Strategy for India's Services Sector: Broad Contours

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1. Growing Importance of Services Sector for India

Services sector has become important for many economies in the world and very important particularly for India. While for the medium and long term, it is important to accelerate the growth of industrial sector particularly manufacturing sector to catch up with the growth of services sector and maintain a decent and stable growth of agricultural sector, which is still subject to the vagaries of nature, in the short and even medium term, the sure bet for higher growth of the Indian economy lies in further accelerating the growth of the services sector, which can be done with considerable ease compared to other sectors. This is evident from the following facts and figures.

1.1 **GDP Growth**

In India, the growth rate of services in 2004-05, 2005-06 and 2006-07 were 9.6 percent, 9.8 per cent and 11.0 per cent, respectively and is expected to grow at 9.9% in the 11th Plan. The GDP growth performance of the Indian economy during 2003-04 and 2004-05 indicated a possible ratcheting up of the trend rate of GDP growth of the economy from 6% to about 7% per year. The sectoral break-up of India's growth shows the ratcheting up of the trend growth rate in the services sector from 6.7% in 1983-93 to 8.2% in 1993-03. Since 2004-05 the growth rate of services sector is at 10 per cent, while the general growth of the economy has moved up to 9.0% in 2005-06 and 9.4% in 2006-07. The manufacturing sector growth was more or less the same at 6% in 1993-03 compared to 6.1% in 1983-93, though it has risen to 9.1 per cent in 2005-06 and 12.3% in 2006-07 with the aim of 12% (10.5% projection for Industries) in the 11th Plan period. Agriculture sector growth was low at 2.3% in 1993-03 and fluctuated from one extreme of 10 per cent in 2003-04 to another extreme of 0.0 per cent in 2004-05. In 2005-06, agricultural growth rate was 6.0 per cent, but in 2006-07 it again fell to 2.7% and is expected to continue at 4.1% for the eleventh plan period. As a result, the share of services in India's GDP has increased from 37.6% in 1993 to 54.1% in 2005-06 and 54.9% in 2006-07. If Construction is considered as services as done by RBI, this share will increase by another 6.9% totaling to 61.8 per cent. Thus, India is nearing the shares of countries like the US, where the share of services in GDP is 73% (2003).

The growing remittances in the balance of payments, reflecting the income from India's labour services abroad, indicates that for a country like India where transfers due to labour services are becoming increasingly important, a better indicator reflecting national growth and income is the Gross National Disposable Income (GNDI) which includes these transfers (besides net factor income from abroad). The absolute value of GNDI has been higher than GDP for India, though the growth rate has been more or less the same at 9.2% in

2006-07 and 9.3% in 2005-06.[1] Thus there is no doubt that India's growth in the last decade has been service led and the 2005 UNCTAD Trade and Development report has included South Asia along with East Asia as the new growth pole due to the economic dynamism of India in South Asia & China in East Asia.

Development theory usually identifies three stages of development, the 1st stage when the primary sector is the dominant sector in GDP, the second stage in which manufacturing is dominant and the third stage in which the tertiary sector is dominant and is identified with countries in an advanced stage of development. India's growth experience does not seem to follow this theory of stages as the high growth and high share of services sector which is a feature of a developed economy has been attained by India even before reaching a developed stage. Rather than debating on which growth strategy is ideal, it is important to realise that the constraints in the industrial and agricultural sectors and the natural advantage of India in services sector has led to a services led growth of the economy. While the constraints in the other two sectors need to be removed as is being attempted now, there is no need to expect the hare to sleep for the tortoise to overtake it. There is infact a need to tap our full potential in the services sector.

Services sector growth can also complement growth in manufacturing sector. There are sectors where a lot of complementarity exists between services & manufacturing growth e.g. Telecom Services and Telecom equipment manufacturing, electronic hardware & software where a hardware-software combination can accelerate growth of both hardware and software as suggested in the Medium Term Export Strategy (MTES) of the Department of Commerce, healthcare services and pharmaceutical sector, shipbuilding along with ship repair & maintenance services and shipping where growth is sure with growth in volume of trade, R&D services and pharma & biotech sectors, etc. Identifying and promoting the growth of these sectors with considerable backward – forward linkages can help growth of both services and manufacturing and some manufacturing sub-sectors can ride piggy back on the success of the complementary services to achieve quick growth.

Thus the services sector has high potential. Till now, we have been focusing mainly on software. We have many such niche sectors in services. The recent growth in export of professional services is an example of the potential of other services.

[1] GNDI figures at current prices have been deflated by GDP deflators to arrive at GNDI figures at constant prices.

1.2 **Services Export Growth**

While there is a services dominated growth, India is also moving to a services dominated export growth. While merchandise export growth was 21% in 2006-07 on the top of a 23%, growth in 2005-06, services export growth rate in 2006-07 was 32.5% on top of a 31.7% growth in 2005-06. While the $ 31.3 billion software services grew by 32.6% in 2006-07 on top of a 37.2% growth in 2005-06, the $31.1 billion non-software miscellaneous services (mainly including business services) neared the value of exports of software services with growth of 39.3% in 2006-07 on top of a 67.0% growth in 2005-06 and 150.3% growth in 2004-05. Services Exports at $ 81.3 billion in 2006-07 is nearing merchandise exports at $124.6 billion. If labour services (reflected in private transfers) are taken, then the contribution of services will be still higher.

India's share in world merchandise exports is at the 1% level in 2006 with the rank at 28, while its share in world commercial services exports is 2.7% with a rank of 10.

1.3 **Services and Balance of Payments**

Services trade has been acting as a cushion for India's current Account of Balance of Payments helping in covering the trade deficit. If remittances, which reflects a factor service like labour service is also considered, then the two components (factor and non-factor services) have more than covered the trade deficit leading to a current account surplus till 2003-04. While in 2002-03 and 2003-04, the gap between net services and net transfers was substantial, this gap has now narrowed down, and in 2006-07 net services of $32.7 billion was higher than the $ 27.4 billion net transfers. This has happened despite the liberalization of services imports resulting in a near doubling of services imports in 2004-05 compared to 2003-04 and further growths of 20.5% and 29.5% in services imports in 2005-06 and 2006-07, respectively. This is due to the near doubling of services exports in 2004-05 compared to 2003-04 and further growths of 31.7% and 32.5% in 2005-06 and 2006-07, respectively.

In today's situation, where high Petroleum prices leading to high oil imports is a reality and high non-oil imports a necessity to sustain the high growth of exports and industrial production, the best possible way to have a positive current account balance or a low current account deficit, is by boosting services exports.

There is a debate that for a developing country like India, current account deficit is needed and a current account surplus may not really be a good sign. However, the real issue is not the current account deficit, but trade deficit. If the current account surplus or low current account deficit is due to the positive impact of services and remittances, then there is no issue.

1.4 Openness of the Economy

India's trade in merchandise as a percentage of GDP which is usually used to measure the openness of an economy shows an increase from 14.7% in 1990-91 to 37% in 2006-07. If services trade which has been increasing steadily for India is also considered, total trade as a percentage of GDP shows a remarkable increase from 17.5% in 1990-91 to 52.7% in 2006-07.

1.5 FDI in Services

The world Investment Report 2004 has stated that world over there is a shift in FDI towards services. This is more so with India's FDI inflow to services sector. In 2006-07 services sector (financial & non financial) constituted around 30% of FDI equity inflows compared to the 12.5% in 2004-05. This is however an underestimate as the Department of Industrial Promotion & Policy's (DIPPs) definition of services does not include computer software, telecommunications and transport.

1.6 WTO negotiations on Services

Another important development in the services sector is the ongoing negotiations at WTO on Services. While the Doha round of negotiations which was freezed due to the stalemate in Agricultural negotiations, has been defreezed, failure of negotiations could result in loss to India in services sector where it could be a major beneficiary unlike other developing countries. A clearcut strategy for services highlighting the potential gains for India in terms of growth, employment and exports is needed to give a possible new direction to the Indian strategy in WTO negotiations.

1.7 Employment and Services

The tertiary sector is the leading sector of growth in the Indian economy not only in terms of output, but also in terms of employment. Studies show that the employment elasticity in the tertiary sector as a whole in the post-reform period (1993-2000) has been 50 per cent higher than in manufacturing sector. India's share of employment growth in the tertiary has been higher than in manufacturing sector on Usual Principal Status (UPS) basis(see Table 1). In the decades of eighties and nineties, the fall in the share in employment in agriculture sector has been increasingly absorbed by the tertiary sector. However, in 2004-05 compared to 1999-2000, there is a change with the fall in employment share of the agriculture sector being absorbed both by the manufacturing and teritiary sectors with a higher share for the former. Like other countries of South East Asia, like Malaysia, Thailand and Indonesia, in India also a larger share of employment has been created in the tertiary sectors, in the eighties and nineties.

Table 1

Shares and change in sectoral shares of employment in India(UPS basis)

	1983			1993-94			1999-2000			2004-05		
Shares	Agri	Man	Serv	Agri	Man	Serv	Agri	Man	Serv	Agri.	Man	Ser.
(percentage)	66.2	14.6	19.8	61.7	15.7	22.6	58.5	16.7	24.7	54.2	19.4	26.4
Change in shares				83 to 93-94			93-94 to 99-00			99-2000 to 2004-05		
				Agri	Man	Serv	Agri	Man	Serv	Agri	Man	Ser.
				-4.5	1.1	2.8	-3.2	1.0	2.1	-4.3	2.7	1.7

Source: Planning Commission

While the recent rise in share in employment growth in manufacturing sector is a positive development, the importance of services in employment creation needs to be noted, particularly when India is competitive in many labor-intensive and skill-intensive services and there is a huge market (both domestic & external) including outsourcing to India, which needs to be tapped further.

1.8 **Inflation & Services and Domestic Terms of Trade including Services**

The Wholesale Price Index (WPI) which is the main indicator of inflation, in India does not include services. The consumer price index for industrial workers(CPI-IW), Consumer Price Index for Urban Non-Manual Employees (CPI-UNME) and Consumer Price Index for Agricultural Labourers and Rural Labourers (CPI-AL&RL) include some services but their weightage is only about 10-15 per cent, though services form 54 percent of the GDP. While, in USA, where the contribution of services to GDP is around 73 percent, the consumer price index for all urban consumers (CPI-U) gives 59.9% weightage for services and consumer Price Index for urban wage earners and clerical workers (CPI-W) gives 55.4% weightage for services. In India, the services included in CPI-IW and CPI-UNME are Medical Care, Education, Recreation & Amusement, and Transport & Communication, while in the GDP of India the major services are trade, hotels, transport and communication and financing, insurance, real estate and business services. Even these indices are based on some sample surveys and are sometimes just approximations. A look at some services items included in CPI-IW for the latest available month shows that in May 2007, point to point inflation of Education & Recreation is only 2.0% compared to general CPI-IW inflation of 6.6%. Another item, Medical care (including both services and commodities) has inflation of only 5.9%. Transport and communication has a inflation of only 1.6% which is also a reflection of the low inflation of fuel. But none of these services have the high inflation of 9.1% of food group. While the services taken here are very limited, with the fall in prices of services like telecommunications, air transport (with no frills flights) and metro services, there is an indication that inflation could have a moderating effect, if services are included in inflation calculations. Besides, prices of services do not fluctuate at short intervals like commodity and manufacturing prices.

The expert committee to formulate services price index in India is examining the different methodologies to include services in the inflation index which would give a true picture of inflation in India. It would be interesting to see whether these services have a lower inflation rate with the growth in technology. This is also important in the context of domestic terms of trade which at present (except for a few attempts to compute domestic terms of trade including services) reflects only the prices of agriculture and manufacturing sectors. Inclusion of services in domestic terms of trade would reflect the actual change in distribution of income between all the three sectors.

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2. Export Opportunities and Export Capabilities for Services

Services, particularly the financing and transportation of goods, have played an important role in world trade for centuries. In recent years, the focus of services trade has shifted away from just facilitating trade in goods as the sector has emerged as an independent entity in itself with services trade in the four supply modes opening up new opportunities. More recently, the integration of telecommunications and computer technologies has made virtually all services tradable across borders. Rapid technological advances in the past few decades in transport, computing and telecom have resulted in enterprises making use of distant resources for production and serving wider markets. The trend of globalization, reinforced by liberalization policies and the removal of regulatory obstacles has fuelled steady growth of international investment and trade in services. Better communications and multinational enterprises have also facilitated the movement of people, both as independent service employers and employees. The convergence between computers and telecommunication technologies has had a number of significant consequences for the competitiveness of services like making it possible for firms to provide services rapidly and conveniently, locating the work force of a firm anywhere in the world, as long as they can telecommute to work, etc.

The growth of the Services sector and consequently the growth of the Indian economy, perhaps has a trade angle. Though external trade is taken only 'net' in the GDP and its effect may not be felt directly as the deficit in merchandise trade overshadows the positive balance in services trade, the indirect effects of exports of services is high on the domestic growth of services and even industry. For example, the domestically dynamic services like trade, hotels, transport and communications etc. are related to important services in exports like travel and transportation. The growth in export of software services have given fillip to domestic production and use of these services. The dynamic growth of professional services exports have a bearing on the growth of these services domestically. Similarly growth of shipping services and travel services exports can have a direct bearing on domestic industries related to these services.

The importance of the vast and growing export business opportunities for India's services sector can be seen by juxtaposing the import demand of major service importers with our export capabilities.

2.1 **World Import Basket of Services**

The import basket analysis of the $2.6 trillion world imports of services in 2006 will show the major demandeurs of services and the major types of services in demand. The top 10 importers in world commercial services in 2006 as per WTO data were USA (11.7%), Germany (8.2%), U.K. (6.5%), Japan (5.5%), France (4.1%), Italy (3.9%), China (3.8%), Netherlands (3.0%), Ireland (3.0%) and Spain (2.9%). India which moved from the 15th position in 2004 to 10th position in 2005 was in the 12th position in 2006 with 2.7% share. The growth rate of India's imports of services at 40% in 2006 was the highest among the top 30 importers with Luxembourg at second place with 23%. Infact, 73% of total imports of Services are from the leading 20 importers which include besides the above, countries like Canada, Republic of Korea, Singapore, Belgium, Russia, Denmark, Austria, Sweden and Hong Kong. Thus the major demandeurs of Services are the developed countries.

As per the latest available data for OECD countries, their share in world services imports in 2003 was 75%. Of these, the three countries/groups, namely, USA, EU-15 and Japan constitute 63.5% of world imports of services. In the case of EU, intra-EU trade was 25.2%, while extra-EU trade was 18.4%. Despite India's good performance in Services it is not among the top seven partners of any OECD country in their bilateral service trade, both in exports and imports in 2003, while China, Singapore, Taiwan, Hong Kong and even smaller and relatively less developed countries like South Africa, Croatia, Egypt, etc. appear in the list.

As per latest available Balance of Payments data of IMF, in the world imports of Services, the major service category is other services (43% share) which mainly consist of business services. (see table 2). The share of this category has steadily increased from 41% in 1998 to 43% in 2004. Travel with 26% share in 2004 is lower by about three percentage points compared to 1998. Transportation with a share of 26% has more or less retained the same share. Thus in the world imports of services, the growing importance of 'other services' can be seen.

Table 2: Share of different services in World imports of services						
	Value ($ Billion)		Percentage shares			Growth Rates
	2000	2004	1998	2000	2004	2004
1. Goods	6360.5	8989.5				21.5
2. Services	1540.8	2222.3				17.8
a) Transportation	414.4	581.5	26.2	26.9	26.2	21.2
i) Passenger Services	87.6	107.8	5.5	5.7	4.9	17.3
ii) Freight	224.3	332.8	14.5	14.6	15.0	23.6
iii) Other Transportation	102.5	140.9	6.1	6.7	6.3	18.9
b) Travel	434.3	583.8	29.0	28.2	26.3	16.9
c) Govt. Services n.i.e.	67.5	101.8	4.0	4.4	4.6	12.0
d) Other Services	624.7	955.2	40.8	40.5	43.0	16.9

Source : Calculated from IMF : Balance of Payments Statistics Yearbook 2005

In the Indian case also, the exports of 'other services' are very important with a share of 70% in total services exports in 2003 with a steady rise from around 60% in 1998 (Table 3) while the share of Travel and Transportation are falling. If we see India's exports of services as a percentage of world imports of services, 'other services' show a steady increase from 1.23% in 1998 to 2% in 2003 and the share of transport services has also increased from 0.49% to 0.65% for the same period. However, compared to India's share of 1% in world merchandise exports and 2.7% in world services exports in 2006, the share of India's transport services at 0.65% in 2003 of world transport services imports is rather low. Thus there is a need to focus immediately on transport services which includes Shipping/Aviation and related services like Port Services besides focusing on the growing business services reflected in other services'.

Table 3 : India's exports of Services as a percentage of World imports of Services : by types							
	World imports ($ billion)		India's exports ($ bn)	Percentage shares of India in world imports		Percentage share in India's total services exports	
	2003	2004	2003	1998	2003	1998	2003
1. Goods	7395.8	8989.5	59.3	0.6	0.8		
2. Services	1887.2	2222.3	23.4	0.8	1.2		
a) Transportation	479.7	581.5	3.1	0.4	0.7	15.4	13.3
i) Passenger Services	91.9	107.8					
ii) Freight	269.3	332.8					
iii) Other Transportation	118.5	140.9					
b) Travel	499.4	583.8	3.9	0.7	0.8	24.8	16.7
c) Govt. Services n.i.e.	90.9	101.8					
d) Other Services	817.2	955.2	16.4	1.2	2.0	59.8	70.1

Source: Calculated from IMF: Balance of Payments Statistics Year Book 2005

In the case of imports by OECD countries, the major services are Travel, Transportation and other business services with the former two having low growth rates in 2002 and also low average annual growth rate between 1997-2002, compared to the 7%

growth rate of other business services for both 2002 and 1997-2002. The other three services imports of OECD countries in 2002 with high growth rates for 1997-2002 were Insurance services (12.7%) computer and information services (11.4%) and financial services (7.1).

In order to see the changing and growing demand for different services, if we examine the shares of different services in total services imports of a major service importer like USA over the years as per IMF Balance of Payments data (Table 4), we can notice the rising importance of 'other services' from 39.5% in 1997 to 50.2% in 2004, while the share of transportation has fallen from 28.3% to 26.3% and travel from 32.2% to 23.5% for the same period. Among other services, the share of 'other business services' has increased from 13.88% in 1997 to 16.64% in 2004, and insurance from 3.5% to 10% for the same period mainly due to reinsurance. Leaving Government services, the next important category is Royalties and licence fees. In the case of computer and information services, which is India's major service exports to USA, US total imports of this service category is only 0.68%! This shows that if India could make a big impact in this service category which has a small share in US imports, then there are many more big ticket service items where India can make a much higher impact.

Table 4: US imports of Services: Sector-wise

	Value ($ billion)	Share in total services imports(%)	
	2004	1997	2004
Goods imports	1473.0	-	-
Services imports	296.1	100.0	100.0
Transportation services	77.9	28.3	26.3
Passenger	23.7	10.9	8.0
Freight	39.2	10.6	13.3
Travel	69.5	32.2	23.5
Business travel	0.4	0.1	0.1
Personal travel	69.2	32.1	23.4
Other services	148.7	39.5	50.2
Communications	4.9	5.3	1.7
Construction	1.0	0.3	0.3
Insurance	29.9	3.5	10.1
Financial	5.0	2.0	1.7
Computer and information	2.0	0.5	0.7
Royalties and licence fees	23.9	5.5	8.1
Other business services	49.3	13.9	16.6
Personal, cultural, and recreational	0.3	0.1	0.1
Government, n.i.e.	32.5	8.4	11.0

Source: Calculated from IMF; Balance of Payments Statistics Yearbook 2005

If the OECD data for US (which gives further details, but is only up to 2002) is taken, the share of different services in US imports (Table 5) shows that business services are becoming important in US imports, while the share of transportation and travel are falling. The share of Insurance Services has suddenly increased in 2002 (compared to 2000) to 6.8%

due to reinsurance. Though financial services also have a significant share of 4.1% in 2002, the share has fallen. Though computer and information services have a share of 1.8%, the share of computer services is only 0.46% and has fallen from 0.66% in 2000. Royalties and license fees have a significant share of 8.5% in 2002 which is an increase by about 1 percentage point. Another category of services, growing in importance is other Business services (18.3% share) consisting of a host of professional and technical services. Among them, some services like accounting, auditing, book keeping, business management, R&D and architectural services are slowly rising in importance. This indicates the need for India to focus on these services in its exports to USA, and India's export data also reveals that India is capable of exporting many of these services. The other two important services in US imports are Government services (9.6% share) due to its military units and agencies and services between related enterprises (8.5% share), indicating the need for greater FDI and involvement of US enterprises in India's services trade.

Table 5
US Imports of Services : By sub categories

	Value ($ mn)	Share in total services(%)		
	2002	1997	2000	2002
Total Services	227380.0	100.0	100.0	100.0
Transportation	58496.0	28.6	29.7	25.7
Sea Transport	19402.0	7.5	9.4	8.5
Freight	18622.0	7.2	9.1	8.2
Air Transport	24067.0	13.0	12.8	10.6
Passengers	19189.0	10.8	10.7	8.4
Freight	4878.0	2.2	2.1	2.2
Other Transport	15027.0	8.2	7.5	6.6
Travel	60843.0	32.7	30.3	26.8
Health-related expenditure	1901.0	0.7	0.7	0.8
Education-related expenditure	2466.0	0.9	0.9	1.1
Communications services	4546.0	5.4	2.7	2.0
Telecommunication Services	4180.0	5.1	2.5	1.8
Construction services	226.0	0.3	0.1	0.1
Insurance services	15348.0	2.4	3.4	6.8
Other direct insurance	3214.0	0.8	0.7	1.4
Reinsurance	11966.0	1.6	2.8	5.3
Financial Services	9265.0	3.7	5.3	4.1
Computer and information services	4193.0	1.0	1.9	1.8
Computer services	1057.0	0.4	0.7	0.5
Royalties and license fees	19258.0	5.6	7.5	8.5
Other business services	41647.0	13.8	16.2	18.3
Operational leasing services	990.0	0.7	0.5	0.4
Miscellaneous business, professional and technical services	41362.0	13.7	16.1	18.2
Legal, accounting, management consulting and public relations services	2672.0	0.9	1.0	1.2
Legal services	768.0	0.3	0.4	0.3
Accounting, auditing, book-keeping and tax consulting services	716.0	0.2	0.2	0.3

Business and management consultancy	3788.0	0.4	0.3	1.7
Advertising, market Research and public opinion polling	1360.0	0.5	0.4	0.6
Research and development	2140.0	0.3	0.4	0.9
Architectural, engineering and other technical services	312.0		0.0	0.1
Other business services	3324.0	1.2	1.2	1.5
Services between related enterprises	19367.0	8.0	8.2	8.5
Government services, n.i.e.	21799.0	8.5	7.2	9.6
Embassies and consulates	2009.0	1.1	0.9	0.9
Military units and agencies	19245.0	7.1	6.1	8.5

Source: Calculated from OECD (2005)

2.2 India's Export Basket of Services

Latest data (2006-07) of export of Services for India available mainly by broad categories shows the high growth of miscellaneous services (including software services and business services) which grew by 70.5% in 2004-05 and further by 47.6% in 2005-06 and 35.9% in 2006-07 (Table 6). Travel services exports grew by 20% and transportation by 28% in 2006-07.

Table 6: Services Exports : By Major Categories

	Value in 2006-07(P) ($ million)	Growth rate (%)in 2006-07	Shares (%)
Services (Total)	81330	32.5	100
1. Travel	9423	20.0	11.6
2. Transportation	8069	28.3	9.9
3. Insurance	1200	14.3	1.5
4. Govt. not included elsewhere	273	-11.7	0.3
5. Miscellaneous	62365	35.9	76.7
A) Software	31300	32.6	38.5
B) Non-Software	31065	39.3	38.2
i) Communication Services	2068	-5.2	2.5
ii) Construction	397	-56.7	0.5
iii) Financial	3213	88.6	4.0
iv) News Agency	438	29.2	0.5
v) Royalties, Copyrights & License Fees	164	27.1	0.2
vi) Business Services	23459	82.4	28.8
vii) Personal, Cultural, Recreational	251	96.1	0.3
viii) Others	1075	-73.4	1.3

Source: Calculated from RBI data P= Preliminary PR=Partially Revised

The major category of export of services of India is the miscellaneous services category with a share of 76.7% in total services exports in 2006-07. While software services is the major item under miscellaneous services exports, since 2003-04, non-software miscellaneous services exports have grown rapidly almost equaling the value of software services exports. The major contributors among non-software miscellaneous services are business services (75.5% share and 82.4% growth) and financial services (10.3% share and 88.6% growth). The next two important services are communications services and 'others' which have registered negative growth in 2006-07. While negative growth of communications services(6.7% share and -5.2% growth) is probably a reflection of falling prices of telecommunications services, the negative growth of others (3.46% share and -73.4% growth) is probably a reflection of the improving data classification by RBI following the recommendations of the committees to systematize the data on services. On the imports side also, business services at $20.2 billion is the most important category with a near doubling in 2006-07.

Thus, besides transportation, travel and software services, the main focus of our exports needs to be on business services, (mainly consisting of architectural, engineering & other technical services and business management & consultancy services), communications services and financial services. (Table 7). This matches well with the world demand for these services.

Table 7: Services Exports: By Sub-Categories

Items	Value (US $ million)	Growth Rates (%)		Shares	
	2005-06P	05-06/ 04-05	04-05/ 03-04	1999-00	2005-06
Services (Total)	60610	40.1	61.0	100.0	100.0
i) Travel					
Tourist Expenses in India	7789	16.8	32.3	19.3	12.9
Total	7789	16.8	32.3	19.3	12.9
ii) Transportation					
a) Sea Transport					
Surplus remitted by Indian companies operating abroad	441	112.0	477.8	0.4	0.7
Operating expenses of foreign companies in India	607	31.4	59.9	1.0	1.0
Charter hire charges	139	189.6	-48.9	0.3	0.2
b) Air Transport					
Surplus remitted by Indian companies operating abroad	193	48.5	34.0	1.1	0.3
Operating expenses of foreign Companies in India	107	0.0	494.4	0.1	0.2
Charter hire charges	21	5.0	11.1	0.2	0.0
c) Freight on exports	4424	20.9	48.2	6.8	7.3
d) Others	345	618.8	-74.1	1.0	0.6
Total	6277	34.0	46.0	10.9	10.4
iii) Insurance					
a) Insurance on export	583	22.0	28.2	1.2	1.0
b) Premium					
Life	38	52.0		0.0	0.1
Non-life	75	-74.0	2308.3	0.0	0.1

Reinsurance from foreign companies	194	921.1	111.1	0.01	0.3
c) Commission on Business received from foreign companies	78	169.0	480.0		0.1
d) Others	74	146.7	50.0	0.1	0.1
Total	1042	19.8	107.6	1.5	1.7
iv) Government Not Included Elsewhere					
a) Maintenance of foreign embassies and diplomatic missions in India	202	-11.8	23.8	1.3	0.3
b) Maintenance of international and regional institutions in India	103	-40.1	212.7	2.4	0.2
Total	305	-23.9	67.1	3.7	0.5
v) Miscellaneous					
a) Communication services	2182	57.7	39.8	6.8	3.6
b) Construction services	916	86.6	7.2	2.5	1.5
c) Financial services	1704	232.8	71.2	2.3	2.8
d) Software services	23600	33.3	38.3	25.2	38.9
Of which:					
IT Services	17300	32.1	42.4	21.6	28.5
ITES-BPO	6300	37.0	27.8	3.6	10.4
e) News agency services	339	98.2	147.8	2.2	0.6
f) Royalties, copyright and license fees	129	81.7	121.9	0.3	0.2
g) Business services (1 to 12)$	12874	149.2	298.7	4.1	21.2
1. Merchanting services	504	81.3			0.8
2. Trade related services	889	107.2			1.5
3. Operational Leasing Services	138	392.9			0.2
4. Legal services	390	51.8			0.6
5. Accounting / Auditing services	93	144.7			0.2
6. Business Management & consultancy services	3722	139.2	20.1	4.1	6.1
7. Advertising/ trade fair	435	168.5			0.7
8. Research & Development services	519	134.8			0.9
9. Architectural, Engineering & other technical services	4640	227.5			7.7
10. Agricultural, Mining & on-site processing services	35	-32.7			0.1
11. Maintenance of offices abroad services	1491	105.9			2.5
12. Environmental services	18	260.0			0.0
h) Personal, Cultural & Recreational services	128	21.9			0.2
i) Refunds/rebates	117	-69.2	645.1	0.3	0.2
j) Other services	3208	-31.0	135.9	20.9	5.3
Total (a to j)	45197	47.6	70.5	64.6	74.6

Source : Calculated from RBI data P = Provisional

Some more details are available for computer services exports of India as a result of the RBI's 'Survey on Software and IT services exports, 2002-03' which shows that almost 50 per cent of the companies reported 'Development, production, supply and documentation of customized software, including operating systems made on order for specific users' as one of their activities while the activity of 'Analysis, design and programming of systems ready to use (including web page development and design), and technical consultancy related to software' occupied second position with a share of 42 per cent as one of the activities of the companies. Majority of the computer services exports were made to USA, Canada and Europe accounting for around 87 per cent of total computer services exports. Exports to

Asian countries were only around 9 per cent of the total computer services exports. About 53 per cent of the computer services exports were offshore exports, while the rest were onsite exports. The survey also shows that nearly 90 per cent of the companies had exports of less than Rs.10 crore. However, their share in total exports was only around 6 per cent. Companies with exports of at least Rs.100 crore each, though relatively few in number, accounted for almost 83 per cent of total exports. The survey also indicated that the offshore exports held a larger share of nearly 74 to 86 per cent in respect of exports of size less than Rs.100 crore and the share was low for exports of at least Rs.100 crore. Companies with exports of at least Rs.100 crore had around 53 per cent on account of onsite exports against the survey average of around 47 per cent. Mode-1 (cross border supply) accounted for around 39 per cent of total international trade (sale) in computer services by India, while Mode-3 accounted for around 48 per cent. The higher share for Mode-3 can be attributed to the fact that companies with exports of at least Rs.100 crore had nearly 51 per cent of their trade (in terms of amount) through Mode-3. Around 13 per cent of total international trade in computer services (in terms of amount) was through Mode-4 (presence of natural persons) while the share of Mode-2 remained very insignificant. Cross border supply (Mode-1) and commercial presence (Mode-3) accounted for around 40 per cent and 45 per cent, respectively of the total trade (sales) of the top ten companies. Another interesting fact revealed is that the invoice in US dollar accounted for the maximum share at 75 per cent in total computer services exports which reduces profit margins during appreciation of the rupee *vis a vis* the dollar as could have happened recently in the case of exporters who have not resorted to hedging. US dollar together with Great Britain Pound and Euro accounted for around 94 per cent of total computer services exports. Exports in Indian Rupee and Japanese Yen had a share of less than 2 per cent each.

2.3 Country-wise Exports of Services of India

Country-wise exports of services of India is not published now by RBI, though earlier RBI used to publish data by different currency areas. Some rough indication of country-wise exports of India can be seen from the mirror data of other countries. Some examples are given below.

In US imports of other commercial services in 2003, the share of the $1.14 billion imports from India was 1.1% with a growth rate of 35.4% in 2003 over 2002. While the major sources of imports were the European & American countries and Japan, among the other Asian countries, only Hong Kong with $1.42 billion is ahead of India (though its exports to US has fallen in 2003) and India though is ahead of even Singapore. Exports to US of a NAFTA member like Mexico is nearly double that of India, though its growth rate is only 9.2%. This should be a pointer regarding the item and destination of our exports and also the need for a special agreement with USA for services. Another aspect to be seen is the share of different countries in USA's source-wise imports of other Commercial Services (Table 8). While Europe is the dominant source of imports with 50% share, the **share of other American countries at 31%, particularly NAFTA at 11% is noteworthy**. The share of Asia and Oceania has fallen from 20.5% in 2000 to 17.3% in 2003. **Among the Asian countries, India's share has not changed from 1.1%.** The share of China, Taiwan, Hong Kong and even Singapore have fallen. Among other countries, Israel which has a Free Trade Agreement (FTA) with USA has a rising share though small.

Table 8
Other Commercial Services imports of USA : Source-wise

	Value ($ min)	**Share(%)**	
Imports from	**2003**	**2000**	**2003**
World	103182		
NAFTA	10827.0	11.8	10.5
Canada	8673.0	9.3	8.4
Mexico	2154.0	2.5	2.1
OECD Asia and Oceania	10957.0	12.8	10.6
Australia	1119.0	1.4	1.1
Japan	9262.0	10.7	9.0
Korea	466.0	0.6	0.5
OECD Europe			
Switzerland	6887.0	4.6	6.7
EU-15	43356.0	43.8	42.0
United Kingdom	17478.0	18.4	16.9
France	5250.0	6.2	5.1
Germany	9164.0	7.6	8.9
Netherlands	3650.0	3.8	3.5
America	20814.0	15.0	20.2
South America			
Argentina	210.0	0.4	0.2
Brazil	595.0	0.6	0.6
Chile	114.0	0.2	0.1
Venezuela	106.0	0.2	0.1
Asia and Oceania	6862.0	7.7	6.7
Israel	652.0	0.6	0.6
Other Asia			
China	461.0	0.5	0.5
Chinese Taipei	343.0	0.4	0.3
Hong Kong, China	1427.0	2.0	1.4
India	1144.0	1.1	1.1
Phillippines	422.0	0.3	0.4
Singapore	840.0	0.9	0.8
Thailand	132.0		0.1
Total Africa	894.0	0.9	0.9
Total America	31641.0	26.8	30.7
Total Asia and Oceania	17819.0	20.5	17.3
Total Europe	51754.0	49.7	50.2

In US imports of travel services also, the European and American countries are the major sources. Mexico has greatly benefited mainly due to its proximity to USA and due to

NAFTA with a share of 12.9% in 2003, while other Latin American countries like Brazil (1.3%) and Argentina (0.6%) have a very small share. Imports from India at $726 million with 1.2% share is also low, though it is the only major source in other Asia except China with a value of $1013 million (which has also been consistently falling since 2001).

In the case of Transportation in 2003, the European and Asia & Oceania groups are the major sources besides the American countries. In Asia, Taiwan, China, Singapore and Hong Kong are the major sources. While China's share is 3.6%, India's share at 0.5% is negligible. Among Latin American countries, only Mexico has a relatively significant share of 2.9% due to NAFTA. The miniscule share of shipping services of India in US shipping services imports also points to the need for a strategy for this sector.

The above clearly indicates the need for a strategic partnership with USA which can help in increasing India's exports of different services manifold. The importance of FDI in services is also evident from the fact that US trade in services with the foreign affiliates of its companies alone is 8.5% in 2002.

Like USA, EU and Japan are also big markets and the total imports of services of OECD countries was $1.4 trillion in the world services imports of $1.8 trillion dollars in 2003.

In the case of European Union imports of total services in 2003, the $3.2 billion imports from India was only 0.4% of EU's total imports of services. In Asia, imports of EU from China (0.6%), Hong Kong (0.7%) and Singapore (0.5%) have higher shares. EU's imports of services is mainly from Europe (69.5%) followed by America (17.5%). In the case of other commercial services imports, while India's presence is visible in US, in EU, the share is only 0.3% in 2003, though the growth rate is 25.5%. In Asia, China (0.4%), Hong Kong (0.8%) and Singapore (0.5%) have higher shares than India. In travel services also, imports of EU from India is only 0.5%, though India is the second important Asian destination after Thailand (0.7%). South Africa, Mexico and Brazil also have higher shares than India. In the case of transport imports of EU also, India's share is only 0.5%, while in Asia, China (1.2%), Hong Kong (1.3%) and Singapore (1.2%) are ahead of India. Thus, in the case of Services imports, India's presence is much lower in EU than in the US. However, in the case of UK's imports of total services in 2003, India has a share of 0.9% which is the highest among UK's imports from Asian countries. In the case of other commercial services imports of UK also India has a share of 0.8%, though among Asian countries Hong Kong has the highest share of 1.3%. In the case of UK's imports of travel services, India has a share of 1.2% which is the highest among Asian countries, Latin American countries and even Japan. In the case of Transportation imports also, India has a share of 1.1% with Hong Kong (1.3%) and China (1.1%) having slightly higher shares. The above analysis shows that the results in the case of imports of services by UK from India are quite different compared to imports of EU from India. In fact, the pattern of India's exports of services to UK is similar to that of US, rather than EU. The historical and cultural ties between India and UK may also be one of the reasons for this.

In the case of Japan's imports of total services, India's share is only 0.2%, while China's share is 4.3% and all South East Asian countries have much higher shares than India. In the case of 'other commercial services' also, where India has a competitive advantage, India's share in Japanese imports of these services is only 0.3%, while all other South East Asian countries have a higher share with China having a share of 2.6% and Singapore 3.8%. India's situation is similar even in the case of travel and transportation imports of Japan. This clearly shows that India has not made any impact in the Japanese market in services.

Thus, the country-wise exports of services of India shows India's differing experiences with respect to the different developed countries. While US and UK are clearly the destinations where India has a comparative advantage in services, all EU destinations may not be as important as UK with respect to services. Even in the case of some EU countries where India's presence in services is insignificant, in some services, India does have some presence as in the case of travel services imports of France and Italy. Similarly in the case of some South-East Asian countries, though India's presence in services is insignificant, it has some presence in some services, for example, in transportation services imports of Hong Kong with 1.5% share. Thus India's experience with services exports is not only different from other developing countries (which have yet to develop and market many of these services), but also different with respect to its direction of exports even among the developed countries. A strategic partnership with a developed country like the US or UK in services could help in increasing India's exports of different services, reap the advantages of FDI in services and also remove the different market access barriers.

2.4 **Services Export Basket of Developed Countries**

The major exporters of Services are the developed countries. Leaving China (3.2% share, 8^{th} rank) and India (2.7% share, 10^{th} rank), all the other top 10 exporters of commercial services in the world in 2006 in terms of shares were the developed countries, namely, USA (14.3%), UK(8.2%), Germany (6.1%), Japan (4.5%), France (4.1%), Italy (3.7%), Spain (3.7%) and Netherlands (3.0%). India which is among the top 10 also has the highest growth rate of 34% followed by China with 18%.

In the $1.86 trillion world export of services in 2003, the share of OECD countries is 77.5%. Country-wise exports of different services of the developed countries with respect to

India shows some interesting results in the case of US exports. While among Asian countries, India is the second major source of imports of USA in 'other commercial services', after Hong Kong, in the case of US destination-wise exports of other commercial services, China and the other major South-East Asian countries like Singapore, South Korea, Hong Kong and Taiwan are much ahead of India (with only 0.5% share). But in the case of travel exports of USA (i.e. foreigners travelling to USA), India (3.4%) is the second major Asian destination after South Korea (4.1%).

In US exports of services also, as per IMF Balance of Payments data, 'other services' category is the most important category with 56% share in 2004 (Table 9). Among other services, besides other business services, royalties and license fees and financial services are the important services with rising shares.

Table 9 : US Exports of Services: Sector-wise

	Value ($ billion)	Share in total Services exports (%)	
	2004	1997	2004
Goods exports	811.0		
Services exports	340.4	100	100
Transportation services,	55.7	18.8	16.4
Passenger	18.9	8.2	5.5
Freight	15.8	4.6	4.6
Other	21.1	6.0	6.2
Travel	93.9	33.9	27.6
Business travel	4.3	1.3	1.3
Personal travel	89.7	32.6	26.3
Other services	190.8	47.3	56.1
Communications	4.6	1.6	1.4
Construction	3.0	1.4	0.9
Insurance	6.1	0.8	1.8
Financial	21.9	4.0	6.4
Computer and information	6.6	1.4	1.9
Royalties and licence fees	52.6	13.1	15.5
Other business services	69.8	15.2	20.5
Personal, cultural, and recreational	7.5	1.4	2.2
Government, n.i.e.	18.6	8.4	5.5

2.5 Focus Markets for India's Services

In the case of services, the first tier of markets for commercial services as of now are clearly the US, EU, and Japan and some other OECD countries who are the major demandeurs of commercial services. However, if labour services, both skilled and unskilled services are taken, then we have the Gulf countries as the major importers of labour services, particularly unskilled and semi-skilled services. But there are some services, which if marketed well can be demand-creating like satellite mapping services, entertainment services, the services related to Ayurveda and Yoga, etc. Even among the major markets, the composition of the import basket differs and accordingly the importance of the different services for different countries differ.

As per the NASSCOM-McKinsey report 2002, in the case of IT services, besides the traditional markets, i.e. USA and UK, there are the under-penetrated English speaking markets of Canada, Netherlands, Sweden & Australia and the under-penetrated non-English speaking markets of Japan, Germany, France, Italy which should be fully tapped.

In the case of super-specialty hospital services, India's export effort is still in its early stage, though great scope exists in markets like USA, Sri Lanka, Nepal, Bangladesh, Mauritius, Middle East, Malaysia etc.

In the case of satellite mapping services, India can export these services to Middle East, Bangladesh, South Africa, African countries and even some developed countries.

In the case of standardization and quality assurance services, the potential markets for exports of these services are the middle eastern countries, South Asian countries and African countries.

In the case of printing services, besides the developing country markets, India can be the hub of advanced printing services for developed countries by making use of its advancement in software.

In the case of technology intensive education services, India enjoys an important position in countries like SAARC countries, South Africa, Malaysia, etc. Some courses like Ayurvedic medicines, aircraft maintenance, ship repairs, printing technology, etc. are hardly offered anywhere else in the world.

2.6 List of Important Services for India

India has export potential in all skill-based and labour-based services. India has to build up on the initial advantage it has gained in software and IT related services. The list of services (other than software services, tourism and travel related services and transport services) which are particularly important for India are: **professional services** including legal services, accounting, auditing and book keeping services, architectural and engineering services (along with construction), medical and dental services, services by midwives, nurses, physiotherapists and paramedical personnel; **R & D services; Other business services** including management and other consultancy services, repair of ships, printing & publishing services, telecommunication services; **educational services; some financial services; entertainment services** like films; **satellite mapping services**; and **standardization & quality assurance services**. Further all goods and services traded by e-commerce will be important and India has a potential to provide these services. In fact there is a great potential for India to be an outsourcing destination for many of the above services.

2.7 Need for proper mapping of services

While our export basket shows that miscellaneous services representing business services are very important, the import basket of major countries also shows that other services representing business services are very important. Thus broadly the import and export baskets tally with each other. What is now needed is a proper mapping of the different services to be exported by India to the potential markets.

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3

3. Issues and Problems

The potential of the services sector for India's GDP growth, exports and employment being very high, there is a need to address some issues which need the immediate attention of policy makers at the highest level. This can facilitate further growth of the sector.

3.1. Data Issues in Services

One of the important issues in services sector is the issue of data. Unfortunately, while the importance of services is growing, statistical data and other relevant information on services is abysmally low. The word 'invisibles' seems very relevant for this sector in the context of data, as data are invisible or partially visible. Even where data are available, they are not qualitative and suffer from deficiencies related to definition, method of collection, suitability for pricing and construction of indices. There are many sectors within the services sector, and consequently the data collected are also diffused.

WTO negotiations are taking place in 151 services and negotiators need statistics as a guide to negotiate specific commitments in services taking note of India's export potential. But unlike merchandise trade, in services, such data are not available. Leave alone price data, even disaggregate value data, sector-wise and country-wise are not available. As a result of the recommendations of the Committees on Services in the Reserve Bank of India (RBI) and Department of Commerce, a much better set of data is being currently given by RBI. But this is also far from adequate compared to our needs. Some of the important recommendations of the Services Committee of the Dept of Commerce, for the National Statistical Commission (Prasad Committee), related to international trade in services data (see Appendix 1) like sorting out definitional issues in services, conducting mandatory benchmark and annual surveys, classifying available data on services under different modes, collecting bilateral trade data on services, collecting export/import prices of important services, etc, need to be implemented in a fixed time period. Some recommendations like conducting benchmark surveys for software services by RBI and rationalizing the classification of services which has made the share of 'others' in the business services smaller are being implemented by RBI. It is however a matter of concern, that we have a 'miscellaneous services' category which consists among others the most dynamic services like 'Business services' which again has a subcategory of 'others'. A lot of work needs to be done in the balance of payments data particularly related to services both in India & internationally, which includes basic definitional issues, classification issues and even verification of the work done in the different countries.

In the National Accounts Statistics also, constant prices for services are calculated and many-a-times proxies like GDP deflators are used. In the absence of necessary published data for pricing services, these estimates provide only a rough indication of the price movements of services.

In the case of inflation also, services are not accounted. While WPI by definition does not include services, only Medical Care, Education & Recreation and Transport & Communication with only 15.61% weightage are included under miscellaneous group in the CPI-IW. Similar is the case with CPI-UNME and in CPI-AL&RL.

3.2. **Need for a single nodal department/division/institution for services policy making**

Different service sectors have their own special characteristics. Some are mainly in the public sector, some mainly in the private sector and some others in both. For some, the policies can be at the central level, while for some others, it is at the state level. For some, detailed commitments have been given by countries under the negotiations at World Trade Organisation (WTO), while some others do not even find mention in these commitments. In the case of supply of some services, consumption abroad and movement of natural persons mode are important, while for some others cross-border supply and commercial presence mode are more important. Public policy in the services sector has to be seen by taking note of the diversities in the services sector, the supply base for the services, domestic regulations in India and other countries, domestic and external demand for services, market access barriers for these services in India and abroad and the status of commitments, requests & offers under general and plurilateral negotiations in the WTO.

Lack of a single nodal department/division/institution is the biggest lacunae in the services sector. While the Software sector has received encouragement and an Export Promotion Council (EPC) was also formed, EPC for Services has just been formed and is yet to take off. For domestic policy making, there is no single Ministry or Department for all services. State governments are also involved in this sector and some services are in the state list. So a coordinated policy action is lacking. There is a need for a nodal department or division, preferably in the Department of Economic Affairs, Ministry of Finance which can look into all aspects related to services, while the individual departments dealing with some services or some aspects of services can continue their usual work as is being done by them at present. A National Commission for Services can also be set up on the lines of the National Manufacturing Competitiveness Council and National Farmers Commission. All this is long overdue with more than three-fifth of the GDP being accounted by services in India.

3.3 **Market Access for Services**

Another issue is the market access for services which can be seen by the actual visible and invisible trade barriers for services and trade barriers for services which continue to exist under WTO bindings of different countries.

3.3.1 **Actual Trade Barriers for Services**

There are both visible and invisible barriers to services trade. The illustrative examples given here for US and other countries show the major forms of trade barriers which are currently in operation or have the potential to restrict exports of services of India and other countries.

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, there are the 'Buy American' provisions and frequently changing visa provisions for work permits.

In the case of **legal services,** while some of the states, namely, New York, Texas, Washington D.C., and California allow foreign 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. Most states and districts require a minimum of five years work experience.

In the case of **Communication Services,** although due to the GATS negotiations, the US has undertaken commitments on telecommunications services, it has still retained several restrictions. For example, non-US firms and foreign-owned firms wishing to invest in radio telecommunications infrastructure and to provide mobile and satellite services are virtually denied access due to stringent legislation in US. The events of September 11, 2001 have added a new dimension to these market access limitations with US law enforcement agencies imposing strict corporate governance requirement on companies seeking FCC (Federal Communications Commission) approval of the foreign takeover of a US communications firm in the form of network security arrangements.

In the case of **Financial Services**, the restrictions are the requirement of the Office of the Comptroller of the Currency (OCC) and some State banking supervisors to maintain "asset pledges" in addition to the paid up capital they maintain in their home country. While an asset pledge reform by the New York State Banking Department has significantly reduced the regulatory burden for New-York-state-licensed branches of foreign banks (though further risk-sensitivity seems desirable), this legislation still has to enable the OCC to set its asset pledge ("capital equivalency deposit") requirement for federally-licensed branches of foreign banks in a risk-sensitive way. Further, there are access issues under state law for insurance as foreign insurance companies seeking to operate in the US market face the fragmentation of the market into 56 different jurisdictions, almost each of which is having different licensing, solvency, operating requirements and own insurance regulatory structure with direct discrimination on a number of fronts, such as need for foreign insurance companies to first be licensed in another state before seeking a license in the first state to underwrite risks in one state, need in some states of US for foreign insurers to buy reinsurance from state-licensed companies before allowing re-insurance premiums to leave the state, white listing of bigger foreign companies to operate on a cross border basis in the US wherein companies have to name a US attorney and lodge a trust fund in a US bank of upto US $ 60 million to receive approval, etc.

In the case of **Transport & Travel Services**, there are barriers in the Computer Reservation system; restrictions in foreign ownership of air carriers as foreign investors are prohibited from taking more than 49% stake in a US carrier and the holding of voting stock is restricted to 25%; restrictions related to foreign repair stations; application of security measures to foreign carriers under the Hatch Amendment 1996; various forms of assistance in US to its domestic shipping industry such as the reservation of a minimum of 50% of government cargo for US registered ships all cargo provided with loans from the US Exim Bank to be reserved for US registered ships though a 50% waiver may be granted, all military and strategic cargo for US registered ships, all personal property of government employees who are transferred to be sent in US registered ships; retaliatory measures against discriminatory actions by foreign governments that violate the interests of US shipping; restrictions in domestic commercial shipping where the US requires shippers operating in internal waters to use ships that were built in the US; subsidy programme providing an operating cost subsidy of $ 100 million a year for a period of ten years for US registered ships meeting certain requirements; discrimination by the Federal Maritime Commission (FMC) between foreign shipping companies and US ships by unilaterally regulating the shipping fees charged by foreign shipping companies; significant restrictions on the use of foreign built vessels in the US coastal trade under Jones Act which stipulates that all coastal shipping in the country should be carried on vessels built and registered in the US and in relation to access to certain international cargoes from which non-US vessels are excluded; prohibition on foreign built vessels for documentation and registration for dredging, towing or salvaging in the US; issue of US ensuring terms of shipment, favourable to US, while not being liberal in allowing foreign ships to operate in US; the application of restrictive measures to US public procurement contracts which introduces uncertainty for those businesses whose tenders include shipping goods to the US, as they are required to ship the goods on US-flagged vessels, which charge significantly higher freight rates than other vessels; etc.

In the case of **IT, Software and Business Services related to IT**, there are also many and new restrictions. Some US States are passing laws to limit business outsourcing. The New Jersey law is one such example. This phenomenon has not only spread to other states of US, but also to the federal level. This along with restrictions on H1B visas are the new market access barriers in US for these services. These restrictions deny non-US competitors market access to a very sizeable pool of US business and trade, while providing protection for domestic companies.

In the case of **Audio-Visual services**, there are restrictions in the European Community. For example, France provides that at least 60 percent of movies on television must be made in Europe and that more than 40 percent of the programmes must be broadcast in French.

In the case of **Port Services** there is the issue of Harbour Maintenance Tax (HMT) and Harbour Services Fee in US. The HMT is levied in all US ports on waterborne imports, at an ad valorem rate of 0.125 per cent. The money collected is transferred to the Harbour Maintenance Trust Fund to provide for the operation and maintenance of channels and harbours. However, the ad valorem basis for the HMT collection makes it difficult to justify as a fee approximating the cost of the service provided. Moreover, there is significant accumulation of unused funds, which reached $1.609 billion in Fiscal Year 1999 and has risen further since. This rise, points to the excessive nature of the HMT. The US Court of International Trade in October 1995 ruled that under US law the HMT is a tax and not a user fee. The US Constitution prohibits taxes on exports. The US Court of Appeals confirmed this ruling in June 1997 as did the US Supreme Court in March 1998. As a result, the US authorities have stopped collecting HMT on exports. However, the HMT is still being collected on imports.

In the case of **construction and related engineering services and urban planning and landscape services**, while there are no national treatment limitations in the US commitments to WTO (2005) under modes 2, 3 & 4, the "Buy American" or "Buy local" legislations passed in many states of US have gone to the ridiculous extent of even insisting on the materials used (i.e. cement) to be of domestic origin for construction of public works projects financed by state funds.

The huge subsidies in the **Civil Aviation sector** to Aircraft in both US and EU act as indirect market access barriers.

3.3.2 Trade Barriers for Services Exports existing under WTO Bindings

- In the case of Horizontal Commitments in WTO, the horizontal clauses limit the sectoral offers. For example, even in the revised US offers for 2005, the US commitment in the case of fashion models and speciality occupations continues to be up to 65000 persons annually on a world wide basis. The actual visas which was higher than this commitment has now been lowered. While this offer is no offer and the share of any country in this offer would be a small miniscule, the conditions of market access for speciality occupations are that the wages paid to the person should be higher than that paid to individuals in that establishment with similar qualifications and experience, no labour management disputes should be in progress, no worker should have been laid off 6 months previous or 90 days after the filing of an Visa application, etc. Thus the US horizontal offer for market access of natural persons is no offer both quantitatively and qualitatively. Perhaps it is easier to enter US as fashion models than for speciality occupations! US has now reduced its actual visas to WTO commitment levels, which was not envisaged by our software exporters earlier, even though we had pointed out such a possibility. However, the demand for software professionals continues to be high.

- In the case of legal services in Sweden, though there are no national treatment limitations in modes 1, 3 and 4, under the earlier GATS offer, the use of the Swedish title 'advokat' was protected. Thus virtually non-citizens cannot use this title. Now under the conditional revised offers (2005) of EU, this has been cleverly reworded as follows. 'Admission to the Bar necessary only for the Swedish title "Advokat" which is subject to a residency requirement'. Though foreign lawyers can freely offer legal services when not appearing under the title 'advokat', this protection creates an artificial barrier in the form of Grade A and Grade B lawyers. In Japan also, for legal services under all 4 modes, there is the need to be recognised as 'Gaikoku-Ho-Jimu-Bengoshi' by the Minister of Justice. Legal services have to be supplied by a lawyer qualified as a "Bengoshi" under Japanese law. Japan has refused to remove the most restrictive regulatory hurdle facing foreign lawyers in Japan – the ban on hiring or forming partnerships with Japanese lawyers (Bengoshi) in Japan.
- In the case of healthcare services, while there are no market access limitations under mode 2, there is the national treatment limitation of federal or state government reimbursement of medical expenditure for medical services availed abroad to certified facilities in the US or in a specific US state and the general tendency of US insurance companies not to reimburse medical expenditure for services consumed in countries like India. These are important trade barriers. Similarly under mode 3, there are needs based quantitative limits for market access. In the case of EC countries, the provision of free medical services to all citizens under the National Health Service (NHS) system in countries like UK acts as an invisible market entry barrier. This even helps the export

wing of the NHS. The removal of such subsidies is a issue for future negotiations in WTO. This can open up a huge market for healthcare services exports.

- In the case of Banking, in the US market, there are many restrictions and in some states specified activities are unbound.
- In the case of Engineering Services, under mode 4, the market access limitation that US citizenship is required for licensure in the District of Columbia is removed in the Revised Offer (2005), though it is included for engineering services under Energy Services.
- In the case of Maritime Services, US has not given any commitments and has many protective measures in this sector. Even in the case of ship repair services as stated in the Trade Policy Review of US for 2006, US applies a 50% ad valorem tax on the cost of equipment and non-emergency repairs for US flag vessels. US owned foreign-flag vessels are not subject to the duty and under NAFTA and the Chile and Singapore FTAs, this duty was eliminated. This is a tax or an example of tariff barrier on services by US!
- Further, while sector-specific commitments are limited by conditions like the economic needs test, in-state residency, citizenship, etc., the limited horizontal commitments for professional services virtually puts the benefits under sector-specific commitments in deep freeze. There are also restrictions at the state or district level in US. For example, for legal services, market access under mode 3 and 4 are restricted in many States of US. Besides there are MFN exemptions.

3.4 WTO negotiations and Policy issues for Services Negotiations

3.4.1 Main Issues

The main issues in WTO Negotiations in Services Sector for India are the following:

- Harmonisation of accreditation and titles.
- Status of existing Mutual Recognition Agreements (MRAs) and MRAs under which countries like India would like to be included.
- Orderly movement of professionals by more meaningful negotiations under Mode-4.
- Removal of limitations like economic needs test, in state residency, citizenship, etc. found in national schedules.
- Removal of subsidies given by developed members in services like shipping, aviation, healthcare, etc. At present WTO negotiations are focused on farm subsidies. But the subsidies given by developed countries to services are also high.
- Extent of quantitative restrictions (QRs) on services, like quantitative limitations on setting hospitals, educational institutions, etc.
- Issue of reimbursement of medical expenditure incurred overseas.

- Issue of social security contributions to be made by Indian professionals.
- Issue of the impact of extension of negotiations in maritime services to multi-modal transport.
- Need to negotiate on trade barriers to services.
- The need for India to emphasise on supply of services not only through temporary movement of natural persons and cross border mode, but also by consumption abroad mode.
- Using FTAs/RTAs for coalition building in WTO while complementarities are not lost sight of. Developed countries emphasise on improved commitments in mode 3 i.e. commercial presence so that service suppliers can choose their preferred form of doing business (e.g. as majority joint ventures, 100% foreign-owned subsidiaries, or branches). They use the new WTO Accessions and Regional Initiatives for immediate gains e.g. the strategy for gaining from regional initiatives as in the case of USA like the Free Trade Areas of the Americas (FTAAs), the Transatlantic Economic Partnership(TEP) with the European Union, assisting the Japanese government's efforts in the financial services "Big Bang" and major capacity-building component to help African nations, the Everything But Arms (EBA) initiative by European Community (EC), and the recent Aid for Trade for LDCs initiative by developed countries.
- Need for a special negotiating team for services. Developed countries like US have made a headstart proactive agenda and the US has set up a Special Services Negotiating Committee. So, developing countries have to take quick actions, lest they lose in sectors which they consider to have a potential in future.
- Consultation with state governments on issues related to services standards and regulations. The US has worked out model schedules or templates for sectors and held extensive consultations. There is greater involvement of State Governments as service standards and regulations are established by State Governments or private professional associations in US.

The future WTO negotiations will be a completely new ball game where economic details and market intelligence will be more important.

3.4.2 Key Strategies and Policies for WTO Negotiations

- Our future strategies should depend on our assessment of the export potential in the near and medium term in different services, the likely increase in market access in different services as a result of WTO negotiations which can benefit India and the likely impact on India's growth.

- Need for greater synergy not only between trade strategies and WTO negotiations, but also between growth & development strategies and WTO negotiations.
- Appropriate institutional and diplomatic set up: India is one of the developing countries having a large staff in its mission at Geneva and also in the WTO wing of the Ministry of commerce. There is a need for direct involvement of trade specialists also in this team during negotiations. While trade economists along with diplomats should be included in this team, a core committee including representatives from different economic ministries, ministry of external affairs, senior economists, legal experts, WTO experts and representatives from trade and industry should be set up. They must be fully engaged in WTO work and negotiations and interact with State Governments, NGOs and other stake holders.
- Strategic alliances: Future negotiations would need realistic strategic alliances which can fetch good dividends for us. For example, while India and Brazil have become very close coalition partners, the economic interests of the two are not necessarily the same.
- Our own agenda: We have to be more forthcoming in future negotiations and set our own agenda and make others to react instead of we reacting as has been the case till now. This reversal of the roles would however depend on intensive study of the different issues based on India's export potential besides its trade, growth and development strategies.

3.5 Policy issues for export promotion of services

Services exports has been promoted consciously in many countries, while services sector has had an almost natural growth in India with the Government facilitating in some sectors. However, there has been no comprehensive strategy for services.

3.5.1 Experiences of some countries in promoting services

Services sector has been promoted by different countries. The US actively supported services negotiations under GATS & WTO after studies in US revealed that this was the potential sector for USA in the future.

In the case of Hong Kong, services like financial services and port services have developed due to the policies of the government to develop Hong Kong as an off-shore financial centre and free port. In the case of professional services, the main feature is the setting up of a joint office with common facilities for professional institutions in Hong Kong. In the case of printing services, a low tax policy has made Hong Kong a publishing centre.

Singapore has a range of technology intensive services to offer besides port related and financial services. Exhibition management services are promoted with more than 2,00,000 foreign trade fair visitors and exhibitors, taking part in some 100 trade exhibitions in Singapore each year. Singapore is fast becoming the international franchise hub in Asia. The majority are in retail, service and food franchises. In the case of legal services, Singapore is facilitating Singaporean law firms to go regional and to carve a niche with the opening up of legal markets around the world. Singaporean law firms have already been granted licenses to operate in China, Vietnam, Indonesia, Malaysia and Myanmar.

3.5.2 **Some General Policies for India to promote services exports**

Some of the ways in which the Indian government or export promotion agencies can support service exporters are the following.

- Helping service exporters to become known suppliers of quality services and providing relevant export market information;
- Providing appropriate export financing with reduced transaction costs and reviewing the common practice of collateral in the case of services.
- Following the Silicon Valley example where Banks securitise the CEOs of companies.
- Marketing of services with the help of Indian Embassies/Industry associations, etc.
- Anchoring people, particularly, committed specialists, for promoting services.
- Leveraging India's potential purchasing power in services negotiations at multilateral and bilateral levels.
- Concluding totalisation agreements with target countries to resolve the social security benefits issue.
- Visa on arrival at least for selected countries.
- Including appropriately issues related to services in Regional Trade Agreements (RTAs), Free Trade Agreements (FTAs) and Comprehensive Economic Cooperation Agreement (CECAs).
- Focus on Services in some SEZs.
- Stress should also be on developing front yard technology, in different services and not focusing exclusively on the BPO industry coupled with a hardware-software combination for computer services.
- Under the India Development Initiative, Government of India extends Lines of Credit to many countries with an aim to enhance India’s economic interests abroad. These Lines of Credit are routed through Exim Bank. Though the lines are applicable for all items covered under the Foreign Trade Policy, including services, the Government

could consider extending specific dedicated lines focusing on promotion of service exports from India such as construction services, IT related services and education services.

- Export prospects in services depend on the realities of the past negotiations in WTO on services and the ongoing negotiations in services. The export potentialities in services also influence the negotiating stands of different countries at WTO on services. With the Doha round of negotiations at a standstill, useful Comprehensive Economic Cooperation Agreements (CECAs) which include services can help in the removal of many market access obstacles if negotiated well and also lead to higher inflow of foreign investment in services via commercial presence mode.
- The absence of a separate service category for outsourcing and the fact that many developed countries did not realise the potential of outsourcing when they probably gave a more liberal commitment for different services under mode 1, highlights the need for India to make use of the opportunities thrown open by WTO.

3.5.3 **Sector-Specific Policies for India**

India has a good potential for exports of different services, besides software in which it has already made an impact. While the importance of different modes differ for different services, with greater tradability of services leading to outsourcing, mode 1 i.e. cross-border supply mode is assuming greater importance for many services as it can do what can be done by mode 4, i.e. supply of services through natural persons mode, while avoiding the disadvantage in this mode related to visas. Some sector specific issues and policies for some services are indicated below.

Healthcare Services

In the case of Super-Speciality Hospital Services, India has a good supply base for various super-speciality hospital services and can supply them under all four modes of supply, though the consumption abroad mode is the most important mode for India. Though India has a good supply base and is cost competitive, good marketing and publicity regarding these services are needed.

The National Health Service Systems of EC countries like UK which virtually deny market access, US medical insurance companies not covering medical expenditure incurred abroad, need based quantitative limits, need to be natural persons, accreditation rules, etc. have to be negotiated both multilaterally and bilaterally.

In the case of medical, dental and midwives services, where again India has great potential for exports, in EC under mode 3, there are no national treatment limitations, but market access in Germany is restricted to natural persons only. There is also the economic needs test for medical doctors and dentists who are authorised to treat members of public insurance scheme. These market access barriers need to be negotiated at multilateral, plurilateral and bilateral levels.

Some of the policies for the healthcare sector are developing India as a regional healthcare hub, tie-ups as done by Germany wherein if there is delay in NHS service in UK, patients can go to Germany, recognition of technical degrees by other countries, setting up Health Consultancy Parks which combine both preventive and curative health care with tourism.

Satellite Mapping Services

In the case of Satellite Mapping Services, India has a good supply base for economic application of satellite mapping services and is also cost competitive. The public sector institutions are the main suppliers of these services. There are limitations due to defense reasons, non-inclusion of these services in commitments to WTO and the fact that these services cannot be viewed totally from a commercial angle.

Policies for Satellite Mapping services could include negotiating with US, EC and other developed and developing countries regarding defense restrictions, examining possibilities of sharing some common facilities of public sector institutions with private sector like sharing of some data of ISRO with private sector, consortium bidding and including government institutions like ISRO in the consortium.

IT Services

Policies for IT services include steps to move to systems software and not merely application software or Business Process Outsourcing (BPO), negotiating with EU regarding 'Data Protection Act in EU' as half of off-shore work does not come to India and other countries due to this Act and fully exploiting the great outsourcing revolution in services.

Project Exports

The policies in the case of Project Exports could include facilitating project exports related to power generation and power transmission abroad where we have adequate expertise; resolving the issue of precondition in most of the overseas tenders floated by clients wherein equipment to be supplied by the contracting company should necessarily be sourced from approved list of suppliers from developed countries; examination of the need to consider double guarantee avoidance treaty on the lines of double taxation avoidance treaty as overseas clients insist for the Bank Guarantees to be issued under the contract to be routed through a local bank operating in the country of project execution which results in Indian contracting companies being called upon to pay the bank guarantee charges to Indian banks as also to the local overseas banks which issue the final end guarantees to the client, based on the counter guarantees from the Indian Banks; addressing the issue of high dispute settlement costs of International Chambers of Commerce (ICC) and lack of uniform laws for dispute settlement as well as a standard contract document in India for domestic projects; reduction of delays in international bidding due to formalities at different levels of the government; etc.

R&D, Design and Engineering Services

The policies in the case of R&D, Design and Engineering Services are setting up R&D labs in SEZs, examining the possibility of cheaper loans taking note of gestation period in R&D services, patent funding to reimburse costs of patenting, promoting lab testing services for use of South Asian countries in India, setting up design, engineering, consultancy parks.

Ship repair Services

Ship repair services under consumption abroad mode has been opened up by many countries like US. It is not demand that is lacking or any difficulty of market access. What is needed is capacity building and marketing.

Some policies for Ship repair and port services include effective marketing of ship repair services, providing port services by port based SEZs like international bunkering facilities, pilotage facilities, supply of spare parts, ship repairs, etc.

Printing Services

In the case of Printing Services, India has a good potential for exports. There is a need to be cost competitive and leverage our capacities in software sector for this purpose.

Accounting, Auditing and Bookkeeping Services

In the case of these services where India has a good potential for exports, the limitations are mainly in the form of licensing, accreditation, in-state residency and state level restrictions in countries like US. The horizontal limitations on the entry for speciality occupations, automatically restricts opportunities in this sector. These need to be addressed and the potential of outsourcing many components of these services has to be fully tapped.

Unskilled labour Services

A large number of Indians work in the Gulf area mostly as unskilled workers. If they are trained and skill certified before going abroad, they will get better jobs, earn more and have higher disposable income, leading to higher GNDI. Countries like Philippines, Thailand and even Sri Lanka provide such training and skills.

3.6. Domestic regulations and domestic policy reforms for services

There are many domestic regulations for services in our trading partner countries and also in our country, which need to be addressed. The WTO negotiations on services also deals with these domestic regulations.

At the Uruguay Round negotiations, governments recognized the potentially trade-restrictive effects of even non-discriminatory domestic regulatory measures, and agreed to develop specific disciplines to ensure that they were not unduly burdensome or trade restrictive. The result was Article VI:4 of the General Agreement on Trade in Services (GATS), which refers to licensing requirements and procedures, qualification requirements and procedures, and technical standards – and mandates the development of "any necessary disciplines". In the Working Party on Professional Services (WPPS), disciplines for accountancy profession were adopted (December 1998). In April 1999 the Council for Trade in Services established the Working Party on Domestic Regulation (WPDR) to discuss the sector-specific and generic disciplines in Domestic Regulations. Domestic regulations act as a barrier to effective market access for our service providers, especially in Mode 4. As a result, market access is not available even in sectors where our trading partners have taken specific commitments. While basically there are no tariffs to regulate services trade, domestic regulations perform this role in the case of services trade. Disciplining domestic regulations of our trading partners is therefore necessary for greater market access in services. However, any disciplines that are developed would also be applicable to India's own domestic regulations. In fact disciplining many of our own domestic regulations could also help in the growth and export of many of our services. In the Hong Kong Ministerial Conference held in December 2005, WTO Members have been given the mandate to develop disciplines on Domestic Regulations under GATS Article VI:4 before the end of the current round of negotiations.

As an outcome of the discussions in the WPDR and based on the proposals tabled, an illustrative list of possible elements was compiled by the Chairman of the WPDR for facilitating discussions on developing sector-specific and generic disciplines in Domestic Regulations. In brief, these elements include the following:-

a) "Licensing requirements" which are substantive requirements, other than qualification requirements and technical standards, with which a service supplier is required to comply in order to obtain or renew authorization to supply a service.
b) "Licensing procedures" which are administrative or procedural rules relating to the administration of licensing requirements for the supply of a service, including those

relating to submission and processing of an application for a licence or renewal thereof.

c) "Qualification requirements" which are substantive requirements relating to the competence to supply a service that a service supplier is required to demonstrate prior to obtaining authorization to supply a service.

d) "Qualification procedures" which are administrative or procedural rules relating to the administration of qualification requirements, including those aiming at verifying the compliance of candidates with qualification requirements as well as those relating to acquiring or supplementing such qualifications.

e) "Technical Standards" which are measures that lay down the characteristics of a service or the manner in which it is supplied. Technical standards also include the procedures relating to the enforcement of such standards.

While the domestic regulations should not be unduly burdensome, there are also some domestic policy reforms which need to be undertaken. Some of the Domestic regulations and domestic policy reforms in some sectors in India are given below. This is only an indicative list and not an exhaustive list.

3.6.1. **Telecom**

(i) **Multiple levies and duties**

Telecom services face multiple taxes and levies. The levies and duties in the Indian telecom sector are one of the highest in the world. The total levies, including license fee, service tax and spectrum charges were at around 26% of AGR(Adjusted Gross Revenue) in 2006-07, which in turn makes consumers pay higher (In Malaysia it is around 6.5% and in China it is around 0.5% + 3%, tax). Besides the above, there is ADC paid to the BSNL at 0.75% of AGR for domestic long distance calls and call by call ADC for international long distance calls at the rate of Rs.1.00 per minute for incoming calls. There is also a 5% import duty on handsets and 16% on Telecom infrastructure while in other countries it is either nil or much lower than India.

A single service tax for telecom sector may not be possible given the present system where a part of the service tax collections are shared with states. So there is a need for a time bound phasing out of the different types of taxes till they are merged into two or three levies/taxes. Meanwhile existing levies and charges could be reduced. Recognising the importance of this issue in Budget 2007-08, the Finance Minister has stated that "the telecommunications industry has repeatedly requested that the multifarious taxes, charges and fees applicable to the industry should be unified and a single levy on revenue should be collected. The request merits consideration. Hence, I propose to request the Department of Telecommunications to constitute a committee to study the present structure of levies and make suitable recommendations to Government'.

(ii) **License fees on unrelated activities**

The Adjusted Gross Revenue (AGR) as defined by DOT for computation of the license fee includes several revenue streams which are unrelated to service activities of service providers such as:

a) Interest income from investments
b) Dividend income from investments
c) Revenue from sale of handsets
d) Revenue from sale of capital goods
e) Revenue from sharing/leasing of infrastructure
f) Port Charges/Lease – hire charges

Telecom Dispute & Settlement Appellate Tribunal (TDSAT) has ruled against inclusion of the above in the AGR for computation of license fee except the following:

(c) Revenue from sale of handsets when bundled though it has ruled against inclusion for stand-alone handsets; and

(f) Port Charges/Lease-hire charges.

Urgent policy intervention is needed is this area even in cases where TDSAT has not ruled against their inclusion as, for example, complete exclusion of sale of handsets from AGR can lead to handset bundling schemes with airtime and make India a hub for telecom manufacturing activity.

(iii) **Policy and procedural hiccups**

There are also policy issues related to the following which need to be resolved.

a) Bank Guarantees which block capital
b) Fraudulent practices
c) Broadband policies including duties on inputs and finished products for broadband services

There is a need to examine whether Bank Guarantees could at least be replaced by Corporate Guarantees.

(iv) **Infrastructure sharing and development:**

In a capital starved country like India, it would be a waste if every operator were to duplicate the costly infrastructure. BSNL the incumbent operator has created an extensive nationwide infrastructure. This infrastructure can be shared with private operators at commercial terms, just as infrastructure created by private operators can be shared with BSNL and with each other. Infrastructure sharing should be encouraged effectively. In fact, TRAI has recommended sharing of critical infrastructure, which could be considered by DOT.

3.6.2 Port Services

While there is the issue of the Indian ports not having the necessary draft leading to big ships not entering the Indian seas and in turn resulting in transshipment of Indian cargo outside the country, 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. While the inefficiency of ports is one of the reasons for this high cost, the procedure of including unrelated costs like pension and other contributions for port labor in the port services is another cause. If port charges were to be lower and near to international standards, then India's exports could become more competitive. On the import side, imports including essential commodities can be cheaper, which is important particularly when domestic supply bottlenecks lead to inflation in essential commodities. There is a need for rationalization of port dues, and examining the possibility of providing differentiated levels of tariff for different size of vessels or for different cargoes to attract mother ships to berth at Indian ports. Besides there is the need to address the 'gang system' in ports.

The facilities at existing ports related to cargo handling, stevedoring, pilotage services, bunker services, warehousing facilities etc. need to be streamlined and upgraded wherever necessary in order to bring them on par with the leading ports of the world. Transshipment of Indian cargo taking place outside the country at present needs to be handled at Indian ports through concerted measures. Actual capacity expansion plans in ports should be carried out much before the requirement for such additional capacity arising. While developing roads connecting ports, it should be made clear to the concerned that the roads need to be of good quality and long lasting, and poor road construction should be made a criminal offence. In fact a large part of our infrastructure spending is wasted due to poor quality of the infrastructure construction, necessitating repeat of the same work.

3.6.3 Distribution Services

The plurilateral request at WTO for distribution services include coverage of all subsectors (commission agents' services, wholesale trade services, retail services and franchising), exclusion of limited number of sensitive products, market access and natural treatment under mode 1, 2 & 3 with no limitations, flexibility concerning transition period, limited number of non-discriminatory economic needs tests and limited number of other exceptions. In mode 4, the request is to ensure in particular, access for business visitors and intra corporate transferees.

The main issue here is opening retail trade, where FDI is prohibited (except single brand product retailing subject to 51% cap), while there is a large unorganized sector with low tax compliance. As per a World Bank Study (2004), in retail distribution, the penetration of supermarkets, hypermarkets, department stores and speciality chains in India is only 2% compared to 55% in Malaysia and 36% in Brazil. While incentives could be given for the existing local retailers to adjust to modern times, consumers should not be denied the benefits of modern retailing. The farmers also benefit due to modern retail trade. Efforts should also be made to see that such opening provides greater market access for India's exports.

3.6.4 **Shipping Services**

In the case of shipping services, there are domestic policy issues like withholding tax on interest paid to foreign currency loans to acquire ships abroad, withholding tax on charter hire paid to foreign shipowners on ships taken on charter, etc.

In this context the treatment offered by Singapore to its shipowners needs to be examined. Under the domestic law of Singapore, charter fees paid to non-residents is subject to withholding tax @15%. However, pursuant to a ruling from the Singapore Comptroller of Income tax, time charter and bareboat charter fees are subject to the reduced final withholding tax rates (Table 10).

Table 10: Withholding Tax in Singapore

Particulars	Time charter	Bareboat charter
• Recipient is resident in a country which has a Tax Treaty with Singapore and which provides for -full exemption of shipping profits -50% exemption of shipping profits	 Nil 1%	 2% 2%
• Recipient is resident in a country which is regarded as a tax haven country	3%	3%
• Others	2%	2%

In case of an 'Approved International Shipping Enterprise', on obtaining specific approval, the aforesaid withholding tax rate is reduced to 'nil' in all cases. The aforesaid taxation is as per the domestic law of Singapore. In cases where the foreign shipowner is resident of a country which has signed a Tax Treaty with Singapore, it can avail of the beneficial provisions of the Tax Treaty. Thus as per the domestic law of Singapore the rate of withholding tax on charter hire charges would be either 'nil' or between 2-3%. which is very low compared to the withholding tax rate of 10% in India.

Another issue is of Service Tax. In India, service tax is applicable to most of the services availed by shipping industry like cargo handling, clearing and forwarding, general insurance/P&I, clearing house agents, port services, repair and maintenance, steam agent, storage & warehousing, survey and exploration, manpower recruitment and other services, for domestic service; and general insurance/Protection & Indemnity (P&I), survey and exploration, manpower recruitment and other services in the case of services abroad, while in EU, Ireland, Singapore, Australia, etc. these services are either tax exempt or zero rated.

(Table 11). Recently as per notification dated 17.9.2007, refund of service tax has been given for exports by India in the case of port services, other port services, services of transport of goods by road from ICD to port of export provided by Goods Transport Agency and Services of Transport of export goods in containers by rail from ICD to port of export.

Table 11

Service Tax treatment on World Shipping

	European Union	United Kingdom	Republic of Ireland	Singapore	Australia
Cargo Handling	Exempt	Zero Rated	Zero Rated	Zero Rated	Exempt/Nil
Clearing & Forwarding	Exempt	Zero Rated	Zero Rated	Zero Rated	Exempt/Nil
General Insurance	Exempt	Exempt	Nil	Zero Rated	Nil
Clearing House agent	Exempt	Zero Rated	Zero Rated	Zero Rated	Nil
Port Services	Exempt	Zero Rated	Zero Rated	Zero Rated	Nil
Repair & Maintenance	Exempt	Zero Rated	Zero Rated	Zero Rated	Exempt/Nil
Steamer Agent	Exempt	Zero Rated	Zero Rated	Zero Rated	Nil
Storage and Warehousing	Exempt	Zero Rated	Nil	Zero Rated	Nil
Survey and Exploration	Exempt	Zero Rated	Nil	Zero Rated	Nil
Manpower Recruitment	Exempt	Zero Rated	Nil	Zero Rated	Nil
Other Services	Nil/Exempt/ Zero rated	Nil/Exempt/ Zero Rated	Nil/Exempt/ Zero rated	Nil/Exempt/ Zero rated	Nil/Exempt/ Zero rated

Nil: Under the domestic tax regime, where the services are used for purely business purposes i.e. "Creditable purpose" and not for private use or used as input services for financial suppliers, residential, rent residential premises, precious metals, school, canteens or fund raising events conducted by charitable institutions, the tax paid on the input service is refundable and or adjustable against any output tax, even where no output service has been generated from the input services. The end result being that there is no service tax payable by any business.

There are also issues related to seafarers, India has one of the largest pools of seafarers in the world. The industry spends a lot of resources in their training and development. Since the introduction of tonnage tax, the shipping companies have provided approx. 2.3 lakh training mandays. However, despite this, Indian shipping companies face an acute shortage of seafarers, particularly in the officers' category because of drift of personnel from Indian flag ships to foreign flag under lure of higher 'take home' pay packets, without having to pay tax in India. This is affecting its performance and also ability to acquire more ships to augment the tonnage. Indian officers working on board Indian ships are granted non-resident status for purpose of taxation of salary income earned by them provided they are outside India for a period of 183 days in a year. Their actual stay in India is determined by exit/entry immigration stamp through any Indian port as well as on the basis of number of days the Indian ship on which they are working is actually in Indian territorial waters. These records are maintained by the shipowners' offices and tax is deducted from salary accordingly. In case of Indians working on foreign ships and calling on Indian ports/transiting through Indian waters, such details are not compiled and not taken into consideration for computing their salary (based on their "stay" in India), by the foreign employers. Indians employed on foreign ships are thus in a better position to comply with the requirement to become eligible for NRI status. Even if they are not eligible for NRI status, they are not subject to TDS. Indians employed on Indian ships get discriminated and find working on Indian ships unattractive. While Indian personnel working on any ship should be subject to equitable taxation with respect to their income earned during their period of employment on-board, there is also a need to ensure that foreign shipping lines employing Indians adhere to all the prevalent tax laws of the country. In order to remove any 'disadvantage' of working on Indian ships and to make employment on any ship at par it is essential to bring all Indian seafarers under a common and easily administered tax practice. Such a tax practice should also be revenue neutral to the national exchequer.

The shipping sector has its own uniqueness in terms of capital intensiveness of business and the services being provided even from third countries through flags of convenience (FOC) arrangements. The strength of Indian merchant fleet in operation as on 1.4.2006 comprised 8.46 million GT. Out of this about 3.79 million GT are likely to be scrapped over the next 5 years due to the completion of commercial life as well as on account of IMO regulation for phasing out single hull tankers (which constitute around 40% of the Indian fleet) coming into force by 2010. The estimated balance of the existing fleet at the end of next 5 years would be around 4.67 million GT. Thus 44% of the existing fleet will have to be replaced over the next 5 years which involves an estimated investment of US$ 4 to 5 billion. Broad category-wise ships to be scrapped/phased out during the next 5 years include dry bulk carriers – 1.56 million GT, Crude tankers – 0.71 million GT, product tankers – 0.89 million GT, and others – 0.63 million GT. In order to meet the massive investment required for replacement of ships during the next 5 years, all possible methods of funding need to be tapped. At today's costs, for achieving the proposed tonnage target of the 11th Five Year Plan of 12 million GT (after replacing 3.7 million GT of old and single hull vessels), an estimated investment of Rs.11 billion will be required in the shipping sector. The industry is not of the size which can raise such resources easily nor has it a comparative return on investment that it can attract equity easily. This issue needs to be examined carefully as acquiring ships would be critical for a country where merchandise trade is increasing at more than 25 per cent in the last few years.

Some changes need to be made in the Merchant Shipping Act also. The Indian shipping industry is regulated by the Merchant Shipping Act 1958. Though robust in framework, the Act, over the years, needs certain amendments to facilitate new business environment for Indian shipping like offshore maritime services, inter modal transport, cruise shipping etc. and to reflect the current global best practices in shipping. There are issues like definition of the vessel, coastal trade of India, acquiring vessels on BBCD basis etc.

Some changes are also needed in the Multimodal transportation of Goods Act 1993.Since the cargo movement from different modes within the country caters to more than one mode of transport to reach the maritime port for exports (vice versa in respect of imports) and increasing recourse towards picking up and reaching the cargo at the door of origin/destination, the need for synergies amongst the different modes of transport for such multimodal transportation is well established. Promotion of multimodal transport needs to address the various issues so as to save time and cost efficiency. This would require rationalization of the existing provisions of the Multi-Modal Transportation of Goods Act, 1993, to support easy transportation and documentation through different modes of transport.

Some other issues which need to be examined include minimizing the difficulties faced in conversion of foreign-going vessels into coastal vessels and vice versa under the Customs Act in order to save time and costs in the interest of overseas trade and coastal shipping; evolving a strategy to maximise commercial interests to increase use of ships of the country's flag to carry the trade; and promoting ship registry services in India.

The plurilateral requests presented to India at WTO in the case of maritime transport include elimination of cargo reservation (mode 1), elimination of restrictions on foreign equity participation (mode 3), elimination of restrictions on the right to establish a commercial presence (Market Access, Mode 3), elimination of nationality requirements of board members (mode 3) and elimination of any other preferential treatment (National Treatment) in the case of commitments on international freight transport (less cabotage). Similarly there are requests for maritime auxiliary services, additional commitments on the access to and use of services necessary for the conduct of multimodal transport operations, elimination of MFN exemptions, etc. While there is a need to examine which of these domestic restrictions can be removed by India, the requests include some additional commitments on the access to and use of port services like making available to international maritime transport suppliers on reasonable and non discriminationary terms and conditions pilotage, towing and tug assistance, provisioning and fuelling & watering, garbage collection and ballast waste disposal, port captain's services, navigation aids, shore-based operational services essential to ship operations including communications and water and electrical suppliers, emergency repair facilities and anchorage and berth and berthing services. While some of these restrictions exist even in developed countries, it may not be difficult to remove some of these restrictions which may even facilitate India's trade. Similarly the collective request in logistic services submitted to India include requests like ensuring that various procedures and formalities such as documentary requirements, customs clearance, customs inspection, and electronic processing, would not be unnecessarily burdensome and request of ensuring that electronic versions of trade administration documents will be accepted. In comparison to US, India's restrictions are very mild. There is no price preference, only a right of first refusal for government cargo in favour of Indian ships if they match the lowest bid received, and a weak cabotage policy that is relaxed readily if no Indian ship of exactly matching description is immediately available. However, India can examine whether accepting some of these requests may facilitate India's trade and help in putting pressure on some countries like US (which has been opposing negotiations in maritime services) to negotiate.

3.6.5. **Other Transport Services**

While 100 per cent FDI is allowed in maritime and road transport, for air transport services, FDI cap is at 49 per cent, though 100 per cent FDI is allowed for NRI and 100% FDI is allowed for airports. In the case of railways which is in the public sector, both FDI and private participation are not allowed. Some issues in transport which are also linked to internal trading are the restrictions on inter-state movement of goods and coordination issues between government departments in the case of multimodal transportation.

Inland Water Transport (IWT) also needs to be promoted. For example, for a city like Mumbai that gets about 80 million tons of cargo from two major ports alone (JNPT and Mumbai Port) every year, waterways could come as a big relief, more so because cargo traffic in the region is set to cross 154 million tons by 2013-14. Estimates show that if inland waterways are used, the distance from Mumbai Port to Nagothane which is 97 km by road, will stand reduced to 57 km, and the Mumbai Port to Belapur will be only 23 km against the existing 38 km. Even the Mumbai-Panvel distance which is 44 km by road and 68 km by rail will be reduced to just 32 km. A 1,000 ton barge (small ship) takes off 100 trucks from road. It is also estimated that per billion ton-km of cargo shifted to inland waterways transport mode would result in annual savings in excess of Rs.50 crore by way of savings in fuel alone. The inland waterways revenue collection of Rs.1 lakh results in 11 times the employment that is generated when the rail mode of transportation is adopted, or roughly eight times the employment created through the road mode. The average road haulage of a kilo meter with 25 ton of cargo will consume one liter fuel, while the same haulage by rail will carry 80 tons of cargo. With inland waterways it can carry 105 tons of cargo. These savings are apart from the benefit of reduction of pollution. Since the social and economic benefits are very significant, the role of IWT in social development can be noteworthy and needs to be examined carefully and urgently.

There is also the issue of free movement of cargo between various ICD's, CFSs and Ports. Currently the movement of cargoes is permitted under custodian bond between CFSs/ICDs at Inland destination with gateway ports only. For the movement of cargoes between two CFSs or two ports separate bond and Bank Guarantee has to be given by users. Many a times exporters from foreign countries send consignments for more than one port. In such cases, the cargo has to be transshipped at a port outside India from where it is segregated for different Indian Ports. There is a need to examine whether free movement between any Port/ICD/CFS under their respective custodian bond could be permitted without requirement of separate Bond or Bank Guarantee by the user.

The issue relating to levy of Service Tax on transport by rail is another important issue. The entire position can be summarized as follows: For rail transportation of containers, an abatement of 70% is permitted. When a container is booked for transportation by rail, Container Corporation of India Limited (CONCOR) collects service tax on 30% element of rail freight. As such the amount billed towards rail freight by CONCOR is 1.03672 times the rail freight. Since almost all the shippers carry out their transactions through shipping lines, the shipping lines pay the rail freight charges to CONCOR on behalf of the shipper. Shipping lines, in turn, include the amount paid to CONCOR towards rail freight (inclusive of service tax charged as per rules) in the consolidated bill to shipper and again levy service tax @12.24% on this element also as this is the rate at which service tax has to be charged on Business Support Services. Thus the shipper ends up paying 1.16527 times (1.03672 x 1.124) the rail freight, thus amounting to a service tax levy of 16.53% as against 3.672% leviable as per rules and as actually charged by CONCOR. The double levy of service tax at two stages, thus results in increase of transaction costs affecting multimodal movements in the country. This cascading effect of the service tax is because there is a provision in Service Tax (Determination of value) Rules 2006, as per which there are conditions prescribing that a service provider should act as pure agent of recipient of Service. As per shipping lines interpretation, they have 'principal to principal' relationship with their clients. Hence, they levy service tax on entire amount leading to cascading effects. This is also prompting many rail users to turn to road where the levy is only on 25% of the road freight (after abatement of 75%) and where road transporters always act as 'agents' of shippers. This matter needs to be examined and clarifications issued, if necessary.

3.6.6 **Construction, Engineering and related Services**

The plurilateral requests made to India at WTO include elimination of foreign equity limitation (Market Access (MA)), elimination of restriction on types of commercial presence (i.e. subsidiaries, branches and representative offices) and joint venture and joint operation requirements (MA/National Treatment (NT)), elimination of discriminatory registration requirement and licensing procedures (NT), elimination of restrictions on the types of projects undertaken by foreign service suppliers, including the size of projects assessed by the total project value (MA/NT) and elimination of burdensome asset requirements. However, India's revised offers have no limitations under mode 1 and 2 while it has market access limitations under mode 3 that establishment would be only through incorporation and subject to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required. Mode 4 is unbound except as indicated in horizontal section related to visas particularly for contractual service suppliers under engineering and architectural services category where access is available for the mentioned sectors, provided employees have appropriate educational and professional qualifications relevant to the services to be provided. For independent professionals also access is available for these specific sectors. The USTR has reported that many construction projects are offered in India only on a non-convertible rupee payment basis. Only government projects financed by international development agencies permit payments in foreign currency. Foreign construction firms are not awarded government contracts unless local firms are unable to perform the work. Foreign firms may only participate through joint ventures with Indian firms.

Though 100 per cent FDI is allowed in Construction, Development projects, there are restrictions like minimum capitalization norms, some restrictions on repatriation, minimum area norms under Press note 2 (2005) and a general umbrella clause that all applicable rules/bye laws/regulations of the state government/municipal/local body concerned have to be complied with. There is also the issue of high stamp duty in some states, though the central government has been able to persuade some state governments to lower stamp duties. The other issues are, need for a standard contract document for all domestic projects, uniformity in regulatory norms, addressing the issue of the demand for employment of locals, need for consortiums to bid effectively for international projects, issues related to bank guarantees or earnest money in the bidding process, etc. The small size of Indian firms in construction is another constraint for India. For example, nearly 90% of housing construction companies in India are single owner proprietorships. A World Bank study has pointed out that one reason why construction services firms in India operate at a small scale, and cannot exploit economies of scale, is the legal framework governing the sale and acquisition of land as outlined in the Urban Land (Ceiling and Regulation) Act (ULCRA), 1976. According to the ULCRA, no person is entitled to hold any vacant land, in excess of the ceiling limit stated by the Act. This law in effect prevents anyone from buying a large tract of land to construct houses. The law also vests discretionary powers in state governments to grant exemptions, leading to corruption in the exercise of these powers. Further, the government has the power to acquire the entire ceiling-surplus vacant land at a nominal price, leading to lengthy disputes and litigation. Consequently, competition in housing construction is not based on costs but on securing access to lands and circumventing the regulatory impediments.

Some policy measures that could be taken to help this sector are competitive access to land and institutional finance and amending the Urban Land Ceiling Act, which could lead to larger size of firms, higher market capitalization and professionalism.

Liberal import of high tech equipment is permitted for infrastructure projects, but the procedures require fine-tuning. For example, there is a 5-year restriction on sale of imported equipment. These equipments are expensive and have 10-15 years of useful life though the project may use it only for 2-3 years. Allowing its resale or lease could enable construction companies engaged in similar projects to buy or lease the equipment from other domestic companies. There is a need to address this issue. There is also a need to examine whether the member companies of Joint Ventures can be allowed to import duty exempt goods in their own name instead of in the name of JV, since these have to be held for 5 years as per policy, while a JV may cease after 2-3 years on completion of a project.

3.6.7 **Insurance Services**

The Indian insurance sector was opened to private and foreign participation as suggested in the report of the Committee on Reforms in Insurance Sector (Malhotra committee). As a result, today there are 16 companies licenced in Life Insurance and 15 in non-life insurance sectors. Though GIC Re is the only reinsurer operational in India as of now, even this area is open to entry for foreign and private participation.

In the case of Insurance services, there is the main issue of 26% cap on foreign investment besides restrictions like minimum capitalization norms, funds of policy holders to be retained within the country, compulsory exposure to rural and social sectors and backward classes. The regulatory restrictions mentioned here are within the purview of Government and Insurance Regulatory & Development Authority. A consensus is needed in some of these issues to make further headway.

3.6.8. **Health Services**

There are no explicit barriers on commercial presence of foreign firms, but there are restrictions on foreign service providers under mode 4. Besides, responsibilities are divided between centre and states and there is the absence of a standardized accreditation system.

In the case of medical and dental services, services provided by midwives, nurses, physiotherapists and para-medical personnel and hospital services, India has no market access and national treatment restrictions at WTO under mode 2. Under mode 1, there are no national treatment restrictions and there are no market access restrictions for provision of services on provider to provider basis such that the transaction is between established medical institutions covering areas of second opinion to help in diagnosis of cases or in the field of research. In the case of mode 3, market access is only through incorporation with a foreign equity ceiling of 74% subject to the condition that the latest technology for treatment will be brought in and subject to the condition that in the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required. In the case of national treatment under mode 3, publicly funded services may be available only to Indian citizens or may be supplied at differential prices to persons other than Indian citizens. Mode 4 is unbound except for horizontal commitments related to entry visas.

In the requests at WTO made by India's trading partners, India has been requested to take full market access and national treatment commitments under all 4 modes, allow joint ventures and permit foreign doctors with national linceses in the country of origin to practise for three years or more for medical and dental services; take full market access and national treatment commitments in all modes for services provided by midwives, nurses, physio therapists and medical personnel; and take full market access and national treatment commitments in modes 2 & 3 and remove equity limit of 51 per cent. While India has now raised this equity limit to 74 per cent, there is a need to examine carefully the other requests related to relaxation of domestic regulations also keeping in mind the social implications.

3.6.9. **Accounting**

The accountancy service providers in India are self-regulated through a combination of legal and professional bodies like the Institute of Chartered Accountants of India (ICAI) and the Institute of Cost and Work Accountants of India. The accountancy professionals are only allowed to operate either as a partnership firm or as a sole proprietorship firm. Since the Partnership Act of India permits only 20 or less professionals under one firm, this *de facto* means that the number of partners in Indian accounting firms are limited to 20 or less. Further, the number of statutory audits of companies per partner are restricted to 20. Indian regulations also proscribe inter-disciplinary professional models, i.e. accounting firms are not allowed to hire management professionals to perform consulting/management services. As a consequence of the above restrictions, less than 200 firms (or 0.5 per cent of total accountancy firms) have more than 10 partners. A World Bank study has pointed out that many Indian services sectors are highly fragmented compared to international standards. For example, there are 100,000 chartered accountants in India and 43,000 audit firms, with an average of two chartered accountants per firm compared to an average of between 350 and 1500 chartered accountants in the "big four" accounting firms in India. Due to their small size, domestic firms have been less successful in competing with international firms in the lucrative consultancy/advisory and non-statutory work markets.

The restrictions in Accounting sector in India as pointed out by other countries are the following. Only graduates of an Indian university can qualify as professional accountants in India. Foreign accounting firms can practice in India, if their home country provides reciprocity to Indian firms. Internationally recognized firm names may not be used, unless they comprise the names of proprietors or partners, or a name already in use in India. This limitation applies to all firms except those that were established prior to the imposition of this rule. The Institute of Chartered Accountants of India (ICAI) continues to ban the use of logos of accounting firms. Only firms established as a partnership may provide financial auditing services. Foreign accountants may not be equity partners in an Indian accounting firm. Given the high potential for export of accountancy services of India by the outsourcing mode, there is a need to examine which of the domestic regulations can be relaxed particularly to facilitate tie-ups and penetrate the foreign markets. To enhance export of accountancy services, there is also a need for the foreign countries to give due recognition to Indian qualifications in terms of mutual recognition agreements (MRAs). In certain cases, the problem has been compounded by non-recognition of overseas qualifications by domestic players. Problems arising from frequent changes in the provisions of the Company Act is another issue which needs to be addressed.

3.6.10 **Legal Services**

The Advocates Act, 1961 and the Bar Council of India Rules, 1975 are the rules which regulate the legal services sector in India and the Bar Council constituted under Advocates Act, acts as the final regulating body. In India, legal services can be provided only by natural persons who are citizens of India, who are on the rolls of the advocates in the states where the services are being provided. The service provider can either be a sole proprietorship or a partnership firm consisting of persons similarly qualified to practice law.

In order to be eligible for enrollment as an advocate, a candidate has to be a citizen of the country or a country which allows Indian nationals to practice as per the reciprocity treatment, has to hold a degree in law from an institution/university recognized by the Bar Council of India (BCI) and be at least twenty one years of age. FDI is not permitted in this sector, and international law firms are also not authorized to open offices in India. Foreign service providers may be engaged as employees or consultants in local law firms, but they cannot sign legal documents, represent clients, or be appointed as partners.

Moreover, Indian advocates are not permitted to enter into profit sharing arrangements with persons other than Indian advocates. Foreign Law firms are not permitted to open offices in India as per the Advocates Act 1961 and they are also prohibited from giving any legal advice that could constitute practicing of Indian law.

India has not undertaken any commitment in the legal services sector during the Uruguay Round of negotiations. It has neither offered any commitments in legal services in its Initial Offer nor in its Revised Offer submitted to the WTO during the course of on-going services negotiations under GATS. There is a strong sentiment amongst various members of the profession that permitting foreign law firms even in a limited way would lead to the shrinking of the opportunities available to domestic lawyers.

A Department of Commerce paper on 'Trade in Legal Services' states that it is important to look into the immense trade potential of the Indian legal profession, but without compromising on the interests of Indian advocates. At the same time, it is a reality that the Indian economy is fast integrating into the global economy. While a number of foreign companies are investing in India, Indian companies are also acquiring foreign companies on a regular basis. This requires capacity building of Indian lawyers and Indian law firms in areas such as international law, third country law, patents law, etc. so that they can, not only advise the foreign companies in India, but also support Indian companies acquiring assets abroad.

The global legal services market has been estimated approximately at US$ 20 billion annually and India has the world's second largest legal profession with more than 600,000 lawyers with the Indian commercial law practice estimated at around Rs.600-650 crore per annum. The Department of Commerce paper also states that development of legal profession in India has been restricted on account of a number of impediments in the current regulatory system which hinder Indian law firms from competing effectively against foreign firms. Some of the current restrictions, which severely limit the scope of growth in the legal profession, are:-

i) Partnerships are the only permitted model of practice for law firms in India.

ii) Further modes of practice such as limited liability partnerships or limited liability corporation are not permitted.

iii) Limitation on the number of partners to 20. This limits the growth and size of Indian law firms.

iv) Bar on advertising, even having entries in law directories.

v) Practice of law is treated as a profession and not an industry resulting in lack of finance for lawyers.

vi) Ban on advertising.

vii) Multidisciplinary practicing firms not allowed

Having functioned in such a limiting framework for the past fifty-years, the Indian legal profession is today ill-equipped to compete on par with international lawyers, who have grown their practices in liberalized regimes and have vast resources at their disposal. Besides there are only a few firms in India having the expertise to handle commercial work for multinationals.

The Bar Council of India is opposed to the entry of foreign lawyers/law firms in any manner and the stand of the Bar Council of India has been brought to the notice of the Government of India on a number of occasions. With the recent developments like outsourcing of administrative work of legal firms of UK, we need to have a more open mind on legal services and at least facilitate overseas firms to outsource legal services to India.

3.6.11 **Education Services**

India has not given any commitments during the Uruguay Round in higher education services. However, 100 per cent FDI in higher education services on automatic route is allowed in India. Also, foreign participation through twinning, collaboration, franchising, and subsidiaries is permitted. India has received requests from several countries like Australia, Brazil, Japan, New Zealand, Norway, Singapore, and the US. A similar request in higher education services was repeated in the plurilateral negotiations held recently at the WTO.

In the revised offer of India in August 2005, while mode 4 is unbound except for horizontal commitments, there are market access limitations under mode 1 like the condition that service providers would be subject to regulations as applicable to domestic providers in the country of origin and under mode 3 the condition that fees to be charged can be fixed by an appropriate authority and that such fees do not lead to charging capitation fees or to profiteering. Further, this is subject to such regulations, already in place or to be prescribed by the appropriate regulatory authority. In the case of foreign investors having prior collaboration in that specific service sector in India, FIPB approval would be required. The condition that service providers would be subject to regulations as applicable to domestic providers in the country of origin (and not the host country) needs to be examined.

Even though India included higher educational services in its Revised Offer, many civil society groups continue to express reservations on the grounds that this would open floodgates for entry of foreign higher education providers into India. Their entry was opposed for their being insensitive towards cultural and educational ethos in India and the fear that this would lead to the commodification of education in India. It is also feared that education could be positioned as a 'trade off' for gains in another sector. However, a Department of Commerce paper states that public education services provided free of cost on a non-commercial basis and not in competition with other service suppliers is outside the purview of GATS. In addition, the role of domestic regulation has been explicitly recognized for ensuring equity, consumer protection, standards, etc. in provision of public services. Given that India needs all the investment that it can get in the higher education sector, such fears and reservations seem to be somewhat overstated. What we should be aiming at is a sound regulatory framework with transparent rules and a stringent accreditation mechanism, which would protect the interests of students.

The Department of Commerce paper also states that India should also put in place a sound regulatory framework to govern private players (both domestic and foreign), which can focus on setting the rules of the game and have student interest as the main objective. Further, a viable financing model, with a mix of public and private participation has to be put in place. There is also a need is to see that Foreign Educational Institutions (FEIs) who may have low stakes in the overall system and make minimum investments in infrastructure and faculty do not misuse the system. Instead they should be encouraged to give quality education. Foreign governments should also be encouraged to fund their Indian campuses for sensitive, cutting-edge research.

Another issue needing attention is the multiple controls and regulations exercised by the central and state governments and statutory bodies. This arises from the provisions in the Constitution of India, which has made education a concurrent subject, leading to interference and controls from both central and state governments, and controlling institutions. For example, the IMC Act 1956 was enacted at a time when the subject of "Education" including higher technical education was a "State" subject under the Constitution of India. In 1992 however, "Education" was transferred to the "concurrent" list of the Constitution and the Central Government/Parliament acquired the powers to enact legislation on higher technical education. Consequently, the IMCI Act was amended by the Parliament giving higher powers to the MCI and the Government of India with respect to Medical Education. For example no new Medical College's could henceforth be established without the prior permission of the Government of India, which had to refer all applications for the new Medical College's and/or augmentation of intake capacity or starting of new courses to the MCI. The IMC Act has laid down, extremely strict regulations which need to be reviewed as there has been enormous changes in the manner in which patient care is administered and in the methodologies regarding medical instruction. For example, as per MCI laws for a new Medical College there should be 25 acres of land. This would practically rule out establishment of Medical College's in metropolitan areas as costs would be prohibitive and render investments totally unviable. MCI also insists that new Medical College's must own and operate their own hospitals which means heavy investment while there are many government hospitals or even good private hospitals owned by others which can be attached to medical colleges, resulting in upgradation of services due to cross fertilization of talent between a medical college and the hospital. The insistence on a certain number of patients "350 to 500" and 80% occupancy by MCI is possibly outdated. This is because in a large number of procedures the stay in the hospital has been shortened drastically and highly sophisticated teaching modules have been developed, along with teaching aids which can lessen interface with patients. With today's advanced techniques such as keyhole surgery a gall bladder removal does not require hospitalization of even three days.

So the regulations with respect to establishment of new Medical Colleges, Patient load factors should be reviewed to be in tune with present day equipment intensive patient care and modern practices and procedures of medical education. Policy reforms should actively encourage Public Private Partnership (PPP) both in higher medical education and healthcare.

Quality of education and demand supply mismatch are other issues. While a select number of institutions in the country do offer, world-class education, in most institutions the quality of education is quite unsatisfactory without a continuous effort to upgrade standards, teaching methods, content of learning, and the quality of teachers. There is also a serious mismatch between institutional output and the demand in the market. In some areas there is a surplus, whereas in many others shortages are felt. There are some serious mismatches between states. For example, there is high demand for medical and engineering colleges/seats in Delhi. But there are few medical colleges and new colleges do not come up despite the potential for many institutions/hospitals to set up medical colleges. Neighbouring states are capitalizing on this situation. In fact, the higher education system has not yet prepared itself to meet the new challenges posed by the increase in the pace of liberalization of the Indian economy and its gradual integration with the world economy. Worldwide there is a shortage and many countries are taking active measures to import talent. France has introduced a "Scientist Visa" and Singapore and China are offering a range of incentives. Countries are also actively encouraging expatriates to return. China is going through a massive expansion in technical education aimed at creating 100 world class Universities with a growth in Research and Development expenditure from US$12 billion in 1990 to US$85 billion in 2003.

3.6.12 **Banking Services**

The predominance of government ownership in the banking sector is considered to have led to insufficient competition in the Indian banking system. A World Bank study has pointed out that this lack of competition in turn has increased the cost of intermediation, lowered the efficiency of capital allocation and led to under-lending to the private sector. While the market share of public sector banks in total assets has declined by 10 percentage points between 1991 and 2001, at the present 80 percent share, the public sector ownership of the Indian banking system remains one of the highest in the world. The study suggests that for every ten percentage points decline in the public sector ownership in the banking sector, the interest spreads could fall by 39 basis points and the ratio of private sector credit to GDP could increase by as much as 7 percent. The Indian public sector banks (PSBs) are also saddled with excessive labour and higher non performing assets (NPAs) relative to both new private sector banks and foreign banks. Though in absolute terms, the Gross NPAs of PSBs are high at 78.6% of total NPAs of Scheduled Commercial Banks (SCBs) in 2005-06, as a percentage of both net advances and total assets, they have been falling and are at around 1%, as is the case with private sector and foreign banks.

Under its commitments made in December 1997, India has withdrawn the exemption it had on MFN principle based on reciprocity in insurance, banking and other financial services. India has also increased the limit on the number of bank licences to be granted per year from eight to twelve and has also introduced more flexibility in reinsurance allowed to be taken abroad. Automatic access to financial market is not committed yet and licensing to foreign banks would be curtailed when the share of these banks in the total assets of the banking system exceeds 15%. As competition intensifies and risks of recovery mount, the need for banks and Financial Institutions (FIs) to evolve sophisticated tools for evaluating different types of risks will assume greater importance and Indian banks should be prepared for this.

Corporate customers today face a highly competitive environment where they need to cut costs, maintain quality of products, adhere to international standards and keep up strict delivery schedules. Banks and FIs will therefore have to cut down on the time taken for project appraisals and disbursements. This can be done by promoting within themselves special appraisal skills meant for specific industries. The RABO Bank of Netherlands specializes in financing agro-based and processed foods industries. Banks in India will also have to gear up through restructuring and reorganisation to develop specialized project appraisal cells. This can be done by capitalising on the skills developed and information base built up in the past, accompanied by the setting up of a streamlined internal data management system. In this context, the idea of setting up a Credit Information Bureau, designed to obtain and share data on borrowers to facilitate sound credit decisions is a welcome move and will enhance the speed of sound credit related decisions. Merging of the core competencies of FIs with those of commercial banks will also bring in the much needed consolidation in the domestic financial sector, which can successfully address the emerging challenges of the GATS obligations and benefit from the opportunities offered through Market Access and MFN.

Along with the challenges posed by the GATS Agreements, the negotiations that would follow between member nations regarding Market Access and MFN, on the basis of reciprocity could eventually open up opportunities for Indian banks and FIs to look beyond the domestic markets. For this, Indian public and private sector banks and FIs have to adopt and imbibe international norms and practices and strengthen their capital base by mergers and acquisitions before launching their operations in the highly mature international financial markets.

3.6.13 **Tourism Services**

Tourism contributes over 10 per cent of global GDP and its potential in India, given the country's enormous natural, human and technological resources, is well-recognised The sector's backward and forward linkages, are felt particularly in hotels, restaurants, and handicrafts. While a recent study by National Council of Applied Economic Research estimates tourism's contribution towards GDP (both direct and indirect) in India at only 5.9 per cent, India has already emerged as a very fast growing tourist destination in the world. Given its bio-diversity, variety of unique destinations and natural locales, India can transform itself into a 365 days a year destination with increased emphasis on new products like medical tourism, rural tourism, and wellness tourism, and marketing India as a destination for Conventions and Exhibitions through a network of India Trade Promotion Organisation (ITPO) like institutions.

Some issues related to Tourism sector include reducing the overall tax impact on tourism which is around 30-35% in India, and is high compared to other countries, easing barriers on travel through easy visa on arrival for select countries, establishing a special tourism police force at important tourist destinations, establishing Budget hotels at identified railway sites with private sector participation, upgrading airport infrastructure in a time bound manner, cleaning drives in tourist spots and metros, etc.

3.6.14 **Printing and Publishing Services**

The printing and publishing industry is developing at a very fast pace and India has the advantage of having low cost labour and a large English knowing young population. With 12.5 per cent growth per annum, the Indian Printing Industry can generate phenomenal increase in employment opportunities.

One of the policy issue related to this sector which needs to be examined is the Customs duty on import of state-of-the-art printing and allied machinery and equipment which are not being manufactured in India and at present is at 7.5% with 16.48% CVD and 4% special CVD with total duty of 31.011% . Besides, in India, printers have to pay 10 per cent customs duty together with 12.36% CVD and 4% special CVD with total duty of 29.275% on paper and paperboard. The total duty on import of paper and paperboard is therefore relatively high. But, printed materials can be imported at nil or lower customs duty due to the bilateral trade agreements. In case of countries like Singapore & Hongkong known for printing and publishing services, the customs duty is 'Nil' for both printing machinery and paper and paper board. In China, the customs duty on paper and paperboard in 2005 was 7.5% and for printing machinery it was 8.12%.

There is also the issue of the relatively high Central Excise on carton, boxes etc. (covered under Chapter 4819) at 16%. The SSI Units supply the above materials entirely on credit basis and the buyers delay the payment inordinately for periods as long as 4 to 6 months. So, the SSIs have to pay out of their own funds, 16% central excise duty on the aggregate clearances every month. Lowering of central excise duty to, say 8% could be an option as it would help the SSIs from the substantial financial burden. Since there is no loss of revenue as a result of the above as cartons, boxes and other packing containers are only intermediary product inputs used for packing final products and whatever excise duty is charged on them will be availed of as cenvat credit by the buyers of such packaging materials for packing their end products in them. Such end products will, in any case, yield the full excise duty on the aggregate value of the end products including the value of the packaging materials. However, total customs duty will also fall due to fall in CVD if this is reduced.

There is also the issue of inverted duty structure in printing sector as paper and paperboard has 32% duty and printed material has lower duty.

The above limited but vital issues, if examined and addressed, could help this sector substantially.

3.6.15 **Consultancy Services**

Consultancy is another important service sector with promising signs for India. Global market of consultancy services is estimated at US$160 billion. It is estimated that management consultancy services exports can reach $8 billion by 2015. A new opportunity that is coming up is in the form of offering back office consulting and sub-contracting work from foreign consultancies.

International accreditation is an important issue for consultancy. Chinese consultants are catching up, learning English at quick pace and have recently become members of the International Council for Management Consulting Institute. CEC China which is spearheading the movement has been recently accredited by ICMCI. However, this is lacking in India. There is a need for recognition of either CDC or IMCI so that there is proper accreditation which is internationally recognised.

In the engineering consultancy services sector, as these services are linked to a large extent with engineering projects, there is a need to build up a comprehensive data base which could provide information on services sectors with high export potential. While such data are available for the software sector, the same needs to be built up for engineering consultancy services. Regarding market access, a policy of quid-pro-quo could help to open up overseas markets for Indian service providers in markets like European Union.

3.6.16 **Inference**

Thus, India’s services sector has many restrictions. A World Bank study has pointed out that those sectors that have been aggressively liberalized – telecommunications, computer and related services, other business services (management consultancy, R&D, advertisement etc.) and hotels and restaurants – have experienced higher employment growth than sectors which are relatively less liberalized or closed.

Removing some of the restrictions 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 socials 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. Entering into mutual recognition agreements (MRAs) for recognition of qualifications, titles & standards and getting accreditation for Indian institutions in target countries is another area for focus.

4

Executive Summary and Conclusion

4.1 **Growing Importance of Services Sector for India**

Services sector is important particularly for India. In the short and even medium term, the sure bet for higher growth of the Indian economy lies in further accelerating the growth of the services sector, which can be done with considerable ease compared to other sectors due to India's competitive advantage in services.

4.1.1 **GDP Growth:** In India, the growth rate of services in 2004-05, 2005-06 and 2006-07 were 9.6 percent, 9.8 per cent and 11.0 per cent, respectively and is expected to grow at 9.9% in the 11^{th} Plan. The ratcheting up of the trend rate of GDP growth of the economy from 6% to about 7% per year and reaching 9.4% in 2006-07 was due to the ratcheting up of the trend growth rate in the services sector from 6.7% in 1983-93 to 8.2% in 1993-03 and further to 10 per cent since 2004-05 to reach 11 per cent in 2006-07. As a result, the share of services in India's GDP has increased from 37.6% in 1993 to 54.1% in 2005-06 and 54.9% in 2006-07. If Construction is considered as services, this share will increase to 61.8 per cent. Thus, India is nearing the shares of countries like the US, where the share of services in GDP is 73% (2003).

India's growth experience does not seem to follow the theory of stages as the high growth and high share of services sector which is a feature of a developed economy has been attained by India even before reaching a developed stage. The constraints in the industrial and agricultural sectors and the natural advantage of India in services sector has led to a services led growth of the economy. While the constraints in the other two sectors need to be removed as is being attempted now, there is a need to tap the full potential of the services sector. Services sector growth can also complement growth in manufacturing sector as there are many sectors where a lot of complementarity exists between services & manufacturing growth. Identifying and promoting the growth of these sectors with considerable backward and forward linkages can help growth of both services and manufacturing and some manufacturing sub-sectors can ride piggy back on the success of the complementary services to achieve quick growth.

4.1.2 **Services Export Growth:** While there has been a services dominated growth, India is also moving to a services dominated export growth. While merchandise export growth was 21% in 2006-07, services export growth rate in 2006-07 was 32.5% on top of a 31.7% growth in 2005-06. While the \$ 31.3 billion software services grew by 32.6% in 2006-07, the \$31.1 billion non-software miscellaneous services (mainly including business services) neared the value of exports of software services with growth of 39.3% in 2006-07 on top of a 67.0% growth in 2005-06 and 150.3% growth in 2004-05. This shows that besides Software services, there are many other niche sectors like professional services.

Services Exports at $ 81.3 billion in 2006-07 is nearing merchandise exports at $124.6 billion. While India's share in world merchandise exports is only 1% in 2006 with the rank at 28, its share in world commercial services exports is 2.7% with a rank of 10.

4.1.3 **Services and Balance of Payments**: Services trade has been acting as a cushion for India's current Account of Balance of Payments helping in covering the trade deficit. If remittances, which reflects a factor service like labour service is also considered, then the two components (factor and non-factor services) have more than covered the trade deficit leading to a current account surplus till 2003-04. While in 2002-03 and 2003-04 the gap between net services and net transfers was substantial, this gap has narrowed down, and in 2006-07 net services of $32.7 billion was higher than the $ 27.4 billion net transfers. This has happened despite the liberalization of services imports resulting in a near doubling of services imports in 2004-05 compared to 2003-04 and further growths of 20.5% and 29.5% in services imports in 2005-06 and 2006-07, respectively.

4.1.4 **Openness of the Economy:** If services trade which has been increasing steadily for India is also considered, total trade as a percentage of GDP shows a remarkable increase from 17.5% in 1990-91 to 52.7% in 2006-07.

4.1.5 **FDI in Services:** World over there is a shift in FDI towards services. This is more so with India's FDI inflow to services sector which constituted around 30% of FDI equity inflows compared to the 12.5% in 2004-05. This is however an underestimate as the Department of Industrial Promotion & Policy's (DIPPs) definition of services does not include computer software, telecommunications and transport.

4.1.6 **WTO negotiations on Services:** While the Doha round of negotiations which was freezed due to the stalemate in Agricultural negotiations, has been defreezed, failure of negotiations could result in loss to India in services sector where it could be a major beneficiary unlike other developing countries. A clearcut strategy for services highlighting the potential gains for India in terms of growth, employment and exports can possibly give a new direction to the Indian strategy in WTO negotiations.

4.1.7 **Employment and Services:** The tertiary sector is the leading sector of growth in the Indian economy not only in terms of output, but also in terms of employment with India's share of employment growth in the tertiary sector being higher than in manufacturing sector on Usual Principal Status (UPS) basis. In the decades of eighties and nineties, the fall in the share in employment in agriculture sector has been increasingly absorbed by the tertiary sector. However, in 2004-05 compared to 1999-2000, there is a change with the fall in employment share of the agriculture sector being absorbed both by the manufacturing and tertiary sectors with a higher share for the former. While the recent rise in share in employment growth in manufacturing sector is a positive development, the importance of services in employment creation needs to be noted, particularly when India is competitive in many labor-intensive and skill-intensive services and there is a huge market (both domestic & external) including outsourcing to India, which needs to be tapped further.

4.1.8 **Inflation & Services and Domestic Terms of Trade including Services:** The Wholesale Price Index (WPI) which is the main indicator of inflation, in India does not include services. The different consumer price indices in India include some services but their weightage is only about 10-15 per cent (though services form 54 percent of the GDP), while, in USA, where the contribution of services to GDP is around 73 percent, the consumer price index for all urban consumers (CPI-U) gives 59.9% weightage for services and consumer Price Index for urban wage earners and clerical workers (CPI-W) gives 55.4% weightage for services. In India, the services included in consumer price indices are medical care, education, recreation & amusement, and transport & communication, while in the GDP of India the major services are trade, hotels, transport and communication and financing, insurance, real estate and business services. A look at some services items included in Consumer Price Index for Industrial Worker (CPI-IW) for the latest available month shows that in May 2007, point to point inflation of Education & Recreation is only 2.0% compared to general CPI-IW inflation of 6.6%. Another item, Medical care (including both services and commodities) has inflation of only 5.9%. Transport and communication has a inflation of only 1.6% which is also a reflection of the low inflation of fuel. But none of these services have the high inflation of 9.1% of food group. With the fall in prices of services like telecommunications, air transport (with no frills flights) and metro services, there is an indication that inflation could have a moderating effect, if services are included in inflation calculations. Besides, prices of services do not fluctuate at short intervals like commodity and manufacturing prices. Further, inclusion of services in domestic terms of trade would reflect the actual change in distribution of income between all the three sectors.

4.2 Export Opportunities and Export Capabilities for Services

The growth of the services sector and consequently the growth of the Indian economy, perhaps has a trade angle. Though external trade is taken only ‘net’ in the GDP and its effect may not be felt directly as the deficit in merchandise trade overshadows the positive balance in services trade, the indirect effects of exports of services is high on the domestic growth of services and even industry. For example, the domestically dynamic services like trade, hotels, transport and communications etc. are related to important services in exports like travel and transportation. The growth in export of software services have given fillip to domestic production and use of these services.The dynamic growth of professional services exports have a bearing on the growth of these services domestically. Similarly growth of shipping services and travel services exports can have a direct bearing on domestic industries related to these services.

4.2.1 **World Import Basket of Services** : In the $2.6 trillion world imports of services in 2006, the top 10 importers in world commercial services in 2006 as per the WTO data were USA, Germany, U.K., Japan, France, Italy, China, Netherlands, Ireland and Spain. India which moved from the 15th position in 2004 to 10th position in 2005 was in the 12th position in 2006 with 2.7% share. The three countries/groups, namely, USA, EU-15 and Japan constitute 63.5% of world imports of services. Despite India's good performance in services, it is not among the top seven partners of any OECD country in their bilateral service trade, both in exports and imports in 2003, while China, Singapore, Taiwan, Hong Kong and relatively less developed countries like South Africa, Egypt, etc. appear in the list. In the world imports of services, the major service category is other services (mainly consisting of business services) with its share steadily increasing to reach 43% in 2004. In the Indian case also, the exports of 'other services' are very important with a share of 70% in total services exports of India and 2% share in world imports of other services in 2003. However, compared to India's share of 1% in world merchandise exports and 2.7% in world services exports in 2006, the share of India's transport services at 0.7% in 2003 of world transport services imports is rather low. Thus there is a need to focus immediately on transport services which includes Shipping/Aviation and related services like Port Services besides focusing on the growing business services reflected in the 'other services' category. The other three services imports of OECD with high growth rates for 1997-2002 were Insurance services (12.7%) computer and information services (11.4%) and financial services (7.1%). The next important category is Royalties and licence fees particularly in US imports. In the case of computer and information services, which is India's major service exports to USA, US total imports of this service category is only 0.68% in 2004! This indicates that if India could make a big impact in this service category which has a small share in US imports, then there are many more big ticket service items where India can make a much higher impact.

4.2.2 **India's Export Basket of Services:** Growth of Miscellaneous services (including software services and business services) was high in 2006-07 at 35.9 per cent on top of growths of 70.5% in 2004-05 and 47.6% in 2005-06. The major category of export of services of India is also the miscellaneous services category with a share of 76.7% in total services exports in 2006-07. Non-software miscellaneous services exports have grown rapidly almost equaling the value of software services exports with business services (75.5% share and 82.4% growth) and financial services (10.3% share and 88.6% growth) being the major contributors. Communications services is the next important service. **Thus, besides transportation, travel and software services, the main focus of our exports needs to be on business services, (mainly consisting of architectural, engineering & other technical services and business management & consultancy services), communications services and financial services. This matches well with the world demand for these services.**

4.2.3 **Country-wise Exports of Services of India:** Some rough indication of country-wise exports of India can be seen from the mirror data of other countries. In US imports of other commercial services in 2003, the share of the $1.14 billion imports from India was 1.1% with a growth rate of 35.4% in 2003 over 2002. While the major sources of imports were the European & American countries and Japan, among the major Asian countries, only Hong Kong is ahead of India. Exports to US of a NAFTA member like Mexico is nearly double that of India, though its growth rate is only 9.2% and the share of a FTA partner like Israel though small is increasing . In US imports of travel services also, Mexico with a share of 12.9% in 2003 has greatly benefited mainly due to its proximity to USA and due to NAFTA, while other Latin American countries have a very small share. Imports from India with 1.2% share is also low, though it is the only major source among Asian countries except China. In the case of Transportation in 2003, India's share at 0.5% is negligible. Among Latin American countries, only Mexico has a relatively significant share of 2.9% due to NAFTA. The miniscule share of shipping services of India in US shipping services imports also points to the need for a strategy for this sector. Like USA, EU and Japan are also big markets and the OECD countries accounted for 75% of world services imports in 2003. In the case of European Union imports of total services in 2003, the $3.2 billion imports from India was only 0.4% of EU's total imports of services and in the case of other commercial services imports, while India's presence is visible in US, in EU, the share is only 0.3% in 2003, though the growth rate is 25.5%. In travel and transport services also, India's share is very low in EU imports, while China, Hong Kong and Singapore are ahead of India. Thus, in the case of Services imports, India's presence is much lesser in EU than in the US. However, in the case of UK's imports of total services, other services, travel services and even transportation services, India has relatively higher shares. Infact, the pattern of India's exports of services to UK is similar to that of US, rather than EU. The historical and cultural ties between India and UK may also be one of the reasons for this. India has not made any impact in the Japanese market in services. **Thus India's experience with services exports is**

not only different from other developing countries (which have yet to develop and market many of these services), but also different with respect to its direction of exports even among the developed countries. A strategic partnership with a developed country like USA or UK in services could help in increasing India's exports of different services manifold and even help in removing the different market access barriers. The importance of FDI in services is also evident from the fact that US trade in services with the foreign affiliates of its companies alone is 8.5% in 2002.

4.2.4 **Services Export Basket of Developed Countries:** The top 10 exporters of commercial services in the world in 2006 were the developed countries except China and India with the OECD countries having a share of 78% (in 2003). However, among the top 10, India has the highest growth rate of 34%, followed by China with 18%. In the US case, while among Asian countries, India is the second major source of imports in 'other commercial services', after Hong Kong, in its destination-wise exports of other commercial services, China and the other major South-East Asian countries are much ahead of India, which has only 0.5% share. But in the case of travel exports of USA (i.e. foreigners travelling to USA), India with 3.4% share is the second major Asian destination after South Korea. 'Other services' category is the most important category even in exports of developed countries with business services, royalties and license fees and financial services being the important services with rising shares.

4.2.5 **Focus Markets for India's Services:** In the case of services, the first tier of markets for commercial services as of now are clearly the US, EU, and Japan and some other OECD countries who are the major demandeurs of commercial services. However, if factor services like labour services, (both skilled and unskilled services) are taken, then we have the Gulf countries as the major importers of labour services, particularly unskilled and semi-skilled services. But there are some services, which if marketed well can be demand-creating like satellite mapping services, entertainment services, services related to Ayurveda and Yoga, etc. Even among the major markets, the composition of the import basket differs and accordingly the importance of the different services for different countries differ. For IT services, besides the traditional markets, i.e. USA and UK, there are the under-penetrated English speaking markets of Canada, Netherlands, Sweden & Australia and the under-penetrated non-English speaking markets of Japan, Germany, France, Italy which should be fully tapped. In the case of super-specialty hospital services, India's export effort is still in its early stage, though great scope exists in markets like USA, India's neighbouring countries, Middle East, Malaysia etc. In the case of satellite mapping services, India can export these services to Middle East, Bangladesh, South Africa and other African countries and even some developed countries. In the case of standardization and quality assurance services, the potential markets for exports of these services are the middle eastern countries, South Asian countries and African countries. In the case of printing services, besides the developing country markets, India can be the hub of advanced printing services for developed countries by making use of its advancement in software. In the case of technology intensive education services, India enjoys an important position in countries like SAARC countries, South Africa, etc. Some courses like Ayurvedic medicines, aircraft maintenance, ship repairs, printing technology, etc. are hardly offered anywhere else in the world.

4.2.6 **List of Important Services for India**: India has export potential in all skill-based and labour-based services. Besides software, tourism and travel related services and transport services, the services which are particularly important for India are: **professional services**, **R & D services, consultancy services, printing and publishing services, telecommunication services, repairs including ship repair services, construction services, educational services, some financial services, entertainment services**, **satellite mapping services,** and **standardization & quality assurance services**. Besides, India has a great potential to be an outsourcing destination for many of the above services.

4.2.7 **Need for proper mapping of services**: While our export basket shows that miscellaneous services representing business services are very important, the import basket of major countries also shows that other services representing business services are very important. Thus broadly the import and export baskets tally with each other. What is now needed is a proper mapping of the different services to be exported by India to the potential markets.

4.3 **Issues and Problems**

The potential of the services sector for India's GDP growth, exports and employment being very high, there is a need to address some issues which need the immediate attention of policy makers at the highest level. This can facilitate further growth of the sector. Some of these issues and problems are given below.

4.3.1 **Data Issues in Services:** While the importance of services is growing, statistical data and other relevant information on services is abysmally low. Even where data are available, they are not qualitative and suffer from deficiencies related to definition, method of collection, suitability for pricing and construction of indices. There are many sectors within the services sector, and consequently the data collected are also diffused. With WTO negotiations in 151 services, negotiators need statistics to negotiate specific commitments in services taking note of India's export potential. Leave alone price data, even disaggregate value data, sector-wise and country-wise are not available. Some of the important recommendations of the Services

Committee of the Dept of Commerce, for the National Statistical Commission, related to international trade in services data like sorting out definitional issues in services, conducting mandatory benchmark and annual surveys, classifying available data on services under different modes, collecting bilateral trade data on services, collecting export/import prices of important services, etc, need to be implemented in a fixed time period. A lot of work needs to be done in the balance of payments data particularly related to services both in India & internationally, which also includes basic definitional issues, classification issues and even verification of the work done in the different countries. In the National Accounts Statistics also, many-a-times, constant prices for services are calculated using proxies like GDP deflators, thus providing only a rough indication of the price movements of services. In the case of inflation also, services are not accounted, though the consumer price indices include some services under miscellaneous group.

4.3.2 **Need for a single nodal department/division/institution for services policy making:** Different service sectors have their own special characteristics. Some are mainly in the public sector, some mainly in the private sector and some others in both. For some, the policies are at the central level, while for some others, it is at the state level as some services are in the state list. For some, detailed commitments have been given by countries under the negotiations at WTO, while some others do not even find mention in these commitments. In the case of supply of some services, consumption abroad and movement of natural persons mode are important, while for some others cross-border supply and commercial presence mode are more important. Public policy in the services sector has to be seen by taking note of the diversities in the services sector, the supply base for services, domestic regulations in India and other countries, domestic and external demand for services, market access barriers for these services in India and abroad and the status of commitments, requests & offers under general and plurilateral negotiations in the WTO. Lack of a single nodal department/division/institution is one of the weaknesses of the services sector, particularly for domestic policy making. Since, a coordinated policy action is needed, there is a need for a nodal department or division, preferably in the Department of Economic Affairs, Ministry of Finance which can look into all aspects related to Services, while the individual departments dealing with some services or some aspects of services can continue their usual work as is being done by them at present. A National Commission for Services can also be set up on the lines of the National Manufacturing Competitiveness Council (NMCC) and National Farmers Commission (NFC). All this is long overdue with more than three-fifth of the GDP being accounted by services in India.

4.3.3 **Market Access for Services**

4.3.3.1 **Actual Trade Barriers for Services**: There are both visible and invisible barriers to services trade. Some examples are as follows:

- In the case of **Business Services and IT 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, there are the 'Buy American' provisions and frequently changing visa provisions for work permits and US states passing laws to limit business outsourcing.
- In the case of **legal services,** while some states, of US like, New York, Texas, Washington D.C., and California allow foreign 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. Most states and districts require a minimum of five years work experience.
- In the case of **Communication Services,** non-US firms and foreign-owned firms wishing to invest in radio telecommunications infrastructure and to provide mobile and satellite services are virtually denied access due to stringent legislation in US. The events of September 11, 2001 have added a new dimension to these market access limitations with US law enforcement agencies imposing strict corporate governance requirements
- In the case of **Financial Services**, the restrictions are the requirement of the Office of the Comptroller of the Currency (OCC) and some State banking supervisors to maintain "asset pledges" in addition to the paid up capital they maintain in their home country. Further, foreign insurance companies seeking to operate in the US market face the fragmentation of the market into 56 different jurisdictions, almost each of which is having different licensing, solvency, operating requirements and own insurance regulatory structure with direct discrimination on a number of fronts, such as need for foreign insurance companies to first be licensed in another state before seeking a license in the first state to underwrite risks in one state and need in some states of US for foreign insurers to buy reinsurance from state-licensed companies before allowing re-insurance premiums to leave the state.
- In the case of **Transport & Travel Services**, while the huge subsidies in the Civil Aviation sector to Aircraft in both US and EU act as indirect market access barriers, in the US there are restrictions in foreign ownership of air carriers as foreign investors are prohibited from taking more than 49% stake in a US carrier and the holding of voting stock is restricted to 25%; restrictions related to foreign repair stations; various forms of assistance in US to its domestic shipping industry such as the reservation of a minimum of 50% of government cargo for US registered ships, all cargo provided with loans from the US Exim Bank to be reserved for US registered ships though a 50% waiver may be granted, restrictions in

domestic commercial shipping where the US requires shippers operating in internal waters to use ships that were built in the US; subsidy programme providing an operating cost subsidy of $ 100 million a year for a period of ten years for US registered ships meeting certain requirements; discrimination by the Federal Maritime Commission (FMC) between foreign shipping companies and US ships by unilaterally regulating the shipping fees charged by foreign shipping companies; significant restrictions on the use of foreign built vessels in the US coastal trade under Jones Act; prohibition on foreign built vessels for documentation and registration for dredging, towing or salvaging in the US; ensuring terms of shipment favourable to US, while not being liberal in allowing foreign ships to operate in US; the application of restrictive measures to US public procurement contracts which require the goods to be shipped in US-flagged vessels, which charge significantly higher freight rates than other vessels; etc.

- In the case of **Audio-Visual services**, France provides that at least 60 percent of movies on television must be made in Europe and that more than 40 percent of the programmes must be broadcast in French.
- In the case of **Port Services** there is the issue of Harbour Maintenance Tax (HMT) and Harbour Services Fee in US only on waterborne imports, at an ad valorem rate of 0.125 per cent while it is prohibited for exports. The ad valorem basis for the HMT collection makes it difficult to justify as a fee approximating the cost of the service provided.
- In the case of **construction and related engineering services and urban planning and landscape services**, while there are no national treatment limitations in the US commitments to WTO (2005) under modes 2, 3 & 4, the "Buy American" or "Buy local" legislations passed in many states of US have gone to the ridiculous extent of even insisting on the materials used (i.e. cement) to be of domestic origin for construction of public works projects financed by state funds.

4.3.3.2 **Trade Barriers for Services Exports existing under WTO Bindings:** Some examples are as follows:-

- In the case of Horizontal Commitments in WTO, the horizontal clauses limit the sectoral offers. For example, even in the revised US offers for 2005, the US commitment in the case of fashion models and speciality occupations continues to be upto 65000 persons annually on a world wide basis. The actual visas which was higher than this commitment has been lowered to this level. While this offer is no offer and the share of any country in this offer would be a small miniscule, the conditions of market access for speciality occupations are also rigid.

- In the case of legal services in Sweden, though there are no national treatment limitations in modes 1, 3 and 4, under the earlier GATS offer, the use of the Swedish title ‘advokat’ was protected which has now been intelligently reworded. In Japan also, for legal services under all 4 modes, there is the need to be recognised as ‘Gaikoku-Ho-Jimu-Bengoshi’.
- In the case of healthcare services, under mode 2, there is the national treatment limitation of federal or state government reimbursement of medical expenditure for medical services availed abroad to certified facilities in the US or in a specific US state and the general tendency of US insurance companies not to reimburse medical expenditure for services consumed in countries like India. In the case of EC countries, the provision of free medical services to all citizens under the National Health Service (NHS) system in countries like UK acts as an invisible market entry barrier and even helps the export wing of the NHS.
- In the case of Banking, in the US market, there are many restrictions and in some states specified activities are unbound.
- In the case of Maritime Services, US has not given any commitments and has many protective measures in this sector. Even in the case of ship repair services, US applies a 50% *ad valorem* tax on the cost of equipment and non-emergency repairs for US flag vessels done outside US. US owned foreign-flag vessels are not subject to the duty and under NAFTA and the Chile and Singapore FTAs, this duty was eliminated. This is a tax or an example of tariff barrier on services by US!
- Further, while sector-specific commitments are limited by conditions like the economic needs test, in-state residency, citizenship, etc., the limited horizontal commitments for professional services virtually puts the benefits under sector-specific commitments in deep freeze. There are also restrictions at the state or district level in US.

4.3.4 **WTO negotiations and Policy issues for Services Negotiations:** The main policy issues and strategies include the following:-

- Negotiating on harmonisation of accreditation and titles, orderly movement of professionals by more meaningful negotiations under Mode-4, removal of limitations like economic needs test, in state residency, citizenship, etc., removal of subsidies given by developed members in services and removal of trade barriers to services.
- Using FTAs/RTAs for coalition building in WTO while complementarities are not lost sight of and laying emphasis on supply of services not only through temporary movement of natural persons and cross border mode, but also by consumption abroad mode.
- Forming a special negotiating team for services and having consultations with state governments on issues related to services standards and regulations.

- Formulating future strategies depending on the assessment of the export potential in the near and medium term in different services, the likely increase in market access in different services as a result of WTO negotiations which can benefit India and its likely impact on India's growth.
- Greater synergy not only between trade strategies and WTO negotiations, but also between growth & development strategies and WTO negotiations.
- Having an appropriate institutional and diplomatic set up with the direct involvement of trade specialists also in this team along with diplomats during negotiations.
- Realistic strategic alliances which can fetch good dividends for India. For example, while India and Brazil have become very close coalition partners, the economic interests of the two are not necessarily the same.
- Preparing our own agenda in future negotiations and make others to react instead of we reacting as has been the case till now.

4.3.5 **Policy issues for export promotion of services**: Services exports has been promoted consciously in many countries. The US actively supported services negotiations under GATS & WTO after studies in US revealed that this was the potential sector for USA in the future. In the case of Hong Kong, services like financial services and port services have developed due to the policies of the government to develop Hong Kong as an off-shore financial centre and free port, while setting up of joint office with common facilities has helped professional services and a low tax policy has helped printing services. Singapore with a range of technology intensive services, port related and financial services is actively promoting exhibition management services, franchising services and even legal services by facilitating Singaporean law firms to go regional and to carve a niche with the opening up of legal markets around the world.

4.3.5.1 **Some General Policies for India to promote Services exports**: While services sector has had an almost natural growth in India with the Government facilitating in some sectors, there has been no comprehensive strategy for services. Some of the ways in which the Indian government or export promotion agencies can support service exporters are the following.

- Helping service exporters to become known suppliers of quality services and providing relevant export market information;
- Providing appropriate export financing with reduced transaction costs, reviewing the common practice of collateral in the case of services, considering extension of specific dedicated lines of credit focusing on promotion of service exports like construction services, IT related services and education services.

- Following the Silicon Valley example where Banks securitise the CEOs of companies.
- Marketing of services with the help of Indian Embassies/Industry associations, etc; anchoring people, particularly, committed specialists for promoting services and focusing on services in some SEZs.
- Leveraging India's potential purchasing power in services negotiations at multilateral and bilateral levels.
- Concluding totalisation agreements with target countries to resolve the social security benefits issue.
- Including appropriately issues related to services in Regional Trade Agreements (RTAs), Free Trade Agreements (FTAs) and Comprehensive Economic Cooperation Agreement (CECAs).
- Developing front yard technology, in different services instead of focusing merely on the Business Process Outsourcing(BPO) segment.

4.3.5.2 **Sector-Specific Policies for India:** India has good potential for exports of different services, besides software in which it has already made an impact. While the importance of different modes differ for different services, with greater tradability of services leading to outsourcing, mode 1, i.e. cross-border supply mode is also assuming greater importance for many services as it can do what can be done by mode 4, i.e. supply of services through natural persons mode, while avoiding the disadvantage in this mode related to visas. Some sector specific issues and policies for some services are the following:

Healthcare Services: In the case of Super-Speciality Hospital Services, India has a good supply base and can supply them under all four modes of supply, though the consumption abroad mode is the most important mode for India. Though India has a good supply base and is cost competitive, good marketing and publicity regarding these services are needed. Some of the policies include negotiating for removal of market access barriers and recognition of technical degrees by other countries, developing India as a regional healthcare hub, tie-ups with some developed countries under CECAs on the lines of Germany wherein if there is delay in NHS service in UK, patients can go to Germany, setting up Health Consultancy Parks which combine both preventive and curative health care with tourism.

Satellite Mapping Services: In the case of Satellite Mapping Services, India has a good supply base for economic application of satellite mapping services and is also cost competitive. Policies for Satellite Mapping services could include negotiating with US, EC and other developed and developing countries regarding defense restrictions, examining possibilities of sharing some common facilities and data of public sector institutions like

ISRO with private sector, consortium bidding and including government institutions like ISRO in the consortium.

IT Services: Policies for IT services include steps to move to systems software coupled with hardware-software combination, further progress in application software along with full exploitation of the great outsourcing revolution in services and negotiating with EU regarding 'Data Protection Act in EU' as half of off-shore work does not come to India and other countries due to this Act.

Project Exports: The policies in the case of Project Exports could include resolving the issue of precondition in most of the overseas tenders floated by clients wherein equipment to be supplied by the contracting company should necessarily be sourced from approved list of suppliers from developed countries; examination of the need to consider double guarantee avoidance treaty on the lines of double taxation avoidance treaty as overseas clients insist for the Bank Guarantees to be issued under the contract to be routed through a local bank operating in the country of project execution which results in Indian contracting companies being called upon to pay the bank guarantee charges to Indian banks as also to the local overseas banks which issue the final end guarantees to the client, based on the counter guarantees from the Indian Banks; reduction of delays in international bidding due to formalities at different levels of the government; etc.

R&D, Design and Engineering Services: The policies in the case of R&D, Design and Engineering Services are setting up R&D labs in SEZs, examining the possibility of cheaper loans taking note of gestation period in R&D services, patent funding to reimburse costs of patenting, promoting lab testing services for use of South Asian countries in India and setting up design, engineering, consultancy parks.

Ship repair Services: Some policies for Ship repair and port services include capacity building and effective marketing of ship repair services, providing port services by port based SEZs like international bunkering facilities, pilotage facilities, supply of spare parts, ship repairs, etc.

Printing Services: In the case of Printing Services where India has a good potential for exports there is a need to be cost competitive and leverage India’s expertise in software sector for this purpose.

Accounting, Auditing and Bookkeeping Services: In the case of these services where India has a good potential for exports, the limitations are mainly in the form of licensing and accreditation. The horizontal limitations on the entry for speciality occupations, automatically restricts opportunities in this sector and needs to be negotiated, while the potential of outsourcing many components of these services has to be fully tapped.

Unskilled labour Services: Since a large number of Indians work in the Gulf area mostly as unskilled workers, there is a need to train and skill certify them before going abroad as done by countries like Philippines, Thailand and Sri Lanka. This will help them to get better jobs, earn more and have higher disposable income.

4.3.6 **Domestic regulations and domestic policy reforms for services**

Domestic regulations perform the role of tariffs in regulating services trade. While disciplining domestic regulation of our trading partners which are unduly burdensome can lead to greater market access in services, the disciplines would also be applicable to India's own domestic regulations. In fact disciplining many of our own domestic regulations could also help in the growth and export of many of our services. The basic elements include licensing requirements and procedures, qualification requirements and procedures, technical standards and regulatory transparency. Some of the domestic regulations which may need disciplining in India and some domestic policy reforms needed in some sectors are given below. This is only an indicative and not an exhaustive list.

4.3.6.1 **Telecom**

- **Multiple levies and duties:** Telecom services in India face multiple taxes and levies which are one of the highest in the world. The total levies, including license fee, service tax and spectrum charges were around 26% of AGR(Adjusted Gross Revenue) in 2006-07, which in turn makes consumers pay higher (In Malaysia it is around 6.5% and in China it is around 0.5% + 3%, tax). Besides the above, there is ADC paid to the BSNL at 0.75% of AGR for domestic long distance calls and call by call ADC for international long distance calls at the rate of Rs.1.00 per minute for incoming calls. There is also a 5% import duty on handsets and 16% on telecom infrastructure while in other countries it is either nil or much lower than India. So there is a need for reduction in levies and charges and a time bound phasing out of the different types of taxes till they are merged into two or three levies/taxes.
- **License fees on unrelated activities**: The Adjusted Gross Revenue (AGR) as defined by the Department of Telecommunications (DOT) for computation of the license fee includes several revenue streams which are unrelated to service activities of service providers, particularly revenue from sale of handsets. Even the TDSAT ruling has not ruled against inclusion of this if it is bundled and not stand alone. Policy intervention is this area can help as exclusion of sale of handspets from AGR can lead to handset bundling schemes with airtime and make India a hub for telecom manufacturing activity.
- **Infrastructure sharing and development:** BSNL the incumbent operator has created an extensive nationwide infrastructure. This infrastructure can be shared with private operators

at commercial terms, just as infrastructure created by private operators can be shared with BSNL and with each other. Even TRAI has recommended sharing of critical infrastructure which could be considered by DOT.

4.3.6.2 **Port Services :** While there is the issue of the Indian ports not having the necessary draft leading to big ships not entering the Indian seas and in turn resulting in transshipment of Indian cargo outside the country, 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. While the inefficiency of ports is one of the reasons for this high cost, the procedure of including unrelated costs like pension and other contributions for port labor in the port services is another cause. If port charges were to be lower and near to international standards, then India's exports could become more competitive. On the import side, imports including essential commodities can be cheaper, which is important particularly when domestic supply bottlenecks lead to inflation in essential commodities. There is a need for rationalization of port dues, examining the possibility of providing differentiated levels of tariff for different size of vessels or for different cargoes to attract mother ships to berth at Indian ports and addressing the 'gang system' in ports. Actual capacity expansion plans in ports should be carried out much before the requirement for such additional capacity arising .

4.3.6.3 **Distribution Services**: The main issue here is opening retail trade, where FDI is prohibited (except single brand product retailing subject to 51% cap), while there is a large unorganized sector with low tax compliance. While incentives could be given for the existing local retailers to adjust to modern times, consumers should not be denied the benefits of modern retailing. Since farmers also benefit due to modern retail trade, efforts should be made to see that such opening provides greater market access for India's exports.

4.3.6.4 **Shipping Services:** Some issues in this sector are the following:-

- There are domestic policy issues in shipping services like withholding tax on interest paid to foreign currency loans to acquire ships abroad, withholding tax on charter hire paid to foreign shipowners on ships taken on charter, etc. In Singapore the rate of withholding tax on charter hire charges in different cases is either 'nil' or between 2-3% which is very low compared to the withholding tax of 10% in India.
- Service tax is applicable to most of the services availed by shipping industry in India, while in EU, Ireland, Singapore, Australia, etc. these services are either tax exempt or zero rated. Recently, concessions in the case of some services were given to Indian exports which use services not in the nature of "input services".
- Existence of differential pay package for seafarers in Indian flag ships and foreign flag ships due to the NRI status.

- With the completion of commercial life of many ships as well as on account of IMO regulation for phasing out single hull tankers (which constitute around 40% of the Indian fleet) coming into force by 2010, there is a need for capital investment in this sector. Since, the industry may not be able to raise such resources easily as comparative returns on such investments are not attractive for equity investments, the issue needs to be examined carefully as acquiring ships would be critical for a country where merchandise trade is increasing at more than 25 per cent in the last few years.
- Changes are also needed in the Merchant Shipping Act and the Multimodal transportation of Goods Act 1993, to support easy transportation and documentation through different modes of transport.
- Promoting ship registry services in India is another issue which is related to a low tax regime and SEZs related to services could possibly help.
- While there is a need to examine which of these domestic restrictions can be removed by India, the requests of other countries include some additional commitments on the access to and use of port services like making available to international maritime transport suppliers on reasonable and non discriminationary terms and conditions pilotage, towing and tug assistance, provisioning and fuelling & watering, garbage collection and ballast waste disposal, port captain's services, navigation aids, shore-based operational services essential to ship operations including communications and water and electrical suppliers, emergency repair facilities and anchorage and berth and berthing services. While some of these restrictions exist even in developed countries, it may not be difficult to remove some of these restrictions which may even facilitate India's trade. Similarly the collective request in logistic services submitted to India include requests like ensuring that various procedures and formalities such as documentary requirements, customs clearance, customs inspection, and electronic processing, would not be unnecessarily burdensome and ensuring that electronic versions of trade administration documents are accepted. In comparison to US, India's restrictions are very mild. There is no price preference and there is only a right of first refusal for government cargo in favour of Indian ships if they match the lowest bid received, and a weak cabotage policy that is relaxed readily if no Indian ship of exactly matching description is immediately available. However, India can examine whether accepting some of these requests can facilitate India's trade and help in putting pressure on some countries like US (which has been opposing negotiations in maritime services) to negotiate.

4.3.6.5 **Other Transport Services**: Some issues in transport services which are also linked to internal trading are the restrictions on inter-state movement of goods and coordination issues between government departments in the case of multimodal transportation. Inland Water Transport (IWT) also needs to be promoted as the savings are apart from the benefit of reduction of pollution. There is also the issue of free movement of cargo between various ICD's, CFSs and Ports, and the issue relating to levy of service tax on transport by rail leading to a cascading effect of the service tax because there is a provision in Service Tax (Determination of value) Rules 2006, as per which there are conditions prescribing that a service provider should act as pure agent of recipient of service. As per shipping lines interpretation, they have 'principal to principal' relationship with their clients and hence, they levy service tax on entire amount leading to cascading effect.

4.3.6.6 **Construction, Engineering and related Services :** Though 100 per cent FDI is allowed in construction and development projects, there are restrictions like minimum capitalization norms, some restrictions on repatriation, minimum area norms under Press note 2 (2005) and a general umbrella clause that all applicable rules/bye laws/regulations of the state government/municipal/local body concerned have to be complied with. There is also the issue of high stamp duty in some states, though the central government has been able to persuade some state governments to lower stamp duties. The other issues are, need for a standard contract document for all domestic projects, uniformity in regulatory norms, need for consortiums to bid effectively for international

projects, etc. Some policy measures that could be taken to help this sector are competitive access to land and institutional finance and amending the Urban Land Ceiling Act, which could lead to larger size of firms, higher market capitalization and professionalism.

4.3.6.7 **Insurance Services:** In the case of Insurance services, there is the main issue of 26% cap on foreign investment besides restrictions like minimum capitalization norms, funds of policy holders to be retained within the country, compulsory exposure to rural and social sectors and backward classes. A consensus is needed in some of these issues to make further headway.

4.3.6.8 **Health Services**: In the requests at WTO made by India's trading partners, India has been requested to take full market access and national treatment commitments under all 4 modes and remove equity limit of 51 per cent. While India has now raised this equity limit to 74 per cent, there is a need to examine carefully the other requests related to relaxation of domestic regulations keeping in mind the social implications.

4.3.6.9 **Accounting:** Due to their small size, domestic accountancy firms have been less successful in competing with international firms in the lucrative consultancy/advisory and non-statutory work markets. Besides there are the following restrictions in India. Only graduates of an Indian university can qualify as professional accountants in India. Foreign accounting firms can practice in India, if their home country provides reciprocity to Indian firms. Internationally recognized firm names may not be used, unless they comprise the names of proprietors or partners, or a name already in use in India. This limitation applies to all firms except those that were established prior to the imposition of this rule. The Institute of Chartered Accountants of India (ICAI) continues to ban the use of logos of accounting firms. Only firms established as a partnership may provide financial auditing services. Foreign accountants may not be equity partners in an Indian accounting firm. While due recognition by foreign countries to Indian qualifications in terms of mutual recognition agreements (MRAs) are needed, the problem has been compounded by non-recognition of overseas qualifications by domestic players in some cases. Given the high potential for export of accountancy services of India by the outsourcing mode, there is a need to examine which of the domestic regulations can be relaxed particularly to facilitate tie-ups and penetrate the foreign markets.

4.3.6.10 **Legal Services:** In order to be eligible for enrollment as an advocate, a candidate has to be a citizen of the country or a country which allows Indian nationals to practice as per the reciprocity treatment, has to hold a degree in law from an institution/university recognized by the Bar Council of India (BCI) and be at least twenty one years of age. FDI is not permitted in this sector, and international law firms are also not authorized to open offices in India. Foreign service providers may be engaged as employees or consultants in local law firms, but they cannot sign legal documents, represent clients or be appointed as partners.

They are also prohibited from giving any legal advice that could constitute practicing of Indian law. Moreover, Indian advocates are not permitted to enter into profit sharing arrangements with persons other than Indian advocates. Some of the other restrictions, which severely limit the scope of growth in the legal profession in India include partnerships being the only permitted model of practice for law firms in India and modes of practice like limited liability partnerships or limited liability corporation not being permitted, limitation on the number of partners to 20 limiting the growth and size of Indian law firms, bar on advertising and even having entries in law directories, practice of law being treated as a profession and not an industry resulting in lack of finance for lawyers, and multidisciplinary practicing firms not being allowed. The Bar Council of India is opposed to the entry of foreign lawyers/law firms in any manner. With the recent developments like outsourcing of administrative work of legal firms of UK, we need to have a more open mind on legal services and at least facilitate overseas firms to outsource legal services to India.

4.3.6.11 **Education Services**: Some issues in the case of education services are the following:-

- While, India needs large investments in the higher education sector, sound regulatory framework with transparent rules, stringent accreditation mechanism and protecting the interests of students are also needed. So a viable financing model, with a mix of public and private participation has to be put in place. There is also a need is to see that Foreign Educational Institutions (FEIs) who may have low stakes in the overall system and make minimum investments in infrastructure and faculty do not misuse the system. Instead they should be encouraged to give quality education. Foreign governments should also be encouraged to fund their Indian campuses for sensitive, cutting-edge research.
- Another issue needing attention is the multiple controls and regulations by the central and state governments and statutory bodies.
- The regulations with respect to establishment of new medical colleges, patient load factors should be reviewed to be in tune with present day equipment intensive patient care and modern practices and procedures of medical education. Policy reforms should actively encourage Public Private Partnership (PPP) both in higher medical education and healthcare. Quality of education and demand supply mismatch are other issues.

4.3.6.12 **Banking Services:** The predominance of government ownership in the banking sector is considered to have led to insufficient competition in the Indian banking system and increased cost of intermediation. Corporate customers today face a highly competitive environment where they need to cut costs, maintain quality of products, adhere to international standards and keep up strict delivery schedules. So banks and FIs have to cut down on the time taken for project appraisals and disbursements which can possibly be done by promoting within themselves special appraisal skills meant for specific industries as in the case of the RABO Bank of Netherlands specialising in financing agro-based and processed foods industries and capitalizing on the information base built up in the past. In this context, the idea of setting up a Credit Information Bureau, designed to obtain and share data on borrowers to facilitate sound credit decisions is a welcome move that can enhance the speed of sound credit related decisions._Merging of the core competencies of FIs with those of commercial banks will also bring in the much needed consolidation in the domestic financial sector. Indian public and private sector banks and FIs have to adopt and imbibe international norms and practices and strengthen their capital base by mergers and acquisitions before launching their operations in the highly mature international financial markets. The operationalisation of the offshore financial centres can possibly be the first step.

4.3.6.13 **Tourism Services:** India has already emerged as a fast growing tourist destination in the world. Given its bio-diversity, variety of unique destinations and natural locales, India can transform itself into a 365 days a year destination with increased emphasis on new products like medical tourism, rural tourism, and wellness tourism, and marketing India as a destination for Conventions and Exhibitions through a network of India Trade Promotion Organisation (ITPO) like institutions. Some issues related to Tourism sector include reducing the overall tax impact on tourism which is around 30-35% in India, and is high compared to other countries, easing barriers on travel through easy visa on arrival for select countries, establishing a special tourism police force at important tourist destinations, establishing budget hotels at identified railway sites with private sector participation, upgrading airport infrastructure in a time bound manner, cleaning drives in tourist spots and metros, etc.

4.3.6.14 **Printing and Publishing Services:** With around 13 per cent growth per annum, the Indian Printing Industry can generate phenomenal increase in employment opportunities. One of the policy issue related to this sector which needs to be examined is the Customs duty on import of printing and allied machinery & equipment which are not being manufactured in India and at present is at 7.5% with 16.48% CVD and 4% special CVD with total duty of 31.011% . Besides, in India, printers have to pay 10 per cent customs duty together with 12.36% CVD and 4% special CVD with total duty of 29.275% on paper and paperboard. The total duty on import of paper and paperboard is therefore relatively high. But, printed materials can be imported at nil or lower customs duty due to the bilateral trade agreements. In countries like Singapore & Hongkong known for printing and publishing services, the customs duty is 'nil' for both printing machinery and paper and paper board and in China the customs duty was 7.5% on paper and paperboard and 8.12% for printing machinery in 2005. There is also the issue of the relatively high central excise duty on carton, boxes etc. (covered under Chapter 4819) at 16%. The Small Scale Industry (SSI) Units supply the above materials entirely on credit basis and the buyers delay the payment inordinately for periods as long as 4 to 6 months. So, the SSIs have to pay out of their own funds 16% central excise duty on the aggregate clearances every month. Lowering of central excise duty to say 8% could be an option as it would help the SSIs from the substantial financial burden. Since there is no loss of revenue as a result of the above, as cartons, boxes and other packing containers are only intermediary product inputs used for packing final products and whatever excise duty is charged on them will be availed of as cenvat credit by the buyers of such packaging materials for packing their end products in them. Such end products will, in any case, yield the full excise duty on the aggregate value of the end products including the value of the packaging materials. However, total customs duty will also fall due to fall in CVD if this is reduced. There is also the issue of inverted duty structure in printing sector as paper and paperboard has 32% duty and printed material has lower duty.

4.3.6.15 **Consultancy Services:** Consultancy is another important service sector with promising signs for India. A new opportunity that is coming up is in the form of offering back office consultancy and sub-contracting work from foreign consultancies. International accreditation is an important issue for consultancy and recognition of either CDC or IMCI could help as there would be proper accreditation which is internationally recognised.

Thus, India's services sector has many restrictions and removing some of the restrictions could help in the growth of the different services. However, there is a need to carefully examine which domestic regulations should continue for achieving socials goals, which regulations can be removed as a *quid pro quo* in WTO and bilateral negotiations and which regulations can be removed voluntarily to facilitate growth and trade in services. Entering into mutual recognition agreements (MRAs) for the recognition of qualifications, titles & standards and getting accreditation for Indian institutions in target countries is another area for focus.

4.4 **Conclusion:** The above bunch of issues gives a birds-eye-view of the issues for policy making in the services sector. This growth, employment and export oriented sector in India having a proven competitive advantage needs to be given its due attention. While inflation in some of the categories of services is less, the non-inclusion of services in the inflation index when its share in GDP is the highest is an anomaly which needs to be corrected soon. Tapping the export potential of this sector by suitable policies, negotiating at bilateral, plurilateral and multilateral levels to remove the different visible and invisible market access barriers, while removing our domestic regulations which may have outlined their utility and hinder the growth of this sector, utilising the opportunities thrown open by WTO in services sector, formulating suitable strategies for WTO and CECAs with strategic partners keeping in view the growth and export potential of this sector are some of the important tasks for a successful domestic services strategy and successful international negotiations in services where the stakes are high for India.

In short the strategy for the services sector should include the following major issues mentioned above.

- Identifying the burdensome domestic regulations in India and reforming them which also includes many fiscal issues. Since different services differ in nature, the issues are varied as given in the indicative examples and involve different institutions, departments and even governments (central & states), the policy responses will also differ.
- Identifying the different market access barriers to India's exports of services and focusing on the important ones for negotiations at bilateral and multilateral levels

taking note of India's domestic growth, export potential of services and import basket analysis of trading partners. Greater synergy is needed not only between trade strategies and multilateral/bilateral negotiations, but also between growth and development strategies and multilateral/bilateral negotiations.

- Focus should be on export of untapped services and markets and services with high linkage effects with manufacturing, growth of the economy and employment.
- Resolving in a fixed time period, the data and definitional issues in services both in the national accounts and external sector including balance of payments. This will also involve issues related to prices for services.
- Including services in the inflation index to give a realistic picture of inflation and also in domestic terms of trade to reflect the actual change in distribution of income between all the three sectors.
- All this would involve coordinated strategy and policy making for which a single nodal department/division/institution for services is needed.

The above calls for not only hard and systematic work but also some unconventional decision making at the highest level.

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Appendix 1

Recommendations of the Prasad Committee on International Trade in Services

a) There is a need for change in the format of data collection by RBI particularly for "miscellaneous services" and as many services as possible should be included and in case there are still unclassified services as 'others' in these miscellaneous category, the exporters/importers should be asked to specify the service. Otherwise there is a tendency to simply mark the 'others' column.

b) The Authorised Dealers (ADs) should be asked to give a list of exporters/importers by sectors. Though RBI has expressed its difficulty in asking ADs to provide this information, as this is not possible under the extant statute, the Committee desired that RBI should ask ADs to give the list of exporters/importers of services by types of services and if necessary by making changes in the statute. The actual value of transactions need not be provided if it is considered confidential. This master list along with lists from other sources should be used for conducting well designed periodic surveys.

c) There is a need for mandatory benchmark and annual surveys. A clear distinction between official and non-official data should be maintained as surveys can supplement the information already available.

d) The method of collecting the data is more important than cosmetic changes in allocating the existing data at different levels. At the international level, the WTO and United Nations (UN) should help governments in this regard.

e) The definition of different services is very important, particularly in the context of services like shipping, where exports are on f.o.b. and imports are on c.i.f. basis.

f) In the case of software data, though RBI uses 'R' returns to validate the data of National Association of Software and Service Companies (NASSCOM), RBI should try to get more details on data from NASSCOM as NASSCOM only gives aggregates of the data it gives to RBI.

g) Issues related to statistics on prices of services have to be examined and necessary data should be collected for some key services. This can follow the methods given in the study of Kravis & Lipsey (1971) and other studies on pricing services.

h) A task force should monitor the initial benchmark surveys. The existing data should be put in one place and examined by the task force on services. Mapping of available data under different modes should be done and data on movement of persons should be given primary importance in India unlike the UN Task Force report which has yet to work on this aspect.

i) Data/information from existing General Agreement on Trade in Services (GATS) Trade Points set-up under the mandate of WTO should be collected and analyzed. Since the WTO negotiations on services is likely to continue for the next few years, new data and information needs are likely to arise. The technological developments in E-commerce further add to these needs. Unlike commodity trade where institutional mechanism exists and there is a fair amount of expertise, in services, this is lacking. But there is an immediate need to work out the details like method of data collected by different countries, the quality of the data, their suitability for WTO negotiations, analyzing available data/information on an on-going basis, arriving at a format for data collection on services and interacting with the UN Task Force which is yet to finalise its recommendations. So a Services Task Force like the IT Task Force to examine services exports and issues for WTO negotiations should be set up immediately.

j) Bilateral data for trade in services of India with major trading partners have to be collected on a priority basis for important services, particularly with the help of mandated surveys and with the help of concerned industry associations.