



# **Emerging Global Economic Situation: Opportunities and Policy Issues for Services Sector**

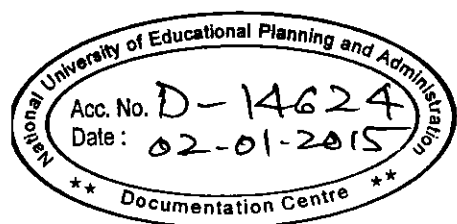
**Dr. H.A.C. Prasad**

**R. Sathish**

**Salam Shyamsunder Singh**

**January 2014**

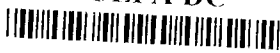
Government of India  
Ministry of Finance  
Department of Economic Affairs  
Economic Division  
[www.finmin.nic.in](http://www.finmin.nic.in)



## **Disclaimer and Acknowledgement**

The views expressed in this paper are those of the authors and do not necessarily reflect the view of the Ministry of Finance or Government of India.

The authors would like to thank the Secretary, Dr. Arvind Mayaram and former Chief Economic Adviser, Dr. Raghuram Rajan (presently the Governor of RBI) for their encouragement. The authors would also like to thank the EXIM Bank of India for coordinating the meetings with the different stake holders and providing logistics support. The authors would also like to thank the different service providers and experts/participants who interacted with them in meetings in India and the different ministries, different institutions, NASSCOM and its members and some service sector companies in UK & US who provided useful inputs. However, errors, if any, are the responsibility of the authors.

**NUEPA DC**  
  
**D14624**

## Contents

<b>Executive Summary and Conclusion</b> .....	<b>i</b>
<b>Section- I:- Emerging Global Economic Situation &amp; Services Sector</b> .....	<b>1</b>
World Economy and Trade .....	1
Services GDP and Trade: Global Scenario .....	2
<b>Section-II:- India's Services Sector</b> .....	<b>4</b>
India's Services GDP .....	4
FDI in Services Sector .....	4
India's Services Trade.....	5
<b>Section-II :- Performance of India's Services Sub-Sectors</b> .....	<b>7</b>
Performance of Major Services Sub-sectors .....	8
Trade and Tourism Services .....	8
Transport related Services.....	9
Real Estate Services .....	11
Some Select Business Services .....	12
IT and ITeS Services .....	12
Engineering and Consultancy Services .....	13
Research and Development (R & D) Services .....	13
Health Care Services .....	14
Banking and Financial Services .....	14
Education and Skill Development .....	15
Telecom and related Services .....	16
<b>Section-IV:-Recent Policy Measures/Reforms in Services Sector</b> .....	<b>17</b>
<b>Section-V :- Policy Issues in Services Sector</b> .....	<b>19</b>
Market Access for India's Services Exports .....	19
Domestic regulations & policy reforms for services .....	23
(i) General Issues .....	23
(ii) Sector Specific Policy Issues .....	28
<b>Section-V:- Conclusion</b> .....	<b>40</b>
<b>References</b> .....	<b>41</b>
<b>Annexure I: Performance of India's Services Sector: Some Indicators</b> .....	<b>42</b>

## **Executive Summary and Conclusion**

The services sector has been the major growth propeller of the Indian economy with the highest sectoral contribution in India's Gross Domestic Product (GDP). However, in recent quarters, in line with general slowdown of the economy, the growth of services sector has also decelerated. Services export growth has also decelerated since 2011-12 and was at 3.4 per cent both in 2012-13 and H1 of 2013-14. However 'Net Services' growth which decelerated to 1.4 per cent in 2012-13 picked up to 12.6 per cent in H1 of 2013-14. This paper makes an attempt to analyze the recent performance services sector and list out some important policy issues in this sector.

Performance of different Services: During 2012-13, 'trade, hotels and restaurants' (i.e tourism related) sector grew at 9.1 per cent. However the combined growth of this sector and 'transport, storage and communication' decelerated to around 4 per cent in first two quarters of 2013-14. Though, the number of foreign tourist arrivals grew by 4.4 per cent in first half of 2013-14 as compared to 2.9 per cent in 2012-13, the foreign exchange earnings in USD terms decelerated to 1.2 per cent in H1 of 2013-14 as compared to 5.6 per cent in 2012-13. In transport related services, the performance of aviation and railway sector have shown some improvement during H1 of 2013-14, while shipping sector's performance was moderate. The growth of construction sector which decelerated in 2011-12 and 2012-13 remained at the same level of 4.3 per cent in Q2 of 2013-14 as in 2012-13. In IT and ITeS sector, the growth of total IT and BPM services revenue moderated to 7.5 per cent in 2012-13, though NASSCOM has forecasted a growth in revenue of 13-15 per cent for software sector in 2013-14. Teledensity which is an important indicator of telecom penetration, increased from 18.22 per cent in March 2007 to 73.01 per cent as on 30<sup>th</sup> Sept 2013.

Recent Policy measures/Reforms in the Services Sector: The government has taken many policy reforms like opening more sectors for FDI, freeing the control on opening new bank branches subject to certain conditions, setting an innovation fund to boost scientific innovation in R & D sector, incentivizing shipping sector by withdrawing excise duty and CVD on imported ships, notifying safe harbor rules, and setting aside an amount of Rs. 14,000 crore for capital infusion into banks.

Policy Issues in Services Sector: These issues can be classified into two major categories. The first category is the market access issues for India's services exports, and the second is related to domestic regulations and policy reforms. While, issues on market access need to be addressed through proper persuasion/ negotiations at the bilateral and multilateral levels, issues related to domestic regulations can be addressed through policy reforms.

Market Access Issues: The proposed VISA rules of US, different domestic regulations in our trading partner countries like licensing, state level regulations in different services tax and the buy American legislation, etc are among the major market access issues.

Domestic Regulations & Policy Reforms: Here, there are some general issues like the need for a nodal agency for services; need for promotional activities for service exports by setting up a portal for services, showcasing India's competence also in non-software services, and using the services of dedicated brand ambassadors and experts in services; greater ease of doing business in India; inadequate database on services sector for policy formulation; disinvestment of some service sector public sector units; FDI/privatization of railways; employment related issues; credit related issues like 'collateral free' loan; and tax and foreign trade policy issues like the discrimination in Bank Guarantees which is based on past export performance for services; use of the net foreign exchange criteria for the benefits of Served from India Schemes (SFIS); non-exemption of technical services by Indian companies in Double Taxation avoidance agreement with Japan; retrospective amendments of tax laws as in the case of the definition of royalty to include payment of any rights via any medium for use of computer software; mergers & acquisitions occurring outside India; need for provision to tax incentives in the form of Intellectual Property Box; and tax administrative measures to tackle delay in refunds.

Sector –Specific Policy Issues: These include the following.

In aviation sector, Maintenance, Repair and Overhaul (MRO) services has good scope, but anomalies caused in duty drawback schemes due to high content of scrap needs to be addressed. In tourism and hospitality sector, infrastructure issues and multiple taxation needs to be addressed. In telecom sector, there are issues related to spectrum reforms in terms of method of allocation, auction, linking the reserve price to economic downturn, trading and sharing of spectrum, auction of unutilized spectrum, definition of Adjusted Gross Revenue

(AGR) which includes non-licensed activities like interest income and forex gain and the need to bridge the growing urban-rural divide in teledensity.

In IT and ITeS sector, there are issues like the need for software products to be incentivized, need to sign a social security agreement with US as the PF Act 2008 defines international workers as those who have been posted in a country having bilateral social security agreements with India, need for patenting software as in US and European countries, focusing on software for domestic economy, shift of focus to offshore activities, issues related to safety and travel of women IT professionals and issue of multiple levels of tax for all internet downloads of software and related services. In engineering and consultancy services, the issues are need for a single nodal agency, a national register of consultants and a developed accreditation system. In construction, issues are related to UL CRA act, non recognition/ non-acceptance by government agencies of performance guarantee certificates issued by existing private sector banks and high project finance cost.

In R & D services, there is need for greater attention for innovation and research which is implementable and put to practical use. In healthcare, there are issues like many governments/ institutions being involved with the responsibilities divided between centre and states; getting international accreditation for Indian companies along with national standardized accreditation system and the need to address issues like exchange rate risk and transaction cost due to the system of refunding the deposits of foreign patients. In port services, there are issues like the many port charges in India and the port charges in India being considerably higher than in many developed countries. In shipping services, the issues include the need to replace our ageing ships with new ones. In the case of geriatric services there are issues like meeting the growing demand for houses for senior citizens, allowing foreign investment in retirement housing facilities, need for incentivizing senior citizens care companies and also providing facilities for training personnel in caring senior citizens. In financial services, there are issues like the high Non Performing Assets (NPAs) of public sector banks, FDI in Insurance sector, and issues like the minimum capitalization norms in Insurance sector.

In Education and Skill Development, there are issues like Education coming under the concurrent list with multiple controls and regulations by central and state governments and statutory bodies, need for speedy implementation of skill development policy and quality of

education issues. In the case of trade and transport services, there are issues related to constraints faced by retail outlets like low sales, low productivity, low and inefficient supply chain, over regulated industry, multiple taxes, archaic labour laws and high real estate cost; restrictions on inter-state movement of goods which could ease with the adoption of the model Agriculture Produce and Marketing Committee (APMC) Act by many states; the Multimodal Transportation of Goods Act 1993 which needs revision to ease the existing restrictions on transportation and documentation through different modes of transport, particularly restrictions in the Customs Act which do not allow seamless movement of goods; and restrictions on free movement of cargo between Inland Container Depots (ICDs), Container Freight Stations (CFSs) and Ports. In accounting services, there are issues like FDI not being allowed and Foreign Service providers not being allowed to undertake statutory audit of companies as per the provisions of the laws in India and prohibition of use of individual logos for partnership and single proprietorship accounting firms.

Conclusion: This is only an indicative list and not an exhaustive list of issues, policies and domestic regulations. Removing some of the restrictions and addressing the policy issues mentioned here could help in the growth of the different services. A targeted approach with focus on big ticket services could lead to exponential gains for the services sector in particular and for the economy in general.



## **I - Emerging Global Economic Situation & Services Sector**

### **World Economy and Trade**

The world economy has been receiving shocks at regular intervals since the 2008 crisis. While, there was recovery in global economy after the 2008 crisis, with developing countries leading the recovery and developed countries like US and Euro Area countries facing unemployment and recessionary trends, a reversal of roles seems to have taken place recently. As per the IMF's World Economic Outlook, October, 2013, advanced economies are gradually strengthening whereas, the growth in the emerging market economies has slowed down. This confluence is leading to tensions, with emerging market economies facing the dual challenges of slowing growth and tighter global financial conditions. Each update of IMF has lowered its earlier estimate in the last few years. In the October 2013 update of the World Economic Outlook, the IMF has lowered its world output projections (from the July 2013 projections) by 0.3 and 0.2 percentage points to 2.9 percent and 3.6 percent for 2013 and 2014, respectively. Actual world output growth in 2012 was at 2.9 per cent with 1.5 per cent growth for advanced countries and 4.9 per cent for emerging market and developing economies (EMDEs).

The advanced economies are projected to grow at 1.2 per cent and 2.0 per cent in 2013 and 2014 respectively with no lowering of projections. But there is a lowering of projections for emerging market and developing economies (EMDEs) by 0.5 and 0.4 percentage points for 2013 and 2014. As a result they are now expected to grow by 4.5 per cent and 5.1 per cent in 2013 and 2014 respectively. India's growth has been lowered sharply by 1.8 and 1.1 percentage points for 2013 and 2014 respectively resulting now in a projected growth rate of 3.8 per cent and 5.1 per cent in 2013 and 2014 respectively. (India's actual growth rate in 2011 was 6.3 per cent and in 2012 it was 3.2 per cent.)

World trade volume (goods and services) growth decelerated from 6.1 percent in 2011 to 2.7 per cent in 2012 as per the IMF with projections at 2.9 per cent for 2013 and 4.9 per cent for 2014 which have been lowered by 0.2 and 0.5 percentage points respectively from July 2013 projections. Exports of Advanced economies are projected to grow by 2.7 per cent and 4.7 per cent in 2013 and 2014 respectively with downward revisions, while exports of EMDEs

are projected to grow by 3.5 per cent and 5.8 per cent in 2013 and 2014 which are lower by 0.8 and 0.5 percentage points respectively from July 2013 projections.

Some green shoots for world economy are also noticed which are as follows:

- GDP growth of USA at 2.8 per cent during Q3 of 2013 and picking up of Euro Area's GDP growth, though low at 0.1 per cent and of EU 28 at 0.2 per cent in Q3 of 2013.
- Export/import growth of many important countries is picking up with US export growth at 0.4 per cent in Sept 2013, EU's at 6.7 per cent in Sept 2013 and China's at 5.6 per cent in Oct 2013. However, its import growth in October increased by 7.6 per cent. Though World Trade Organization (WTO) has also lowered its forecasts for world trade growth to 2.5 per cent for 2013 (down from the 3.3 per cent forecast in April) and 4.5 per cent in 2014 (down from 5.0 per cent), it has said that conditions for improved trade are gradually falling into place.

### **Services GDP and Trade: Global Scenario**

The services sector has the highest sectoral contribution in global GDP with a share of 67.5 per cent in world GDP of US\$70.2 trillion in 2011, as per UN National Account Statistics. While the growth of world economy decelerated in 2012, the services sector growth in some major countries also decelerated and this trend is continuing in 2013 with the growth deceleration of US consumption expenditure on services at 0.1 per cent in Q 3 of 2013 as compared to 1.2 per cent in the previous quarter. In India also, the growth of services sector has decelerated to 6.6 per cent in Q1 of 2013-14 from 7.7 per cent in Q1 of 2012-13 and 5.9 per cent in Q2 of 2013-14 from 7.6 per cent in Q2 of 2012-13. Unlike India, the latest country estimates of some countries like China and Brazil in 2013 show acceleration in growth rate of services sector. For example, in China, services growth accelerated to 8.4 per cent in first three quarters of 2013 over same period of 2012. In Brazil also, the rate has increased to 2.4 per cent in Q2 of 2013 over the same period of 2012.

World services export growth which increased by 12.5 per cent in 2008 (as per WTO data), fell sharply by 9.5 per cent to USD 3.5 trillion in 2009. It bounced back in 2010 with 9.7 per cent growth and 11.5 per cent in 2011. However, in 2012, world services export growth rate was a tepid 2 per cent. While world trade in services is dominated by the developed countries, emerging economies like China and India are now playing an increasing role. India is the most dynamic exporter of commercial services in the world, the highest among the top 10

exporters. It ranks 6<sup>th</sup> among the leading world exporters of commercial services in 2012 with a value of \$ 148 billion and a share of 3.4 percent and growth of 8 percent. China ranks 5<sup>th</sup> with a share of 4.4 percent, but a lower growth rate of 4 percent in 2012.

As per the WTO's latest quarterly estimates, world exports of commercial services grew by 5.0 per cent in Q2 of 2013 compared to 1 per cent growth registered in Q2 of 2012. While, the exports of commercial services registered a growth at 4.0 per cent in both US and EU during Q2 of 2013, the exports of commercial services growth from India registered a low growth of 2 per cent and from Brazil, a negative growth of 2 per cent. However, in Russia and China, the services exports grew by 15 per cent and 8 per cent respectively during Q 2 of 2013.

## II - India's Services Sector

### India's Services GDP

The share of services in India's GDP at factor cost (at current prices) increased from 33.5 per cent in 1950-51 to 55.7 per cent in 2011-12 and to 56.9 per cent in 2012-13. If construction is also included, the service sector's share increases to 65.0 per cent in 2012-13.

The ratcheting up of the overall growth rate (CAGR) of the Indian economy from 5.7 percent in the 1990s to 8.8 percent during 2004-05 to 2010-11 was mainly due to an acceleration in growth of the services sector from 7.5 per cent in the 1990s to 10.2 per cent during 2004-05 to 2010-11. Since 2011-12, in line with the general growth trend, the growth rate of services sector also decelerated. However the growth deceleration of the services sector was lower than that of the overall growth. Services sector growth rates were 8.2 per cent in 2011-12 and 7.1 per cent in 2012-13. In the first two quarters of 2013-14, growth of services sector was 6.6 per cent and 5.9 per cent respectively.

### FDI in Services Sector

The services sector remains the most attractive sector for foreign direct investment (FDI) inflows in India. As per the latest data on FDI released by Department of Industrial Promotion and Policy (DIPP), the combined FDI share of 'financial and non-financial services, construction development, telecommunications, computer hardware & software, and hotel & tourism' is 46.0 per cent of the cumulative FDI equity inflows during the period April 2000-August 2013. (Table 1) These five sectors are also among the sectors attracting the highest cumulative FDI inflows to the economy with financial and non-financial services topping the list during the period April 2000 to August 2013.

**Table 1 : Services Attracting Highest FDI Equity Inflows** (in US \$ million)

Ranks	Sector	2010-11	2011-12	2012-13	Cumulative (Apr. 2000-Aug 2013)	Percentage to total	Growth Rate	
							2011-12	2012-13
1	Services sector	3,296	5,216	4,833	38,430	19.0	58.3	-7.3
2	Construction	1,655	3,141	1,332	22,672	11.2	89.8	-57.6
3	Telecommunications	1,665	1,997	304	12,879	6.4	19.9	-84.8
4	Computer Services	780	796	486	11,943	5.9	2.1	-38.9
5	Hotel & Tourism	308	993	3,259	6,790	3.4	222.4	228.2
Top five services		7,704	12,143	10,214	92,714	46.0	57.6	-15.9
Total FDI inflows		34847	46553	36,860	201,743	100	33.6	-20.8

*Source:* Based on FDI statistics of DIPP.

In 2011-12, FDI inflows to the services sector (top five sectors including construction) grew robustly at 57.62 per cent to US \$ 12.14 billion compared to the growth of overall FDI inflows at 33.6 per cent. However, in 2012-13, overall FDI inflows fell by 20.8 per cent to US\$ 36.86 billion from US\$ 46.55 billion in the previous year. Following this trend, FDI inflows in the top five services also fell by 15.9 per cent to US \$ 10.21 billion.

### **India's Services Trade**

The overall openness of the economy reflected by total trade, including services trade as a percentage of GDP shows a higher degree of openness at 59.5 per cent in 2012-13 compared to 38.1 per cent in 2004-05. The openness indicator based only on merchandise trade is at 46.5 per cent in 2012-13 compared to 28.3 per cent in 2004-5. The share of India's services trade to total trade (goods & services) at 21.9 per cent in 2012-13 is also marginally higher than the 21.4 per cent in 2011-12, though, it is much lower than the 27 per cent recorded in 2006-07.

India has also been moving towards a service led export growth. While the CAGR of merchandise export growth during 2004-05 to 2008-09 was at 22.2 percent, services export growth was at 25.3 percent. As a result of the slowdown in world economy, services sector's exports growth has slowed down in 2009-10 and was at (-) 9.4 percent. In 2010-11 it jumped to 30.2 per cent which is also partly due to the base effect. However after that services export growth started decelerating to 13.1 per cent in 2011-12 and 3.4 per cent in 2012-13. Services import growth which was at 35.3 per cent in 2010-11 became negative at -4.5 per cent in 2011-12, but grew by 5 per cent in 2012-13. Net services which grew by 21.8 per cent in 2010-11, grew sharply by 45.3 per cent in 2011-12, as import growth was negative. However in 2012-13, with sharp deceleration in services export growth, net services growth was a tepid 1.4 per cent resulting in a lower cushion provided by services trade to finance the current account deficit (CAD).

In 2013-14 (April-Sept), there is again a pick up in services export growth to 3.4 per cent, while import growth was negative at (-) 3.9 per cent. As a result net services grew by 12.6 per cent.

In 2012-13, among the major services exports, there is negative growth in transport services (a reflection of the external trade situation); travel services (a reflection of international trade situation and despite the depreciation of the rupee) and financial services; low growth for

computer software services but good growth for other business services (Table 2). In the first half of 2013-14, there is pick up in growth of travel services (4.8 per cent), robust growth in financial services (34.3 per cent) and construction (37.2 per cent), continuation of low growth in computer services (5.6 per cent) and negative growth in other business services (-0.1 per cent).

**Table 2: Growth Rate of India's Services Trade**

	Value (\$ million)	Growth Rate (Per cent)					
	2012-13	2010-11	2011-12	2012-13	Q1 2013-14	Q2 2013-14	H1 2013-14
<b>Total Services Exports</b>	<b>145,677</b>	<b>30.2</b>	<b>13.1</b>	<b>3.4</b>	<b>2.1</b>	<b>4.7</b>	<b>3.4</b>
Transport	17,334	27.8	27.7	-5.1	-2.7	-1.6	-2.1
Travel	17,999	33.2	16.9	-2.5	9.1	0.9	4.8
Construction	1,004	20.8	18.8	24.9	61.5	15.8	37.2
Insurance and pension services	2,227	22.3	35.3	-15.4	-5.5	-1.9	-3.7
Financial services	4,949	76.3	-8.3	-17.1	37.7	31.1	34.3
Telecommunications, computer, and information services	67,785	6.4	15.9	6.0	6.6	6.3	6.4
Telecommunications services	1,686	-17.1	9.4	2.0	51.5	26.4	38.4
Computer services	65,867	6.8	17.2	5.9	5.5	5.7	5.6
Information services	232	72.4	-82.5	118.6	-34.0	65.0	8.1
Other business services	28,447	102.1	7.6	15.8	-4.6	4.6	-0.1
<b>Total Services Import</b>	<b>80,763</b>	<b>35.3</b>	<b>-4.5</b>	<b>5.0</b>	<b>-5.5</b>	<b>-2.1</b>	<b>-3.9</b>
Transport	14,806	15.9	18.0	-10.0	1.1	-16.5	-8.3
Travel	11,823	18.0	24.8	-14.1	-3.3	3.7	0.2
Construction	1,220	16.0	-13.1	21.3	32.7	14.4	23.6
Insurance and pension services	1,409	8.9	7.0	-5.9	5.6	-6.3	-0.9
Financial services	4,633	61.2	6.7	-42.0	66.4	-6.6	34.6
Charges for the use of intellectual property n.i.e.	4,159	20.2	32.3	29.7	33.8	-41.8	-10.2
Telecommunications, computer, and information services	3,511	15.3	-13.1	7.8	8.6	19.8	14.1
Other business services	30,349	48.5	-4.4	19.2	-18.4	4.4	-8.1
<b>Net Services</b>	<b>64,915</b>	<b>21.8</b>	<b>45.3</b>	<b>1.4</b>	<b>12.6</b>	<b>12.5</b>	<b>12.6</b>

Source: computed from RBI data

Sector-wise in 2012-13, among the major services imports, only 'other business services' with a share of 37.6 per cent and 'charges for the use of intellectual property' with 5.1 per cent share, had high and positive growth of 19.2 per cent and 29.7 per cent respectively. However, in the first half of 2013-14, among major services imports, only 'financial services' and 'Telecommunications, computer and information services' had high growth.

### III: Performance of India's Services Sub-Sectors

Trade, hotels, and restaurants as a group is the largest contributor to GDP among the various services sub-sectors with an 18.7 per cent share, followed by financing, insurance, real estate, and business services with a 17.1 per cent share in 2012-13. Among the major broad categories of services, 'trade, hotels & restaurant' category's growth accelerated to 9.1 per cent in 2012-13 from 6.2 per cent recorded in 2011-12. However, the growth of 'financing, insurance, real estate and business services', and 'transport, storage & communication' decelerated to 8.6 per cent and 1.9 per cent in 2012-13 respectively.

The quarterly estimates of services sector growth during 2013-14 show a decelerating trend from Q1 of 2012-13 onwards. The growth rate of services sector during the Q1 and Q2 of 2013-14 was at 6.6 per cent and 5.9 per cent compared to 7.7 per cent and 7.6 per cent in Q1 and Q2 of previous year (Table 3). The slowdown in services growth in Q1 and Q2 of 2013-14 is mainly due to slowdown in trade, hotels, and restaurants category to 3.9 per cent and 4.0 per cent respectively. Construction sector's growth which decelerated to 2.8 per cent in Q1 grew by 4.3 per cent in Q2 of 2013-14. The growth rate of 'community, social & personal services' during Q2 decelerated to 4.2 per cent from 9.4 per cent in Q1 of 2013-14. On the other hand, growth rate of 'financing, insurance, real estate and business services' was high at 8.9 per cent in Q1 and 10.0 per cent in Q2 of 2013-14.

**Table 3 : Sector-wise share & growth rate of Service Sector**

Sector/Sub Sector	Share (at current prices)	Growth Rate ( at constant prices)									
		2012-13	2010-11	2011-12	2012-13	2012-13				2013-14	
						Q1	Q2	Q3	Q4	Q1	Q2
<b>Total Services (excluding construction)</b>	<b>56.9</b>	<b>9.8</b>	<b>8.2</b>	<b>7.1</b>	<b>7.7</b>	<b>7.6</b>	<b>6.7</b>	<b>6.6</b>	<b>6.6</b>	<b>5.9</b>	
<b>Total Services(including Construction)</b>	<b>65.0</b>	<b>9.8</b>	<b>7.9</b>	<b>6.8</b>	<b>7.6</b>	<b>7.1</b>	<b>6.2</b>	<b>6.3</b>	<b>6.2</b>	<b>5.8</b>	
<b>Trade, hotels &amp; restaurant #</b>	<b>18.7</b>	<b>11.5</b>	<b>6.2</b>	<b>9.1</b>	<b>6.1</b>	<b>6.8</b>	<b>6.4</b>	<b>6.2</b>	<b>3.9</b>	<b>4.0</b>	
Trade	17.2	11.5	6.5	9.5							
Hotels & restaurants	1.5	10.8	2.8	4.9							
<b>Transport, storage &amp; communication</b>	<b>6.8</b>	<b>13.8</b>	<b>8.4</b>	<b>1.9</b>							
<b>Financing, insurance., real estate &amp; business services</b>	<b>17.1</b>	<b>10.1</b>	<b>11.7</b>	<b>8.6</b>	<b>9.3</b>	<b>8.3</b>	<b>7.8</b>	<b>9.1</b>	<b>8.9</b>	<b>10.0</b>	
Banking & insurance	5.9	14.9	13.2	7.9							
Real estate, Ownership of dwellings & business services	11.2	6.0	10.3	9.3							
<b>Community, social &amp; personal Services</b>	<b>14.3</b>	<b>4.3</b>	<b>6.0</b>	<b>6.6</b>	<b>8.9</b>	<b>8.4</b>	<b>5.6</b>	<b>4.0</b>	<b>9.4</b>	<b>4.2</b>	
Public administration & defence	6.1	0.0	5.4	3.3							
Other services	8.2	8.0	6.5	9.1							
<b>Construction</b>	<b>8.1</b>	<b>10.2</b>	<b>5.6</b>	<b>4.3</b>	<b>7.0</b>	<b>3.1</b>	<b>2.9</b>	<b>4.4</b>	<b>2.8</b>	<b>4.3</b>	
<b>Overall GDP</b>	<b>100</b>	<b>9.3</b>	<b>6.2</b>	<b>5.0</b>	<b>5.4</b>	<b>5.2</b>	<b>4.7</b>	<b>4.8</b>	<b>4.4</b>	<b>4.8</b>	

Source: computed from CSO data,

Note: # - {'transport, storage & communication' sectors are clubbed in quarterly figures}.

## Performance of Major Services Sub-sectors

### Trade and Tourism Services

While overall GDP growth and even services GDP growth decelerated during 2012-13, the growth of 'trade, hotels and restaurant services' category accelerated to 9.1 per cent from 6.2 per cent in 2011-12. Out of this, the main component - trade with a share of above 15 percent in India's GDP in the last seven years (17.2 percent in 2012-13) grew by 9.5 per cent to Rs.8,87,837 crore. Hotels and restaurant services also grew by 4.9 per cent in 2012-13 as compared to 2.8 per cent in 2011-12. However in Q1 and Q2 of 2013-14, following the general trend, even the combined growth of 'trade, hotels & restaurants' decelerated to 3.9 per cent and 4.0 per cent respectively.

Trade: Indian retail trade is currently in a transformational stage. An expanding middle class, rising incomes and spending power, majority of youth in total population, rapid urbanisation and several other factors have shaped India's consumption pattern. As per the industry estimates, Indian retail industry accounting for around 14-15 per cent of GDP, is estimated to be worth around US\$ 500 billion currently. As per the estimates of the Department of Consumer Affairs, the domestic retail market is projected to be worth US\$ 1.3 trillion by 2020. Future prospects pose a tremendous growth opportunity for retail players, domestic as well as foreign, with increasing popularity of businesses like online shopping and direct selling. McKinsey Global Institute predicted that India's consumer market would be worth US\$ 1.5 trillion by 2025, surpassing Germany to become the fifth largest economy (behind the US, Japan, China and the UK) in the world. Home to one of the top five retail markets in the world, India offers immense scope of growth and opportunities in this area with almost 90 per cent of the Indian retail sector controlled by tiny family-run shops (i.e. the unorganised segment). The organised retailers have a lot of room for further penetration in this flourishing sector. After opening FDI in retail sector in September 2012, the retail landscape is expected to change rapidly.

Tourism : As per the industry estimates, the total market size of Indian tourism and hospitality sector stood at US\$ 117.7 billion and is expected to touch US\$ 418.9 billion by 2022. Tourism has been identified by the WTO and OECD, as one of the key five sectors with great potential for high impact in aid for trade. Global economic conditions have greatly affected India's tourism sector with both foreign tourist arrivals (FTAs) and foreign exchange



earnings (FEEs) in dollar terms showing as sharp deceleration in 2012-13. During the first half (April to Sept) of FY 2013-14, while FEE in dollar terms has decelerated further to 1.2 per cent, foreign tourist arrivals have shown a slight pick up to 4.4 per cent (Table 4), indicating the growth in low-spending back-packers. The number of tourists availing the Visa on Arrival (VOA) scheme during January to August, 2013 has recorded a growth of 29.4 percent with a total number of 12,176 VOAs issued as compared to 9,412 VOAs during the corresponding period of 2012.

With world tourist arrivals expected to increase by 43 million every year, on an average, from 2010 to 2030 and FTAs in emerging countries expected to grow faster than in advanced economies, a goldmine of an opportunity in tourism is available for India. The industry is likely to become more competitive due to the entry of additional international flight operators, which could offer improved services to tourists. Cruise shipping is one of the most dynamic and fastest growing components of the global leisure industry. India with a vast and beautiful coastline, virgin forests, and undisturbed idyllic islands could also be a fabulous tourist destination for cruise tourists.

**Table 4: Growth Performance of Tourism Sector**

Indicators	Value	Growth ( Percentage)			
	2012-13	2010-11	2011-12	2012-13	(April-Sept) H1 of 2013-14
Foreign Tourists Arrivals ( in lakhs)	66.94	10.0	9.7	2.9	4.4
Foreign Exchange Earnings ( Rs Crore terms)	99,594	13.7	26.5	19.1	9.4
Foreign Exchange Earnings ( US \$ million terms)	18,319	17.9	19.5	5.6	1.2

Source: Based on Ministry of Tourism data

### **Transport related Services**

Aviation services: Air transport currently supports 56.6 million jobs and accounts for over US\$ 2.2 trillion of the global gross domestic product (GDP). India is currently the 9th largest aviation market handling 121 million domestic and 41 million international passengers. Today, more than 85 international airlines operate to India and 5 Indian carriers connecting over 40 countries. However, the problems in the Indian aviation sector continued in 2012-13 which is reflected in the performance of the passenger travel. The total number of passengers

travelling by air drastically dropped by 4.79 per cent in 2012-13 to 94.8 million, in comparison to 12.05 per cent growth achieved in 2011-12. Out of this, there is a relatively high fall of 5.24 per cent in domestic travel compared to international travel with 4.09 per cent decline. International cargo handled by airlines which fell by 5.66 per cent in 2011-12 fell further in 2012-13 by 8.83 per cent reflecting the worsening external trade situation. However, the total number of passengers travelled by air and cargo handled during the first half of 2013-14 grew by 6.3 per cent and 1.4 per cent compared to the declines of 4.8 per cent and 6.5 per cent, respectively, in 2012-13.

Shipping services: India's total fleet strength in terms of gross tonnage also declined by 7.34 per cent to 10.2 million GT during 2012-13. While, gross tonnage of Indian fleets declined during 2012-13, the business of ship scrapping in India sharply increased by more than three times with scrapping of 69 ships in 2012-13 as compared to only 20 ships in 2011-12. However, during first half of 2013-14, there has been increase by 0.5 per cent in gross tonnage with an addition of 22 ships in Indian fleet strength and reaching a total number of ships at 1,186 as on Sept 30, 2013.

Port services: During 2012-13, Port traffic handled by all Indian ports grew by 2.20 per cent over the previous year to reach 934.01 million tonnes as a result of the increase in port capacity. In 2012-13, the 9.75 per cent growth of port traffic handled by non-major ports compensated the decline in growth by 2.57 per cent in major ports. The three ports-related performance indicators for major ports show improvement in 2012-13. The average output-per-ship-berth-day improved to 13,149 tonnes in 2012-13 compared to 10,575 tonnes in 2011-12. The average pre-berthing detention time (PBDT) for major ports declined from 2.05 days in 2011-12 to 0.49 days in 2012-13. The average turn round time (TRT) also marginally improved to 3.94 days in 2012-13 compared to 4.56 days in 2011-12. This greater efficiency of ports may be due to slow down of external trade as well as increase in Indian port capacity during 2012-13.

India's 12 big ports, which account for about 58 per cent of the total cargo shipped through the country's ports, handled 321.1 million tonnes (MT) of goods during 2013-14 (April-Oct). Container cargo volumes at these 12 ports stood at 4.34 million standard containers (TEUs) during April-Oct 2013, as per the data of the Indian Ports Association (IPA).

Rail transport services: The performance indicator of rail transport services, the freight traffic by railways increased by 4.2 per cent to reach 1, 010 million tonnes in 2012-13 whereas, the net tonne kilometer of railways declined by 3.9 per cent to 641.8 billion. However, recent data for the first half of 2013-14 shows an increase of 6.2 per cent in freight traffic as well as a 2.7 per cent increase in the net tonne kilometer over the corresponding period of previous year.

Storage Services: The warehousing services sector plays an important role in the Indian economy. Warehousing services are an integral part of both inbound and outbound logistics as the goods produced have to be stored in different geographical locations before shipping/dispatch as per demand/order inflows. The warehousing sector also provides ancillary services like handling, transportation, pest control, farmer extension schemes, dedicated warehousing at doorsteps and consultancy. As per the Central Warehousing Corporation (CWC), the storage capacity has reached 106.3 lakh MT at the end of 30<sup>th</sup> Sept 2013 with 86 per cent utilization.

### **Real Estate Services**

As per the Central Statistical Office (CSO) data, the 'real estate and ownership of dwellings and business services' sector valued at Rs 5,343 billion in 2012-13 accounted for 9.7 per cent of the overall GDP at factor cost at 2004-05 prices. The contribution of this sector has increased by 0.7 per cent in last 9 years driven by increase in economic growth. There was decline in contribution to GDP in 2010-11 due to slow growth to 6 per cent witnessed in this sector, but the sector regained its position in 2011-12 and 2012-13 with growth of 10.3 and 9.3 per cent respectively. The growth of construction sector with as share of 8.1 per cent to GDP decelerated in 2011-12 to 5.6 per cent and further decelerated to 4.3 per cent in 2012-13 and to 2.8 per cent in Q 1 of 2013-14 and 4.3 per cent in Q2 of 2013-14.

As per the Centre for Monitoring Indian Economy (CMIE)'s economic outlook, the real estate and construction sectors are among the largest contributors to the exchequer. In the year 2011-12, the sector contributed Rs. 120 billion to the exchequer. The real estate sector of India is expected to post annual revenues of US\$ 180 billion by 2020 as compared to US\$ 66.8 billion in 2010-11, registering a compound annual growth rate (CAGR) of 11.6 per cent. In fact, the demand is expected to grow at a CAGR of 19 per cent between 2010 and 2014,

with tier I metropolitan cities projected to account for about 40 per cent of this. As per National Skill Development Council's Report 'Human resources and skill requirements in the building, construction and real estate services sector (2022)', this sector currently employs 145 million employees and would require additional 10.47 million people by 2022. According to estimates by the Credit Rating Information Services of India Limited (CRISIL), the demand-supply gap in India's housing sector will stand at 75.5 million units by the end of 2014.

## **Some Select Business Services**

### **IT and ITeS Services**

India's total IT industry's (including hardware) share in the global market stands at 7 per cent; in the IT segment the share is 4 per cent while in the ITeS space the share is 2 per cent. As per a report by Gartner, IT spending in India is projected to reach US\$ 71.5 billion in 2013, an increase of 7.7 per cent as compared to US\$ 66.4 billion projected for 2012. The enterprise software market in India is expected to reach US\$ 3.92 billion in 2013, registering a growth of 13.9 per cent over 2012 revenue of US\$ 3.45 billion.

The IT- Business Process Management (BPM) sector remains the largest foreign exchange earning sector with the exports of this sector contributing 52.3 per cent to India's total services exports of US \$ 145.68 billion in 2012-13. However, with the uncertain international economic conditions, the growth of IT-BPM service revenues (both software and hardware) decelerated from 14 percent in 2011-12 to an estimated 7.5 percent reaching US\$108.4 billion in 2012-13 as per NASSCOM data (Table 5).

The growth of software sector (with 87.7 percent share in IT-BPM services) decelerated from 15.0 percent in 2011-12 to 8.4 percent in 2012-13, with growth of domestic revenue of software decelerating from 9.7 percent to a 1.9 per cent and exports decelerating from 16.5 per cent to 10.2 per cent during these years. While as per NAASCOM, IT-BPM (Software) export growth is 10.2 per cent, the growth of computer services as per RBI was only 5.9 per cent as growth was very low in last two quarters of 2012-13. For 2013-14, NASSCOM has estimated a growth of 13-15 percent for total IT-BPM revenue, 12-14 percent for exports and 13-15 percent for domestic sector.

**Table 5: IT-BPM : Annual Revenues**

Sector	Value ( USD billion)					Growth Rate		
	2008-09	2009-10	2010-11	2011-12	2012-13E	2010-11	2011-12	2012-13E
<b>IT-BPM service Revenues</b>	<b>69.3</b>	<b>74.2</b>	<b>88.5</b>	<b>100.9</b>	<b>108.4</b>	<b>19.3</b>	<b>14.0</b>	<b>7.5</b>
<b>Software</b>	<b>59.9</b>	<b>64.0</b>	<b>76.3</b>	<b>87.7</b>	<b>95.2</b>	19.2	15.0	8.4
Exports	47.1	49.7	59.0	68.8	75.8	18.8	16.5	10.2
Domestic	12.8	14.3	17.3	19.0	19.3	20.6	9.7	1.9
<b>Non-software (Hardware)</b>	<b>9.4</b>	<b>10.1</b>	<b>12.1</b>	<b>13.1</b>	<b>13.3</b>	<b>19.6</b>	<b>8.2</b>	<b>1.3</b>
Exports	0.4	0.4	0.4	0.4	0.4	0.0	5.0	0.0
Domestic	9.0	9.7	11.7	12.7	12.9	20.4	8.3	1.3

Source: NASSCOM

### Engineering and Consultancy Services

The Indian engineering sector is of strategic importance to the economy owing to its intense integration with other industry segments. The total exports of Indian engineering goods sector stood at US\$ 56.7 billion during 2012-13 and are expected to grow to US\$ 125 billion by 2013-14. Exports from the engineering segment have registered a compound annual growth rate (CAGR) of 11.0 per cent over the period 2008-13. The engineering industry has been de-licensed and enjoys 100 per cent foreign direct investment (FDI). In engineering consultancy, by having comparative advantage of lower cost, Indian engineering service providers enjoy a crucial place, with about 23 per cent of the overall engineering and R&D outsourcing pie as stated by management consulting firm Zinnov. The cost of engineering services in India is approximately one eighth of UK and one third of South East Asian Countries. India's exports in the R&D and product engineering segment are currently US\$ 16.3 billion and are poised to grow exponentially over the coming years.

### Research and Development (R & D) Services

India was ranked seventh globally in terms of research and development (R&D) investments in 2012. Its R&D investments are expected to increase to US\$ 45.2 billion in 2013 from US\$ 38 billion in 2011. India ranks ninth globally in the number of scientific publications and 12th in the number of patents filed. By 2020, the global share of publications is expected to double and the number of papers in the top 1 per cent journals will quadruple from the current levels. However, as per the Global Innovation Index (GII) 2013, India's rank has slipped by 2 positions from 2012 and is now ranked at 66<sup>th</sup> among the 142 most innovative countries.

## **Health Care Services**

The Indian healthcare industry, which comprises hospitals, medical infrastructure, medical devices, clinical trials, outsourcing, telemedicine, health insurance and medical equipment, is expected to reach US\$ 160 billion by 2017. On the back of continuously rising demand, the hospital services industry is expected to be worth US\$ 81.2 billion by 2015 as per industry estimates. The Indian hospital services sector generated revenue of over US\$ 45 billion in 2012. This revenue is expected to increase at a compound annual growth rate (CAGR) of 20 per cent during 2012-2017, according to a business research and consultancy firm RNCOS report titled, 'Indian Medical Device Market Outlook to 2017'. The hospital and diagnostics centre sector in India received foreign direct investment (FDI) worth US\$ 2.02 billion, while 'drugs & pharmaceuticals' and 'medical & surgical appliances' industry received FDI of US\$ 11.39 billion and US\$ 717.61 million, respectively during April 2000 to August 2013.

India is fast becoming the preferred destination for high-end pathology and diagnostic services. The highly fragmented diagnostics and pathology labs market in India is at US\$ 3.4 billion, according to a report by Pricewaterhouse Coopers. An increasing number of hospitals from the UK, US, Middle East and neighbouring countries are tying up with Indian diagnostic centres to conduct laboratory tests. The Indian diagnostic services market is expected to grow at a compound annual growth rate (CAGR) of around 26 per cent during 2012-2015 on the back of huge investments, fast expansion into tier II & III cities, and strong government support strengthening the healthcare infrastructure in the country. According to RNCOS research report "Booming Clinical Trials Market in India", the number of clinical studies by domestic and global players has sharply risen. India, over the last decade, has developed significant capabilities in clinical trials, along with certain capabilities in project management and data management.

## **Banking and Financial Services**

India's Rs 77 trillion (US\$ 1.25 trillion)-banking industry is the backbone of the economy. The sector remained strong even after the global financial crises and which shook most of the developed economies. Indian banking sector is expected to become fifth largest in the world by 2020 as per the report prepared by KPMG in association with the Confederation of Indian Industry (CII). Bank credit is expected to grow at a compounded annual growth rate (CAGR) of 17 per cent in the medium term, eventually leading to higher credit penetration in the economy.

A robust insurance sector is a boon to a country's economy. Industry body CII projects the growth rate for Indian insurance industry in 2013-14 at around 5 per cent. It also projects that 60 per cent of non-life insurance companies would record an average growth of more than 10 per cent. Increasing the FDI limit from 26 per cent to 49 per cent in the sector is being viewed as a major factor to push the insurance density in India. The Insurance Regulatory and Development Authority (IRDA) estimated that the insurance business in India would touch Rs 4 lakh crore (US\$ 65.32 billion) by the end of 2013-14.

### **Education and Skill Development**

Education and skill development are crucial for reaping the demographic dividend. The market size of Indian education sector is expected to increase to Rs 602,410 crore (US\$ 95.80 billion) by 2014-15 on the back of strong demand for quality education, according to a report by India Ratings. Indian education sector's market size in 2011-12 was estimated at Rs 341,180 crore (US\$ 54.20 billion). The sector grew at a compounded annual growth rate (CAGR) of 16.5 per cent during 2004-05 to 2011-12.

Considering the importance of education and skill development, the Government of India has set itself an aggressive target of achieving 30 per cent gross enrolment ratio (GER) in higher education by 2020, which translates into doubling the GER in the next eight years. According to the Ministry of Human Resource and Development (HRD) data, enrolments have increased from 15.5 million (GER of 12.4 per cent) in 2006-07 to 17.3 million (GER of 15 per cent) in 2009-10 and further increased to 27.5 million (GER 19.4 per cent) in 2010-11.

Realising the fast growth of education sector in India, many private companies are looking for relevant acquisitions and alliances in this space. Major investments are being seen in the areas of pre-schools, private coaching and tutoring, teacher training, development and provision of multimedia content, educational software development, skill enhancement, IT training and e-learning. The private education sector is estimated to reach US\$ 70 billion by 2013 and US\$ 115 billion by 2018, according to a consulting firm Technopak.

## **Telecom and related Services**

Telecom sector is another sunrise sector in which India has made a mark with the second largest telephone network in the world, next to China. The Indian telecom industry has been the flag-bearer of the Indian liberalization /reforms process driving connectivity from a meager 0.8 per 100 persons in 1994 to over 73 per hundred persons today. As per Industry estimates, telecom sector contributed 6.9 per cent of GDP in 2012-13 providing employment to more than 5.7 lakh employees. However, total telecom connections declined to 899.86 million as on 30<sup>th</sup> Sept 2013 as compared to 965.5 million as on 30<sup>th</sup> June, 2012. This decline in telecom user base has been primarily due to removal of inactive mobile telephone connections by the service providers. Teledensity (the number of telephones per 100 population) which is an important indicator of telecom penetration, increased from 18.22 per cent in March 2007 to 73.01 per cent as on 30<sup>th</sup> Sept 2013, with urban teledensity at 144.02 per cent and rural at 41.70 per cent, providing the best possible services at one of the most affordable rates globally. Moreover, the Telecom sector's revenue grew by 13.4 per cent to reach US\$ 64.1 billion in 2012-13.

As per a study of Cisco Systems, Inc., Internet traffic in India is expected to reach 2.5 exabytes per month in 2017 from 393 petabytes per month in 2012. In addition, the wireless connectivity in India is expected to grow at about 40 per cent traffic by 2017, up from 38 per cent in 2012. As per the Network Readiness Index 2013 issued by the World Economic Forum (WEF) on parameters like Broadband Internet subscriptions, Mobile Broadband subscriptions per 100 population, India is ranked 102 out of 144 countries. Incidentally the same index ranks India at number 6 and 4 on Affordability in terms of Mobile Cellular tariffs and Fixed broadband and internet tariffs respectively at PPP levels. .



#### **IV - Recent Policy Measures in Services Sector**

The government has been taking many policy reforms in services sector. Some of the recent reforms are as follows:

- The budget 2013-14 has set aside of Rs 14,000 crore for capital infusion into banks with a plan to leverage by asking banks to raise additional equity capital from the open market, in proportion to the non-promoter shareholding in each bank. Besides there are many other measures taken in the financial services sector like allowing Banks to open branches in tier-I cities without seeking the Reserve Bank of India's prior approval in each case subject to fulfilling certain inclusion criteria in underserved areas in proportion to their expansion in the urban areas.
- To help R & D services, India plans to set up a dedicated Rs 5,000 crore (US\$ 806.45 million) fund – India Inclusive Innovation Fund – to boost scientific innovations that can improve the life of the common man. The Union Government will initially contribute Rs 100 crore (US\$ 16.13 million) to this fund. Under the Union Budget 2013-14, a sum of Rs 4,727 crore (US\$ 762.42 million) for medical education, training and research has been allocated. In addition, Rs 3,415 crore (US\$ 550.81 million) for agricultural research and Rs 200 crore (US\$ 32.26 million) has been set aside to fund organizations that will scale up Science and Technology (S&T) innovations.
- To help the shipping sector, in Budget 2013-14, Ships and vessels have been exempted from excise duty. Consequently, there will be no CVD on imported ships and vessels.
- To help the IT sector, the government has notified safe harbour rules which aims to remove uncertainties related to transfer pricing. This will be applicable for 5 assessment years starting from assessment year 2013-14. Accordingly the ceiling of Rs. 100 crore on transactions in the routine nature of IT and ITeS activities has been removed and transactions upto Rs.500 crore has been provided safe harbour margin of 20 per cent and transactions above Rs.500 crore has been provided safe harbour margin of 22 per cent. Similarly, the ceiling of Rs.100 crore provided for transactions

in the nature of corporate guarantees has also been removed. The safe harbour would be available in case of transactions above Rs.100 crore only if the wholly owned subsidiary has been rated to be of adequate to highest safety by a rating agency registered with SEBI. The safe harbour margin for such transactions above Rs. 100 crore has been reduced to 1.75 per cent of the amount guaranteed. Besides rationalizing KPO definition, operating margin has also been reduced from 30 per cent to 25 per cent and the ceiling for KPO transactions has also been removed.

- The government has also taken many policy initiatives recently to liberalize the FDI policy for the services sector. These are given in Table 6:

<b>Sector/Areas</b>	<b>FDI Cap</b>	<b>Route</b>
Single Brand Retail Trading	Upto 49% 49% to 100%	Automatic FIPB
Basic and Cellular Services	Upto 49% 49% to 100%	Automatic FIPB
Courier Services	100%	Automatic
Asset Reconstruction Companies	Upto 49% 49% to 100%	Automatic FIPB
Insurance	49% (Subject to Parliament Approval)	Automatic
Multi-Brand Retail	51%	FIPB (Subject to certain conditions)
<u>Air Transport Services</u>		
Scheduled	49% (100% for NRIs)	Automatic
Non-Scheduled	49%	Automatic
Helicopters / Seaplane (requiring } DGCA approval)	49% to 74% (100% for NRIs) 100%	FIPB Automatic
Teleports, DTH Cable Network, Mobile TV, Head-in the Sky Broadcasting Service (HITS)	49% 49% to 74%	Automatic FIPB
Cable Network	49%	Automatic

Source: Prepared based on information from DIPP

## V: Policy Issues in Services Sector

There are two major set of issues in services sector. The first is related to market access issues for India's services abroad and second is related to Domestic regulations and policy issues in India.

**A) Market Access for India's Services Exports:** There are a number of market access barriers, some visible and some less visible which hinder India's services exports. Some examples are as follows:

- In the case of **Business Services**, access to the US market, remains non-transparent and unsatisfactory as licensing of professional service suppliers is generally regulated at State level. In addition to this, there are the Buy American provisions.
- In the case of **legal services** while some of the states, namely, New York, Texas, Washington D.C., and California allow overseas lawyers to practice within the state, the system and requirements are set by the concerned state bar associations and therefore differ from state to state.
- In the case of shipping, in US the market access obstacles are many like the many types of assistance in US to its domestic shipping sector such as a minimum of 50% of government shipments for US registered ships, limitation of use of ships built in US in internal waters, huge subsidies etc.
- In the case of **construction and related engineering services and urban planning and landscape services**, the "Buy American" or "Buy local" legislations passed in many states of US have gone to the extent of even insisting on the materials used (i.e. cement) to be domestically manufactured for public works projects financed by state funds.
- In the case of financial services, particularly in insurance, overseas companies face 56 jurisdictions in US each of which has its own system of licensing, solvency and

regulations with visible discrimination like need to be licensed in another state before seeking a licence in a state.

- In the case of Port services, there is the issue of Harbour Maintenance tax (HMT) and Harbour services fee in US of 0.125% . While US has stopped collecting HMT on exports, it is still being collected on imports.
- UK Government's plan to seek 3,000 pounds refundable bonds from Indians applying for UK visas in the immediate future is the latest issue and a matter of concern. However, as of now, this plan was dropped by UK government.
- USA proposed law which makes US visas restrictive for Indian companies is also a major concern. The proposed immigration reform legislation in the United States include S. 744, the Border Security, Economic Opportunity, and Economic Modernization Act of 2013; HIR 2131, the SKILLS Visa Act; and HR 15, the Border Security, Economic Opportunity, and Immigration Modernization Act. On the positive side, these bills would increase the number of H-1B visas available to technology companies so that they would have greater access to high skilled talent to help their businesses grow. The bills also seek to eliminate counterproductive backlogs in the green card process that prevent many talented people from becoming permanent US residents. However, in the process of addressing these critical issues, there are serious concerns about provisions of the bills that would undermine the intent of the bills, and would impose numerous restrictions and discriminatory practices that could create long term damage to US businesses and the US economy. The provisions of greatest concern are the following.

(1) Proposed ban on contracting for services of H-1B and L-1 workers for visa dependent companies: Both S 744 and HR 15 would implement a ban on contracting for the services of H-1B and L-1 workers for any employer with more than fifteen percent of its workforce on H-1Bs or L-1s. This is a substantial concern. Many companies engage vendors to develop, implement and maintain complex technology systems, and the complexity of these systems often requires the services of highly skilled individuals who may hold H-1B or L-1 visas. In particular, with a global delivery model, it is critical that some of the employees of the companies spend time on-site at

client locations. These employees are often in the United States on H-1B or L-1 visas. This provision unnecessarily hinders the ability of businesses to organize and deploy their workforces when and where they need them to serve US customers. Equally alarming is the fact that, the provision essentially dictates to U.S. customers which consulting companies they can use. This restriction is ostensibly to prevent H-1B and L-1 workers from being used as “labor for hire.” In any event, the visa status of a particular employee should not be a factor in what projects that individual may participate, and the proposed ban on “contracting for” the services of an H-1B or L-1 worker could directly control how companies can utilize their workers. This would be a sea change in the U.S. government’s control of operations of private companies, and could have negative effects for India as well as US. Ironically, this restriction also penalizes companies in the technology consulting industry that perform work in the US, while benefitting consulting companies that outsource most of the work abroad. Companies that essentially shift all of the work outside of the United States and thus do not utilize a significant number of H-1B or L-1 visas, for instance, are put in a better position than companies that perform substantial work in the United States by bringing talent to the US to supplement their US workforce. Creating an incentive for technology consulting companies to shift work offshore is not a positive economic policy even for the United States.

- (2) Limits on Total Percentage of H-1B and L-1 Workers : S 744 and HR 15 would also impose arbitrary limits on the percentage of H-1B and L-1 workers that could make up a company’s workforce in the US. The limits would be:
- October 1, 2014 – September 30, 2015 – no more than 75%
  - October 1, 2015 – September 30, 2016 – no more than 65%
  - October 1, 2016 and after – no more than 50%

This provision is tempered somewhat by an exception in the bills such that “intending immigrants” -- defined as those employees for whom the green card process had been started by the company-- would count as US workers and would not count toward the H-1B or L-1 population for purposes of determining percentages. It is critical that this intending immigrants concept remain in the bills, so that employers are not penalized because of the green card backlog or processing delays. It is because of the backlog and these delays that some companies need to keep extending H-1B or L-1 status for

employees who are going to be permanent additions to the US workforce as soon as their green card applications are approved. In calculating a company's total H-1B or L-1 population, those intending immigrants for whom the green card process has been started should be counted as US workers.

- (3) Border Security Fee Increases : S 744 and HR 15 would also arbitrarily impose unreasonably high visa fees on companies with more than 30% of their US workforce on H or L visas. Under the bills, new visa fees would rise to \$5,000 beginning in FY 2015 through FY 2024 for employers with more than 30% and less than 50% H-1B and L-1B workers. For FY 2015 through FY 2017, there would be a \$10,000 fee for employers with more than 50% and less than 75% H-1B and L-1B workers.
- (4) Increases to Above-Market Wages for H-1B and L-1 Workers : All three of the proposed bills would significantly increase wage requirements for employees on temporary work visas, such as H-1Bs and L-1s, to wages that are well above the market rate in the United States. Under the proposal, even entry-level workers would have to be paid at least 80% of the mean wages for the occupation, regardless of what the data actually shows entry-level wages to be. The bills would also effectively prohibit the use of independent compensation surveys, meaning that the US government's wage data would be the only source to show the market rate, which has not always been reflective of US market wages. The practical effect of this change would be dramatic. For example, the required wage for an entry-level Software Engineer in the Newark, New Jersey area would increase from around \$71,000/year to more than \$97,000/year, and required wages for a middle-tier Software Engineer in the Newark area would increase from around \$96,000/year to almost \$122,000/year. For some companies, this would mean that employers could be forced to pay non-US workers more than their US workers.

All these changes are proposed even when it is well documented that there exists a shortage of qualified highly-skilled workers in the United States, particularly in science, technology, engineering, and mathematics fields, and it is for this reason that many companies go to the significant expense of sponsoring foreign workers for H-1B and L-1 visas. A government-imposed requirement to pay above-market wages effectively penalizes employers for making the decision to keep jobs in the United

States rather than offshoring them. This hurts the ability of those companies to be competitive with companies in other countries that do not face this kind of additional government-mandated expense.

(5) Processing Delays and Lack of Predictability in Adjudications: Separate and apart from the proposed legislation, many information technology companies struggle with processing delays under the existing rules, and with a lack of predictability in agency adjudications. Applications that have been routinely approved in the past, for instance, will suddenly and without explanation be denied. This causes substantial uncertainty for employers, and impedes business planning. In fact the United States will greatly benefit from allowing skilled professionals to remain in the United States and become citizens that fully contribute to the American economy. Moreover policies enacted should be applicable to all companies equitably without regard to volume of visa usage or business model, such as product versus services models. Discriminatory policies that differentiate between and among companies bias the free marketplace and unfairly confer competitive advantage on some companies at the expense of others.

**B) Domestic regulations & policy reforms for services:** There are many Domestic Regulations for Services in other countries and also in India. Disciplining the many domestic regulations could help in growth and exports of services. Some of the domestic regulations existing in India and some domestic policy reforms needed in India are the following. These can be classified under the (i) General issues which cut across sectors and (ii) sector specific issues.

(i) **General Issues:** some of the general issues are the following:

- Nodal Agency: Despite having a strong growth potential in various services sub-sectors, there is no single nodal department for services. There is an urgent need to have proper institutional framework to tap the opportunities in services sector in a coordinated way. Even the inter-ministerial committee for services set-up under Department of Commerce has not made much headway.
- Promotional Activities: There is a need for greater marketing of services and increasing visibility of India's services abroad. This could be done by setting up a portal for services providing all information on India's services sector in one place, showcasing India's competence in services including non-software services, having regular services related

exhibitions/ symposiums/ abroad and using the services of dedicated brand ambassadors and experts in the areas of services.

- Linkages with other sectors: The linkage effect is considered to be high in services sector. As per industry estimates, around 20 per cent services output is consumed by end consumer whereas the rest 80 per cent is used by others sectors like manufacturing in B2B mode. So, if manufacturing sector grows, services sector will automatically growth further. The absence of this linkage is now being felt in the hardware sector as a major parts of Electronics goods have 'nil' import duty due to ITA-1 since entered into force in 1997. While many economies of South East Asia had developed their semiconductor sector by then. India did not and now it is difficult to do so. As a result the benefit of a hardware-software combination linkage could not be reaped. Recently the Government has taken some measures like notifying the National Policy on Electronics (NPE) to develop the hardware sector with an objective to achieve revenues of about US\$ 400 billion by 2020 with an investment worth US\$ 100 billion and provide employment to around 28 million by 2020. The NPE aims at achieving a turnover of US\$ 55 billion of chip design and embedded software industry and US\$ 80 billion of exports in the sector. The Government of India also plans to set up over 200 electronic manufacturing clusters. These could also help in the growth of software sector.
- Database: Lack of good data base for services sector data is a big challenge for policy analysis. Many committees have been formed like the Expert Committee to render technical advice for development of Service Price Index (SPI), Technical Advisory Committee (TAC) to develop methodology for compilation of the Index of Services Production (ISP) and an Expert Group on Strengthening of Institutional Mechanism for Regular Collection and Compilation of Data on International Trade in Services set up by MOSPI. The RBI has also been rationalizing its classification of services. While these could help, quicker outcomes are needed.
- Ease of doing Business: The speed of Business approval is another issue. In India there is a lot of delay in getting clearances. On the other hand, in the US, for example, the United States Delivery Center of MindTree in Florida University could start functioning within a span of 3 months. Interestingly, even Florida State offered US \$ 9.1 million for starting business and Florida University provides campus infrastructure.



- Tax and Foreign Trade Policy related: Service tax has become an important source of revenue for the Government. In 2012-13 a collection of Rs. 132,697 crore of service tax accounted for around 13 per cent of total tax revenue. However, there are a number of issues related to taxation policy which needs to be addressed to help the growth of services sector. Some of them are as follows:
  - There seems to be some discrimination in the matter of Bank Guarantee to be submitted for import / indigenous procurement of capital goods against EPCG by a service provider. In terms of custom circular 58/04 dated 21.10.2004 as amended, the Units in the manufacturing sector are granted the concession of 15 per cent of the duty saved as Bank Guarantee irrespective of the volume of their past export turnover. Even a new comer, is permitted this concessional facility if he is a manufacturer. On the other hand, when it comes to service providers they are granted the concessional rate of 15 per cent, only if they have free foreign exchange earning of Rs. 50 lakhs or more during the preceding financial year. This issue needs to be addressed.
  - The methodology of calculating foreign exchange for the SFIS (Served from India Scheme) benefit has been restricted on 'net' Foreign Exchange earned. This restriction is not imposed for merchandise exports where benefits like VKGUY, FPS, FMS, MLFPS, SHIS, and Incremental Incentive etc are allowed on 'gross' foreign exchange earnings. The exports of a manufacturer exporter or a merchant exporter and their export incentives are calculated on gross earnings of the foreign exchange and the deduction applied is only the Bank charges. However for the incentives given to a service provider, all foreign exchange outflows like interest on foreign currency loan, marketing commission, foreign travel and promotional expense, etc are deducted. This issue needs to be examined and addressed.
  - Any anomalies in Double Taxation Avoidance Agreements should be set right. For example the Double Taxation Avoidance Agreement (DTAA) with Japan does not exempt Technical Services provided by Indian firms/companies. This needs to be addressed.
  - Retrospective Amendment of Tax Laws: In recent years, the Indian government has enacted certain amendments to tax laws that have a retrospective effect, such as the

amendment to the definition of royalty to include payment of any rights via any medium for use of computer software. Such retroactive changes result in significant uncertainty to otherwise established and widely-accepted application of tax laws, and can serve to undermine investor confidence in a fair and reasonable taxing system. To promote economic growth and continue to foster a strong investment climate in India, amendments to tax laws should be prospective only and not serve to amend established tax principles. The Government of India is also taking steps in this direction.

- Mergers and Acquisitions occurring outside India: Pursuant to an amendment to Section 9 of the Income Tax Act, all mergers/acquisitions occurring outside India may now have potential Indian tax implications. This proposal creates tremendous uncertainty in evaluating and pursuing acquisitions outside of India. The Indian government is enacting exemptions from Indian taxation for mergers and acquisitions occurring outside of India.
- Certain Tax related Administrative Measures: There is a need for the Income Tax Act, through amendment of rules, to bring more certainty to the following administrative issues, including:
  - Establish a specified time frame for refunding taxes; in particular, once the income tax authorities, tribunals and courts have issued a judgment/decision in favor of the assessee;
  - As a matter of right, allow an set-off of the refunded amount against any tax demand; and
  - Establish a grievance procedure for addressing issues when an assessee finds the proceedings before an officer as being unreasonable and irrational.
- Intellectual property (IP) Box: Typically, companies, park profits in the form of intellectual property related income streams like royalties, milestone incomes etc. These incomes are sheltered in holding companies located at 'tax heavens' in order to ensure that bulk of the profits are taxed at lowest potential rates. In order to discourage siphoning of such profits and to encourage creation of intellectual property ('IP'), UK has recently (in June 2013) introduced tax benefits in the form of 'Patent Box' such that incomes earned by companies from patents owned in the UK, is taxed at concessional rate of 10%. India is an IP starved country and it could

encourage creation and harboring of the IP in the country, by providing tax incentives in the form of 'IP Box' (going beyond 'Patents; and covering all forms of intellectual property including copyrights, trademarks, brands, patents etc.).

- Credit related: Credit facilities and particularly producing collateral is another issue for services sector. There is a need for 'Collateral Free' soft loans to support the service sector's cash needs. Even export or business orders could be considered as collateral for credit worthy service firms.
- Disinvestment: There is plenty of scope for disinvestment in the case of PSUs in services sector under both central & state govts. In Prasad and Sathish (2010) had listed out some PSUs for disinvestment. SCI, NBCC, EIL, Balmer & Lawrie company Ltd, Engineering Projects India Ltd, STC were earlier listed for strategic sales. However in Feb 2005, disinvestment through strategic sale of profit making CPSUs were called off as per the NCMP and the above companies continued as CPSUs. There is need to examine this issue and speed up disinvestment in some services sector PSUs which could not only help in government earning revenue, but could also speed up the growth of services sector.
- FDI / Privatization of Railways: Besides the existing policies on FDI in many services sectors, FDI or atleast privatization in Railways could be thought of. This has been successful in some countries, but not in others. Atleast some activities under railways could be privatized as is being done now.
- Employment: There are reports of retrenchment by companies even in Services Sector. This is a disturbing development as young employees will suddenly find themselves left helpless particularly when job market is not encouraging. This has not only social implications but also economic implications including the housing finance sector. The government has come up with some schemes in the budget to incentivize private sector to employ more people. This includes among others the Rs.1,000 crore set apart for National Skill Development scheme and the deduction of 30 per cent of additional wages paid to new regular workman by companies under section 80JJAA. While there is competition in employing young professionals during good times, problems start during recessions and a safety net is needed during such times.

## **(ii) Sector Specific Policy Issues**

### **1) Aviation Sector:**

- The services for MRO (Maintenance, Repairing and Overhauls) is one of the big ticket areas, but there are difficulties due to high duty structure on imported spare parts and complicated duty drawback scheme. In fact under the duty exemption scheme for importing raw materials used for exports, as per the current practice, import content in exported items is calculated in weight terms (kg) for duty exemption purpose whereas, it should have a balance between weight and value. For example, raw materials contained in final product is only 20 per cent in terms of weight due to scrap content being high in MRO services. Exemption is allowed only for 20 per cent whereas import duty needs to be paid on remaining 80 per cent of imports also. This is despite the fact that in value terms exports are high compared to imported raw materials. Even, Under Advance License Scheme, Input Output norms needs to be relooked into. Due to these anomalies, MRO services are less competitive in India. As a result most of India's aircraft go to Dubai, Singapore and Malaysia for repairs and maintenance. There is also competition from other countries like China and Brazil. Recently, the MRO service in aviation sector has been granted infrastructure status, which is likely to boost these services.

### **2) Tourism & Hospitality Services:**

- This sector is a goldmine of opportunity which has not really been tapped. If tapped well, it can lead to higher and inclusive growth. India's share in world tourists inflows was only 0.64% in 2011 (rank 38), while that of USA was 11.3% and of China 4.7%. Interestingly, the share in world tourism expenditure of India is relatively higher at 1.61% (rank 17) implying that foreign tourists spend relatively more in India. Singapore, a small country currently attracts 6 million tourists and has has a fixed target of 10 million in a year. But a large country like India attracted only 6.7 million foreign tourists during 2012-13. Better Tourism Infrastructure even by PPP mode and addressing issues like high luxury tax on hotels by States is necessary. Even the MGNREGA scheme can be used for developing permanent assets like Tourism Infrastructure.
- The benefits of rupee depreciation can be reaped in the tourism sector only if there is proper tourism infrastructure and safety for tourists. Media hype and publicity on issues

related to safety of women also adversely affect tourism, with some countries even issuing travel advisories in the Indian case, which is a matter of concern.

- Medical tourism is an important area where India needs to use its full potential as it has a comparative cost advantage of low medical treatment. Even if travel costs are included, medical treatment in India is much cheaper and super specialty medical services are of international standards. Even tier II cities cater to these services.
- Countries like Sri Lanka have eased VISA rules such as the system of electronic travel authorization in practice. India also needs to do the same to boost tourism.
- Hospitality sector has to face multiple taxes as can be seen from the following table:

Table 7 : Multiple Taxes in Hospitality Industry

TAX on Services	State Government	Central Government
1. Room Rent	- Luxury Tax	Service-tax
2. Restaurants	- Value Added Tax(VAT)	Service-tax
3. Banquets	- Value Added Tax -Luxury-tax& Mangalya Nidhi	Service-tax
4. Bars	- Extra ordinary Licence fees -VAT, purchase tax	Service-tax
5. Business & Ayurvedic Centres	Luxury-tax	Service-tax

While the Goods and Services Tax (GST) could ease the situation, there is a need to address this issue of multiple taxes to help this potential sector.

### 3) Telecom Sector:

- Telecom sector was considered as the second sun-rise services sector of India after software. However, the recent controversies related to this sector have taken away the shine from this sector. Investment in India in networks last year was USD 3 billion as against USD 55 billion in China. Nevertheless this is still a promising sector. There are many issues in the telecom sector like multiple levies and duties, license fees computations including unrelated activities like revenue from sale of handsets, capital goods etc., and hiccups in policies and procedures.

- The issues on Telecom sector such as spectrum reforms in terms of method of allocation, auction, linking the reserve price to economic downturn, trading and sharing of spectrum, unutilized spectrum and unified licensing, etc need to be addressed and the road map on Spectrum needs to be laid down. The fundamental resource for mobile telecommunication is radio frequency spectrum which is a limited natural resource. Transparent allocation of this resource is the need of the hour, not just for industry but for the government from fiscal aspect and the consumers from better and qualitative service offerings. Openness and transparency in allocation of limited natural resources is essential to revive investor confidence. There is also the issue of taking into account the hard economic realities of the day while fixing reserve price. Further there is need to auction all available spectrum as leaving spectrum idle/un-utilized creates no value for and gives no benefit to society. Keeping this resource as inventory is a waste of this valuable resource. The non-utilization of available spectrum is an opportunity lost forever.
- An allied and one of the important aspects of spectrum reforms is the issue of spectrum usage charges - whether it should be uniform or not and whether it should discriminate between technologies.
- Spectrum trading & sharing and a liberal mergers and acquisitions policy that allows consolidation and hive-off of spectrum/business are the other issues which need to be examined carefully and addressed. While TRAI has given its recommendations on these issues, the Telecom Department has not fully accepted them.
- There is also the issue of the definition of Adjusted Gross Revenues (AGR) which forms the basis for payment of license fee and spectrum charges as it includes revenues that do not arise from telecom activities. The definition of AGR should not include the non-licensed activities like interest income and forex gain.
- Another issue is the need for Right Of Way (ROW) which has also been recognized in National Telecom Policy (NTP)-2012, which enunciates the need to review and simplify sectoral policy for Right of Way for laying cable network and installation of towers, etc. for facilitating smooth coordination between the service providers and the State Governments/ local bodies.

- Other issues include, Active Infrastructure Sharing, and Utilisation of the USO Fund. The Government has not been able to utilize the fund for the purpose for which they were collected.
- There is also the need to bridge the growing rural-urban digital divide in teledensity (41.70 % vs. 144.02 %), support and deliver the benefits of broadband revolution to the common man and the rural heartlands. In addition, new technologies and business requirements growing at unprecedented scales are emerging fast e.g. machine to machine (M2M), Cloud communication (ie. Internet-based voice and data communications where telecommunications applications, switching and storage are hosted by a third-party outside of the organization using them, and they are accessed over the public Internet), Mobile-governance, etc. However, in order to power this revolution, going forward, significant capital infusion is still required along with continued supportive Government policies, as the sector is under acute debt and operational burden. Debt levels are unsustainable for majority of operators.

#### 4) IT and ITeS sector:

- Computer and software services constitute three different sectors or segments of business which should ideally be broken into three different sectors for policy announcements and also for measuring and reporting exports. These sectors are: (1) IT Services (2) BPO and (3) Software products. Currently all the above are clubbed into one single bucket termed as software exports, though they have distinct characteristics which need to be differentiated.
- There is a need to encourage and incentivise software product exports as software products are far more profitable. As per industry sources, only about 25 per cent of the revenues of IBM come from software products but profits therefrom constitute 50 per cent of IBM's profits. IBM, Microsoft and Oracle's revenues from Software Products is around US \$120 billion (excluding services). However, Software product development and exports need larger investments in both development and marketing. This needs to be recognized and weighted deduction of R&D expenses @ 125 per cent could be considered.
- In software sector, the major impediment is increasing cost of operations in development of services for exports, due to market access issues like VISA fees & regulations, wages

policies, etc ( e.g. competition from increasing wages in NORDIC countries) and hiring local talent. There are also many challenges of wage parity from Continental Europe.

- The issue of Wage Parity under PF Act 2008 in the light of Social Security Agreements: As per this act, International workers are those who have been posted in a country with bilateral social security agreement. India has signed such agreement with 15 countries which does not include US, the major partner in IT for India. Because of this PF act, those posted in US are treated as domestic workers and come under PF Act, which leads to increase in cost for the company. While the definition given in PF Act for international workers needs to be relooked, India also needs to sign the bilateral social security agreement with USA.
- Focus on use of software in domestic economy including social welfare schemes could be furthered. However, recent reports show that the private sector is disinterested in this. Private IT companies are not interested in Government schemes- mainly because of the delayed payment. However some IT firms have been working with the DRDO, UID projects, etc. Big companies can manage if there is delay in payment, but smaller companies find it difficult to manage.
- Need to shift focus from on-site services to offshore activities which do not face much opposition from developed countries like the US. Today on-site services constitute 45 per cent of TCS revenues, 51 per cent of Infosys revenues and 58 per cent of HCL revenues. It surprises many to learn that the world's largest exporter of services, the USA which exported US \$640.3 billion in 2012 rendered most of these services offshore and not onsite. Therefore, there is a need to encourage offshore services.
- Countries like the US are objecting to long-term visas. They do not object to short-term visas which are important to the IT Industry. For example, Dancers and Singers etc. are permitted to perform for short-term assignments overseas. Similarly, short-term visas should also be given to IT professionals.
- India should encourage sales of software in the domestic market. No industry can depend on foreign markets alone. Software brings about an increase in efficiency and productivity



which is good for the nation. There is scope for use of software even in Agriculture. In one farm in Karnataka, there is even RFID tag for cattle.

- Bulk of the India's services exports is software exports, and today the major destination of the software exports is USA. Factors like US visa bill, green card issues, opting local companies for software services make business more expensive for the Indian software company in US.
- India does not patent any software but can only have a copyright for this, whereas western world can have patents. This needs to be examined.
- Need to improve urban transport facility (travel time) and concerns about women's security as more than 50 per cent of IT workforce is women. Their security and travel time need to be addressed. In big metro cities, if travel times take around 4 hours, too and fro to work place from residence, productivity is affected. There is also a need to develop Tier II and III cities.
- There are also the issues of intellectual property protection and Preferential Market Access (PMA) policies on the global IT services sector. Longstanding tensions over intellectual property protections between the United States and India have fueled additional political incentives to use immigration policy regarding the export of Indian professional services as a potential bargaining tool in continuing negotiations between the US and India. For example, many business interests in the United States and Members of Congress believe that India is failing to respect the intellectual property rights of US pharmaceutical manufacturers, harming both imports into India and increasing the import of lower cost, Indian produced generic drugs into the US market. Large trade associations in the US, including PhRMA, the National Association of Manufacturers, and the US Chamber of Commerce, have challenged the US government to deal strongly with the Indian government on these issues and pressure it to respect the intellectual property rights of US pharmaceutical manufacturers. Members of Congress have challenged the Obama Administration to do the same.

With respect to the immigration debate, the contest over intellectual property rights has likely further tainted the perceptions of US policy makers with respect to India's trade

policies and has further fostered an environment in which retaliating against India in trade related matters is viewed as acceptable. Further, in the current political environment, the risk is high that policy makers will conflate these various trade related issues in an effort to create more favorable leverage in bilateral negotiations, particularly with respect to pharmaceuticals and, as discussed below, PMA.

Similarly, India's effort to provide PMA for products has created tensions with American manufacturers seeking to import products into India, which they see as a growing market. These kinds of actions, as well as bilateral issues between the United States and India, have in turn resulted in American interests drawing upon the current political environment to encourage congressional policy makers to include restrictive provisions designed to harm the export of professional services from India. In the long term, such policies will benefit neither India nor the United States. Aggravation over PMA policies has given certain interests the incentive to pursue retaliatory immigration language, ostensibly to threaten India's desire to export professional services as leverage to pursue relief from the perceived threats to US imports. The Government of India's decision to suspend implementation of certain aspects of the PMA policy has had a favorable impact in the US and India's willingness to consider U.S. company needs in the context of the U.S./India trade relationship, has led to reducing calls for further immigration restrictions on IT services companies.

- Dual Levies on Software – VAT and Service Tax : For all internet downloads of software and related services such as maintenance contracts, there is a dual levy of both value-added tax (“VAT”) and service tax, as well as potentially tax deductible at source (“TDS”). Software downloads and aligned services are the only categories of purchases potentially subject to VAT/CST, Excise Duty/Service Tax and TDS simultaneously. There is need to address the multiple levels of tax with respect to the same transaction.

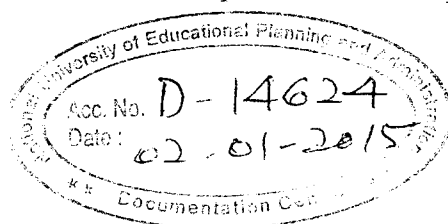
##### **5) Engineering, Consultancy Services and Construction:**

- Engineering consultancy and Management consultancy have huge potential. However there is no national register of consultants and no single nodal organization for this purpose. These issues need to be addressed.

- Many countries have well developed accreditation mechanism for consultants and incentives are provided on this basis. However, in India accreditation has started, but is in a nascent stage. Export of consulting services need to have a very well developed accreditation system.
- In construction, bottlenecks resulting from continuation of restrictions under the Urban Land Ceiling and Regulation Act (ULCRA) in some states which have not yet repealed it and the confusion in the process required for clearance of buildings even after the repeal of ULCRA by passing of the Urban Land Ceiling and Regulations Repeal Act 1999 by the other states. There is also lack of clarity on the role of states as facilitators in the land acquisition policy resulting in increasing number of court litigations adding to risk profile of builders/projects thereby restricting lenders from extending finance to such builders/projects. There are also restrictions on floor area ratio (FAR) in many states; and other restrictions like the application of bye laws/regulations and its exemptions e.g. increase in FAR which varies from project to project and is sometimes discriminatory. Obtaining environment clearance is another major hindrance.
- In construction sector, the performance guarantee certificate issued by existing private sector banks are not recognized/accepted by government agencies and the latter insist on certificates from public sector banks. This type of discrimination between private and public sector banks needs to be removed.
- Project finance cost is very high for Indian investors investing in overseas markets, while in countries like China, it is half that of India. This may be due to the subsidization by china. This needs to be examined and addressed.

## 6) Research and Development:

- It is a fact that today countries who lead in Research & Innovation are leading economically. In India, tens of thousands of rupees are spent every year on public research, be it ICAR, CSIR, BARC, Defense. However, most of the research is found to be ending in publishing of 'Research Papers' in Journals or Obtaining Patents and not even 1 per cent of the research is commercialized to reach the masses. So, greater attention should be given for innovation and research which is implementable and put to practical use.



## 7) Health Care Services:

- The main problem in healthcare is due to many governments/ institutions being involved with the responsibilities divided between centre and states. There is also a need to get international accreditation system for Indian institutions along with national standardized accreditation system.
- Telemedicine has good scope in India, but there is shortage of manpower which needs to be addressed.
- There are many overseas patients coming to India for medical treatment. At the time of admission, the hospital has to collect foreign currency and deposit it in the banks. After treatment, the remaining amount is to be paid in foreign currency to the overseas patients. This involves a huge amount of transaction cost and exchange rate risk. This issue needs to be addressed.

## 8) Port and Shipping Services:

- While there is the issue of the Indian ports not having the necessary depth or draft, there are also issues like the many port charges in India and the port charges in India being considerably higher than in many developed countries.
- The share of Indian ships in the carriage of India's overseas cargo fell sharply from about 40% in the late 1980s to 10.4% in 2011-12 with 17.05% share in India's oil imports. Meanwhile Indian ships are ageing with the average age of the Indian fleet increasing from 15 years in 1999 to 16.83 years as on 31 December 2012 (with 41.59 per cent of the fleet over 20 years and 11 per cent in the age group 16-20 years). This needs to be addressed urgently. Due to the global slowdown, prices of ships are the lowest and this is possibly an opportune time to increase our shipping fleet.
- Issue of opening up Shipping Corporation of India (SCI), a PSU, for disinvestment.

- 9) **New emerging services like Geriatric Care Services.** India with the second largest aged population in the world has been ranked 73<sup>rd</sup> (out of 91 countries) amongst the poorest of nations to grow old in global watch index (GAWI), developed by UN Fund for Population and Development. India's ranking is low compared to neighbouring Sri Lanka

that has been ranked 36<sup>th</sup> while Nepal (77), Pakistan (89) and Afghanistan (91) score even worse. The ageing index, calculated using 13 indicators under four domains namely income security, healthcare, employment and education and enabling environment, ranks Sweden as the best country to grow old followed by Norway, Germany, Netherlands and Canada while the US languishes at eight place. As per this report, India fares poorly in almost all four domains as health status ranking (85), employment and education (73), enabling environment (72) and income security (54). Some issues in this sector which need to be addressed as follows:

- There is a growing demand for houses for the senior citizen as only 5 per cent of the senior citizens have access to housing facilities. Senior citizens are also required to pay service tax for these homes. Removal of service tax imposed on senior citizens for these homes could be considered. There is also vast scope for providing retirement/ senior citizens homes for the foreigners. Currently, FEMA rules do not permit investment of foreigners in real estate, unless they get RBI approval. Accordingly, the FEMA Act needs to be amended to atleast facilitate foreigners to invest in such retirement housing facilities. This could also help India to earn more foreign exchange.
- Senior Citizens Care is a specialized subject where the providers of such services should have the requisite passion, show compassion and also be trained in Geriatric Care. Currently, there are no legislations and seeing the opportunities, a large number of “fly-by-night” operators are entering to make quick buck and dupe the senior citizens. So, there is need to spell out the qualifications for such operators as is done in other countries, carry out audits through experts and insulate the senior citizens from being duped. There is also a need for recognition of companies, which take care of senior citizens either in terms of tax incentives or easy access to funds.
- There is lack of facilities of training personnel in caring senior citizens who need special assistance due to age and or either temporary or permanent disability. This needs to be addressed.

#### **10) Financial Sector:**

- The predominance of government ownership in the banking sector is considered to have led to insufficient competition in the Indian banking system. Recently the RBI has allowed the opening of new private banks. The Indian public sector banks are also

saddled with excessive labour and higher non performing assets (NPAs) relative to both new private sector banks and foreign banks. Increasing NPAs in banking sector during Q1 of 2013-14 is a major concern.

- In Insurance sector, besides the FDI issue there are issues like the minimum capitalization norms.

### **11) Education and Skill Development:**

- Education comes under the concurrent list with multiple controls and regulations by central and state governments and statutory bodies.
- There is a need to focus more on Skill Development to reap the demographic dividend. As per National Skill Development Corporation (NSDC) 2005, 500 million skilled laborers are required. Speedier implementation of Skill Development policy is needed and training in new areas of skill like telemedicines should also imparted. Bilateral skill deals with countries like Singapore could also be thought of.
- Deteriorating quality of education in India is a big concern where reforms are needed. There is a saying now “ B.Tech is the new B.Sc. and MBA is the new BA”. This also raises the issues of employability. There are weaknesses in the AICTE (the regulator) also which needs to be reformed.

### **12) Trade and Transport Services:**

- The issues are related to opening retail trade to FDI, while there is a large unorganized sector with low tax compliance. Now FDI in retail has been opened up.
- FDI in retail can be the mechanism to ease the issues associated both with marketing and procuring agricultural sector items. Some issues in the context of retail outlets are the following:
  - Low sales per outlet (Rs 1000 – 1200 per day Rural and Rs 7000 – Rs 8000 per day Urban)
  - Low productivity of Labor (6% of USA levels)
  - Long Supply chain (5 to 6 intermediaries vs 2-3 in USA/Europe)

- Inefficient supply chain (Poor infrastructure – Roads, Storage etc and Low percentage of processed food)
- Over regulated industry (Antiquated APMC laws restricts farmers choice)
- Multiple taxes (State VAT, Central CST, Octroi, etc)
- Archaic labour laws (shift timings, holidays, contract labor issues etc)
- High Real estate costs (Cost of real estate in Cities is very high)

The above need to be examined and addressed for making the retail sector successful.

- There are also restrictions on inter-state movement of goods which could ease with the adoption of the model Agriculture Produce and Marketing Committee (APMC) Act by many states; the Multimodal Transportation of Goods Act 1993 which needs revision to ease the existing restrictions on transportation and documentation through different modes of transport, particularly restrictions in the Customs Act which do not allow seamless movement of goods; and restrictions on free movement of cargo between Inland Container Depots (ICDs), Container Freight Stations (CFSs) and Ports.

### **13) Accountancy services:**

- FDI is also not allowed in this sector and foreign service providers are not allowed to undertake statutory audit of companies as per the provisions of the laws in India. There are also domestic regulations like prohibition on the use of individual logos for partnership and single proprietorship accounting firms. These regulations need to be relaxed and streamlined to facilitate tie-ups and penetrate foreign markets given the potential for exporting these services by the outsourcing mode.

### **14) Legal services:**

- In legal services, FDI is not permitted and international law firms are not authorized to advertise and open offices in India. Foreign service providers can neither be appointed as partners nor sign legal documents and represent clients. Indian advocates are not permitted to enter into profit-sharing arrangements with persons other than Indian advocates.

## V: Conclusion

In the earlier section, an assorted list of issues, policies and domestic regulations which need to be addressed have been given. This is by no means an exhaustive list, but is only an indicative list. Removing some of the restrictions and addressing some of the policy issues mentioned in the earlier section could help in the growth of the different services. However, there is a need to carefully examine which are the domestic regulations that should continue for reasons like achieving the social goals, which are the regulations which can be removed as a *quid pro quo* in WTO and bilateral negotiations and which are the regulations that can be removed voluntarily to facilitate growth and trade in services. A targeted approach with focus on big ticket services could lead to exponential gains for services sector and for the economy.

\*\*\*\*\*



## References

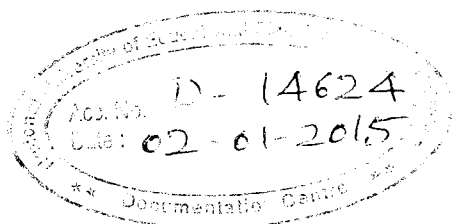
1. Balance of Payments Database of RBI, (<http://dbie.rbi.org.in/DBIE/dbie.rbi?site=home> )
2. Economic Surveys and Budget Documents; (<http://indiabudget.nic.in> )
3. FDI statistics of DIPP, (<http://dipp.nic.in/English/default.aspx> )
4. Global Age Watch Index (GAWI) Report, 2013. (<http://www.helpage.org/global-agewatch/>)
5. IMF, World Economic Outlook, 7, Oct, 2013  
(<http://www.imf.org/external/pubs/ft/weo/2013/02/> )
6. India brand equity foundation, Industry Analysis: (<http://www.ibef.org> )
7. Indian Medical Device Market Outlook to 2017, RNCOS, 2013  
([http://www.rncos.com/Press\\_Releases/Indian-Medical-Device-Market-Outlook-to-2017.htm](http://www.rncos.com/Press_Releases/Indian-Medical-Device-Market-Outlook-to-2017.htm))
8. National Accounts Data released by CSO, 2013,  
([http://mospi.nic.in/Mospi\\_New/site/inner.aspx?status=3&menu\\_id=82](http://mospi.nic.in/Mospi_New/site/inner.aspx?status=3&menu_id=82) )
9. Prasad, H.A.C. (Dr.), 2007, Strategy for India's Services Sector: Broad Contours ;  
([http://mof.gov.in/WorkingPaper/1\\_2007\\_DEA.pdf](http://mof.gov.in/WorkingPaper/1_2007_DEA.pdf) )
10. Prasad, H.A.C.(Dr.) & Sathish, R. ,2010, Policy for India's Services Sector;  
(<http://www.finmin.nic.in/workingpaper/policy%20Paper%20on%20Services%20Sector.pdf> )
11. UN National Accounts Statistics, ( <http://unstats.un.org/unsd/snaama/Introduction.asp> )
12. UNCTAD, Database accessed on 4<sup>th</sup> Oct 2013; (<http://unctadstat.unctad.org> )
13. World Bank, Database accessed on 4<sup>th</sup> Oct 2013;( <http://data.worldbank.org> )
14. World Economic Forum, The Global Information Technology Report 2013

\*\*\*\*\*

## Annexure I: Performance of India's Services Sector: Some Indicators

Sector	Indicators	Unit	Annual		Quarterly					
			2011-12	2012-13	2012-13				2013-14	
					Q1	Q2	Q3	Q4	Q1	Q2
Aviation	Total Passenger	million	99.7	94.9	24.6	21.5	24.1	24.7	25.3	23.7
	Domestic	million	60.8	57.6	15.4	12.7	14.7	14.9	15.5	14.4
	International	million	38.8	37.2	9.2	8.8	9.4	9.8	9.8	9.3
	Total Cargo	th. MT	1671.8	1563.4	409.0	394.7	391.5	368.2	406.2	417.2
	Domestic	th. MT	452.5	451.7	115.1	109.2	118.4	109.0	89.7	94.7
	International	th. MT	1219.3	1111.7	293.9	285.5	273.1	259.2	316.5	322.5
Telecom	Total	million	951.4	898.0	965.5	937.7	895.5	898.0	903.1	899.9
	Wireline	million	32.2	30.2	31.4	31.1	30.8	30.2	29.7	29.3
	Wireless	million	919.2	867.8	934.1	906.6	864.7	867.8	873.4	870.6
	Tele density	Per Cent	78.7	73.3	79.6	77.0	73.3	73.3	73.5	73.0
Tourism	Foreign Tourists Arrivals	lakhs	65.0	66.9	12.6	14.0	20.2	20.3	12.8	14.2
	Foreign Exchange Earnings	Rs. th. Cr.	83.6	99.6	18.8	22.3	28.4	30.1	20.4	24.6
	Foreign Exchange Earnings	US\$ bn	17.3	18.3	3.5	4.0	5.2	5.6	3.7	4.0
Shipping	GT of Indian Shipping	million GT	11.0	10.2	10.3	10.3	10.4	10.2	10.4	10.3
	No. of Ships	Numbers	1135.0	1164.0	1127.0	1130.0	1154.0	1164.0	1177	1186
	No. of Ships scrapped	Numbers	20.0	69.0	--	--	--	--	--	--
Ports	Traffic at Indian all Ports	mn. Ton	913.9	934.0	--	--	--	--	--	--
	Traffic at Indian Major Ports	mn. Ton	560.2	545.8	138.5	132.1	134.8	140.5	137.2	139.7
	Port Capacity	mn. Ton	696.5	744.9	--	--	--	--	--	--
	Avg. Turn Round Time( TRT)	days	4.6	3.9	--	--	--	--	--	--
	Avg. Pre-Berthing Detention Time (PBDT)	days	2.1	0.5	--	--	--	--	--	--
	Avg. Output per Ship Berth Day	Th. Ton	10.6	13.1	--	--	--	--	--	--
Railways	Freight Traffic by railways	mn tonnes	969.1	1009.8	244.8	236.6	253.9	274.5	256.8	254.2
	Net tonne kilometers of railways	billion	667.6	641.8	156.3	153.6	161.1	170.9	159.0	159.2
Storage (CWC)	Overall Storage Capacity	lakh MT	100.3	102.3	100.7	101.2	101.8	105.7	107.5	106.3
	Percentage of utilisation	Per Cent	91.0	93.0	96.0	94.0	91.0	91.0	92.0	88
	Total Nos. of warehouses	Numbers	468.0	469.0	469.0	470.0	466.0	469.0	464.0	464
IT and BPM	IT-BPM Service Revenues	US \$ mn	100.9	108.4	--	--	--	--	--	--
	Software	US \$ mn	87.7	95.2	--	--	--	--	--	--
	Exports	US \$ mn	68.8	75.8	--	--	--	--	--	--
	Domestic	US \$ mn	19.0	19.3	--	--	--	--	--	--
	Non-software (Hardware)	US \$ mn	13.1	13.3	--	--	--	--	--	--
	Exports	US \$ mn	0.4	0.4	--	--	--	--	--	--
Domestic	US \$ mn	12.7	12.9	--	--	--	--	--	--	

Source: Based on Inputs from the various organizations/ministries/depts.



NUEPA DC



D14624

\*\*\*\*\*