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सत्यमेव जयते

# Services Sector: Challenges, Issues and Policy Suggestions

## with special focus on IT-BPM, Tourism, Shipping, Real Estate Services and Project Exports

By
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Government of India
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# Disclaimer and Acknowledgements

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

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## Contents

# EXECUTIVE SUMMARY AND CONCLUSION

## Executive Summary and Conclusion

This paper, based on both desk research and interactions with stakeholders outlines major policy issues along with suggestions, both general and specific to five sectors viz. IT-BPM, Tourism, Shipping, Real Estate and Project Exports. The first three sectors are important both in the domestic and export front, Real Estate sector mainly in the domestic front and Project exports which is a mix of both goods and services in the export front. Each sector has its own peculiarities, problems and strengths.

The growth of the services sector has been pulling up the overall growth of the economy. However, in 2016-17, services growth decelerated to 7.7 per cent in line with the deceleration in overall growth to 7.1 per cent. In H1 of 2017-18, while overall growth decelerated to 6.0 per cent, services growth improved to 7.9 per cent powered by the good growth of 10.5 per cent in the trade, hotel, transport and storage category. India's commercial services exports increased from US$ 52.2 billion in 2005 to US$ 161.3 billion in 2016 as per WTO data, with its share in global services exports increasing to 3.4 per cent from 2.1 per cent during the above period. In 2016-17, services exports recorded a positive growth of 5.7 per cent with pick up in some major sectors like transportation, business services and financial services; and good growth in travel. In 2017-18 H1, Services exports grew by 16.2 per cent, while services imports grew by 17.4 per cent resulting in net services growth of 14.6 per cent which financed almost 44 per cent of Trade Deficit. Sector-wise, Travel has performed well in 2016-17 and 2017-18 H1. Software services growth after decelerating in recent years became negative at -0.7 per cent in 2016-17, but returned to positive territory at 2.3 per cent in H1 of 2017-18.

### Recent Policy Initiatives in Services Sector

Various initiatives have been taken by the Government to help the services sector. Some recent measures include the increase in SEIS (Service Export from India Scheme) incentives by 2% for notified services such as Business, Legal, Accounting, Architectural, Engineering, Educational, Hospital, Hotels and Restaurants; increasing the validity period of the Duty Credit Scrips from 18 months to 24 months to enhance their utility in the GST framework; reducing the GST rate for transfer/sale of scrips to zero from the earlier rate of 12%; and creating a new Logistics Division in the Department of Commerce to develop and coordinate implementation of an Action Plan for the integrated development of the logistics sector. Many initiatives have been taken in the five select sectors also. These include the various initiatives under Digital India programme in the IT sector; E-Visas, Swachhta Action Plan, launch of Global Media campaign, launch of the 'The Heritage Trail' and 'Adopt a Heritage Scheme' to promote world Heritage sites in India, and initiatives by the National Medical and wellness Tourism Board to promote medical Tourism; reduction of GST on bunker fuel, easing procedural compliance for ship registration, measures to promote cruise shipping amd preparing a vision for coastal shipping to promote shipping; launching Pradhan Mantri Awas Yojana, Smart Cities mission, RETIS and InvITs, and RERA to help Real Estate sector; extending Lines of Credit, introducing Buyer's credit under the National Export Insurance Account, concessional financing scheme, Export Development fund, and Project Development fund for CLMV countries to help project exports.

## Issues and Policy Suggestions

The issues are divided into two broad categories, Major Cross Cutting Issues and Sector Specific Issues.

## Major Cross Cutting Issues

**Impact of Demonetization:** Demonetization, temporarily impacted services sector as in the case of other sectors. While there was deceleration in services GVA in 2016-17 Q3 to 6.9 per cent, it picked up to 7.2 per cent and 8.7 per cent in the subsequent quarters. Services PMI also fell after demonetization for a few months though it picked up subsequently. Services exports fell in December 2016, but picked up in next three months. However, all these could have been due to other factors as well and not necessarily due to demonetisation. There was not much impact of demonetisation on Tourism, with Foreign Exchange Earnings (FEE) in dollar terms increasing after demonetisation. Bank credit by commercial Banks also increased after demonetisation. Residential sales across top-eight cities in India in 2016 and new residential unit launches fell. This was primarily due to the prolonged slump and execution delays in project completion which resulted in inventory pile-up across all cities. Demonetistion could possibly have impacted the new launches and sales in the short term with several states recording drop in property registrations post-demonetization. However, there was not much impact on property prices. While demonetization is now a thing of the past, there were also many positive impacts on services like greater digitization, increase in payments to local bodies and discoms as demonetized notes were legal tender for such payments for some time, net flows into mutual funds increasing by nearly 19 times due to reduction in interest rates on bank deposits after demonetisation and Premia collected by Life Insurance Corporation of India increasing by 142 per cent in November 2016 and by private sector life insurance companies by nearly 50 per cent due the window provided for depositing old notes to make these payments for a short while.

**Goods and Services Tax (GST) and Services:** In the case of Services, the GST rates are NIL for education and health services and 5 per cent for transport of goods by rail and vessel, supply of tour operators services (without ITC). Only 4 services items are in the highest slab of 28 per cent which include among others entertainment events or access to amusement facilities including exhibition of cinematograph films, theme parks, joy rides, etc; and hotels, inns, having room tariff above Rs. 7500 per day per room. The GST Council in October 2017 recommended changes in GST rates to provide relief on the services side also, particularly to aviation, restaurants and job work related to services. Further during recent amendments some measures specific to services were also taken which include reduction in tax rates on some services including services related to job work which will benefit many sectors including Gems and Jewellery, exempting service providers with annual turnover of less than Rs2 million from the need to register even in cases where they are making inter-state supplies, etc.

GST has helped the services sector in many ways like avoiding confusion as pre-GST, both Central and State Govt. had the right to collect the tax which was leading to confusion in finding out to whom the tax is to be paid for services like software, works contract etc. resulting in disputes between Central and State Governments. There are also benefits due to the compulsion for every stakeholder to upload the GST-tax paid to get input tax credit. There is also fall in logistics costs with abolition of check posts and the E-way bill is expected to further reduce the logistics costs. However, there are some early hiccups and difficulties like higher tax on services as Pre-GST, service tax was applicable at the rate of 15% on Services rendered which included 0.5% for Swachh Bharat Cess and 0.5% for Krishi Kalyan Cess, while Post-GST the service sector is under the higher taxation of 18 percent though for some services, it is 'Zero' or low and gradually rates are supposed to be lowered. Besides tax credit is available and exports are not taxed. The major difficulty is registration of Place of Business as agents will have to register in all states that they operate in and file in each of them in the GST regime. However, increased compliance requirements will be faced only by a small number of agents with a pan-India presence whose ability to comply will be commensurately greater. There are also issues of GST network as, in the GST network, not more than 100 branches of Bank can register. In the case of Healthcare Services, while there are no taxes on health care services, the input tax credits are not available for the very reason that healthcare services are exempt from GST.

There are also some early results of GST affecting services with 24 states abolishing check posts while others are in the process, resulting in reduction in transportation cost, fuel use and fall in congestion. There has also been better tax compliance with 71 lakh central and state taxpayers having migrated to the Goods and Services Tax (GST) system and 15 lakh new tax payers having been registered.

**Domestic Regulations and Services Trade Restrictiveness:** Reforms in Domestic regulations are important both for domestic production and export of services. However domestic regulations should not act or be used as restrictive trade barriers. OECD's Services Trade Restrictiveness Index (STRI) helps to identify policy measures restricting trade. Among the 44 countries, India has a STRI score above average in all sectors and the highest in 3 services out of a total of 22 services. Sound recording, engineering and broadcasting are the three sectors with the lowest score relative to the average. Accounting services, legal services and rail freight transport, are the three sectors with the highest scores relative to the average. While the STRI indicators can help, there is a need for improvement in methodology, data collection and transparency. The OECD's STRI also does not include important services like

Tourism and Real Estate Services though construction is included. OECD's STRI needs to be examined carefully, as for example, in the case of computer services, not only is India's STRI higher than that of UK and USA, it is even higher in the sub-indicator of restrictions to movement of people. In the STRI for Maritime Transport sector, OECD's Services Trade Restrictiveness Index (STRI) ranks India at an overall 0.32 while the USA is only at 0.38. Comparing the domestic cabotage, Foreign Direct Investment (FDI) and related policies of India and US will show this ranking is not appropriate. This ranking is even more difficult to understand given that OECD bases its STRI largely on mode 3 – Commercial presence. This is permitted in India with 100% FDI in Shipping from 2001. Infact higher restrictiveness in foreign entry can make better performances in other indicators ineffective. The weakness in the methodology is also due to equal weightage given to all the indicators and lack of distinction in quality of restrictions. While it is important for every country to examine the STRIs from their perspective, changes in methodology, greater transparency in selecting experts who give opinions on the different indicators for different countries, making the selection more balanced by including experts from developing countries like India as well and providing better data can help in making STRI more useful.

**Market Access Barriers:** There are many market access barriers in India's trading partner countries. Some of them for major services include Visa issues in different countries for Professionals; licensing of professional service suppliers which is generally regulated at State level in the US; the Buy American provisions; restrictive regime in the case of shipping, in US with many types of assistance to domestic shipping sector such as a minimum of 50 per cent of government shipments for US registered ships, limitation of use of ships built in US in internal waters, huge subsidies, and very restrictive cabotage laws with domestic transportation even when carried out by US operators can only be performed by using vessels which are US built, US owned/controlled, US crewed and US maintained. These market access restrictions need to be negotiated in the WTO and bilateral meetings.

**Free Trade Agreements (FTAs)/CECAs:** Due to various reasons there is break up or slowdown in the formation of Mega FTAs. Meanwhile India's FTAs have benefitted its trading partners more than India, though some FTAs are just for strategic reasons. Moreover, the GSP benefits have been withdrawn for India but not for some of its competitors in important sectors. So, there is a need for useful FTAs/CECAs including services and also project exports which hitherto has not been considered in the FTAs/CECAs.

**FDI liberalisation and Disinvestment:** In the last three years, 21 sectors also including services activities and covering 87 areas of FDI policy have undergone reforms. FDI policy provisions were radically overhauled across sectors such as construction development, broadcasting, retail trading, air transport, insurance and pension. Above all, the Foreign Investment Promotion Board (FIPB) has been abollished. There is a need to see whether further liberalisation of FDI in Services can be done. There are also sectors like shipping where 100 per cent FDI in shipping exists since May 2001 and yet there have been no takers which needs to be examined.

There is plenty of scope for disinvestment in services PSUs under both central and state governments. The services PSUs listed by the Government recently are India Tourism Development Corporation (ITDC) in three locations Bhopal, Guwahati and Bharatpur. However, in the case of shipping sector any disinvestment policy should keep in mind the need to develop India's own shipping fleet as the experience in the past shows that the presence of national shipping serves as a deterrent to international cartels and monopolies and has a moderating effect on freight rates charged by foreign flag shipping. So, a careful listing of sectors and companies in services where disinvestment is possible and needed could help.

**Employment in Services:** India's services sector has a high share in income and relatively low share in employment, while in China, the shares of both services income and services employment are relatively low. While services like IT are skill oriented, services like Tourism are employment generators. There is a need for further efforts to enhance both unskilled/semi-skilled employment and skilled and quality employment in services sector. The skill India initiative could be further dovetailed for services sector employment.

**Need for a "Services from India" Initiative:** A 'Services from India" initiative on the lines of 'Make in India' is needed to strengthen our services sector domestically and also for exports along with more promotional activities in target markets including showcasing India as a major quality service provider at competitive rates. There is also a need to make the Service Export Promotion Council (SEPC) more active. This council should also network with the Indian missions abroad and the ITPO.

**Sector specific Issues:**

**IT-BPM / Software Sector:** The fall in India's computer services export growth by 0.2 per cent in 2016 is happening even when the World computer services exports are growing at 5.8 per cent in 2016; some advanced countries like USA, Israel and competing countries of South East Asia, Latin America and East Europe like Philippines, Brazil, Chile, Russia and Ukraine are having modest to robust growth and India's computer services imports is also growing at 30.4 per cent. Thus, the IT-BPM sector is affected not just by the global slowdown and challenging market access situation, but other challenges as well. The issues and challenges in the IT-BPM sector are both in the international and domestic front.

International Challenges include the following. In the US there is the tightening of Visa regime for software services with the US Government's hardening stance on the H-1B visa and the "Buy American, Hire American" Presidential executive order which called for the collection of data, increased oversight followed by a number of administrative policy changes and proposed changes that target the visas most commonly used by India's IT sector. The recent threat is the 'Protect and Grow American Jobs' (H.R. 170) bill passed by US House Judiciary committee which puts higher restrictions on H-1 B dependent companies. The UK has introduced the Migration Advisory Committee's recommendations entailing the changes like closure of Tier 2 Intra-Company Transfer (ICT) Short Term visa route, imposing Immigration Skills Charge (ISC) of £1,000 per migrant hire per valid visa year and Immigration Health Surcharge and also increase in the minimum salary threshold for Tier 2 (ICT) visas from £25,000 to £41,500. The EU's Data Protection and Privacy Rules effectively prevent Indian companies from providing services from India. There is also the issue of stalling of the discussions on a Totalization Treaty with the U.S. for a long time due to lack of flexibility on the U.S. side.

India is also facing increasing competition from new digital only entrants from Eastern Europe and Latin American countries. This is also linked to the Job Loss Challenges with the growth in digital technologies like cloud-based services making it necessary for companies to learn the new technologies and reskill.  In the light of the gentle deceleration in growth of net hiring and the threat from new technologies, there is a need to note that job loss challenge in IT sector will not just be a short term problem but a medium to long term challenge.

Domestic Challenges  include the need to consider extending the SEIS benefit to units covered under STP scheme; GST  payable on import or domestic procurement of services by STPIs which affect the working capital requirement and hence the need to consider upfront exemption from payment of GST on imports and domestic procurement of services by STPIs on  par with SEZ units; the issue of de-notification of SEZs without  having provisions for treatment of exit by such developers in the IT Act 1961;  GST related registrations and multi-level authority and the need to consider atleast centralized assessment, audits and investigations either by one authority or a team consisting of both Central and State authorities; need for parity in  treatment to Residents and Non-residents regarding capital gains from sales of unlisted shares which attracts a tax of 10% from non-residents and 20% in the hands of residents resulting in domestic investors particularly angel investors being discriminated compared to foreign investors; parity in taxes for services offered online vs offline; and other domestic challenges like shortage of skilled digital talent, and underdeveloped infrastructure in Tier 2 & 3 cities.

**Tourism Sector:** India's share in international tourist arrivals (ITA) is a paltry 1.1 per cent with a rank of 24, though in terms of International tourism receipts (ITR), India has a slightly higher share of 1.8 per cent and a better ranking of 14. Some policy suggestions and issues in this sector include the following. Three basic things are needed in atleast five major tourist destinations like  making India Tourism friendly and Tourist safe Country with a special Tourist Protection force; Cleanliness hygiene and ambience of acceptable standards; and Good Tourism Infrastructure including beautifying riversides passing the middle of cities,  providing accommodation for tourists by increasing the number of hotel rooms and improving infrastructure in important tourist sites by privatization of some areas of infrastructure or Public Private Partnership along with government support on the lines of the Government's 'Adopt a Heritage Project'. There is also a need for further improvement in E-Visas and Immigration procedures like increasing the number of E-VISA counters in Delhi Airport to reduce the waiting time which at present is 3 hours on average.

Another area is promoting Medical Tourism by facilitating imports for hospitals providing medical tourism and providing a package of services for medical tourists including state of the art medical facilities, ambulance services at airports, airlifting of medical tourists to hospitals by helicopters and fast track clearance of medical visas, immigration and other formalities.

GST related issues in tourism sector include the place of provision issue and the need to treat foreign exchange earnings in tourism services as exports or deemed exports; issue of GST rates in India being very high compared to the tax rates in other competing countries at 5 % on an average and the need to treat tourism exports on par with other exports & services & such transactions to be zero rated or taxed at a very low rate without stopping the input tax; need to consider giving input tax credit for tour operator services; and creating a simple mechanism for GST refund for international tourists purchasing goods in India.

**Shipping and Port Services:** Though shipping is an important means of transport in India's International Trade and both a foreign exchange earner and saver, India's share in total world DWT is only 0.9 per cent as on 1 January 2017. Despite having one of the largest merchant shipping fleets among developing countries, there has been a sharp decline in the share of Indian ships in the carriage of India's overseas trade from about 40 per cent in the late 1980s to 7 per cent in 2015-16. In the coastal business, Indian ships carried around 70 per cent cargo in the same year.

Some issues in this sector include the following. There is a need for 'Indian flag vessels for India's Trade' policy in shipping as Indian ships carried just 7.9% of Indian EXIM trade and 71.82% of coastal trade in 2015-16 despite the government's "Free on Board" (FoB) for imports policy and the Right of First Refusal (RoFR) policy. The operating costs of a shipping company in India are high due to high taxes payable in India than overseas and therefore foreign shipping companies do not prefer to flag their ships in India. There is also the issue of terms of shipment with a majority of India's bulk imports being done on C&F/CIF basis despite the policy of imports on FoB basis and the Indian companies not even getting the benefit of ROFR in these trades with the result that the share of Indian flag vessels in India's bulk imports is miniscule. Though 100% FDI is allowed in Indian shipping since 2001, and foreign companies have been permitted to form local shipping companies to carry Indian cargo, this has not resulted in growth of the Indian flag as this would entail bearing responsibility of paying taxes in India, employing Indian seafarers and contributing to the economic activity of India which the foreign shipping companies are averse to. Therefore, there is a need to examine the terms of shipment aspect very carefully and if necessary mandate Indian PSUs and Government Departments to import cargo only on FOB Basis. No objections to ship imports on a CIF basis must be given only as an exception and not as a rule. All long term purchases need to be done on a FOB basis in order to provide the chance to Indian Companies to bid for the said business. This can also lead to investment in the Indian flags as foreign companies will realise that there is an advantage in being an Indian flag shipping company. Other ancillary services such as training seafarers, ship repair, marine insurance, surveyors, brokers, classification services and other support services such as bunkering, pilotage, port support services etc. would develop and grow and long term benefits could be reaped by the Indian economy. Thus the 'Indian flag vessels for India's Trade' policy would be a great step towards a 'Services from India policy' on the lines of 'Make in India Policy'.

There is also the need for long term partnerships for carriage of Indian imports between Indian PSUs and governments' user departments and Indian shipping companies to increase the share of Indian vessels and the need to ensure that foreign shipping companies are not allowed to dump freight in India which is even lower than the operating costs of the Indian shipping companies as on the return leg which is normally empty and for which costs have already been covered in the laden leg, foreign ships resort to services dumping by providing the services at throwaway freight rates, well below the operating costs of Indian shipping companies. This also bring to the fore the need for a mechanism to review shipping freight rates offered by foreign flag vessels and to initiate, enquire and levy appropriate anti-dumping duty. There is also a need for a Maritime Development Fund to help in the purchase of ships as Indian ships are ageing and need replacement while the asset prices are still low. In the case of GST issues in shipping sector, there is the issue of GST applicability on sale of ships located abroad, while earlier, such a sale was outside the purview of the Indian VAT laws and hence was not liable to VAT; resolving the issue of GST on charter hire as there are two rates for renting services, 5 % and 18% with some oil majors insisting that the charter hire for chartering vessels comes under the 5% GST, as the oil companies do not get any credit for GST that they pay on services of vessels that carry products like Motor Spirit (gasoline), high speed diesel (HSD), crude oil, etc. since these commodities have not been brought under GST, while shipping companies insist that it comes under 18 % GST. There is also a need to consider parity in GST treatment for services of international transportation of goods by sea by Indian shipping companies vs foreign shipping companies, as pre-GST, both Indian and Foreign shipping companies had to pay 5% services tax for import cargo services provided to overseas consignor and post GST, only Indian shipping companies have to pay 5% GST. In all the major international maritime jurisdictions including Canada, Malaysia, Australia, UK, Indonesia and EU countries, transportation of export as well as import cargo qualifies for zero rating. So there is a need to consider, international transportation services for both import cargo and export cargo as 'zero rated supplies'. There is the issue of IGST on ships & related imports at 5% while pre-GST excise duty was absent on such items. There is also the issue of GST input tax credit on goods purchased in various states like furnace oil, lubes, spares, ship stores, etc. as the place of supply for goods is *'location of the goods at the time at which movement of goods terminates for delivery to the recipient'* as per the IGST Act. Based on the above, for goods such as furnace oil, lubes, spares, ship stores, etc. purchased by shipping companies at various ports / States, the place of supply shall be the respective State / port where goods are delivered. Such purchase of goods would attract CGST and SGST of the respective State where goods are procured. Shipping companies may not have any place of business or any output GST liability in the States where the purchases are made and hence may not be able to utilise the input tax credit in respect of goods procured at various States. This could result in significant blockage of input tax credit in various States and needs to be addressed. Some other issues include the need to consider extending the S4A scheme of RBI i.e. the 'Flexible Structuring of Existing Long Term Project Loans to Infrastructure and Core Industries' to the shipping industry; use of broadband and VSAT on Ships; lack of necessary draft; high Port Handling Charges; and Light House Dues as the Light Houses having no role to play in the navigation of ships at present.

**Real Estate Services:** Real estate sector including ownership and dwellings accounted for 7.6 per cent share in India's overall GVA in 2015-16. The growth of this sector decelerated in the last three years from 7.5 per cent in 2013-14 to 6.7 per cent in 2014-15 and further to 4.5 per cent in 2015-16. This was mainly due to the ownership and dwelling segment having a share of 6.8 per cent in overall GVA decelerating from 7.1 per cent in 2013-14 to 3.2 per cent in 2015-16. The construction sector accounted for 8.1 per cent share of GVA in 2015-16. The growth of the construction sector which includes buildings, dams, roads, bridges etc., has decelerated to 1.7 per cent in 2016-17 from 5.0 per cent in 2015-16. Housing and Infrastructure sectors are pivotal to nation building, as they have direct impact on social and economic development. They also generate varied employment opportunities ranging from unskilled, semi-skilled and skilled labourers to professionals and experts. Some of the issues and challenges affecting growth in real estate and housing sector include the delay in approvals of permits; high land registration costs including stamp duty; rising debt levels and NPAs; lack of skilled workforce; need to implement the single –window clearance for construction permits in all states on top priority; higher risk provisioning assigned to real estate sector by the RBI and dwindling profits in the real estate sector; GST Issues, like all components of construction except bricks being charged at the highest slab of 28% GST which needs a relook; delay in payment for Government projects; funding problems for land acquisition; and need for new financing instruments including expanding the Secondary Market and considering the feasibility of Covered Bonds.

**Project Exports:** Indian Project Exporters have executed a variety of projects in diverse markets overseas. Satisfactory performance, in terms of cost effectiveness, application of technical expertise and timely delivery of quality products and services have earned project exporters from India a fair degree of goodwill and standing. Project Exports include both goods and services and therefore have some peculiar problems. Some problems and policy suggestions related to this sector include lack of accuracy of data and absence of a specific HS code resulting in Project Exporters not qualifying for Export Benefits; exploring the potential for project exports in the SAARC and CLMV (Cambodia, Laos PDR, Myanmar and Vietnam) regions; including Project exports in FTA/CECA negotiations; promoting Project Exports through rupee trade and need to examine whether the Indian content can be reduced further on a case by case basis to promote project exports to Africa.

**Conclusion:** The analysis in this paper of the Services Sector in general and five sectors in particular indicates not only the potential of the services sector, but also the major issues and problems areas. While only few services are analyzed here, there are many more potential services. Telecom is one area where India has already made a mark. Some other services are Super Specialty healthcare, Satellite Mapping and Professional services where there are prospects are bright and India has the necessary competence to provide them. Many of the issues suggested in this paper along with the new ones in other sectors if addressed can help in further growth of the services sector. This can make the services sector which is already the dominant growth contributor to become a high growth propeller, along with foreign exchange earner and employment provider for India.

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# CHAPTER 1
# INTRODUCTION

## Chapter 1

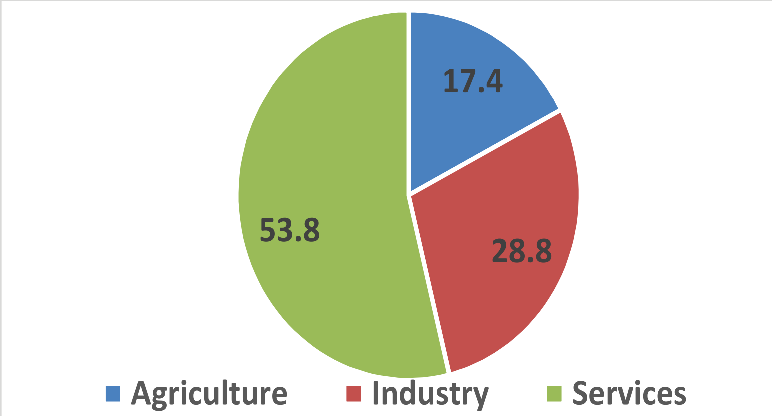
### 1. Introduction

In this paper, an attempt has been made to examine the performance of services sector and policy issues particularly in 5 sectors, IT-BPM/Software, Tourism, and Shipping which are important both in the domestic and export front, Real Estate sector in the domestic front and Project exports which is a mix of both goods and services in the export front. Each sector has its own strengths, problems, and peculiarities.

### 1.1) India's Service Growth

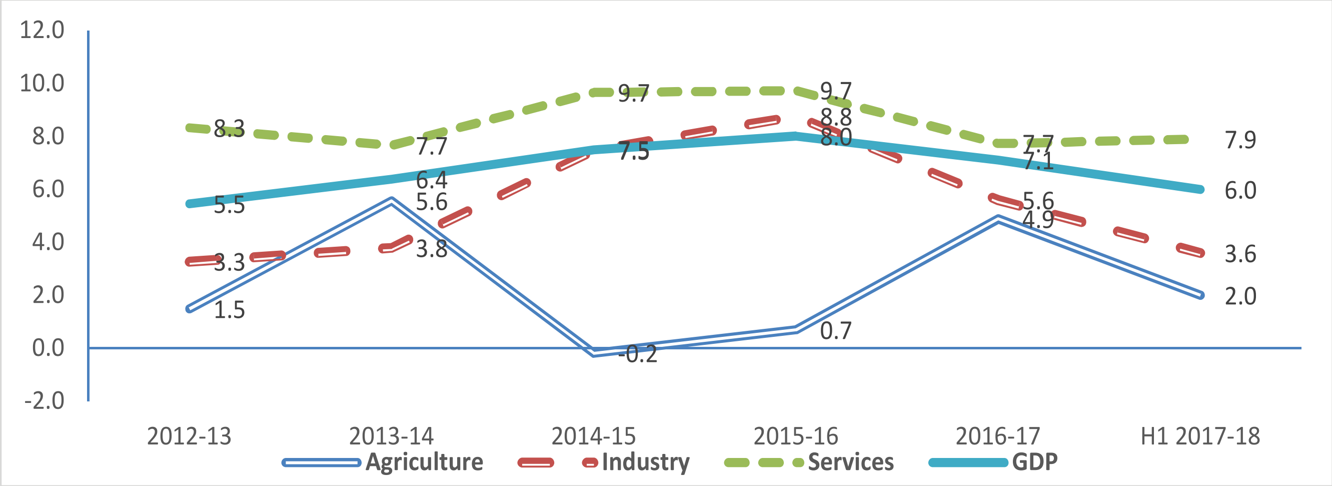
Services sector is the dominant sector in the Indian economy. More than half of the Indian economy consists of the services sector. (Figure 1.1)

**Figure 1.1: India's GDP: Sectoral Share (GVA) 2016-17**




The growth of the services sector has been pulling up the overall growth of the economy. However, in 2016-17, services growth decelerated to 7.7 per cent in line with the deceleration in overall growth to 7.1 per cent. In H1 of 2017-18, services growth improved to 7.9 per cent despite deceleration in overall growth to 6.0 per cent (Figure 1.2).

**Figure 1.2: GDP and Sectoral GVA Growth (%)**




Source: Based on CSO data.

In 2016-17, service sector growth, though moderate was led by a significant pick-up in public administration, defence & other services, that were boosted by the payouts of the Seventh Pay Commission. In the first half of 2017-18, the growth of this sector was mainly due to the increase in growth of trade, hotel, transport, storage category at 10.5 per cent.

**Table 1.1: Growth Rate of GVA at Basic Prices for Different Sectors (per cent)**

| Sector | Annual | | | | Half Yearly | |
|---|---|---|---|---|---|---|
| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2016-17 H1 | 2017-18 H1 |
| Services | 7.7 | 9.7 | 9.7 | 7.7 | 8.4 | 7.9 |
| Trade, hotel, transport, storage | 6.5 | 9.0 | 10.5 | 7.8 | 8.3 | 10.5 |
| Financial, real estate & professional services | 11.2 | 11.1 | 10.8 | 5.7 | 8.1 | 6.1 |
| Public administration, defence, etc. | 3.8 | 8.1 | 6.9 | 11.3 | 9.1 | 7.6 |

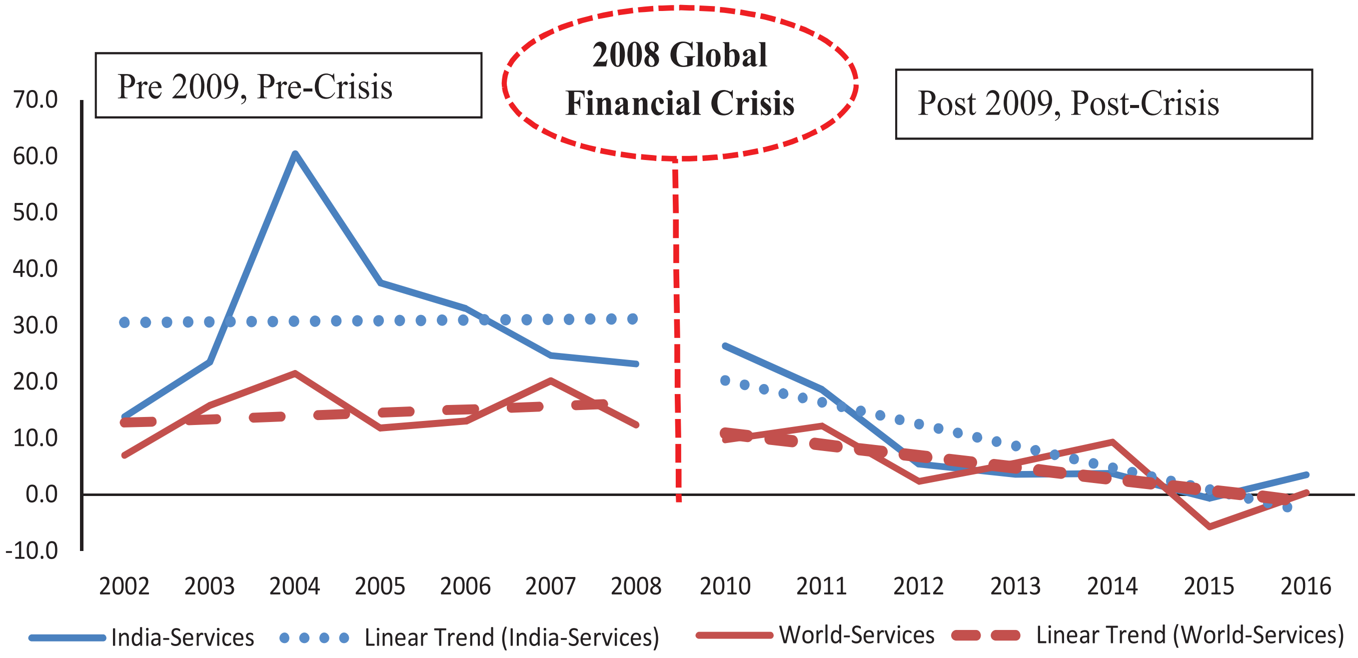
Source: CSO

The Nikkei Services PMI for India which had jumped to 51.7 in October 2017 slumped to 48.5 in November, 2017. It was the first contraction in services activity since August 2017. New orders declined, while employment growth eased from September's high and input cost inflation accelerated to the fastest since October 2013.

**1.2) Services Trade: India and World**

As per WTO data, India’s commercial services exports increased from US$ 52.2 billion in 2005 to US$ 161.3 billion in 2016. The share of India’s commercial services to global services exports increased to 3.4 per cent in 2016 from 2.1 per cent in 2005. India’s services exports have been registering good growth for nearly a decade till the global financial crisis in 2008. Services export growth slowed down from 21.6 per cent CAGR during 1994-95 to 2004-05 to 11.9 per cent during 2005-06 to 2014-15. As a result of the uncertain global conditions and weak external demand, India’s services export growth even turned negative at -2.4 per cent in 2015-16 after a span of five years. As per the latest World Trade Organization (WTO) data for 2016, services export growth is in negative territory for many economies, though for India it is positive at 3.6 per cent and higher than the 0.4 per cent global services export growth. While it is also positive and higher than that of India for countries like Japan, Australia, Spain and Mexico, it is negative for China at – 4.3 per cent.

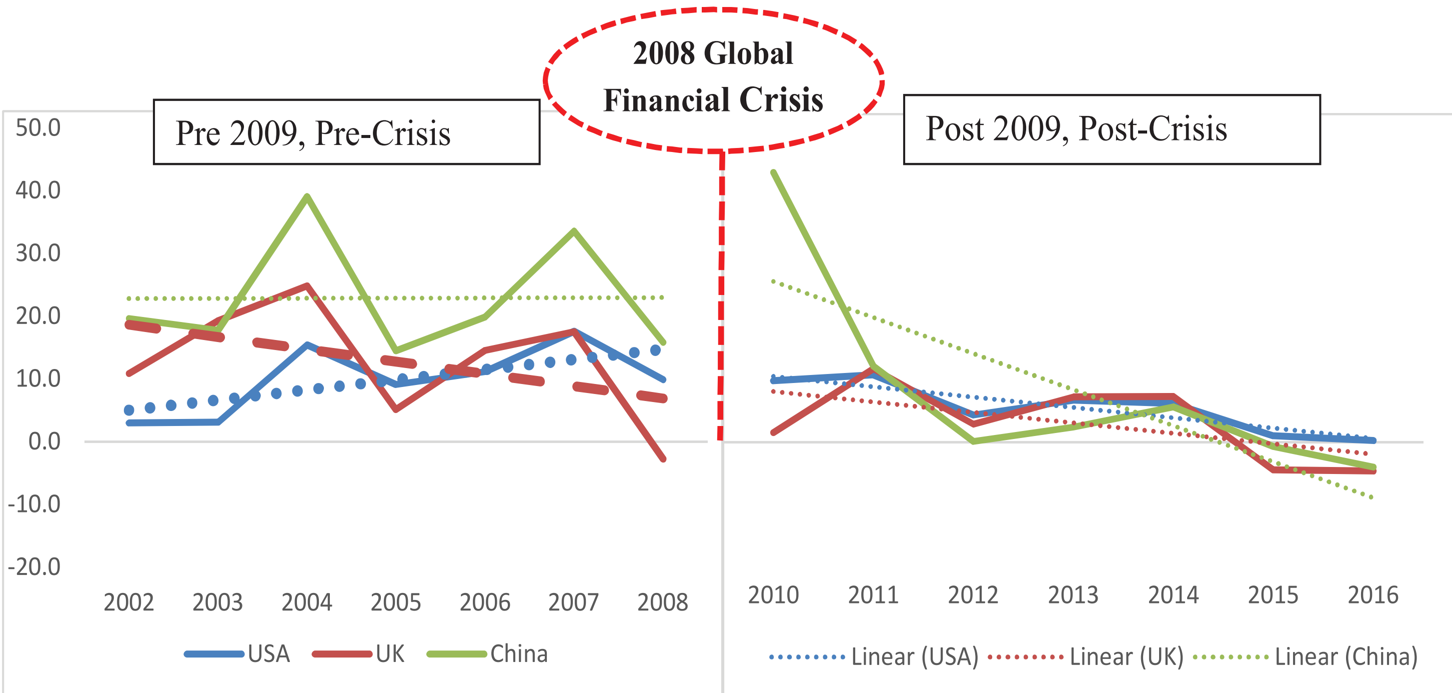
**Figure 1.3: World's and India's Services Export Growth Rate: Pre & Post 2009**




Source: Based on WTO data. (Economic Survey 2016-17 Volume-2).

The deceleration in India's services export growth over the years is more marked particularly in the post crisis period. India's and world's services exports trend growth were almost flat in the pre-crisis period, though India's Services export growth rate was higher than that of the World. In the post crisis period, the deceleration in trend growth of India's services exports was sharper than world services export growth as was also the case with China. (Figure 1.4)

**Figure 1.4 : Services Export Growth Rate of USA,UK and China: Pre & Post 2009**




Source: Based on WTO data

**India's Trade in Services**

In 2016-17, services exports recorded a positive growth of 5.7 per cent with pick up in some major sectors like transportation, business services and financial services; and good growth in travel. In 2017-18 H1, Services exports grew by 16.2 per cent whereas, services imports grew by 17.4 per cent resulting in net services growth of 14.6 per cent financing almost 44 per cent of Trade Deficit. Net services surplus financed around 60 per cent of India's merchandise trade deficit in 2016-17 and 44 per cent in 2017-18 H1.

**Table 1.2 : Growth Rate of Services Trade**

| | Value ($ bn) | Growth Rate (Per cent) | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2016-17 | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 H1 |
| Services Exports | 163.1 | 14.2 | 2.4 | 4.2 | 4.1 | -2.4 | 5.7 | 16.2 |
| Services Imports | 95.7 | -2.9 | 3.2 | -2.5 | 3.6 | 3.7 | 13.0 | 17.4 |
| Net Services | 67.5 | 45.4 | 1.3 | 12.6 | 4.7 | -9.0 | -3.2 | 14.6 |

Source: Calculated from RBI data

Sector-wise, Travel has performed well in 2016-17 and 2017-18 H1. Software services growth after decelerating in recent years became negative at -0.7 per cent in 2016-17, but returned to positive territory at 2.3 per cent in H1 of 2017-18.

**Table 1.3: Sub-Sector wise Growth Rate of Services Exports and Imports**

| | Value (US $ Billion) 2016-17 | Share (%) 2016-17 | Growth (%) | | |
|---|---|---|---|---|---|
| | | | 2015-16 | 2016-17 | 2017-18 H1 |
| **Services Exports** | **163.1** | **100.0** | **-2.4** | **5.7** | **16.2** |
| *Travel* | 23.2 | 14.2 | 4.6 | 9.3 | 27.7 |
| *Transportation* | 15.9 | 9.7 | -19.9 | 13.2 | 6.9 |
| *Miscellaneous* | 121.2 | 74.3 | -0.9 | 4.1 | 15.6 |
| *Software Services* | 73.7 | 45.2 | 1.4 | -0.7 | 2.3 |
| *Business Services* | 32.9 | 20.2 | 2.0 | 13.6 | 7.6 |
| *Financial Services* | 5.1 | 3.1 | -12.7 | 3.1 | -13.4 |
| **Services Imports** | **95.7** | **100.0** | **3.7** | **13.0** | **17.4** |
| *Travel* | 16.4 | 17.2 | -3.4 | 11.1 | 12.0 |
| *Transportation* | 14.1 | 14.8 | -6.8 | -6.3 | 15.0 |
| *Miscellaneous* | 63.0 | 65.9 | 9.8 | 19.5 | 19.3 |
| *Software Services* | 3.6 | 3.7 | -0.3 | 32.9 | 47.6 |
| *Business Services* | 32.3 | 33.7 | 12.5 | 3.7 | 11.3 |
| *Financial Services* | 5.9 | 6.1 | -12.4 | 86.7 | -0.2 |

Source: Calculated from RBI data

# CHAPTER 2
# SOME RECENT POLICY INITIATIVES IN THE SERVICES SECTOR

## Chapter 2

# 2 Some Recent Policy Initiatives in the Services Sector

## 2.1 Recent initiatives in foreign Trade Policy (FTP)

Various initiatives have been taken by the Government to help the services sector. In the recent FTP also some steps were taken in this direction which include the following.

- To provide an impetus to the services trade, the SEIS (Service Export from India Scheme) incentives have been increased by 2% for notified services such as Business, Legal, Accounting, Architectural, Engineering, Educational, Hospitals, Hotels and Restaurants amounting to Rs. 1140 crore.
- The validity period of the Duty Credit Scrips has been increased from 18 months to 24 months to enhance their utility in the GST framework. GST rate for transfer/sale of scrips has been reduced to zero from the earlier rate of 12%. This will also help services sector.
- New Logistics Division created in the Commerce Department to develop and coordinate implementation of an Action Plan for the integrated development of the logistics sector, by way of policy changes, improvement in existing procedures, identification of bottlenecks and gaps and introduction of technology in this sector.
- New Services division to be set up in DGFT to examine EXIM policies and procedures from the point of view of "Services"
- Second Hand Goods imported for the purpose of repair/ refurbishing/re-conditioning or re-engineering have been made free, thereby facilitating generation of employment in the repair services sector.

## 2.2 Select Major Sectors

Some of the recent initiatives in five select major services sectors are the following:

**IT Sector:** The Government of India's rapid adoption of technologies as a platform to delivery of government-to-government and government-to-citizen services is a tremendous push factor for the domestic IT-BPM market. The Government of India is also taking a lead in adopting digital technologies and is one of the most proactive users of social media as a means to communicate with the public. It has developed its own cloud platform – MeghRaj – that offers Platform-as-a-Service (PaaS), Infrastructure as a Service (IaaS), Software as a Service (SaaS) and Storage as a Service (STaaS). The focus of this initiative is to accelerate delivery of e-services in the country while optimizing Information Communication & Technology (ICT) spending of the Government. It also intends to make India a hub for cyber security solutions for the world. Through long-term initiatives like Digital India, Make in India, Smart Cities, e-Governance, push for digital talent through Skill India, drive towards a cashless economy, efforts to kindle innovation through Start-up India, etc., uptake of technology is expected to grow substantially in the future. Government, as part of its DigiDhan Mission, intends to accomplish the target of 2500 crore digital transactions for 2017-18, of which around 1100 crores have already been accomplished till November, 2017. The mission also aims at promotion and sustenance of a secure National Digital Payments ecosystem. In addition, innovative schemes and working / business models, products, platforms and sustainable service delivery models will also be encouraged to leverage the foundation laid by the digital transactions, one such example being Direct Benefits Transfer. These initiatives will help in the accomplishment of DigiDhan mission thereby transforming India into digitally empowered society and knowledge economy. Some of the initiatives under Digital India programme include Universal Digital Identity (Aadhaar); Common Services Centres (CSCs) which are basically ICT enabled front-end service delivery outlets; Digital Locker, a safe and secure place for keeping documents online; eSign, an initiative for easy, efficient and secure signing of electronic documents by an Aadhaar holder; UMANG(Unified Mobile App for New Age Governance), a single mobile platform to deliver major Government services with Core Platform integrated with Aadhaar, DigiLocker, PayGov, Rapid Assessment System (RAS) etc.; Jeevan Pramaan scheme for Digital Life Certificate for Pensioners; National Scholarship Portal, a one-stop solution to implement end-to-end disbursement of scholarships to the beneficiaries; National Centre of Geo-informatics (NCoG) project, a GIS platform developed for sharing, collaboration, location based analytics and decision support system for Departments, etc. Other initiatives include the “Pradhan Mantri Gramin Digital Saksharta Abhiyan (PMGDISHA)” to usher in digital literacy in rural India by covering 6 crore rural households (one person per household) by 31st March, 2019; steps to secure the country’s cyber space, by launching several Cyber Swachhta Kendras, a Botnet Cleaning and Malware Analysis Centre; and CERT-Fin which is being established to work towards strengthening cyber security in the financial sector in close coordination with all financial sector regulators and national level CERT-In (Indian - Computer Emergency Response Team).

**Tourism:** Recent policies to promote Tourism include, E-Visa for the citizens of 162 countries, promotion of India as a 365 days destination, Swachhta Action Plan (SAP), Skill Development Initiative, launching of Multilingual Tourist Infoline, and Swachh Paryatan Mobile App. During January to September, 2017 a total of 12.43 lakhs e-Visa holders visited India registering a growth of 59.2 per cent over the same period of 2016. E- visa is allowed under three sub-categories − e-Tourist Visa, e-Business Visa, and e-Medical Visa. The window for application under e-Visa has been increased from 30 days to 120 days and the duration of stay in India under e-Visa has also been increased from 30 days to 60 days. These were also suggested in our earlier working paper (DEA 2016). A series of promotional activities are undertaken in important and potential markets overseas through the India Tourism offices abroad and within India through domestic India Tourism offices, with the objective of showcasing India’s tourism potential to foreign and domestic tourists under the Incredible India Branding. Some examples are the launch of Global Media Campaign for 2017-18 on the Euro Sports Channel in August 2017; launch of ‘The Heritage Trail’ to promote the World Heritage Sites in India and Domestic Television Campaigns on Doordarshan to promote tourism to the North East Region and to the State of Jammu &

Kashmir and to encourage travel to tourist destinations in these regions; launch of International Media Campaign of Ministry of Tourism on Al Jazeera TV channel in the Middle East Region, on Travel Channel Global Feed, CNN, BBC, Discovery, TLC, NGC, Euronews, History, CNBC, CBS- USA and TABI – Japan; organization of CICA (Conference of the Interaction and Confidence Building Measures in Asia) workshop on "Building bridges across Asia through tourism" on 28th September, 2017 at New Delhi; celebration of 'Paryatan Parv' during 5th-25th October, 2017 with 3 components: Dekho Apna Desh to encourage Indians to visit their own country, Tourism for All with tourism events at sites across all states in the country and Tourism & Governance: Interactive Sessions & Workshops with Stakeholders on varied themes.

Globally, the medical value travel (MVT) market is expected to cross US$ 100 billion in 2019, growing at a CAGR of 19.4 percent and India's share was 3.8 per cent of the global medical tourists and 5.5 per cent of the global revenue from medical tourism in 2014. The Government has initiated many policies to make India a Medical Value Travel destination which include constituting the National Medical and Wellness Tourism Promotion Board in 2015 and launching e-tourist visa and m-visa facilities. The board has taken many initiatives which inter alia include:

a) Stressing on easing entry formalities for those arriving for Medical Visits. On the recommendations of the Board, Government has done away with the procedure for reporting of those coming on medical visas to Foreigner Regional Registration Offices (FRRO) and accepts hospital's reporting.
b) Giving emphasis on accreditation of institutions and organizations dealing with Medical and Wellness Tourism at all levels.
c) Encouraging the Medical and Wellness Tourism stakeholders to work in a transparent and fair manner by listing out indicative cost of procedures.

Ministry of Tourism also provides Market Development Assistance (MDA), for participation in approved Medical/Tourism Fairs/Medical Conferences/Wellness conferences/ Wellness Fairs and its allied Road Shows, to the Medical Tourism Service Providers and Wellness Tourism Service Providers. The Medical Visa and Medical Attendant Visa are special category of visa provided to visitors coming for medical purposes. The E-Visa regime has also been extended to include visits for medical purposes as well. Special immigration counters have been set up at airports for this category.

Another recent initiative in the Tourism Sector is the Adopt a Heritage Project. The 'Adopt a Heritage Scheme' of Ministry of Tourism was launched on World Tourism Day i.e. 27th September, 2017 by the President of India. Thereafter, Ministry of Tourism invited Private Sector Companies, Public Sector Companies and Corporate individuals to adopt the sites and to take up the responsibility for making our heritage and tourism more sustainable through conservation and development. This scheme is a unique endeavour of Ministry of Tourism in close collaboration with Ministry of Culture and Archaeological Survey of India (ASI) which envisages developing monuments, heritage and tourist sites across India and making them tourist friendly to enhance their tourism potential and cultural importance, in a planned and phased manner. Seven shortlisted companies have been given 'Letters of Intent' for fourteen monuments under 'Adopt a Heritage Scheme'. These companies will be the future 'Monument Mitras'.

For creation of tourism infrastructure, the Ministry of Tourism has two plan schemes viz. Swadesh Darshan - Integrated Development of Theme-Based Tourist Circuits and PRASAD-Pilgrimage Rejuvenation and Spiritual Augmentation Drive for development of tourism infrastructure in the country including historical places and heritage cities.

**Shipping & Ports:** To encourage the growth of Indian tonnage and for higher participation of Indian ships in Indian EXIM trade, the government has implemented several measures which include reduction of GST from 18% to 5% on bunker fuel used in Indian flag vessels; brought parity in the tax regime of Indian seafarers employed on Indian flag ships vis-à-vis those on foreign flag ships; removing obstacles in the smooth implementation of the India Controlled Tonnage (ICT) scheme which allows Indian companies to directly own ships in foreign flags; and easing many procedural compliance issues like ship registration, procuring chartering permission and payment of chartering fees online.

A vision for coastal shipping, tourism and regional development has been prepared, with a view to increasing the share of the coastal/inland waterways transport mode from 7 percent to 10 percent by 2019-20. The key elements of the initiative include development of coastal shipping as an end-to-end supply chain, integration of inland water transport (lWT) coastal route development of regional centers to generate cargo for coastal traffic, and development of lighthouse tourism. To achieve the elements of the vision, the government has relaxed cabotage for Roll-on-Roll-off vessels, expanded the scope of coastal berth scheme and merged it with the Sagarmala Programme; provided financial assistance of 50% of project cost to Major Ports/State Governments for construction of Coastal Berths, Breakwater, mechanization of coastal berths and capital dredging; simplification of customs procedures to reduce turnaround of coastal ships; moderated manning and technical requirements for vessels operating within Indian territorial waters through a river sea vessel notification to reduce cost of operations; increasing the discount on port charges for Ro-Ro ships by major ports from 40% to 80% for two years w.e.f 20th September, 2016; including movement of subsidized fertilizers by coastal route and road for reimbursement of freight subsidy which will encourage the coastal movement of fertilizer; etc.

To develop cruise shipping and tourism in the country, Government has taken many steps like constructing New cruise terminals at Mormugao port and Chennai Port, revising the Standing Operating Procedures (SOPs); E-visa facility to 5 major ports namely Mumbai Port, Mormugao Port, New Mangalore Port, Cochin Port and Chennai Port; fixing a uniform tariff rate at all major ports at $0.35 per GRT for the first 12 hours to attract cruise vessels in India; and extending the facility for foreign flag passenger vessels to call at Indian ports without obtaining license from

DG(S) from February, 2019 to February, 2024; and extending the facility for foreign flag passenger vessels to call at Indian ports without obtaining license from Directorate General of Shipping (DGS) from February, 2019 to February, 2024. In 2016-17, the 5 major ports handled 158 vessels and 1.92 lakh cruise passengers which is significantly higher than the 103 vessels & 80,645 passengers during 2013-14.

Some of the initiatives taken by the Government in 2016-17 to improve the performance of major ports include benchmarking major ports to international standards; introducing major Ports Authorities Bill, 2016 in parliament on 16.12.2016 to replace Major Ports Trust Act, 1963 to modernize the institutional structure of major ports, though the Bill still pending in the Lok Sabha; operationalizing Radio Frequency Identification System (RFID) to reduce dwell time, transaction time and ease congestion in 7 major Ports of which for 4 major Ports, it would be operationalized this year; initiating direct port delivery and direct port entry at major ports for EXIM containers; replacing manual form 11 and 13 by single web-based e-form for seamless entry at port gate, signing an International Agreement between India and Iran to set up two berths outside India in Chabahar Port and integrating PCS and ICEGATE with terminal operating system of JNPT facilitating smooth flow for messages.

**Real Estate:** Some of the recent policy measures taken by the Government include Pradhan Mantri Awas Yojana (PMAY- Urban), Smart Cities Mission, Real Estate Investment Trust (REITs) and Infrastructure Investment Trusts (InvITs), relaxation of conditions to claim tax incentive for affordable housing projects, and the Benami Transactions (Prohibition) Amendment Act, 2016 and introducing Real Estate (Regulation & Development) Act, 2016 (RERA) with the following features, besides mandatory registration of projects and Real Estate Agents:

- Depositing 70% of the funds collected from buyers in a separate bank account in case of new projects and 70% of unused funds in case of ongoing projects;
- Projects with plot size of minimum 500 sq.mt or 8 apartments shall be registered with Regulatory Authorities;
- Both developers and buyers to pay the same penal interest of SBI's Marginal Cost of Lending Rate plus 2% in case of delays;
- Liability of developers for structural defects for five years; and
- Imprisonment of upto three years for developers and upto one year in case of agents and buyers for violation of orders of Appellate Tribunals and Regulatory Authorities.

Recently, to improve affordability, the Government of India has not only announced tax and fiscal concessions, but also notified affordable housing under the Harmonized Master List of Infrastructure Sub-sectors.

**Project Exports:** Export of projects and services is an indicator of a country's advancement in technology and its upward movement in the value chain of its export performance. They can be broadly classified into four categories, viz. Supply contracts on deferred payment terms, Civil Construction, Turnkey and Consultancy Services Contracts. Project export contracts are generally of high value and exporters undertaking them are required to offer competitive credit terms to be able to secure orders from foreign buyers in the face of stiff competition. Long term deferred credit thus plays an important role in securing project export contracts. Some of the initiatives to promote project exports include the following:

- **Line of Credit (LOCs):** Under the IDEA scheme, Government supported Lines of Credit are made available to the developing countries, through Export-Import Bank of India (Exim Bank), for support of developmental and other projects. Grants or project assistance to developing countries in Africa, South Asia and other parts of the developing world, are provided under the scheme with a view to also leverage and promote India's strategic economic interests abroad. A new set of guidelines for the scheme has been issued on December 07, 2015 which have streamlined the process. The salient features of the new guidelines include mandatory preparation of a detailed project report preceding the project execution, appointment of an independent project management consultant through competitive bidding process, prequalification of competent Indian companies and vetting of tender documents by Exim Bank, submission of bid evaluation report and draft contract by the LOC recipient country to Exim Bank and strengthening of the project monitoring mechanism under the LOCs. During 2017-18 (April-November), Exim Bank extended 8 GOI-guaranteed LOCs, to 8 countries, with credit aggregating to US$ 5.51 billion. As on November 30, 2017, there were 224 operative LOCs to 63 countries, with credit commitments aggregating to US$ 21.36 billion, out of which 217 LOCs to 59 countries, aggregating US$ 21.14 billion were guaranteed by the Government of India. The LOCs finance exports from India and execution of infrastructure projects by Indian companies in developing countries. Besides offering a risk-free, non-recourse export financing option to Indian exporters, Exim Bank's LOCs demonstrate Indian expertise and project execution capabilities in emerging markets. The LOCs enable the recipient developing countries to set up developmental and institutional projects and create capacities and skills. During 2017-18 (April-November), LOCs have been extended for a variety of sectors such as railways development in Sri Lanka; developmental projects in Bangladesh; establishment of vocational training centres and business incubation centres in Rwanda, equity participation for various infrastructure projects in Mauritius and upgradation of military hospitals in Cote D'Ivoire.

- **Buyer's Credit under the National Export Insurance Account:** The introduction of the Buyer's Credit under the Government of India's (GOI) National Export Insurance Account (BC-NEIA) program has further helped in increasing project exports from India. BC-NEIA is a unique financing mechanism that provides a safe mode of non-recourse financing option to Indian exporters and serves as an effective market entry tool to traditional as well as new markets in developing countries, which need deferred credit on medium or long term basis. At present, a positive list of 85 countries have been identified by ECGC Ltd. for which Indian exporters may avail of BC-NEIA facility. Exim Bank has till date sanctioned an aggregate amount of US$ 2.82 billion for 22 projects valued at US$ 3.02 billion under BC-NEIA, and has a robust pipeline of US$ 7.70 billion across 64 projects.

- **Concessional Financing Scheme to support Indian companies bidding for strategically important infrastructure projects abroad:** Under GOI's Concessional Financing Scheme (CFS), Exim Bank offers concessional finance to support Indian companies bidding for strategically important infrastructure projects overseas., Exim Bank has extended a term loan of US$ 1.60 billion to the Bangladesh India Friendship Power Company Pvt. Ltd. [BIFPCL], a 50:50 joint venture between the Bangladesh Power Development Board, Bangladesh and NTPC Ltd., India for financing the 1320 MW ultra-super-critical strategically important Maitree Super Thermal Power Project in Rampal, Bangladesh. The Facility Agreement for the said loan was exchanged in New Delhi on April 10, 2017 and BHEL has already started project work and the advance payment has also been released on March 29, 2017.

- **Export Development Fund:** The Export Development Fund (EDF), a special fund created by the Government of India and administered by Exim Bank of India has been operationalized in 2016-17. On May 04, 2016, the EDF concluded an umbrella Framework Agreement with seven Iranian banks to enhance a Buyer's Credit facility to finance the export of goods and services from India to Iran, from Rs. 900 crore to Rs. 3000 crore. The Framework Agreement of Rs.3000 crore is earmarked for two steel rail contracts and Chabahar Port Development project.

- **Project Development Fund for CLMV countries:** Exim Bank has been partnering the Government of India under the GOI's "Look East Act East Policy" by way of a Project Development Fund for the CLMV Region with a corpus of Rs. 500 crore. Presently, 4 project opportunities, one in Cambodia, two in Myanmar and one in Vietnam in the Healthcare Sector, Education Sector and Pharmaceuticals Sector have been identified, wherein preparation of Detailed Project Reports (DPRs) is being undertaken, after which SPVs will be set up in the respective countries for implementing the identified projects.
- **Supporting Infrastructure Projects through KPDC:** Exim Bank in collaboration with IL&FS, African Development Bank and SBI, has set up the Kukuza Project Development Company (KPDC) in Africa to identify and develop infrastructure projects. The KPDC is expected to provide specialist project development expertise to take infrastructure projects from the concept stage to the commissioning stage in the African Continent.

# CHPATER 3
# SERVICES SECTOR: MAJOR CROSS-CUTTING ISSUES AND POLICY SUGGESTIONS

## Chapter 3

# 3. Services Sector: Major Cross-Cutting Issues and Policy Suggestions

The issues can be divided into two broad categories, Major Cross Cutting Issues and Sector Specific Issues. In this section, major cross cutting issues are given and in the next section sector specific issues in select major sectors are given along with sector wise performance. The major cross cutting issues are the following.

## 3.1) Impact of Demonetization

Demonetization announced on November 8, 2016, could have impacted services sector temporarily as in the case of other sectors. Some of the impacts of demonetization on services sector are the following.

- While GDP growth decelerated to 7.0 per cent, 6.1 per cent and 5.7 per cent in Q3 2016-17, Q4 2016-17 and Q1 2017-18, Services GVA growth decelerated to 6.9 per cent, and then picked up to 7.2 per cent and 8.7 per cent respectively during these periods. The deceleration in GDP however is due to different factors and demonetisation could have been only one among them.
- Like manufacturing PMI, Services PMI also fell after demonetization for a few months and then picked up.
- While merchandise export growth of goods decelerated for few months and then picked up, services exports fell in December 2016, but picked up in next three months (Table 3.1). These could be due to other factors as well and not necessarily demonetisation.
- There was not much impact of demonetisation on Tourism with Foreign Exchange Earnings (FEE) in dollar terms increasing after demonetisation. Bank credit by commercial Banks also increased after demonetisation.
- As per Knight Frank Research (January 2017), Residential sales across top-eight cities in India in 2016 fell to a five-year low of about 2,45,000 units, due to subdued demand over the past three years. Similarly, new residential unit launches, fell to only 1,76,000 unit launches during 2016. This was primarily due to the prolonged slump and execution delays in project completion which resulted in inventory pile-up across all cities. Demonetization in November 2016 possibly impacted the new launches and sales in the short term with several states recording drop in property registrations post-demonetization as per NAREDCO. However, there was not much impact on property prices.
- While demonetization is now a thing of the past, there was also positive impact on services due to greater digitization with measures like launch of Unified Payments Interface (UPI), Bharat Interface for Money (BHIM) app, and BHIM-Aadhaar Pay, etc. This could have a long term effect on services sector.
- Payments to local bodies and discoms increased as demonetized notes were legal tender for such payments for some time.
- Due to reduction in interest rates on bank deposits after demonetisation, debt and equity mutual funds (MFs) have become more attractive. Net flows into mutual funds stood at

Rs.1,69,500 crore in the post-demonetisation period compared to the Rs.9,100 crore recorded in the previous year.

- Premia collected by Life Insurance Corporation of India increased by 142 per cent (y-o-y) in November 2016 and by private sector life insurance companies increased by nearly 50 per cent due the window provided for depositing old notes to make these payments for a short while.

**Table 3.1: Possible Impact of Demonetisation on Services: Some select Indicators**

| Month | PMI Index | | FEE (US$ terms) Growth Rate (%) | Bank credit by commercial banks (Rs Billion) | Growth (%) | |
|---|---|---|---|---|---|---|
| | PMI Services | PMI Manufacturing | | | Goods Exports | Services Exports |
| Mar-16 | 54.3 | 52.4 | 8.7 | 72,496 | -4.7 | -8.2 |
| Apr-16 | 53.7 | 50.5 | 7.3 | 72,323 | -5.8 | -0.8 |
| May-16 | 51.0 | 50.7 | 2.9 | 72,264 | -0.5 | 13.4 |
| Jun-16 | 50.3 | 51.7 | 5.9 | 72,280 | 1.5 | 4.4 |
| Jul-16 | 51.9 | 51.8 | 12.8 | 72,405 | -6.8 | -4.6 |
| Aug-16 | 54.7 | 52.6 | 7.0 | 72,477 | 0.1 | -1.5 |
| Sep-16 | 52.0 | 52.1 | 10.9 | 74,981 | 4.1 | 3.4 |
| Oct-16 | 54.5 | 54.4 | 11.8 | 73,844 | 8.9 | -1.7 |
| **Nov-16** | **46.7** | **52.3** | **10.4** | **72,923** | **2.6** | **11.0** |
| Dec-16 | 46.8 | 49.6 | 14.7 | 73,481 | 6.5 | -1.7 |
| Jan-17 | 48.7 | 50.4 | 16.3 | 74,178 | 5.5 | 7.9 |
| Feb-17 | 50.3 | 50.7 | 13.7 | 74,853 | 18.6 | 5.9 |
| Mar-17 | 51.5 | 52.5 | 17.0 | 78,815 | 27.9 | 10.0 |
| Apr-17 | 50.2 | 52.5 | 32.0 | 76,113 | 18.1 | 0.0 |
| May-17 | 52.2 | 51.6 | 25.4 | 75,985 | 7.4 | -0.2 |
| Jun-17 | 53.1 | 50.9 | 28.0 | 76,637 | 3.7 | 0.5 |
| Jul-17 | 45.9 | 47.9 | 9.4 | 76,179 | 3.9 | 3.2 |
| Aug-17 | 47.5 | 51.2 | 16.1 | 77,056 | 10.3 | 2.4 |
| Sep-17 | 50.7 | 51.2 | 23.5 | 80,088 | 25.7 | -0.3 |
| Oct-17 | 51.7 | 50.3 | 21.7 | | -1.1 | NA |
| Nov-17 | 48.5 | 52.6 | | | | |

Source: Based on data from RBI, Department of Commerce, Ministry of Tourism, and www.markiteconomics.com

## 3.2) Goods and Services Tax (GST): Impact on Services

To streamline the indirect tax system, the GST has been implemented from 1 July 2017 with amendments from time to time. GST is a destination based consumption tax and would be applicable on the supply of goods or services as against the earlier concept of tax on the manufacture or sale of goods or provision of services. This means that tax would accrue to the State or the Union Territory where the consumption takes place.

In the case of Services, the GST rates are 'NIL' for education and health services and 5 per cent for transport of goods by rail and vessel, supply of tour operators services (without ITC); Only 4 services items are in the highest slab of 28 per cent which include among others entertainment events or access to amusement facilities including exhibition of cinematograph films, theme parks, joy rides, etc; and hotels, inns, having room tariff above Rs. 7500 per day per room.

- The GST Council in October 2017 recommended changes in GST rates to provide relief on the services side also, particularly to aviation, restaurants and job work related to services. These are as follows:
    - All stand-alone restaurants irrespective of air conditioned or otherwise, will attract 5% GST without ITC. Food parcels (or takeaways) will also attract 5% GST without ITC.
    - Restaurants in hotel premises having room tariff of less than Rs 7500 per unit per day will attract GST of 5% without ITC.
    - Restaurants in hotel premises having room tariff of Rs 7500 and above per unit per day (even for a single room) will attract GST of 18% with full ITC.
    - Outdoor catering will continue to be at 18% with full ITC.
    - GST on services by way of admission to "protected monuments" to be exempted from GST.
    - GST rate on job work services in relation to manufacture of those handicraft goods in respect of which the casual taxable person has been exempted from obtaining registration, to be reduced to 5% with full input tax credit
    - GST rates on aircraft engines reduced from 28%/18% to 5%, aircraft tyres from 28% to 5% and aircraft seats from 28% to 5%.
- In order to obviate dispute and litigation, the GST council has recommended that irrespective of whether permanent transfer of Intellectual Property is a supply of goods or service. -

    (i) permanent transfer of Intellectual Property other than Information Technology software attracts GST at the rate of 12%; and

    (ii) permanent transfer of Intellectual Property in respect of Information Technology software attracts GST at the rate of 18%.

Further during recent amendments some measures specific to services were also taken which include reduction in tax rates on some services including services related to job work which will benefit many sectors including Gems and Jewellery, exempting service providers with annual turnover of less than Rs 2 million from the need to register even in cases where they are making inter-state supplies, etc.

In the case of Services, GST has led to many benefits and some early hiccups and difficulties which will subside over time (**Box 3.1**). There are also some early results of GST affecting services with 24 states abolishing check posts while others are in the process, resulting in reduction in transportation cost and fuel use. Already there are signs of fall in congestion with abolition of check posts. There has also been better tax compliance with 71 lakh central and state taxpayers having migrated to the Goods and Services Tax (GST) system and 15 lakh new tax payers having been registered.

**Box 3.1: GST impact on Services Sector**

GST has many benefits for Services as well as early difficulties. Some are given below:

**Benefits:**

- **Confusion avoided:** Pre-GST, both Central and State Govt. had the right to collect the tax. Because of this, sometimes there was confusion in finding out to whom the tax is to be paid for services like software, works contract etc. This resulted in disputes between Central and State Governments. This confusion has disappeared with the introduction of a single tax GST regime which includes both central and state GST.
- In the GST regime, it is imperative for every stakeholder to upload the GST paid. If one does not, the other party forces it to do so immediately to get input tax credit. This also benefits services sector.
- Logistics costs will fall with abolition of check posts and the E-way bill is expected to reduce the logistics cost to meet the international benchmark.

**Early Difficulties:**

- **Costlier Services:** Pre-GST, service tax was applicable at the rate of 15% on Services rendered which included 0.5% for Swachh Bharat Cess and 0.5% for Krishi Kalyan Cess. Post-GST the service sector is under higher taxation of 18 percent from the previous 15 percent. However for some services, it is 'Zero' or low and gradually rates are supposed to be lowered. In fact tax credit is available and exports are not taxed.
- **Registration of Place of Business:** Previously, since only the Centre imposed the service tax, agents had to register with, and hence file to, only one authority. Now, agents will have to register in all states that they operate in and file in each of them. In the discussions in the GST Council, attempts were made to preserve the previous, simpler system, but states were nearly unanimous in insisting for multiple registration as a way to ensure that they receive their due share of revenues. The complexity of the taxation can be well understood from the example of cloud services provision by an IT company having its headquarters in Delhi and the infrastructure in UP. However, increased compliance requirements will be faced only by a small number of agents with a pan-India presence whose ability to comply will be commensurately greater.

- **GST Network:** There are also issues of GST network. As per GST rule, each business like Bank Branches need to be registered in the place of Business. However, in the GST network, not more than 100 branches of Bank can register. Hence, a number of Bank Branches are not yet registered due to this technical issue.

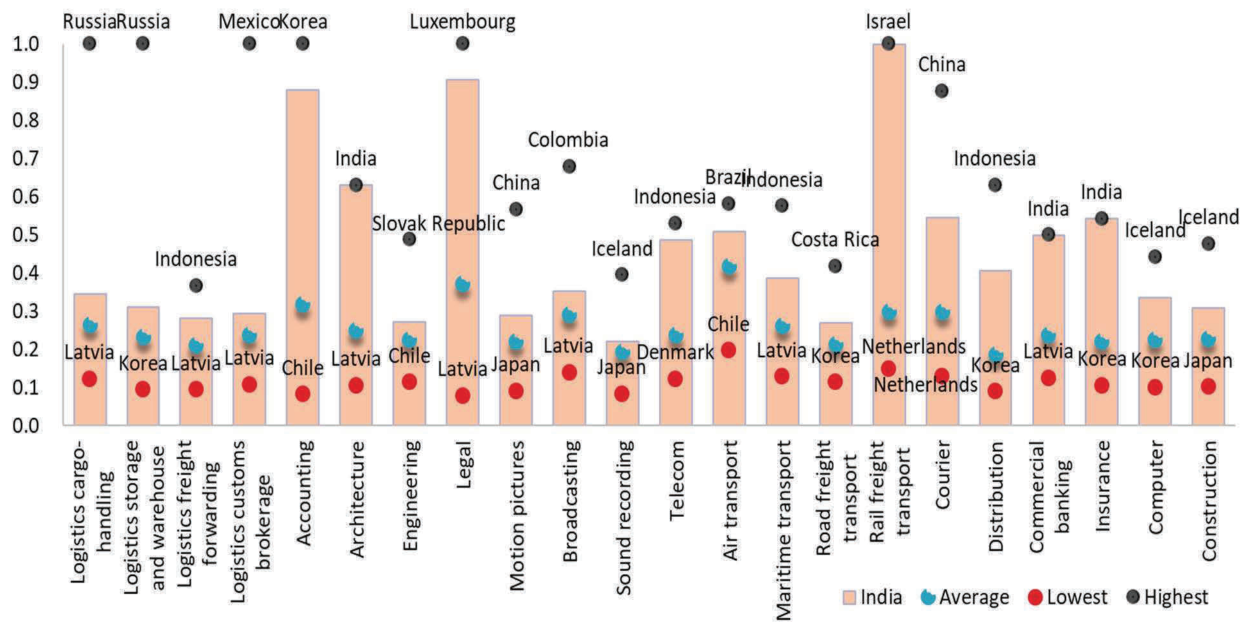
- **Impact on Healthcare Services:** There are no taxes on health care services, thus making them cheap and easily available to all. However healthcare services being exempt from GST, the input tax credits are not available for healthcare services provider.

Source: Based on various reports and interactions with service providers.

## 3.3) Domestic Regulations and Services Trade Restrictiveness

Reforms in Domestic regulations are important both for domestic production and export of services. However domestic regulations should not act or be used as restrictive trade barriers. OECD has come up with a Services Trade Restrictiveness Index (STRI) which helps to identify policy measures restricting trade, provide policy makers and negotiators with information and measurement tools to open up international trade in services and negotiate international trade agreements and also help governments identify best practices and then focus their domestic reform efforts on priority sectors and measures. It is intended to provide a quantitative measure of the level of trade restrictiveness in 22 services sectors and has been computed for 44 countries. The STRI scores are broken down on five policy areas: restrictions on market entry conditions, restrictions on the movement of people, other discriminatory measures, barriers to competition and regulatory transparency. While the STRI indicators can help, there is a need for improvement in methodology, data collection and transparency. The OECD's STRI also does not include important services like Tourism and Real Estate Services though construction is included.

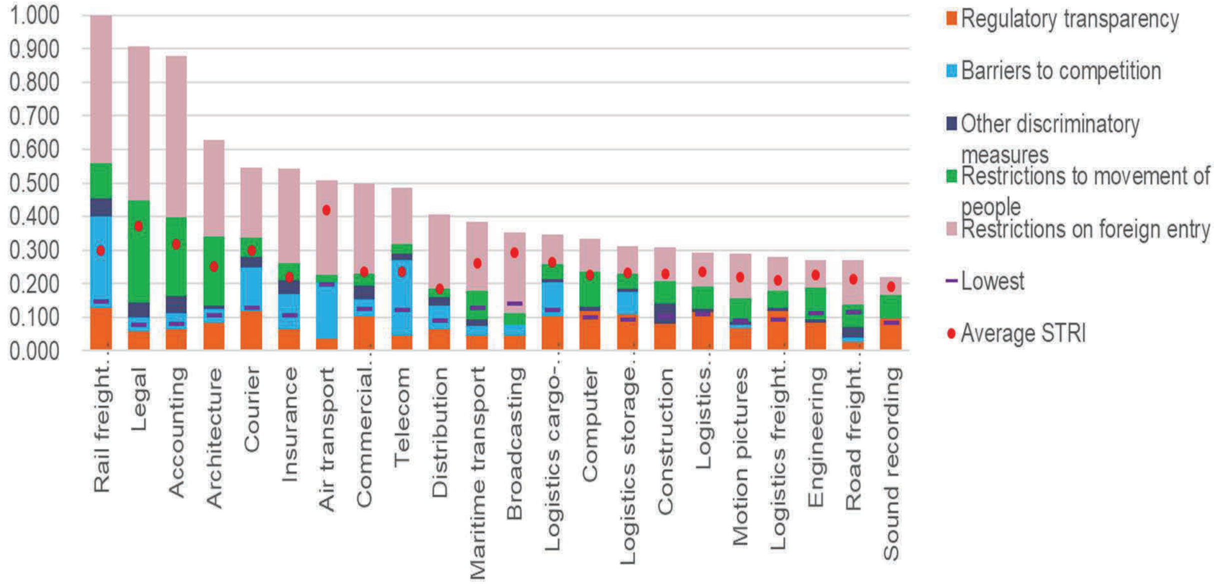
**Figure 3.1: India's STRI compared with Highest, Lowest and Average STRIs (2016)-Sector-wise**




Source: OECD STRI database

Among the 44 countries, India has a STRI score above average in all sectors and the highest in 3 services out of a total 22 services. Sound recording, engineering and broadcasting are the three sectors with the lowest score relative to the average. All these three sectors follow the automatic route upto 100 per cent equity share. Accounting services, legal services and rail freight transport, are the three sectors with the highest scores relative to the average as accounting and auditing are reserved for licensed accountants and auditors and a license is required to own and manage an accounting or an auditing firm and only Indian nationals may obtain a license; legal services, both national and international law, are reserved for licensed Indian lawyers; and railway operations are in the list of prohibited sectors and reserved for Indian Railways, a state-owned enterprise.

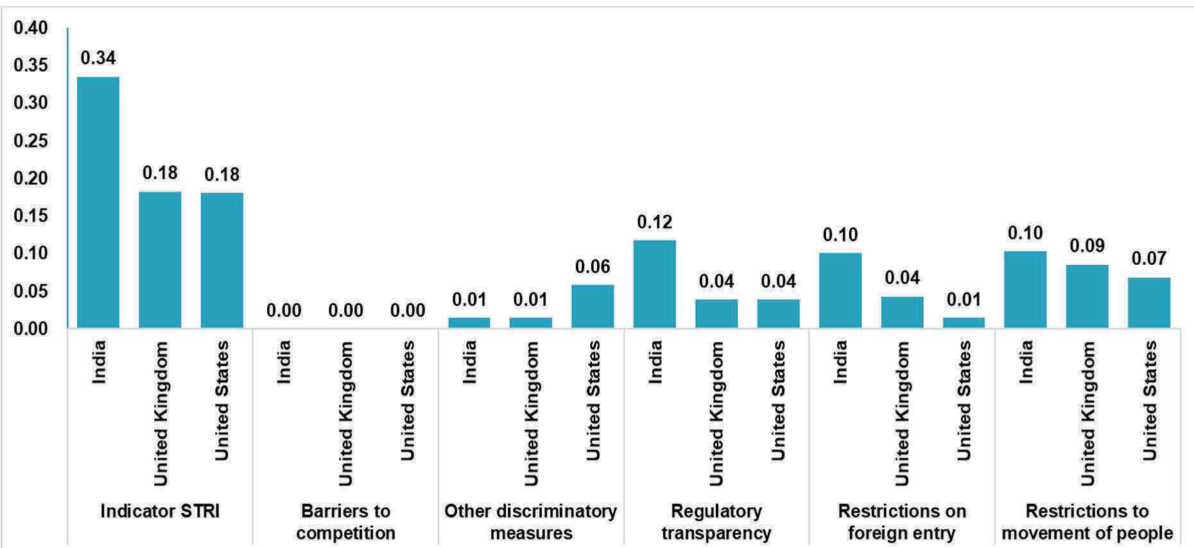
**Figure 3.2: India's sector-wise- STRI-By Policy**




Source: OECD STRI database

OECD's STRI needs to be examined carefully, as for example, in the case of computer services, not only is India's STRI higher than that of UK and USA, it is even higher in the sub-indicator of restrictions to movement of people! (Figure 3.3)

**Figure 3.3: STRI for Computer Services (2016): Comparison of India, US and UK**




Source: OECD STRI database.

Similarly for Maritime Transport sector, OECD's Services Trade Restrictiveness Index (STRI) ranks India at an overall 0.32 and the USA at only 0.38 (Table 2.2). Comparing the domestic cabotage, Foreign Direct Investment (FDI) and related policies of India and US will show this ranking is not appropriate. This ranking is even more difficult to understand given that OECD bases its STRI largely on mode 3 – Commercial presence. This has been permitted in India with 100% FDI in Shipping since 2001. Infact, higher restrictiveness in foreign entry can make better performances in other indicators ineffective. This is also due to the methodology of giving equal weightage to all indicators.

**Table 3.2: STRI for Maritime Transport (2016): India and US**

| Country | Restriction on foreign entry | Restrictions to movement of people | Other discriminatory measures | Barriers to competition | Regulatory transparency | Overall indicator |
|---|---|---|---|---|---|---|
| India | 0.16 | 0.08 | 0.00 | 0.05 | 0.03 | 0.32 |
| USA | 0.28 | 0.05 | 0.03 | 0.02 | 0.00 | 0.38 |

Source: OECD STRI database

A sample examination of the different policies for maritime transport in India and US indicate the weakness in the OECD methodology and the need for making distinction also in the quality of restrictions.

**Table 3.3: Components of Shipping Services Indicators: Comparison of regulations in India and the US**

| Policies for Maritime Transport | **USA** | **India** |
|---|---|---|
| Reflagging restrictions | Yes | No |
| Domestic construction provisions | Yes | No |
| Ownership restrictions | Yes | No |
| Crewing requirements | Yes | Yes |
| Fleet subsidies | Yes | No |
| Foreign Direct Investment | Not 100% | 100% |
| Percentage of cargo carried by foreign ships | Foreign ships can carry American cargoes in national emergencies and after the approval of the US Congress and the President on a per ship basis to enter US waters. | 92.14% |
| Cabotage* | Yes | Yes |

* US cabotage laws are more restrictive than in India or even European countries.
*Note*: The components of STRI indicators are compared for the two countries
Source: Based on INSA inputs.

While the genuine STRIs need to be examined and measures taken, there is a need for careful examination regarding others. Looking at the tariff equivalents of the services restrictions based on STRI is premature particularly when the data is imperfect, methodology is subjective and less transparent. While it is important for every country to examine the STRIs from their perspective, changes in methodology; greater transparency in selecting experts who give opinions on the different indicators for different countries; making the selection more balanced by including experts from developing countries like India as well; and providing better data can help in making the STRI more useful.

### 3.4) Market Access Barriers

There are many market access barriers in our trading partner countries. Some of these barriers for major services are the following:

- Visa issues in different countries for Professionals (Details in Box 3.2).

**Box 3.2: VISA related Issues: Some recent measures in select economies.**

**USA:**

- On 31st March 2017, the U.S. Citizenship and Immigration Services (USCIS) introduced a policy memo on H-1B usage, wherein "computer programmers" do not automatically qualify as specialty occupations. Employers now need to provide further evidence to establish the same e.g., via higher education degrees/ higher wages
- On 18th April 2017, Presidential Executive Order (EO) titled "Buy American, Hire American" targeted high skilled-worker visas & global outsourcing among other items. This was followed by a number of administrative policy changes that target the visas most commonly used by India's IT sector
- The US Administration has been quietly beefing up the "extreme vetting" procedures for people seeking visas to enter the U.S. On 21st June 2017, the present President signed an Executive Order (EO) that strikes part of a 2012 order signed by the former President instructing the State Department to "*ensure that 80% of non-immigrant visa applicants are interviewed within three weeks of receipt of application*"
- Some of the administrative enforcement actions since the announcement of the Executive Order are the following.
  - Initial reports of increased denials and RFEs (Requests for Evidence) and increasing inspections
  - New adjudicatory standards for certain classes of individuals, such as Level 1 or Level 2 beneficiaries and younger computer programmers
  - Reports that visas are being approved for shorter durations
  - Reports of enhanced scrutiny of approved visa holders at the port of entry
  - Proposed changes to the required labor certification forms in order to collect and make public, sensitive & proprietary information
  - Selective aggregation and public release of previously unavailable government data on the visa programs adding to the difficulties of the major sponsoring organizations.
- Further, a number of bills have been, and others are expected to be introduced in the House and Senate that would impose new restrictions and present extreme challenges for the Indian IT industry to successfully operate the global service delivery model in the U.S. These include Senator Orrin Hatch (R-Utah) reintroducing his I-Squared bill; House Judiciary Committee Chairman Bob Goodlatte (R-Va.) twin bills to authorize and reform key immigration agencies, bills by Representatives Issa and Lofgren, Senators Grassley and Durbin, Kilmer and Collins, etc.

**UK:**

- The £120,000 salary threshold for workers to stay in the UK for more than five years (and for a maximum of nine). Most of the middle management employees of Indian companies, critical for business continuity, fall in the salary range of £60,000-£80,000.
- Plans to double the Immigration Skills Charge (ISC) to £2,000 by the end of this Parliament

**Singapore:**

Indian companies have been facing restrictions while transferring skilled resources to Singapore in the past few years, some of which include –

- Multifold hike in minimum salary levels for work permit holders with the aim to force local recruitment
- Some work permit applications from Indians have languished since May 2016 without any decisions.

*Source*: Based on inputs from NASSCOM and internal Research.

- In the case of Business Services, access to the US market, remains non-transparent and unsatisfactory as licensing of professional service suppliers is generally regulated at State level. In addition to this, there are the Buy American provisions.
- In the case of shipping, in US, the market access obstacles are many, like the many types of assistance in US to its domestic shipping sector such as a minimum of 50% of government shipments for US registered ships, limitation of use of ships built in US in internal waters, huge subsidies, etc. US cabotage restrictions are the effect of various provisions contained in US legislation and regulations, often referred to as the "Jones Act". Cabotage legislation which restricts maritime transportation between ports of the same country is common everywhere in the world. What makes the US legislation peculiar and unduly restrictive is the fact that domestic transportation – even when carried out by US operators - can only be performed by using vessels which are US built, US owned/controlled, US crewed and US maintained. These requirements add to the effects of traditional cabotage measures limitations, in terms of shipbuilding (because no foreign built ship can be used), establishment (because only companies owned and controlled by Americans can carry out coastal trade services) and repair services (because vessels repaired/reconverted outside the US risk losing the necessary qualifications to operate again within US waters).
- In the case of legal services, while some of the states, in USA allow overseas lawyers to practice within the state, the system and requirements are set by the concerned state bar associations and therefore differ from state to state.

- In the case of construction and related engineering services and urban planning and landscape services, the “Buy American” or “Buy local” legislations passed in many states of US have gone to the extent of even insisting on the materials used (i.e. cement) to be domestically manufactured for public works projects financed by state funds.

There are similar examples for other countries as well. These need to be negotiated in the WTO and bilateral meetings.

### 3.5) Free Trade Agreements (FTAs)/CECAs

Brexit, slowdown in global growth and trade, rising protectionist measures in many countries, rising anti globalization sentiments even in developed countries, and the US withdrawal from TPP have all contributed in breaking up or slowing down the formation of Mega FTAs. Growth of mega FTAs could have harmed India’s interests. Meanwhile India’s FTAs have benefitted its trading partners more than India, though some FTAs are just for strategic reasons (Prasad, H.A.C 2017). The GSP benefits also have been withdrawn for India but not for some of its competitors in important sectors. So useful FTAs/CECAs are needed for India. Some of the major FTA/CECAs of India where Services are included are the following.

- India has signed comprehensive bilateral trade agreements, including Trade in Services, with the Governments of Singapore, South Korea, Japan, and Malaysia.

- A Free Trade Agreement (FTA) in services and investment was signed with the ASEAN in September, 2014 which came into effect from 1st July, 2015.

- India has joined the Regional Comprehensive Economic Partnership (RCEP) plurilateral negotiations. The RCEP is a proposed free trade agreement (FTA) which includes the 10 ASEAN countries and its six FTA partners viz. Australia, China, India, Japan, South Korea and New Zealand. The RCEP is the only mega-regional FTA which India has joined.

- India is also engaged in the bilateral FTA negotiations including Trade in Services with Sri Lanka, Canada, Peru, Thailand, Australia, New Zealand, Israel, the European Union (EU) and the European Free Trade Association (EFTA). India has restarted the Comprehensive Economic Cooperation and Partnership Agreement (CECPA) negotiations, including Trade in Services, with Mauritius. Meetings of the two sides were held for finalising the Joint Feasibility Study Group Report (JFSG). The India-Eurasian Economic Union (EAEU) Joint Feasibility Study Group (JFSG) Report stands finalised and the negotiations are due to start.

- India is also engaged in bilateral trade dialogues with the US under the India-US Trade Policy Forum (TPF); with Australia under the India-Australia Joint Ministerial Commission (JMC); with China under the India-China Working-Group on Services and with Brazil under the India-Brazil Trade Monitoring Mechanism (TMM).

While services sector is now being included in FTA negotiations, there should be useful regional/bilateral negotiations including services sector which benefit India equally as the trading partners. Project exports which includes both goods and services, should also be included in the FTA/CECA negotiations.

### 3.6) FDI liberalisation and Disinvestment

In the last three years, there have been a number of reforms by India to ensure that it remains an increasingly attractive investment destination. The scale of reforms can be gauged from the fact that during this period, 21 sectors also including services activities and covering 87 areas of FDI policy have undergone reforms. FDI policy provisions were radically overhauled across sectors such as construction development, broadcasting, retail trading, air transport, insurance and pension. Besides, other initiatives were taken like the composite caps in the FDI policy permitting 100 per cent FDI in retail trading of food products with unqualified condition that such food products have to be manufactured and/or produced in India; 100 per cent FDI under automatic route for any financial sector activity which is regulated by any financial sector regulator; and above all the recent measure of abolition of the Foreign Investment Promotion Board (FIPB).There is a need to see whether further liberalisation of FDI in services can be done. There are also sectors like shipping where 100% FDI in shipping exists since May 2001 and yet there have been no takers. This needs to be examined.

There is plenty of scope for disinvestment in services PSUs under both central and state governments. The services PSUs listed by Government recently are India Tourism Development Corporation (ITDC) in three locations Bhopal, Guwahati and Bharatpur. However, in the case of shipping sector any disinvestment policy should keep in mind the need to develop India's own shipping fleet. India which has a vital stake in the rapid expansion of its foreign trade would lose to economically strong maritime nations of the world, if it chose to forego the opportunity to develop its own shipping fleet. The need to ensure development of a strong Indian merchant fleet is of paramount importance for India. The existence of a strong and viable national fleet serves as a balancing factor and helps to dampen freight rates in the shipment of export and import of goods and to maintain export competitiveness of Indian manufacturing. The presence of national shipping serves as a deterrent to international cartels and monopolies and has a moderating effect on freight rates charged by foreign flag shipping as can be seen from the following experiences of India in the past:

- The introduction of container vessels by SCI on UK/Continental route in 1990s resulted in the box rates declining by US$300 to US$400.
- Similarly, with the introduction of Indian edible oil tankers, the freight levels were brought down for import shipment of the cargo from US$28/mt to US$17/mt for W.C. India. The freight was pushed up to US$35/mt when these tankers were diverted from carrying edible oil trade due to lack of support by the concerned canalizing agency (STC).
- With the acquisition of Indian Offshore Support Vessels (OSVs) for employment with ONGC in 1982-83, the charter rates came down from around US$4600 per day and have

ruled steady thereafter at around US$2500/US$2800 per day.

- With the acquisition of Indian LPG carriers, the freight rates have dropped from US$55 per tonne to below US$40 per tonne.

So a careful listing of sectors and companies in services where disinvestment is possible and needed would be useful.

### 3.7) Employment in Services

Among the top 15 services producer countries, the services sector accounts for more than two-thirds of total employment in 2016 in most of them except India, China, and Mexico where the shares are low. India's services sector has a high share in income and relatively low share in employment, while in China, the shares of both services income and services employment are relatively low. The latest employment growth scenario based on Labour bureau data given below shows some increase in services employment in October 2016 over 1st July 2016 and 1st Jan 2017 over 1st October 2016.

Table 3.4: Estimated Change in Employment in Eight Selected Sectors (in Lakhs)

| S. No. | Sector | 1st Jul 2016 over 1st Apr, 2016 | 1st Oct 2016 over 1st Jul, 2016 | 1st Jan, 2017 over 1st Oct, 2016 |
|---|---|---|---|---|
| 1 | Manufacturing | -0.12 | 0.24 | 0.83 |
| 2 | Construction | -0.23 | -0.01 | -0.01 |
| 3 | Trade | 0.26 | -0.07 | 0.07 |
| 4 | Transport | 0.17 | 0.00 | 0.01 |
| 5 | Accommodation & Restaurant | 0.01 | -0.08 | 0.00 |
| 6 | IT/BPO | -0.16 | 0.26 | 0.12 |
| 7 | Education | 0.51 | -0.02 | 0.18 |
| 8 | Health | 0.33 | 0.00 | 0.02 |
| | **Services (3 to 8) excluding construction** | **1.12** | **0.09** | **0.40** |
| | **Services (2 to 8) including construction** | **0.89** | **0.08** | **0.39** |
| | Total | 0.77 | 0.32 | 1.22 |

While services like IT are skill oriented, services like Tourism are employment generators. There is a need for further efforts to enhance both unskilled/semi-skilled employment and skilled and quality employment in services sector. The skill India initiative could be further dovetailed for services sector employment.

### 3.8) Need for a "Services from India" Initiative

While the government is helping marketing efforts in services by Market Access Initiative (MAI) scheme and by organising Services Expo in India, there is a need for more promotional activities abroad including showcasing India as a major quality services provider at competitive rates. A "Services from India" initiative on the line of "Make in India" is needed to strengthen our services sector and also make it a major export sector. There is also a need to make Services Export Promotion Council (SEPC) more active. This council needs to network with the Indian missions abroad and the ITPO.

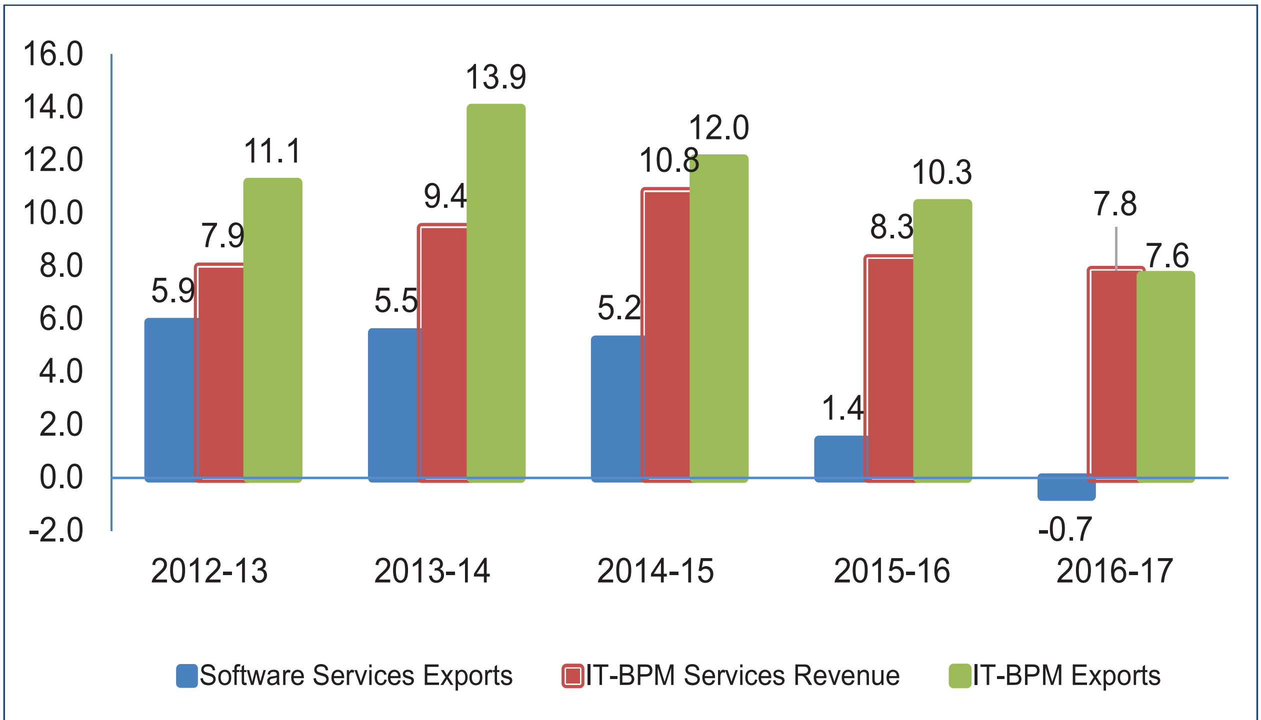
# CHAPTER 4
# SELECTED MAJOR SECTORS: PERFORMANCE, ISSUES AND POLICY SUGGESTIONS

# 4. Selected Major Sectors: Performance, Issues and Policy Suggestions

## 4.1) IT-BPM / Software Sector

India's Software exports which were growing robustly at 27 to 38 per cent during 2002-03 to 2007-08 have slowed down in recent years with exports even falling. In 2016-17 software exports fell by 0.7 per cent to US $ 73.7 billion compared to US 74.2 billion in 2015-16 as per RBI's BoP data, while IT-BPM exports are expected to reach USD 117 billion, with a growth of 7.6 per cent in 2016-17 as per NASSCOM. IT-BPM exports growth for 2017-18 has been pegged to 7-8 per cent by NASSCOM

**Figure 4.1 Growth of Software Services Exports and IT-BPM Revenue and Exports**




Source: Based on NASSCOM and RBI data

The fall in India's computer services exports by 0.2 per cent in 2016 (as per WTO data) is happening even when the World computer services exports is growing at 5.8 per cent in 2016 and some advanced countries like USA, Israel and competing countries of South East Asia, Latin America and East Europe like Philippines, Brazil, Chile, Russia and Ukraine are having modest to robust growth. India's computer services imports is also growing at 30.4 per cent resulting in negative net computer services export growth of (-) 1.7 per cent in 2016. This indicates that the IT-BPM sector is affected not just by the global slowdown and challenging market access situation, but other challenges as well.

**Table 4.1: Computer Services Export Growth: Select Countries**

| | Growth Rate (%) | | | | |
|---|---|---|---|---|---|
| | 2009 | 2010 | 2014 | 2015 | 2016 |
| **Australia** | -13.1 | 12.2 | 7.1 | 16.5 | 3.1 |
| **Brazil** | 6.5 | -8.7 | 140.6 | 15.6 | 14.8 |
| **Chile** | 12.3 | 36.7 | 4.8 | 1.2 | 10.4 |
| **India** | **-9.0** | **20.5** | **1.3** | **1.2** | **-0.2** |
| **Philippines** | 35.3 | 24.1 | 10.1 | 1.3 | 63.6 |
| **Russia** | -21.8 | 5.0 | 5.7 | -7.4 | 8.5 |
| **Ukraine** | 9.5 | 24.7 | 16.1 | 11.2 | 18.4 |
| **USA** | 3.8 | 1.9 | 7.4 | 12.7 | 8.1 |
| **Israel** | 1.3 | -43.9 | 18.2 | -2.0 | 26.9 |
| **World** | NA | NA | NA | -3.6 | 5.8 |

Source: Based on WTO data.

The issues and challenges in the IT-BPM sector are both in the international and domestic front.

**International Challenges:** These are the following.

- **Visa Issues** : This is a major issues for the IT sector (Also see Box 3.2 ) Immigration and visa issues, which have long plagued the information technology sector seem to have hurt Indian IT services companies recently with the US Government's stance on the H-1B visa issue. Challenges in the U.S. are twin-fold – via both Administrative action, as well as Legislative changes. On the Administrative side, the "Buy American, Hire American" Presidential executive order (dated 18th April 2017) called for the collection of data, increased oversight and enforcement actions, and the development of administration plans to reform and curtail the high skill visa programs. The Executive Order has been followed by a number of administration policy changes and proposed changes that target the visas most commonly used by India's IT sector. Departments of Justice, Homeland Security, State, and Labor all have issued memos, policy guidance aimed at imposing new restrictions on the visa programs, enhancing enforcement, increasing scrutiny of sponsors, and enhancing penalties for violations. The new US Administration has been quietly beefing up the "*extreme vetting*" procedures for people seeking visas to enter the U.S. The Department of Labor (DoL) is considering revisions to the Labor Condition Application (LCA) forms. In August 2017, it sought comments from relevant agencies to certain proposed changes. U.S. Citizenship and Immigration Services introduced a policy memo on H-1B usage, wherein "computer programmers" do not automatically qualify as specialty occupations. Additional details from visa applicants are required by the Department of State as part of Government's extreme vetting process. Significantly more details on the Labor Condition Applications (LCA) which companies must file before submitting H-1B petitions are now required as per Department of Labor's plans. Various bills relating to H-1B visas have been tabled in the U.S. Congress, the latest being the House Judiciary Committee Chairman Bob

Goodlatte's twin bills which have been passed in the US congress on 29 June 2017 and is now going to the senate. The first bill would strip federal dollars from self-proclaimed 'sanctuary' cities that shield residents from federal immigration authorities, while the second bill (also called as Kates's Law) would stiffen punishments for people who re-enter the US illegally.

On the legislative side, the U.S. Congress has imposed new restrictions on the IT sector. The most recent example includes the Protect and Grow American Jobs (H.R.170) Bill passed by the U.S. House Judiciary Committee on a unanimous, bipartisan voice vote on 15th November 2017 targeted at Indian IT (and few U.S.-based India-centric companies deploying an identical business model). This would only apply to H-1B dependent companies. Their U.S. competitors and others would not be impacted by the legislation and would be given a clear competitive advantage in the marketplace. This bill puts the burden of compliance on H1-B Visa-dependent companies. The bill proposes that H-1B dependent employers pay a mean wage level for the occupational classification in the area of employment which is usually higher than what Indian companies pay. Exemption from hiring US workers first by 50 per cent, to US$ 90,000 per annum from the current US$ 60,000 per annum, is available if H1-B employee receives yearly pay wage of US$ 60,000 or higher and also if H1 B employee has a master's degree. The Bill also entails higher scrutiny and audits of H1B dependent employers. The bill also requires an inflation adjustment to the salary threshold every third fiscal year. A number of other bills have been introduced, and are expected to be introduced in the House and Senate that would impose new restrictions and present extreme challenges for the Indian IT industry to successfully operate the global service delivery model in the U.S. These include Senator Orrin Hatch (R-Utah) reintroducing his I-Squared bill; Senators Grassley and Durbin reforms, Kilmer and Collins bipartisan bill, etc.

There is some relief now with US allowing 65,000 H1B Visas and allowing merit based system Green cards to be issued which was stalled. However concerns continue with US Congress having multiple bills relating to H1B and L1 visa programmes. The bills seek to amend the various provisions related to the grant of H1 and L1 visas. However, so far none of these bills have been passed and no comprehensive policy changes have been made. The introduction of these bills in the US Congress has raised concerns, especially in the Indian IT sector, which gets a chunk of these H1 B visas. Besides, US has made the conditions tighter for renewal of H1 B visas recently. To further compound the challenge in the U.S., there is a strong misperception and negative media narrative that large Indian IT-service providers misuse the system to take a disproportionate share of H-1B visas. Examples include emotive stories built around higher paid American workers being replaced by cheaper H-1B staff, and the displaced American workers having to train their "cheap" H-1B replacements

There are similar concerns regarding other countries. The UK has introduced the Migration Advisory Committee's recommendations with effect from 6th April 2017, entailing the changes like closure of Tier 2 Intra-Company Transfer (ICT) Short Term visa route, imposing Immigration Skills Charge (ISC) of £1,000 per migrant hire per valid visa year and Immigration Health Surcharge and also increase in the minimum salary threshold for Tier 2 (ICT) visas from £25,000 to £41,500. There are also talks to double the Immigration Skills Charge (ISC) limit to £2,000, as was indicated in the Conservative Party manifesto before the UK General Elections, though no action to this effect has been initiated yet.

The EU has also introduced Data Protection and Privacy Rules that effectively prevent Indian companies from providing services from India, while US has negotiated a privacy shield. In Australia, the Federal Government has announced that it would eliminate the 457 visa category and replace it with two new visa streams to protect the interests of Australian workers.

- **Social Security Agreement/Totalisation Treaty Issues:** Discussions on a Totalization Treaty with the U.S. have been stalled for a long time due to lack of flexibility on the U.S. side. The U.S. argues that it will sign a Social Security Agreement with countries having 50% working population covered under mandatory social security scheme and that is not the case in India. After more than six years of engagement and a number of rounds of formal discussions, virtually no progress has been made in this respect. Current requirement of the U.S. Social Security Act is a contribution of 40 quarters to the Social Security System. The H1B/ L1 visa norms entail the contributions being limited to maximum 24 quarters. Structurally, due to conflicting U.S. laws, it is impossible for temporary workers in the U.S. to get any Social Security benefits. This is an unfair decision that harms Indian nationals and companies while giving the U.S. Treasury billions of dollars that should never have been paid at the first instance. The US Administration's response to India's concerns has been to state that U.S. law bars Administrative action on this issue. Using existing laws as an excuse to not extend any benefits to Indian workers who contribute towards the U.S. Social Security system cannot continue forever. Indian skilled professionals have contributed tremendously to the U.S. companies and economy for years. India has signed 20 such treaties with Germany, France, Canada, Belgium, and others. The U.S. has also signed similar agreements with most of these countries. Since India and the U.S. are having Totalization treaties with the same block of countries, there is a need to strongly pursue this issue during bilateral meetings to bring it to a logical conclusion.

- **Competition from new entrants:** Indian service companies gained scale over the last decade as the disrupters, creating the modern offshoring industry, but they are now the incumbents, challenged by a slew of specialized and niche start-ups bred in this new environment. The niche players are creating highly specialized solutions that address very specific use cases or problems for their clients. The horizontal or enterprise platforms like Salesforce.com create entire ecosystems that handle horizontal problems simply with intuitive cloud-based technology. India is facing increasing competition from new digital only entrants from Eastern Europe and Latin American countries including newer companies like Globant, EPAM, and Luxoft. The Indian IT sector currently derives around 14 per cent of its revenues from Digital services, as per NASSCOM. While, the Industry is also adapting to changes, and focussing on skilling, including upskilling, further efforts are needed for India to be competitive and retain its pride of place.

- **EU – Data Protection:** India has long sought to gain data adequacy status with the EU in order to facilitate data transfers and boost its IT-BPM industry, which currently has to rely on binding corporate rules (BCRs) and standard contractual clauses (SCCs) for transfers of personal data from the EU to India. The subject of data adequacy has featured in negotiations of the EU-India FTA since talks began in 2007, although, there has not been much headway. In its January 2017 Communication on Exchanging and Protecting Personal Data in a Globalised World, the European Commission identified India as one of the next countries with which the Commission will engage on the topic of data adequacy depending on progress towards the modernisation of India's data protection laws. With the development of data protection framework in India underway, it is expected the Indian IT sector will be able to leverage it to become a destination of choice and also expand its markets to other geographies.

- **Tax Issues:** The recent tax reforms underway in the US could impact outsourcing sector though we have to wait for details. There are some tax issues with other countries as well. Recently in the case of Tech Mahindra Vs Commissioner of Tax, Australia, the Australian court rejected arguments by an Indian company that offshore services that can be attributed to Australian customer, should not be taxed in Australia, though it provided partial relief in the form of tax exemption for approximately 30% of total offshore services which did not involve changes to the source code of software. With the Australian market for the Indian IT Industry estimated at around $2-$3bn, tax impact of this measure when applied across the industry @ 15% will be about $225 million a year as per the NASSCOM. More importantly, this ruling defeats the purpose of having Double Taxation Avoidance Agreement (DTAA) between the two countries.

- **Job loss Challenges:** The growth in digital technologies like cloud-based services is happening at a much faster pace and the companies have to learn the new technologies and reskill. As per a report of the World Bank (2016), Automation threatens 69 per cent of the jobs in India, while it threatens 77 per cent in China and 85 per cent in Ethiopia. As per Executive search firm Head Hunters India, the job cuts in IT sector will be between 1.75 lakh and 2 lakh annually for next three years due to under-preparedness in adapting to newer technologies. As per the McKinsey & Company report, nearly half of the workforce in the IT services firms will be "irrelevant" over the next 3-4 years and the bigger challenge ahead for the industry will be to retrain 50-60 per cent of the workforce as there will be a significant shift in technologies. There are also Reports of mass layoffs in the IT sector. But as per NASSCOM, this largest private sector employer has added over 6 lakh new employees in the last 3 years and is expected to add over 2.5 to 3 million new jobs by 2025. However, the skills profile is set to undergo a rapid change as demand for skills around digital technologies grows exponentially. Many firms have established dedicated programs to re-skill their existing employees. In 2016-17 around 1.7 lakh jobs were created and in Q4 of 2016-17 alone, there was gross hiring of over 50,000 by top 5 companies. The Labour Bureau of India data indicates that changes in employment in IT-BPO sector during April to December 2016 was only 0.22 lakhs. Thus there is a gentle deceleration in growth of net hiring as also indicated by NASSCOM. So job loss challenge in IT sector is not just a short term problem but a medium to long term challenge which needs to be taken note of while formulating policies for this sector.

**Domestic Challenges:** These include the following:

- **SEIS benefit to units covered under STP scheme and export of IT/ITES**: Under the Service Exports from India scheme (SEIS) of FTP (2015-20),certain services including professional services have been notified as eligible services. Against the net foreign exchange (NFE) earned in a financial year from export of such eligible services, the exporters are given a scrip which is either 3% or 5% of the NFE earned during a financial year. Such scrips, post implementation of GST, can be used to make payment of Basic Customs Duty (BCD), leviable upon import of goods and are also freely tradable. Under this scheme exports of notified services by SEZ units are made eligible to claim the SEIS scrips. However exports of similar notified services by units registered under STP scheme are not eligible to claim the SEIS scrips. This needs to be examined and addressed.
- **Goods and Services Tax payable (‘IGST/CGST/SGST’) on import or domestic procurement of services by STPIs:** GST laws treat any service provided to a SEZ unit as ‘Zero Rated Supply’. Accordingly, a SEZ unit can import services or procure domestically those services required for authorized operations without payment of GST. However, STPI units, which are also into the activity of export of IT/ITES are required to pay GST both on import and domestic procurement of services required for authorized operations and subsequently claim refund of the same. Payment of GST on procurement of services by an STPI unit would increase the working capital requirement. While relief has been provided till March 2018, upfront exemption from payment of GST on import and domestic procurement of services by STPIs could be considered in the GST regime on par with SEZ units.
- **Issue regarding de-notification of SEZ and IT Act, 1961:** Under the SEZ law, there are specific provisions for Developers who wish to opt out of the SEZ scheme subject to compliances to be undertaken under the said law. However, under Income Tax Act there are no provisions for treatment of exit by such developers. Further if the SEZ Developer wishes to de-notify, there are no provisions for the units operating in that SEZ. This

leads to ambiguity on issues like the utilization of the balance period of deduction under section 10AA/ 80-IAB, status of SEZ units operating in SEZ where the developer seeks to de-notify, etc. This needs to be examined and addressed.

- **GST related registrations and multi-level authority:** Under GST, registration needs to be done at all states where the company operates. Given the complexities involved in provision of services from multiple locations to a single customer involving single invoice, contract, consideration, etc. and the fact that states are not agreeable to single registration, atleast centralized assessment, audits and investigations could be undertaken either by one authority or a team consisting of both Central and State authorities.
- **Need for parity in treatment to Residents and Non-residents regarding capital gains from sales of unlisted shares**: The long-term capital gains from sale of unlisted shares in the hands of non-residents attracts a tax of 10% whereas it attracts a tax of 20% in the hands of residents. Angel investors come in at the earliest stage of the company with high risk. Thus domestic investors particularly angel investors are discriminated against compared to foreign investors. While certified startups under startup India action plan have been exempted. Certifying/accrediting angel groups based on specified norms and conditions in the same way that has been done for Startups could be considered.
- **Parity in taxes for services offered online vs offline:** As India embarks on the Digital India journey, the taxation and regulatory regime should ensure that solutions and services being offered online or using online channels should not be taxed higher than similar services offline.
- **Other Domestic Challenges:** There are also some domestic challenges like shortage of skilled digital talent, underdeveloped infrastructure in Tier 2 & 3 cities, and challenges related to Government procurement process and conditions.

## 4.2) Tourism Sector

International Tourist Arrivals to India (including NRI arrivals) were 13.3 million in 2015 with a growth of 1.4 per cent as per the UNWTO, while Foreign Tourist Arrivals (FTAs) (excluding NRIs) during 2015 and 2016 were 8.0 million and 8.8 million with a growth of 4.5 per cent in 2015 and 9.7 per cent in 2016 as per the Ministry of Tourism data. Foreign Exchange Earnings (FEEs) through Tourism, in US$ terms during 2016 were US$ 22.9 billion with a growth of 8.8 per cent over 2015. A comparison with other countries shows that India's share in international tourist arrivals (ITA) is a paltry 1.1 per cent with a rank of 24 compared to the 7.1 per cent of France which ranks 1$^{st}$ in 2015. China ranks 4$^{th}$ with a share of 4.8 per cent. In terms of International tourism receipts (ITR), India has a slightly higher share at 1.8 per cent and a better ranking of 14. But it is nowhere near the 17.1 per cent share of USA which ranks 1$^{st}$ and around half the share of China at 3.8 per cent with 4$^{th}$ rank. Thus a goldmine of an opportunity awaits to be tapped.

Domestic tourism continues to be an important contributor to the sector with the CAGR of domestic tourist visits of 13.6 per cent from 1991 to 2016 and a growth of 12.7 per cent in 2016. The top 5 states in domestic tourist visits in 2016 were Tamil Nadu, Uttar Pradesh, Andhra Pradesh, Madhya Pradesh and Karnataka. As per industry estimates, the total market size of Indian tourism and hospitality sector stood at US$ 117.7 billion in 2014 and is expected to touch US$ 418.9 billion by 2022.

In the Travel and Tourism Competitiveness Index 2017 (WEF, 2017) India has improved its ranking 12 places to reach the 40th position globally among 136 countries. India continues to charm international tourists with its vast cultural and natural resources (9th and 24th position respectively), and its price competitiveness advantage (10th) and its international openness (55th) which is up by 14 places reflecting the implementation of both visas on arrival and e-visa. But it is way behind others in health and hygiene (104th), ICT readiness (112th), security concerns (114th), human resources (87th), tourist service infrastructure (110th) and in prioritization of travel and tourism (104th). Despite having high number of UNESCO World Heritage sites (6th in position with 35 heritage sites), India attracts less foreign tourists compared to other countries and remains below the trend line (See Economic Survey 2016-17 Vol - 2). As per many other indicators like domestic tourism to population ratio, international conventions rankings, visitors to top heritage sites, foreign tourist arrivals in top cities, India is far behind USA and China. While this sector offers a goldmine of an opportunity, drastic changes are needed to tap this opportunity and to make tourism a major foreign exchange earner and growth promoter. Some policy suggestions and issues are given below.

- **Three basic things in five major tourist destinations:** These are the following.
  - **Making India Tourism friendly and Tourist safe Country**. Here a special Tourist Protection force can be thought of. While some states have such a force, there is a need to extend it to all states and also strengthen it in states where it already exists. This can help in not only providing safety for tourists but also provide employment for the people. Even in Kerala where such a police force exists the number of female tourism police officers is very less. A separate uniform for Tourism Police across India can also be thought of on the lines of the blue colour in Kerala.
  - **Cleanliness hygiene and ambience of acceptable standards**. This should start from the point of entry of tourists till their departure, including hotels, roads and major places of visit. While, heritage sites continue to be dirty, even ferry jetties in places like Kerala lack hygiene. The skill development initiative can also be dovetailed for this purpose.
  - **Good Tourism Infrastructure:** This included many components like roads, railways, cruise travel, infrastructure in heritage sites, place of visits, stay etc. <u>One example</u> is the beautification of riverside. In major cities of the world where rivers flow in the middle of the cities, the river sides are beautified and beautiful pathways are built on the sides. In India, despite having beautiful rivers in the heart of cities, beautification of riverside is conspicuous by its absence. Instead river sides are very dirty places as in the case of Yamuna in Delhi. Sabarmati riverside in Ahmedabad is an exception where some

beautification has been done. Another example is accommodation. The reason why the number of foreign tourists can't increase in India is the lack of accommodation. India has only 120,000 guest rooms in all the categories (1 to 5 star deluxe). If we take only 3 to 5 star hotels, there are only 80,000 rooms which is inadequate to serve the whole country. The Government had planned to increase it to 180,000 more rooms, which could increase the Foreign Tourist Arrivals from 8 million to around 16 million tourists. For this purpose infrastructure status was given to hotels. The big issue however is the resource required for this purpose. One more example is Water Ambulance needed in places like Kerala, due to the geographical conditions. In places like Munnar, the helicopter evacuation facility in case of emergency is not available. Thus besides basic tourism infrastructure, specific infrastructure for different segments of tourism needs to be developed on a fast track basis. One possible solution besides, active government support, is privatization of some areas of infrastructure or Public Private Partnership.

If the above mentioned three basic things can be provided in atleast five major tourist destinations in India, then it is possible to achieve a reasonable share of World tourism arrivals and receipts.

- **Further improvement in E-Visas and Immigration facilities**:
  - **Increasing E-Visa Counters:** There has been a near to threefold increase in eTV, though the increase in number of foreign tourist arrivals was only 9.7 per cent in 2016. This could be due to shifting from traditional mode to eTV mode. Our earlier report (*DEA,2015*) had suggested extending ETV for medical tourists; extending the window for application under e-Visa from 30 days to 120 days and increasing the duration of stay in India under e-Visa from 30 days to 60 days, etc. These have now been implemented by the Government. Further improvements related to e-tourist visa and ordinary visa are needed. The number of E-VISA counters in Delhi Airport is very less and the waiting time on average is 3 hours. This needs to be addressed.
  - **Delay in Commencing the Operation of Extension Counter of Immigration Office at Vallarpadam**: The new Immigration office at Vallarpadam is not yet functional, owing to the delayed telephone/internet connectivity and human resources issues. This needs to be speeded up.
- **Medical Tourism:**
  - **Emulating policies of some ASEAN countries:** The value of medical tourism in the world and India are estimated to be at US$ 20 billion and US$ 4 billion respectively as per industry sources. Here policies of countries like Singapore, Thailand, Malaysia, etc. in promoting Medical Tourism could be emulated. For example, the Tourism Authority of Thailand (TAT) has a comprehensive medical tourism website that acts as a guide for potential visitors and also highlight popular treatment options and reputed hospitals for medical tourists. The Ministry of Health, Singapore has established "Singapore Medicine", which works closely with private healthcare providers to expand their reach

and referral networks in key target markets. The Malaysian Government's Healthcare Travel Council (MHTC) was established in 2009 to develop the healthcare travel industry and promote Malaysia as a preferred destination for healthcare tourism in the region.

- **Facilitating imports for hospitals providing medical tourism:** The Hospitals which provide medical tourism and have to import capital goods like threadmill face difficulties under EPCG scheme, as there are stringent conditions like the Rs 50 lakh foreign exchange earnings in previous years' rule which deters the smaller services startups.
- **Medical Tourists Package**: There is a need to provide a package of services for medical tourists including state of the art medical facilities, ambulance services at airports, airlifting of medical tourists to hospitals by helicopters and fast track clearance of medical visas, immigration and other formalities.

- **GST related issues:**
  - **Need to treat foreign exchange earnings in tourism services as exports or deemed exports**: While goods & services exported from India are exempt from GST, for tourism services this is not the case as they are governed by a special provision of being served in India. Tourism exports meet all the criteria as other goods & services exports i.e. the service provider is in India, earnings are in foreign exchange & the buyers are of foreign origin. However, since their place of provision is in India, they are charged GST. The place of provision of service must be in India only as tourism services are intangible & can't be delinked from our tourism products. This issue of definition needs to be resolved.
  - **GST rates in India are very high:** India has become less competitive as the tax rates in other competing countries are on an average 5%. India loses heavily to these markets where tourist arrivals & foreign exchange earnings are higher than India. With GST for hotels at around 18% & tour operators at 23%, India is among the highly taxed tourism countries. Countries smaller than India such as Singapore, Malaysia, Thailand have tourism visitors ranging from 12 million to 28 million as against around 9 million in India. China at around 55 million tourists has a GST rate of 6%. So there is a need to treat tourism exports on par with other exports & services & such transactions may be zero rated or taxed at a very low rate without stopping the input tax. This can make Indian tourism products & services highly competitive.
  - **GST rate of 28% on hotels above ₹7500:** Hotels above a tariff of ₹7500 have been declared as luxury hotels and placed under the highest slab of 28%. This is higher than even the indirect tax on hotels (luxury tax + service tax) in the pre-GST regime of around 18%-21%. Tax rates for hospitality sector in the case of Asian competitors is around 6%. Therefore, the highest slab rate of 28% for luxury hotels needs to be re-examined.
  - **Input Tax Credit be unlocked for Tour Operator Services**: Under the current GST rates, Tour Operator services have been allowed 5% GST rate but without input tax credit. Tour operators work on a distribution model by distributing tours between tour

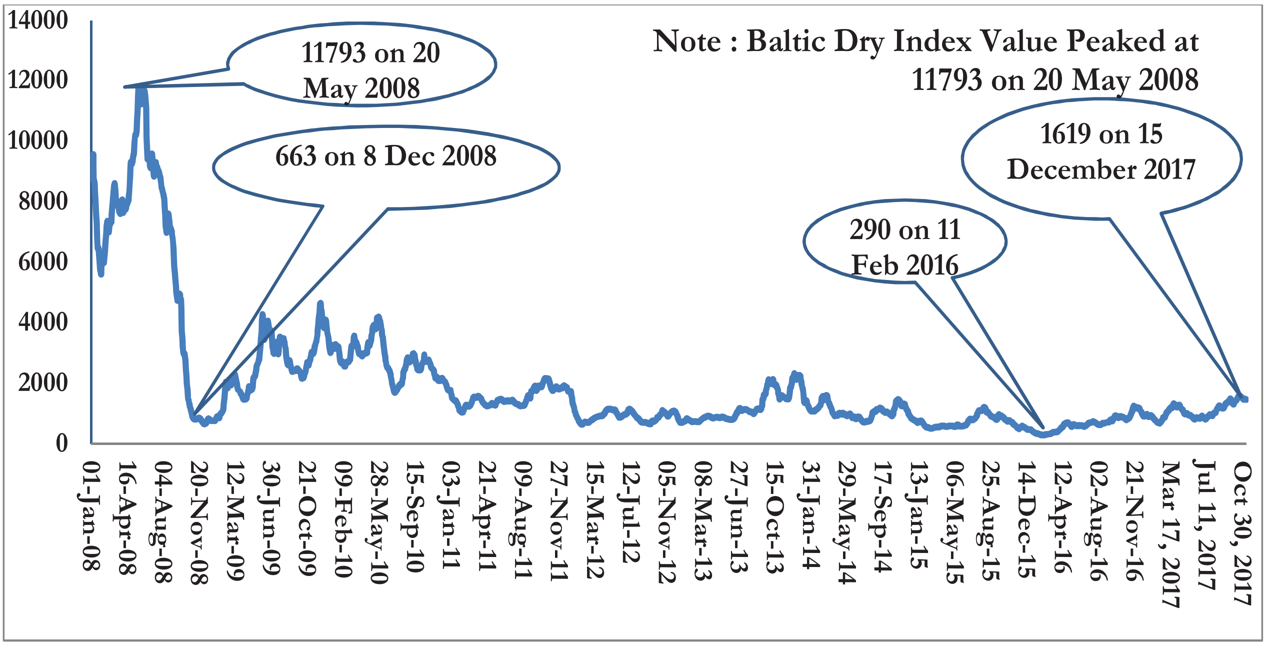
operators to tour operators across tier A, B & C cities of India. Not having an input tax credit is creating tax on tax on redistributing tours which is artificially marking up India both within the domestic & also the international markets. Since under the service tax, CENVAT was available also on the chain between tour operator to tour operators, Input Tax Credit could be considered for tour operators.

- **Special provision & services account code of adventure for tour operators:** One key segment of tourism is adventure tour operators who undertake activities in remote hinterlands of India, the Himalayas, the forests, the deserts, rivers, Sundarbans, etc. Tour operators running nature based tours work, camps, in this remote areas of natural beauty of India are creating local employment through local help, porters, sherpas, local travel & transportation support, etc. Sometimes they even create local infrastructure such as roads and many families to whom conventional financial and state help is not available, rely on these operators for their livelihood. These services were not chargeable earlier under service tax. As now, tour operators have to pay 5% GST with no input tax credit available, these services are becoming expensive. So for tour operators who are classified as adventure tour operators by the Ministry of Tourism, a mechanism like creation of a separate services account code and exemption from GST could be considered. Adventure equipment could also be made custom duty free to ensure utility of highest quality of equipment in the field of adventure tourism in India to ensure safety and security.
- **Refund of GST for International Tourists on goods**: As per the section 15 of IGST Act, the International Tourists can claim GST refund on the goods purchased in India while leaving the country. This is on the lines of countries like Singapore where there is a simple mechanism for refund. However, the mechanism for claiming GST refund is yet to be determined.

### 4.3) Shipping and Port Services

The pickup in global growth in the first half of 2017 brought some signs of recovery to the world shipping industry which has been facing stormy weather since 2008. The Baltic Dry Index, a freight index and a good proxy for the robustness of trade and shipping services had fallen from a peak of 11,793 on 20 May 2008 to a low of 663 on 8 December 2008. Though it picked up slightly in the following years, it has been in the lower range since then and was in the red at 290 as on 11 February 2016, which is even lower than the lows of 2008. It has improved in October 2017 and was at 1,619 as on 15 December 2017. Despite this slight macro optimism, overall the shipping industry continued to be subdued due to excessive shipping capacity over a prolonged period of time. The world order book or the tonnage ordered declined by 29.3 per cent from 307.3 million DWT as on 1 January 2016 to 217.1 million DWT as on 1 January 2017.

**Figure 4.2: Baltic Dry Index Value**




Shipping is the primary means of transport for export and import of commodities in India. Around 95 per cent of India's trade by volume and 68 per cent in terms of value is transported by sea. As on November 30, 2017, India had a fleet strength of 1,367 ships with Gross Tonnage (GT) of 12.34 million, with the public-sector Shipping Corporation of India having the largest share of 27.43 per cent with 3.38 Mill. GT. Of these, 441 ships of 10.87 million GT cater to India's overseas trade and the rest to coastal trade. According to Containers India Market Report, 2016 by Drewry and Gateway Research, Indian container throughput has witnessed a growth of 6.1 per cent in 2016 with combined traffic of 12.53 Million TEU handled at all Indian ports. Though shipping is an important means of transport in India's International Trade and both a foreign exchange earner and saver, India's share in total world DWT is only 0.9 per cent as on 1 January 2017. Despite having one of the largest merchant shipping fleets among developing countries, there has however been a sharp decline in the share of Indian ships in the carriage of India's overseas trade from about 40 per cent in the late 1980s to 7 per cent in 2015-16. In the coastal business, Indian ships carried around 70 per cent cargo in the same year.

Indian shipping continued to grapple with a mix of legacy issues and some new issues like the GST. Some issues in this sector are the following:

- **Need for 'Indian flag vessels for India's Trade' Policy**: Most of the countries reserve a major part of their cargo for domestic ships with countries like US being highly protective. In the Indian case, the government's stated policy for imports is "Free on Board" (FoB) and there is also the policy of Right of First Refusal (RoFR). Despite this, Indian ships carried just 7.9% of Indian EXIM trade and 71.82% of coastal trade in 2015-16. Currently, Indian ships have the first right to carry India cargo provided it matches the freight offered by a foreign flag vessel. However, Indian flag vessels are in a competitively disadvantageous position as given in Table 4.2.

**Table 4.2: Operating parameters for Indian flag vessels vis-à-vis foreign operators (Coastal operations)**

| Operating parameters for a coastal voyage | Impact on an Indian flag ship | Impact on a foreign flag ship | Competitive advantage rests with |
|---|---|---|---|
| **Safe manning rules** | | | |
| **1) Number of seafarers**<br><br>**2) Nationality of seafarers** | The number of seamen to be mandatorily employed is fixed and higher per voyage.<br><br>Always employing Indian seafarers | Not in the purview of these rules; lower manning Scales, so lower costs<br><br>No obligation to employ Indian seafarers | Foreign flag ship |
| **Bunker rate** | Costlier due to high base rate | Buying fuel abroad which is cheaper | Foreign flag ship |
| **Seafarers taxation** | Indian seafarers on Indian flag ships operating on the coast have to pay tax on wages and hence cost of employees goes up | Not levied at all. | Foreign flag ship |
| **Tonnage tax** | Higher rate of tonnage tax | Lower rate of tonnage tax | Foreign flag ship |
| **IGST on import of ships** | 5% on value of ship | Can carry cargo on Indian coast without payment of 5% IGST on ship import | Foreign flag ship |

Source: INSA

The costs of operating a shipping company in India are higher than overseas and therefore foreign shipping companies do not prefer to flag their ships in India. Most of the high input costs of Indian shipping companies is due to taxes payable in India. The quantum of difference in the cost of operations has reduced after October 2017, with the reduction in the GST and IGST on Fuel Oil from 18% to 5%. Due to this, the Indian shipping companies have been able to reduce the disparity in part of their input costs vis-à-vis foreign shipping companies operating on the Indian coast on the cost head of fuel though the difference in input costs on several other parameters remains.

As an Indian company is not able to quote lowest freight due to its high input costs, huge cargo volumes get transported by foreign flag ships. This is despite the fact that the GoI rule mandates that all import contracts by PSUs and Government controlled cargo shall be done on FOB basis. Many-a-times exceptions are made to this rule, and more often the exception becomes the rule with 70% of Indian oil import cargoes being carried by foreign flag ships and less than 5% of coal/fertilizers imports in Indian ships today.

Foreign sellers would always prefer to sell on CIF basis so that they are able to control the shipping and the freight. Of late, even countries such as Saudi Arabia have offered to sell Crude oil at a small discount provided India would buy CIF to support their own national tanker fleet. The CIF contracts are always opaque since the freight component remains unknown and converting a CIF contract to FOB is always difficult since the supplier artificially increases the FOB component in order to show that the freight being offered is the lowest which once again prohibits Indian shipping companies from entering the market. A FOB contract allows the buyer to control freight costs and choose the transporter which are extremely critical factors for a net importing country like India. The FOB import contracts can lead to long term cargo contracts with Indian flag shipping companies. This will ensure that freight does not flow out of India with simultaneous growth of Indian tonnage. Transporting critical energy cargo on FOB with long term contracts on the national flag provides certainty and surety to the supply chain of the nation. Given the competitive disadvantage faced by Indian flag vessels, the RoFR remains ineffective.

In 2015-16, Indian ships carried only about 20% of the PSU crude oil imports and 12.5% of overall Indian crude oil imports. The reason for this is that a majority of India's bulk imports are done on C&F/CIF basis and therefore Indian companies do not even get the benefit of ROFR in these trades with the result that the share of Indian flag vessels in India's bulk imports is miniscule. This is despite the policy of imports FoB. Thus, while the existing RoFR policy does not hamper carriage of goods and services, yet the declining share of Indian ships and the quantum of annual freight outgo reveals the fact that the RoFR system is inadequate which also makes the FDI policy ineffective. Though 100% FDI is allowed in Indian shipping since 2001 and foreign companies have been permitted to form local shipping companies to carry Indian cargo, this has not resulted in growth of the Indian flag. This is due to the fact that doing so would entail bearing responsibility of paying taxes in India, and employing Indian seafarers which the foreign shipping companies are averse to. Even with this aversion, 92.55% of India's EXIM cargo is carried by them. Therefore, there is a need to examine the terms of shipment aspect very carefully and if necessary mandate Indian PSUs and Government Departments to import cargo only on FOB Basis. No objections to ship imports on a CIF basis must be given only as an exception and not as a rule. All long term purchases need to be done on a FOB basis in order to provide the chance to Indian Companies to bid for the said business. This can also lead to investment in the Indian flags as foreign companies will realise that there is an advantage in being an Indian flag shipping company. Other ancillary services such as training seafarers, ship repair, marine insurance, surveyors, brokers, classification services and other support services such as bunkering, pilotage, port support services etc. would develop and grow and long term benefits could be reaped by the Indian economy. The disparity in tax between Indian and Foreign Ships should also be addressed. Thus the 'Indian flag vessels for India's trade' policy would go one step ahead towards a "Service from India" policy on the lines of " Make in India" policy.

- **Long term partnerships for carriage of Indian imports between Indian PSUs and governments' user departments and Indian shipping companies to increase the share of Indian vessels:** This issue is related to the earlier one. With around 92 % of India's EXIM cargo carried by foreign shipping companies in 2015-16 at an approximate freight cost of US$ 50 billion, there is a net annual forex outgo for India. Around 28 % of coastal trade was also carried by foreign ships in 2015-16 though there is no estimate of the freight paid. Around 50% of China's crude is to be shipped in Chinese ships by 2017 on the basis of which China has about 25 new VLCCs on order. On these lines, at least 50% of Indian EXIM cargo and majority of coastal cargo should be carried in Indian ships and the national fleet should be large enough for this purpose. To increase the share of Indian cargo in Indian vessels from the current 7.9% of India's external trade in 2015-16, the user government departments/PSUs need to enter into long term charter contracts with Indian shipping companies owning and operating Indian flag ships for at least 50% of their annual import requirements for both dry and liquid bulk cargoes. Meanwhile, the Right of First Refusal should continue on balance 50%. The percentage maybe gradually increased. A similar policy can be replicated for coastal cargoes of PSUs. This will make the Indian flag attractive and such contracts can help Indian companies acquire additional tonnage duly financed by Indian banks who would be willing to lend to the shipping companies based on these cargo contracts.

  This will ensure security of India's transportation network and serve as a safeguard against predatory pricing. So a policy of using Indian cargo to strengthen Indian fleet backed by Indian banks is necessary. When an Indian ship carries Indian cargo, the freight earned is retained in India by an Indian company, and it has a multiplier effect on the Indian economy including employment and making foreign companies flag in India. It is also important strategically.

- **Need to ensure that foreign shipping companies are not allowed to dump freight in India which is even lower than the operating costs of the Indian shipping companies:** The foreign shipping companies dump freight in India that is even below the operating costs of Indian shipping companies. The modus operandi of the foreign shipping companies is to bring cargo into India with freight on par with market, based on international rates. However, on the return leg which is normally empty and for which costs have already been covered in the laden leg, these ships resort to services dumping by providing the services at throwaway freight rates. Such rates are well below the operating costs of Indian shipping companies. Thus, the Indian ships lose out as they are unable to match the lowest rate as quoted by foreign shipping companies. Therefore, there is a need for a mechanism to review shipping freight rates offered by foreign flag vessels and to initiate, enquire and levy appropriate anti-dumping duty.

- **Maritime Development Fund:** This is also related to the first two issues. As on November 30, 2017, 32.43% of the Indian fleet was over 20 years of age and 17.82% in the age group of 15-19 years. The average age of Indian ships increased from 15 years in 1999 to 18.5 years as on November 30, 2017. In contrast as on 1st January 2017, the international average age of ships was 14.5 years. The old ships needs to replaced urgently.

The size of the fleet is also inadequate and can carry only 7.9% of India's merchandise trade in 2015-16. The national fleet should atleast be large enough to carry 50% of national critical cargoes on the lines of China. So large scale acquisitions are needed in the shipping sector, particularly when the asset prices continue to be very low. But Indian shipping faces dearth of funding options and the cost of available funds is high with short tenures. Internationally, considering long gestation period characterizing the sector, ship acquisition is often funded by way of foreign currency denominated bonds whereas in India the sector has primarily been supported by the Banking system. Raising low cost funds is itself a challenge for the Indian banking sector. Further, the Banks are constrained to limit the loan tenures in order to avoid asset liability mismatch. This puts additional pressure on the Indian borrower, especially in times of distress as is being experienced for the past few years, which ultimately has led to defaults. Such defaults further restrict the credit flow to the sector as Banks are averse of taking further exposure in the sector. The modifications in ECB guidelines too have not been of adequate help to the sector since very few of them would be able to raise funds at economical rates given the financial position of the Indian players in the sector. For Indian companies to be competitive globally, it is imperative that they are able to secure financing at similar rates as their global competitors. Given the sustained volatility in international freight rates and the oversupply of ships internationally since 2008, most financial institutions have reduced lending to the shipping sector and banks world-wide have cut their shipping portfolios. Raising low cost funds is itself a challenge for the Indian banking sector. Banks are constrained to limit the loan tenure in order to avoid asset liability mismatch. As a result, individual shipping companies are unable to raise funds abroad at economical rates despite the enabling provisions of ECB/FCCB granted by RBI. The reasons for this are that traditionally European banks have lent money to shipping and today European banks themselves are cash strapped. Mortgaging an Indian asset (ship) of an Indian company is also difficult for an overseas lender as the Merchant Shipping Act gives protection to Indian assets. However this Act is under review at present.

Currently, three major Indian banks, by and large, participate in the funding of shipping assets and the cost of funds averages about 13.5% for small to medium sized shipping companies which has to be repaid in 7 years. Comparatively, the competing foreign shipping companies are able to source funds at about 2-3.5% for about 12 to 15 years. Since international shipping is an extremely competitive business, this cost differential due to interest and shorter tenures squeezes the operating margins of Indian companies. Indian companies cannot even bid for most contracts as their daily requirement of cash to cover just the operating costs is far higher, impacting profitability as well as cash flows which further impact internal accruals that could be used to expand further.

In the past, dedicated sectoral funds in India have effectively addressed the issues particular to a sector. To support the maritime sector and increase the Indian flag tonnage, there is a need to help in the growth of the maritime sector and enhance credit availability for the sector. There has also been no investment in shipping sector in most of the plans, though there has been investment in Ports and Shipbuilding (Table 4.3). A Maritime Development Fund as mentioned earlier on the lines of Infrastructure Development Fund could possibly help in this regard.

## Table 4.3: Investment in Shipping

| **Plan Outlay - XII$^{th}$ Plan (In Rs. Crore)** | | | | |
|---|---|---|---|---|
| **Ministry** | **GBS Outlays** | **Percentage share** | **IEBR*** | **Percentage share** |
| Ministry of Road Transport & ighways | 144769 | 41.85 | 64834 | 20.79 |
| Ministry of Railways | 194221 | 56.14 | 225000 | 72.16 |
| Ministry of Shipping (Ports) | 6960 | 2.01 | 21990 | 7.05 |
| Ministry of Shipping (Shipping) | | NIL | | NIL |
| **Plan Outlay - XI$^{th}$ Plan (In Rs. Crore)** | | | | |
| Ministry | GBS Outlays | Percentage share | IEBR | Percentage share |
| Ministry of Road Transport & Highways | 155562 | 75.93 | 83856 | 30.69 |
| Ministry of Railways | 44263 | 21.60 | 150000 | 54.89 |
| Ministry of Shipping (Ports) | 3749 | 1.83 | 26574 | 9.72 |
| Ministry of Shipping (Shipbuilding) | 170 | 0.08 | 550 | 0.20 |
| Ministry of Shipping (Shipping sector) | 1131 | 0.55 | 12285 | 4.50 |
| **Plan Outlay - X$^{th}$ Plan (In Rs. Crore)** | | | | |
| Ministry | GBS Outlays | Percentage share | IEBR | Percentage share |
| Ministry of Road Transport & Highways | 34790 | 53.74 | 24700 | 35.50 |
| Ministry of Railways | 27600 | 42.63 | 33000 | 47.43 |
| Ministry of Shipping (Ports) | 2350 | 3.63 | 11870 | 17.06 |
| Ministry of Shipping (Shipping) | | NIL | | NIL |
| **Plan Outlay -IX$^{th}$ Plan (In Rs. Crore)** | | | | |
| Ministry | GBS Outlays | Percentage share | IEBR | Percentage share |
| Ministry of Road Transport & Highways | 19393 | 53.02 | 18279 | 31.11 |
| Ministry of Railways | 16491 | 45.08 | 34120 | 58.08 |
| Ministry of Shipping (Ports) | 696 | 1.90 | 6350 | 10.81 |
| Ministry of Shipping (Shipping) | | NIL | | NIL |
| **Plan Outlay - VIII$^{th}$ Plan (In Rs. Crore)** | | | | |
| Ministry | GBS Outlays | Percentage share | IEBR | Percentage share |
| Ministry of Road Transport & Highways | 17059 | 76.04 | | |
| Ministry of Railways | 5375 | 23.96 | 21827 | 100 |
| Ministry of Shipping (Ports) | | NIL | | NIL |
| Ministry of Shipping (Shipping) | | NIL | | NIL |

Note:* Internal and Extra Budgetary Resources (IEBR) Source: INSA

- **Employment and Training in Shipping**: There is a backlog of young cadets in India estimated to be around 3,000-4,000 who have completed their pre-sea training and are awaiting sea time due to limited training slots on Indian flag ships. It is mandatory for Indian ships only to carry out training of fresh cadets. Foreign flag ships demand hefty sums to train Indian cadets while Indian companies train cadets for free. While this backlog needs to be addressed, expansion of Indian fleets can automatically solve this problem as acquisition of one vessel provides employment on board to at least 45 Indian seafarers as well as ensures training for new Indian seafarers. Indian companies who train young seafarers on their Indian flag ships, have until now trained 40 lakh seafarers between April 1st 2005 to March 31st 2017.

- **GST issues in shipping sector:**
  - **GST applicability on sale of ships located abroad:** GST is applicable on the sale of a ship by an Indian shipping company which has a ship located abroad. Earlier, such a sale was outside the purview of the Indian VAT laws and hence was not liable to VAT. However, as per the IGST Act, while the supplier is located in India and place of supply is outside India, such supply now qualifies as an interstate supply of goods. While, export of goods outside India is zero rated from GST (Section 16 of the IGST Act), 'export' is defined to mean 'taking goods outside India to a place outside India'. In the present case, since the ships are located outside India prior to their sale, sale of ships may not qualify as export of goods. Hence the sale of ships outside India is subject to IGST. If GST is levied on sale of ships located outside India, the customer being an overseas entity, would not be eligible for input tax credit of GST and hence such GST would be an additional cost for the Indian shipping company. Some clarification is needed in this regard.

  - **GST on charter hire:** There are two rates for renting services one for code 997319-Leasing or rental services concerning other machinery and equipment 'with or without operator' with 5% GST and the other is code 996602- Rental services of water vessels including passenger vessels, freight vessels and the like 'with or without operator' for which GST rate is 18%. Some oil majors insist that the charter hire for chartering vessels comes under the 5% GST, while shipping companies insist that it comes under 18 % GST. The oil companies do not get any credit for GST that they pay on services of vessels that carry products like Motor Spirit (gasoline), high speed diesel (HSD), crude oil, etc. as these commodities have not been brought under GST. Hence, it is in the interest of oil companies to pay as little GST as possible on these services. As a result, there is a lot of disagreement between the Indian National Shipowners' Association (INSA) and oil companies. In the bargain, Shipping companies have been facing problems of late payments of GST invoices and have in the past also paid the difference between 18% and 5% i.e. 13% GST to the government from their own pockets to avoid non-compliance with the Act. Therefore, there is a need to issue a clarification on the tax rate for charter, with a special mention of GST rate for tanker vessels. The clarification should include the applicable GST rate on the different types of vessel charter services offered i.e. Time Charters, Voyage charters, Bareboat Charters (BBC) and Bareboat Charters with Demise (BBCD).

- **Need for parity in GST treatment for services of international transportation of goods by sea by Indian shipping companies' vs foreign shipping companies:**

    - Pre-GST, both Indian and Foreign shipping companies had to pay 5% services tax for import cargo services provided to overseas consignor. Post GST, if a foreign charterer desires to engage a shipping line for transportation of cargo from abroad to India, he would prefer to engage a foreign shipping line over an Indian shipping line on account of GST – since Indian shipping company would charge 5% GST on its freight invoice and foreign shipping line would not charge any tax on its freight invoice to Overseas Charterer.

    - Pre-GST, in the case of export cargo services provided to Indian consignor, no tax was applicable since the place of supply is based on destination of cargo which is outside India (Rule 10 of Place of Provision of Services Rules, 2012) and Indian shipping company was also eligible for CENVAT credit refund on input services. However post GST, if an Indian charterer desires to engage a shipping line for transportation of cargo from India to aboard, the Indian charterer could prefer to engage a foreign shipping line over an Indian shipping line on account of GST, since Indian shipping company would charge 5% GST on its freight invoice and foreign shipping line would not charge any tax on its freight invoice.

In all the major international maritime jurisdictions including Canada, Malaysia, Australia, UK, Indonesia and EU countries, transportation of export as well as import cargo qualifies for zero rating. So there is a need to see whether international transportation services for both import cargo and export cargo can be considered as 'zero rated supplies'.

- **IGST on ship imports at 5%:** Pre- GST, the excise duty was exempt on items like Cruise ships, Excursion boats, ferry boats, cargo ships, barges, etc. for transport of persons or goods and dredgers. As a result, CVD on import of such goods was also exempt. Since Basic customs duty on the aforesaid goods was exempt, Special Additional Customs Duty was also exempt. In addition to the above, import of specified goods such as vessels and other goods which are required for oil exploration activities under specified projects were exempt from custom duties, subject to 'essentiality certificate'. Now a 5% GST has been levied on various types of ships including Cruise ships, Excursion boats, ferry boats, cargo ships, barges, etc. for transport of persons or goods; dredgers; tugs and pusher crafts. Worldwide, also no VAT or GST is levied on import of foreign going vessels. Therefore, there is a need to consider whether these goods can be exempt from IGST.

- **<u>Input tax credit on inputs and capital goods for transportation services:</u>** Pre-GST, two options were available for service tax payment on transportation services by vessel: i.e to pay service tax at 15% with full input tax credit on input services, inputs and capital goods, or to pay service tax with 70% abatement i.e. 4.5% effective tax rate with full input tax credit on input services, but no input tax credit on inputs and capital goods. Now there is 5% GST with input tax credit on input services and capital goods (Vessels) and there is no input tax credit on inputs and capital goods (other than vessels) used for transportation services. Therefore, there is a need to consider allowing input tax credit on inputs and capital goods for transportation services by vessel with 5% GST on transportation services.
- **<u>GST input tax credit on any goods purchased in various States</u>:** Goods such as furnace oil, lubes, spares, ship stores, etc. are purchased by shipping companies at various ports/States. However, as per the IGST Act, the place of supply for goods is *'location of the goods at the time at which movement of goods terminates for delivery to the recipient'*. Based on the above, for goods such as furnace oil, lubes, spares, ship stores, etc. purchased by shipping companies at various ports / States, the place of supply shall be the respective State / port where goods are delivered. Such purchase of goods would attract CGST and SGST of the respective State where goods are procured. Shipping companies may not have any place of business or any output GST liability in the States where the purchases are made and hence may not be able to utilise the input tax credit in respect of goods procured at various States. This could result in significant blockage of input tax credit in various States and needs to be addressed.

**Some other issues:**

- **<u>Applicability of the S4A scheme of RBI:</u>** Arising out of the unexpected and sudden lowering of rates , Indian offshore vessel owners had to reduce charter hires by about a third in 2016. This resulted in a mismatch of cash flows for Indian shipping companies. Therefore, there is need to restructure loans of the Indian shipping companies to match their restricted cash flows. There is a need to consider extending the S4A scheme of RBI i.e. the 'Flexible Structuring of Existing Long Term Project Loans to Infrastructure and Core Industries' to the shipping industry.
- **<u>Use of broadband and VSAT on Ships:</u>** Worldwide, the shipping industry uses modern satellite communication system viz Broadband/VSAT services on board ships, not only for voice and text communication but also for data communication for its day to day operations and enhancing safety of life at sea. However, Indian shipping companies do not have the ability to use modern satellite based communication system viz Broadband/VSAT services and continue to use outdated satellite communication technologies permitted under Global Maritime Distress and Safety System (GMDSS). The terminals permitted under GMDSS have very limited transmission rate and are totally inadequate for modern day communication needs. India has ratified the Maritime Labour Convention (MLC-2006) of the International Labour Organisation in October 2016. The MLC-2006 mandates Internet/Broadband/ VSAT communication facilities to be made available at sea as one of the crew welfare measures as the members of the crew on a ship also require these communication facilities to keep in touch with their friends and family members. The provisions of this Convention are required to be effectively implemented.

Indian shipping companies have been seeking permission from the Department of Telecommunication to use Inmarsat Satellite Communication Systems viz Broadband/VSAT services on board Indian flag ships plying internationally as well as in coastal waters. This issue needs to be addressed.

- **<u>RBI approval needed to remit upto US$ 5 million into an escrow account in a foreign bank for purchase of second hand ships:</u>** Most second hand purchase transactions require deposits of a certain percentage of the proposed sale price into a joint escrow account held by the buyer and seller of a ship in a bank account outside India. Upon successful completion of sale transaction, the amount held in escrow is transferred to the seller. Currently, RBI does not permit automatic opening of a joint escrow account of the buyer and seller. The Indian buyer has to await permission and the Seller is unwilling to wait for such a permission leading to the Indian company losing the ability to close a deal. RBI permits direct remittance of upto US$ 5 million to the Seller without prior approval. There is a need to consider granting automatic approval to remit, say, upto US$ 5 million into a joint escrow account of the buyer and the seller in a foreign bank. Permission to automatically hold such an account would provide considerable ease in being able to proceed with sale and purchase transactions of second hand ships by Indian shipping companies.
- **<u>Lack of necessary draft:</u>** The Indian ports do not have the necessary depth or draft. e.g Indian ports have an average draft ranging from 8m to 12m. In comparison, the draft available at international ports ranges from 12m to 23m.
- **<u>High Port Handling Charges:</u>** There are also issues like the high port charges in India which are considerably higher than in many developed countries. Not only are port charges high in India compared to other counties, even within India, some non-major private ports have even high port charges. Cochin Port/IGTPL is the most expensive port for the exporters and importers of South India. In Kerala, Cochin being the only port, the shipping community is compelled to use this port. While TAMP had called for hearing, the Licensor Cochin Port Trust has asked IGTPL to reduce their charges by 30%. The High Court of Kerala had also directed IGTPL to be customer friendly and be impartial to all customers. However the guidelines by High court are yet to be implemented.
- **<u>Light House Dues:</u>** Another concern is the payments made by the shipping companies/vessel operators in respect of the Light House dues to the Government of India through Commissionerate of Customs. Owing to technological advancement and other related developments, Light Houses have no role to play in the navigation of ships. The said cost is actually adding up to the vessel operations costs and needs to be reviewed urgently

### 4.4) Real Estate Services

Real estate sector including ownership and dwellings accounted for 7.6 per cent share in India's overall GVA in 2015-16. The growth of this sector decelerated in the last three years from 7.5 per cent in 2013-14 to 6.7 per cent in 2014-15 and further to 4.5 per cent in 2015-16. This was mainly due to the ownership and dwelling segment having a share of 6.8 per cent in overall GVA decelerating from 7.1 per cent in 2013-14 to 3.2 per cent in 2015-16. The construction sector accounted for 8.1 per cent share of GVA in 2015-16. The growth of the construction sector which includes buildings, dams, roads, bridges etc., has decelerated to 1.7 per cent in 2016-17 from 5.0 per cent in 2015-16.

Housing and Infrastructure sectors are pivotal to nation building, as they have direct impact on social and economic development. They also generate varied employment opportunities ranging from unskilled, semi-skilled and skilled labourers to professionals and experts. As per a NCAER Study, housing sector accounts for 1% of the GDP as well as 6.9 % of the total employment. Housing was the fourth largest employment generating sector in the country. For every ₹1 lakh invested in the housing sector, 4 new jobs were created and ₹2.9 lakh got added to the GDP through multiplier effect. Housing also has a significant multiplier effect in boosting economic activity and output in 269 ancillary industries either directly or indirectly. The housing sector has been facing slowdown in recent years with residential sales across top-eight cities in India in 2016 falling to a five-year low of about 2,45,000 units, due to subdued demand over the past three years. Similarly, new residential unit launches, too, fell to only 1,76,000 unit launches during 2016. This was primarily due to the prolonged slump and execution delays in project completion which resulted in inventory pile-up across all cities. However residential sales outpaced the new supply consecutively for two years in 2015 and 2016.

Demonetization in November 2016 possibly impacted the new launches and sales in the short term with several states recording drop in property registrations post-demonetization. Foreign Direct Investment (FDI) inflows to the construction sector have also declined to US$ 1.9 billion in 2016-17, as against US$ 4.6 billion in 2015-16 even though there was relaxation of FDI norms for the construction development sector undertaken over the past two to three years. Despite the subdued demand, residential prices did not fall with the NHB RESIDEX, showing increase in prices in 36 cities out of 50 cities in 2017-18 Q1 over 2016-17 Q1.

Some of the issues and challenges affecting growth in real estate and housing sector include the following:

- **Delay in approvals of permits, high land registration costs including stamp duty, rising debt levels and NPAs, lack of skilled workforce:** As per the World Bank's 'Ease of Doing Business 2018', India ranks 181 out of 190 countries in dealing with construction permits. With over 30–35 regulatory approvals required to be obtained by a developer to develop a real estate project in India, it takes anywhere between six to twelve months or even higher in obtaining various approvals. As a result, the whole process becomes cumbersome and also leads to delays, which inflates the project cost by 20–30 per cent. India ranks 154 out of 190 countries, in registering a property. Bye-laws have also not been updated as per global benchmarks and best practices. The Urban Local Bodies of NCT Delhi and Mumbai have recently streamlined their Building Plan Approvals through online mode. An online Building Plan Approval System has been introduced to ensure that all the required clearances by the external and internal agencies are accorded in a seamless, integrated manner, without any physical interface. Government of Andhra Pradesh have also introduced Development Permission Management System (DPMS) which has integrated all the urban local bodies of the State to a common portal to give building plan approvals online in an expeditious manner and getting all inspections after approval. Several other State Governments have also taken similar initiatives. The Government of India has issued guidelines for implementing on-line building plan approval system in million-plus cities for guidance of Urban Local Bodies and Urban Development Authorities. Further, revision of State building bye-laws along with introduction of single window system for plan approvals is one of the prescribed reforms under the Atal Mission for Rejuvenation and Urban Transformation (AMRUT). There is a need to implement the single –window clearance for construction permits in all states on top priority.

- **Rising non-performing assets (NPA), higher risk provisioning assigned to real estate sector by the RBI and dwindling profits in the real estate sector**: These have affected bank lending to the sector. Among the major funding sources to real estate sector, bank lending to the real estate sector has significantly dropped from over 57 per cent in 2010, to less than 24 per cent in 2016, while private equity investments have increased (NAREDCO and KPMG). The total housing credit outstanding of scheduled commercial banks (SCBs) in India as on March 31, 2017 was around Rs 8.6 trillion, with growth (y-o-y) of 15.2 per cent while the total housing credit outstanding of housing finance companies (HFCs), was Rs 5.0 trillion with a growth of 15.0 per cent during the same period. The real estate sector has also been grappling with liquidity issues and piling debt. The total outstanding debt of listed real estate developers in India has risen from Rs 25,000 crore (US$ 3.7 billion) in 2006-07 to over Rs 83,000 crore (US$ 12 billion) in 2015-16 (NAREDCO and KPMG).
- **Slowdown in Delivery:** There is slowdown in respect of delivery of flats to buyers. However, RERA has benefited the buyers ensuring uniformity, transparency and accountability, through prescription of carpet area for pricing, disclosure of project details and completion and penalties for non-compliances. There is a however a need to speed up delivery of houses and complete handover even of completed projects.
- **GST Issues:** While construction sector is the worst hit sector due to economic slowdown and demonetization, all components of construction except Bricks are charged at 28 % GST. This needs a relook.
- **Delay in payment for Government projects**: Delays in payments by the Government blocks the fund flows of Private companies and needs to be speeded up.
- **Funding problems for land acquisition**: Currently, funding is only available for construction purpose, but not for land acquisition. Land acquisition alone constitutes 60% of the entire cost in a particular project now, compared to 30-40% earlier. After funding for the acquisition of a land, developer needs to wait for 12 to 18 months, during which period, the developer does not get any money, but gets burdened with interest charges. These issues need to be examined and addressed.
- **Need to Expand Secondary Market and Improve Affordability:** Banks and HFCs are the major primary market players in providing housing and infrastructure finance. In

recent years, they have clocked high growth rates, with outstanding bank credit to infrastructure and housing, increasing from Rs.95 billion and Rs.254 billion in March 2001 to Rs.9.8 trillion and Rs.7.5 trillion in March 2016, respectively. Similarly, HFCs outstanding housing loans has increased from Rs.332 billion in March 2001 to Rs.6.8 trillion in March 2016. Outstanding housing loans of Banks and HFCs to GDP ratio has increased from 2.2% in 2000-01 to 9.3% in 2015-16. However, when compared with developed economies the penetration level is low. Limitations on expansion through primary markets occurs because of their risk exposures on long-term assets catered through short-term liabilities, which carry structural liquidity and interest rate sensitivities risks for banks and HFCs. Secondary market development increases flow of long term funds, reduces cost of fund through more efficient risk allocation, and promotes creation of long-term fixed rate assets, with synergic relationship between both primary and secondary markets. Currently, infrastructure finance is dominated by direct equity investments and bank loans. Boosting infrastructure finance will require broadening of the potential group of investors and tapping the vast financial resources of capital markets. Covered Bonds is one such instruments. Covered Bonds (CBs) are securities created from either mortgage loans or public sector loans and typically carry maturity up to ten years with relatively high credit ratings. CBs are dual-recourse bonds having claim both on the issuer and a cover pool of high-quality collateral, issued under specific covered bond legislation or contracts. This needs to be examined.

## 4.5) Project Exports

Indian Project Exporters have executed a variety of projects in diverse markets overseas. Satisfactory performance, in terms of cost effectiveness, application of technical expertise and timely delivery of quality products and services have earned project exporters from India a fair degree of goodwill and standing. The nature of project exports being undertaken, in a sense, reflects the technological maturity and industrial capabilities of a country. Exports of projects and services can be broadly categorized into (i) civil construction projects, (ii) turnkey projects, (iii) consultancy services, and (iv) supplies, primarily by way of capital goods and industrial manufactures. With industrial demand slowing down globally, governments around the world are now targeting energy and infrastructure projects as vital conduits to exporting high-value machinery, labor, expertise, and technology packaged as project engineering, procurement and construction (EPC).

A World Bank study (2015) indicates that the annual infrastructure investment requirements for emerging markets and developing economies is at a staggering US$ 836 billion. Excluding China, the requirement stands at US$ 711 billion. According to the Asian Development Bank (2010), during the ten year period of 2010-2020, the largest infrastructure investment needs are in the countries of SAARC and ASEAN region with investment needs of US$ 8 trillion. Of this total infrastructure investment, electricity and transportation sector (mainly roads) require a major portion of investments (almost 85%) followed by telecommunications and water and sanitation (about 15%). Another study by the World Bank (2010) estimated that Africa needs around US$ 93 billion annually for the next ten years for its infrastructure sector development. Out of this, about 2/3rd is required for new investment in physical infrastructure and 1/3rd for maintenance and operations. The power sector needs more than 40% of the required spending, transport and water utilities an additional 20% each; and ICT needs 10% of required spending.

Projects funded by Multilateral Development Banks, both in India and in regional borrower countries present attractive business opportunities for Indian suppliers, contractors and consultants. These opportunities are spread across an array of sectors including power, water supply, transport, telecommunication, agriculture, education and health. Due to their technical expertise and relevant experience in such sectors, Indian companies are often well-placed to secure contracts in projects funded by MDBs. Moreover, in terms of appropriateness of technology as also assurance of payment, such opportunities enable Indian companies to widen their export footprint at minimal risk level. While Indian firms have been successful in securing and executing such contracts, there exists significant potential to increase India's share in funded projects.

From 1 January 1966 to 31 December 2016, of the total contractors and suppliers involved in 2,06,915 contracts for goods, works, and related services under ADB loan and grant projects worth US$ 158.7 billion, 11,960 contracts (5.8%) were awarded to contractors and suppliers from India worth US$ 21.9 billion (13.8%). From 1 January 1966 to 31 December 2016, of the total consultants involved in 52,232 contracts for consulting services under ADB loan, grant, and technical assistance projects worth US$ 11.3 billion, 3,093 contracts (5.9%) were awarded to consultants from India worth US$ 734.7 million (6.2%). From 2011 to 2016, a total of 13,562 goods, works and services contracts were floated for African Development Bank funded projects, valued at US$ 12.2 billion. Of this, India secured nearly 97 contracts (share of 0.7%), with a total value of US$ 666.6 million (share of 5.5%). During the fiscal year 2015 and 2016, a total of 16,993 contracts were floated for World Bank funded projects, valued at US$ 26.9 billion. Of this, India secured 603 contracts (share of 3.5%), valued at US$ 4.4 billion (share of 16.4%).

Project Exports include both goods and services and therefore have some peculiar problems. Some problems and policy suggestions related to this sector are the following:

- **Data issues:** Accurate data on Project exports is not available in India. As per DGCI&S data, India's project goods exports fell by 31.3 per cent in 2015-16 to US $ 25.13 million. However, as per Project Export Promotion Council (PEPC), project exports fell by 8.7 % in 2015-16 to US$ 5014.9 million. The wide variation is because the Directorate General of Commercial Intelligence and Statistics (DGCIS) compiles data on exports of only project goods and not project exports. Though PEPC compiles the data on project export orders secured during a financial year, the underlying trends concerning products and services utilized in overseas projects is not being generated since there is no head or code for project exporter to declare the same.
- **Due to data issues Project Exporters do not qualify for Export Benefits**: Project exporters are not able to declare project exports in the shipping bill as it would result in the bill being considered as "free shipping bill" and thus not qualifying for any export

incentives. This is because a head or specific HS code is not allocated to project exports and the project exporters are not able to declare the same in the shipping bill. In case "Project Exports" are declared by the company in the shipping bill, then the bill is considered as "free shipping bill" and in the absence of specific HS code, the export is not qualified for any incentives. Therefore, project exporters file exports under different heads resulting in non-availability of consolidated data for project exports. A system is needed for collecting project exports data. The Ministry of Commerce is looking into this issue and the issue needs to be resolved quickly.

- **<u>Potential for project exports in the SAARC and CLMV(Cambodia, Laos PDR, Myanmar and Vietnam) regions</u>**: There is a need to explore the potential in CLMV as the Middle East market is facing difficulties;
- **<u>FTAs/CECA negotiations:</u>** Project exports are not in the agenda during FTA/CECA negotiations. Since Project Exports are important for India, there is a need to include them in the agenda.
- **<u>Promoting Project Exports through rupee trade:</u>** In African countries some of which have added Indian currency in their currency basket, there is scope for project exports through rupee trade. This needs to be explored.
- **<u>Indian content under the lines of credit.</u>** At present, Indian content requirement is 75%. There is also the provision for relaxation not exceeding 10% on a case by case basis for projects involving significant civil construction work which should be sought before the project is tendered. There is a need to consider whether the Indian content can be reduced further on a case by case basis to promote project exports to Africa.

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