

*Report of the High Level Group on
Services Sector*



**Government of India
Planning Commission
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Preface

The Planning Commission had constituted a High Level Group on Services Sector on 4th May, 2007 under the chairmanship of Member (International Economics), Planning Commission for comprehensively examining the different aspects influencing the performance of the services sector and suggest short-term and long-term policy measures to improve and sustain its competitiveness in the coming years. A copy of the Order constituting the Group is given in Annexure I.

Apart from holding two formal meetings on 22nd June, 2007 and 28th January, 2008, the chairman held a number of consultations with individual Members of the Group and with outside experts on aspects relevant to the Group's mandate.

These consultations were very useful to the Group in preparing this Report. The names of the experts with whom consultations were held are given in Annexure II. Besides, the Group also benefited from inputs received from Dr. Suparna Karmakar, Senior Fellow, ICRIER.

The Group had set up two sub-Groups, i.e., Sub-Group on Financial Services headed by Shri K.V.Kamath, Managing Director & CEO, ICICI Bank Limited and Sub Group on Tourism headed by Shri S.S.H.Rehman, Executive Director, (Hotels, Travels, Tourism & Foods), ITC Limited. These sub-Groups submitted their Reports and these have been duly incorporated in the Report of the High Level Group.

It is my pleasure and privilege to thank all the Members of the Group and the experts who have been consulted for their valuable suggestions and contributions for finalization of this Report.

Dated 18 March, 2008

(ANWARUL HODA)
Member (International Economics), Planning
Commission
Chairman, High Level Group on Services Sector

Executive Summary

Chapter 1: Services Sector Competitiveness Report

The rapid growth of India's exports of commercial services during the period 2000-2006, from US \$ 16 billion to US \$ 72.8 billion, and of India's share in world exports from 1.1 per cent to 2.7 per cent provides ample evidence of India's international competitiveness in the services sector as a whole. However, calculations of Revealed Comparative Advantage (RCA) show falling RCA in respect of travel (tourism) and transportation (of which shipping is the major component) and accelerating RCA in respect other commercial services (computer and information services and other business services, which includes professional and technical services such as legal, accounting, market research, architectural, and engineering).

Prerequisites for enhancing competitiveness

While the needs of each sub-sector are unique in many respects, the Group felt that action on three fronts was critical for enhancing the competitiveness of the services sector. The education system must be reformed and expanded, the skill deficit in almost all service sectors must be eliminated through concerted action and the physical infrastructure including the urban infrastructure and civic amenities brought to world standards.

Expansion and Reform of Education

Higher education in particular needs attention, as the existence a small number of institutions of excellence has diverted attention from the serious problems of quality in the majority of institutions of higher learning. The curricula must be revised periodically, the method of assessment of students changed so that it encourages the development of analytical and creative skills rather than testing memory. In order to overcome the problem of shortage of teachers particularly in technical education, it is necessary to look into the salary structure and career opportunities of teachers, give them greater freedom to undertake consultancies and allocate funds for them to undertake research.

Apart from expanding public investment in higher education as envisaged in the XI Plan, having regard to the magnitude of new investment needs, it would be necessary to involve the private and corporate sector fully for expanding facilities for higher education. While giving freedom to the private sector institutions in respect of fees, it would be necessary to ensure that they provide scholarships and free-ships to an adequate number of meritorious students (and those from historically disadvantaged and vulnerable groups) who do not have the means to pay the fees. For this the present disability imposed by the UGC and the Regulations of the AICTE and other regulatory bodies on the eligibility of 'for-profit' entities to establish educational institutions must be removed.

Skill Development

For skill development, the Group has noted that shortages exist equally at the level of managers and supervisors and of skill categories. In some categories, the numbers being turned out by the institutions are extremely inadequate while in others the quality of trainees is poor and they need to undergo a 'finishing' process so that they become employable. The needs of each sub-sector are so diverse that a common template will be inappropriate. The Group has therefore recommended the establishment of the private sector led Development Councils for each sub-sector broadly on the model of the Construction Industry Development Council, which could be entrusted with the task of promoting the running of courses, training of trainers, setting up the curriculum and catalyzing the establishment of independent structures for performing regulatory functions such as testing, certification and accreditation.

Physical Infrastructure

The quality of physical infrastructure including power, telecommunications, road, rail, airports and ports are important for the efficiency of the services sector, although the inter se importance of individual element differs from sub-sector to sub-sector. Except in telecommunications, significant deficiencies in infrastructure erode the competitiveness of the services sector. Of particular importance to the services sector is the quality of urban infrastructure, including sewerage, drainage, water supply, solid waste management and urban transportation.

While two green field airports at Bangalore and Hyderabad are nearing completion there are serious shortcomings in their connectivity with the city. While constructing green field airports or modernizing existing airports attention needs to be given to put in place road and rail connectivity before the new or modernized facility becomes operational. It should not be that the benefit of modern facilities in the newly commissioned airports is nullified by the time taken to reach the city from the airport or vice versa. If the airport is at a distance from the city center it is important that the passengers have the option to travel by fast means such as express trains between the airport and city center.

Urban transportation infrastructure is equally important for enabling smooth movement within the city. All cities must have an integrated traffic and transportation plan, the implementation of which should be monitored by a Unified Metropolitan Transport Authority, as envisaged in the National Urban Transport Policy. In large cities a major requirement is provision of mass rapid transit systems, connecting various parts of the cities including the railway stations and airports. The competitiveness of the services sector is affected if too much time of the worker is taken in commuting between residence and the workplace. In view of the increasing congestion and rising costs in existing metros, it is necessary for the State Governments to promote new townships.

Chapter 2: IT and IT enabled (BPO) Services

Trade in Information Technology and Information Technology enabled services (IT and BPO services) has been the main driver of growth in India's trade in services in recent years. Exports have shown phenomenal growth from US \$ 2.7 billion to over US \$ 40 billion during this period. India's exports of IT and BPO services fall in three broad categories, IT services, BPO, and Software products and Product Engineering Services. India have become a leader in both the IT and BPO offshore segments accounting for an estimated 64 per cent of offshore IT spends and 41 per cent of offshore BPO spends in 2007.

India cannot aspire to become a knowledge society with a Gross Enrolment Ratio (GER) of 11 per cent against the world average of 23.2 per cent. It has become

imperative to consider ways of expanding the system for higher education. And one of the ways for doing this would be to eliminate the constraint of educational institutions being run only by not-for-profit organisations. The concern for social equity can be met by mandating full or part scholarship seats for meritorious students who do not have the means to pay the fees. The Group recommend that to begin with only technical education be opened up to for-profit enterprises. The private sector institutions should of course be subject to regulation, but only on matters related to curriculum and standards of staffing and physical infrastructure, not for fees and salaries.

Improvement of urban infrastructure is very important for ensuring the competitiveness of IT and BPO industry. Apart from development of urban basic infrastructure under Jawaharlal Nehru Urban Renewal Mission (JNURM), what would be equally important is the creation of additional commercial space for renting and a commensurate increase in residential accommodation, educational, healthcare, retail and recreation facilities. For this, it would be necessary for State Governments to facilitate the creation of new satellite townships. Some State Governments are already doing this by acquiring land and undertaking basic development for private developers to take up construction in allotted land. However, to augment the supply of residential and office space, additional townships could be developed by the private sector if the State Governments undertake to provide trunk level services.

The Group is of the view that a separate data protection law in conformity with EU Directives on data protection and EU Safe Harbour Decision is required. Without such a law the cost of Indian suppliers is raised because of the need to invest in additional processes and additionally they are exposed to the uncertainties of arbitration under contractual agreements.

The income tax exemptions for export profits of units in IT and BPO will end on 31st March 2009. The introduction of the income tax benefit under the SEZ Act has queered the pitch and if the concession is not extended for STPIs a non-level playing field would be created after March 31, 2009, between STPI units, which will not get income tax benefits and units within the SEZs, which will get such benefits. It is imperative for the Government to address this issue at the earliest.

A larger domestic base will undoubtedly enhance the competitiveness of Indian IT and BPO industry. While the demand from the private sector is growing, the Government can also contribute considerably by allocating resources to implement the NeGP.

The authentication of certificates of birth and educational qualification for the purposes of application for visa and work permits in European countries is time taking and imposes additional costs on the personnel and the IT and BPO companies. What is needed now is to put in place procedures for enabling speedy certification on behalf of the Government of India of documents produced by the IT and BPO personnel who intend to apply for visa and work permit in European countries.

Chapter 3: Tourism Services

Tourism is estimated to contribute 5.83 per cent to the GDP and 8.27 per cent to employment in the country; the employment generated by tourism is estimated at 51.1 million in 2006-07. In 2006, foreign tourist arrivals (business travellers, leisure travellers and persons of Indian origin holding foreign passports) had increased to 4.42 million, while the number of domestic tourists as reported by the Ministry of Tourism was 462 million. However, the Revealed Comparative Advantage (RCA) of India in travel services has been on the decline.

It is estimated that the shortfall in tourist accommodation in the country will be 1,50,000 rooms by 2010 of which more than 1,00,000 will be in the budget category. The main reason for the shortage of hotels is the short supply of land suitable for construction hotels, particularly budget hotels. Also, land prices have shot up to astronomical levels and in many cities. In view of this the Group recommends the following measures to be taken by the Central/ State Governments or authorities under them could alleviate the difficulties in this regard:

- Land use conversions may be allowed liberally from agricultural and institutional use, and even from residential use to hotel use within city limits or in their close proximity.

- A higher Floor Area Ratio (FAR) may be allowed for hotels in places where there is no congestion, in conjunction with strict rules on underground parking.
- Land may be given on long-term lease or on a revenue sharing basis instead of being auctioned by a Government land owning agency.
- Railways may make available lands for development of budget hotels by competitive bidding, on PPP basis. A modicum of freedom in taking commercial decisions will have to be given to the private sector partner although these will have to be subject to reasonable regulation.
- Additional land is likely to be made available for hotel construction in the course of city side development in many of the 48 non-metro airports and 2 metro airports being developed by the Airports Authority of India and the 2 metro airports being constructed on PPP basis by the private sector. Other ideas to augment the supply of land for hotel construction include earmarking of the surplus lands within cantonment areas. In the scenario of acute shortage of urban land Cantonments could consider releasing some areas by construction of multi-storied residential and office buildings.
- Many State Government Corporations have hotels and hotel-like properties. These are in most cases being run at sub optimum levels and in many cases at a loss. The availability of rooms can be enhanced and the quality of service upgraded if long-term leases are given to professional private sector hoteliers on the basis of international competitive bidding.

Apart from increasing the supply of land for the construction of hotels, some aspects of State taxation practices that impact on hotels also deserve attention. State Governments levy Luxury Tax on hotel rooms ranging from 5 to 20 percent. A bigger problem is that in some States the charges are levied on the basis of the rack rates or the published rates, and no allowance made if variations occur in the rate charged. Charging of taxes on the basis of published rates causes great annoyance to both domestic and foreign clients and undermines the competitiveness of the Indian tourism.

One of the best ways of improving the competitiveness of Indian tourism is to moderate the taxes on Aviation Turbine Fuel (ATF). Two solutions could be considered: either the Centre brings ATF within the definition of Declared Goods, reducing the

incidence of duty to 4 per cent, or the States are persuaded to adopt the standard VAT rate of 12.5 per cent.

In order to save the tourist vehicle operators and the tourists from harassment, the Group recommends that the tourist buses may be given a distinct number plate by an amendment in the Motor Vehicles Act. Taxes should be chargeable on a quarterly or six-monthly basis and it should be made possible for the buses to enter a State just by swiping a smart card showing that taxes have been paid. In order to make this workable, swiping facilities should be provided at all points on inter state borders. The Group is also of the view that is strong case for abolishing per seat passenger tax on the same logic as most States have abolished octroi.

A monitoring system should be created to ensure that the roads leading to important tourist destinations are kept in good condition. For this purpose associations of tourist bus operators could be asked to post information on the website of the Ministry of Tourism about any deterioration in the condition of National Highways of tourist interest and on the websites of the State Departments of Tourism about the State Highways. On the basis of information received on the website the Ministry of Tourism for National Highways and the State Tourism Department for State Highways should take up the question of repairs and maintenance or even upgradation of the roads with the agencies/authorities concerned (NHAI or State PWD).

The Group believes that in order to conserve the monuments and maintain their environs in top condition and undertake restoration work from time to time, the annual allocations from the Budget need to be increased very substantially by the Centre and the States. If this is not feasible, the Group would suggest that the ASI and the counterpart State bodies should retain the exclusive right to maintain only for the World Heritage Sites and other important monuments and sites for which the funds made available annually are adequate.

For the conservation of the remaining monuments and archaeological sites and development and maintenance of their environs, an appropriate partnership arrangement should be considered with the private sector. Other alternatives could also be considered such as tripartite agreements involving apex chambers of trade and industry (CII, FICCI,

ASSOCHAM and PHD chamber) along with selected private sector enterprises and the ASI. It is imperative to redeem the lesser-known protected monuments, including many in the Delhi area, which are lying in a derelict state at present all over the country.

Several cities with tourist interest have been included in the 63 cities identified as mission cities under the Jawaharlal Nehru Urban Renewal Mission (JNNURM), but the priority in the Mission is for schemes for water supply, sewerage, drainage and solid waste management. In order to improve the competitiveness of heritage tourism in India the Group recommends that funds should be earmarked from the provisions for JNNURM for the beautification of the urban surroundings of the heritage sites in these cities.

States such as Kerala has enacted Kerala Tourism (Conservation and Preservation of Areas) Act, 2005, which provides for the declaration by the State Government of any area, which has or is likely to have importance from the point of view of tourism, as 'Special Tourism Zone' for the conservation, preservation and integrated development of such an area. The Group was of the view that other State Governments with tourism activity should consider enacting a similar law so that planned development of tourist areas at the initiative of State Tourism Departments could be undertaken with the participation of local authorities.

Beaches are one of the most important destinations for the affluent tourists from the Northern hemisphere. One factor, which affects the competitiveness of beach tourism in India, is the stringent coastal regulations zone requirements (CRZ), under which a hotel cannot be built within 200 metres of the coast. To improve India's competitiveness in beach tourism the Group recommends that a decision be taken quickly on hotel construction on beaches according to the prevailing practice in other countries.

Meetings, incentives, conferences and exhibitions (MICE) is another area of tourism in which India lacks in competitiveness. What needs to be done is to facilitate the establishment of four or five large convention centres in the country. In order to have more convention centres it would be necessary for the States to facilitate the allocation of land and for the Central Government to give such centres infrastructure status under Section 80- 1A of the Income Tax Act, so that they can have tax benefits.

The foreign tourists as well as domestic leisure travellers want some form of entertainment, particularly in the evening. For this purpose consideration needs to be given to allowing casinos to operate in certain locations. It is necessary to hold shows such as sound and light shows at a larger number of major historical sites and substantially improve their quality.

The rapid increase in disposable income in the upper middle class in India presents a big opportunity for development of tourism in the country. The Group recommends the creation of tourism clusters of areas between 100 and 500 acres within a distance of 150 kms for the cities for the setting up of a cluster of facilities and attractions for tourism. The entire development, including the acquisition of land, will have to be undertaken by the private sector, but as an incentive they will need to be given infrastructure status under Section 80- 1A of the Income Tax Act.

The Group believes that expansion of education and training in hotel management, food crafts, travel and tourism education (including the training of tour guides) should be left to the private sector and the Central Government should devote its attention primarily to regulation. For this purpose, both the National Council of Hotel Management & Catering Technology (NCHMCT) and the Indian Institute of Travel & Tourism Management (IITM) should function as apex institutions and should be vested with powers to regulate affiliated institutions, hold examinations and grant degrees and diplomas, independent of the AICTE. It may be necessary for Central Government to consider giving statutory status to the NCHMCT and IITM as regulatory organizations. The existing IHMs and FCIs should function as institutes of excellence and devote a substantial part of their resources for training of teachers.

Since IHMs can be run on a self-sustaining basis, the only help that privately run IHMs may need is allocation of land at reasonable cost or on long term lease by the State Governments. The requirement of hospitality personnel in the skilled categories is however very large and much wider initiative for undertaking vocational training programmes is required than is being envisaged at present. For taking such initiative, the establishment of a Development Council with the full participation of the industry, would appear to be the right step.

Chapter 4: Shipping Services

India is not a large shipping nation in terms of its merchant fleet and at the beginning of 2006 it was ranked 20th in terms of its fleet size in gross tonnage (gt) by flag of registration, constituting 1.16 per cent of the world fleet size. The Indian shipping fleet's share in the carriage of India's own overseas trade has in fact been slipping over the years. In transportation services also India's RCA Index has been on the decline. However, it is not that Indian shipping is inherently incompetent but that it does not have enough capacity to carry more of Indian cargo.

Foreign ship owners would normally be inclined to obtain the services such as P&I insurance, brokerage/commission, banking etc from Foreign Service suppliers and pay no service tax as these taxes are either exempt or zero rated. On the other hand the Indian ship owners would have to pay service tax on all these services supplied by foreign and domestic service suppliers. In order to even out the differential incidence of service tax on Indian and foreign ship owners it is necessary to take the following measures:

- (i) Shipping companies should be exempted from service tax on all services provided from outside India, whether received in India or outside.
- (ii) Shipping companies should be exempted from service tax on all services provided within India in respect of services in which they have the option to employ service suppliers from abroad or from India such as P&I, ship management fees, repair and maintenance, commission and brokerage, and manpower recruitment. This will have the effect also of encouraging the shipping companies to obtain the services from Indian suppliers.

In India profit on sale of vessels is not covered under the tonnage tax regime. The company availing of the tonnage tax regime is liable to pay MAT. The Group was shown extracts from the relevant laws prevailing in the United Kingdom, Singapore, Ireland, Netherlands, Germany, Spain and Belgium, all of which showed that the profit on sale of vessels is covered within the scope of tonnage tax regime. In light of the practice in these

important shipping nations it would be necessary to provide in our tax laws also that the surplus resulting from sale of vessels is covered within the scope of tonnage tax regime.

The Indian tonnage tax regime requires the creation on a compulsory basis of a special reserve to be utilised for acquisition of tonnage within a period of eight years. While waiting for the accumulation of sufficient reserves and the opportune time for acquisition of tonnage the amounts in the reserve earn interest, which is liable to income tax at present. In Double Taxation Agreements with a number of countries, viz., Belgium, China, Denmark, Germany, Netherlands, Mauritius, South Africa, Sri Lanka and the USA, interest on funds has been treated as income arising from shipping operations. Consistency of approach in our tax laws would also require the interest income to be treated as income from shipping operations and brought within the purview of the tonnage tax regime. There is therefore a case for the interest earned from special reserves to be treated as income from core activities and covered within the scope of the tonnage tax regime.

The Group was of the view that Indian shipping companies were being put to a serious disadvantage by the way the Indian income tax laws were being applied to Indian seafarers working on Indian flag vessels and an appropriate solution had to be found to provide a level playing field to Indian flag ships on taxation of Indian seafarers.

The withdrawal of exemption from withholding tax on remittances of interest on ECBs taken on or after 1-6-2001, has adversely affected the Indian shipping industry. Presently, the interest paid by Indian shipping companies to foreign lenders on acquisition of ships is subject to withholding tax at the rate of 20 per cent which may be reduced to 10-15 per cent as provided in the respective DTAAs. The Group was of the view that in order to provide a level playing field on taxation matters, the exemption from withholding tax on interest paid to foreign lenders under Sec. 10(15)(IV) C of the Income Tax Act 1961 should be restored for Indian shipping companies.

In India payment towards in-chartering of foreign flag ships is being treated as use of 'equipment' under Section 9(1) (VI) the Income Tax Act making the charter hire charges taxable as a royalty and withholding tax is payable @10 per cent. The Group was of the view that both from the point of view of consistent interpretation of law and

providing ships with Indian flag with a level playing field on taxation matters no withholding tax should be levied on in-chartering of foreign ships.

For implementing the policy of cargo support to Indian ships, the Central Government established TRANSCART as the chartering wing of the Ministry of Shipping in 1958 to centralise the shipping arrangement for all Government and canalised cargo and the wing is still in existence. The Group considered the continuation of the policy of cargo support to flag ships through TRANSCART in future and came to the conclusion that since the competitiveness of Indian ships was diminished by the tax handicaps and since the growth of Indian shipping needs to be encouraged, the cargo support policy needed to be continued. The policy could be revisited after progress has been achieved in eliminating the tax handicaps of Indian shipping.

In the evolving context of India's growing energy demand and consequent dependence on global energy markets, the Group also considered the urgent need to own and develop a national "core" fleet in the energy sector. It is felt that this core fleet of strategic marine assets, similar in concept to the United States "Sea-lift Command", can be used in case of national emergency and/or war to ensure energy security, by means of un-interrupted transport and service of essential commodities such as crude oil, petroleum products, gas, coal and offshore oil fields.

Coastal traffic has a share of more than 25 per cent in the traffic of major ports. It is expected to grow from a level of about 110 MMT in 2004-05 to 220 MMT by the end of the XI Plan period (2011-12). As mentioned earlier the policy on cabotage was a subset of the policy of cargo reservation whereby foreign flag ships were not to be permitted to carry coastal cargo. The Group considered the cabotage policies pursued by advanced maritime nations and noted that the US and Chinese cabotage laws are quite restrictive in the world. The Group took the view that the policy on cabotage needed to be continued. The brand value of the national flag can be maintained only through such policies like first right of refusal and cabotage.

Chapter 5: Healthcare Services

Public institutions played a dominant role in the Indian Healthcare sector in the past, in the urban as well as in the rural areas. However, the public healthcare has been on a serious decline during the last two or three decades because of non-availability of medical and paramedical staff, diagnostic services and medicines. Consequently there has been a pronounced decline in the percentage of cases of hospitalized treatment in Government hospitals and a corresponding increase in the percentage treated in private hospitals, despite higher costs in the private sector.

The Group is of the view that it is imperative for the health and safety of the population to enforce minimum standards on clinical establishments in both the private and public sectors by laying down minimum standards and enforcing them rigorously. The Clinical Establishments (Registration and Regulation) Bill, 2007 having been introduced in the Parliament it would be important to ensure that it becomes law at the earliest and that it enters into force for all the States. The next step would be for the proposed National Committee to set appropriate standards for all categories of clinical establishments.

Implementation of the minimum standards will only be the initial step for improving the quality of healthcare institutions in the country. The next step for improving their quality should be for all stakeholders to advocate that these institutions take advantage of the accreditation system already established in the country. It would be important for the Central and State Governments to take steps to enable the clinical establishments in the public sector also to avail of the accreditation system.

National Commission for Enterprises in the Unorganised Sector (NCEUS) proposed health insurance scheme for BPL families to cover the entire BPL population of 30 crore (5 crore families) in five years time. The High Level Group recommended that the Health Insurance Programme for BPL categories be implemented at the earliest.

The overriding requirement in the country is for increasing the supply of human resources at all levels, from specialists to paramedical personnel and to improve their quality. The Group is of the view that the only way to accomplish this is for the medical education sector to be opened up completely for private sector participation and companies to be allowed to establish medical and dental colleges just as they have been

allowed to open nursing colleges. Other entry barriers such as the requirement of land and built up space need also to be lowered to realistic levels in order to facilitate the opening up of new colleges. Government's role should be limited to opening a few high quality institutions dedicated to research.

In order to improve the quality of education in Government medical colleges it is necessary to give incentive to the teaching faculty. Wherever possible they should be allowed to undertake private practice and in other cases granted handsome non-practicing allowance.

The establishment of the regulatory Paramedical Council is crucial for expansion of training facilities and for improvement of the training programme in respect of paramedical personnel and the High Level Group expressed the hope that the law will be enacted shortly. In addition Government should encourage private players, including large hospitals and hospital chains, to undertake training programmes under the regulatory control of the Paramedics Council. A development council for taking wider initiatives for the training of paramedical personnel could also be considered.

The High Level Group is of the view that the qualifications of doctors and radiologists who have been trained in the UK or other foreign countries should be recognized by the Indian Medical Council on an exceptional basis in order to increase the pool of quality medical personnel available to the Indian service providers and increase their competitiveness in providing service for medical value travel, telemedicine as well as clinical research.

The Group considers the shortage of trained personnel to be the biggest challenge for improving the country's competitiveness in the field of clinical research. The Group recommends the establishment of a Clinical and Medical Research Council with the participation of the private sector for formulating, promoting and running training programmes for the area.

The Drugs Controllers office needs to be suitably strengthened and manned with personnel (including guest personnel from abroad) who are equipped with knowledge of the latest advances in medical research. A world class testing laboratory should be set up

in the country in the PPP mode, where the Central Governments gives assistance for construction of building and purchase of equipment but the management is undertaken by the private sector. Arrangement needs to be made for accreditation of CROs for the purpose of certifying their adherence to Guidelines for Good Clinical Practices.

Chapter 6: Financial Services

The importance of the financial sub-sector goes beyond the output and employment it directly generates, given its critical role in enabling broader economic activity, whether in industry, agriculture or other services. The financial sub-sector provides products for mobilizing household and corporate savings, credit for producing and consuming goods and creating long-term assets, transaction banking for facilitating economic activity and insurance for risk mitigation, long-term savings and social security. This report seeks to recommend the key measures that taken together would help in meeting the objectives of achieving greater financial inclusion, serving emerging customer needs and enhancing global competitiveness.

Banking

The banking sector reforms were carried out during the 1990s based on the recommendations of the Narasimham Committees in 1992 and 1998. Certain key recommendations continue to remain substantially unimplemented.

- (i) There is a strong case for gradual reduction in SLR in line with other markets. Similarly, CRR which has been increased several times recently as a monetary measure, may be aligned over time with an appropriate globally benchmarked level.
- (ii) It is observed that the directed agricultural lending targets have not had the desired impact in terms of financial inclusion; banks have often mis-priced credit to achieve the volume targets and have suffered high credit losses. It would therefore be appropriate to move from a mandated directed lending target to a market-based approach, where banks develop sustainable models to engage a wider set of customers in the economic mainstream.
- (iii) There has been limited progress in consolidation in the Indian banking system. The issue of consolidation is particularly relevant for the mid-sized public sector

banks that are currently duplicating investments in technology and other infrastructure, and not benefiting from economies of scale. There is an urgent need to catalyse consolidation among these players, and leverage the synergistic benefits.

- (iv) The branch licensing requirement emanates from statute, as well as from regulatory objectives. The statutory requirement can be eliminated by amendment to the statute, or an exemption from the licensing requirement under extant provisions. In any event, banks may be required to have a minimum proportion of branches in rural/ semi-urban or under-banked areas, as required by the existing banking license conditions for the new generation private sector banks.
- (v) Banks majority owned by the government continue to account for about 70.0 per cent of the Indian banking system. The Narasimham Committee had recommended that the minimum government ownership in these banks be reduced to 33 per cent, and the banks should become board-managed companies. Firstly, the oversight of public sector banks by the Central Vigilance Commission (CVC) may be reviewed. The existence of CVC oversight creates a culture of avoidance and delay in decision-making that seriously damages the banks' competitive positioning. Secondly, individual banks should be given the freedom to determine their recruitment, placement, promotion, performance evaluation and compensation policies, including performance bonuses and stock options. These are essential tools in attracting, retaining and leveraging human capital, which is a key competitive differentiator. Thirdly, the selection of non-executive board members, the CEO and other executive board members should be determined by the board of directors of each bank.

Insurance

The insurance sector in India has witnessed rapid development since its liberalization in 2000. The key recommendations for reform in the insurance sector are:

- (i) In order to encourage market players to develop products that meet customers' needs, all insurance products should be de-tariffed subject to appropriate regulatory oversight.
- (ii) The higher capital requirement restricts growth and increases the cost of insurance for the policy holders after considering the minimum return on capital required by shareholders. It is therefore recommended that the capital

requirement of insurance companies be set at 100 per cent of the solvency margin requirement. Given the high growth scenario, scarcity of equity capital and higher return expectations of equity investors, alternative forms of capital, such as preference shares, subordinated debt and hybrid instruments that have fixed cost as well as some risk/ loss absorption characteristics, may be evaluated and permitted as capital. Insurance in India is in a high growth phase with substantial investment requirements over a number of years before the new insurance companies achieve stable profitability. In this scenario, permitting foreign investors to own a larger share may be considered.

- (iii) A separate exemption limit is recommended for long-term life insurance and pension/ annuity products. A similar provision may be considered for investment in dedicated close-ended infrastructure mutual funds and long-term bank deposits. Life insurance companies are required to pay service tax on the auxiliary services provided by insurance agents, even if the taxable service value is lower than the threshold limit. This may be rectified by giving the benefit of the threshold irrespective of the actual tax paying entity.
- (iv) The investment regulations may be reviewed on an ongoing basis to enhance the ability of insurance companies to invest in emerging instruments and derivative products, to optimally manage their portfolios.
- (v) In order to ensure efficient utilization of capital on a system-wide basis, general insurance companies may be permitted to take on risks originated by other players. As recommended for other insurance companies, FDI restrictions on re-insurance companies should be removed.
- (vi) The insurance sector is governed by several statutes and regulations issued thereunder. There is a need for a simple unified legislation that sets out the key principles and statutory provisions, with several aspects currently defined by statute being moved into regulations.
- (vii) In keeping with greater liberalization, increased disclosure norms to report both gross and net level incomes, liabilities and reserves would be needed.
- (viii) The insurance and asset management sectors have substantial overlap in terms of the products offered, such as in the area of unit linked insurance plans vis-à-vis mutual funds. It is recommended that the regulatory and other treatment of similar products offered by different segments of the financial sector may be reviewed to ensure appropriate alignment.

- (ix) There is a need to develop disaster insurance by mandating it in certain zones prone to frequent losses, setting up insurance pools, and providing tax concessions for reserves set apart by corporates and insurance companies for meeting losses associated with natural disasters.
- (x) In order to increase penetration of health and other personal non-life insurance products, especially in rural areas, premia associated with these insurance products may be made eligible for tax exemptions.
- (xi) Given the importance of risk mitigation in agriculture, and the need to promote private investment in this high risk and long gestation business, it is recommended that an appropriate policy framework, including consideration of fiscal incentives, be developed to promote commercially sustainable development of agricultural insurance.

Asset Management

While mutual funds in India have grown rapidly, they continue to face two key challenges, namely, short-term investment horizon and secondly, relatively low retail participation with a large part of mutual fund corpus comprising deployment of corporate surpluses. Therefore, there is a need for a focused ongoing investor education campaign encouraging retail investors to participate in the capital markets through the mutual fund route, as also about the merits of allocation of a portion of their savings to long-term equity investments.

The VCPE investor pool in India comprises primarily foreign investors, and Indian investors are largely excluded from the benefits of this asset class. While foreign investors investing into India need not pay tax on gains from their investments due to the benefit of double taxation treaties, Indian investors in VCPE funds are taxed; through recent amendments to the tax laws, trusts used to pool VCPE monies for investment have been denied tax pass through status unless the investments are made in a few specified sectors. These factors place VCPE funds at a disadvantage to mutual funds, both in terms of access to investors as well as tax treatment. The relevant provisions of tax laws may be reviewed given the critical role played by VCPE funds in providing longer-term capital for growth and restructuring of enterprises.

Pension Reforms

Along with Public sector entities, an appropriate level playing field for Private sector banks and insurance companies is recommended for managing the pension funds. Further, the new pension scheme should be extended expeditiously to unorganized sector employees. Finally, all categories of pension and provident funds should be permitted to diversify their investment portfolios, shifting from the current excessive share of government securities to various categories of corporate debt, securitized paper, and an appropriate proportion of equity investments. Alternate asset classes may also be considered in due course.

Financial Markets

The number of participants in the capital markets, whether directly or through the mutual fund route, is still small relative to the earning population of the country. An active and coordinated programme of investor education and spreading financial literacy is recommended. Some of the steps that can be undertaken to start the programme could be:

- using the unclaimed dividends and redemption amounts of mutual funds for the investor education campaign, amending the SEBI Act to provide that all fines and penalties levied by SEBI remain with SEBI for investor education, mutual fund industry setting apart a portion of their asset management fee annually for the campaign, mutual fund distributors contributing a certain percentage of their commission income and the Ministry of Finance making a budgetary provision for investor awareness and placing the funds at the disposal of SEBI.

The bond market in India remains limited whether in terms of instrument types and maturities, issuer diversity, investor participation and liquidity. The key recommendations of committee chaired by Dr. R. H. Patil, 2006 such as rationalization and uniformity in stamp duties levied by various states on debt instruments, freedom to banks to issue bonds of various maturities including long-term bonds to finance long-term assets, market making in corporate bonds etc. still remain largely unimplemented.

It is recommended that the securitization market be developed through affordable and uniform rates and levels of stamp duty, listing of securitization paper and pass through tax treatment to securitization SPVs similar to mutual funds. Further,

securitization SPVs should also be permitted to act as counterparties in derivative transactions.

The currency and interest rate derivative market is, along with a deep and liquid bond market, the key “missing market” in India. Besides, there are no exchange traded derivatives (ETDs). In view of this, it is recommended that steps should be taken for trading of vanilla derivative products on existing exchanges, to enhance the liquidity and depth of the derivative market, while structured and exotic products may continue to be transacted on an OTC basis. Banks and other market participants should be permitted to trade in interest rate futures to impart liquidity to the market.

Currently, banks are not permitted to participate in equity derivatives. This may be considered as it would permit banks to better manage risks in their equity portfolios and would also enhance market liquidity. Similarly, banks are not permitted to participate in the commodity derivatives market. This is essential to bring depth and liquidity to the commodity derivatives market.

Payment systems

A safe, secure and efficient nationwide payment system is an important prerequisite for the smooth functioning of a financial system, as well as for providing the base infrastructure necessary for financial inclusion. There is a need to increase the number of clearing houses and more importantly, convert the existing non-MICR clearing houses to MICR clearing houses. MICR code should be made mandatory for each bank branch in India, with the code being allocated centrally to avoid duplication. This would facilitate cheque clearing.

Clearing house automation is being sought to be achieved through the cheque truncation project. Rather than focus on improvement of processing of paper-based payment, the emphasis should be on moving payments to electronic modes directly.

Electronic Clearing System (ECS) should be made available out of more locations, than it is currently available. Further, there is a need for a centralized application for management of ECS. National Electronic Fund Transfer (NEFT) and Real Time Gross Settlement (RTGS) should be expanded by substantially increasing the number of bank branches that are able to process inward transactions and initiate outward

transactions. Customers should be encouraged to use these through an education process as well as by rationalizing charges. An option of pull-based RTGS transaction should be developed where a bank can pull money from another bank on the basis of certain pre-approved arrangements. Further, rationalization of these three payment systems into two systems – one each for large and small value payments – should be considered.

Looking ahead, card-based solutions are likely to emerge as the key mechanism for delivering financial services to the unbanked. There is therefore a need to create a national payments system with participation by all banks, reduce transaction costs and substantially increase the deployment for POS terminals and their utilization for both high and small value payments. Mobile phone may be used as a device to transfer funds and make payments from a bank account using appropriate authentication protocols.

Financial inclusion

The Group recommends the following measures to facilitate the growth of micro finance institutions:

(i) measures to promote transparency in microfinance operations such as annual registration, rate monitoring and quarterly rate disclosures, and random audits; (ii) refraining from interest rate caps in microfinance, which have sometimes been imposed at the state level; (iii) measures to facilitate the development of non-credit services – savings, insurance, pensions etc. through regulatory support for pilots and hybrid models; (iv) a strong focus on urban microfinance to provide services to growing numbers of urban poor; and (v) incentives that allow non-traditional players with strong rural presence and distribution networks to explore options to provide financial services.

The poor financial health of rural financial institutions primarily entrusted with providing credit to the priority sector is testament to the fact that these guidelines need to be seriously reconsidered if they are to meet their originally envisaged goals. The key challenge faced by financial services providers relates to the cost of doing business and enabling credit, recovery and distribution infrastructure. Suggested measures could include allowing banks to self-set inclusive financial service targets, developing enabling infrastructure such as low-cost payment systems and credit bureaus, making priority sector lending obligations tradable, and using well targeted subsidies for specific areas where standalone operations would not be viable, but which are priorities from a policy perspective.

There is a need to generate demand for financial services by improving the infrastructure for rural lending in partnership with the private sector wherever feasible.

Creation of International Financial Centre

The Group broadly endorses the findings of the High Powered Expert Committee (HPEC) on making Mumbai an international financial centre and recommends that the policy measures highlighted in that report be implemented.

A new approach to the financial sector

There are restrictions on undertaking complementary activities and on sharing information and infrastructure. In the context of the evolution of the financial sector, there is a need to examine whether this is the optimal structure for the future growth of the sector. Going forward, it would be appropriate to consider a holistic rather than a segmented approach towards the financial sector. This would involve the following key steps:

- (i) Enabling the formation of financial services holding companies;
- (ii) Elimination of anomalous differences in the ownership regulations for various segments of the financial sector, with a bias towards freeing up ownership restrictions to the greatest possible extent;
- (iii) Sharing of distribution and “back-end” infrastructure, including a review of the current prohibition against assigning asset management activity by insurers to asset managers, among financial service providers; and
- (iv) Move towards a single regulator for financial services, as opposed to the current multiplicity of regulators for different segments.

There is a need now for rapidly embracing innovation in order to meet the needs of various customer segments and achieving global competitiveness. There is therefore a need to consider a shift from a “rules-based” regulatory framework that is prescriptive and focused on controlling the financial sector, to a “principles-based” approach that encourages innovation and growth, within an overall framework of financial stability.

Development of human capital and skills

The growth of the Indian financial services sector will be hampered by shortage of qualified people, unless we invest in educating and training professionals. There is a

need to continuously plan ahead by revamping curricula, improving service delivery especially in the rural areas and expanding teaching facilities through use of technology. There is a need for vocational training to equip those with high school and graduate level qualifications with skills required for financial sector jobs.

Chapter 7: Retail Trading Services

Retailing in India is largely unorganized, dominated by the kirana shops or groceries in every locality, supplemented by paan & beedi shops, handcart or head load hawkers and pavement vendors. However, recent years have witnessed considerable activity by the organized sector and several corporate-backed retail chains have come to the fore and are opening large number of stores all over the country. What has helped this trend is the rapid growth of the upper middle class, with increasing disposable incomes, and working couples, who have less time for daily shopping of groceries. Even so, organized retail is in its infancy in India and its share in 2006 is estimated to be only 4 per cent of the retail sales in the country.

Retail trade is heavily dependent on logistics and increases in logistical cost impair the efficiency of retail trade. It is estimated that in 2005-06 the total logistic cost on India was close to 15 per cent of the GDP. The Group would make the following specific recommendations to cut down the logistic cost incurred by retail trade and also by the manufacturing sector:

- (i) For the smooth flow of goods moving particularly by road transport, integrated logistics hubs should be identified in consultation with industry associations and developed on PPP basis across the country; and
- (ii) The Administrations of one million plus cities should develop Transport Nagars outside the municipal areas for smooth flow of vehicles containing both incoming and outgoing supplies.

The Group considered that the method of valuation of the service of the service provider unfairly increased the burden of taxation on the retail industry. The Group recommend that the service tax in these cases should be limited to the fee element and should not be levied on the gross amount including the salary.

Ministry of Food Processing Industries plans to implement the Mega Food Park Scheme, which aims to provide a mechanism to bring together farmers, processors and retailers and link agricultural production to the market so as to maximize value addition, minimize wastage, increase farmers' income and create employment opportunities in the rural sector. The Group supports the speedy implementation of the Mega Food Parks Programme.

The Group recommends that the States should move forward to frame rules and regulations under the Agricultural Produce Marketing Committee (APMC) Act to provide for quick remedy against contract violations and speedy settlement of disputes as this will stimulate resort to contract farming. Widespread use of contract farming will be a boon to the farmers and will also improve the efficiency of retail chain operations.

The retail trade industry has to secure a total of 45 licenses, clearances, registration certificates or notification requirements for each outlet. The Group did not consider single window licensing retail outlets practicable. However, the Group is of the view that authorities should grant clearance/license/certificate to all the outlets of a retail chain that lie within their jurisdiction in one transaction, instead of requiring separate processing for each outlet.

One of the most important State level Acts governing retail trade is the Shops & Establishment Act. In many States, the Acts in force today were enacted over 50 years ago and is outdated and the Group recommends that the Government of India should set up a Committee consisting of representatives of Government, Trade Associations and the Unions to review the provisions and propose changes that take into account today's realities in terms of workplace practices, use of technology etc.

The practice at present is that the inspecting authorities hold the retailers also liable for any violations in compliance with the standards of Weights and Measures Act. The Act needs to be amended to make only the manufacturers and packers responsible for non-compliance and not the retailers.

The Group suggests that the Government should set up a Committee to evaluate the performance of the ESI scheme and make suggestions for its performance. Since now

a number of health insurance companies have come up in the private sector, employers/employees should be given the option of subscribing to alternative health insurance programmes.

The Essential Commodities Act, 1955, provides for the control of production, supply and distribution of essential commodities. Powers to issue control orders under this Act have been delegated by the Central Government to the State Governments vide orders dated 25th October, 1972, 13th March, 1973 and 9th June, 1978. The Ministry of Consumer Affairs, Food and Public Distribution issued an order dated 15.02.2002 removing the said restrictions with reference to the specified essential commodities. In August 2006 the Central Government issued an order whereby controls were reintroduced temporarily for a period of six months in respect of wheat and pulses. This order has been extended periodically and is at present valid until 30th August 2008. The High Level Group is of the view that the reimposition of controls on these products has not had any favourable effect on the price or availability of these commodities and has only added to costs of dealing with them at the retail level. The Group therefore recommends that the especial dispensation in respect of wheat and pulses should be allowed to lapse with effect from 31st August 2008.

It has been noted above that nagging doubts remain with respect to the effect of organized retail on the self-employed small retailers. One way of taking care of this concern is for the large retailers to share the benefit of supply chains in these products by selling goods in bulk packages for the benefit of small retailers.

Chapter 1

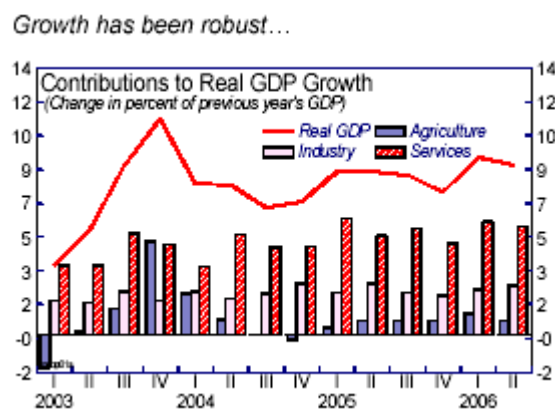
Services Competitiveness Report

1.1 Overview of India's Services Economy

Services Sector in Indian Economy

The services sector has been the key driver of growth of the Indian economy in the past decade, during which India has ranked among ten fastest growing economies in the world, with average economic growth at over 7 per cent a year, and over 8.5 per cent in the last four years (See Figure 1). During the 1990s, India's services sector grew at an average annual rate of 9 per cent, well ahead of the growth rate of industry at 5.8 per cent per annum and that of agriculture at 3.1 per cent per annum. Services contributed approximately 68.6 per cent of the overall average GDP growth (Service Value Added) in the past 5 years between 2002-03 and 2006-07. In 2006-07, growing at 11.2 per cent year on year, services (excluding construction) constituted 54.9 per cent of Indian GDP (with the Indian GDP growing at 9.2 per cent to Rs. 28,48,157 crores, at 1999-2000 prices).¹

Figure 1



Source: IMF Country Report, February 2007

¹ Calculated from Central Statistical Organisation estimates of GDP (at factor cost) data at 1999-2000 prices for the services categories excluding construction; http://mospi.nic.in/pressnote_31may07.htm

Sub-sectoral composition of Indian Services Sector

Although the growth of the Indian services sector has been broad-based as shown in Tables 1a & 1b, certain infrastructure services such as communications (of which telecommunication services is the principal constituent) and insurance & banking have grown more rapidly, underpinning growth of the services sector as a whole. Data from National Accounts Statistics for the period 1981-82 to 2006-07 show that the share of communications sub-sector increased from 1.8 per cent to 7.5 per cent, while banking and insurance sub-sectors increased their share from 6.5 to 11.3 per cent. During this period, the shares of all other services sub-sectors either declined or at best remained same (details in Tables 1a and 1b below). In the National Accounts Computer related services (IT and IT enabled services) as well as Other Business Services comprising legal services, accounting, research & development, engineering services, market research services and the like fall under Real Estate, the share of which has been falling since 1991-92. Details given in the National Accounts show that under this heading only computer related services have increased substantially over the past five or six years. Inexplicably these data do not reflect any dynamism in respect of Other Business Services, although India's exports have been growing rapidly.

Table 1a: Share of Different Sub-sectors within Services

(at 1999-2000 prices)

	1981-82	1986-87	1991-92	1996-97	2001-02	2006-07
Trade	28.3	27.0	25.1	27.3	26.6	26.7
Hotels & Restaurant	2.0	2.0	2.0	2.4	2.6	2.5
Railways	4.4	4.0	3.5	2.7	2.3	2.2
Other Transport	9.5	9.4	9.5	10.0	9.2	10.1
Storage	0.4	0.3	0.3	0.2	0.2	0.1
Communications	1.8	1.7	1.7	2.3	4.3	7.5
Banking & Insurance	6.5	8.1	10.2	10.7	11.2	11.3
Real Estate	13.8	14.8	16.0	15.1	14.7	14.1
Public Administration	14.7	15.3	14.5	12.4	12.8	10.6
Other Services	18.8	17.5	17.1	16.8	16.2	14.9
Total	100	100	100	100	100	100

Source: National Accounts Statistics

Table 1b: Growth Rate within the Services Sector

	Sixth Plan	Seventh Plan	Eighth Plan	Ninth Plan	Tenth Plan
Trade	5.3	6.5	9.1	7.3	9.3
Hotels & Restaurant	5.4	6.9	11.2	9.3	9.0
Railways	2.8	5.7	1.9	4.7	7.7
Other Transport	6.9	7.0	8.4	6.0	11.4
Storage	3.5	1.8	2.4	2.2	5.6
Communications	6.7	5.3	14.1	21.8	22.1
Banking & Insurance	7.5	13.4	8.2	9.0	9.3
Real Estate	7.3	8.1	6.1	7.2	8.3
Pub. Ad.	6.1	7.9	3.9	8.5	5.2
Other services	3.9	6.0	7.0	7.0	7.6

Source: National Accounts Statistics

Employment in Services Sector

At present services account for about 26 per cent of total organized sector employment in the country while contributing a little over 55 per cent to the national GDP. A sectoral disaggregation of the employed workforce shows that the contribution to employment of services (excluding construction) rose from 22.8 to 23.4 per cent, while the workforce increased from 397.0 to 457.8 million between 1999-2000 and 2004-05 (details in Table 1c below). Out of the increase in workforce by 60.8 million, the incremental share of services was 16.8 million. However, despite the low overall elasticity of employment in the country (at just 0.48) and not only in the services sector, the latest NSSO data shows that employment elasticity is reasonably high (and increasing) in certain services categories, with financing, insurance, real estate and business services registering an elasticity of employment of 0.94 followed by construction sector employment elasticity at 0.88.

Table 1c: Employment Statistics (disaggregated)

	Sectoral Share (million) 1999-2000	Sectoral Share (%) 1999-2000	Sectoral Share (million) 2004-05	Sectoral Share (%) 2004-05	Elasticity
Agriculture, forestry & fishing	237.56	59.8	267.57	58.4	1.52
Mining & quarrying	2.27	0.6	2.74	0.6	0.82
Manufacturing	48.01	12.1	53.51	11.7	0.34
Electricity, gas and water supply	1.28	0.3	1.37	0.3	0.33
Construction	17.62	4.4	25.61	5.6	0.88
Trade, Hotels & restaurant	37.32	9.4	47.11	10.3	0.59
Transport, storage & communication	14.69	3.7	17.38	3.8	0.27
Financing, insurance, real estate and business services	5.05	1.3	6.86	1.5	0.94
Community, social and personal services	33.20	8.4	35.67	7.8	0.28
All Services excl. construction	90.26	22.8	107.02	23.4	
Total	397.0	100	457.82	100	0.48

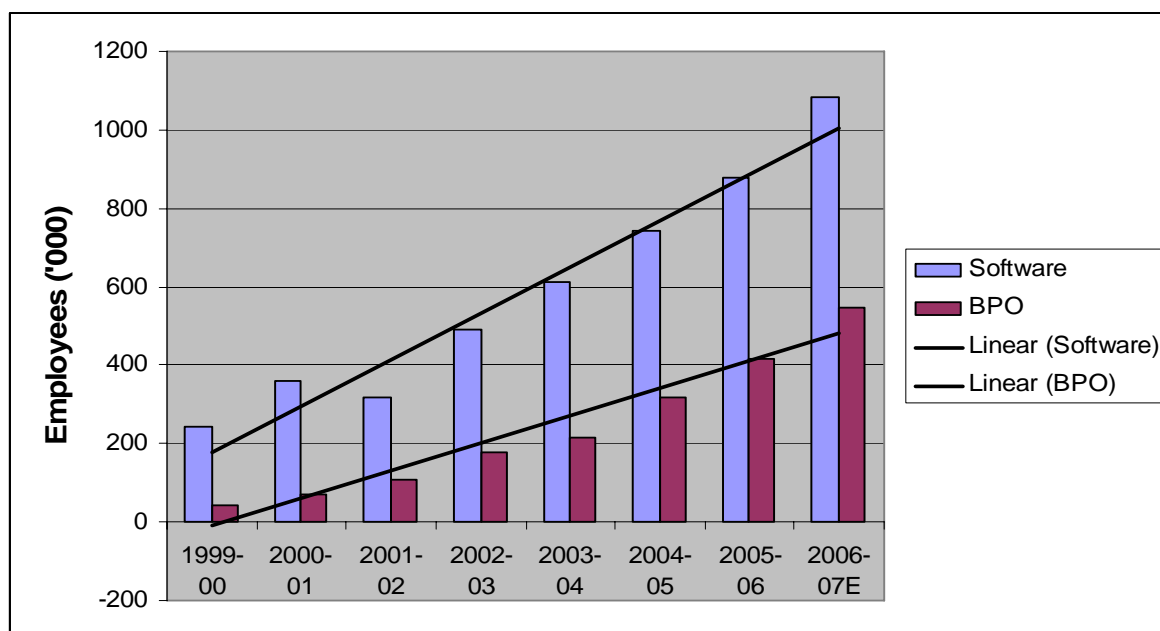
Source: C Rangarajan et al (2007), 'Revisiting Employment and Growth', ICRA Bulletin - Money & Finance Vol 3(2); data sourced from NSSO 2004-05, based on 61st Round Survey.

Nonetheless, drawing ready inferences from the above official data may be misleading, as it is believed that a significant portion of the Indian population presently accounted for under the agriculture/rural employment is working in the unorganized services sectors, both in the rural and the urban areas, in particular in the Trade, hotels and transport business services; and the Community, social and personal services sectors (though the employment share of this last sector is declining in the formal sector, as indicated in Table 1c above).²

² Assessment based on information on the employment-generation-potential in the unorganised service sectors. India's chief statistician Dr pronab Sen said at a recent ICRIER conference on 'Productivity Growth in a Globalising Economy: Implications for Business and Policy'; "The NSSO data suggests that almost 50 per cent of the income in rural areas is coming from non-agriculture sources.. economic analysts should keep in mind the fact that several Indian manufacturing and service companies have started outsourcing the non-core activities, resulting in high growth of services".

The other new source of employment has been the Business Processing Outsourcing (BPO) services. Figure 2 below highlights the rapid employment growth in India's IT and ITes/BPO sectors. According to NASSCOM estimates, the number of total knowledge professionals employed in the Indian IT-BPO sector increased from 230 thousand in 1998 to nearly 2 million in 2007-08. Decomposition of the employees in the domestic as opposed to export sectors is shown in Table 1d.

Figure 2: Rapid Growth in Employment in India's IT & BPO industry



Source: NASSCOM 2007

Table 1d: Knowledge Professionals Employed in the Indian IT-BPO Sector
(in thousands)

	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08E
Software (exports sector)	110	162	170	205	296	390	513	690	865
Software (domestic sector)	132	198	146	285	318	352	365	378	427
BPO	42	70	106	180	216	316	415	553	704
Total	284	430	522	670	830	1058	1293	1621	1996

Source: NASSCOM Strategic Review 2008.

Growing Exports of Commercial Services from India

India has emerged as one of the leading exporters of commercial services in the world. In recent years, India's merchandise exports to the rest of the world crossed the 1

per cent mark (global ranking 28th as exporter), growing at an average 25 per cent over the last 3 years, but the net merchandise trade balance is negative. But India's invisible (net) inflows continue to compensate the growing trade deficit to a large extent; in 2005-06, India's commercial services exports constituted around 37 per cent of the country's global exports (goods and services). Indian export of commercial services has been among the fastest growing globally in the past 15 years, and grew at over 17 per cent per annum in the 1990s as compared to the world average of 5.6 per cent. Between 2001 and 2006, on average, India's exports of commercial services grew at over 30 per cent against the world average of 10 per cent; in 2005-06, India's services exports grew by 35 per cent.

With the advancement in technology and increase in internationalisation of product processes, in 2006 global trade in services is estimated in WTO International Trade Statistics at US \$ 2755 billion, comprising transportation services (US \$ 630 billion or 22.87 per cent), travel services (US \$ 745 billion or 27.04 per cent) and Other Commercial Services (US \$1380 billion or 50.09 per cent). In 2006, India exported US \$72.8 billion of commercial services, equivalent to 2.7 per cent of global services trade, having grown at 34 per cent over last year's exports (see Table 1e below for details). In 2005, with a share of 2.2 per cent and US \$54.4 billion of world exports in commercial services, India had already moved up to the 10th position in the world from 16th in 2004.³

Table 1e below highlights India's performance in exports of commercial services in the present decade. Data showing detailed break up of exports of commercial services are available for 2005. Against world exports of US \$ 576 billion in transportation services⁴ India's share was US \$ 5.76 billion. In travel services⁵ India's export in that

³ While the dynamic growth of India's commercial exports — and in particular software services (comprising computer services, IT enabled services and business process outsourcing) — are widely reported, the dynamic expansion of its services imports has attracted less attention even though the growth rate in 2006 exceeded that of exports. According to the most recent numbers put out by the WTO, India has turned a net exporter of commercial services in 2006, though India's commercial services imports grew robustly by 40 per cent in 2006 and are only about 5 per cent short of its commercial services exports.

⁴ Transportation services covers sea, air and other including land, internal waterway, space and pipeline transport services that are performed by residents of one economy for those of another, and that involve the carriage of passengers, the movement of goods (freight), rentals (charters) of carriers with crew,

year was US \$ 6.55 billion against the world exports of US \$ 685 billion. In other commercial services, India's export aggregated US \$ 42.06 billion against world exports US \$ 1197.2 billion, constituting more than three per cent against less than one per cent in the other two categories. In 2005 the main contribution in India's export performance in other commercial services was of other business services⁶ (US \$ 20.5 billion out of world exports of US \$595 billion) and computer and information services⁷ (US \$ 16 billion out of world exports of US \$105 billion). A significant feature of India's services sector is India's emergence as a world leader in IT&BPO services. India accounted for 65 per cent of the global market in offshore IT services and 46 per cent of the global BPO market in 2004-05.

Table 1e: Exports of Commercial Services

	2000	2001	2002	2003	2004	2005	2006
Global Exports (US \$ billion)	1,493.8	1,498.0	1,607.8	1,842.2	2,210.9	2,451.9	2,710.8
India's Exports (US \$ billion)	16.0	16.8	19.1	23.1	37.2	54.4	72.8
RoG (y-o-y) of India's exports (%)		4.8	13.8	20.7	61.0	46.4	33.8
India's Share in World Exports (%)	1.1	1.1	1.2	1.3	1.7	2.2	2.7

Source: Calculations based on data from *International Trade Statistics*, WTO, several issues.

and related supporting and auxiliary services (Metadata: WTO International Trade Statistics 2007).

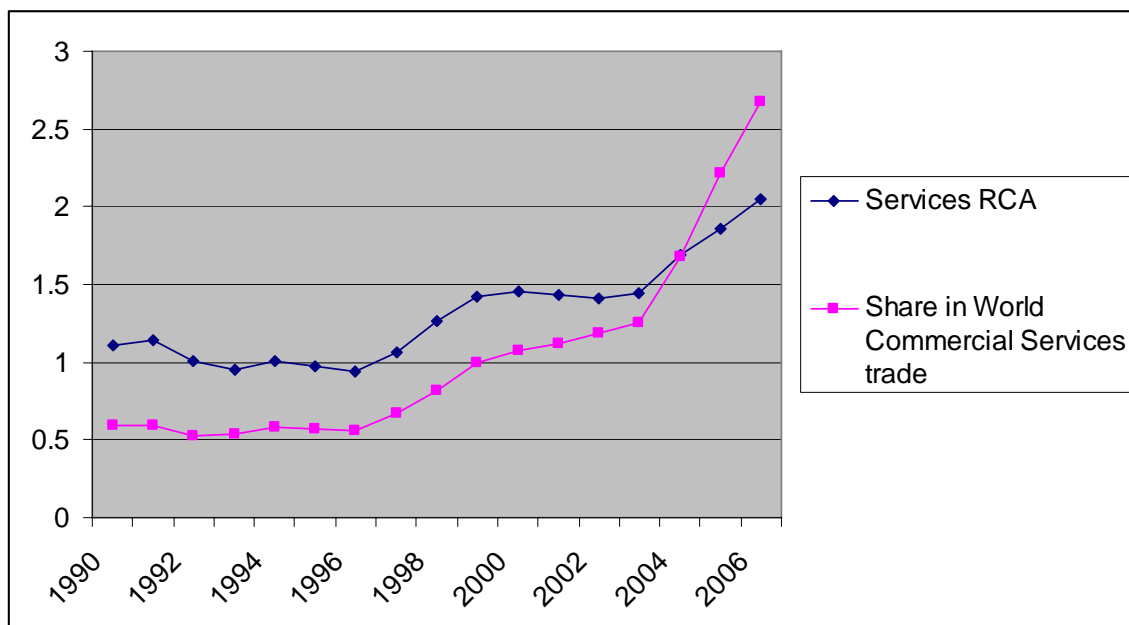
⁵ Travel includes goods and services acquired by personal travellers, for health, education or other purposes, and by business travellers. Unlike other services, travel is not a specific type of service, but an assortment of goods and services consumed by travellers. The most common goods and services covered are lodging, food and beverages, entertainment and transportation (within the economy visited), gifts and souvenirs (WTO International Trade Statistics 2007, op cit).

⁶ Other business services, comprise trade-related services, operational leasing (rentals), and miscellaneous business, professional and technical services such as legal, accounting, management consulting, public relations services, advertising, market research and public opinion polling, research and deployment services, architectural, engineering, and other technical services, agricultural, mining and on-site processing (WTO International Trade Statistics 2007, op cit).

⁷ Computer and information services include computer services (hardware and software related services and data processing services), news agency services, and other information provision services (WTO International Trade Statistics 2007, op cit).

Statistical analyses indicate that India continues to exhibit a strong revealed comparative advantage⁸ (RCA) in services.

Figure 3: India's RCA vs Share in Global Commercial Service Exports



Source: WTO International Trade and Tariff Database, Statistical Program – Time Series, accessed January 2008 (for data on country and world exports)

Computation of RCA for the three categories of commercial services shows that while in transportation services and travel services, India's competitive position has been on the decline, it has been sharply rising in respect of other commercial services, mainly on account of computer services and other business services, in which areas we have already seen that India has substantial exports.

⁸ Balassa's Revealed Comparative Advantage (RCA) Index is computed as:

$$R_{ih} = (X_{ih}/X_{it}) / (X_{wh}/X_{wt}),$$

Where R_{ih} = Balassa's Index of RCA

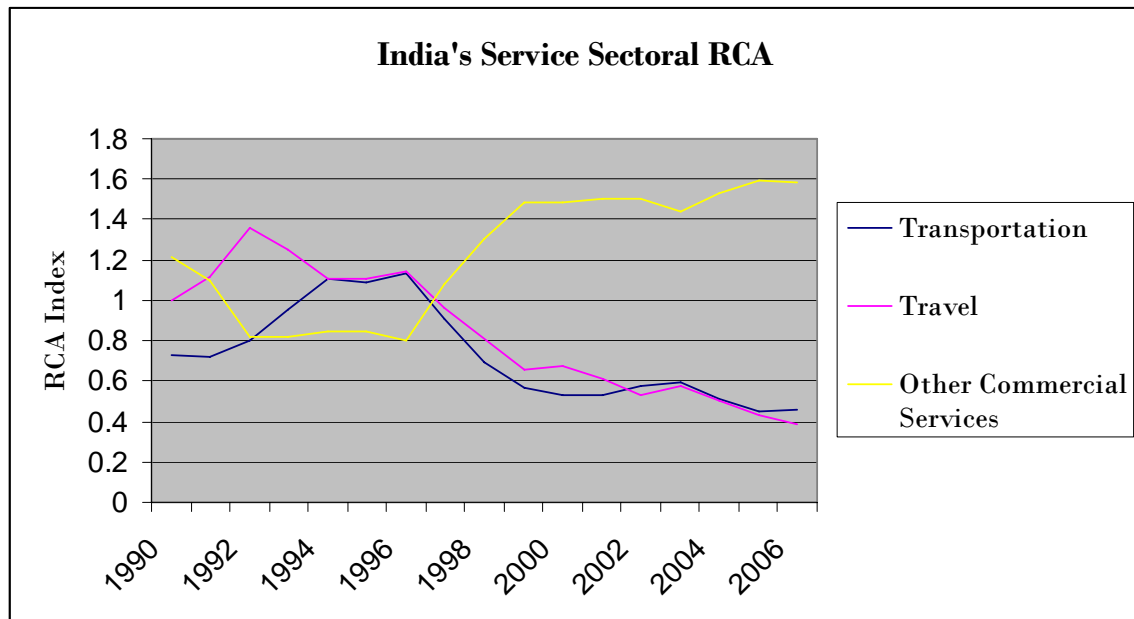
X_{ih} = Country i 's export of product h

X_{it} = total export of country i

X_{wh} = world export of product h

X_{wt} = total world export

Figure 4



Source: WTO International Trade and Tariff Database, Statistical Program – Time Series, accessed January 2008 (for data on country and world exports).

1.2 Enhancing Competitiveness of India's Services Sector

The terms of reference of the High Level Group were to comprehensively examine the different aspects influencing the performance of the services sector and suggest short-term and long-term policy measures to improve and sustain its competitiveness. Given the time given for submission of the report, it was clear from the outset that the Group would have to concentrate its attention on a representative group of services sub-sectors. In any case, the question of competitiveness is relevant only for those sub-sectors in which international commercial exchange takes place, which fall under the category of commercial services. We have seen above that according to the International Trade Statistics 2007 (WTO) the shares in 2006 of major constituents of commercial services were 22.87 per cent for transportation, 27.04 per cent for travel and 50.09 per cent for other commercial services. In transportation, sea freight had the largest share and in other commercial services three of the largest components were financial services and insurance (18 per cent), royalties and license fees (11%) and computer and information services (9 per cent). Accordingly four of the sub-sectors selected by the High Level Group for detailed examination of measures needed to enhance competitiveness were Shipping, Tourism, Financial Services and IT & IT Enabled Services. The Group added Healthcare to the list, as with the emergence of

organized private sector in this sub-sector India is becoming a competitive destination for medical value travel, clinical research and telemedicine.

Among the services sub-sectors, Trade contributes the largest share to India's GDP. In the context of the WTO Services negotiations multi-brand retail trade figures high on the request lists of our major trading partners but there has been no consensus in the country on opening up because of the fear that the unorganised sector, which dominates the domestic retail trade scene, would be adversely affected. There are concerns also that the unorganised sector would be adversely hit by the fast rising domestic organised retail as much as by the multinational retail chains, should the latter be given access in India for multi-brand retail. Competitiveness has thus become an issue for retail trade also, although the issue is complex and multifaceted. Retail trade completes the group of six service sub-sectors included in the deliberations of the High Level Group for listing the constraints on competitiveness and recommending measures needed to enhance competitiveness.

Analyses of constraints and the recommendations of the High Level Group for sustaining and enhancing competition in the six selected sub-sectors are presented in the Chapter 2 to 7. In some sub-sectors domestic regulations are an issue and the constraints are seen as arising from over-regulation or under-regulation. Finance is clearly over-regulated while healthcare is under-regulated. These aspects have been dealt with in the relevant chapters. Fiscal issues also figure in more than one sub-sector. Before including fiscal concessions in its list of recommendations (in the appropriate chapter) the Group made sure that the tax imposed a really serious limitation on competitiveness. Issues relating to availability of finance to service enterprises from commercial banks were also raised in the High Level Group. [Several sub-segments of the services sector, including shipping, tourism, retailing and healthcare, require significant capital investment and need to raise debt resources to finance asset creation. Currently, access to external commercial borrowings for these sectors is constrained both due to general restrictions on these borrowings, and also due to the treatment of borrowings for certain of these sectors as borrowings for real estate. The latter also impacts domestic bank lending to these sectors. The High Level Group is of the view that these regulations and guidelines need to be reviewed. Further in certain other services segments such as business services, which are primarily cash-flow based rather than asset-based, there is a need to evolve](#)

more effective methods for financing working capital, which addresses lenders' risks while also providing necessary funding to services enterprises.

While the needs of each sub-sector are unique in many respects, the High Level Group felt that action on three fronts was critical for enhancing the competitiveness of the services sector in India. The education system must be expanded and reformed, the skill deficit in almost all services sub-sectors must be eliminated through concerted action and the physical infrastructure and civic amenities brought to world standards. We take up each of these aspects in turn.

Reforming Education

Members of the High Level Group stressed the centrality of education in sustaining and enhancing the competitiveness of India's services sector. It is widely acknowledged that the education system in India is woefully inadequate for the social and economic development of the country in general and for enhancing the competitiveness of the services sector in particular. The goal of bringing all children in the age group of 6-14 to schools is still unrealised although the number of out-of-school children has been brought down from 32 million in 2001-02 to 7.1 million in July 2006. Although a great deal of progress has been made under the Sarva Shiksha Abhiyan the quality of education at the primary level still lags behind. Students need more than eight years education to acquire the skills needed for the services market and secondary education is the minimum needed for this purpose. The general enrolment ratio (GER) in secondary education is a little over 50% and the XI Plan aims to raise it to 75%. However, the ultimate goal must be universal secondary education and the services sector will receive a boost if this goal is reached by the end of the XII Plan period in 2017.

For developing a knowledge economy, we have to build further on the base of secondary education and give attention to improvement of both quality and quantity of higher education. Despite the impressive growth in higher education in the country, the university and college enrolments in the country at present account for only 11% of the eligible population (18-23). This compares unfavourably with 54.65% enrolment in the developed countries and the world average of 23.2% for the age group. What is even more worrisome is the marked decrease in the quality of teaching in the institutions of

higher learning. And this is not a new phenomenon. As far back as in 1964 the Kothari Commission had noted that ‘the situation in higher education was unsatisfactory and even alarming in some ways, that the average standards have been falling and rapid expansion has resulted in lowering quality’. The country has 367 universities and 18064 colleges but very few the figure in the ranking of world’s top universities. What is worse the gap in standards of our institutions and those in the developed countries has been widening. The existence of a small number of institutions of excellence in the country has diverted attention from the serious problems of quality in the majority of institutions of higher learning. As observed by Prof. Dr.Bhalchandra Mungekar, Member, Planning Commission, in his convocation address at the Bharathiar University, Coimbatore:

‘ The deep-seated malady of higher education system is not yet discernible simply because there are pockets of excellence, an enormous reservoir of talented young people and an intense competition in the admissions process. The country is rightly proud of the international standing of IIT and IIMs but a handful of these world class institutions are not sufficient to usher in an emerging knowledge society.’

The quest for quality in institutions of higher learning must not take attention away from the need to obtain a sizeable expansion in quantitative terms. Enrolment needs to be scaled up from the current level of 11% to at least 15% in the next 4-5 years. The goal should be that all aspiring young persons have access to college and university level courses. Recent decades have seen the emergence of private sector institutions particularly in technical education financed by large capitation fees charged by them. This development has been inequitable, as it has led to the deprivation of a large number of students who have not been able to pay the substantial sums involved in the capitation fees. While encouraging private sector initiative to expand higher education it has become necessary for the Government to ensure that private sector institutions take measures to provide scholarships and free-ships to an adequate number of meritorious students (and those from historically disadvantaged and vulnerable groups) who do not have the means to pay the fees.

A number of measures need to be taken to obtain quantitative expansion and qualitative improvement in higher education. The need to increase public sector

investment in higher education must receive top priority. Sadly there has been a decline in public expenditure on higher education, from a level of 0.77 % of GDP in 1990-91 to 0.62% in 2003-04. The University Grants Commission, which is the apex body for regulating higher education, is also the main funding agency of the Central Government for education. Almost 65% of the UGC budget is allocated for meeting the operating expenses of Central Universities and their affiliated colleges. The other 116 eligible State Universities and their affiliated colleges receive the remaining 35% A large number of affiliated colleges of State Universities, although technically under the purview of the UGC, do not receive any assistance because they do not fulfil the minimum eligibility norms in terms of physical facilities, infrastructure and human resources. Out of 14000 colleges in the country under the purview of the UGC, only about 5000 are eligible to receive grants from the UGC. The other 9000 colleges not only have inadequate facilities but not eligible for funds to enable them to overcome the deficiencies.

One of the main reasons for falling standards of higher education is the teacher shortage in the institutions of higher learning, particularly the technical education institutions. The salaries commanded by graduates in the market are so high that they do not have the motivation to move on for post-graduation or doctoral level with the ultimate objective of becoming teachers. In order to make the teaching profession attractive and motivate bright young professionals to take post-graduate courses, it is necessary to look at the salary structure and career opportunities of teachers in colleges. Research project funds must be shared as incentive payment to the faculty and the faculty should be given maximum freedom to undertake consultancies.

The decline in standards in higher education is also due to the failure to revise the curricula to keep pace with the developments in the various fields of knowledge as well in the society. The curricula must be revised every three years and the revisions must be subjected to outside peer review. The process of revision should be streamlined and decentralised with more autonomy given to teachers.

One of the major reforms needed in the education system is a change in the method of assessment of students, which relies exclusively on examinations. The current system is inadequate because it tests memory rather than understanding and does not encourage the development of analytical and creative abilities. Assessment of students

must be based on the work done throughout the year rather than being judged solely on the performance during the annual examination. Evaluation of courses and teachers by students should also be used as an input in the process of assessment of students. Semester system must be introduced in the institutions of higher education. Also important is the need to introduce a system of credits whereby a student who discontinues studies or who changes institutions may be granted recognition for the courses completed earlier, thus granting them spatial and temporal flexibility in pursuing studies.

The main instrument used by the UGC to obtain improvement in the standards of teaching in institutions of higher education is to require them to adhere to minimum standards in infrastructure and physical facilities and human resources as a condition for financial assistance. However, what is needed is to induce them to be for ever striving to undertake self-improvement on a voluntary basis to obtain better standards. With this end in view in 1994 the UGC established the National Assessment and Accreditation Council (NAAC) to undertake accreditation of institutions desirous of undertaking such improvement. Unfortunately the response has not been satisfactory and up to 2007 only 130 out of 367 universities and 3381 out of 18000 colleges have been accredited. It is necessary to promote the process of accreditation by making available additional discretionary funds to the funding agencies to be utilised for the purpose.

The educational institutions are regulated by the UGC and a number of Councils such as the All India Council for Technical Education (AICTE), the Medical Council of India (MCI) etc. The Councils have their own rules and regulations and there is a large overlap of their functions with that of the UGC. It has become imperative to restructure the apex level bodies in order to streamline their functioning. There is also an acute need for reform in the structures of governance of universities. The size and composition of University Courts, Academic Councils and Executive Councils slows down decision making processes. These bodies and the Vice Chancellors are unable to function harmoniously. It is necessary to establish smaller Standing Councils of academic councils for meeting frequently and taking expeditious decisions.

Many of the above-mentioned reform measures have already been envisaged in the XI Plan approved by the Government of India. Even more importantly the Central

Government envisages a massive expansion of institutions of higher learning and technical education as detailed below:

- (i) Central assistance for setting up 370 new colleges and 30 new Central Universities;
- (ii) Expansion of intake capacity in the existing institutions with UGC additional funding for 166 Universities and 5625 Colleges and support to the hitherto uncovered universities (150) and colleges (8775) in partnership with States;
- (iii) Expansion and up-gradation of 200 Technical institutions in the States;
- (iv) Expansion of intake capacity of centrally funded institutions of excellence (IITs, IIMs, NITs, IIITs, and NITTRs);
- (v) Upgrading of seven Technical Universities
- (vi) Setting up of new technical institutions (8 IITs, 7 IIMs, 5 IISERs, 2 SPAs, 10 NITs, 20 IIITs, and 50 Centres for training and research in frontier areas).

The High Level Group welcomes the XI Plan provision for expansion of higher education but Members expressed the view that having regard to the magnitude of the new investment needs it would be necessary to involve the private and corporate sector fully for expanding facilities for higher education. While giving freedom to the private sector institutions in respect of fees, it would be necessary to ensure that they provide scholarships and free-ships to an adequate number of meritorious students (and those from historically disadvantaged and vulnerable groups) who do not have the means to pay the fees. In this connection, the Group recommends in particular that the present disability imposed by the UGC Act and the Regulations of the AICTE and other apex bodies on the eligibility of the corporate sector (for-profit entities) to establish educational institutions must be removed. The High Level Group also is of the view that reform for improvement of quality of teaching need as much attention as expansion of the facilities.

Promoting Skill Development

Virtually every service sub-sector in the country is experiencing a severe shortage of skilled personnel on account of the booming conditions prevailing in service economy during the past few years. Shortages persist not only at the level of managers and supervisors but also at the level of skilled workmen in most sub-sectors. Thus in healthcare there is a shortage of not only doctors and nurses but also of radiographers and

laboratory technicians; in the hospitality sector there is dearth of hotel managers as well as of cooks and waiters; in IT and BPO services we need not only software specialists but also simple graduates with some amount of fluency in the English language. In many cases the products of existing education and vocational training institutions are not fit for employment without undergoing further training while in others there is shortage of educational and training facilities. Expansion of technical and higher education and improvement in its quality will take care of some of the shortages but the vocational training requirements of the services sector need to be systematically addressed and given impetus through government initiative.

The Central and State Governments run a number of important programmes for imparting vocational training in the country. Under the Ministry of Labour and Employment's Craftsmen Training Scheme, there are 1913 Industrial Training Institutes (I.T.Is) run by the State Governments and 3552 privately run Industrial Training Centres (ITCs) imparting training in 60 engineering and non-engineering trades. These courses are open to those who have passed class VIII or XII under the general educational system depending on the trade and are of 6 months to 3 years' duration. Under a World Bank assisted programme 238 I.T.Is are undergoing upgradation and under the PPP scheme 309 I.T.Is in 29 States have been identified with corresponding industry partners.

The National Council of Vocational Training (NCVT) designs curriculums, conducts examinations and issue certificates. The States too have a counterpart organization in the State Council of Vocational Training (SCVT).

In 1993-94 a system of vocational training was introduced at the plus 2 stage of secondary education as an alternative to pursuing studies in science, humanities or commerce. There are at present about 9,583 schools offering about 150 educational courses of two years' duration in the broad areas of agriculture, business and commerce, engineering and technology, health and paramedical, home science and science and technology to about 1 million students. Another important programme under the Human Resource Development Ministry is of three-year diploma courses in various branches of engineering run by 1,244 polytechnics with a capacity of over 2.95 lakh students. The Ministry of MSME and its field institutions have also been imparting training to new entrants in the workforce for more than five decades.

A new initiative has been successfully launched by the Ministry of Rural Development for uneducated/low educated unemployed BPL youth, whereby the Government meets the cost of training of BPL trainees. A pilot project has been successfully carried out in the garment industry and the programme is now being extended to cover leather footwear and other areas.

In the services sector there are two existing bodies concerned with vocational training. The National Council for Hotel Management & Catering Technology (NCHM&CT) is a slim regulatory body for the programmes run by the Ministry in hotel management and craft training. The Construction Industry Development Council is a larger developmental body, which inter alia organizes training programmes in various trade connected with construction and even runs diploma courses in civil engineering.

In the Budget speech of 2008-09 the Finance Minister announcing the launching of the National Skill Development Mission made the following statement:

‘Today, skill development programmes are diffused and administered by a number of ministries/departments. I have no intention of interfering with these sector-specific programmes. However, there is a compelling need to launch a world-class skill development programme, in mission mode, that will address the challenge of imparting the skills required by a growing economy. Both the structure and the leadership of the mission must be such that the programme can be scaled up quickly to cover the whole country. Hence, I propose to establish a non-profit corporation and entrust the mission to that corporation. It is my intention to garner about Rs 15,000 crore as capital from Governments, the public and private sector, and bilateral and multilateral sources. I shall begin by putting Rs 1,000 crore as Government’s equity in the proposed non-profit corporation.’

Detailed plans in respect of the National Skill Development Mission are still unfolding. In the meantime the High Level Group took the following view on skill development in the services sector:

It was noted that the extant programmes for vocational training were primarily oriented towards the manufacturing sector and recommended that wherever possible the

general programmes run by the Industrial Training Institutes and polytechnics should be expanded so as to include the services sector.

The needs of the services sector are highly diversified: some sub-sectors need the graduates produced by existing colleges and institutions to be only subjected to a 'finishing' process; others need additional skills to be imparted through courses extending from a few weeks to a few months; a few others require formal training extending over a year or more. In some areas such as hospitality skills and paramedical personnel there is dearth of training facilities and the numbers that are being turned out are grossly insufficient to meet the demand. Against this background the High Level Group did not regard it as practicable to suggest a generic template for promoting skill development in all service sub-sectors. Rather the Group recommends that for a number of service sub-sectors the Central Government should encourage the establishment of Councils with the full participation of industry (unless one is in existence already) for managing vocational training programmes. Wherever appropriate the Councils could also be assigned other tasks, including acting generally as an interface between the Central Government and the industry. To facilitate the establishment of such Councils the Central Government should make an initial grant as was done in the case of the Construction Development Council. The main task of the Councils should be to promote the running of courses including training of trainers and set up the curriculum for the courses. They should also catalyze the establishment of separate and independent structures for performing regulatory functions such as testing, certification and accreditation. The active involvement of the Central Government or Central Government institutions in the functioning of the regulatory body will be necessary. Since most of the skill development courses in the service sector are of short term they can be run in accommodation made available to them on a part time basis. Generally it would be possible for the State Governments to make accommodation available in the Industrial Training Institutes, Polytechnics and educational institutions. The courses should normally be expected to run on a self-sustaining basis but to lighten the burden on students Government should consider giving capital grants to the Councils for such purposes as purchase of equipment and preparation of course material needed for training purposes. In many cases it would be possible for the service enterprises to sponsor trainees, meeting fully the cost of training. On the pattern of the scheme of the Ministry

of Rural Development, the Central Government should also meet the cost of training in respect of students belonging to the BPL categories.

For longer term courses extending over a year or more PPP models could be considered. In some courses it would be enough for the State Government to allocate land at reasonable cost and in others it may be necessary to construct the building and/or provide the equipment leaving it to the industry to run the courses on a self sustaining basis. The Development Councils concerned should work out the proposals for Government assistance with justification.

Improving Physical Infrastructure

The quality of physical infrastructure and infrastructural services is crucial for the competitiveness of the services sector, although the inter se importance of individual elements of infrastructure differs from sub-sector to sub-sector. Telecommunications, power, roads, railways, ports, airports are all important for the efficiency of the services sector. The telecommunications sector in India stands apart as it can be said to have reached world standards. However, there are serious shortcomings in all other areas resulting in high logistics cost for service enterprises.

The power situation in the country has remained bad with deficiencies in both quality and quantity of electricity supplies. Supplies have been increasing but they have been outstripped by demand with the result that shortfall between peak demand and availability has increased in the past few years. Maintaining captive power generation units increases the costs of hotels, hospitals, retail outlets, banks and IT and ITES establishments.

A massive National Highways Development Programme is in the process of implementation but the stretches not taken up for development are in a state of disrepair. The State highways are being maintained well in some States but in others their condition is deplorable. For efficiency and for cutting down the logistic costs the entire road network needs to be maintained in good condition. The traffic conditions on the Golden Quadrilateral, which has been taken up for six-laning will also be well short of world standards because of the mix of motorized and non-motorised roads and also because of the fact that they pass through inhabited areas, and ribbon development, which interferes with traffic flows, is a widely prevalent phenomenon. Another big impediment is the

stoppage of vehicles at the check-posts at inter-state borders by commercial taxes, transport, forest and police officials even if the vehicles are merely transiting through the States. The cumulative result of all this is that even if the road surface is good and has adequate width, vehicles move at a slow speed. On the average Indian trucks are used for 60,000 to 100,000 kms a year, which is less than a quarter of those in the developed countries.

Indian Railways have been performing well in recent years and the involvement of private operators for the transportation of containers has increased the efficiency of movement of goods by train. However, the goods trains are still being slowed down by congestion in saturated corridors like Delhi-Mumbai. The Dedicated Freight Corridors on the Western and Eastern routes have been on the anvil for the last two years but there has been no perceptible progress in their implementation.

There has been slippage in the average pre-berthing time taken by ships in the ports because of congestion, but no new major contract has been awarded for construction of berths in recent months. In the airports there is an ambitious programme assigned to the Airports Authority, but for the present the congestion in the major airports of Mumbai and Delhi has increased. While two green field airports at Bangalore and Hyderabad are nearing completion there are serious shortcomings in their connectivity with the city. While constructing green field airports or modernizing existing airports attention needs to be given to put in place road and rail connectivity before the new or modernized facility becomes operational. It should not be that the benefit of modern facilities in the newly commissioned airports is nullified by the time taken to reach the city from the airport or vice versa. If the airport is at a distance from the city center it is important that the passengers have the option to travel by fast means such as express trains between the airport and city center. The services sector also needs reasonably good urban infrastructure, water supply, drainage, sewerage, solid waste management, and the development of planned housing. Urban transportation infrastructure is equally important for enabling smooth movement within the city. All cities must have an integrated traffic and transportation plan, the implementation of which should be monitored by a Unified Metropolitan Transport Authority, as envisaged in the National Urban Transport Policy. In large cities a major requirement is provision of mass rapid transit systems, connecting various parts of the cities including the railway stations and airports. The competitiveness

of the services sector is affected if too much time of the worker is taken in commuting between residence and the workplace. With congestion in the existing cities new townships need to be developed.

The infrastructure deficiencies outlined above would need to be addressed with greater urgency if the services sector in the country is to measure up to world standards.

Chapter 2

IT and IT enabled (BPO) services⁹

Trade in Information Technology and Information Technology enabled services (IT and BPO services) has been the main driver of growth in India's trade in services in recent years. The total turnover of the industry is estimated to have increased ten-fold between 1998-99 and 2007-08, from about US \$ 6 billion to nearly US \$ 64 billion. Exports too have shown phenomenal growth from US \$ 2.7 billion to over US \$ 40 billion during this period. Direct employment is estimated to have risen from 230,000 in 1998-99 to nearly 2 million in 2007-08, of which the export segment accounted for over 1.5 million. Projections of growth during the XI Plan indicate that the exports in the year 2011-12 will be US \$ 86 billion and direct employment from exports 3.4 million. IT and BPO services revenue as a percentage of the overall GDP is estimated to have grown from about 1 per cent in 1999-2000 to over 4 per cent in 2007-08. Including IT hardware the percentage is estimated to have increased from 1.8% to 5.5% during the period.

2.1 Profile of India's IT- BPO Exports

India's exports of IT and BPO services fall in three broad categories, IT services, BPO and Software products and Engineering Services. Export values in these categories during the latest four years are given in the table below.

Table2a: Segment wise export value trends in IT-I-BPO industry (US \$ billion)

	2004-05	2005-06	2006-07	2007-08 E
IT services	10	13.3	18	23.1
ITES-BPO	4.6	6.3	8.4	10.9
Software Products & Engineering Services	3.1	4	4.9	6.3
Total	17.7	23.6	31.4	40.3

Source: NASSCOM Strategic Review 2008

⁹ The factual base of this section is derived largely from NASSCOM-McKinsey, *NASSCOM-McKinsey Report 2005: Extending India's leadership of the Global IT and BPO Industries*; NASSCOM, *Strategic Review 2008: The IT-BPO Industry in India*; NASSCOM-BCG, *NASSCOM-BCG Innovation Report 2007* and Rupa Chanda, 2007, *Trade in IT and IT-Enabled Services: Issues and Concerns in an India-EU FTA*.

Table 2b: Destination of India's IT-BPO exports (percentage)

	2002-03	2003-04	2004-05	2005-06	2006-07
USA	67.7	68.2	66.5	66.5	61.4
Europe	22.3	22.6	23.1	25.1	30.2
Of which UK	14	14.5	14.0	15.3	18.1
Rest of World	10	9.2	10.4	8.4	8.3

Source: NASSCOM Strategic Review 2008

Three- four tier players account for 45% of IT services and 7-8 tier 2 players for up to 25 % of these services. Offshore operations of global IT majors account for 10-15 % and emerging players do so for another 10-15 %. On the BPO side, about 150 captive units account for 50% share, 40-50 pure-play BPO providers for 20%, off shore operations of global IT majors for 10-15%, and tier 1 and 2 players for about 10% among them.

IT services constitute more than half of exports and according to NASSCOM the biggest three components of this segment are custom application development (43%), application management (15.4%) and IS Outsourcing (14.3%). Other significant components are IT consulting, systems integration, network consulting & integration and software testing. Additionally, steady growth in export revenues from relatively high-value-added services such as engineering and R&D, offshore product development and made-in-India software products is also helping India to strengthen its role in global technology IP creation.

BPO accounts for about 27 per cent of total exports. Starting out with basic data entry tasks, the industry rapidly acquired a reputation as the primary low-cost destination for voice-based customer contact / support services, finance and accounting, and a range of back-office processing activities. The past few years have seen the scope of these services expanding to include increasingly more complex processes involving rule-based decision making and research / analytics services requiring informed individual judgment and domain/vertical knowledge. Key categories within horizontal BPO services include Customer Interaction and Support (CIS), Finance and Accounting (F&A) and other related processing services, Knowledge Services, Human Resource Management (HRM) and Procurement BPO. With experience and maturity, several providers are also

beginning to develop increasing vertical specialization, thereby complementing their horizontal BPO service offerings with vertical specific services.

Among the verticals serviced by India's IT- BPO sector, those that account for the largest share of revenue are banking, financial services and insurance (40%), hi-tech/telecom (19%), manufacturing (15%), retail (8%), with smaller contributions coming from media, publishing and entertainment, construction and utilities, healthcare and airlines and transportation. Important industry verticals being serviced by the BPO segment are insurance, retail banking, travel and hospitality, auto manufacturing, telecom and pharmaceuticals. India is the leader in both the IT and BPO offshore segments accounting for an estimated 64 per cent of offshore IT spends and 41 per cent of offshore BPO spends in 2007.

It is also estimated that the IT and BPO industries have a large growth potential as only about 20 per cent of the 'potentially addressable market' had been captured in 2007. The addressable market in global offshore IT industry is estimated to be of the order of US \$ 220-250 billion and in the BPO segment to be US \$ 160-190 billion (Strategic Review 2008).

The worldwide technology and related services spending crossed US\$ 1.6 trillion in 2007 and growing at a CAGR of 5.6 percent it would reach US\$ 2.2 trillion in 2011 (NASSCOM Strategic Review 2008). Growth in global outsourcing is expected to outpace growth in spending and is expected to rise to US \$ 120-140 billion in that year. The Review estimates that in 2010 Indian IT-BPO revenue will achieve the target of US \$ 60 billion in exports and the domestic market will add another US \$ 13-15 billion to it.

2.2 Strategies of Indian IT- BPO companies

Indian companies adopt all the modes for supply of IT services abroad. The larger companies have set up wholly owned subsidiaries in the USA, the UK and the European continent or have opened branches to facilitate the supply of services. Some of them have adopted the strategy of acquiring local companies or entering into strategic partnerships with them. They use the quality processes, innovative technologies and delivery models of acquired companies to penetrate the local market. They have permanent employees or hire consultants based in the host country. All four modes of supply, cross-border (Mode

1), consumption abroad (Mode 2), establishment (Mode 3) and movement of natural persons (Mode 4) are used. In the case of BPO services Mode 1 and 3 are predominant, while in the case of IT services the supplies are made substantially by means of Modes 1, 3 and 4. In the case of IT services Indian companies deploy human resources principally from India and sometimes from other foreign bases in order to provide on-site services and have also to send persons for business visits, prospecting, and sales. 'The deployment needs vary across the lifetime of a project as initially the onsite-offshore mix may be as high as 50-50, with the onsite presence falling over time' (Rupa Chanda). Whenever the supply is made through Modes 3 and 4 the investment and immigration policies of the host government become critical determinants of trade flows.

In the USA and the UK the operations are facilitated by the friendlier policies on these aspects, and the EU is known to be considering the introduction of the 'blue card' – an EU-wide work permit. However, so far the immigration policies in Europe have remained problematic because of long time lines, absence of internal market mobility and non-transparent and discretionary approval processes. A similar difference has existed between the investment procedures in the USA and those in the countries on the European continent. The situation has been epitomised well in the experience of one company, which reported that it took 3 hours to set up a branch in the USA against 4 months in Sweden (Rupa Chanda).

2.3 Challenges facing Indian IT and IT Enabled Services

Abundant talent available at lower cost, quality infrastructure in Indian cities, government incentives and growing domestic IT/BPO market are among the reasons, which have contributed to India being able to strengthen its leadership position. The industry attributes the success of Indian IT and BPO also to the support provided by the Government of India and individual State Governments through an enabling business policy and regulatory environment as well as information security provided by means of Indian laws and by voluntary action by industry associations. Recent analyses by experts have revealed that the above sources of strength are getting eroded and the industry is likely to face several challenges in future. In order to consider what further needs to be done by the Central and State governments to sustain and enhance India's competitiveness the Group examined the evolving situation on each of the elements that have constituted a source of strength of industry so far.

2.3.1 Availability of talent

A large talent pool, particularly of engineering graduates and their knowledge of the English language were the original sources of India's strength in IT and BPO services. This enabled the number of IT-BPO professionals employed in India to grow from about 200,000 in 1997-98 to over 1.6 million in 2006-07. At the end of the X Plan, the Indian higher education system was one of the largest in the world with 378 universities, 18064 colleges, faculty strength of 4.92 lakh and an estimated enrolment of 140 lakh students, out of which about 5 lakh were technical graduate courses. There were 23 central universities, 216 state universities, 110 deemed universities, 11 private universities and 33 institutions of national importance established through central legislation and 5 institutions established through state legislations.

Among the technical education institutions mention must be made of 7 Indian Institutes of Technology (IITs) and 6 Indian Institutes of Management (IIMs), 1617 engineering and technology colleges, 525 institutions for Diploma in pharmacy, and 4 Institutions of Architecture. For post-graduate colleges, there are 1147 educational institutions for MBA/PGDM and 953 for MCA. There are 7 Deemed-to-be-Universities, including the Indian Institute of Science, Bangalore, School of Planning & Architecture (SPA) and the Institute of Information Technology (IIIT) Allahabad and 20 National Institutes of Technology (NITs) and a number of other specialised institutions.

Currently the industry estimates that India has a pool of 1.773 million graduates suitable for IT-BPO, which is more than the combined talent pool in China and Russia. However, even to enable India to maintain its current share of worldwide IT-BPO a gap is likely to appear within a year or so between the demand and supply of suitable graduates. One reason for this is the low proportion of fresh graduates who are employable in the sector. Assuming that only 25% of engineers are suitable for IT jobs, 15 % of commerce graduates for employment in BPO finance and accounting work, and 10 % generalist graduates for other BPO work, the industry assessment is that the 100,000 additional graduates will have to be available beyond the projected supply each year (NASSCOM-McKinsey Report 2005). If India is to enhance its competitiveness and increase its share of worldwide IT- BPO the requirement will be for a larger number of graduates.

Much of the BPO work is of a routine nature such as customer contact services, but increasingly the outsourced jobs are getting sophisticated and industry estimate (Kiran Karnik) is that in 2007 the share of Knowledge Services was 15%. The main Knowledge Services already outsourced to Indian companies are animation and simulation services, data research and analytics, and litigation services. Other possibilities are in intellectual property research, medical content and services, pharmaceutical services, writing/content development services, database development services and end-to-end logistic invoice services. The big impediment in India making progress from data processing and customer contact services to knowledge process services is deficiency in qualified talent in both quantitative and qualitative terms in economics and statistics, law, medical science, pharmacy, media and English language in particular.

2.3.2 Infrastructure

The most important physical infrastructure needs of IT and BPO are power and telecommunications, but there is significant dependence on urban infrastructure including road transport as well. The personnel need to move speedily from their homes to workplace and they require good urban infrastructure for providing them with quality of life. Proximity to airports and good international air connections are also critical to enable them to travel frequently to foreign destinations. With all these facilities the industry requires office space. Tier 1 and 2 players need developed land to construct their own buildings but others need rented accommodation provided by developers in which they can move quickly.

Developments following the end of Government of India monopoly in public telecommunications resulting in large capacity creation by the private sector and significant decline in tariffs coupled with improvement in service quality have been one of the factors contributing to the growth of IT and BPO . The cost of E1 line for instance has declined by almost 50 % over the past five years and is expected to reduce further and reach international levels. Large capacity expansion by a number of players has established a strong framework of planned redundancies, thus ensuring continuous network connectivity. Telecom is one infrastructure service in which no impediment is foreseen in the expansion of IT and BPO services . There is only a data protection related

handicap created by restrictions in connectivity of home telephones, which inhibits the qualified homemakers from joining the workforce in their spare time.

The quality and quantity of power remains a major problem all over the country (except Chennai and Kolkata to some extent) and the need to have private generation and back-up resources units increases the cost. This problem is not specific to IT and BPO and needs to be addressed by the Central and State Governments for the improvement of all sectors of the economy.

On the air transport front huge improvements have already taken place in international connectivity due to the adoption virtually of Open Skies policy and domestic deregulation has led to the growth of private domestic airlines, which have not only increased the frequency of connections domestically but also resulted in reduction of fares. Problems remain in airport infrastructure due to congestion arising from rapid growth of traffic, but these are receiving due attention. New green field airports at Bangalore and Hyderabad will be ready in March 2008, and the existing one at New Delhi will be expanded and modernised by 2010. A concession has already been given to a private sector developer for Mumbai airport and a DPR is being prepared for the construction of a new airport at Navi Mumbai. Chennai and Kolkata as well as 48 non-metro airports are being modernised by the Airports Authority of India.

Bangalore has witnessed a sharp deterioration in urban infrastructure while at the same time rents and the price of land have gone up. The scope for building additional commercial space in the five tier 1 cities, New Delhi, Bangalore, Hyderabad, Mumbai and Chennai is becoming increasingly difficult, even as the preference of industry remains to have new office space near these cities, because of availability of business infrastructure, residential space, health care facilities, educational institutions, facilities for entertainment and recreation, civic amenities, public transport and domestic and international connectivity. The challenge is to add commercial office space at the estimated rate of 25 million square feet and obtain commensurate expansion of business infrastructure, residential space and other amenities and facilities every year to keep pace with the demand.

2.3.3 Information Security

One of the key requirements for the competitiveness of the Indian IT and BPO industry is assurance of information security, which is a sensitive concern of all customers. By virtue of its adherence to the WTO TRIPS Agreement India is committed to the introduction of world class intellectual property laws and it is widely recognised that these laws are now in position. Of particular relevance to the IT and BPO sector are the Indian Copyright Act, as under the Indian law computer programmes have copyright protection, not patent protection. While the law is considered adequate, it is the area of enforcement that needs considerable improvement. Conviction percentage is low, cases take a long time to get decided and the organised nature of piracy is not addressed in the enforcement strategy. The awareness of the criminal justice system needs to be raised, followed by skill development, process standardisation and use of scientific evidence.

The Information Technology Act, 2000 provides inter alia for data protection and privacy of information held in the computer systems or networks. Section 43 provides for civil liability to pay damages if a person accesses data stored in a computer system without authorisation. Section 66 provides for prosecution of a person who commits hacking of a computer system and section 72 provides for penalties for breach of confidentiality and privacy by a person, who having secured the data lawfully discloses the data without consent of the person concerned. These specific laws are supported by the provisions in the general laws of the country, including the Indian Contract Act and the Indian Penal Code. Most urban police units in the country have acquired the basic understanding of cyber crimes, but need to progress to the next level, of acquiring specialised forensic equipment and using it to solve more complicated cases.

The framework of laws established by the Government has been buttressed by the firm level and industry wide initiatives. Tier 1 companies have dedicated security teams and conduct periodic review and audit of security policies and practices. Most companies have documented security policies. Both tier 1 and 2 companies sign confidentiality and non-disclosure agreements, and undertake background screening of their employees. In addition NASSCOM has established the National Skills Registry, an online database containing third party verified personal, qualification and career-related information of IT-BPO professionals. NASSCOM has further taken the Self Regulatory Organisation (SRO) initiative, a self-certification scheme for Indian companies to audit themselves against benchmarks and adhere to standards set by the SRO. The Data Security Council

of India (DSCI) has been established to focus attention on awareness generation, capacity creation and dissemination of best practices in data protection.

The Central Government is proposing further strengthening of the laws for data protection and privacy. In the Bill for amending the IT Act, 2000 it is proposed to insert a new section 43A fixing responsibility on the body corporate and companies for any negligence in maintaining reasonable security practices regarding personal data or information. Further a new section 72A will extend the scope of section 72 to cover breach of confidentiality by an intermediary and service provider, who has secured any material or information from a user, and make such intermediaries or service providers liable for passing such material or information, without the consent of the person concerned and or in breach of the contract. A new section 84 A is also being introduced empowering the Central Government to prescribe the modes or methods of encryption for secure use of the electronic medium and for promotion of e-governance and e-commerce. Putting the onus of protecting data on the companies processing the data will have salutary effect in preventing data breaches, but the enactment should be followed by an effective campaign to introduce a culture of respecting privacy of individual data and promoting security.

The adequacy of laws in the country for personal privacy protection is an issue on which views in the country are not unanimous. The larger players in the industry as well as the IT Ministry are agreed that the proposed amendment of the IT Act, 2000 will be sufficient for the purposes of data protection and information security. Their view is that enactment of a comprehensive law on personal privacy protection needs to be considered primarily in the context of the needs of the citizens of India rather than of the clientele of IT and BPO residing in other countries. However, others are of the view that India's inability to meet the requirements pertaining to transfer of sensitive data under the EU's Safe Harbour Decision continues to be a problem. The European Commission prohibits the transfer of personal data to non-European nations where legislation does not meet its standards for privacy protection, in contrast to the approach used in the US, which requires a mix of legislation and self-regulation by companies. It is not that the concern for data security is any less in the US but that showing compliance with data security in dealing with US companies is based largely on self-regulation. At present EU companies outsourcing to India rely upon contractual obligations and the internal security measures

taken by the Indian service providers for protecting non-public information. In their Service Level Agreements (SLAs), companies need to sign data confidentiality, IP and other protection clauses when entering into agreements involving live data work in India for EU companies. The larger companies take the fulfilment of these contractual obligations in their stride but the additional costs incurred reduce the competitiveness of smaller and mid-size companies. Additionally they are exposed to the uncertainties of arbitration in the event of disputes.

2.3.4 Government Incentives

There can be no doubt that after the economic reforms of 1991-92, liberalisation of external trade, elimination of duties on imports of information technology products, relaxation of controls on both inward and outward investments and foreign exchange and the fiscal measures taken by the Government of India and the State Governments and other incentives provided by them specifically for IT and BPO services have been major contributory factors for the sector to flourish in India and for the country to be able to acquire a dominant position in offshored services in the world. The major fiscal incentives provided by the Government of India have been for the Export Oriented Units (EOU), Software Technology Parks (STP), Special Economic Zones (SEZ) and Electronic Hardware Technology Park (EHTP). Some of the other benefits available to the sector are the EPCG scheme, the Star Export House Scheme & Target Plus Scheme, Services Tax Exemptions and certain specific customs and excise duty exemptions for inputs and specified capital goods for IT hardware and software.

One of the most effective schemes for the promotion of exports of IT and BPO is the Software Technology Parks of India (STPI) programme. The 48 STPIs that have been set up since inception of the programme have given a major boost to IT and BPO services exports. Apart from exemption from customs duty available for capital goods (with a few exemptions) there are also exemptions from service tax, excise duty, and rebate for payment of Central Sales Tax. But the most important incentive available is 100 percent exemption from Income Tax of export profits for a period of 10 year beginning from the commencement of manufacturing. However, the exemption for export profits is due to expire on March 31, 2009. SEZ Act 2005 gives benefits to units within the SEZ in respect of exports similar to those available to units within STPIs in respect of indirect taxes, although there are minor differences in operational details. There is a

significant difference, however, in respect of income tax holiday: in that the exemption from income tax is tapered down over 15 years from the date of commencement of manufacture. There is 100 % exemption of export profits from income tax for the first five years, 50 % for the next five years and 50 % for the another five years subject to transfer of profits to special reserves.

But the most important difference is that unlike in the STPI there is no overriding sunset clause and new SEZ units will go on getting the benefits for a period of 15 years from the commencement of manufacturing for each of them. With the sunset clause for income tax exemption for STPIs becoming effective on March 31, 2009, there is a major problem of non-level playing field between units within existing STPIs and new units set up in the SEZs. Those within STPIs will stop getting income tax exemption and those within SEZs will be getting benefits for 15 years from the date of commencement of manufacturing. The STPIs are particularly concerned because their income tax benefits are coming to an end at a time when their profits have shrunk because of the appreciation of the Indian Rupee.

2.3.5 Domestic IT and BPO Market

Growth of India's IT and BPO industry has been export led and in 2006-07 exports accounted for two-thirds of the total revenue. However, the overall size of the domestic market comprising hardware, software and services has become significant having grown to US \$ 15.9 billion in 2006-07. Banking, financial services and insurance (BFSI), manufacturing, telecom, and the government are already the key domestic users of hardware systems and software services and education, retail and healthcare are some of the emerging areas in which the use of IT is growing. It is estimated that software and services spending has now overtaken spending on hardware. Increasing complexity of IT requirements has compelled the corporate users to outsource IT services. BPO demand in the domestic market is also growing rapidly not only by the MNCs but also by the public sector.

While the need to become competitive in a globalised environment will undoubtedly drive the domestic manufacturing and service industries to enhance the use of IT hardware, software and services, a big impetus could be provided for the expansion of domestic IT and BPO services, if the Government of India and the State Governments

could accelerate implementation of the National e-Governance Plan (NeGP), which was approved in May 2006. The Plan aims at making all government services accessible to the common man through common service delivery outlets. The NeGP has 27 Mission Mode Project components as shown in the table below.

Table 2c: List of Projects in the National e-Governance Plan

Serial no.	Central Government Category	State Government Category	Integrated Services Category
1	Income Tax	Land Records	EDI(e-Commerce)
2	Visa& Immigration	Road Transport	e-Biz
3	MCA21	Property Registration	Common Service Centres
4	Insurance	Agriculture	Indian Postal
5	Citizen Database	Treasuries	e- Gateway
6	Central Excise	Municipalities	e-Courts
7	Pensions	Gram Panchayats	e-Procurement
8	Banking	Commercial Taxes	
9	e-office	Police	
10		Employment Exchange	
11		e-district	

Source: Planning Commission, 2007, XI Five Year Plan

A body under the chairmanship of the Prime Minister has been constituted to lay down the milestones and monitor the achievements of the NeGP. Of the 27 components only the modernisation and computerisation programme of the Ministry of Corporate Affairs (MCA 21) has become fully operational. A few States have already implemented some of the elements at least partly, particularly those related to land records, property registration and road transport. The other components are in various stages of planning and implementation. The ambitious programme launched under the NeGP is aimed at creating a governance mechanism, which will ensure efficiency, transparency, reliability and cheaper delivery of such services and at the same time will give a fillip to domestic IT and BPO industry.

2.3.6 Documentation for Visa and Work Permit

As noted above for the delivery of IT services Indian companies deploy human resources principally from the home base in order to provide on-site services and have also to send persons for business visits, prospecting, and sales. The on-site offshore mix generally starts at 50-50 in the delivery of IT services, while for BPO generally nothing more than business visits are required.

The non-transparent and discretionary approval processes of certain countries make it cumbersome for the IT companies to get the visas and work permits but the difficulties get compounded by the insistence of these countries on extensive local verification of documents. The authorities in these countries require that the original certificates of birth and educational qualification be certified at the person's birthplace and/or place of education. Lack of proper records in the local bodies and the absence of a personal identification and tracking system in India make the task daunting. In addition some European Governments require all documents to be attested by the concerned government agency and the responsibility is discharged by a Secretary to Government in the State Government concerned, who is designated by the Ministry of Home Affairs for the purpose. After attestation the sealed documents are sent by the State Government to the Home Ministry for onward transmission to the Foreign Embassy or Consulate concerned. The onerous requirements for documentation impose large costs on the companies and entail considerable loss of business for them.

2.4 Responding to Challenges

2.4.1 Increasing the Availability of Talent

The industry has taken the lead in increasing the availability of qualified personnel for the BPO segment by instituting the NASSCOM Assessment of Competence (NAC), whereby a comprehensive skill assessment and certification programme for entry level talent and executives is undertaken. NASSCOM is also promoting the concept of 'finishing schools' to supplement the education of graduates who are not considered suitable for employment in the IT and BPO sector. This is a laudable initiative to improve the quality and enhance the employability of graduates from the current level of 10-25 percent.

As mentioned in Chapter I in the XI Five-Year Plan a bold initiative is underway for the expansion and up-gradation of higher education. However, for expanding the turnout of graduates and improving their quality more needs to be done.

The situation in the country is alarming in higher education: India cannot aspire to become a knowledge society with a GER of 11% against the world average of 23.2%. It has become imperative to consider ways of expanding the system for higher education. And one of the ways for doing this would be to eliminate the constraint of educational institutions being run only by not-for-profit organisations. The concern for social equity can be met by mandating full or part scholarship seats for meritorious students who do not have the means to pay the fees. A basic change in policy is warranted also for the following reasons:

- (i) Hundreds of thousands of students are being deprived in the country at present of the chance to pursue higher education in institutions of quality. Those who can afford are going abroad and it is estimated that as much as US \$3 billion is the annual outgo on this account. It would be far better if at least a part of this amount were spent in the country.
- (ii) The corporate entities, which have built a reputation in the country in manufacturing or services, are likely to run educational establishments of much better quality than new organizations being set up as trusts and societies.

The private sector institutions should of course be subject to regulation, but only on matters related to curriculum and standards of staffing and physical infrastructure, not for fees and salaries. The Group will recommend that to begin with only technical education be opened up to for-profit enterprises.

2.4.2 Improving Infrastructure

Improvement of physical infrastructure but of transport infrastructure and services is of fundamental importance for manufacturing, which depends on large volumes of goods being moved in the country and requires water and power to run the factories. While most elements of physical infrastructure have some relevance to IT and BPO industry telecommunication and electricity are the more important. The telecommunication sector in India can be said to have reached world class, but much improvement is needed in the quality and quantity of supply of electricity in order to

improve the competitiveness of the IT and BPO industry. But the most important is the urban infrastructure. Success in the implementation of the Jawaharlal Nehru Urban Renewal Mission for restoring the basic infrastructure of large cities and for bringing about reform in the functioning of urban local bodies will improve the competitiveness of the industry. What would be equally important is the creation of additional commercial space for renting and a commensurate increase in residential accommodation, educational, healthcare, retail and recreation facilities. For this it would be necessary for State Governments to facilitate the creation of new satellite townships. Some State Governments are already doing this by acquiring land and undertaking basic development for private developers to take up construction in allotted land. However, to augment the supply of residential and office space additional townships could be developed by the private sector if the State Governments undertake to provide trunk level services.

2.4.3 Strengthening Information Security

We have seen above that with the passage into law of the Bill introduced in the Parliament for amendment of the IT Act 2000 the data protection and information security framework in the country will be more or less adequate for the purposes of meeting the concerns of our trading partners. However, we have also noted that without a separate data protection law in conformity with the EU Directives on data protection and EU Safe Harbour Decision the cost of Indian suppliers is raised because of the need to invest in additional processes and additionally they are exposed to the uncertainties of arbitration under contractual agreements. This affects particularly the small and mid-size players. Although the need for introduction of such laws cannot be regarded as urgent it may be eventually necessary to facilitate the expansion of business for the small and mid size players in the EU market.

Effective implementation of the extant laws needs action for raising the awareness of the criminal justice system on various dimensions of information security, developing skills, standardising processes and use scientific evidence. The urban police units, which have acquired the basic understanding of cyber crimes and to move to the next level of using specialised forensic equipment to solve more complicated cases.

2.4.4 Rationalising Investment Incentives

No industry has received more incentives than IT and BPO and it should not have been necessary to consider more. The end of income tax exemption for export profits, which is due on March 31, 2009, is in accordance with the direction of economic reform set in motion in 1991-92. All industries were similarly eligible for income tax exemption under Section 80 HHC of the Income Tax Act but the benefit was phased out by March 31, 2005. It would therefore seem in the fitness of things to allow the phase out of the benefit for the IT and BPO industry with effect from the date on which it is due. However, as explained earlier, the introduction of the income tax benefit under the SEZ Act has queered the pitch and if the concession is not extended for STPIs a non-level playing field would be created after March 31, 2009, between STPI units, which will not get income tax benefits and units within the SEZs, which will get such benefits. Additionally the withdrawal of STPI benefits will have more adverse effect on the SMEs. When they need to expand, unlike the larger companies, SMEs do not have the capacity to build or occupy independent SEZ units, and will have to settle for the sub-optimal (and likely more expensive) alternative of renting parts of a large multi-product SEZ. It is imperative for the Government to address this issue at the earliest.

2.4.5 Increasing Domestic demand for IT and BPO

A larger domestic base will undoubtedly enhance the competitiveness of Indian IT and BPO industry. While the demand from the private sector is growing, the Government can also contribute considerably by allocating resources to implement the NeGP. The main objective of this will be to improve governance in the country but the industry will also gain because of the expanded domestic base. The body under the chairmanship of the Prime Minister established for setting milestones and monitoring needs to meet periodically to energise the Ministries to take steps for implementation of the NeGP.

2.4.6 Facilitating Compliance with Documentation Requirements For Visa and Work Permit

We have seen above that authentication of certificates of birth and educational qualification for the purposes of application for visa and work permits in European countries is time taking and imposes additional costs on the personnel and the IT and BPO companies. India has taken the first step for alleviating the problem by signing the

Apostille Convention. The Apostille Convention (the 1961 Hague Convention) abolishes the requirement of diplomatic and consular legalisation for public documents originating in one Convention country for use in another. Documents issued in a Convention country, which have been certified by a Convention Apostille (certification), are entitled to recognition in any other Convention country without any further authentication. What is needed now is to put in place procedures in India for enabling speedy certification on behalf of the Government of India of documents produced by the IT and BPO personnel who intend to apply for visa and work permit in European countries.

Chapter 3

Tourism

Tourism is estimated as contributing 5.83 % to the GDP and 8.27 % to employment in the country. According to a sophisticated statistical model--the Tourism Satellite Account (TSA)—developed by the Ministry of Tourism in collaboration with the NCAER the employment generated by tourism is estimated at 51.1 million in 2006-07. Foreign tourist arrivals (business travellers, leisure travellers and persons of Indian origin holding foreign passports) had increased to 4.42 million in 2006 and the earnings in US \$ to 8.93 billion in the same year. The number of domestic tourists as reported by the Ministry of Tourism was 462 million in 2006. Although the authenticity of this figure remains to be rigorously verified, it is established that the domestic tourists are mostly people on social visits .

Tourism in India has an impressive variety of tourism products: heritage and culture tourism (with the 26 and 14 potential World Heritage Sites at the core); eco-tourism (wild life in National Parks); adventure tourism (mountain climbing, mountain trekking, river-based sports including rafting, and skiing); wellness (ayurveda and yoga institutes in Kerala and Rishikesh) and medical tourism (being developed by private sector hospital chains); beach tourism (centred around Goa); religious tourism (Varanasi, Haridwar, Tirupati, Bodh Gaya, Ajmer, to name a very few); MICE (meetings, incentives, conferences and exhibitions) tourism; desert tourism; and finally rural tourism.

The past four years, 2003-06 have seen a good growth in international tourist arrivals as well as in the foreign exchange earnings from tourism as can be seen from the following table:

Table 3a: Foreign Tourist Arrivals and Estimated Foreign Exchange Earnings

Year	Arrivals	% change over previous year	Foreign Exchange Earning in Rs crore	%change over previous year	Foreign Exchange Earning in million US \$	% change over previous year
2003	2726214	14.3	20729	37.6	4463	43.8
2004	3457477	26.8	27944	34.8	6170	38.2
2005	3918610	13.3	33123*	18.5	7493	21.4
2006	4447167	13.5	403758	21.9	8934	19.2
2007**	4977193	12.4	49413*	22.4	11956	33.8

Source: *Tourism Statistics 2007 at a Glance*, Ministry of Tourism, Government of India

* Revised estimates ** Estimates

Undoubtedly tourism in India has a remarkable variety and contributes substantially to the economy, particularly in providing jobs, full time or part time. Growth in international tourist arrivals during recent years has been significant. International tourism has also provided sustenance to the Indian handicrafts industry (carpets and other handcrafted textile products; brassware; inlaid marble and rosewood; bidri; papier mache etc). However, as we have seen in Chapter I the Revealed Comparative Advantage (RCA) of India in travel services¹⁰ has been on the decline.

The increase in international tourist arrivals in the last four years looks good because of the very low base as the starting point. According to World Tourism Organisation (WTO) in 2006 there were more than 800 million international tourist arrivals, and the tourist's receipts were US\$ 735 billion. Despite the increase India's share of international tourist arrivals in that year was a meagre 0.52 % and of tourism receipts 1.12 per cent. In 2006 the arrivals of international tourists in India were a small fraction of the international arrivals in the world's top tourism destinations viz., France (79.1 million) and Spain (58.5 million). India figures low in the hierarchy of attractiveness of tourist destinations even in the region and some countries with much less variety in

¹⁰ See footnote 5 for definition of travel services

tourism products attract much higher numbers of international tourists, as can be seen from the following table:

Table 3b: International Tourist Arrivals in Asia & Pacific Region: in millions

S no	Countries	2004	2005	2006
1	China	41.8	46.8	49.6
2	Malaysia	15.7	16.4	17.5
3	Hong Kong	13.6	14.8	15.8
4	Thailand	11.7	11.6	13.9
5	Macau	8.3	9.0	10.7
6	Singapore	6.5	7.0	7.6
7	Japan	6.1	6.7	7.3
8	Korea, Republic	5.8	6.0	6.2
9	Australia	4.7	5.0	5.1
10	Indonesia	5.3	5.0	4.9
11	India	3.4	3.9	4.4

Source: UN WTO *World Tourism Barometer*, October 2007

During the last few years the number of Indians going out for tourism of India has risen rapidly and in 2006 it was approaching twice that of incoming international tourists.

Table 3c: Inbound and Outbound Tourists in India: in millions

Year	Inbound	Outbound
2003	2.78	5.35
2004	3.46	6.21
2005	3.92	7.18
2006	4.45	8.34

Source: *Tourism Statistics 2006 at a Glance*, Ministry of Tourism, Government of India

Many Indian leisure travellers find it more attractive to travel to foreign destinations than to destinations within the country and a substantial proportion is travelling to countries in the region, most notably Malaysia, Thailand and Singapore. According to International Passenger Survey conducted in 2003 about 16 per cent of Indians travelling abroad were leisure or holiday travellers. As the number of leisure travellers with the

means to travel abroad has grown India's position as a competitive tourism destination has clearly come under threat even for the Indian tourist.¹¹

What are the impediments that lie at the root of this lack of competitiveness in tourism? Paucity of tourist accommodation, inadequate transportation arrangements made expensive by deficient infrastructure and taxation, inadequate development of tourist destinations, which are bereft of ambience and lacking in amenities for tourists and facilities for their entertainment are some of the major causes. One aspect that is becoming increasingly relevant is the sheer shortage of places of entertainment within a motorable distance of cities where families may go for leisure purposes for weekends. Most of the hill stations in both North and South India are highly overcrowded during the season and is avoided by the tourist class that has the a large disposable income. There are other more specific problems also and we take them all up in turn.

3.1 Tourist Accommodation

A proper census of the available hotel rooms in various cities and rural areas in India has never been held but unofficial estimates put the number at one million. But at the end of 2006-07 the number of rooms in hotels in star categories approved by the Ministry of Tourism was 100,000, out of which 30 % were in five star / five star-deluxe categories. As against 60,000 hotel rooms in Bangkok, for instance, there are 20,000 in Delhi and 25000 in Mumbai. An extreme shortage of hotel rooms has been felt particularly in Delhi, Mumbai, Bangalore and Goa. The shortage of rooms in these and other cities has pushed up the tariff rates to unprecedented levels, driving them beyond the reach of the upper middle class leisure traveller. India's competitiveness for holding international meetings and conferences has been seriously affected and many of them whose first preference was to hold them in India moved to South East Asia on cost considerations.

¹¹ A Report by the Mckinsey Global Institute (*The "Bird of Gold": The Rise of India's Consumer Market*) has estimated that 3.6 million households in India had an income above Rs five lakh in 2005 and that this figure will go up to 8.8 million by 2015 and 42.6 million by 2025. Given this profile it is likely that the demand for tourism will grow manifold in the country in the coming years. As observed by the Sub Group on Tourism in its Report to the High Level Group: 'With the rapidly growing disposable incomes, growing educational and awareness levels, holiday travel is growing at a very healthy rate in the country. Business travel is also booming because of the high growth in the country's economy. These trends are likely to continue for many years. Domestic tourism has a very wide spread, benefiting people and businesses in all parts of the country. There will be no limit in this expansion, so long as we can create the right infrastructure of products, services, access facilities and also adopt effective marketing and promotional strategies.'

It is estimated that the shortfall in tourist accommodation in the country will be 1,50,000 rooms by 2010 of which more than 1,00,000 will be in the budget category. The main reason for the shortage of hotels is the short supply of land suitable for construction hotels, particularly budget hotels. Action by the State Governments coupled with private sector activity have eased up the situation to some extent but the problem remains acute in some cities like Delhi, where auctioning of hotel sites by the DDA has priced out the construction of budget hotels. Land prices have shot up to astronomical levels and in many cities, especially the metros, land cost may account for 30 to 50% of the project cost against the international norm of 10 to 15 %.

The following measures to be taken by the Central/ State Governments or authorities under them could alleviate the difficulties in this regard:

- Land use conversions may be allowed liberally from agricultural and institutional use, and even from residential use to hotel use within city limits or in their close proximity.
- A higher floor area ratio (FAR) may be allowed for hotels in places where there is no congestion, in conjunction with strict rules on underground parking.
- Land may be given on long-term lease or on a revenue sharing basis instead of being auctioned by a Government land owning agency.
- Railways may make available lands for development of budget hotels by competitive bidding, on PPP basis. A modicum of freedom in taking commercial decisions will have to be given to the private sector partner although these will have to be subject to reasonable regulation.
- Additional land is likely to be made available for hotel construction in the course of city side development in many of the 48 non-metro airports and 2 metro airports being developed by the Airports Authority of India and the 2 metro airports being constructed on PPP basis by the private sector. Other ideas to augment the supply of land for hotel construction include earmarking of the surplus lands within cantonment areas. In the scenario of acute shortage of urban land Cantonments could consider releasing some areas by construction of multi-storied residential and office buildings.
- Many State Government Corporations have hotels and hotel-like properties. These are in most cases being run at sub optimum levels and in many cases at a

loss. The availability of rooms can be enhanced and the quality of service upgraded if long-term leases are given to professional private sector hoteliers on the basis of international competitive bidding.

- Adoption of single-window clearance of hotel projects as per the system adopted by the Governments of Andhra and Karnataka.
- Encouragement of bed & breakfast schemes whereby owners of suitable residential accommodation are registered for offering accommodation to tourists and are treated as non-commercial activity and given the concession of relief from luxury tax and VAT and of residential rates for water supply and electricity, as has been done in NCT.

Apart from increasing the supply of land for the construction of hotels some aspects of State taxation practices that impact on hotels also deserve attention. State Governments levy Luxury Tax on hotel rooms ranging from 5 to 20 percent. A bigger problem is that some States the charges are levied on the basis of the rack rates or the published rates, and no allowance made if variations occur in the rate charged. The Group was informed that the concept of published rates is going out of favour in the hotel industry and most hotels work on floating or flexible tariffs. Rates are changed from season to season and sometimes from customer to customer. In the summer or monsoon months discounts are given ranging up to 50 per cent. In business cities like Bangalore deep discounts are given during the weekend. Charging of taxes on the basis of published taxes causes great annoyance to both domestic and foreign clients and undermines the competitiveness of the Indian tourism.

3.2 Air Transport

A few years ago non-availability of seats on flights to and from India deterred international tourists and the high domestic fares was a handicap for leisure travellers within the country. The position has eased considerably and with the progressive liberalization of bilateral agreements and introduction of open skies policy there is better availability of seats on international flights. The process of liberalization must continue in order to increase (i) direct international connectivity with non-metro destinations and (ii) direct air connectivity with long haul overseas markets. The entry of low cost domestic carriers has improved access to air travel within the country as well and eventually could

lead to opening up new areas to tourism in India such as the North East. The growth in air traffic has also led to the inadequacies of the airport infrastructure being exposed but the work of upgradation of 48 non-metro airports, the construction of green field airports in Bangalore and Hyderabad, the expansion of airports in Delhi and Mumbai on PPP basis, and the modernisation of Chennai and Kolkata airports being taken up by the Airports Authority is likely to improve the situation in the next two or three years. However, it is necessary to take up modernization of the remaining non-metro airports also as they too are becoming congested due to growth of traffic. With the modernization of airports and operationalization of some green field airports it is necessary that the aspect of fast connectivity between the city centre and the airports receives attention simultaneously.

More needs to be done to make air travel within the country affordable for the tourist. The State Governments levy sales tax on ATF at a high rate that goes up to 40 per cent in some cases and sales tax on petroleum products has remained outside the purview of State VAT. As it is Indian ATF prices have been high and rising further because of the escalating crude oil prices and the taxation makes our ATF prices 60 to 70 per cent costlier than in competing countries. High ATF prices is one of the principal factors responsible for high domestic air fares as a result of which it is cheaper for the Indian leisure traveller in North India to take a holiday in Malaysia or Thailand than in South India. One of the best ways of improving the competitiveness of Indian tourism is to moderate the taxes on ATF. Two solutions could be considered: either the Centre brings ATF within the definition of Declared Goods, reducing the incidence of duty to 4 %, or the States are persuaded to adopt the standard VAT rate of 12.5 %.

3.3 Road Transport

A large number of foreign and domestic tourists use dedicated tourist vehicles mainly buses for visiting tourist destinations and the private sector has made large investments in these vehicles. The road and passenger tax regimes of the State Governments increase the cost of travel but more importantly they are a source of harassment to the tourists because of the manner of their implementation. Some States charge taxes on a quarterly basis, some per day and others on a per seat basis, which could be in addition to the quarterly charges. The buses carrying tourists have to stop at the borders for long periods every trip as the papers are checked and taxes collected where necessary. Even if the quarterly or daily taxes have been paid there is no respite from standing in the queue along with other

such vehicles and trucks. The problem is exacerbated by the limited and over worked staff.

In order to save the tourist vehicle operators and the tourists from harassment the Group recommends that by an amendment in the Motor Vehicles Act the tourist buses may be given a distinct number plate. Taxes should be chargeable on a quarterly or six-monthly basis and it should be made possible for the buses to enter a State just by swiping a smart card showing that taxes have been paid. In order to make this workable swiping facilities should be provided at all points on inter state borders. The Group is also of the view that is strong case for abolishing per seat passenger tax on the same logic as most States have abolished octroi.

Road connectivity is crucial for the development of tourism. While the entire network of National Highways and State Highways has to be maintained in good condition for the development of the economy it is important that all current and proposed World Heritage sites and other tourist destinations are connected to airports and/railway stations with single/double/four-lane roads (depending on the traffic intensity) and maintained in good condition with adequate allocation of funds for repair and maintenance. A monitoring system should be created to ensure that the roads leading to important tourist destinations are kept in good condition. For this purpose associations of tourist bus operators could be asked to post information on the website of the Ministry of Tourism about any deterioration in the condition of National Highways of tourist interest and on the websites of the State Departments of Tourism about the State Highways. On the basis of information received on the website the Ministry of Tourism for National Highways and the State Tourism Department for State Highways should take up the question of repairs and maintenance or even upgradation of the roads with the agencies/authorities concerned (NHAI or State PWD).

3.4 Maintenance of Heritage Sites

The Archaeological Survey of India (ASI) has the responsibility for the maintenance and upkeep of all monuments and archaeological sites notified by the Government of India as a protected monument under the Ancient Monuments and Archaeological Sites and Remains Act, 1958. Some of the States have also enacted similar legislation and notified monuments and archaeological sites under the Acts. The allocation of funds

made available to the ASI is grossly inadequate for the maintenance and restoration of the monuments and the environs of these monuments. The difference that adequate funds can make to a monument has been well illustrated by the case of Humayun's Tomb in New Delhi, which has been transformed with the help of donations from the Agha Khan Foundation. Paucity of funds is also a contributory factor for the present state of neglect in which the Delhi Red Fort finds itself. The position is not very different in the case of monuments protected by the State Governments. In a large number of monuments not even minimum facilities such as provision of drinking water and toilets has been provided. The Group believes that in order to conserve the monuments and maintain their environs in top condition and undertake restoration work from time to time the annual allocations from the budget need to be increased very substantially by the Centre and the States. If this is unfeasible the Group would suggest that the ASI and the counterpart State bodies should retain the exclusive right to maintain only for the World Heritage Sites and other important monuments and sites for which the funds made available annually are adequate. For the conservation of the remaining monuments and archaeological sites and development and maintenance of their environs an appropriate partnership arrangement should be considered with the private sector. A classic PPP would be to hand over to selected private sector enterprises the environs surrounding the monument (outside the immediate perimeter of the monument) for their development and maintenance in lieu of permission for some commercial development so that the enterprise gets a stream of revenue which is enough to provide a return on initial investment as well as for the maintenance of the facilities. The private sector partner should not be allowed to handle conservation work of monument itself, but should be asked to contribute for its conservation and restoration where necessary, which should be undertaken only by expert bodies such as INTACH or under their supervision. Other alternatives could also be considered such as tripartite agreements involving apex chambers of trade and industry (CII, FICCI, ASSOCHAM and PHD chamber) along with selected private sector enterprises and the ASI. It is imperative to redeem the lesser-known protected monuments, including many in the Delhi area, which are lying in a derelict state at present all over the country.

3.5 Integrated Infrastructure Development of Tourist Sites

Schemes for the development of infrastructure at tourist sites have been undertaken under the Five year Plans and some good results have been obtained. But the funds have been spread thinly and the schemes have not been integrated with plans for the beautification of the urban surroundings of the sites. Several cities with tourist interest have been included in the 63 cities identified as mission cities under the Jawaharlal Nehru Urban Renewal Mission (JNNURM), but the priority in the Mission is for schemes for water supply, sewerage, drainage and solid waste management. In order to improve the competitiveness of heritage tourism in India the Group recommends that funds should be earmarked from the provisions for JNNURM for the beautification of the urban surroundings of the heritage sites in these cities.

The Group's attention was drawn to the enactment of the Kerala Tourism (Conservation and Preservation of Areas) Act, 2005, which provides for the declaration by the State Government of any area, which has or is likely to have importance from the point of view of tourism, as 'Special Tourism Zone' for the conservation, preservation and integrated development of such an area. The Act envisages the constitution of a Tourism Conservation and Preservation Committee, with the main function to prepare sustainable tourism development plans including guidelines to regulate developmental activities in the area and powers to give directions to the local authority for the implementation of such plans and guidelines. The Group was of the view that other State Governments with tourism activity should consider enacting a similar law so that planned development of tourist areas at the initiative of State Tourism Departments could be undertaken with the participation of local authorities.

3.6 Beach Tourism

Beaches are one of the most important destinations for the affluent tourists from the Northern hemisphere. India has a coastline of 6000 kms but beach tourism is not well developed, Goa being the only international beach destination in the country. One factor, which affects the competitiveness of beach tourism in India, is the stringent coastal regulations zone requirements (CRZ), under which a hotel cannot be built within 200 metres of the coast. Such a restriction does not exist in any successful beach destination in the world. In 1992 the Ministry of Environment and Forests (MOEF) had issued orders for relaxation of the requirement so as to enable hotels to be built between 200 and 100

metres of the beach. The Hon'ble Supreme Court also issued a direction asking the Government to identify the stretches on the coastline on which beaches could be developed and report back to them. Although 15 years have elapsed this work has not been completed, as the MOEF has got involved in the task of comprehensive revision of the CRZ Regulations.

To improve India's competitiveness in beach tourism the Group recommends that a decision be taken quickly on hotel construction on beaches according to the prevailing practice in other countries. The sensitive areas could be clearly defined and one or two long stretches of the coastline, particularly on the west coast, could be opened up for development of tourism.

3.7 Conference Tourism

Meetings, incentives, conferences and exhibitions (MICE) is another area of tourism in which India lacks in competitiveness because of lack of world class conference centre apart from Delhi's Vigyan Bhawan, which is normally reserved for Government conferences. It is estimated that about 500 large annual conferences are held in India by domestic organisations alone. This has the potential to give India a competitive edge, as the conference centre would have assured business for a large number of days in the year. But what needs to be done is to facilitate the establishment of four or five large convention centres in the country. So far a large facility has been built in Hyderabad and another conference centre is proposed to be taken up in Dwarka in Delhi. In order to have more convention centres it would be necessary for the States to facilitate the allocation of land and for the Central Government to give such centres infrastructure status under Section 80- 1A of the Income Tax Act, so that they can have tax benefits.

3.8 Entertainment for tourists

Whether it is heritage tourism or beach tourism, the foreign tourists as well as domestic leisure travellers want some form of entertainment, particularly in the evening. For this purpose consideration needs to be given to allowing casinos to operate in certain locations. Though the subject has remained a taboo in the country it has to be borne in mind that casinos will not only increase the competitiveness of tourism destinations in the country but also have the potential to generate substantial revenues for the State

Governments, just as lotteries have done for some of them. Casinos are the mainstay of the economies of tourist destinations such as Las Vegas, Monte Carlo and Macau. Singapore too has allowed the establishment of two casinos in its territory.

For heritage sites sound and light shows are a favourite form of entertainment. Such shows are being held by the State Tourism Departments in some tourist destinations but they are of poor quality. It is necessary to hold such shows at a larger number of major historical sites and substantially improve their quality.

3.9 Tourist Clusters

In the affluent countries there is flow of tourists out of the cities not only during holidays and almost every weekend, weather permitting. The weekend tourists, particularly those with children, normally go out short distances to resorts and tourist destinations, such as mountains, lakes and beaches. But they also go to man made attractions and clusters of attractions such as Santosa Island Resort in Singapore.

The rapid increase in disposable income in the upper middle class in India presents a big opportunity for development of tourism in the country. The Group recommends the creation of tourism clusters of areas between 100 and 500 acres within a distance of 150 kms for the cities for the setting up of a cluster of facilities and attractions for tourism. They may have hotels, restaurants, spas, theme parks like Appu Ghar in Delhi and Essel World in Mumbai, and attractions such as skating rinks, lakes with boating and sailing facilities, golf courses, tennis courts, and indoor games. Although the clientele of tourist clusters will primarily be domestic, they will also serve to increase the attractiveness of traditional tourist destinations for international tourists. The entire development, including the acquisition of land, will have to be undertaken by the private sector, but as an incentive they will need to be given infrastructure status under Section 80- 1A of the Income Tax Act.

3.10 Human Resource Development

As in some other service sectors there is a large skill deficit in the tourism sector, which is impeding its development and impinging on its competitiveness. There are 26 Institutes of Hotel Management (IHMs), which have come up with Central financial assistance, and 12 more are in the pipeline. There are 125 private institutes affiliated to various universities/boards, which run hotel management courses. There are 6 Food

Craft Institutes (FCIs) run by the Central Government and four more have been sanctioned and 20 run privately. The hotel management institutes including the private ones are producing 14000 graduates annually and the FCIs 4000 workers in the skilled categories. It is estimated that there is 35% attrition to other industry leaving only about 9000 graduates and 2500 skilled workers available annually to the hotel industry. Against this the annual requirement is estimated at 69,000 in managerial and 1.34 lakh in skill level categories. Thus there is a very large shortage of skilled personnel in the hospitality sector and the deficit is more acute in non-managerial categories.

The hotel management courses (of four years) fall under the purview of the All India Council of Technical Education (AICTE), but by virtue of a dispensation granted by the Hon'ble High Court the National Council of Hotel Management & Catering Technology (NCHMCT) has been performing the regulatory functions, fixing the curriculum and affiliating hotel management institutes, holding examinations and granting degrees to graduates in the tie up with the IGNOU. The NCHMCT has also undertaken the regulatory work in respect of the food craft institutions, although a large majority of private institutions remain unrecognised and are not seeking affiliation.

The Indian Institute of Travel & Tourism Management (IITM) is an institute affiliated to the All India Council for Technical Education, running courses for tour operators and holding examinations and granting diploma. The IITM also conducts short-term courses for tour guides, holds examinations and grants diplomas for the profession.

The Ministry of Tourism is proposing to set up 9 more IHMs and 25 more FCIs, so that each State has one IHM (with some tourist oriented States having two) and one FCI. Initiatives are also proposed to make the Industrial Training Institutes, Polytechnics and Secondary Schools in the vocational streams to undertake programmes for increasing the supply of personnel in the skill categories. In the Group there was full support for all these initiatives but the Group also felt that even after all of them fructify there will still remain a huge shortage of skills in the hospitality sector.

The Group believes that expansion of education and training in hotel management, food crafts, travel and tourism education (including the training of tour guides) should be left to the private sector and the Central Government should devote its attention primarily to regulation. For this purpose both the NCHMCT and the IITM should function as apex institutions and should be vested with powers to regulate affiliated

institutions, hold examinations and grant degrees and diplomas, independent of the AICTE. It may be necessary for Central Government to consider giving statutory status to the NCHMCT and IITM as regulatory organizations. The existing IHMs and FCIs should function as institutes of excellence and devote a substantial part of their resources for training of teachers.

Since IHMs can be run on a self-sustaining basis, the only help that privately run IHMs may need is allocation of land at reasonable cost or on long term lease by the State Governments. The requirement of hospitality personnel in the skilled categories is however very large and much wider initiative for undertaking vocational training programmes is required than is being envisaged at present. For taking such initiative the establishment of a development council with the full participation of the industry, as suggested in Chapter I, would appear to be the right step.

Chapter 4

Shipping

India is not a large shipping nation in terms of its merchant fleet and at the beginning of 2006 it was ranked 20th in terms of its fleet size in gross tonnage (gt) by flag of registration constituting 1.16 per cent of the world fleet according to Lloyd's-Fairplay "World Fleet Statistics 2006". The world cargo carrying fleet has been experiencing a boom in recent years and has grown from the level of 464.99 million gt in 1995 to 528.79 million gt in 2000 and further to 687.98 million gt in 2006. In India there was slow growth in the size of the fleet during this period but tax reform with effect from 1.4.04 induced impressive growth thereafter, from below 7 million gt on 1.4.04 to more than 8.5 million gt on 1.4.06 and more than 9 million gt on 1.10.07.

The Indian shipping fleet's share in the carriage of India's own overseas trade has been slipping over the years. While India's merchandise trade has been increasing by over 20 percent per annum in terms of value over the past few years and the sea borne trade has risen from 224.62 MMT in 1999-2000 to 447.14 MMT in 2005-06 the share of Indian ships in the carriage of India's overseas trade has fallen from 31.5 percent in 1999-2000 to 13.7 percent in 2005-06.

We have seen in Chapter I that in transportation services India's Revealed Comparative Advantage Index has been on the decline. Since international movement of goods by sea constitutes a large proportion of transportation service transactions¹² this decline reflects a weakening in the competitive situation of Indian shipping as well. It is not that Indian shipping is inherently incompetent but that it does not have enough capacity to carry more of Indian cargo. The additions to the Indian fleet have been concentrated mainly in oil tankers (in which the capacity has increased from about 3.0 million gt as on 1-4-2002 to 4.7 million gt on 1-10-2007) while in others such as bulk carriers and liner vessels there has been an actual fall in the gross tonnage. According to the Report of the Task Force on Financing Plan for Ports the sea borne traffic at major

¹² See footnote 4 for definition of transportation services.

Indian ports is likely to rise to 708 MMT by 2011-12 from 464 MMT in 2006-07, with the container traffic registering the maximum increase.

Bulk carriers and tankers constitute a large proportion of the country's merchant fleet accounting for around 85% of the tonnage. Due to the growing energy demand in the country there is potential for Indian ship owners to expand their tanker fleet even further. Apart from this there is scope for them to add offshore supply vessels to cater to the planned programme of oil and gas exploration in the country. The programme for expansion of ports and deepening of channels has also created a big opportunity for addition of dredgers to the Indian fleet.

The unwillingness of Indian entrepreneurs to add to the merchant fleet is not due to a dearth in availability of trained seafarers in the country, although there is a problem associated with the taxation regime relating to seafarers with which we shall deal later, which has led to shortage of officers to man Indian ships. Indian seafarers are internationally acclaimed for their know how in ship operation and management. India's share of global maritime manpower is currently 26,950 officers and 52,000 ratings comprising an estimated 6 percent of world seafarers.

As far as container shipping is concerned, it must be acknowledged that Indian entrepreneurs do have a late entrant's disadvantage in entering the business of carriage of containers. As noted by the XI Plan Working Group on Shipping and Inland Water Transport 'container shipping companies that succeed in their business are the ones that succeed in combining or commanding expertise in shipping with container handling, logistics management and multimodal operations for the efficient carriage of small lots of containers for different ports and the return of empty, preferably stuffed containers back to their mother ships.' At present 61 percent of the containers originating in or destined for India are being transhipped from Colombo. The assessment of the XI Plan Working Group is that given the complexity of container movement and the lack of expertise in the country in container handling and the level of sophistication of container logistics management the growth of Indian flag will for some time remain confined to feeder vessels. Apart from the above difficulty in achieving quick growth in container related fleet size the shipping industry does not suffer from any inherent handicap.

In fact the burgeoning growth of India's sea borne trade and the long tradition as a provider of seafarers to the world shipping, India should be in a strong position to expand its merchant fleet and aspire for a larger share of carriage of its international cargo. Since ships with foreign flags compete for Indian cargo on equal terms with Indian flag vessels the latter's competitiveness is strongly influenced by any differential in the fiscal regimes. 29 countries accounting for more than 70 percent of the world tonnage, including the Flags of Convenience countries, give wide flexibility to the ship owners registered in those countries in their operations along with low taxation levels under the Tonnage Tax scheme. Many European countries and Korea, which account for about 15 percent of world tonnage, have adopted a dual tax system under which the Tonnage Tax scheme is offered as an alternative option to the corporation tax scheme. Since the lower taxes in other maritime nations was a major disincentive to Indian shipowners to expand their tonnage, the Government of India introduced Section 33 AC in the Indian Income Tax Act 1961 with effect from 1.4.90. Under this provision the shipping companies were given the benefit of transferring into a Special Reserve a part of the profits derived from shipping operations up to twice the paid up share capital, the general reserves and the amount credited to the share premium account of the company. The amounts so transferred into the Special Reserve were to be utilized for purchasing ships within eight years. Although Section 33AC was estimated to have reduced the incidence of direct tax on shipping companies to about 15 percent it failed to adequately encourage acquisition of new tonnage by Indian ship owners.

The decision to adopt the tonnage tax system with effect from 1.4.04 had a much more favourable effect and boosted the growth of Indian merchant fleet. Under the new regime shipowners can opt for the tonnage tax whereby income tax is levied on the basis of presumptive income of the Net Tonnage (NT) of each ship owned by Indian shipowners determined according to a fixed scale. It has been estimated to have reduced the incidence of tax to a level of around 3 percent. The new regime imposes two obligations on the shipowners: they have to transfer 20 percent of the book profit derived from shipping operations to a Special Reserve (Tonnage Tax Reserve) account to be utilized for additions to tonnage within eight years and they have to train officers in the ratio of one trainee officer for a complement of 10, based on Safe Manning Document employed by them. The shipowners are also subject to the restriction that they cannot in-

charter more than 49 percent of the NT (including the NT owned by them) operated by them in any previous year.

4.1 Taxation Issue

The industry maintains that the benefit of tonnage tax in 2004 has been eroded by certain taxes which were introduced or the rates of which were enhanced subsequently as shown below:

Particulars	As on 01.04.04	As on 31.12.07
Service Tax (Number of services covered)	76	107
Rate	8%	12.36%
Dividend Distribution Tax	13.07%	17%
Minimum Alternate Tax	7.84%	11.33%
Fringe Benefit Tax	Nil	Deemed benefit computed at varying rates on various types of expenditure which is subjected to normal Corporate Rate of 33.99%

The XI Plan Working Group on Shipping and Inland Water Transport has enumerated the following taxes and taxation practices affecting the competitiveness of Indian shipping companies and the Indian National Shipowners' Association (INSA) has drawn attention to the same taxes and taxation practices in its presentation to the HLC:

Direct Taxes

Corporate Tax on Interest and Other Income

Minimum Alternate Tax (MAT) on profit on sale of vessels

Dividend Distribution Tax

Fringe Benefit Tax

Withholding Tax Liability on Interest paid to Foreign Lenders

Withholding Tax Liability on Charter Hire Charges Paid to Foreign Shipowners

Seafarer's Taxation- Cost to Employer

Wealth Tax

Indirect Taxes

Service Tax

Sales Tax/ Value Added Tax (VAT) on ship supplies/Spares

Lease Tax on Charter Hire Charges

Customs Duty on Import of certain categories of Ships, Stores, Spares & Bunkers

In October 2005 the Ministry of Shipping, Road Transport & Highways had set up a Group to review the tax regime applicable to the shipping industry and the Group submitted its Report in August 2007. The following is the Executive Summary of the Group's Conclusions and Recommendations:

'Recognising the importance of Indian shipping to the country's trade and economy and with a view to provide a level playing field so that Indian shipping becomes internationally competitive, the Group recommends that

- Income such as interest income earned by tonnage tax companies should be covered under the tonnage tax regime. Further, the income from incidental activities qualifying under the tonnage tax regime should be suitably enhanced from the existing 0.25% to 1.00 % of the turn over from core activities.
- Surplus resulting from sale of vessels should be covered within the scope of tonnage tax regime.
- Indian shipping companies should be exempted from payment of dividend distribution tax on dividend declared/ distributed to the shareholders.
- Indian shipping companies should not be subject to Fringe Benefit Tax (FBT) on their major component of expenditure such as travel expenses, boarding and lodging expenses etc. incurred for official purposes to ensure their competitiveness.
- Indian shipping companies should be exempted from withholding tax on interest paid to foreign lenders.
- Indian shipping companies should be exempted from withholding tax on charter hire charges paid to foreign ship owners.
- Indian shipping companies should be exempted from the burden of grossing up of tax on salaries of seafarers received in India (even in a case where services are

rendered outside India) or on salary related services rendered in India. Alternatively a fixed/ flat rate of tax (5%) be collected from all Indian seafarers irrespective of their residential status and/or the company or flag of ship they work for.

- Wealth tax should be leviable only on immovable property and that movable property should be kept outside the scope of said tax.
- The ship supplies/spares provided to foreign going Indian ships should be zero rated.
- The lease tax/nor VAT payable on charter hire charges in each State should be zero rated for international sea going vessels.
- Customs duty should not be applicable on import of stores, spares and bunkers on the supplies for use in international sea-going vessels. The 5% customs duty on import of Tugs and Pusher Crafts, Dredgers and Floating Docks/ cranes/ production platforms be removed.
- Since in almost all the maritime countries the shipping industry is not subject to service tax either domestically or internationally, Indian shipping should also be provided with similar treatment to ensure a level playing field in their international operations. Moreover, it is imperative that no national level as well as state level fresh levies should be made applicable to the shipping industry.’

The High Level Group noted that the proposals for improving the competitiveness of Indian shipping was heavily reliant on tax concessions. However, the Group also took into account the fact that governments compete for getting the registration of ships done in their jurisdictions and the tax advantages they offer is the main consideration influencing the decision of investors in new shipping tonnage. Other considerations are the availability of cargo and of trained seafarers in the concerned jurisdictions. On both these aspects India was quite favourably placed. The fact that the reduction in incidence of tax in 2004-05, consequent upon the introduction of the tonnage tax regime, had led to immediate increase in Indian owned tonnage confirmed the sensitivity of decisions of investors in shipping to the tax levels. But the fact that the initial impact had tended to peter out and there was no investment from foreign investors despite 100 percent FDI being permitted indicated that more needed to be done on the tax front. The Group was of the view that in granting tax concessions to any particular sector, the Government had to

be conservative and in the case of shipping only those proposals needed to be considered, which improved the competitiveness of Indian shipowners vis-à-vis foreign shipowners. Of the 12 taxes and tax practices enumerated above, according to INSA the ones that impinge the most on Indian ship owners are service tax, MAT on profit on sale of vessels, corporate income tax on interest, seafarers' income tax- borne by employers, withholding tax on charter hire charges and withholding tax on interest on ECB, and the Committee examined these in detail.

4.1.1 Service Tax

The shipping companies are liable to pay service tax @12.36% on various services rendered to them , such as cargo handling, clearing and forwarding, general insurance/ P&I, clearing and forwarding agent service, port services, repair and maintenance, steamer agents, storage and warehousing, survey, manpower recruitment and professional services. The nature of some of these services (e.g. cargo handling, clearing and forwarding, clearing house agent, port charges, steamer agent, and storage and warehousing) is such that their suppliers have necessarily to be local and at the Indian end both Indian owned and foreign ships pay the same service tax. At the foreign end no service tax is levied on foreign ship owners as shipping services are either exempt or zero rated worldwide. Indian shipping companies in terms of normal conditions of business, are obligated to obtain and consume outside India services (input services) like port services, repairs, dry-docking, cargo handling (loading/unloading), steamer agents services to name a few. But they have to pay service tax in India even on services provided from outside and received outside India unless they have been specifically exempted. Ministry of Finance notification No. 11/2006 dated 19 April 2006 on Taxation of Services (provided from outside and received in India) Rules, 2006 (Import of Services Rules) gives partial exemption from service tax and the services availed outside India in relation only to a limited list including maintenance and repair, port charges, and cargo handling. However, these rules impose service tax on services received in India from overseas such as P&I insurance, brokerage/commission, banking and other financial services, manpower recruitment, ship management services etc. Foreign ship owners would normally be inclined to obtain the services in the latter group from foreign service suppliers and pay no service tax as these taxes are either exempt or zero rated. On the other hand the Indian ship owners would have to pay service tax on all these services supplied by foreign and domestic service suppliers.

In order to even out the differential incidence of service tax on Indian and foreign ship owners it is necessary to take the following measures:

- (iii) Shipping companies should be exempted from service tax on all services provided from outside India, whether received in India or outside.
- (iv) Shipping companies should be exempted from service tax on all services provided within India in respect of services in which they have the option to employ service suppliers from abroad or from India such as P&I, ship management fees, repair and maintenance, commission and brokerage, and manpower recruitment. This will have the effect also of encouraging the shipping companies to obtain the services from Indian suppliers.

4.1.2 Minimum Alternate Tax (MAT) on Profit on Sale of Vessels

In India profit on sale of vessels is not covered under the tonnage tax regime. The company availing of the tonnage tax regime is liable to pay MAT @ 11.22 % on the book profits in case the tax payable on income (other than tonnage income) is less than 10% of the book profits. The profit on sale of vessels gets credited to the profit and loss account and is included in the book profits of the qualifying shipping company on which MAT is applicable. The Group was shown extracts from the relevant laws prevailing in the United Kingdom, Singapore, Ireland, Netherlands, Germany, Spain and Belgium, all of which showed that the profit on sale of vessels is covered within the scope of tonnage tax regime. In light of the practice in these important shipping nations it would be necessary to provide in our tax laws also that the surplus resulting from sale of vessels is covered within the scope of tonnage tax regime.

4.1.3 Corporate Income Tax on Interest

As mentioned above the Indian tonnage tax regime requires the creation on a compulsory basis of a special reserve to be utilised for acquisition of tonnage within a period of eight years. While waiting for the accumulation of sufficient reserves and the opportune time for acquisition of tonnage the amounts in the reserve earn interest, which is liable to income tax at present. While in most jurisdictions investment income is no doubt outside the tonnage tax system no other country with a tonnage tax system requires the creation of reserve for acquisition of ships. Taxation of interest income arising from

the special reserve, which has been created compulsorily as a condition of the operation of the tonnage tax regime clearly erodes the benefit of the regime. In Double Taxation Agreements with a number of countries, viz., Belgium, China, Denmark, Germany, Netherlands, Mauritius, South Africa, Sri Lanka and the USA, interest on funds has been treated as income arising from shipping operations. Consistency of approach in our tax laws would also require the interest income to be treated as income from shipping operations and brought within the purview of the tonnage tax regime. There is therefore a case for the interest earned from special reserves to be treated as income from core activities and covered within the scope of the tonnage tax regime.

4.1.4 Seafarers' Taxation- Cost to Employer

Ships registered in India are statutorily required to be manned by trained/qualified and experienced personnel who can effectively implement quality systems and maintain high value assets to prevent accidental losses and environmental degradation. Indian ships face acute shortage of experienced manpower, mainly officer category, because ships under foreign flags are able to offer so-called 'tax free' pay packet to them. The differential tax treatment of manpower is not really intended in our tax laws but is the result of circumstance. For the payment of income tax an Indian citizen employed as a seafarer may be treated either as resident or a non-resident (in case his stay is outside India for more than 182 days). For their earnings outside India as non-resident they pay no income tax while for their earnings in India they pay income tax. If a seafarer is employed on a vessel of Indian flag the employer is obliged to deduct income tax at source and the deduction is meticulously made for the full period the vessel has spent in Indian waters. On the other hand a foreign flag owner is under no obligation to deduct income tax at source leaving it to the seafarer to make appropriate declaration in the income tax return. Since there is no proof on the passport on how much time the vessel (or the seafarer) has spent in Indian waters the seafarer makes the declaration on the basis of entries in the passport thus escaping from the tax net for the period the vessel has spent in Indian waters. In this manner the seafarer gets a tax advantage while working on foreign flag vessels. Naturally the preference of all seafarer will be to work on ships of foreign flag unless the Indian shipping company is willing to reimburse the income tax paid. This results in increasing the cost for Indian ships in employing seafarer. Because of the differential tax treatment received from Indian and foreign ships qualified and

experienced seafarers avoid to work on Indian shipping companies thereby given foreign shipping companies an advantage.

A comparative table showing the tax regime for seafarers in India and selected maritime countries is attached at Annex I. It would be seen that there is wide variation in practice of taxation on seafarers. While some exempt taxes for all seafarers employed by vessels, whether of national or foreign flag, others exempt only seafarers employed on board the ship flying the national flag. In some countries employers are entitled to reduction in tax on the salaries payable to seafarers while in others the seafarers serving on national flag vessels pay a much lower income tax on a flat rate.

Having regard to the international practice INSA has suggested three alternative solutions for consideration of Government:

- Easing of procedural constraint by counting the seafarers stay outside the country on the basis of dates stamped on the CDC.
- Non-resident status for the purpose of taxation of salary income of seafarers being granted on the basis of stay of 120 days outside the country instead of 182 days.
- Instead of the current system of tax on accrued income basis a flat tax being levied on all Indian seafarers irrespective of their residential status and/or the flag status of the shipping company they work for.

The Group was of the view that Indian shipping companies were being put to a serious disadvantage by the way the Indian income tax laws were being applied to Indian seafarers working on Indian flag vessels and an appropriate solution had to be found to provide a level playing field to Indian flag ships on taxation of Indian seafarers.

4.1.5 Withholding tax on ECB interest

The withdrawal of exemption from withholding tax on remittances of interest on ECBs taken on or after 1-6-2001, has adversely affected the Indian shipping industry. Presently, the interest paid by Indian shipping companies to foreign lenders on acquisition of ships is subject to withholding tax at the rate of 20% which may be reduced to 10-15% as provided in the respective DTAAs. The Indian National Shipowners' Association drew attention of the Group to the fact that around 70% of the world tonnage operates from flag of convenience countries such as Panama, Liberia, Bahamas etc. where there was neither any ECB restriction nor withholding tax. Interest paid on loans

for acquisition of ships is exempted from withholding tax in other maritime nations also. In Singapore complete exemption from withholding tax is provided on interest paid to foreign lenders if the loan is utilised for purchase of vessels to be registered under the Singapore flag. For the present the exemption window is for the period of 1st Nov. 2003 to 31st Dec. 2008. In Netherlands, there is no withholding tax on interest and in case of a non-resident having zero/less than 5% shareholding, the Netherlands sourced interest income is not subject to domestic tax. Similarly, under the domestic law of Germany, there is no withholding tax on interest paid to non-residents. Since almost 75 to 80% of the funding for ship acquisition is through foreign lending, the Group was of the view that in order to provide a level playing field on taxation matters, the exemption from withholding tax on interest paid to foreign lenders under Sec. 10(15)(IV) C of the Income Tax Act 1961 should be restored for Indian shipping companies.

4.1.6 Withholding Tax on charter hire charges

In India payment towards in-chartering of foreign flag ships is being treated as use of 'equipment' under Section 9(1) (VI) the Income Tax Act making the charter hire charges taxable as a royalty and withholding tax is payable @10%. Clause (iva) of Explanation 2 to section 9 (1) (VI) defines royalty to include payment made inter alia for the use or hire of industrial, commercial or scientific equipment. Further section 43 (3) of the Income tax Act defines 'plants' to include 'ships, vehicles, books, scientific apparatus and surgical equipment used for the purposes of the business or profession'. Thus it is not consistent with other provisions of the Income Tax Act to treat ships as equipment under section 9(1) (VI) of the Income Tax Act.

In the UK there is no withholding tax on charter hire paid to foreign ship owners. In Singapore charter fees paid to non-residents is subject to withholding tax @15% but following a ruling of the Comptroller of Income Tax withholding tax is being paid @ 0-3%. In Netherlands too no withholding tax is payable on charter hire charges payable to foreign ship owners. The same is the case in Ireland.

The Group was of the view that both from the point of view of consistent interpretation of law and providing ships with Indian flag with a level playing field on taxation matters no withholding tax should be levied on in-chartering of foreign ships.

4.2 Cargo support issue

Recognition of the need for a policy for cargo support in India predates Independence. The report of the Reconstruction policy Sub-Committee on Shipping, which was accepted by Government of India by the Resolution of July 1947, envisaged a cargo reservation policy for 100 percent coastal cargo, 100 percent strategic cargo like crude oil and oil products on the coast and overseas, 50 percent dry bulk cargo in overseas trade and 40 percent cargo in liner trade. This policy was subsequently enshrined in the Merchant Shipping Act of 1958. India also adopted the UN Code for liner Conferences which provided for 40:40:20 sharing of liner cargo. The policy of cargo support to Indian ships took concrete shape in the form of cargo policy directive requiring the Central/State Government Departments and Public Sector Undertakings to enter into import contracts on FOB/FAS basis and export contracts on C&F/CIF basis. Since much of the bulk imports and exports in the pre-reform era was canalized through CPSUs this directive covered a substantial proportion of trade.

For implementing the policy of cargo support to Indian ships the Central Government established TRANSCHART as the chartering wing of the Ministry of Shipping in 1958 to centralise the shipping arrangement for all Government and canalised cargo and the wing is still in existence. Presently it operates on the basis of giving the right of first refusal to Indian shipping companies to accept the freight rate that it offers after inviting quotations from both Indian and foreign shipping companies. Thus there is no price preference but only purchase preference for Indian shipping companies. Over the years TRANSCHART has been a source of strength for Indian vessels in the carriage of Government owned/controlled cargoes. A review of its operations since 1960 shows that particularly in the years of recession in shipping, it could obtain a high share for Indian vessels in the carriage of such cargo, reaching a maximum of about 75% in 1987. During the recent boom it has succeeded in raising the share of Indian vessels from about 23 % in 2001 to almost 44% in 2006. During the period 1.4.06 to 31.3.07 Indian vessels carried 42.55% of Government and PSU cargo. However, in terms of the quantum of cargo carried by Indian vessels, there was a decline from 243.80 lakh tonnes in 2004 to 176.39 lakh tonnes in 2006. Nevertheless, the cargo support policy has helped to strengthen the Indian shipping industry, which is keen on its continuance.

With the economic situation improving in the country and controls on foreign trade being dismantled the cargo reservation policy has been under pressure. First in 2001 relaxed the requirement of centralized shipping arrangement for exports and the Government Departments/ PSUs were permitted to finalise the export contracts on FOB/FAS basis without seeking prior TRANSCHART clearance. In recent years most of the oil companies have been permitted to make their own arrangement of shipping for import contracts as well on the plea that finalising contracts through TRANSCHART was causing delays and resulting in higher transportation costs. The dilution in Government policy on cargo reservation for Government controlled/ owned cargo has already had substantial impact on the TRANSCHART operations and the volume of shipping arrangements in respect of such cargo declined by more than 25 % in 2006 as compared to the previous year.

The Group considered the continuation of the policy of cargo support to flag ships through TRANSCHART in future and came to the conclusion that since the competitiveness of Indian ships was diminished by the tax handicaps discussed above and since the growth of Indian shipping needs to be encouraged, the cargo support policy needed to be continued. Among major industrialised economies, the USA and China have a proactive policy of cargo reservation, requiring only vessels with the domestic flag to be used for carriage of national cargo. The policy could be revisited after progress has been achieved in eliminating the tax handicaps of Indian shipping.

In the evolving context of India's growing energy demand and consequent dependence on global energy markets, the Committee also considered the urgent need to own and develop a national "core" fleet in the energy sector. It is felt that this core fleet of strategic marine assets, similar in concept to the United States "Sea-lift Command", can be used in case of national emergency and/or war to ensure energy security, by means of un-interrupted transport and service of essential commodities such as crude oil, petroleum products, gas, coal and offshore oil fields. During peace times this core fleet could be deployed on long-term contracts with public sector units serving the commercial shipping requirement of the nation. This fleet would also serve as protection against the imperative 2010 phase out of single hull tankers. While the economy benefits in terms of national security, the industry too benefits as long-term contracts often lead to lower financing costs, which in turn can be shared with the end user.

4.3 The Cabotage Issue

Coastal traffic has a share of more than 25 % in the traffic of major ports. It is expected to grow from a level of about 110 MMT in 2004-05 to 220 MMT by the end of the XI Plan period (2011-12). The country's coastal vessel tonnage as on 30-09-2007 comprised 497 vessels of 870255 gt.

As mentioned earlier the policy on cabotage was a subset of the policy of cargo reservation whereby foreign flag ships were not to be permitted to carry coastal cargo. The Merchant Shipping Act 1958 does not prohibit the carriage of coastal cargo by foreign flag vessels but requires permission of the Director General Shipping to be taken under sections 406 and 407 of the Act for the purpose. Permission for chartering of foreign flag vessels is granted on receipt of an application seeking such permission if no objection is received within 24 hours of the notice inviting objections being published on the website of the Directorate General of Shipping.

The Group considered the cabotage policies pursued by advanced maritime nations and noted that the US and Chinese cabotage laws are quite restrictive in the world. These countries have taken a very strident position in protecting the coastal trade to vessels of national ownership, documentation, control, construction and crewing. Japan and Korea also pursue cabotage policy for strategic cargoes like LNG and have almost exclusive control over the transportation of their LNG imports. They have gone one step further by backward integration of the LNG chain by building LNG ships in their country and thus also controlling LNG shipping. The Committee took the view that the policy on cabotage needed to be continued. The brand value of the national flag can be maintained only through such policies like first right of refusal and cabotage. Allowing foreign lines to have an open access in the carriage of Indian cargo, without the need for registering ships in India, will defeat the objective of building a national tonnage.

Chapter 5

Healthcare Services

5.1 Overview of Healthcare Services in India

5.1.1 Public Health System

Public institutions played a dominant role in the Indian Healthcare sector in the past, in the urban as well as in the rural areas. The vast network of public health institutions in the country comprises 3910 Community Health Centres (CHCs), 22,669 Primary Health Centres (PHCs), and 144,988 Sub Centres (SCs), in the rural areas and 7663 Government Hospitals, mainly in the urban areas. However, the public healthcare has been on a serious decline during the last two or three decades because of non-availability of medical and paramedical staff, diagnostic services and medicines. The situation in availability of specialist manpower in CHCs is particularly bad as against the sanctioned posts about 59.4 % surgeons, 45% obstetricians and gynaecologists, 61 % physicians and 53 % paediatricians were not in position (in March 2006). Equally distressing is the fact that essential therapeutic drugs are not supplied in most public health institutions with the exception of some States. Consequently there has been a pronounced decline in the percentage of cases of hospitalized treatment in Government hospitals and a corresponding increase in the percentage treated in private hospitals. According to the NSSO (1986-2004) data the utilization of government hospitals declined from 59.7% in 1986-87 to 41.7 % in 2004 in rural areas and from 60.3 % in 1986-87 to 38.2 % in 2004 in urban areas. The XI Plan document sums up the situation that prevails over a large part of the country (but not including some States) as follows:

‘Despite higher costs in the private sector, this shift shows the people’s growing lack of trust in the public system. Critical shortage of health personnel, inadequate incentives, poor working conditions, lack of transparency in posting of doctors in rural areas, absenteeism, long wait, inconvenient clinic hours, poor outreach, time of service, insensitivity to local needs, inadequate planning, management, and monitoring of service/facilities appear to be the main reasons for low utilization’.

Public healthcare expenditure, which accounts for less than 1 per cent of GDP compares unfavourably with developed countries, which is 5 per cent of GDP, and even with developing countries as a group, which is 3 per cent of GDP. Another significant feature of India's healthcare is that public healthcare accounts for only 25 per cent of the total healthcare expenditure in the country, and out-of-pocket expenditure, private health insurance, employers etc account for the remaining share. This contrasted with the situation in the developed economies. In the EU for instance, the share of private health spending was in the range of 23-24 per cent during 2000-2003 (Yuen, Compendium of Health Statistics 2005-06, Radcliffe Publishers, 2005, cited in Rupa Chanda, India-EU Relations in Health Services: Issues and Concerns in an India-EU Trade and Investment Agreement, ICRIER, 2008).

5.1.2 Initiatives on Public Health Infrastructure in the XI Plan

During the XI Plan it is proposed to raise the public health expenditure level from 1% of GDP at the end of the X Plan to 2% of the GDP at the end of the XI Plan. In the National Rural Health Mission (NRHM) the main aim is to expand the infrastructure in the rural areas and to fill in the human resource gap during the XI Plan period. Over 5 Lakh Accredited Social Health Activist (ASHA) will be provided, one for every 1000 population. Nearly 1.75 lakh SCs will be made functional by providing the services of two Auxiliary Nurse Midwives (ANM) by 2010. 30,000 PHCs will be staffed with 3 Staff Nurses each to provide 24x7 service by 2010. 6500 CHCs will have 7 Specialist and 9 Staff Nurses by 2012. 1800 Sub Divisional and 600 District Hospitals will also be strengthened. Untied grants and annual maintenance grants will be given to every SC, PHC and CHC. The National Urban Health Mission (NUHM) will meet the health needs of the urban poor, particularly the slum dwellers by making available to them essential primary health care services.

An essential component of strengthening primary health facilities will be a system of guaranteeing essential drugs. Since unsafe drinking water and lack of sanitation increases exposure to diseases in the rural areas and in the urban slums, one of the policy initiatives is to bring about convergence of health care, hygiene, sanitation and drinking water at the village level and in urban slums.

5.1.3 Healthcare in the Private Sector

Recent decades have seen a tremendous growth in private sector investment in healthcare. As noted in the XI Plan document, 'There is diversity in the composition of the private sector, which ranges from voluntary, not-for-profit, for-profit, corporate, trusts, stand-alone specialist services, diagnostic services to pharmacy shops and a range of highly qualified to unqualified providers, each addressing a different market segment'. According to the NSSO data, by 2004 the private healthcare providers were already accounting for 60 % of the cases of hospitalized treatment in the country and this proportion is likely to have gone up since then.

Although 100% FDI has been permitted in the country under the automatic route since 2000, FDI activity has been limited. Of the 90 projects approved for FDI during the period 2000-2006 (up to July), 21 were for hospital and the remaining for diagnostic centres. While FDI flows are likely to pick up in future it is not expected that very large corporate hospital chains would move into the country in the near future. However, there has been considerable corporate investment already in hospitals in the country with the help of FIIs and foreign equity and this is likely to continue. Some of the big names are Apollo Hospitals, Fortis Healthcare, Max Healthcare and Wockhardt. Apollo is the world's third largest health provider and has 7,000 beds in 38 hospitals, 46 primary clinics and over 135 pharmacies operating in more than 20 cities in India, besides the hospitals in the Middle East and Sri Lanka (Burrill India Life Sciences Quarterly-January 2007). Fortis is the second largest private health provider in India, with 1580 beds in 12 hospitals in North India at present but it has ambitious plans to run 40 hospitals nationwide by 2010 (Bruce Stokes, Bedside India, National Journal May, 2007). Wockhardt has earned a name for excellence in cardiac care and has an international alliance with Harvard Medical International. Max Healthcare is another large player, which has set up a number of hospitals and primary health centres in North India.

Some of the major proposed and newly established hospital projects are: Dr Naresh Trehan's Medicity, Gurgaon (Rs 1,200 crore- 1,600 beds); Apollo Health City, Hyderabad (Rs 1,000 crore- 500 beds); Fortis Medicity, Gurgaon (Rs 1,200 crore- 600 to 800 beds); Fortis Medicity, Lucknow (Rs 500 crore to Rs 800 crore-800 beds); Health

City, Bangalore (Rs 2000 crore -5000 beds); and Bengal Health City project spread over 800 acres about 20 Kms from Kolkata.

There are a number of prospective FDI players who are contemplating investment in the country. Gleneagles, which has earlier entered into a joint venture with Apollo, is reported to be interested in entering on its own. EMAAR Group from Dubai has plans to set up more than 100 hospitals in India and the Pacific Group, which already begun operations in a small way at Hyderabad, is another prospective player.

With no regulatory impediments on the expansion of private healthcare the expectation is for sizable investment by private players in the sector in the next few years. A FICCI- ERSNT & Young study projects that out the 1 million beds that are likely to be added in the country up to 2012 as many as 896,000 will be added by the private sector.

5.1.4 Medical Value Travel in India

What is significant is that the hospitals established by the private corporate players are of world class. They have not only the latest medical technological facilities but also the services of Indian doctors and nurses with a high degree of proficiency. Corporate hospitals are completely equipped, up market and proficient and can measure up, or even outshine, any hospital in the west. India's value proposition is it being able to offer highly cost competitive medical treatment with the most up-to-date technological advances (Burrill India Life Sciences Quarterly- January 2007). The quality of their service coupled with the highly competitiveness charged by them for common surgeries has made India an attractive destination for medical value travel. It is estimated that in 2002 as many as 150,000 medical tourists travelled to India bringing in earnings of US \$300 million. The CII-McKinsey Report of that year projected that this figure would go up to US \$ 2 billion by 2012. The Indian Government has moved to provide visa facilities for the medical tourists. The main clientele comes from the SAARC countries but an increasing number of NRIs settled in the US and the UK have also been availing of the healthcare services in India. There is a good prospect of patients coming from the Middle East in future. The main impediment for medical tourists coming from the UK and US for major surgeries is the fact that the insurance companies are generally not willing to cover treatment in India. However, the cost savings involved in getting treatment done in India is bound to result in the insurance company imposed barriers breaking down in future.

Already some hospitals are entering into alliance with international insurance companies for making it possible to send patients to India for treatment.

Table 5a Costs of selected procedures in selected countries (US \$s)

Procedure	Thailand	India	Singapore	US	UK
Heart bypass graft surgery	7,894	6,000	10,417	23,938	19,700
Heart valve replacement	10,000	8,000	12,500	2,00,000	90,000
Angioplasty	13,000	11,000	13,000	31,000–70,000	---
Hip replacement	12,000	9,000	12,000	22,000-53000	---
Hysterectomy	10,000	---	13,000	---	---
Bone marrow transplant	----	30,000	---	2,50,000-4,00,000	150,000
Liver transplant	----	40,000-69,000	---	3,00,000-5,00,000	200,000
Neurosurgery	----	800	---	29,000	
Knee surgery	8,000	2,000-4,500	---	16,000-20,000	12,000
Cosmetic surgery	3,500	2,000	---	20,000	10,000

Source: Burrill India Life Sciences Quarterly-January 2007, Arunanondchqair and Fink (December 2005), CUTS (2007), Abinid, Alavi, and Kamaruddin (2005), Escorts Heart Institute and Research Centre Limited (2007), and various web sources. (Cited from Smith,R., R. Chanda and Tangcharoensathien, 'Trade in health-related services', *The Lancet*, Elsevier Publishers, UK)

The competitiveness of India in medical value travel is enhanced by the attractiveness of the alternative systems of medicine, Ayurveda in particular, for the foreign tourists. A large number of tourists, both domestic and foreign, undergo treatment under Ayurveda not only for improving their fitness and well-being but also for curing many types of chronic diseases. For the regulation of Ayurveda clinics and for ensuring that they employ techniques in accordance with traditional methods the Ministry of Health has issued guidelines to be used by the States. Accordingly Kerala, the most popular destination for tourists for treatment under Ayurveda has promulgated an Ordinance regulating Ayurveda Health Centres. The Ordinance requires registration of such centres and prescribes the facilities and medical staff that they must have in order to run them. The unique position that Kerala enjoys with respect to Ayurveda is due to the fact that the treatment in the State has proved effective in dealing with certain diseases,

which are incurable by other systems. The State is also well endowed with herbs and medicinal plants, which are used for treatment.

5.1.5 Indian Medical Professionals in Foreign Countries

One of the main reasons for the international competitiveness of private healthcare institutions in India is the quality of Indian medical professionals. While the quality is highly variable across the country the best professionals in India match the quality of professionals in the developed countries. For several decades Indian medical professionals have been serving not only in the Middle East but also in several English speaking developed countries including the USA and the UK. As the Table below shows almost 60,000 physicians were working in four major English speaking countries, constituting up to about 5% of the work force.

Table 5b 20 major nations providing physicians to the US, UK, Canada and Australia in 2004

Source country	% of US physician workforce	% of UK physician workforce	% of Canadian physician workforce	% of Australian physician workforce	Total no. from source country
USA	-	0	0.8	0	519
UK	0.4	-	4.0	8.6	10,838
Canada	1.1	0	-	0	8,990
Australia	0	0.5	0.4	-	1,119
India	4.9	4.9	2.1	4.0	59,523
Philippines	2.1	0	0.4	0.3	18,291
Pakistan	1.2	2.1	0.5	0.2	12,713
South Africa	0	1.2	2.0	2.3	4,987
Ireland	0	3.0	1.7	0.8	4,433
Egypt	0.5	1.1	0.8	1.0	7,278
Germany	0.4	0.6	0	0.2	4,695
New Zealand	0	0.3	0	3.2	2,047
China/HK	0.8	0	0.3	0.8	7,335
Sri Lanka	0	0.5	0.2	1.2	2,212
Poland	0.3	0	0.6	0.3	2,995
Jamaica	0	0.4	0.3	0	651
Vietnam	0	0	0.3	0.2	331
Lebanon	0.3	0	0.2	0	2,717
Mexico	0.5	0	0	0	4,578
Nigeria	0.3	0.8	0	0	3,921

Source: Mullan (February 4, 2005). USA based on ECFMG, AMA (2004); UK based on NHS (adjusted); Canada based on Canadian Institute for Health Information, CAPER (2002); Australia based on Australian Institute of Health and Welfare, 1999 (adjusted)

It is not only physicians but also nurses who are in demand as can be seen in the Table below:

Table 5c Top Five Countries for Nurse Applicants for New Work Permits in the UK, 2002

Country	No. of Work Permits Issued
Philippines	10,424
India	3,392
South Africa	2,835
Zimbabwe	2,346
Nigeria	1,501
TOTAL	25,602

Source: Dovlo (September 2003), Table 5, p.9.

India ranks at the top of nations whose physicians are working in the major developed countries and holds the second position to Philippines in respect of nurses.

India has also emerged as a supplier of other categories of healthcare professionals to a number of countries, particularly radiologists, laboratory technicians, dental hygienists, physiotherapists and medical rehabilitation workers.

India's strong position as a supplier of healthcare professionals is notwithstanding the fact that the medical qualifications awarded by Indian institutions are not recognized by the authorities in the developed countries and the professionals have to qualify in examinations held by those authorities. As a measure of reciprocity Indian Medical Council also does not recognize the qualifications awarded by those authorities.

5.1.6 Telemedicine in India

A recent phenomenon in the Indian Healthcare sector has been the growing use of telemedicine. In 2001, the Indian Space Research Organization (ISRO) launched a pilot project that connects 78 hospitals in remote areas to super specialty hospitals in the cities. The Manipal Education and Medical Group and the Apollo Group of Hospitals have established telemedicine centres in India as well as abroad.

Telemedicine can be real time (synchronous) or at a later point in time (asynchronous). Synchronous telemedicine requires the presence of two sets of medical

professionals one at either end present at the same time with a 'tele' link between them that allows a real-time interaction to take place. There are also devices, such as teleophthalmoscope or tele-stethoscope, which can be attached to computers or the video-conferencing equipment, which can aid in interactive examination. Asynchronous telemedicine does not require medical professionals at the two ends at the same time. It involves acquiring and storing medical data such as x-rays, pathology slides or ECG, which can be viewed by the specialists at the other end offline at a time convenient to the latter.

Telemedicine has opened up possibilities of professionals providing expert healthcare service in remote rural areas from their locations in cities. What is relevant for the terms of reference of the High Level Group is the emergence of opportunities for Indian service providers to supply telemedicine services to the developed countries in such segments as teleradiology, telepathology, teleradiology, intensive care, ophthalmology, dermatology, psychiatry, and even in continuous online remote monitoring. Rising costs and dearth of medical personnel have created pressures for the public healthcare providers in developed countries for exploring the possibility of electronic delivery of services across the borders and looking for opportunities for outsourcing of diagnostic services to private healthcare providers. As mentioned above a number of telemedicine providers are already operating within the country. In a recent study it has been reported that supply of telemedicine services from India has not taken off in a big way, except to the US and Singapore (Rupa Chanda, *India-EU Relations in Health Services: Issues and Concerns in an India-EU Trade and Investment Agreement*, ICRIER, 2008). The client base of telemedicine business in the US has increased in recent years to scores of hospitals and the National Healthcare Group of Singapore has tied up with Indian telemedicine institutions for providing teleradiology services to designated hospitals in Singapore. The potential in respect of the EU has not been translated into actual business as yet on account of a number of factors such as data protection laws of EU Member States, and difficulties in certification of qualifications and accreditation of Indian telemedicine providers by the authorities in EU member states. There are other issues as well that come in the way such as malpractice policies, liability insurance and jurisdiction issues for settling disputes that might arise. While most of these problems are surmountable, it takes time and money to resolve them.

One of the main problems impeding growth of supply of telemedicine services by Indian service providers is the large variation in the quality of medical professionals with graduate and post-graduate qualifications produced by institutions across the country, which is a major constraint in receiving recognition from overseas medical authorities. It costs US \$ 12-18000 per doctor to train up these doctors in the UK for getting them registered and certified. This problem can be resolved over time with measures to improve the quality of education in the country, which will take some time to fructify. However, the problem has been exacerbated by the fact that the Medical Council of India does not recognize the undergraduate and post-graduate qualifications of institutions in countries that do not grant recognition to qualifications secured in India. It was suggested to the High Level Group that the qualifications of doctors and radiologists who are NRIs and have been trained in the UK or other foreign countries should be recognized by the Indian Medical Council on an exceptional basis so as to enable the telemedicine service providers in India to draw upon this overseas pool of medical professionals for supplying telemedicine services.

5.1.7 Health Insurance

Traditionally healthcare insurance in the country has been limited to the Employees State Insurance Schemes (ESIS) for industrial workers, the Central Government Health Scheme (ECHS) for employees and pensioners of the Central Government and the Ex Servicemen Contributory Health Scheme (ECSH) for the former Armed Forces Personnel. After general insurance was opened up to the private sector and further to FDI, there has been a considerable expansion of health insurance, covering mainly the urban upper-middle class. However, healthcare insurance schemes have experienced problems such as high premium, delay in settling claims and non-transparent procedures in deciding reimbursements. The system of Third Party Administrators (TPAs) has facilitated cash payments and expanded access to providers and as a result delivery of healthcare services to the upper middle class has improved. Other segments of the population, the BPL categories in particular, have remained deprived of the benefits of health insurance in the country.

Side by side with the development of health insurance on a commercial basis the country has seen the emergence of Community Based Health Insurance (CBHI). CBHI is a not- for- profit insurance scheme managed by the members themselves on the basis of

collective pooling of health risks. CBHI schemes are being operated by organizations such as ACCORD, BAIF, Karuna Trust, SEWA, DHAN Foundation and VHS.

5.1.8 Clinical Trials and Research

Clinical Research has emerged as a very promising area in the country during the last few years. Today the market value of clinical trial research outsourced to India is estimated at around US \$ 300 million (the market grew by around 65% in 2006), with projected revenues of US \$ 1.5-2 billion by 2010. This will still be relatively small in size against the global clinical trials industry estimated at around US \$ 30 billion. Several leading global pharmaceutical companies have set up offices in India and are routing their clinical research work through Clinical Research Organisations (CROs) based in India.

According to the data furnished by the Indian Pharmaceutical Alliance these global companies are currently outsourcing 139 trials to India, while they are getting only 98 trials in China. Glaxo Smith Kline leads the list with 22 trials, followed by Johnson & Johnson 22, Eli Lilly and BMS 17 each, Pfizer 16, Sanofi Aventis 15, Astra Zeneac10, Novartis 9, Merck 8 and Roche 5.

The increased clinical trial flow to India is the result of several fundamental strengths. Factors such as a diverse genetic pool, large patient pool with diseases such as heart disease, diabetes and psychiatric disorders, which are prevalent in industrialized countries, drug-naïve population, competent medical professionals, good hospitals where trials can be undertaken, potential cost and time savings have played a role in stimulating the increased flow of clinical research to India. The cost of conducting research in India ranges between 20 and 60 per cent of the cost in industrialized countries. Savings come from hiring clinical researchers, nurse and IT staff at less than a third of wages in the industrialized countries, in addition to differences in the costs associated with patients. Some Indian research laboratories and CROs are able to offer a wide-ranging test menu of over 1500 highly sophisticated tests under one roof. Today about 20 CROs and 80 government and private hospitals are engaged in clinical trials for global and local clients.

Two other factors have contributed to India becoming popular as a clinical research destination. First India has put in position world-class laws on intellectual property rights. Second the Ministry of Health has established the complete framework of

rules for conducting clinical trials. Schedule Y of the Indian Drugs and Cosmetics Act lays down the guidelines for conducting clinical trials, encompassing the responsibilities of Sponsors, Investigators, and Ethics Committees. The guidelines cover pre-clinical trials (animal pharmacology), Phase I (Human Pharmacology, that is estimation of safety and tolerability by humans of the new drug), Phase II (therapeutic exploratory trials), Phase III (Therapeutic confirmatory trials) and Phase IV (Post marketing Trials). The guidelines contain the requirement for obtaining prior informed of the trial subject and entrust the responsibility to the Ethics Committee to safeguard their rights, safety and well being. Detailed guidelines are also prescribed for the constitution of the Ethics Committee. There is a general mandate for the laboratories used for generating data for clinical trials to be compliant with Good Laboratory Practices. The clinical trial Sponsor is responsible for implementing and maintaining quality assurance systems to ensure that the clinical trial is conducted and data generated, documented and reported in compliance with the Good Clinical Practices (GCP) issued by the Central Drugs Standard Control Organization of the Government of India. The Good Laboratory Practices and Good Clinical Practices guidelines issued by the Government of India are very much in line with the guidelines issued by the International Conference on Harmonization (ICH) and the WHO.

A majority of trials being conducted in India by global companies are Phase III, forming 65% of the trials conducted in India, Phase II trials constitute 16 %, Phase IV 15% and Phase I a mere 4%.

The assessment is widely shared that the regulatory structure in India on all aspects of drugs including clinical trials is weak and not equal to the challenge posed by technological developments. On the recommendations of the Mashelkar Committee it is proposed to set up the Central Drugs Authority for strengthening the Central Drugs Standard Control Organization and legislation (Drugs and Cosmetics Amendment Bill 2007) has been introduced in the Parliament for strengthening the regulatory system for drugs and cosmetics. Of the 10 divisions in the proposed Authority two will be tasked exclusively for new drugs and clinical trials and biological and biotechnology products.

The Ministry of Health is considering substantial strengthening of manpower and infrastructural facilities and capacity building to enable the Central Drugs Control Organization to cope with the challenges ahead.

5.2 Challenges before the Healthcare Sector in India

5.2.1 Regulation

The competitiveness of healthcare services in the country suffers from under-regulation on the whole but over-regulation on the medical education front. Medical professionals are regulated through Central legislation, viz., the Indian Medical Councils Act, the Dentist Act and the Nursing Council Act. These laws provide for the setting up of regulatory councils at the National and State levels. The National Councils prescribe norms and standards of education, while the State Councils deal primarily with registration and enforcement of these standards. The Ministry of Health & Family Welfare has developed Indian Public Health Standards (IPHS) for certain Governmental clinical establishments viz., Community Health Centres (CHC), Primary Health Centres (PHC) and Sub-Centres, which are implemented through administrative means. Standards are also being evolved for the larger hospitals, up to 500 beds. A few States and Union Territories have enacted laws (The Bombay Nursing Homes Act, 1949; Delhi Nursing Homes Act, 1953; and Tamil Nadu Private Clinical Establishments Act, 1997) for registration and regulation of nursing and clinical establishments, but they were not comprehensive in that they did not cover laboratories and diagnostic centers, and there were deficiencies in laying down minimum standards. More importantly their implementation has remained ineffective. There has been resistance from some stakeholders against the introduction of law for the regulation of health care service providers because of the fear of Inspector Raj. Opposition to regulation of health service providers has also been fuelled by the exemption provided in some of the State laws for the public health institutions. On the other hand there is skepticism among policy makers whether publicly funded healthcare institutions will be able to adhere to the standards. The multiplicity in the types of clinical establishments has also daunted policy makers from undertaking the task of formulating minimum standards, which are a prerequisite for effective regulation. At the Central level, some specific aspects of healthcare services have been regulated through legislation, such as management of medical waste, setting up

of blood banks, and pre-natal diagnostic tests, but there is absence of an overall statutory framework for the licensing of healthcare establishments such as hospitals, nursing homes and clinics, and laying down the minimum standards that must be met.

We have noted above that some of the private medical establishments rank with quality institutions in the industrialized countries but the lack of regulation of clinical establishments has also resulted in many of them including those in the private sector being of poor standard and lacking in elementary facilities.

5.2.2 Licensing

There are rules for the registration of medical practitioners and separate regulations for professional conduct, etiquette and ethics. The latter contain certain recommendatory rules, such as use of generic names of drugs, but also mandatory rules, such as for the maintenance of medical records of indoor patients for minimum period of three years and maintenance of a register of certificates issued. There is however a serious regulatory gap in the country in that there are no mandatory standards prescribed and enforced for hospitals, nursing homes, clinics, as well as establishments undertaking diagnosis or treatment of disease. The standards for hospitals, for instance, should cover all aspects ranging from building and fire safety to availability of potable water and from basic laboratory services to employment of health professionals. According to international best practice license is granted initially on the basis of some form of external evaluation of compliance with the prescribed minimum standards.

Recently the Clinical Establishments (Registration and Regulation) Bill, 2007 has been introduced in the Lok Sabha to fill this gap in regulation of medical establishments. Article 2 of the Bill defines clinical establishments as:

- (i) 'a hospital, maternity home, nursing home, dispensary, clinic, sanatorium or an institution by whatever name called that offers services, facilities with beds requiring diagnosis, treatment or care for illness, injury, deformity, abnormality or pregnancy in any recognized system of medicine established and administered or maintained by any person or body of persons, whether incorporated or not; or

- (ii) a place established as an independent entity or part of an establishment referred to in clause (i), in connection with the diagnosis or treatment of diseases where pathological, bacteriological, genetic, radiological, chemical, biological investigations or other diagnostic or investigative services with the aid of laboratory or other medical equipment, are usually carried on, established and administered or maintained by any person or body of persons, whether incorporated or not'

All Government hospitals are covered but not those controlled and managed by the Armed Forces.

The Bill seeks to provide for the compulsory registration of all clinical establishments in two stages, provisional at first and permanent thereafter. It is at the time of permanent registration that compliance with the prescribed minimum standards would be required. There would not be any prior inspection of the establishment but before the grant of permanent registration the evidence submitted by the applicants of having complied with the standards would be displayed for the information of the public at large for filing objections. If objections are received they shall be communicated to the clinical establishment for response. Permanent registration can be granted to the applicant only after it has fulfilled the prescribed standards. While there is no provision for periodic inspection the registering authority has been given the power to conduct an inquiry or inspection of the clinical establishment at any time and to issue directions. The designated authority is also empowered to cancel the registration if it is satisfied that the conditions of registration are not being fulfilled, and restrain the clinical establishment from carrying on if there is imminent danger to the health and safety of patients. There is provision for appeal to the State Government from orders rejecting or cancelling registration. Penalties are provided for contravention of the provisions of the Act. The Bill provides for a fine up to Rupees Five Lakh for contravention of the provisions of the Act.

The Bill envisages the establishment of the National Council, which will have the function inter alia of setting the minimum standards to be mandatory for all clinical establishments. The Bill indicates the functionaries and representatives who will constitute the Council.

The enactment, when it comes will make only a small beginning on regulation of clinical establishments in the country because initially it will come into force only in respect of the four States, Arunachal Pradesh, Himachal Pradesh, Mizoram and Sikkim and in the Union Territories. Since health is a subject on which the Constitution gives the authority to the States to legislate, any statute passed by the Parliament can apply to a State only if the State adopts it. So far the legislatures of only the afore-mentioned States have passed resolutions to the effect that clinical establishments in those States would be governed by the law passed by the Parliament.

The High Level Group attached high importance to the setting up of mandatory standards for clinical establishments envisaged in the Bill and once the Bill becomes statute to the extension of its application to all the States. It also recommend that the following comments on the proposed legislation be given consideration by the Central Government:

- (i) For impartial functioning of the regulatory system the appeal against rejection of registration or similar orders under Section 36 should lie not with the State Government but with an authority independent of the administrative control of Government; and
- (ii) In the constitution of the National Council one or more representative/s of the Quality organizations (such as NABH) should be inducted.

5.2.3 Accreditation

The commencement in 2006 of an accreditation programme for secondary and tertiary hospitals by the National Accreditation Board for Hospitals & Healthcare Providers (NABH), a constituent board of the Quality Council of India, represents a strong attempt to improve the quality of healthcare establishments in the country. Accreditation is a voluntary process, involving evaluation of an organization's compliance with pre-established performance standards. The organization is granted accreditation if it is assessed to meet an acceptable level compliance, or it may be given a conditional accreditation.

NABH has so far granted accreditation to 11 hospitals and 43 are in various stages of evaluation. It has 120 qualified assessors on its panel, comprising senior clinicians, hospital administrators and nursing supervisors, who are assigned the task of carrying out the evaluation.

An accreditation system such as what has been established in India is the best way of improving the quality of performance of clinical establishments. The challenge in the country is for more and more clinical establishments to take advantage of the accreditation system in order to improve the quality of healthcare service in the country. As for clinical establishment run by the Central and State Governments the first step should be that they adhere to the minimum standards prescribed under the proposed legislation, but as a subsequent step they should also come forward and take advantage of the accreditation system.

5.2.4 Skill Deficit in Healthcare

A distressing feature of India's Healthcare Services is the shortage of human resources. The number of doctors registered by different State Councils stood at 6, 68,131 during the year 2006, giving a doctor to population ratio of 60:100000. Although this is better than the standard set in India by the Bhore Committee just after independence (50:100000), it is well short of the ratio prevalent in the developed countries (Australia: 249.1; Canada: 209.1; United Kingdom: 166.5; and USA: 548.9). The state-wise distribution of doctors is highly skewed, with certain States and Union Territories (Delhi, Goa, Karnataka, Tamil Nadu and Kerala) having a favourable ratio and other States (Haryana, Bihar and UP) being underserved. If the targeted doctor population norm is taken as 1:1000, there is a requirement of at least 600,000 doctors.

There is a more acute shortage of dental surgeons in India. Here there is a shortage even according to the recommendations of the Bhore Committee. The Task Force on Human Resources in the Health Sector set up by the Planning Commission for the XI Plan assessed the number of dental surgeons registered in India was 73,271 against the requirement of 282,130 in 2007.

There is a similar shortage of nurses. Going by the Bhole Committee norm of nurse population ratio (1:500) the requirement of nurses should be 2,188,890 in 2007, against which only 1,156,372 nurses were available.

Although the number of pharmacists is considered to be adequate in the country (578,261 available in 2006 against the requirement of 564,261 according to the Bhole Committee nurse population norm of 1:2000), there is also an acute shortage of paramedical staff, such a radiographers, x-ray technicians, physiotherapists, laboratory technicians, dental hygienist, orthopaedist, optician etc.

5.2.5 Health Education

Medical education is highly regulated and there is an access barrier for setting up new medical and dentist colleges. Eligibility for setting up medical or dentist colleges is limited to the following organizations:

1. A State Government/ Union territory;
2. A University;
3. An autonomous body promoted by Central and State Government;
4. A Society registered under the Societies Registration Act, 1860(21 of 1860) or corresponding Acts in States; or
5. A public religious or charitable trust registered under the Trust Act, 1882 (2 of 1882) or the Wakf Act, 1954 (29 of 1954).

What is significant here is that the corporate sector is not eligible and only not-for-profit organizations can apply. The private sector medical and dental colleges that have been established in large numbers have all done so by setting up not-for-profit societies.

For medical colleges another access barrier is the condition that the applicant must own or possess a suitable single plot of land measuring not less than 25 acres by way of 99 years lease for the construction of the college. For dental colleges the requirement is less restrictive and only an area of 5 acres is required and that too for a minimum period of 30 years. For nursing colleges it is significant that companies are eligible to set up nursing colleges and schools and there is no bar on commercial (for-

profit) organizations. Further instead of the requirement for a specific area of available land, the requirement is for built up space. However, here too there is an access barrier as the requirement of a large size campus of more than 23 000 square feet for the college and 30,000 for the hostel is out of proportion of the requirement for a 50-seat college.

For the paramedical personnel there several institutions, in the States but also in the private sector but these are unregulated and there is lack of uniformity in the training imparted. For regulating training of paramedics it is proposed to set up the Paramedics Council and a Bill for the same has already been introduced in Parliament. Separately, there is also a proposal in the Ministry of Health & Family Welfare to set up a National Institute of Paramedical Sciences (with branches in New Delhi and Chennai) for undertaking and coordinating training programmes in the country in collaboration with State Governments. The Ministry is proposing to use distance education to ensure large coverage of the training programmes.

Besides the problem of the numbers of healthcare personnel there is an acute problem of quality as well. Some of the private colleges are produce graduates far below the standards required but the Government colleges have also deteriorated, in part because of shortage of staff, the vacancies remaining unfilled because of unattractive remuneration. In Government medical colleges another reason for deterioration of the quality of medical graduates is that they do not get the opportunity to observe the treatment of patients because of the fall in the number of patients coming to Government hospitals for treatment.

5.2.6 Limited Coverage of Health Insurance

While the middle class has benefited from the entry of the private health insurance companies the real challenge is to enhance access to healthcare for the poorer sections of the population through health insurance. The healthcare insurance companies in the public or in the private sector cannot take up this challenge because the poorer sections (30 crore of BPL population) does not have the capacity to pay the premium at rates required to run the programme on a commercial basis. A health insurance programme, which covers the BPL categories, will also give the choice to the population in these categories to turn to the healthcare providers in the private sector. In order to

make the implementation of such a programme feasible it would be necessary to introduce a smart card system for the beneficiaries. Such a scheme will not only benefit the poorer sections but also private healthcare service providers, whose business will expand.

5.2.7 Impediments in Expansion of Clinical Research

Although the prospects for outsourcing of clinical research by global pharmaceutical companies look bright there are number of problems that need attention.

- (i) While the National Accreditation Board for Laboratories (NABL) has a programme for accrediting laboratories certifying their adherence to Good Laboratory Practices, it does not have the international standing for its accreditation to be recognized outside the country. As for Good Clinical Practices there is no organization in India at present, which has been authorized or has undertaken accreditation work. In the result the Indian laboratories and CROs need to be accredited internationally by such organizations as the College of American Pathologists (CAP), thereby incurring additional costs, resulting in lower competitiveness:
- (ii) There are weaknesses in the regulatory infrastructure and the Office of the Drugs Controller is understaffed and lacking in capacity to deal with such new areas as stem cell research, GM food etc. There is lack of a world class testing laboratory for validation of tests; and
- (iii) Most importantly there is a looming shortage of clinical research personnel, estimated at 30,000 to 50,000. We need more trial investigators, auditors, personnel to serve on Ethics Committees, Data Safety Management Boards and personnel in other categories.

5.3 Responding to Challenges

5.3.1 Regulation of clinical establishments and improving the quality of healthcare institutions

The High Level Group is of the view that it is imperative for the health and safety of the population to enforce minimum standards on clinical establishments in both the private and public sectors by laying down minimum standards and enforcing them

rigorously. The Clinical Establishments (Registration and Regulation) Bill, 2007 having been introduced in the Parliament it would be important to ensure that it becomes law at the earliest and that it enters into force for all the States and its applicability does not remain limited to four States and Union Territories. The next step would be for the proposed National Committee to set appropriate standards for all categories of clinical establishments.

Implementation of the minimum standards will only be the initial step for improving the quality of healthcare institutions in the country. The next step for improving their quality should be for all stakeholders to advocate that these institutions take advantage of the accreditation system already established in the country. It would be important for the Central and State Governments to take steps to enable the clinical establishments in the public sector also to avail of the accreditation system.

5.3.2 Expanding Health Insurance

In the Central Government a health insurance scheme for the BPL categories is already taking shape following the recommendations of the National Commission for Enterprises in the Unorganised Sector (NCEUS). It is proposed to cover the entire BPL population of 30 crore (5 crore families) in five years time. It has been estimated that the premium per family would come to Rs 750, of which 75 per cent would be paid by the Central Government, the remaining 25 per cent coming from the State Government. The cost of the smart card will be borne by the Central Government and the beneficiaries would need to pay only Rs 30 per annum as registration/renewal fee. While the State Governments will determine the benefits that the beneficiaries would be entitled, the proposal is that hospitalization expenses will take care of most common illnesses, all pre-existing diseases will be covered, and transportation costs within an overall limit of Rs 1000 will be provided. The selection of the health insurance provider will be done by the state/implementing agency through a tendering process.

The High Level Group recommend that the Health Insurance Programme for BPL categories be implemented at the earliest.

5.3.3 Medical Education

There is a shortage of about 600,000 doctors, 1 million nurses, about 200,000 dental surgeons and large numbers of paramedical staff. Against this the annual turnover of medical colleges is about 30,000 of Dental Colleges about 20,000 and of Nursing Colleges (BSc Nurses) about 45,000 and of Nursing Schools (General Nursing Midwives and Auxiliary Nurse Midwives) about 60,000. The number of postgraduate degrees/diplomas being awarded annually in the country is only 3181/1316. The turnout of personnel with postgraduate is very low considering the number of teaching staff needed in the country as well as the requirement for filling up the openings now available in the country for Research & Development including Biotechnology. Additional demand has been created by the requirement of healthcare personnel from India in foreign countries, particularly in the US and the UK, and also the increasing opportunities in the country for medical value travel (medical tourism).

In light of the above the XI Plan envisages completing setting up of 6 AIIMS like institutions and upgrading 13 existing medical institutes. In the XI Plan it is envisaged that 60 new medical colleges and 225 new nursing colleges would be established in the PPP mode besides taking action for upgrading of nursing schools into colleges, strengthening of existing nursing colleges and up gradation and strengthening of existing government medical colleges.

The overriding requirement in the country is for increasing the supply of human resources at all levels, from specialists to paramedical personnel and to improve their quality. The Group is of the view that the only way to accomplish this is for the medical education sector to be opened up completely for private sector participation and companies to be allowed to establish medical and dental colleges just as they have been allowed to open nursing colleges. Other entry barriers such as the requirement of land and built up space need also to be lowered to realistic levels in order to facilitate the opening up of new colleges. Government's role should be limited to opening a few high quality institutions dedicated to research. Having regard to the magnitude of the investment requirement for healthcare education and the paucity of resources with Government there is no alternative to allowing greater involvement of the private sector in health education.

In order to improve the quality of education in Government medical colleges it is necessary to give incentive to the teaching faculty. Wherever possible they should be allowed to undertake private practice and in other cases granted handsome non-practicing allowance. The private sector colleges will need to be regulated for their quality but no regulation is needed either for the fees charged by them from students or the emoluments paid by them to the teachers. As a measure of social equity they may be mandated to grant full or half scholarships for a proportion of the seats for meritorious students who do not have the means to pay the fees.

Ample supply of qualified personnel at all levels will not only improve the competitiveness of the private segment of the Indian healthcare sector but will also help to improve the efficiency of public health care institutions, which are at present handicapped mainly by personnel shortages.

The establishment of the regulatory Paramedical Council is crucial for expansion of training facilities and for improvement of the training programme in respect of paramedical personnel and the High Level Group expressed the hope that the law will be enacted shortly. The proposed Institute of Paramedical Sciences also needs to be set up urgently for enabling the implementation of a concerted programme for training of paramedical personnel in different fields. In addition Government should encourage private players, including large hospitals and hospital chains, to undertake training programmes under the regulatory control of the Paramedics Council.

A development council for taking wider initiatives for the training of paramedical personnel, such as the one proposed by the Group in Chapter I could also be considered.

Measures to improve the quality of education in the country will take time to fructify. As mentioned earlier in Section 5.6 the shortage of quality personnel has been exacerbated by the fact that the Medical Council of India does not recognize the undergraduate and post-graduate qualifications of institutions in countries that do not grant recognition to qualifications secured in India. As a result the hospitals and other clinical establishments cannot draw upon the pool of NRI medical professionals, who may be willing to work in India. The High Level Group is of the view that the qualifications of doctors and radiologists who have been trained in the UK or other

foreign countries should be recognized by the Indian Medical Council on an exceptional basis in order to increase the pool of quality medical personnel available to the Indian service providers and increase their competitiveness in providing service for medical value travel, telemedicine as well as clinical research.

5.3.4 Boosting Clinical Research

The High Level Group considers the shortage of trained personnel to be the biggest challenge for improving the country's competitiveness in the field of clinical research. The requirement is diversified and of substantial numbers. In line with the ideas outlined in Chapter I the Group recommends the establishment of a Clinical and Medical Research Council with the participation of the private sector for formulating, promoting and running training programmes for the area.

The Drugs Controllers office needs to be substantially strengthened and manned with personnel (including guest personnel from abroad) who are equipped with knowledge of the latest advances in medical research. A capacity building programme has to be undertaken and drugs testing facilities in terms of infrastructure and equipment augmented. A world class testing laboratory should be set up in the country in the PPP mode, where the Central Government gives assistance for construction of building and purchase of equipment but the management is undertaken by the private sector. Arrangement needs to be made for accreditation of CROs for the purpose of certifying their adherence to Guidelines for Good Clinical Practices.

Chapter 6

Financial Services¹³

6.1 Introduction

The importance of the financial sub-sector goes beyond the output and employment it directly generates, given its critical role in enabling broader economic activity, whether in industry, agriculture or other services. The financial sub-sector provides products for mobilizing household and corporate savings, credit for producing and consuming goods and creating long-term assets, transaction banking for facilitating economic activity and insurance for risk mitigation, long-term savings and social security. The perspective of this report is therefore not only the growth of the financial sector, but its effectiveness in its larger role as an agent of economic change. Driven to a significant extent by the liberalization measures of the 1990s, the sector has witnessed robust growth. However, its penetration in India remains low relative to many markets, with bank credit/ GDP at under 50.0%, overall insurance premium/ GDP at under 5.0% and general insurance premium/ GDP at under 1.0%.

In accordance with its mandate the Group examined the different aspects influencing the performance of the financial services sub-sector and with a view to suggesting short-term and long term policy measures to improve and sustain its competitiveness in the coming years. At the outset the Group considered it important to review the status of financial inclusion in India i.e. the extent of access to and utilization of financial services by households and businesses that are geographically dispersed and vary widely in terms of income and other indicators. Studies reveal that despite the policy and regulatory directives towards financial inclusion, 41.0% of the adult population is un-banked. Further, there exists a significant urban-rural divide in the access to banking facilities and credit, with only 39.0% and 9.5% of the adult rural population having bank accounts and loan accounts respectively, as compared with 61.0% and 14.0% in urban

¹³ This Section of the Report of the High Level Group is substantially based on the report of the Sub Group of Financial services, of which Shri K. V. Kamath, Managing Director & CEO, ICICI Bank Limited was the Chairman, and Shri K. N. Bhandari, Secretary General, General Insurance Council, Shri M. V. Nair, Chairman & Managing Director, Union Bank of India, Shri Aditya Puri, Managing Director, HDFC Bank Limited, Shri Deepak Satwalekar, Managing Director & CEO, HDFC Standard Life Insurance Company Limited and Shri U. K. Sinha, Chairman & Managing Director, UTI Asset Management Company Private Limited, were members.

areas¹⁴. Clearly, there is a need to rethink our approach to financial inclusion from the prescriptive approach adopted thus far to a more market-based approach that achieves the desired level of penetration in a sustainable manner.

At the opposite end of the spectrum lie the increasingly complex and sophisticated financial services needs of large businesses that are operating in a globalised environment. The ability of the existing Indian financial sector to meet these requirements is constrained by the relatively small size of Indian financial intermediaries that limits their risk-taking capability, regulatory restrictions on products and services that may be offered and the absence of liquid and deep markets in several segments in India.

An analysis of measures needed for the financial sub-sector in India must be centred on enhancing the ability of the financial sub-sector to address this continuum of financial services needs. For sustaining and enhancing the competitiveness of the financial sub-sector the Group was of the view that it was imperative to consider permitting freer foreign participation in the Indian financial sector, and empowering the Indian financial sector participants in general, and the public sector participants in particular, to compete in a globalised environment.

This report seeks to recommend the key measures that taken together would help in meeting the objectives of achieving greater financial inclusion, serving emerging customer needs and enhancing global competitiveness.

6.2 Key reform measures

This section briefly sets out the key recommendations of the Group for reforms required within the existing broad framework of financial sector regulation. There is widespread recognition that the liberalization of the Indian economy has been uneven, with the liberalization of the real sector far outpacing that of the financial sector, as evidenced by the continuing licensing requirements for expansion as well as entry, and the fairly intensive regulation over operational matters. These recommendations thus

¹⁴ Source: “Financial Inclusion – The Indian Experience”, speech by Smt. Usha Thorat, Deputy Governor of the Reserve Bank of India, in London, June 19, 2007.

represent the unfinished agenda of reforms, as well certain specific measures suggested in the context of particular segments.

6.2.1 Banking

The banking sector reforms were carried out during the 1990s based on the recommendations of the Narasimham Committees in 1992 and 1998. Certain key recommendations continue to remain substantially unimplemented. These are set out below:

- (vi) *Reduction in regulatory pre-emption:* While the Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) have been reduced from the high levels prior to liberalization, the level of regulatory pre-emption of bank liabilities in India continues to be very high relative to other economies. With the moderation in the fiscal deficit and government borrowing requirements, and the overall improvement in the efficiency and health of the financial system since the 1990s, there is a strong case for gradual reduction in SLR in line with other markets. Similarly, CRR which has been increased several times recently as a monetary measure, may be aligned over time with an appropriate globally benchmarked level.
- (vii) *Phasing out of directed credit:* Priority sector lending targets continue to apply to the Indian banking sector. It is observed that the directed agricultural lending targets have not had the desired impact in terms of financial inclusion; banks have often mis-priced credit to achieve the volume targets and have suffered high credit losses. However, a positive development is that banking for the un-banked is increasingly being seen as a growth opportunity by banks. It would therefore be appropriate to move from a mandated directed lending target to a market-based approach, where banks develop sustainable models to engage a wider set of customers in the economic mainstream. Key measures to create a facilitative environment for financial inclusion are set out in Section 3.0.
- (viii) *Consolidation and increase in scale:* The Narasimham Committee had envisaged a move to a banking system with three or four large, international banks; eight to ten national banks with a network of branches throughout the country engaged in

“universal” banking; local banks with operations in specific regions; and regional rural banks. However, there has been limited progress in consolidation in the Indian banking system. There are only two Indian banks among the world’s top 100 banks; the largest Indian bank is about one-fifth the size of the largest Chinese bank. The issue of consolidation is particularly relevant for the mid-sized public sector banks that are currently duplicating investments in technology and other infrastructure, and not benefiting from economies of scale. There is an urgent need to catalyse consolidation among these players, and leverage the synergistic benefits. At the same time, the policy environment must favour rapid growth of the banking system to keep pace with economic growth, as well as make Indian banks relevant players in the international arena.

- (ix) *Abolition of branch licensing:* In the context of the overall framework of liberalization of the Indian economy, the requirement of branch licensing may be urgently reviewed as recommended by the Narasimham Committee. It creates challenges in financial inclusion and deeper penetration by constraining the growth of banks. The branch licensing requirement emanates from statute, as well as from regulatory objectives. The key regulatory objectives are to ensure that banks have risk management capabilities commensurate with branch expansion, and achieve financial inclusion through spread of branch infrastructure in under-banked areas. The statutory requirement can be eliminated by amendment to the statute, or an exemption from the licensing requirement under extant provisions. The supervisory objective of ensuring appropriate risk management capabilities can be achieved through the regular inspection and supervisory process. In so far as financial inclusion is concerned, the existing large rural branch network has achieved limited success in this regard, and there is therefore a need for a new approach that recognizes alternative methods of access to financial services. In any event, banks may be required to have a minimum proportion of branches in rural/ semi-urban or under-banked areas, as required by the existing banking license conditions for the new generation private sector banks.

- (x) *Reform of ownership and management of public sector banks:* Banks majority owned by the government continue to account for about 70.0% of the Indian banking system. The Narasimham Committee had recommended that the

minimum government ownership in these banks be reduced to 33%, and the banks should become board-managed companies.

In the medium-term, the ability of these banks to raise capital for growth without reducing the government shareholding to less than 51% would be severely constrained. At the same time, infusion of capital by the government would impose fiscal pressures and would be a sub-optimal deployment of the government's resources, which should be utilized for developmental purposes, while commercial capital is available for the banking sector. It would therefore be appropriate to consider evolution of a path towards reduction of government ownership in a manner that minimizes dislocation or dissonance among various stakeholders. However, as an immediate measure, it is necessary to empower the government-owned banks to address the key competitive challenges that confront them, without altering their public sector character.

Firstly, the oversight of public sector banks by the Central Vigilance Commission (CVC) may be reviewed. This oversight dates back to the nationalization of banks and the pre-liberalisation era when banks essentially allocated credit in line with government guidelines. These banks are now listed entities with non-government minority shareholders; compete with each other and private sector banks to offer credit; and are subject to regulatory supervision and the commercial discipline of the market place. The existence of CVC oversight creates a culture of avoidance and delay in decision-making that seriously damages the banks' competitive positioning.

Secondly, individual banks should be given the freedom to determine their recruitment, placement, promotion, performance evaluation and compensation policies, including performance bonuses and stock options. These are essential tools in attracting, retaining and leveraging human capital, which is a key competitive differentiator. The uniform pay structure and wage settlement across banks is inconsistent with a competitive market. In this context the regulatory limits and approval requirements for remuneration of bank managements even in the private sector may also be reviewed.

Thirdly, the selection of non-executive board members, the CEO and other executive board members should be determined by the board of directors of each bank. The bank should be free to induct non-executive directors of appropriate experience who would add value to the bank, rather than nominees of government/ minority shareholders. Executive management selection should be based on a robust performance management system to identify the pool of candidates, and should be undertaken by board committees with government/ RBI representative as an invitee, rather than the present practice of the government appointing the CEOs and executive directors of various banks. All appointments must be for a minimum fixed tenure.

The above recommendations would also apply to public sector entities in other financial services segments, such as insurance.

6.2.2 Insurance

The insurance sector in India has witnessed rapid development since its liberalization in 2000. The entry of new private sector players has helped to catalyse growth and introduce innovation in products and channels. The key recommendations for reform in the insurance sector are:

- (i) *Liberalization of products and rates in the sector:* In order to encourage market players to develop products that meet customers' needs, all insurance products should be de-tariffed subject to appropriate regulatory oversight. This would especially encourage growth in the non-life sector. For example, in the case of third party motor vehicle insurance, the present administered pricing system is causing serious distortions and heavy losses to the insurance industry. In this segment, users should pay the cost of insurance based on actuarial determination instead of the current cross subsidisation.
- (ii) *Review of capital requirements and related regulations:* The present capital regulations governing insurance companies require maintenance of available solvency margin at 150% of required solvency margin, leading to high capital requirements. The prescribed solvency margins in themselves constitute a prudent

solvency capital standard even without the additional 50% capital requirement. For instance, a 1% solvency requirement has been prescribed for the unit-linked life insurance business where the investment risk is wholly borne by the policy holders. The higher capital requirement restricts growth and increases the cost of insurance for the policy holders after considering the minimum return on capital required by shareholders. It is therefore recommended that the capital requirement be set at 100% of the solvency margin requirement. The excess capital thus held for existing business need not be repaid but can be used to support future growth.

Further, currently only common equity/ share premium and retained earnings qualify as capital. Given the high growth scenario, scarcity of equity capital and higher return expectations of equity investors, alternative forms of capital, such as preference shares, subordinated debt and hybrid instruments that have fixed cost as well as some risk/ loss absorption characteristics, may be evaluated and permitted, as has been permitted for the banking sector.

A related issue is that of foreign ownership limits in private sector insurance companies. Insurance in India is in a high growth phase with substantial investment requirements over a number of years before the new insurance companies achieve stable profitability. In this scenario, permitting foreign investors to own a larger share may be considered. This would also be in line with the higher levels of foreign ownership permitted in the asset management sector and in private sector banks.

- (iii) *Rationalising taxation, including incentivisation of long-term savings:* Currently, savings by individuals are incentivised through tax exemption under Section 80(C) of the Income-tax Act. However, this clubs short-term and long-term savings instruments under the same fungible exemption limit. A separate exemption limit is therefore recommended for long-term life insurance and pension/ annuity products. A similar provision may be considered for investment in dedicated close-ended infrastructure mutual funds and long-term bank deposits.

Service tax is not payable by providers where the taxable service value is less than Rs. 0.8 million, provided the tax is paid to the government directly by the service

provider and not by the service receiver. Life insurance companies are required to pay service tax on the auxiliary services provided by insurance agents, even if the taxable service value is lower than the threshold limit. This may be rectified by giving the benefit of the threshold irrespective of the actual tax paying entity.

- (iv) *Diversification of investment portfolios:* The investment pattern of life insurance companies is prescribed by regulation. Only 15-25% of the corpus may be invested in “other than approved” investments. A number of long-term, high yielding investments fall into the “other than approved” category, and some, such as asset-backed securities, are not permitted at all. The investment regulations may be reviewed on an ongoing basis to enhance the ability of insurance companies to invest in emerging instruments and derivative products, to optimally manage their portfolios.
- (v) *Reinsurance:* The more mature general insurance companies have capital in excess of their current solvency requirements. In order to ensure efficient utilization of capital on a system-wide basis, they may be permitted to take on risks originated by other players. As recommended for other insurance companies, FDI restrictions on re-insurance companies should be removed. Foreign re-insurance companies should be allowed to set up their representative offices and function in India through a network of branches and divisions, thus creating conditions for the development of a buoyant reinsurance market.
- (vi) *Rationalization of laws:* The insurance sector is governed by several statutes such as the Insurance Act, 1938, the Insurance Regulatory & Development Authority Act, 1999, the Life Insurance Corporation Act, 1956, the General Insurance Business Nationalisation Act, 1971 and so on, as well as rules and regulations issued thereunder. There is a need for a simple unified legislation that sets out the key principles and statutory provisions, with several aspects currently defined by statute being moved into regulations.
- (vii) *Increased disclosure norms:* In keeping with greater liberalization, increased disclosure norms to report both gross and net level incomes, liabilities and

reserves would be needed. Reinsurance activities would need higher degree of scrutiny and disclosure.

- (viii) *Addressing market convergence and regulatory overlap:* The insurance and asset management sectors have substantial overlap in terms of the products offered, such as in the area of unit linked insurance plans vis-à-vis mutual funds. However, these are regulated differently. Similarly, the asset management and banking sectors have product overlap such as in the area of the short term debt-oriented mutual funds vis-à-vis bank deposits, but these again differ in terms of regulation and tax treatment. It is recommended that the regulatory and other treatment of similar products offered by different segments of the financial sector may be reviewed to ensure appropriate alignment.
- (ix) *Encouraging the creation of catastrophic insurance:* Natural disasters and catastrophes have historically affected economic assets in India severely. There is a need to develop disaster insurance by mandating it in certain zones prone to frequent losses, setting up insurance pools, and providing tax concessions for reserves set apart by corporates and insurance companies for meeting losses associated with natural disasters.
- (x) *Facilitating penetration of health insurance:* In order to increase penetration of health and other personal non-life insurance products, especially in rural areas, premia associated with these insurance products may be made eligible for tax exemptions.
- (xi) *Facilitating agriculture insurance:* Despite several attempts agriculture insurance has not taken off in India. Given the importance of risk mitigation in agriculture, and the need to promote private investment in this high risk and long gestation business, it is recommended that an appropriate policy framework, including consideration of fiscal incentives, be developed to promote commercially sustainable development of agricultural insurance.

6.2.3 Asset management

The asset management sector in India has been substantially liberalized and privatized, with full foreign ownership permitted in asset management companies. This has led to robust growth in the sector, with Indian asset management companies competing effectively with foreign players. The key recommendations with respect to the asset management sector are:

- (i) *Improving effectiveness of mutual funds:* While mutual funds in India have grown rapidly, they continue to face two key challenges, namely, short-term investment horizon and secondly, relatively low retail participation with a large part of mutual fund corpus comprising deployment of corporate surpluses. There is a need for a focused ongoing investor education campaign encouraging retail investors to participate in the capital markets through the mutual fund route, as also about the merits of allocation of a portion of their savings to long-term equity investments.

- (ii) *Rationalising regulations for venture capital & private equity (VCPE) funds:* The VCPE investor pool in India comprises primarily foreign investors, and Indian investors are largely excluded from the benefits of this asset class. The reasons for this are two-fold. Firstly, unlike internationally where institutional investors constitute the primary investors in VCPE funds in addition to high net worth individuals, in India the ability of institutional investors like banks, insurance companies and pension funds to invest in this segment is constrained or non-existent. This is anomalous given that banks and insurance companies have the necessary financial expertise to undertake a risk-reward assessment of such investment proposals. Secondly, while foreign investors investing into India need not pay tax on gains from their investments due to the benefit of double taxation treaties, Indian investors in VCPE funds are taxed; through recent amendments to the tax laws, trusts used to pool VCPE monies for investment have been denied tax pass through status unless the investments are made in a few specified sectors. These factors place VCPE funds at a disadvantage to mutual funds, both in terms of access to investors as well as tax treatment. These provisions may be reviewed

given the critical role played by VCPE funds in providing longer-term capital for growth and restructuring of enterprises.

6.2.4 Pensions reform

Reform in the structure and management of pension funds is a key area of the unfinished reform agenda. Thus far, public sector entities have been invited to manage the pension funds of all new central government employees who have joined employment from January 1, 2004. In this context, it may be mentioned that private sector banks, insurance companies and mutual funds have played an important and positive role in the development and growth of the financial sector. Life insurance companies in India are already playing an important role in the pension sector through group and personal pension products. An appropriate level playing field is therefore recommended. Further, the new pension scheme should be extended expeditiously to unorganized sector employees. Similar reforms should be initiated for the existing government-managed provident funds. Finally, all categories of pension and provident funds should be permitted to diversify their investment portfolios, shifting from the current excessive share of government securities to various categories of corporate debt, securitized paper, and an appropriate proportion of equity investments.¹⁵ Alternate asset classes may also be considered in due course.

The above reforms are essential to achieve desired long-term returns that would provide the required income security to the beneficiaries post-retirement. Unlike the present practice of holding investments to maturity, professional fund management would create active management of portfolios to optimize returns. A diversified mix of assets with varying risk-return profiles would be superior to concentrated portfolios with fixed returns. This has been evidenced across developed and emerging markets. This includes China, which has permitted overseas investments out of its pension funds.

¹⁵ The new pension schemes for government employees being set up under the pension reforms, to be regulated by the Pensions Fund Regulatory & Development Authority (PFRDA), would be permitted to invest up to 5% of their corpus in equities. This has so far not come into effect.

6.2.5 Financial markets

The development of deep and liquid financial markets, comprising equity, debt, currency and commodity derivative markets, is essential for the healthy growth of the financial sector and the economy as a whole, as they facilitate lower transaction costs in economic activity and efficient diffusion of risk. In India, the various markets are at different stages of development. The key recommendations in this regard are:

- (i) *Increasing penetration:* Early success due to the introduction of electronic trading in the 1990s should not lead to complacency as the number of participants in the capital markets, whether directly or through the mutual fund route, is still small relative to the earning population of the country. An active and coordinated programme of investor education and spreading financial literacy is recommended. Some of the steps that can be undertaken to start the programme could be: using the unclaimed dividends and redemption amounts of mutual funds for the investor education campaign, amending the SEBI Act to provide that all fines and penalties levied by SEBI remain with SEBI for investor education, mutual fund industry setting apart a portion of their asset management fee annually for the campaign, mutual fund distributors contributing a certain percentage of their commission income and the Ministry of Finance making a budgetary provision for investor awareness and placing the funds at the disposal of SEBI.
- (ii) *Developing debt capital market:* The bond market in India remains limited whether in terms of instrument types and maturities, issuer diversity, investor participation and liquidity. The report of the committee chaired by Dr. R. H. Patil submitted in early 2006, which contains several recommendations for the development of bond markets, remains largely unimplemented. The key recommendations are rationalization and uniformity in stamp duties levied by various states on debt instruments, freedom to banks to issue bonds of various maturities including long-term bonds to finance long-term assets, market making in corporate bonds, reducing time and cost of issuance and expanding the investor

base by enhancing the ability of provident/ pension/ gratuity funds and insurance companies to invest in corporate bonds.

Securitisation is an important tool for bridging the gap between mobilisers of savings and originators of debt. It can be used to create instruments of varying yield and maturity to suit the needs of different investor classes. It is recommended that the securitization market be developed through affordable and uniform rates and levels of stamp duty, listing of securitization paper and pass through tax treatment to securitization SPVs similar to mutual funds. Further, securitization SPVs should also be permitted to act as counterparties in derivative transactions.

The shelf registration option for debt issuances is available only to a defined category of financial institutions. This may be extended to other issuers, subject to such criteria including rating that the market regulator may consider appropriate.

- (iii) *Developing derivative market:* The currency and interest rate derivative market is, along with a deep and liquid bond market, the key “missing market” in India. Presently, only over-the-counter (OTC) derivative contracts are available in India and there are no exchange traded derivatives (ETDs). ETDs play a complementary role to OTC derivatives in the development of derivative markets. It is recommended that steps should be taken for trading of vanilla derivative products on existing exchanges, to enhance the liquidity and depth of the derivative market, while structured and exotic products may continue to be transacted on an OTC basis. In particular, exchange traded interest rate futures are imperative to create a meaningful medium term yield curve, as the existing benchmarks are primarily overnight or short-term. Banks and other market participants should be permitted to trade in interest rate futures to impart liquidity to the market.

Currently, banks are not permitted to participate in equity derivatives. This may be considered as it would permit banks to better manage risks in their equity portfolios and would also enhance market liquidity. Similarly, banks are not

permitted to participate in the commodity derivatives market. This is essential to bring depth and liquidity to the commodity derivatives market.

6.2.6 Payment systems

A safe, secure and efficient nationwide payment system is an important prerequisite for the smooth functioning of a financial system, as well as for providing the base infrastructure necessary for financial inclusion. Financial sector participants would find it difficult to expand into under-served areas in the absence of appropriate payment processing infrastructure. More than 80% of India's financial transactions are processed in physical cash. Cash as means of payment has a large cost in terms of handling, transaction processing, holding and risk of loss. The following recommendations may be considered to improve the efficiency of the payments system:

- (i) *Improving efficiency of cheque clearing:* At present there are only 1,075 clearing houses across India and of these, only about 65 are MICR enabled. There is a need to increase the number of clearing houses and more importantly, convert the existing non-MICR clearing houses to MICR clearing houses. MICR code should be made mandatory for each bank branch in India, with the code being allocated centrally to avoid duplication. This would facilitate cheque clearing.
- (ii) *Reviewing cheque truncation project:* Clearing house automation is being sought to be achieved through the cheque truncation project. This project has taken inordinate time in rollout in even one centre, and should be reviewed as it involves expensive hardware installation. Rather than focus on improvement of processing of paper-based payment, the emphasis should be on moving payments to electronic modes directly.
- (iii) *Revamp and promotion of Electronic Clearing System (ECS), National Electronic Fund Transfer (NEFT) and Real Time Gross Settlement (RTGS):* ECS should be made available out of more locations, compared to the 64 locations where it is currently available. Further, there is a need for a centralized application for management of ECS, where the merchant originates a client request, and the paying bank confirms the same based on the mandate they have received. The

bank should have option of allowing access to this centralized application at each centre, rather than only national access. NEFT and RTGS should be expanded by substantially increasing the number of bank branches that are able to process inward transactions and initiate outward transactions. Customers should be encouraged to use these through an education process as well as by rationalizing charges. An option of pull-based RTGS transaction should be developed where a bank can pull money from another bank on the basis of certain pre-approved arrangements. Further, rationalization of these three payment systems into two systems – one each for large and small value payments – should be considered.

- (iv) *Use of card-based payments on a national payments platform:* There is high penetration of credit and debit cards among banking clients today. This has led to increased usage of ATMs as well as point-of-sale (POS) terminals. Looking ahead, card-based solutions are likely to emerge as the key mechanism for delivering financial services to the unbanked. There is therefore a need to create a national payments system with participation by all banks, reduce transaction costs and substantially increase the deployment for POS terminals and their utilization for both high and small value payments.
- (v) *Enabling mobile payments:* India has achieved good mobile penetration both geographically and in terms of socio-economic classes. Enabling mobile payments would facilitate cheaper payment processing, wide geographic coverage, online payments with straight through processing and financial inclusion. The mobile phone can be used as a device to transfer funds and make payments from a bank account using appropriate authentication protocols.¹⁶

6.2.7 Financial inclusion

Despite years of policies aimed at achieving financial inclusion, a large share of Indian households do not have access to even basic financial services such as credit and savings. A new approach is needed to provide comprehensive financial services – credit,

¹⁶ The Review of Payment & Settlement Systems in India released by RBI in October 2007 suggests the use of mobile telephones and cards for payments, and recommends that regulatory changes be carried out to facilitate the same.

savings, insurance, remittances and pensions – to those who have typically not had access to them. This includes small farmers, rural and urban poor and other weaker sections. The goal should be to provide universal access to good quality, comprehensive, financial services at competitive prices by financially sustainable service providers who meet reasonable governance norms.

A number of committees have provided guidance on improving financial inclusion. Most recently, the C. Rangarajan Committee on Financial Inclusion (2007) made detailed recommendations on supply and demand side solutions to improve delivery of financial services through traditional and non-conventional channels. In addition, the Vaidyanathan Committee on restructuring of cooperatives (2004) and the Committee on Moneylender Legislation (2006) recommended policy measures to improve financial inclusion. Based on these and other reports, key government and regulatory policy measures that would help achieve financial inclusion can be broadly categorized in three groups as set out below:

- (i) Provision of a level playing field for various financial services providers – traditional and non-traditional – to compete, subject to appropriate regulations: Given the historical preference for institutional provision of credit via state owned and controlled financial institutions (FIs), non-mainstream FIs such as micro-finance institutions (MFIs) arrived late in India. Indian MFIs have found a market niche by developing products and processes that appear better suited to meet the needs of their target clients than their institutional counterparts. Moreover, MFIs can be useful partners for commercial banks to provide financing to small borrowers. Key measures to facilitate the growth of this segment of financial service providers include: (i) measures to promote transparency in microfinance operations such as annual registration, rate monitoring and quarterly rate disclosures, and random audits; (ii) refraining from interest rate caps in microfinance, which have sometimes been imposed at the state level; (iii) measures to facilitate the development of non-credit services – savings, insurance, pensions etc. through regulatory support for pilots and hybrid models; (iv) a strong focus on urban microfinance to provide services to growing numbers of urban poor; and (iv) incentives that allow non-traditional players with strong rural

presence and distribution networks to explore options to provide financial services.

- (ii) Rethinking priority sector guidelines: It is well documented that while priority sector lending targets did initially help push financial services to the underserved, they had little success in meeting the voluminous demand for credit, and largely excluded small borrowers. Moreover, the poor financial health of rural financial institutions primarily entrusted with providing credit to the priority sector is testament to the fact that these guidelines need to be seriously reconsidered if they are to meet their originally envisaged goals. It may be prudent to study this issue further, and consider the merits of some alternative proposals that have been made. There is increasing recognition among banks and financial institutions of the importance of serving this section, both as a socio-economic necessity and as a vast untapped growth opportunity. This includes both individuals and micro and small enterprises dependent on agriculture, as well as other lower income individuals and micro and small enterprises in both rural and urban areas. The key challenge faced by financial services providers relates to the cost of doing business and enabling credit, recovery and distribution infrastructure. Suggested measures could include allowing banks to self-set inclusive financial service targets, developing enabling infrastructure such as low-cost payment systems and credit bureaus, making priority sector lending obligations tradable, and using well targeted subsidies for specific areas where standalone operations would not be viable, but which are priorities from a policy perspective.
- (iii) Generate demand for financial services by improving the infrastructure for rural lending in partnership with the private sector wherever feasible: Perhaps the greatest benefits of public policy initiatives towards financial inclusion are in the area of creating systemic infrastructure for provision of credit and other financial services. Specific measures include creating credit registries, national identification numbers, payment systems, electronic commodity and auction markets and weather measurement systems – all of which are public goods which would help stimulate economic activity. Other measures that would help generate demand for financial services include public investment in rural infrastructure programs, vocational training programs, and measures to improve market linkages

that help micro entrepreneurs find reliable channels for marketing their products and services. *Creation of International Financial Centre*

The recent report of the High Powered Expert Committee (HPEC) on making Mumbai an international financial centre has highlighted the favourable conditions that exist in India to facilitate the creation of an international financial hub in the country. In addition to the reform measures for various segments of the financial sector, policy reforms to facilitate capital account convertibility, macroeconomic stability and creation of well functioning bond, currency and derivatives market are required to sustain financial sector reforms. The Group broadly endorses the findings of the HPEC and recommends that the policy measures highlighted in that report be implemented.

6.3 The next level of change: A new approach to the financial sector

India has an aspiration of rapid economic growth to become one of the world's leading economies. The financial sector must have the capacity to support and partner in this growth. In this context it is necessary to examine what needs to be done to take the financial sector to the next level, as a means to propel India on its growth trajectory.

The approach to development and regulation of the financial sector in India has been one of segmentation. Each aspect of financial services is required to be conducted by a separate legal entity, independently licensed and regulated, generally by a separate regulator, and having varying restrictions on the nature and size of shareholding. There are restrictions on undertaking complementary activities and on sharing information and infrastructure. In the context of the evolution of the financial sector, there is a need to examine whether this is the optimal structure for the future growth of the sector. The current architecture prevents the efficient utilization of systemic capital, infrastructure, including distribution and back-office infrastructure, and skills, including asset management, credit and investment decision-making and risk management. It thus increases the cost of financial intermediation and the cost of purchase of financial products and services to the customer, and constrains financial inclusion. It makes Indian financial sector players smaller and less competitive than global counterparts. It also creates opportunities for regulatory arbitrage, with differently regulated entities offering essentially the same product with widely different regulatory controls and capital requirements. Finally, it forces the customer to segment his or her purchase of financial

products and services between various providers, and creates greater complexity in understanding the essence and cost of the product or service being delivered.

Going forward, it would be appropriate to consider a holistic rather than a segmented approach towards the financial sector. This would involve the following key steps:

- (i) Enabling the formation of financial services holding companies;
- (ii) Elimination of anomalous differences in the ownership regulations for various segments of the financial sector, with a bias towards freeing up ownership restrictions to the greatest possible extent;
- (iii) Sharing of distribution and “back-end” infrastructure, including a review of the current prohibition against assigning asset management activity by insurers to asset managers, among financial service providers; and
- (iv) Move towards a single regulator for financial services, as opposed to the current multiplicity of regulators for different segments.

It is widely accepted that financial sector regulation must evolve with the changes in the financial sector and the market dynamics. The Indian financial sector has evolved significantly since liberalization, and now possesses a fair degree of resilience and ability to meet the requirements of economic growth going forward. This is due indeed in large part to the initiatives of regulators and policy makers over the past decade. The initiatives of private sector participation, inflow of international capital and calibrated expansion of products and services have been successful. There is a need now for rapidly embracing innovation in order to meet the needs of various customer segments and achieving global competitiveness. There is therefore a need to consider a shift from a “rules-based” regulatory framework that is prescriptive and focused on controlling the financial sector, to a “principles-based” approach that encourages innovation and growth, within an overall framework of financial stability.

6.4 Development of human capital and skills

The financial sector as a whole is estimated to employ between 3.5-4.0 million people, including direct employees and agency forces. To support the GDP growth aspiration of 9-10%, the financial sector would need to grow by 25-30% annually over

the next five years. While the relationship of employment with sectoral growth would not be a linear one, employment in the financial sector should double over the next five years.

At the same time, the demand for human capital is not restricted to financial services alone. There is increasing evidence of the low availability of manpower with relevant skill sets that may lead to erosion of the competitive advantage of Indian industries. A recent survey indicated that over 80% of corporate executives believed that talent would be a significant constraint on the growth of their company over the next five years. Companies are finding that less than a quarter of graduating students have the necessary skills for service occupations. Even among graduates in urban and semi urban locations, where the bulk of hiring typically occurs, less than 30% of graduates have a reasonable command over English. The present college and university education system uses curricula which have undergone only incremental changes over the last several years. The substantive thrust of the curricula continues to be to prepare students for administrative jobs or for jobs in industrial sectors, not for new sectors of an economy that operates in an increasingly globalised environment. There is an over investment in management studies and no development of service sector vocational institutes.

The growth of the Indian financial services sector will be hampered by shortage of qualified people, unless we invest in educating and training professionals. There is a need to continuously plan ahead by revamping curricula, improving service delivery especially in the rural areas and expanding teaching facilities through use of technology. There is a need for vocational training to equip those with high school and graduate level qualifications with skills required for financial sector jobs. This would help equip our large young population with the relevant skills that will enable them to contribute to and benefit from the growth of the financial sector. The Indian financial sector is already taking steps to build in-house training capability as well as partnering with academic institutions to create this knowledge and skill-base. It is necessary to strengthen and extend the industry-academia partnership to reshape curricula and create employment-ready finance professionals.

Chapter 7

Retail Trading Services

7.1 Profile of the Indian Retail Sector¹⁷

According to CSO estimates, the share of domestic trade rose from about 13.0 per cent of India's GDP in 1999-2000 to about 15.2 per cent of India's GDP in 2006-07. Of this it is estimated that retail trade accounts for 11-12 per cent. In 1998 the country had a total of 10.69 million enterprises engaged in retail business, of which 5.23 million were in the rural areas and 5.46 in the urban.

NSSO's Employment and Unemployment Survey for 2004-05 shows the employment in retail trade to be 29.95 million, divided almost evenly between rural (14.94 million) and urban (15.01 million). The contribution to employment of wholesale trade is relatively modest at 4.6 million, of which 3.0 million is in the urban areas and 1.6 million in the rural.

Retailing in India is largely unorganized, dominated by the kirana shops or groceries in every locality, supplemented by paan & beedi shops, handcart or head load hawkers and pavement vendors. The urban areas also have owner-manned general stores and specialty stores, the most common being those dealing with apparel, footwear, drugs and medicines. Until a few years back, organized retailing was uncommon, although the States in the South have had a few small retail chains for decades. However, recent years have witnessed considerable activity by the organized sector and several corporate-backed retail chains have come to the fore and are opening large numbers of stores all over the country. What has helped this trend is the rapid growth of the upper middle class, with increasing disposable incomes, and working couples, who have less time for daily shopping of groceries. Even so, organized retail is in its infancy in India and its share in 2006 is estimated to be only 4 % of the retail sales in the country. As against this the share of organized retail in United Kingdom, Germany and France in that year was 80 per cent and in the USA it was 85 per cent. Even in emerging economies the percentage

¹⁷ The information base of this section is derived mainly from the ICRIER study titled *Impact of Organized Retailing on the Unorganized Sector* (as yet unpublished) being conducted for the Ministry of Commerce & Industry.

share of organized retail was considerably higher than in India: Brazil (36); China (20); Indonesia (30); Korea (15) and Malaysia (55).

Retailing turnover in India has grown at a CAGR of 11.2 % over the period 2004-07, and the sales in 2006-07 are estimated to be Rupees 14,574 (US \$322 billion). Food and grocery constituted almost 60 % of the sales in 2006-07, although the share has fallen from the high of more than 66 % in 2003-04. Organized retail has grown at the faster rate of 19.5 % during this period. Organized retail has so far been concentrated in the clothing and footwear, with furniture, furnishing, appliances and services in the second position. Food & grocery retailing by the organized sector is less than one per cent of the total retail turnover. It may be observed however that some large retail chains, which have entered the scene lately, would be dealing with grocery as well.

The ICRIER study referred to earlier has summed up the rapid growth of organized retail in recent years as follows:

“The growth in organized retailing in recent years can also be gauged by the rise of shopping malls as well as by the rising number of modern retail formats. Back in 1999, India had just 3 shopping malls measuring less than 1 million square feet. By end of 2006 the country had 137 shopping malls equivalent to 28 million square feet. The pace of construction of shopping malls is going rapidly and the number of malls is expected to be about 479 by end of 2008 with a capacity of 126 million square feet (ICICI Property Services-Technopak, 2007).

.....The total number of organized retail outlets rose from 3,125 covering an area of 3.3 million sq. ft. in 2001 to 27,076 with an area of 31 million in 2006. Small-sized single-category specialty stores dominated the organized retail in the beginning with almost two thirds of total space back in 2001. Departmental stores came next with nearly a quarter of total space and supermarkets accounting for the balance of about 12 per cent of organized retail space. There were no hypermarkets in India in 2001. Specialty stores are still the most common modern retail format with over a half of total modern retail space in 2006. Supermarkets and department stores occupied nearly an equal space of 15-16 per cent each in 2006. India had in 2006 about 75 large-sized hypermarkets carrying a

tenth of the total modern retail space in the country. This format is expected gain more prominence in the future.”

7.2 Issues in Retailing

7.2.1 Foreign Direct Investment

After the introduction of economic reforms in 1991-92 foreign direct investment was gradually liberalized in both manufacturing and services sectors, starting with permission given on a case-by-case basis. At that time one or two foreign companies were given permission to do retail business in the country. However, the position changed in 1997, and contrary to the general direction of reform FDI in retail was prohibited on fears that entry of foreign retail companies would have an unfavourable impact on the unorganized sector and would lead to the outflow of foreign exchange. Since then the policy has been relaxed partially and in 2006 foreign companies were allowed to invest up to 51% equity in single-brand retail joint ventures.

FDI in multi-brand retailing is still prohibited. However, the point is made that FDI has made inroads into retailing through several routes. 100 % equity is allowed for cash-and carry wholesale trading but there is no dividing line between this activity and retail trading. There is nothing to prevent the end-use consumers to make wholesale purchases meant for their own consumption. Inroads into activity in the domestic economy have also been made by foreign enterprises through franchising, which is permitted. Further the following types of trading, which is permitted partake of the nature of retail activity:

- Trading of hi-tech items requiring specialized after-sale service
- Trading of items for social sector
- Trading of high-tech medical and diagnostic items
- Test marketing for a period of two years for items for which a company has approval for manufacturing

Even so retailing is the only large service sector, which has not been formally opened to FDI in a big way. Since some policy makers want to maintain the momentum of liberalization many of them feel that there should be some more movement toward liberalization. Among the gains that they visualize are the technology and know how

coming into the country with the large retail chains. The backward linkages developed by the large retailing organizations are likely to help in the scientific development of farming. The case is cited of Macdonald's, which has invested in setting up of supply chains and transferred state-of-the-art food processing technology. Macdonald and its suppliers also worked closely with farmers in some locations in the country to cultivate high quality lettuce (Arpita Mukherjee and Nitisha Patel, *FDI in Retail Sector, India*, ICRIER, 2005). The most significant point that is made is that once the foreign retail chains develop local supplies up to their standard for the local operations, they can also source the same products for the operations in home country as well as in third countries. The activities of the large retail organizations can thus become a big avenue for increasing exports from the country. However, these arguments have not been enough to convince the opponents of FDI in retail and there is lack of consensus on the issue in the ruling coalition.

7.2.2 Organized versus Unorganized Retailing

As a result of the entry of large business houses into retailing and ambitious plans being implemented by them, the FDI issue has receded into the background somewhat. The small retailers now feel threatened by the organized retail giants, and there have been demonstrations in West Bengal and Jharkhand by vegetable vendors. The State Government of Uttar Pradesh has taken pre-emptive action by shutting down independent outlets of retail chains dealing with fresh farm products. The big issue now is whether organized retailing would throw the unorganized sector out of business. One view expressed on this is that local kirana shops and established vegetable vendors would retain their position as convenience shops and would not be displaced. Another view is that since the economy is rising at a rapid pace organized sector will take care of the resultant expansion of retailing activity, leaving the present position of unorganized retail secure to a large extent. It is true that at the height of Asian financial crisis foreign retailers were allowed entry by Thailand the local players were marginalized. However, Mukherjee and Patel have argued that in a crisis-ridden economy, when the local players were already facing a survival problem, foreign competitors squeezed them out. However, in India this is not likely to happen in the present times when the economy is expanding rapidly. The same authors refer to a survey-based study of 100 small retailers in close proximity of Foodworld and Subhiksha by KSA-Technopak in Chennai, which

showed that none of them had to close down on account of the operations of the organized retailers. Most people believe that the organized sector will see new jobs of a higher quality than the organized and there would more jobs for the educated and skilled categories. Nagging doubts remain, however, in some sections about the possibility of adverse effect on the self-employed people in the unorganized retail sector especially if the organized sector expands too fast. Others point out that the benefit to consumers by way of economy in purchases and multiple choice and the benefit to the government by way of increased collection of taxes would far outweigh the adverse effect if any on the small retailers.

7.2.3 Challenges before the Organized Retail Sector and Response to Challenges

7.2.3a Physical Infrastructure

Retail trade depends critically on the quality of physical infrastructure, particularly on power and roads. The shortcomings of the power sector in the country are well known. Over the last five years, while supply increased, it was outstripped by demand with the result that the shortfall between peak demand and peak availability increased from 11.8 % to 13.8 %. Retail trade is significantly dependent on supply of electricity for lighting as well as for refrigeration and deficiencies in the quality and quantity of supplies impairs its efficiency. The need to maintain captive power plants on a standby increases the fixed cost and if the outages from the main grid are for long periods the high cost of generation in small plants increases the variable cost as well. The cost of generation of small captive units is as much as four times that of supplies from the grid.

The world over supplies for retailers, whether of fresh or manufactured goods move by roads, sometimes over long distances. While the National Highways programme has made good progress the traffic constraint problems e.g. mix of motorized and non-motorized traffic, ribbon development, check-posts on interstate borders by various State authorities. The cumulative result of all this is that vehicles move at very slow speed. Delhi-Mumbai takes three days and Delhi-Bangalore five days, when by international standards they should not be taking more than two or three days

respectively. The poor road transportation infrastructure is compounded by the lack of penetration of information technology in the transport sector and by the lack of proper communications infrastructure. In the absence of a shipment tracking system a shipper cannot track the status of a shipment before it reaches the destination.

The longer time involved in road transportation and the absence of a proper communications infrastructure increases the cost of transport and consequently the logistical cost. Retail trade is heavily dependent on logistics and increases in logistical cost impair the efficiency of retail trade. It is estimated that in 2005-06 the total logistic cost on India was close to 15 % of the GDP as compared to just over 9 % in the USA and 10-12 % in other developed economies.

Urban infrastructure, and particularly urban transport infrastructure, is also critical for retail trade. The goods that are brought in from outside for the retail outlets have to be moved into these towns and cities through congested streets, on which the larger vehicles used for trunk routes cannot move.

The inadequacies in the power sector and in the road and urban infrastructure need urgent attention of both the Central and State Governments. Further, the High Level Group would make the following specific recommendations to cut down the logistic cost incurred by retail trade and also by the manufacturing sector:

- (iii) For the smooth flow of goods moving particularly by road transport integrated logistics hubs should be identified in consultation with industry associations and developed on PPP basis across the country; and
- (iv) The administrations of one million plus cities should develop Transport Nagars outside the municipal areas for smooth flow of vehicles containing both incoming and outgoing supplies.

7.2.4 Fiscal Issues

7.2.4a Variations in taxes at State Level

For maximum benefit to the consumer the retail trade chains must operate in several States or preferably on a pan-India basis. Any tax on interstate movement such as

the Central Sales Tax constrains retail operations as the supplies have to be sourced within the State to avoid the tax. Differences in the levels of State taxes also lead to the same results and the retail chains are unable to avail of economies of scale that could be reaped from the centralized procurement of merchandise. Similarly the benefit of backward supply linkages developed in one State gets circumscribed to that State. Octroi or entry taxes levied by the municipal bodies exacerbate the position. Differences in the level of taxes also impose costs on retail operations as the goods have to be priced differentially in various State jurisdictions.

Fortunately the fiscal reforms introduced in recent years are likely to ease the situation in the near future. Phase-out of the Central Sales Tax has commenced and there will be no tax on interstate movement with effect from 31 March 2010. State VAT was introduced by most States with effect from 1 April 2005 and other States have been gradually falling in line. After the decision made lately by Uttar Pradesh all States have agreed to introduce State VAT. This will bring in uniformity in internal taxation of most goods in the country and facilitate retail operations. The Government of Maharashtra has recently decided to withdraw octroi in Mumbai.

The decision in principle to introduce Goods and Services Tax (GST) on 1 April 2010 to integrate all indirect taxes on goods and services at the central and state levels is another positive development for retail trade. A dual tax structure, one at the state level and the other at the central level is likely to be established at the beginning of the financial year 2010-11. The eventual establishment of GST would lead to a quantum improvement in the efficiency of the retail sector

7.2.4b Service Tax on Rentals

One specific fiscal issue of relevance to retail trade brought to the notice of the High Level Group was the levy of Service Tax on rentals of immovable property, which came into force on 1 June, 2007. It is applied on rental payments made for immovable property in the course of business/commerce. With service tax plus educational cess at 12.36%, it means that every tenant has to pay a service tax equivalent to six weeks rental. The point made by the retailing industry is that while manufacturing and other service industries can claim input tax credit of the service tax on rent against the CENVAT/

Service Tax paid by them. The retail industry cannot claim input credit of the service tax on rent as it does not pay service tax but pays State VAT against which input tax credit is not possible.

The Hon'ble Madras High Court has granted an interim injunction restraining the Union Finance Ministry from collecting service tax on rent of commercial buildings following a petition filed by General Star Kitchen Pvt Ltd, which operates a restaurant in Chennai Citi Centre. As the matter is sub judice, the Group refrained from making any recommendations on the issue.

7.2.4c Service Tax on Outsourced Manpower Services

The retail industry is a large user of outsourced manpower services. The service providers involved in providing manpower services to the retail industry have to pay service tax but there is a problem in the assessment of the value of the service transaction. The service is valued not only on the basis of the fee of the service provider but including the salary paid to the employees. The Group considered that the method of valuation of the service of the service provider unfairly increased the burden of taxation on the retail industry. The Group recommended that the service tax in these cases should be limited to the fee element and should not be levied on the gross amount including the salary.

7.2.5 Supply Chains

The world over food and grocery items including fresh fruits and vegetables constitute the largest segment of retail trade. In India retail operations are handicapped by the presence of multiple levels of intermediaries in distribution of these items. The Agricultural Produce Marketing Committee (APMC) Act, which was originally enacted to assist the farmers in getting the best price for their produce became an impediment in achieving this objective as it trapped them in the stranglehold of arhatias (wholesalers). Further one of the advantages of modern retail industry is that the farmers supplying the produce are provided with technology to improve their farming practices as a result of which the retailers have better produce on their shelves and the farmers increase their incomes. For this to become possible the farmers have to undertake contract farming and

sell their products directly to the retail chains. The APMC Act bars such an arrangement, as the farm produce must be sold in the designated markets. While many States have amended their laws and eliminated the obstacle in the way of contract farming the process is still hampered in the absence of a specific law on contract farming affording speedy relief against violations of contract farming.

For efficient operations the retail chains need logistic service providers, to whom a company's entire logistic operations can be outsourced. The logistics industry in India is highly fragmented with each of the segments, road transportation, freight forwarding, warehousing, and management of information service dominated by small operators. Few of the service providers have the capability of providing service in more than one segment and Third Party Logistics (3PL) companies with the capability of providing multiple tactical logistics services are uncommon in the country. The lack of a well - developed logistics industry in the country increases the need for retail chain companies to make investments in supply chain infrastructure. However, they are severely constrained by the unwillingness of commercial banks and financial institutions to lend for retailing, which is not an industry. External commercial borrowings are also barred even for the machinery and refrigeration equipment needed by the retail sector.

In this connection the Group was informed about the plans of the Ministry of Food Processing Industries to implement the Mega Food Park Scheme, which aims to provide a mechanism to bring together farmers, processors and retailers and link agricultural production to the market so as to maximize value addition, minimize wastage, increase farmers' income and create employment opportunities in the rural sector. In the XI Five Year Plan an outlay of Rs 1500 crore has been earmarked for the development of 30 Mega Parks in the country. Although the programme is aimed at stimulating the food processing industry the Group took the view that its successful implementation will strengthen the supply chain in the country and increase efficiency in the operations of retail chains. The Group supports the speedy implementation of the Mega Food Parks Programme.

On contract farming also there has been progress in that several States have amended their laws to make contract farming possible. The success of contract farming for the food processing industry has been demonstrated in Punjab by Pespi Foods Ltd.

Organized retail can similarly benefit from contract farming and at the same time the farmers can gain if the retail companies invest in training the farmers, and in imparting skills in improved farming techniques as well as communication skills. However, for successful contract farming operations regulations are needed to ensure quick remedy against contract violations and speedy resolution of disputes. Many States have not framed the Rules under the Acts for dealing with these problems. A commonly voiced concern is also that the farmers should not lose their land and become bonded labourers.

The Group recommends that the States should move forward to frame rules and regulations under the APMC Act to provide for quick remedy against contract violations and speedy settlement of disputes as this will stimulate resort to contract farming. Widespread use of contract farming will be a boon to the farmers and will also improve the efficiency of retail chain operations.

7.2.6 Multiple License Requirements

The retail trade industry has represented that it has to secure a total of 45 licenses, clearances, registration certificates or notification requirements for each outlet and that its operational efficiency would increase considerably if it had the facility of single window clearance. Six of these are related to infrastructure viz., modification of existing structure in leased premises, lifts & escalators, parking permission from traffic police, power connection, Diesel Generating Set approval beyond the prescribed capacity, license for water usage/connection and NOC for Fire License. Seven are operational requirements such as trade license, stamping and verification (calibration) of any weight or measure used in the transactions, forecourt license, illumination signboard license, approval of State Pollution Board for trade sewerage, medical certificate for persons handling food items and police permission for plying of vehicles for the movement of vehicles for the movement of supplies during the day. Seven of these requirements are related to labour laws, namely, Shops & Establishments Act, license to operate shops for 365 days, the Factories Act, Employees Provident Fund Act, Employees State Insurance Act, the Contract Labour Act (registration certificate as principal employer and licenses for individual contractors), and the Payment of Gratuity Act (notification of opening an establishment and submission of nomination forms). There is a requirement for endorsement of selling location in VAT and CST registration. The most onerous are the

18 requirements, which are product related. These include APMC License for fruits and vegetables and food grains, eating house license, license for trade in milk and milk products, license for storage and sale of meat products and eggs, Prevention of Food Adulteration (PFA) license for different categories of products including baby food, license for storage and sale of freshly prepared foods & sweetmeat, FDA license for storage and retail under the Drugs and Cosmetics Act, appointment of pharmacists for each store, Household Pesticides and Insecticides License, registration of manufacturers, packers and importers under the Standards of Weights and Measures (Packaged Commodities) Rules, licenses for specified commodities under the Essential Commodities Act, license for playing music in the store under the Copyright Act, liquor license, book store license, bakery product manufacturers license, opticians license and perfumery license.

The High Level Group considered the suggestion for single window clearance of retail outlets in depth. It noted that some of the clearances such as the one by the State Pollution Board had to be given by statutory bodies. Further it was necessary to take into account the local conditions such as in the case of clearance for parking or permission for transporting supplies within urban areas for retail outlets during the day. The certificates and licenses had to be given by authorities belonging to various organs of the State Government and of the Municipal bodies, and if a single authority were to be empowered to issue the licenses or clearances through a single window, it would in any case need to coordinate with these organs before granting clearances against various requirements. Such a process could conceivably take a longer time than obtaining the clearances/licenses separately. The High Level did not consider single window licensing retail outlets practicable. However, the Group was of the view that authorities should grant clearance/license/certificate to all the outlets of a retail chain that lie within their jurisdiction in one transaction, instead of requiring separate processing for each outlet.

7.2.7 Onerous Regulatory Requirements

7.2.7a Shops & Establishment Act

One of the most important State level Acts governing retail trade is the Shops & Establishment Act. In many States the Acts in force today were enacted over 50 years ago:

Mumbai / Maharashtra	1948
Tamil Nadu	1947
Delhi	1954
Madhya Pradesh	1954

These State laws have different provisions on opening and closing hours and on the working hours for women. All of them require the shops and offices to be closed for at least one day a week on a mandatory basis. Constraints on opening and closing hours limit the operations of retail outlets and inconvenience the clientele. Restrictive limitation on the working hours of women is anomalous when in the IT sector the limitations have been removed on the condition that transport would have to be provided by the employer to enable women to return home in the night. Compulsory closure of stores and offices for a day in the week is also not warranted because if worker's welfare is the aim it can be accomplished by requiring that employees should be given weekly off day on any fixed day by rotation.

In more ways than one the Shops & Establishment Act is outdated and the High Level Group recommends that the Government of India should set up a Committee consisting of representatives of Government, Trade Associations and the Unions to review the provisions and propose changes that take into account today's realities in terms of workplace practices, use of technology etc.

7.2.7b Compliance with the Standards of Weights & Measures Act

The practice at present is that the inspecting authorities hold the retailers also liable for any violations in compliance with the standards of Weights and Measures Act. The High Level Group found the argument of the retail industry compelling that as they purchase products from large numbers of suppliers, it is not practical for them to verify whether the manufacturers have complied with the provisions of the Act. The Act needs to be amended to make only the manufacturers and packers responsible for non-compliance and not the retailers.

7.2.7c Employees State Insurance (ESI)

The ESI was conceived of as a very good scheme for taking care of the healthcare problems of industrial employees. However, on account of poor implementation of the scheme a very small number of employees of shops and establishments are able to avail of its benefits. The experience of these employees is that issuance of ESI identity cards takes months, generally the doctors are not available, and medicines are in short supply. The requirement that ESI contribution be paid even in respect of temporary employees who, because of the short duration of their service, can never hope for any benefit from the ESI hospitals, is regarded as particularly onerous. The High Level Group suggests that the Government should set up a Committee to evaluate the performance of the ESI scheme and make suggestions for reform. Since now a number of health insurance companies have come up in the private sector employers/employees should be given the option of subscribing to alternative health insurance programmes.

7.2.7d Essential Commodities Act, 1955

The Essential Commodities Act, 1955 was enacted to ensure the easy availability of essential commodities to consumers and to protect them from exploitation by unscrupulous traders. Under the Act various State Governments had issued orders for licensing of dealers/retailers, regulation of stock limits, restricting the movement of food grains, compulsory purchase by the Government under the system of levy and placing restrictions on the entertainment of guests. In 2001 a Committee comprising of Central Ministers and a number of Chief Ministers took the view that while the Essential Commodities Act could continue as an umbrella legislation a progressive dismantling of controls and restrictions was in the best interests of farmers, consumers and traders. Accordingly all restrictions including licensing requirement, stock limits and movement restrictions were dispensed with by the Central Government through the Removal of (Licensing requirements, Stock limits and Movement restrictions) on Specified Foodstuffs Order, 2002 under the Essential Commodities Act, 1955 on 15.2.2002. Dealers were allowed to freely buy, stock, sell, transport, sell, transport, distribute, dispose etc. any quantity in respect of wheat, paddy/rice, coarse grains, sugar, edible oilseeds and edible oils without requiring any license or permit therefore under any order issued under the Act.

In August 2006 the Central Government issued an order whereby controls were reintroduced temporarily for a period of six months in respect of wheat and pulses. This order has been extended periodically and is at present valid until 31st August 2008.

The High Level Group is of the view that the reimposition of controls on these products has not had any favourable effect on the price or availability of these commodities and has only added to costs of dealing with them at the retail level. The Group therefore recommends that the especial dispensation in respect of wheat and pulses should be allowed to lapse with effect from 31st August 2008.

7.2.8 The Challenge of the Unorganized Sector

It has been noted above that nagging doubts remain with respect to the effect of organized retail on the self-employed small retailers. The greatest concern is with respect to the hawkers who deal with fruits and vegetables. One way of taking care of this concern is for the large retailers to share the benefit of supply chains in these products by selling goods in bulk packages for the benefit of small retailers.

No.18 (1)/DP/PC/2007
Government of India
Planning Commission

Yojana Bhavan, Sansad Marg
New Delhi-110 001

May 4, 2007

ORDER

Sub: Constitution of High Level Group on Services Sector

It has been decided to constitute a "High Level Group on Services Sector" with the following composition:

Shri Anwarul Hoda, Member, Planning Commission - **Chairman**

Members

1. Secretary (Commerce), Ministry of Commerce and Industry, Govt. of India
2. Secretary (Tourism), Govt. of India
3. Secretary (Health), Govt. of India
4. Dr. Naresh Trehan, ED, Escorts Heart Institute and Research Centre, N.Delhi
5. Ms. Suneetha Reddy, Director, Appollo Hospitals, Chennai
6. Mr. Nandan Nilekani, CEO, Infosys
7. Mr. K.V. Kamath, MD and CEO, ICICI Bank
8. Mr. S. Ramadorai, CEO and MD, TCS
9. Mr. Azim Premji, Chairman and CEO, Wipro
10. Mr. Kishore Biyani, MD, Pantaloon Retail (India) Ltd.
11. Mr. Noel Tata, MD, Trent Ltd.
12. Mr. S.S.H. Rehman, MD, ITC Hotels
13. Chairman, University Grants Commission
14. Director, IIM, Bangalore
15. Director, IIT, New Delhi
16. Director, NLSIU, Bangalore
17. Mr. Ashok Desai, Consultant Editor, Telegraph
18. Mr. B.K. Zutshi, 12, Shivraj Niketan Colony, Jaipur
(Former Ambassador and Permanent Representative of India to GATT, Geneva)
19. Prof. Rupa Chanda, IIM, Bangalore
20. Dr. Arvind Virmani, Pr. Adviser, Planning Commission - **Member Secretary***

* Shri Paul Joseph, Principal Adviser (DP), Planning Commission functioned as the Member Secretary of the Group with effect from 25th July, 2007.

2. Terms of Reference

To comprehensively examine the different aspects influencing the performance of the services sector and suggest short-term and long-term policy measures to improve and sustain its competitiveness in the coming years.

3. The Chairman of the High Level Group may constitute Sub-groups and /or may co-opt additional members as may be considered necessary.

4. The High Level Group may meet as often as may be necessary and shall submit its report to the Government by October 31, 2007.

5. The Group will be serviced by the Development Policy Division of the Planning Commission.

6. The TA/DA expenditure of the official Members in connection with the meetings of the Group will be borne by the Ministry/Department/State Government to which they belong. In case of non-officials, TA/DA will be borne by the Planning Commission as admissible to Class-I Officers of the Government of India.

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To:

Chairman and all the Members of the Group

Copy to:

- 1 PS to Deputy Chairman, Planning Commission
- 2 PS to Minister of State for Planning
- 3 PSs to All Members/Member-Secretary, Planning Commission
- 4 PS to Pr. Secretary to Prime Minister
- 5 PSs to all Pr. Advisers/Senior Consultants/Advisers in the Planning Commission
- 6 Plan Coordination Division, Planning Commission
- 7 Director(GA)/DS(Adm.)/DS (Accounts), Planning Commission
- 8 Sh. N.N. Kaul, Information Officer, Planning Commission
- 9 IFA Unit
- 10 Drawing and Disbursing Officer, Planning Commission

Names of Experts Consulted by the Chairman

- (i) Shri Raghu Pillai
Director
Reliance Retail Limited, Mumbai
- (ii) Shri N.K. Shah
Vice President (Corporate Finance and Accounts)
Varun Shipping Company Limited, Mumbai.
- (iii) Shri S.S.Kulkarni
Secretary General
Indian National Shipowner's Association, Mumbai
- (iv) Shri Som Mittal
President
NASSCOM, New Delhi
- (v) Shri Kiran Karnik
Former President
NASSCOM, New Delhi
- (vi) Shri Daljit Singh
President- Strategy and Organizational Development
Fortis Healthcare Limited, New Delhi
- (vii) Dr. N. K. Ganguly,
Director General
Indian Council of Medical Research, New Delhi
- (viii) Dr. Nandkumar Jairam
Chairman and Group Medical Director
Columbia Asia Hospitals, India,
Bangalore

Comparative table showing the tax regime for seafarers in India and select maritime countries

India	Mauritius	Malaysia	Singapore	China	Netherlands	Germany	U.K	Greece
<p>Indian seafarers working on board Indian ships are granted non-resident status for the purpose of taxation of salary income earned by them provided they are outside India for 182 days or more. For this purpose, the period of the seafarers' service when the ships are in Indian territorial water is treated as period of service in India for computation of their residential</p>	<p>A Specific tax concession is provided whereby the emoluments relating to employment exercised on board a vessel registered in Mauritius is exempt from tax. Also, emoluments relating to employment exercised on board a foreign vessel are exempt from tax.</p> <p>Relevant extract of the income tax Act of Mauritius is given below:</p> <p>"PART I – PRELIMINARY</p> <p>2. Interpretation <i>In this Act, unless the context otherwise requires -</i></p> <p>"foreign vessel", in relation to item 8 of Part I and item 12 of Part II of the Second Schedule, means a ship registered in Mauritius and owned by -</p> <p>(a) a body corporate incorporated in Mauritius which is not under the effective control of citizens of</p>	<p>Employment income derived by a seafarer who is employed on board Malaysian ship is exempt from tax.</p> <p>Relevant extract of the income tax Act of Malaysia is given below:</p> <p><i>"127. (1) Notwithstanding any other provision of this Act but subject to section 127A, any income specified in Part I of Schedule 6 shall, subject to this section, be exempt from tax."</i></p> <p>"SCHEDULE 6 (Section 127) Exemption From Tax</p> <p>PART I</p> <p>INCOME WHICH IS EXEMPT</p> <p><i>34. (1) Income of an individual derived from</i></p>	<p>Income derived from an employment exercised on board a Singapore ship is exempt from Singapore income tax, provided that the employment is substantially exercised in Singapore. The crew of foreign ships exercising employment on board a ship in international traffic is also exempt from Singapore income tax on their employment income if they are resident in</p>	<p>In the case of non-resident seafarers on ships plying the national flag of the country and sailing outside the territorial waters employment income is not taxable in China as services are rendered outside China.</p>	<p>Employers in the maritime industry are entitled to benefit of reduction (40%) on the salaries payable to seafarers.</p>	<p>Employers in maritime Industry are entitled to benefit of reduction (40%) on the salaries payable to seafarers.</p>	<p>Taxable salary is subject to WHT. However Social security contributions (both by employer and employee) are applicable.</p> <p>Merchant seamen are covered under the social security system.</p> <p>Non-resident is liable to tax on its UK source income. In case the seafarer becomes resident in UK he is entitled to 100% deduction in respect of its foreign sourced</p>	<p>Greek seafarers serving on board Greek flag ships employed in international trades are subject to tax relief by way of lower level of taxation.</p> <p>Effective from 2007 shipboard officers and ratings on Greek flag vessels are subject to a reduced flat income tax rate of 3% and 1% respectively.</p>

<p>status for the purposes of taxation.</p> <p>A resident and ordinarily resident seafarer is taxable on his worldwide income.</p>	<p>Mauritius; or</p> <p>(b) a body corporate which is incorporated outside Mauritius;</p> <p>"seaman" in relation to item 12 of Part II of the Second Schedule, means a seaman who is employed on a vessel registered in Mauritius or a foreign vessel;"</p> <p>“PART II - LIABILITY TO INCOME TAX</p> <p>7. Exempt income</p> <p>(1) The income specified in the Second Schedule shall be exempt from income tax.”</p> <p>“SECOND SCHEDULE (section 7) Exempt Income</p> <p>PART II - EMOLUMENTS</p> <p>12. The emoluments derived by a seaman who is employed on a vessel registered in Mauritius or on a foreign vessel.”</p>	<p><i>exercising an employment on board a Malaysian ship.</i></p> <p><i>(2) For the purposes of sub paragraph (1), “Malaysian ship” has the same meaning as in section 54A(6).”</i></p>	<p>a country that has signed a tax treaty with Singapore and the treaty provides for such relief from Singapore income tax.</p>				<p>income.</p>	
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