

## **Role of Foreign Direct Investment in Telecommunication Industries: A Developing Countries' Perspective**

Chun Hung Lin  
Feng Chia University  
E-Mail: chunhlin@fcu.edu.tw

### **ABSTRACT**

During the past few decades, foreign investment has rapidly increased worldwide and has enhanced economic growth in developing countries. Although foreign investment brings huge economic benefits, many developing countries fear that by opening up markets to competition and foreign investment without restriction, they will lose control of their strategic industries. Among those industries, telecommunications is a sector with substantial impact and influence on national security, social stability and economic development. Therefore, the balance between economic gains from foreign investment and national telecommunications sovereignty presents a challenging task. Is foreign investment a necessary mechanism for developing countries to promote their economic growth? With different developmental models and a myriad of different economic difficulties, is current foreign direct investment on telecommunications suitable to meet the different demands for developing countries? This article will examine current international investment regime and their relation with telecommunications as an influence in developing countries. Assessing these critical issues, this article hopes to find a new position for telecommunications in a forming integrated global market.

Keywords: Foreign Direct Investment (FDI), Developing Countries, Technology Transfer, Markets Competition, Telecommunications

### **INTRODUCTION**

Telecommunications sector plays a dual role in economic activities, not only itself a distinct circle in economic system but also a supplying mean for other sectors. Having

this kind of special character, telecommunications cover and relate to many other industrial and economic sectors such as manufacture, entertainment, and communication sectors. Foreign investment has been one of the most important driving force in the exploration of natural resources and improvement of economic conditions in underdeveloped and developing countries for centuries. Recently, foreign investment has not only increased rapidly but also covered a wide spectrum of industries around the world. The role of foreign investment has played a more and more important role in the world's economy. Generally speaking, foreign investment money will spur economic growth and create a better living standard in the newly invested countries. From an economic standpoint, international investment mutually benefits both sides of the investing and invested countries; however, there is still not an international investment regime or thorough international agreement that fairly addresses both sides. Although foreign investment brings abundant funds and advanced technology, many developing countries fear that by opening up their markets to competition without any restriction, they will be forfeiting economic guiding power and lose control of strategic industries.

Among FDI, telecommunications is one of the most strategic industries of national economic control. Even though foreign investments on telecommunications will bring advanced technological skills, large amount of funds, as well as market competition and will benefit national telecommunications development, many countries guide policy and legal requirements to control foreign investment to correspond to their economic and developmental demands. Telecommunications have a substantial and important influence on national security, social stability and economic development, as well as many industrial sectors. Due to its particular character, telecommunication industries are often state-operated and monopolized in many countries. Therefore, the balance between economic gains from foreign investment and national telecommunications sovereignty presents a challenging task. This article will examine international investment regime and its relation with telecommunications as an influence in the global economic market. From the standpoint of foreign investment, this article hopes to find a new position for telecommunications in a formingly integrated global market.

### **MEANING AND ECONOMIC BENEFITS OF FDI**

Over the past two decades, FDI has been one of the most important driving forces for the world's economic growth. According to the US Department of Commerce, FDI is a direct investment which "implies that a person in one country has a lasting interest in,

and a degree of influence over the management of, a business enterprise in another country.” The US Commerce Department defines FDI as “ownership or control by a foreign person of 10 percent or more of an enterprise's voting securities or the equivalent,” which is deemed enough to influence management decisions. At a Global Investment Forum hosted by the United Nations Conference on Trade and Development (UNCTAD), it was reported that “there was a strong feeling among ministers from some developing countries that more research and analysis was needed about the critical issues at stake in a multilateral framework on investment...and many speakers stressed the complexity of the issues related to the effects of economic policy liberalization on the quantity, quality and distribution of FDI, and its impact on development.”

Requiring sufficient economic information and abundant funds, foreign investment is always accompanied by higher risks. With such risks, foreign investment also comes with the possibility of much greater returns. Traditionally, foreign investment has been very closely related either with trade or with an international development agency. Most current foreign investment thus has either been the result of someone taking a huge risk or the result of an international organization such as the World Bank underwriting that risk. Meanwhile, international developmental agencies often pursue the more enlightened goal of helping countries develop properly rather than seeking the greatest return.

The benefits of foreign investment include promoting economic growth, technology transfer and job-creation in the local economies. It is assumed that exports would increase since a large part of exports is comprised of shipments from domestic companies to their foreign affiliates. Technology transferred from foreign investment projects will improve the efficiency of local firms as well. These effects become the major attractions for developing and underdeveloped countries seeking foreign investment. In addition, FDI can serve to integrate domestic markets into the global economic system far more effectively than could have been achieved only by traditional trade flows. The benefits from FDI will be enhanced in an open investment environment with a democratic trade and investment regime, active competition policies, macroeconomic stability and privatization and deregulation. Under such conditions, FDI can play a key role in improving the capacity of a country to correspond to global economic integration and future national developmental strategies. In practice, the greater the openness and freedom toward FDI, the more economic reforms and potential benefits that receiving countries will reap.

Although FDI implicitly brings large economic benefits and potentially attracts

numerous business opportunities, many countries are only partially open to foreign investment or even refuse business with foreign enterprises. Those countries believe they will be losing the control power over the local economy by inviting foreign investment. They often use performance requirements such as exporting requirements or technology transfer agreements to control the categories and sizes of FDI. For many countries, performance requirements on foreign investment were considered necessary and desirable to ensure that the activities of foreign capitals are consonant with local countries' developmental strategies (Thompson, 1999). The same decline in effectiveness can be seen in terms of policies designed to maximize the potential benefits from inward investment. However, since it has been acknowledged that FDI can stimulate economic growth and national development, there remains a tremendous diversity in countries' approaches on their policies towards FDI. Countries can also screen incoming investment and retain control on foreign participation in particular sectors. Those measures are designed to certify local government can still retain the final decision on economic policies and ensure foreign investment will not cause negative effects on national development.

### **ARGUMENTS ABOUT FDI IN THE GLOBAL ECONOMY**

The economic problems of underdeveloped and developing countries are fundamentally different from those of developed countries and require different measures and policies. Since the 1950s, it was recognized that "late industrialization countries" required even greater protection and state intervention than even the most developed countries had relied upon during their early development (Gerschenkron, 1966). For underdeveloped or developing countries, FDI would undermine many of their development strategies and developmental processes. For example, in Mexico, most people seemed to be economically better off under a more authoritarian regime (Maddison, 1995). Prior to international trade and investment liberalization, Mexican economic growth was fairly rapid, at a real per capita rate of 3.9% in the 1960s and 3.2% in the 1970s. Since the 1980s, after liberalization began, per capita income has stagnated and real wages have actually fallen. Economists have pointed out that the instability of international financial markets was a major cause of the previous 1994 financial crisis in Mexico (Calvo & Mendoza, 1995). The effect of such disinvestments with Mexico, therefore, should be questioned whether or not the deregulation of international capital flows is in the best interest of "emerging market" economies (Weisbrot, 1998).

Likewise, in South Korea, many economic regulations that were prohibited by the national treatment provisions were essential to economic growth and development. The Korean government used measures like subsidized credits, tax and tariff exemptions and export subsidies to intervene against foreign investment. They targeted industries such as cement, fertilizer, steel, chemicals, and consumer goods, etc. FDI was restricted and played a minimal role in South Korea's industrialization and economic development (Westphal, 1990). After Asia's financial crisis in 1997, the IMF required the Korean government to take measures for internationalization and deregulation, including the removal of a number of restrictions on foreign ownership of domestic stocks and bonds, residents' ownership of foreign assets, and overseas borrowing by domestic financial and non-financial institutions (Chang, Park & Yoo, 1998). The sharp reduction in government planning and industrial policy has caused problems such as overcapacity in the petrochemical industry, over-investment, and corporate failures in industries (Chang, Park & Yoo, 1998). Meanwhile, the 1997 Asia Financial Crisis, one of the world's worst economic crises since the Great Depression. The crisis engulfed much of Asia including South Korea, Thailand, and Indonesia caused by the set-off of hot money prior to August 1997, and then a true panic when the Thai baht began to fall. The liberalization of international investment was struck by the Asian financial crisis and economists pointed out that the liberalization of international borrowing and investing in those countries over the last decades created the instability from which the crisis was born. One economist has noted, "The Asian crisis cannot be separated from the excessive borrowings of foreign short-term capital as Asian economies loosened up their capital account controls and enabled their banks and firms to borrow abroad. It has become apparent that crises attendant on capital mobility cannot be ignored (Bhagwati, 1998)." The reversal of capital flows amounting to eleven percent of the regional GDP was a result of foreign and domestic investors stampeding for the exits for fear of being caught with greatly depreciated local currency and assets (Weisbrot, 1998). Economists who supported increasing deregulation of international investment have recently begun to concede that a large number of workers have indeed been hurt by such a process. On the other hand, foreign investors take into account all relevant information affecting asset returns when deciding their market positions and would be hard pressed to explain future disinvestments from these countries (Weisbrot, 1998). The OECD has just issued a report intended to make the case for international investment liberalization where they contend that such negative impacts are "at most, modest."

### **MEANING OF FDI ON TELECOMMUNICATIONS**

Foreign direct investment on telecommunications comprises the ability to establish a commercial presence in a foreign territory, or the purchase of telephone companies by foreign investors or joint ventures between local and foreign partners to establish new telecommunication service companies. Historically, the opportunities for foreign investment in the telecommunication services sector have been limited by the fact that most countries had state-owned monopoly telecommunication carriers. Since 1984, however, forty-four Public Telecommunication Operators (PTOs) have been privatized raising 159 billion US dollars with about one-third of this investment coming from outside the home countries. Obviously, fueling the operation of old PTOs, foreign investment has gradually played a more important role in either domestic or international telecommunication market. For increasing the proportion of foreign investment on telecommunication sectors, foreign capital now has raised either through a share offering or the sale of a minority share of a PTO to foreign partners. Under the process of privatization of telecommunication industries, there are increasing numbers of opportunities for foreign investors to establish foreign subsidiaries or to combine with others in joint ventures.

On the other hand, because telecommunications covers many other industrial sectors including the sectors of manufacture, entertainment, and communication, it has a dual role as both a traded product and service, and as a facilitator of trade in other products and services. Liberal foreign investment on telecommunications will promote more economic gains including new and improved telecommunication products and services with lower prices and additional investment on other industrial sectors. Opening foreign investment on the telecommunication services sector should result in more competition, lowering prices for most businesses and for many consumers and providing both with a choice of different service providers. FDI brings not only new technology and developmental funds to telecommunications industries; it also brings innovation and competition for telecommunications providers. These positive effects promote the capacity of telecommunication in underdeveloped and developing countries and benefit the formation of “world village.”

For most developing and developed countries, foreign investment on telecommunications is not merely a provider for improvement of local telecommunication equipments but also a driving force for telecommunication market

competition and transformation. Seeing the huge benefits from foreign investment in telecommunications, a large portion of the world hopes to attract foreign investment to pursue a schedule of projects to improve the basic telecommunications infrastructure. First, to attract more foreign investment and making market competition, developing countries privatized their public telecommunication operators at the start of the 1990s. By deregulating domestic telecommunication regimes, it is expected that local telecommunication markets will be more efficient and attractive for foreign firms. Second, to attract more foreign investment and to operate toward an integrated global economy, countries have to make more available high-speed data networks, cellular radio, mobile satellite services, Internet access and facsimile for foreign firms. By deregulating domestic telecommunication regimes and upgrading the level of telecommunication methods, these countries expect that FDI would have more willingness to choose them as a base for future global telecommunications competition. In developed countries, they have concentrated more on recognizing telecommunications trends and have tried to satisfy the complex requirements of multinational enterprises. Both developed and developing countries face the same pressure to upgrade and diversify the telecommunications sector, but developing countries typically have less financial, technical and operational resources to do so, particularly in light of an incomplete basic infrastructure. The best way to resolve this dilemma and to attract foreign investment for business and basic telecommunication infrastructure will be through upgrading the technology skill of the labor force and the privatization of public telecommunication regimes.

In the Asia-Pacific region, telecommunications market reform has continued apace with developing countries such as the Philippines, Taiwan and Thailand, and has opened up their markets to foreign investment. In Latin America, several countries that first privatized their domestic operators at the beginning of the decade are now preparing for a second round of market-openings. Even Africa, which has long been the last bastion of telecommunication monopolies, is leading the way by attracting foreign partners investing in their telecommunication sectors (Tarjanne, 1997). Foreign private investment has entered the developing markets through joint ventures with local telecommunication operators, the award of licenses to foreign companies, or the sale of equity stakes in state-owned telecommunication entities to private foreign investors. Private investment was initially permitted mostly in value-added services, but increasingly, it is entering the basic services as well (Chasia, 1998).

In Latin America and Africa, privatizations have been conducted through the sale of an equity interest in the company to foreign strategic investors such as France Telecom, Telekom Malaysia and SBC of USA. Privatization and increased foreign investment in telecommunication markets has resulted in substantial progress in meeting developing countries' basic telephony upgrading goals. It is also expected that market competition as the provision of international and domestic telecommunication services will bring a significant reduction in prices and more parity between domestic and international telephone services. Where markets have been liberalized, the level of investment, particularly foreign investment, has generally increased and telephony and network development has proceeded more rapidly. This combination of competitive markets, private ownership and foreign investment has created an appropriate environment for next generation global telecommunications development.

### **FDI ON TELECOMMUNICATIONS AND INTERNATIONAL ORGANIZATIONS**

The telecommunications sector is currently undergoing a transition from a global market system for telecommunication services that has been based on multilateral arrangements. This should foster a suitable international environment where investment and entrepreneurship can prosper, including the development of new forms of electronic commerce. For FDI in the Telecommunications sector, the WTO and ITU are two of the most important international organizations. The WTO agreement hopes to promote foreign and domestic investment in the telecommunication sector and, as a consequence, the development of each country's telecommunication infrastructure and services. Under the WTO, GATS on Telecommunication which was concluded on February 1997 and which entered into force on February 1998, commits 72 countries to a program of progressive opening of their basic telecommunication service markets to competition and increased foreign investment. Those agreeing countries made commitments to liberalize their telecommunication market and to open up to foreign investment in basic telecommunication services. That is, the provision of voice telephone, telex, telegraph, data transmission and privately leased circuits.

On the other hand, the ITU provides great benefits in terms of telecommunication infrastructure construction and the development of information processing industries. The ITU allocates a global spectrum to particular services and manages scarce communications resources among countries that benefit trade liberalization and the

prevention of discrimination between domestic and foreign suppliers. The ITU also promotes global telecommunication development and plays the role of providing the information to let developing countries understand the benefits that liberalization and trade in telecommunications can bring, as well as the measures necessary to protect national interests. Both WTO and ITU encourage the development of global telecommunication infrastructure and the formation of an integrated global telecommunication market. Global telecommunication development tends to strengthen the leadership role of the private sector in the development of a diverse, affordable, and accessible information infrastructure around the world. Under this trend, it also hopes to promote the involvement of developing countries in the building and utilization of a truly global and open information infrastructure and facilitate activities and identify policy options that foster the effective global application of telecommunications, broadcasting, and information technologies and services (Thompason, 1999).

### **FDI ON TELECOMMUNICATIONS AND ECONOMIC GROWTH**

Investment in telecommunications is a prerequisite for broad based economic development. The dual role of telecommunications as both a traded service and a vehicle for trade in other service sectors means that price reductions, improvements in the level of investment and the development of infrastructure and services brought about by liberalization should also have an impact on other sectors of the economy. In addition, efficient, low-cost telecommunication networks will provide the necessary platform for the growth of electronic commerce. The implementation of liberalized telecommunication investment should produce significant benefits not only within the country's telecommunication sector but also for the national economy as a whole. The opening of telecommunication markets has facilitated the entry of domestic and foreign private capital and technological skills that have in turn accelerated network build-out, the provision of new services and improvements in the quality of service. Market liberalization also has a profound effect in promoting development in other sectors such as information technology and computing, which depend heavily on good, reliable and low-cost telecommunications.

Economic development in these sectors indeed has been constrained in many countries because of the lack of an adequate telecommunication infrastructure to service them. Inadequate telecommunications also reduces efficiency throughout the economy, diminishes the effectiveness of investments and development programs, causes a

comparative disadvantage in attracting investment, and lowers the quality of living standard as well as personal access to communication. The evidence leaves no doubt that there was indeed a correlation between economic development and investment on telecommunications. Throughout economic developmental history, telecommunication infrastructure has played an important role in supporting the economic development of countries. There are numerous documented examples about the direct relationship between investment in telecommunication infrastructure and economic growth. The growth of global telecommunication development will bring rapid expansion of new and advanced information services, attract more domestic and foreign investments, and improve economic development and global competitiveness, as well as a better living standard of health care and education.

### **CONCLUSION**

During the past few decades, foreign investment has rapidly increased among countries and has enhanced global economic growth. The evidence shows us that there was indeed a correlation between economic development and investment in telecommunications. FDI brings the promotion of economic growth, the obtainment of technology transfer and the creation of employment. Although FDI brings huge economic benefits, many countries are still only partially open to foreign investment. Developing countries fear that by opening up markets to competition and foreign investment without any restrictions, they will lose control of their strategic industries. They have used performance requirements to control the categories and sizes of FDI, such as exporting requirements or technology transfer agreements. Balancing economic gains from FDI with the power to control national economic sovereignty is a dilemma with substantial history.

The discussion throughout this article has also pointed out that a more open foreign investment environment does not always violate national economic sovereignty. Although developing countries need stronger control to guide their developmental directions and industrial strategies, such countries often lack necessary capital and technological skills to attain their industrialization goals. Foreign investment brings abundant capital, advanced technologies and huge economic profits, which can easily resolve developing countries' economic problems. However, a stable, transparent and non-discriminatory regulatory system is the best way to attract more foreign investment. Because of increased global economic competition, more and more developing countries

already relax control over foreign investment and provide a more favorable investment environment and accompanying laws to foreign investors.

Additional investment in telecommunications from abroad should bring technology transfer, more abundant capital, and increased market competition, which should benefit national telecommunications development. By introducing foreign investment into developing countries, a workable local telecommunication infrastructure and universal access can be more easily reached. We have shown that increased foreign investment and privatization in telecommunication markets will result in substantial progress in meeting developing countries' basic telecommunications requirements. Of equal importance, telecommunications also have a substantial and essential influence on national security, social stability, economic development and many industrial sectors. In response, the opportunities for foreign investment in the telecommunication services sector historically have been limited and most developing countries have monopolistic and state-owned telecommunication carriers. An efficient trade and investment regime for telecommunication cooperation will have to recognize these two competing factors for a successful agreement between developing and developed countries.

### REFERENCES

- The General Agreement on Tariffs and Trade (GATT, 1994)
- The Multilateral Agreement on Investment (Proposed Vision, OECD, 1998)
- Alexander Gerschenkron, (1966), "Economic Backwardness in Historical Perspective: A Book of Essays;" Cambridge: Harvard University Press, 21-85.
- Avi Nov, (2004), "Tax Incentives To Entice Foreign Direct Investment: Should There Be A Distinction Between Developed Countries And Developing Countries?" Virginia Tax Review, 23, 685-697.
- Barry Eichengreen; (2002), "The Globalization Wars: An Economist Reports From the Front Lines;" Foreign Affairs, July/August 2002.
- Calvin A. Hamilton & Paula I. Rochweger, (2004), "Trade and Investment: Foreign Direct Investment through Bilateral and Multilateral Treaties;" New York International Law Review, 18, 1-66.
- Chang, Ha-Joon, Hong-Jae Park, and Chul Gyue Yoo; (1998), "Interpreting the Korean Crisis - Financial Liberalization, Industrial Policy, and Corporate Governance;" Cambridge Journal of Economics, 22, 6.
- Charles H. Brower II, (2003), "NAFTA's Investment Chapter: Initial Thoughts about

- Second-Generation Rights;” *Vanderbilt Journal of Transnational Law*, 36, 1533-1565.
- David A. Gantz, (2004), “The Evolution of FTA Investment Provisions: From NAFTA to the United States - Chile Free Trade Agreement;” *American University International Law Review*, 19, 679-746.
- Deborah E. Siegel, (2004), “Using Free Trade Agreements to Control Capital Account Restrictions: Summary of Remarks on the Relationship to the Mandate of the IMF;” *ILSA Journal International & Comparative Law*, 10, 297-302
- Guillermo Aguilar Alvarez & William W. Park, (2003), “The New Face of Investment Arbitration: NAFTA Chapter 11;” *Yale Journal of International Law*, 28, 365 -404.
- Guillermo Calvo & Enrique Mendoza; (1995), "Reflections on Mexico's Balance of Payments Crisis: A Chronicle of a Death Foretold," *Journal of International Economics*, 39, 183-201.
- Jagdish Bhagwati; (1998), "The Capital Myth: The Difference between Trade in Widgets and Dollars," *Foreign Affairs*, May/June 1998.
- John H. Jackson; (1995), “The World Trading System, Law and Policy of International Economic Relations; The MIT Press, Cambridge, Mass. & London, England, 2nd Edition.
- John K. Fairbank, Edwin O. Reischauer, Albert M. Craig; (1996), “East Asia-Tradition & Transformation;” *Harvard University Press*, 898-906.
- Larry Westphal; (1990), "Industrial Policy in an Export-Propelled Economy: Lessons from South Korea's Experience," *Journal of Economic Perspectives*, 4, 41-59.
- Luke Eric Peterson; (2003), “International Human Rights in Bilateral Investment Treaties and in Investment Treaty Arbitration;” *IISD Research Paper*, prepared by International Institute for Sustainable Development for the Swiss Department of Foreign Affairs.
- Robert L. Kuttner, (2004), “Development, Globalization, and Law;” *Michigan Journal of International Law*, 26, 19-33.
- Carlos M. Correa, (2004), “Investment Protection In Bilateral And Free Trade Agreements: Implications For The Granting Of Compulsory Licenses;” *Michigan Journal of International Law*, 26, 331-352.
- S. K. Date-Bah, (2003), “Facilitating and Regulating Private Investment in A Developing Economy;” *Pennsylvania State International Law Review*, 22, 3-14.
- Scott S. Quillin, (2003), “The World Trade Organization and Its Protection of Foreign

- Direct Investment: The Efficacy of the Agreement on Trade-Related Investment Measures;” Oklahoma City University Law Review, 28, 875-898
- Surya P Subedi, (2003), “The Road from Doha: The Issues for the Development Round of the WTO and the Future of International Trade;” International and Comparative Law Quarterly, 52, 425-443.
- Terence P. Stewart; (1996), “The World Trade Organization: The Multilateral Trade Framework for the 21th Century and US Implementing Legislation;” American Bar Association Section of International Law and Practice.
- Todd Weiler, (2004), “Balancing Human Rights and Investor Protection: A New Approach for A Different Legal Order;” B.C. International & Comparative Law Review, 27, 429-435.

