Chapter - 3

Sector Economy

Pakistan Economy

In fiscal year 2008-09, Pakitan's economy passed through a critical juncture of domestic volatile security situation and global financial crisis had adversely affected the macro economic conditions. The growth trend slowed down during the year, as the overall economic growth had been reported to be 2 percent, as against the target of 5.5 percent. This deceleration was mainly attributed to the poor performance of large scale manufacturing sector, growing negatively at 7.7 percent. However, a rebound in agriculture sector on the back of a bumper wheat crop helped maintaining the positive growth in the reported year. On macroeconomic front, the inflation continued to surge reaching at 20.8% in 2008-09 compared to 12% in 2007-08. The per capita real income rose by 0.3% in 2008-09, from US$ 1,042 in 2007-08 to US$ 1,046 in 2008-09. Global credit crunch resulted into shrinking of overseas demand and resultantly the country's exports contracted by nearly 5.9%, decreasing from US$ 20.4 billion in 2007-08 to US$ 19.2 billion in 2008-09. The imports declined by 10.4% in 2008-09, standing at US$ 31.7 billion as against US$ 35.5 billion in 2007-08. Lower imports during 2008-09 resulted into substantial fall in the reserves of oil & food items. The FBR [Federal Board of Revenue] failed to achieve tax revenue collection target of 10% of the GDP to 8.8%. Foreign Direct Investment [FDI] declined by 31.2% falling from US$ 5,410 million in the previous year to US$ 3,720 million in 2008-09[1].

State Bank of Pakistan has reported in September 2009 that inflation (YoY) has improved recently while the fiscal and real sector performance still remains tenuous. Moreover, the recent betterment in growth of some of the industrialized countries and the emerging markets may give impetus to the growth of Pakistan's economy the next year. The monetary assistance by donor agencies like IMF, the World Bank and the Friends of Democratic Pakistan are expected to help improve the economic condition in the coming years.

Telecom Economy

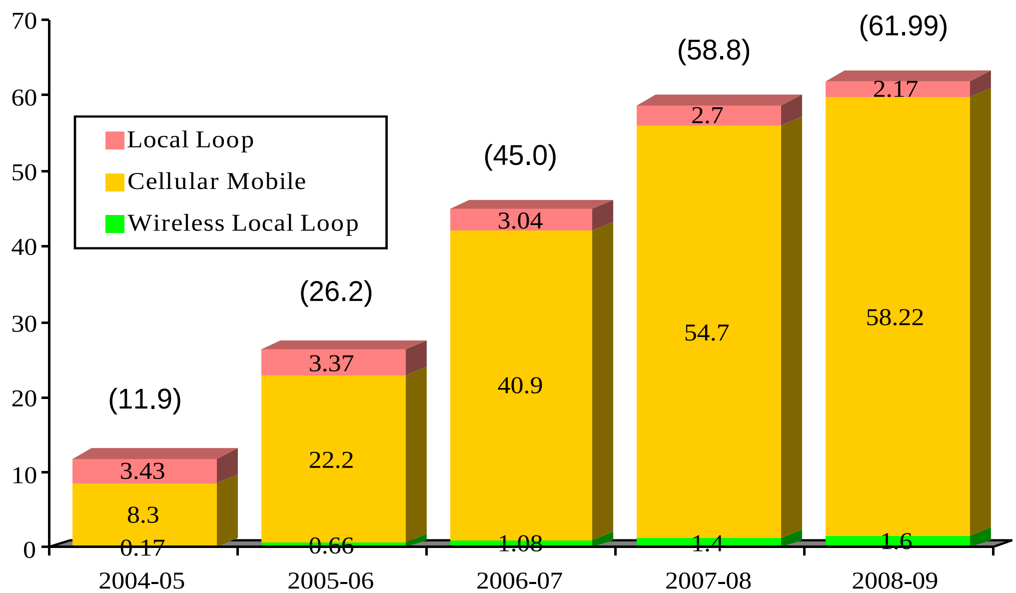
Despite slow down in economy, telecom sector continued to grow positively in terms of subscription, revenue and teledensity. However most of the operators took cost cutting measures including optimization of human resources, cut in employees' perks and freezing

[1] Statistics obtained from Ministry of Finance and State Bank of Pakistan

employment temporarily to avoid negative impact of economic slowdown on the sector. Teledensity of the country jumped to 62% in 2008-09 showing a growth of over 5% over the previous year. During the year 2008-09 the sector's financial health could not be improved in accordance with the expectations owing to heavy taxes and falling exchange rates, which placed unprecedented burden on the operators' import bills. Despite these difficulties, the sectors revenue grew by 19% in 2008-09 which pose confidence in Government and regulators' policies. Due to new emerging services, operators continued making investment in infrastructure expansion. Among cellular mobile operators, Ufone was the only operator reporting a profit while the rest landed with negative earnings. The leading mobile operator, Mobilink slipped from green to red in earnings because of the falling exchange rate and rapid drop in the subscribers' base.

A dismal situation in fixed line penetration is the major area of concern for the policy makers and the regulator in Pakistan. After issuing a number of licenses to the fixed line operators, the regulator believed that the market forces would play their due roll for its expansion, but unfortunately, this could not happen. Unlike the expectations, most of the fixed line operators could not roll out the infrastructure maintaining the incumbent operator still the dominant player with its old copper based infrastructure a main hurdle in the sector's growth. It was also expected that a rapid roll out by wireless technology (WLL) would compensate the declining fixed line penetration, which too did not happen due to lack of investment by WLL operators. Furthermore, the WLL operators like Wateen and Wi-tribe have smartly diverted their resources to Broadband expansion in 3.5 GHz and invested on new technology like WiMax. This too caused slow growth in the fixed line sector. Issues like Right of way and lack of unbundling also proved as major hurdles in the fixed line sector's growth. A huge investment is required to roll out new generation of fiber networks in Pakistan.

Figure - 4
Teledensity in Pakistan

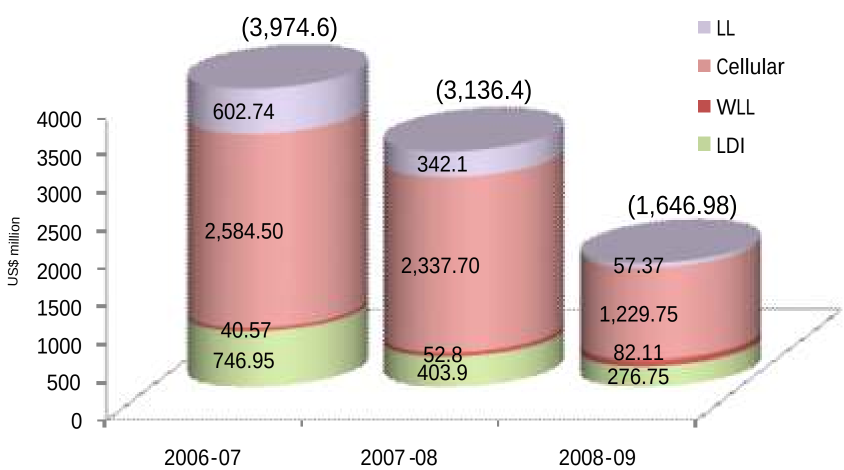


This gives a major opportunity to large scale investors to secure their investments in Pakistan in this segment of the industry.

Telecom Sector Investments

Owing to economic slowdown, saturation in the market and global financial crisis, the total investment in the telecom sector during 2008-09 reduced by nearly 47%. Despite the fact that the operators have speedily rolled out their infrastructure, reaching out to most of the population, there still remains huge areas like Braod-band, WLL and manufacturing etc, where investment opportunities exist. During the current year, a total of US$ 1.6 billion worth of investment has been made by all the operators, of which the cellular mobile share is about 75%. The WLL has marginally increased investment from US$ 52.8 million in 2007-08 to US$ 82.11 million in 2008-09. However, the rest of all of the sectors have reduced the level of their investment.

Figure - 5
Telecom Investment



Foreign Direct Investment

On the conclusion of the World War-II, the cross border investment flows, FDI [Foreign Direct Investment], tremendously increased playing a pivotal role in development of the recipient countries. The Marshal Plan, particularly, is considered to be a good example in this regard. Since then, the developing countries took various initiatives to attract more and more foreign investment to boost their economic growth. Pakistan has also taken measures to secure more foreign investment in the country where it offered various incentives to foreign investors. At present, Pakistan has the most liberal FDI policy in the region, where 100% equity is allowed and investors can repatriate 100% of their profit. Owing to this liberal policy, Pakistan attracted significant foreign investment inflows during the previous years; however, this trend showed decline in 2008-09 where overall FDI declined by 31.2%. During this period, Pakistan attracted FDI worth US$ 3.7 billion altogether. During the last two years, inflows had crossed US$ 5 billion per year.

Pakistan's telecom sector remain-ed the largest recipient of the FDI during the last few years capturing more than one fourth of total FDI. During the last 5 years, Pakistan attracted over US$ 19 billion FDI, of which 34% was in telecom sector. In the current year, the telecom sector received over US$ 815 million FDI, which is 22% of the total FDI in Pakistan.

Major countries which invested more than 70% in last 5 years in Pakistan's telecom sector included United Arab Emirates, United States of America, Norway and the Peoples Republic of China. The UAE emerges as the leading country investing over 36% of the total FDI in the telecom sector in the last 5 years. UAE invested in the companies like Wateen, Warid Telecom and PTCL. Etisalat, UAE based company, bought out 26% shares of the PTCL worth US$ 2.4 billion. The UAE has invested over US$2.3 billion in the telecom sector of Pakistan since 2004-05. China Mobile has its first overseas adventure in Pakistan cellular mobile sector, in addition to telecom manufacturing through companies like ZTE and others. Investment from Republic of China exceeded US$ 599 million in the telecom sector of Pakistan during the last 5 years. Telenor, a Norway based company, also brought about half a billion US dollars foreign investment into Pakistan during the last 5 years.

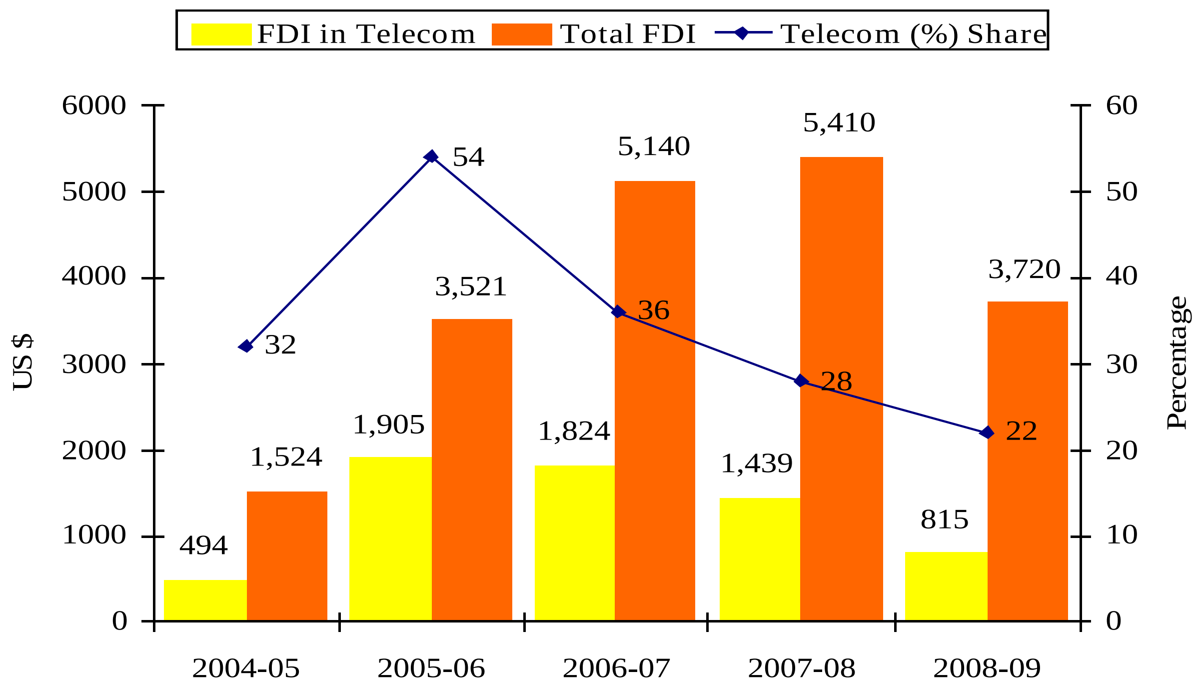
Table - 04
Sources of FDI in Pakistan Telecom Sector

US$ Million

Country	FY05	FY06	FY07	FY08	FY09	Grand Total
UAE	311.96	1360.06	358.77	366.19	-54.27	2,342.70
U.S.A	82.44	58.81	208.92	446.17	157.43	953.8
Norway	30.61	245.27	24.68	270	99.25	669.8
China	0.02	0.04	706.17	0.06	-106.78	599.5
U.K	1.73	100.92	255.27	15.37	-9.63	363.7
Mauritius	0	59.4	59.4	49.24	140.39	308.4
Hong Kong	10.02	2.05	8	180	103.89	304
Malta	0	0	0	60	187	247
Singapore	0	0.06	0.23	0	210.6	210.9
Netherlands	10.88	31.28	42.28	25.37	-26.43	83.4
Germany	0.11	2.8	48.97	4.87	0.32	57.1
Luxembourg	15.5	14.57	10.07	-0.43	-0.26	39.5
Sweden	0.03	6.08	0	2.36	22.43	30.9
Malaysia	18.11	12.55	3.11	-1.82	-1.69	30.2
Egypt	0.13	3.86	0	7.83	14.29	26.1
Saudi Arabia	0.09	0.35	15.5	0.09	0.04	16.1
Ireland	0	0	0	1.58	3.75	5.3
Bermuda	4.49	0	0.8	0	0	5.3
Others	8.33	6.96	82.09	13.24	74.51	185.1
Total	494.4	1,905.10	1,824.30	1,440.10	814.9	6,478.70

Source. State Bank of Pakistan, 2009

Figure - 6
Foreign Direct Investment



Source: State Bank of Pakistan

Taxes

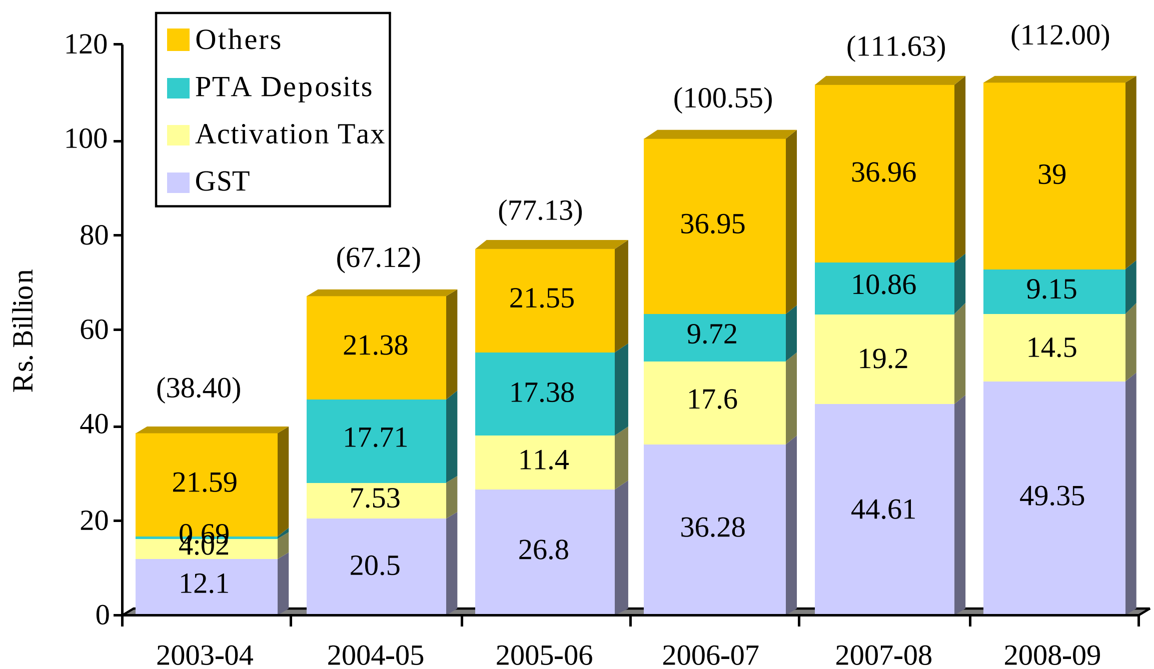
The telecom sector contributes 1-2% in the total GDP, making its share in total tax revenue as 6-7% per annum. During the year 2008-09, the sector continued to contribute handsome amount in national kitty through various taxes and regulatory charges. Telecom sectors' contribution to national exchequer rose to Rs. 112 billion in 2008-09 compared to Rs. 111 billion the previous year.

The sector has been overburdened with taxes by contributing over 31% of its revenue through GST and Withholding Tax. Resultantly little space has been left to spend on infrastructure expansion. Following major tax measures were introduced in the budget for the fiscal year 2008-09:

1. *GST/FED rate was revised from 15% to 21% for telecom sector while this raise was only 16% for rest of the economy*
2. *Import duty on mobile handsets was imposed @ Rs. 750 per mobile hand set(Rs. 500 custom duty and Rs. 250 Regulatory duty)*
3. *Activation Tax on cellular Mobile Sector continued @ Rs. 500/ per new connection*

The enhancement in taxes along with economic slowdown, had an adverse impact on telecom sector. PTA took cognizance of the situation and suggested to the tax authorities and the Prime Minister that Government of Pakistan should reduce taxes on the sector. Particularly it was emphasized that FED / GST that was raised from 15% to 21% for telecom sector needs to be reduced and take par with rest of the

Figure - 7
Telecom Contribution to Exchequer



Source: Federal Board of Revenue and Pakistan Telecommunication Authority.
Note: Note: PTA's contributions comprise of all its receipts including Initial and Annual License Fee, Annual Spectrum Administrative Fee, USF and R&D Fund Contributions, Numbering Charges, License Application Fee, etc.

economy i.e., 16%. Further it was apprised to the Government of Pakistan that imposition of Rs. 750 tax on import of mobile handsets has increased the mobile acquisition cost in Pakistan which needs to be reduced. Further it was suggested that Activation Tax @ Rs. 500, which is liable on every new connection, is a hurdle in the growth of the mobile sector and it should be abolished.

PTA's efforts, however, proved fruitful, as the Government provided the following relief in taxes to the operators in the budget 2009-10:

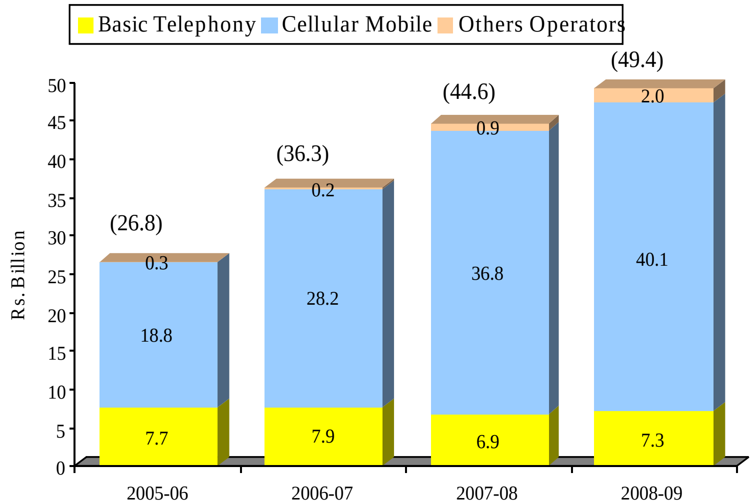
1. *GST /FED rate on telecom sector was brought down from 21% to 19.5%*
2. *Activation Tax rate was reduced from Rs. 500 to Rs. 250 per new connection*
3. *Custom duty on import of Mobile handset was decreased from Rs. 500 to Rs. 250 per set while the Regulatory duty on import of handsets @ Rs. 250 was withdrawn*
4. *Initially Rs. 0.20 tax per SMS was proposed, however it was later on abolished.*

The tax measures introduced in this budget were welcomed by the regulator as well as the operators as they would have far reaching impact on the sector. The FBR is expected to collect extra revenue from the sector during 2009-10.

GST is one of the main taxes collected from the telecom sector and cellular mobile leads in paying this tax, contributing nearly 82% of the total GST annually. The sector has contributed over Rs. 49 billion as GST in fiscal year 2008-09, which is 11% higher than the previous year. However, the rate of growth of FED/GST collection from telecom sector declined in 2008-09 compared to previous years due to high rates. There was only 9% increase in FED/GST collection from cellular mobile sector in 2008-09 compared to 30% growth of last year and 50% growth in the previous year.

Keeping view the difficulties being faced by the sector, the government has reduced the GST/FED rate from 21% to 19.5%, besides providing relief to cellular mobile operators in Activation Tax by 50% i.e. from Rs. 500 to Rs. 250 per new connection. This will certainly enable the sector to contribute more to GST collection in the next year.

Figure - 8
GST/FED Collected



Note: Basic Telephone includes PTCL & NTC & Others includes all other telecom operators

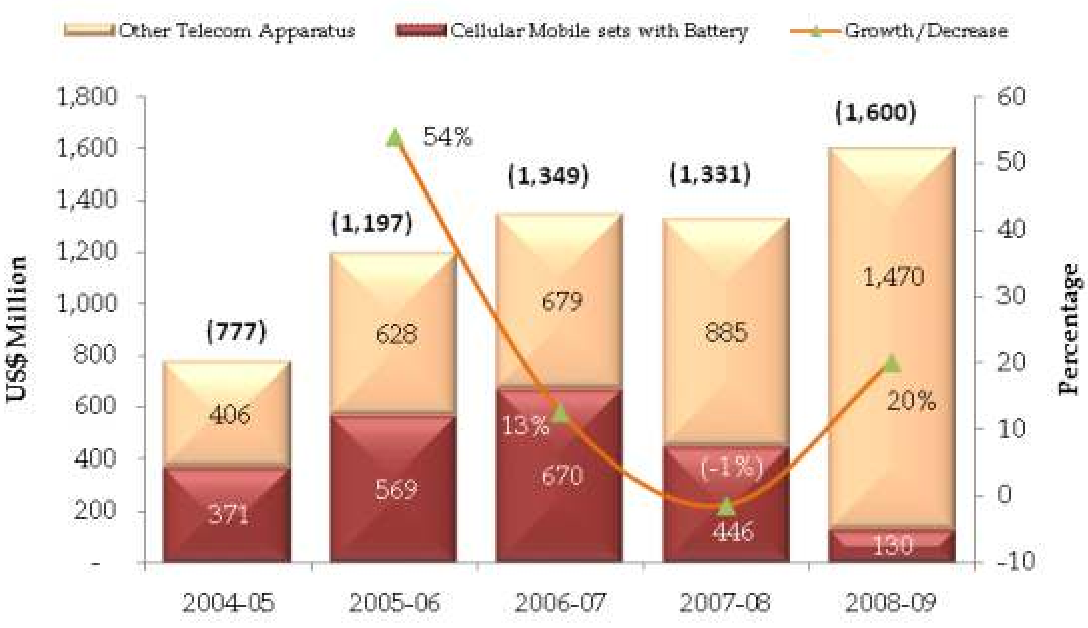
Source: Federal Board of Revenue

Telecom Imports

The rising trade deficit (US$ 12 billion) and depleting Foreign Exchange Reserves forced the Government to take prudent measures to improve the Foreign Exchange Reserves and curtail the import bill, which swelled due to unprecedented high oil prices. To curtail the mobile handsets imports, the Government imposed custom duty and regulatory duty together @ Rs. 750 per mobile handset. Resultantly, the imports of cellular mobile handsets declined by 66% in 2008-09, falling from the previous year's US$ 446 million to only US$ 130 million. Although, the total telecom imports in the year 2008-09 grew by more than 20% reaching to US$ 1.7 billion in 2008-09 compared to 1.3 billion in 2007-08. This indicates that competitive environ-ment has forced all the operators to import machinery and equipment to expand their infrastructure.

In the fiscal year 2009-10, the government has extended support to mobile handsets imports while reducing the custom duty from Rs. 500 to Rs. 250 per mobile handset and abolishing the regulatory duty @ Rs. 250. This step is likely to give impetus to the mobile industry by ensuring provision of mobile handsets at cheap rates, besides checking smuggling of mobile handsets, which is inflicting a serious loss to the Government revenue.

Figure - 9
Telecom Imports



Telecom Revenues

The telecom sector revenue showed a 19.8% growth during 2008-09 compared to 18.2% in previous year. During the year 2008-09, the telecom sector generated revenue to the tune of Rs. 333.9 billion compared to the last year's Rs. 278.5 billion. The cellular mobile sector continued to be the leader in telecom revenue, whose share came out to be 64% in the total telecom revenues. The cellular mobile sector showed about 17% positive growth during the fiscal year 2008-09.

Conclusion

Despite slowdown in economy, telecom sector continued to grow in terms of revenues, subscription and teledensity. Teledensity of the country reached 62% while operators continued investing for infrastructure expansion. Telecom sector remained largest recipient of FDI where it attracted US$ 815 million FDI in 2008-09. Regulator kept vigilant to its duties to safeguard the consumers as well as investors in the sector.

Figure - 10
Telecom Revenues