

ANNEXURE I**Government of India
Ministry of Finance****Adviser to Finance Minister
& Member(TRAI)****Department of Economic Affairs
North Block, New Delhi-110001**D.O. No.1838/Member (TRAI)/2001
September 22,2001

Dear Shri Verma,

I am writing with respect to the recommendations of the Telecom Regulatory Authority of India (TRAI) on Universal Service Obligations.

2. The National Telecom Policy, 1999 (NTP 99) has laid down ambitious goals in respect of the spread of telecommunications in the country. Among its objectives are the provision of widespread access to telecom services in all parts of the country, and making available telephones on demand by the year 2002. The NTP 99 pays specific attention to the availability of telecom services in rural areas. In order to achieve these objectives, NTP 99 has also provided for the raising of resources for meeting the Universal Services Obligations (USOs) through the levy of a Universal Access Levy (UAL) . Accordingly, the TRAI is providing its recommendations on how the USO should be implemented and how resources should be raised through the UAL.

3. In analysing the issues, the Authority has divided the implementation of USO into two separate streams. Stream 1 is the provision of telecommunication and information services through the provision of common access in all rural areas in the country. Stream 2 is the provision of household telephone in net high cost areas of the country through distribution of appropriate subsidies that would cover the losses incurred by telecom service providers because of low tariffs that are applicable to rural areas. **The Authority has quite rightly provided higher priority to the provision of Public Telecommunication Services (PTSS) through common access to be provided by Village Public Telephones(VPTs) and Public Tele Info Service Centres (PTICs).** I am in full agreement with the recommendations of the Authority in regard to the use of resources raised from the UAL for funding VPTs and PTICs.

4. As requested, the Authority is also providing its recommendations for the provision of phones at affordable rates in rural and remote areas as part of USO. It is in this area of Stream 2 recommendation that I am unable to agree with the Authority. The NTP'99 has taken as an objective an increase in rural tele-density in the year 2010 to 4.0 which would be 10 times the level in 1999. The Authority feels that this objective cannot be achieved unless resources are provided to "subsidise loss making telephones in high cost rural and remote areas". Making telephones available on demand by the year 2002, as stipulated in NTP'99, implies that the operators will have to provide telephones on demand without any discrimination and as per waiting lists even though providing connections to low calling subscribers may not be remunerative for the operator on strictly business considerations. Accordingly, the Authority is recommending an area-wise approach for providing support to the operators in respect of DELs to be provided in rural and remote SDCAs. It has proposed that the subsidy would be given in such areas on the basis of an estimation of net

cost of the given area taking into account the service revenue from all DELs in that area. It is also proposed that this subsidy will be available only in specified remote and rural SDCAs.

5. The subsidy to be given would be different for each eligible SDCA based on a costing methodology developed by the Universal Service Fund(USF) Administrator under the guidance of the TRAI. The per line net cost that would be reimbursed, would be based on the difference between per line average cost of access and the per line average total service revenue. In order to administer this system, dis-aggregated costs and revenues would have to be worked out by each operator for each of the eligible rural and remote SDCAs. The USF Administrator would also have to develop a computer based proxy cost model in order to verify the claims submitted by each of the service providers in each of the eligible SDCAs. As has been stated by the Authority, correctness of the calculations will be very crucial since tele-density is at present very low and the support required for the USO would be substantial. The Authority is also concerned that the USF should not be made use of for covering any inefficiency of the operators. Hence, the utilisation of the most cost-effective equipment giving an optimal configuration to improve the telecom service requirements has to be in built in the proxy cost model. Costs should cover only the non-traffic sensitive portion of the network, the capital costs from customer premises to the line card in the exchange or the cost of the access network in case of wireless technologies. These costs should not include other fixed costs such as land and buildings or the tariff sensitive portion of the core network. Furthermore, no capital recovery of any kind should be provided on DELs given before the implementation of the USO.

6. In order to receive subsidies from the USF Administrator, each service provider would have to indicate their SDCA-wise roll out plan including projected cost and revenue at the beginning of each year. The final reimbursement from the USF Administrator would have to be based on the cost estimated by the proxy model for the network actually rolled out for the number of lines for which the support is claimed. Adjustment would have to be made for the differences between the declared roll out plan and the actual roll out achieved.

7. As may be seen from this brief description of the Authority's recommendations regarding the administration of subsidies to rural and remote SDCAs, **a great deal of detailed costing information and revenue information would be required on a disaggregated basis for each eligible SDCA from each operator.** Subsequent to the receipt of all of this information, the USF Administrator would have to subject the information received to the discipline of a theoretical proxy cost model and then make decisions on actual subsidies to be distributed to each operator in each eligible SDCA. This procedure calls for an excessively large amount of information to be submitted twice in every year, once at the beginning of the year and once at the end of the year. The USF Administrator would have to have a large number of qualified staff to administer such a programme and would then have to take many decisions on the quantum of subsidy to be given to each operator in each eligible SDCA.

8. I feel that this is not a practicable approach for the following reasons:

- (i) The segregation of SDCA-wise cost revenue information while taking care of all the exclusions recommended by the Authority will be difficult to be done by each operator in each eligible SDCA.
- (ii) Many delays will occur in the transmission of such information since hundreds of

SDCAs would be involved.

- (iii) Verification of such information by the USF Administrator would be very difficult to achieve since this information would come from hundreds of rural and remote SDCAs.
- iv) After such information is received, the USF Administrator would run this information through their proxy cost model and then arrive at normative levels of subsidies to be given to each eligible operator. The level of such subsidies to be given would be different for each operator in each rural SDCA.
- v) This procedure is guaranteed to give rise to a large number of disputes between the USF Administrator and the eligible operators.
- vi) The USF Administrator would also be subject to tremendous pressures from each of the operators since he would be exercising discretion on the subsidies to be given.

9. The subsidies received by each operator in each eligible SDCA will depend on the volume of net losses incurred by the operator in that SDCA, albeit qualified by the norms of the proxy cost model. Such a scheme is similar to the retention price system used for the distribution of fertilizer subsidies to fertilizer units in the administered pricing mechanism in the fertilizer industry. The experience in assessing such plant based levels of normative costs has not been a happy one, even though the number of fertilizer plants receiving such subsidies are limited in number and have audited accounts. **The problem will be much worse in the scheme proposed since the number of SDCAs will be much larger and these would of course be in rural and remote areas.** In principle also a scheme which provides an incentive to incur losses in eligible SDCAs is not desirable.

10. **I, therefore, feel that the scheme proposed for subsidizing rural and remote SDCAs is simply not practicable, and wrong in principle, and is likely to give rise to a great deal of difficulty and subsequent criticism both of the USF Administrator and the TRAI.**

11. There are other considerations which would suggest that it may be more practical to confine subsidies from the USO fund to be given only to VPTs and PTICs with the objective of providing 100 per cent access to people in all areas of the country, particularly, rural and remote areas. As has been projected, even by 2010, the targeted tele-density is only about 4 per cent. In other words, only the top 20 per cent of rural households (4 per cent tele-density multiplied by average family size of 5) are expected to have household level telephones by 2010. The provision of subsidy for the expansion of DELs would, therefore, imply that subsidies are to be given to the top 20 per cent of households in rural areas over this period. **There would seem to be little justification for the provision of such a subsidy to households that are the richest in rural areas. A much better objective would be to perhaps expand the programme for VPTs and PTICs even further so that subsidies are provided for the less well – off in rural areas.** At present, the objective is to provide a VPT in each village and then expand the service available to PTICs. It should be noted that the size of villages varies from 100 people or less in a village upto almost 10,000 people in some villages. Once at least one VPT is available in each village,

the number of VPTs in larger villages can be expanded and later PTICs. The full subsidy available from the levy of a UAL of 5 per cent can then be provided for the provision of such facilities across the country. **We would then help in achieving the objective of 100 per cent i.e. Universal Access to telecom services across the country, and the subsidy available from the UAL would be well targeted.**

12. Ironically, the objective of expanding overall tele-density and rural tele-density in particular, would perhaps be better served by appropriate tariff re-balancing so that expansion of networks into rural areas does not automatically lead to losses of telecom service providers. Such a policy towards tariff structure will provide better incentives to telecom service providers for expanding their networks. The current tariff structure effectively discourages telecom service providers from extending their networks to rural areas. Such erroneous policies have already led to grave problems in other sectors such as the power sector. The policy of providing loss making low tariffs to selected groups have led to sickness of almost all State Electricity Boards (SEBs). It is always thought initially that remunerative connections can easily subsidize non-remunerative services since their weight in the total would remain small. But as the expansion of network takes place (as is intended) the weight of non-remunerative services increases and the burden on remunerative services goes up to non-sustainable levels as it has in the power sector. The consequence is that the ability of service providers to expand their networks actually falls, as it has in the power sector. **A similar error must not be made in the telecom sector.**

13. **In this sector it would be a much better approach to concentrate on achieving truly universal access through VPTs and PTICs.** This would serve social purpose much better and also make the subsidy distribution mechanism practicable. **I therefore propose that TRAI should confine its recommendations to proposing the use of the USF to funding Stream 1 facilities.**

14. I realize that doing this would depart from some of the objectives of the NTP 99 related to the provision of DELS on demand in all areas. It seems to me that the objective of Universal Access is more important and for the next 10 years we should concentrate on achieving this objective effectively.

With warm regards

Sd/- Rakesh Mohan.
Member (TRAI)