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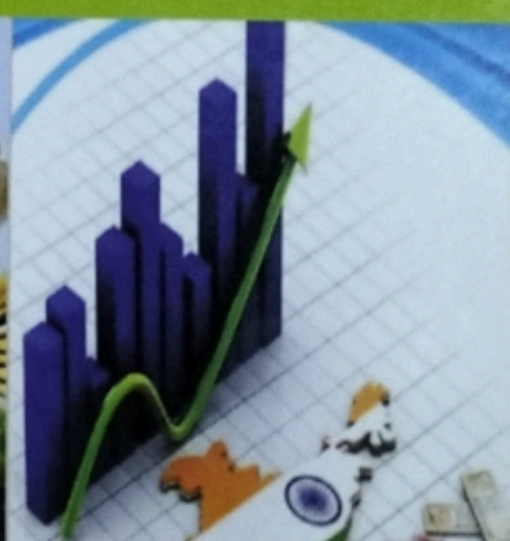
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Indian Services Sector: Development and Issues

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Introduction

This paper outlines major policy issues along with suggestions, both general and specific to some sectors viz. IT, Tourism, Shipping and Project Exports. The first three sectors are important both in the domestic and export front and Project exports which is a mix of both goods and services in the export front. Each sector has its own peculiarities, problems and strengths. The growth of the services sector has been pulling up the overall growth of the economy. However, in 2016-17, services growth decelerated to 7.7 per cent in line with the deceleration in overall growth to 7.1 per cent. In H1 of 2017-18, while overall growth decelerated to 6.0 per cent, services growth improved to 7.9 per cent powered by the good growth of 10.5 per cent in the trade, hotel, transport and storage category. India's commercial services exports increased from US\$ 52.2 billion in 2005 to US\$ 161.3 billion in 2016 as per WTO data, with its share in global services exports increasing to 3.4 per cent from 2.1 per cent during the above period. In 2016-17, services exports recorded a positive growth of 5.7 per cent with pick up in some major sectors like transportation, business services and financial services; and good growth in travel. In 2017-18 H1, Services exports grew by 16.2 per cent, while services imports grew by 17.4 per cent resulting in net services growth of 14.6 per cent which financed almost 44 per cent of Trade Deficit.

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

Major Cross Cutting Issues

Impact of Demonetization:

Demonetization, temporarily impacted services sector as in the case of other sectors. While there was deceleration in services GVA in 2016-17 Q3 to 6.9 per cent, it picked up to 7.2 per cent and 8.7 per cent in the subsequent quarters. Services PMI also fell after demonetization for a few months though it picked up subsequently. Services exports fell in December 2016, but picked up in next three months. However, all these could have been due to other factors as well and not necessarily due to demonetisation. There was not much impact of demonetisation on Tourism, with Foreign Exchange Earnings (FEE) in dollar terms increasing after demonetisation. Bank credit by commercial Banks also increased after demonetisation.

While demonetization is now a thing of the past, there were also many positive impacts on services like greater digitization, increase in payments to local bodies and discoms as demonetized notes were legal tender for such payments for some time, net flows into mutual funds increasing by nearly 19 times due to reduction in interest rates on bank deposits after demonetisation and Premium collected by Life Insurance Corporation of India increasing by 142 per cent in November 2016 and by private sector life insurance companies by nearly 50 per cent due the window provided for depositing old notes to make these payments for a short while.

Goods and Services Tax (GST) and Services:

In the case of Services, the GST rates are NIL for education and health services and 5 per cent for transport of goods by rail and vessel, supply of tour operators services (without ITC). Only 4



services items are in the highest slab of 28 per cent which include among others entertainment events or access to amusement facilities including exhibition of cinematograph films, theme parks, joy rides, etc; and hotels, inns, having room tariff above Rs. 7500 per day per room. The GST Council in October 2017 recommended changes in GST rates to provide relief on the services side also, particularly to aviation, restaurants and job work related to services. Further during recent amendments some measures specific to services were also taken which include reduction in tax rates on some services including services related to job work which will benefit many sectors including Gems and Jewellery, exempting service providers with annual turnover of less than Rs2 million from the need to register even in cases where they are making inter-state supplies, etc.

GST has helped the services sector in many ways like avoiding confusion as pre-GST, both Central and State Govt. had the right to collect the tax which was leading to confusion in finding out to whom the tax is to be paid for services like software, works contract etc. resulting in disputes between Central and State Governments. There are also some early results of GST affecting services with 24 states abolishing check posts while others are in the process, resulting in reduction in transportation cost, fuel use and fall in congestion.

Domestic Regulations and Services Trade Restrictiveness:

Reforms in Domestic regulations are important both for domestic production and export of services. However domestic regulations should not act or be used as restrictive trade barriers. OECD's Services Trade Restrictiveness Index (STRI) helps to identify policy measures restricting trade. Among the 44 countries, India has a STRI score above average in all sectors and the highest in 3 services out of a total of 22 services. Sound recording, engineering and broadcasting are the three sectors with the lowest score relative to the average. Accounting services, legal services and rail freight transport, are the three sectors with the highest scores relative to the average.

Market Access Barriers:

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

Sector specific Issues:

IT / Software Sector:

The fall in India's computer services export growth by 0.2 per cent in 2016 is happening even when the World computer services exports are growing at 5.8 per cent in 2016; some advanced countries like USA, Israel and competing countries of South East Asia, Latin America and East Europe like Philippines, Brazil, Chile, Russia and Ukraine are having modest to robust growth and India's computer services imports is also growing at 30.4 per cent. Thus, the IT-BPM sector is affected not just by the global slowdown and challenging market access situation, but other challenges as well. The issues and challenges in the IT-BPM sector are both in the international and domestic front. International Challenges include the following. In the US there is the tightening of Visa regime for software services with the US Government's hardening stance on the H-1B visa and the "Buy

American, Hire American" Presidential executive order which called for the collection of data, increased oversight followed by a number of administrative policy changes and proposed changes that target the visas most commonly used by India's IT sector.

Tourism Sector:

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

Shipping and Port Services:

Though shipping is an important means of transport in India's International Trade and both a foreign exchange earner and saver, India's share in total world DWT is only 0.9 per cent as on 1 January 2017. Despite having one of the largest merchant shipping fleets among developing countries, there has been a sharp decline in the share of Indian ships in the carriage of India's overseas trade from about 40 per cent in the late 1980s to 7 per cent in 2015-16. In the coastal business, Indian ships carried around 70 per cent cargo in the same year. Some issues in this sector include the following. There is a need for 'Indian flag vessels for India's Trade' policy in shipping as Indian ships carried just 7.9% of Indian EXIM trade and 71.82% of coastal trade in 2015-16 despite the government's "Free on Board" (FoB) for imports policy and the Right of First Refusal (RoFR) policy.

Project Exports:

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

Conclusion:

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



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