that without large flows of FDI Indian telecom sector couldn't increase its Teledensity to 7 per hundred, the target for 2005. Unfortunately for the COAI's argument, the Teledensity in India has grown much more rapidly in the last three years, when the FDI in the sector have been relatively low, and in fact when a number of foreign investors have exited from India. In three years, (from March 2001 to March 2004), it doubled its Teledensity from 3.64 to 7.8 meeting the target of a Teledensity of 7, one year before the targeted 2005 schedule!

The argument for lifting FDI caps has been that India requires very large amounts of capital to rapidly expand its telecom infrastructure. Some of the foreign investment consultants have put this figure at \$20 billion. According to these agencies, without FDI flows, India would have shortage of capital and not be able to increase its Teledensity to levels achieved by countries such as Philippines, Thailand, let alone China, which is far ahead of India in terms of Teledensity. None of these agencies have thought fit to explain why all these countries that have telecom growths far in excess of India still maintain FDI restrictions in their countries? And if they have been able to maintain such growths with FDI restrictions similar to India's, why is it imperative for us to lift these restrictions?

The central argument in all of the above is that India's slow growth is due to a lack of capital. While this may have been true when DoT was strictly a Government department and all its expansion came only from its surplus (DoT had virtually had zero budgetary support from the Government and was not allowed to raise loans), currently it is able to raise money from the capital and loan markets. This is also true for companies such as Bharati Televentures, VSNL (now a Tata company), Reliance Infocom, MTNL, Tata Teleservices, etc. We give below the current revenue reserves and surplus that these companies have. As can be seen, apart from Tata Teleservices and Reliance Infocom (whose balance sheet is not known), all the others have a healthy positive balance. If we take Tatas and VSNL together as VSNL is now a Tata company, then they also have a very healthy balance

sheet. For these companies then raising capital either through public issues in the domestic market or raising loans should present no major problem. Reliance and Tatas, who are the other two major private players, have said that they are unconcerned either way: neither are they interested in selling out, nor do they believe that it will alter the current telecom scenario significantly.

Company	Reserve and Surplus (in Rs. Crore)			
	FY2003	FY2004 (Estimated)	FY2005 (Estimated)	FY2006 (Estimated)
MTNL	8,867	9,861	10,906	12,034
Bharti Televentures	1,803	2,400	3,350	5,150
VSNL	5,265	5,590	5,860	6,090
Tata Teleservices	-780	-1,050	-1,180	-1,187
Reliance Infocom	Figures not available			

Source: SKP Research, July 8, 2004 Report India Telecommunications Sector

It is important to note that major expansion of the telecom, especially the mobile sector took place after sustained campaign by user groups and BSNL/MTNL emerging as major competitors led to dropping of mobile rates. Till then, the mobile rates were kept artificially high. Only when the airtime costs dropped, did the major expansion of the network take place. In all this, the COAI had opposed the lowering of tariffs, resisted the entry of Wireless in the Local Loop (WiLL) technology introduced by MTNL, the unified license regime and almost every measure that went towards lower telecom service costs. While the major foreign investments in telecom took place in the 1995 - 2000 period, the expansion at that time came primarily from BSNL/MTNL in fixed line and Bharti and Airtel in mobile business. The foreign investments had some role in mobile business and almost none in the fixed line business. Post 2000, when the major network expansion -- particularly in mobile sector has taken place -- we have actually seen an exodus of foreign players. It is not the argument here that this exodus has helped the growth of Teledensity in the country. The key driver for telecom growth is and always been the cost of services. The regulatory environment can help by bringing down prices, which it did after 2000. This is far more important than measures such as FDI caps. If the Government wants to increase Teledensity, this is where the country's focus should be.

Competition: The Other Argument for Lifting FDI Caps

Coupled with the argument for lifting FDI caps is that more players will mean more competition and therefore better for the subscribers. This however does not take into account that the cost of duplicating

infrastructure is finally recovered from the subscriber, so beyond a point the benefit of competition is offset by the loss due to this duplication. There is a further problem with capital scarce economies like India, where capital if it comes into telecom, may not then be available for other sectors. Duplication of infrastructure like towers for mobile, cable network and conduits for fixed line operators also impose hardships on the people. For cables, we have to give right of way and allow digging up of roads, all of which impose costs on the public. Therefore, competition is not an unmixed blessing but must be balanced against other costs.

In India, we already have major players in fixed line and mobile segments. Three major networks are emerging, BSNL, Reliance, Bharti, with Tatas close behind. In mobile, BSNL, Reliance, Airtel, Bharati and IDEAS are all in close competition. The Indian market is far more competitive than most markets in advanced countries, where fixed line competition is yet to take off. Therefore, the need for more capital flows to encourage yet more competition does not stand much scrutiny.

It might be noted that one of the reasons for the crash of a number of telecom companies in advanced countries have been this unrealistic rush for expanding infrastructure and duplicating the same. Most analysts agree that the expectation of telecom expansion far exceeded reality and this is what led to the crash of companies such as Worldcom. The trend is by no means over, with AT&T only recently pulling out of the domestic long distance market. In India, while we must encourage competition wherever required, we must not allow it to take place in a way that these companies turn sick and then have to be bailed out. This exercise has already been done once, when the license fees to the Government had to be foregone as the telecom companies had made unrealistic projections of revenue. The warning signs are already there: the average revenue per users (ARPU) has come down by 17% in 2004, giving rise to concerns on this count. Also BSNL and MTNL network capacity is under utilised, indicating that we are already seeing the building up of over capacity in the Indian network. Therefore, we need to be cautious that we do not promote wasteful duplication of expenditure in the name of competition.

Not surprisingly, the proposal to lift FDI limits has been welcomed by the COAI, who has been asking for removal of FDI caps for quite some time. It has also been welcomed by a number of investment bankers — ABN Amro, ICICI and HSBC among others — who have indicated that such a measure will allow some of the current operators to sell out to foreign companies and presumably they would then broker such sales. Market analysts all agree that the two major international players who would benefit are Hutchison, who have bought Essar's out and Singtel, who want to have the major stake in Airtel, the company in which Bharati appears to have controlling share.

The specious argument that lifting FDI caps is vital for increased capital flows is being put forward by the cellular lobby as they want to exit from the market making windfall profits. For them selling out at this stage makes sense as increasingly, the larger players who have an integrated operations are putting the squeeze on them. If there are more buyers, then they can get a much better price; therefore the need for widening the net by allowing in foreign companies. There argument that there is a need for

foreign capital has very little relevance to the expansion of the telecom infrastructure but for making large speculative gains: a quick sale of the existing cellular license holders equity instead of staying for the long haul. For Bharati, if they have to stay for the long term and compete with BSNL, MTNL, Tatas and Reliance, they need deeper pockets than they have; therefore their need to get in Singtel hoping that Singtel will allow Bharati to still retain control. Or they could sell off a part of their network to Singtel and concentrate on the rest. For Hutch, they want to make official what they have achieved through the backdoor: a majority share of the existing equity.

#### Backdoor Control of Indian Telecom Companies

Another argument has been one of transparency: that foreign telecom companies have already found a way around the current limit of 49 per cent using holding companies and therefore let us make this legal, or in his words, "transparent." We will examine the argument in more details in this section.

After the initial scramble and the change from fixed license fees to revenue sharing, a number of foreign companies exited from the Indian market. They were responding to the crisis that they were undergoing, having over-extended themselves in other markets as well. The two companies who today have large stakes are Hutchison Whampoa (known as Hutch in India) and Singtel. Both of them acquired large stakes in two of the major cellular players in the country. Hutchison bought Sterling and a part of Essar's stakes in Delhi and also has Max's share in Mumbai. Though Bharati still owns what appears to be controlling interest in Airtel, Singtel has already acquired major stakes there. According to official sources, though Hutch and Singtel are technically minority shareholders; they have actually acquired a majority stake through holding companies that they own.

The question that the country then needs to ask is if the original cap of 49 per cent of foreign ownership makes sense, why not object to such backdoor manipulations? Government's job should be to see that the loopholes that may have been unwittingly left in the policies are plugged. We cannot legitimise subversion of policies by the foreign companies, and now reward them by lifting all such restrictions.

The license terms and conditions of the license for telecom services, either cellular or basic are very clear. It stipulates, " the licensees shall ensure that total foreign equity in the licensee company, does not at any time during the entire license period exceed 49%." The language is quite clear that this pertains to total foreign equity and should be read to mean direct and indirect equity investments using the holding company as well. If it is taken in conjunction with the other provision of the license that the control of the management shall be in Indian hands, the intent of the license is very clear. Unfortunately, companies (facilitated by successive governments who refused to take action) have interpreted this provision to mean that a holding company, which has more than 50% Indian equity, qualifies as an Indian company and exempting its 49% foreign equity from the 49% limit on foreign ownership. This is in itself a violation of the license terms and conditions and now needs to be addressed.

How did Hutch manage to beat the 49 per cent foreign ownership limit? For example in Mumbai, where they bought a major share of the original Max shares, they also have 49 per cent holding in a joint venture in which Kotak Mahindra hold 51 per cent shares. This company, which is classified as an Indian company as Kotak holds 51 per cent shares, holds another 41 per cent shares in the Hutch Mumbai. If we now total up 49 per cent of shares that Hutch directly owns with 49 per cent of the 41 per cent that Hutch-Kotak joint venture owns, then we can see that Hutch owns in reality about 70 per cent shares in Hutch Mumbai. Though details about Singtel's holdings are not known publicly, we assume that the government is aware of the nature of their holdings in Airtel.

Let us accept that by the holding route, foreign companies in effect control their Indian partners. If Hutch has paid for 70 per cent of the shares of Hutch Mumbai, they effectively own 70 per cent ownership, and have bypassed the FDI limit. Then the right answer would be to put in place mechanisms by which this cannot be done. This should be a simple measure: stipulate that directly or indirectly, the maximum that any foreign company or individual can own is 49 per cent of an Indian telecom company. All it needs is a clarification from the Finance or the Communications Ministry. This will address the vital issue of transparency. Yes, there should be complete transparency in ensuring that foreign ownership is restricted to 49 per cent. But let us not reward those who have broken the spirit of the bar if not its letter.

The Chinese Example: Increase of Teledensity and World Class Manufacturing

There has been adverse comparison between the explosive growth of the Chinese telecom market and the more sedate development of the Indian one. After this comparison, the usual panacea of free FDI flow is offered, leaving people with the conclusion that this must be the route the Chinese have taken. It may come as a rude shock for people to know that Chinese telecom companies that have powered this growth are almost entirely Government owned companies. They are not even private companies, let alone companies that have foreign equity. And the entire Chinese telecom boom is based on domestic manufacture, unlike India, which has seen almost all its mobile and other infrastructure and handsets being imported.

The Chinese have emerged not only as the largest mobile market in the world with 207 m subscribers, the largest mobile company as well as the third largest one are from China. While in China telecom majors such as Lucent, Ericsson, Motorola, Siemens, Alcatel, Nokia have invested billions of dollars to set up manufacturing plants, plants in collaboration with Chinese partners they are not even thinking about that in India. These companies are now in a position not only to meet their domestic demands, but all set to enter the Asian market. It is indeed unfortunate that India, which has a huge growing and diverse domestic market, is not able to get a part of the international telecom equipment business, which is estimated to touch \$1.5 trillion this year, out of which Asia Pacific region would contribute about \$ 112 billion. As we have explained earlier, the key to increasing Teledensity is cost of services. One of key reasons that China had made such a rapid advance is that it could meet its requirement from low cost but world class domestic manufacture.

The Chinese have used their huge domestic market strategically. They first forced the telecom manufacturers to set up plants in China with Chinese partners by making it clear they would accept only equipment manufactured in China. All the Chinese service companies were state owned entities, so all the telecom majors fell in line and set up shop there. This may be contrasted with the Indian scenario, where currently we have a much higher duty on components than on finished goods, making manufacture here less competitive than imports. We also give no preference to indigenous equipment, though the license terms and conditions did stipulate support to domestic manufacture, as did National telecom Policy 1994. The net result is that while foreign equipment and handsets are sweeping the Indian market, China is preparing its assault first in the Asian market and then internationally. Already, Chinese handset manufacturers have exported more than a million handsets to the Asian market, Bird (Siemens collaboration) and TCL (Alcatel collaboration) leading the pack. In 2003, ZTE, another Chinese company, manufacturing mobile exchanges and data transmission, doubled its sales volume to reach US\$ 610 million. In the next five to six years, ZTE hopes that its sales income can reach US\$ 10 billion, in which the income from the international market can account for 50 percent.

The Chinese have two major fixed line companies and three mobile companies. The two fixed line companies -- China Telecom and China Netcom are off shoots of the earlier state owned monopoly carrier. While China has agreed to raise FDI cap to 49% by 2007, the route they are following is public issue of shares in the stock markets abroad, thus ensuring that even this foreign equity is too thinly distributed to offer any serious problems of control. Currently, the Government holds the entire shareholding in these companies. Incidentally, China has the largest fixed line as well as mobile subscriber base in the world.

The Chinese mobile scenario is almost similar. Here, two major players -- China Mobile and China Unicom -- are state owned, with the fixed line companies also entering now into mobile telephony. China Mobile is the world's largest service provider with 207 million subscribers in 2003 while China Unicom is the third largest with 43 million.

If we look at the growth strategy that China has followed, we would see that they first invested in domestic manufacturing and used their manufacturing base to power their major telecom expansion. This way, they held their capital costs down and also are now in a position to enter the global market. In the same period, India starting from a strong manufacturing base with ITI and C-DOT, has opened itself to foreign manufacture and is now protecting imports against domestic competition!

In the Indian case therefore, there is no need to raise the FDI cap beyond 49% by overruling the grave security considerations. The companies who want such restrictions to be lifted are asking for this from speculative considerations and not for long-term growth of the sector.