

Services

The Background

The Services sector, also referred as the tertiary sector, is the largest of the three constituent sectors in terms of contribution to GDP in India. The Services sector comprises of trade, hotels and restaurants, transport, storage, communication, financing, insurance, real estate and business services, community services (public administration and defense), and other services. The Services sector provides services of final consumption nature as well as intermediate nature, the latter accounting for a major share. Substantial part of services such as transport and communications is in the form of intermediate inputs of production of other goods and services.

The traditional paradigm of economic growth in which as economies develop, dependence on primary sector will give way to the heavy reliance on secondary sector which finally would lead to service sector based growth has not been witnessed in India. Starting from 1984-85 when the contribution of services sector to GDP (37.7 percent) overtook Primary sector (37.63 percent), the Services sector has remained as the largest contributor to GDP. The secondary sector thus never got the status of the main contributor to GDP.

Initially in 1980s when the Services sector emerged as the main contributor to GDP, it was attributed to the dominant role played by the public sector and rise in the pay and allowances of workers

of public sector in the aftermath of implementing new pay scales recommended by the Fifth Pay Commission. However, the impact of the liberalisation of trade and industrial policies since 1984 also appears to have resulted in services growth. In addition to this, growing urbanisation has also contributed to the growth in services sector.

In developed countries, the high-income elasticity of demand for services in the presence of growing incomes from Primary and Secondary sectors was the main contributor of growth in Services sector. In India, as stated earlier, the public sector has been a major driver of services sector growth. It has been observed that there was no corresponding shift in the occupational structures of the labour force from Primary to Services sector in 1980s and 90s. The share of services in national income is much larger than its corresponding share in employment.

At present a shift in the composition of services sector is noticeable, away from traditional services such as transport and distribution and more towards finance, insurance, and business services. Strategic business services that consist of software, information processing, research and development, technical services, marketing, business organization, and human resource development, have emerged as the dominant sources of growth for this sector. These services also account for major share in employment. Technological

advancement and innovation- especially in information and communication technology field has resulted in change in the ways of conducting business, shortening the product cycle through increased productivity.

Performance of Services Sector Since 2001-02

Table S.1 contains figures on the annual growth rates of GDP at factor cost, Services sector and its three constituent categories from 2001-02 onwards. Growth rates recorded by three components of services viz., (a) Trade, Hotel, Transport & Communication, (b) Financing, Insurance,

Real Estate, and (c) Community, Social & Personal Service are also given in Table S.1. First, the services sector on aggregate has been registering as much as or higher rates of growth than that observed in GDP. Trade, Hotel, Transport & Communications segment of services sector has always been registering higher growth rates than the other two segments of services. Community, Social & Personal Services segment has relatively lower rates of growth among the three segments.

The contribution of services sector (excluding construction which is sometimes grouped within services sector) to GDP

Table S.1: Growth of Services Sector (per cent)

Year	Trade, Hotel, Transport & Communication	Financing, Insurance, Real Estate	Community, Social & Personal Services	Total Services GDP	Total GDP at Factor Cost
2001-02	9.2	7.3	3.9	7.1	5.8
2002-03	9.1	8.0	3.8	7.3	3.8
2003-04	12.0	4.5	5.4	8.2	8.5
2004-05	10.6	9.2	9.2	9.9	7.5
2005-06	11.5	9.7	7.8	10.0	8.4

Source: Central Statistical Organisation

Table S.2: Composition of Services Sector and its Share in GDP (per cent)

Year	Share of Trade, Hotel, Transport & Communication in Services GDP	Share of Financing, Insurance, Real Estate and Business Services in Services GDP	Share of Community, Social & Personal Services in Services GDP	Share of Service in GDP
2001-02	45	26	29	50
2002-03	46	26	28	52
2003-04	48	25	27	52
2004-05	48	25	27	53
2005-06	49	25	26	54
2006-07(Q1)	49	26	25	54

Source: Central Statistical Organisation

Table S.3: Indicators of Services Sector Output

Indicator	Period	2006-07	2005-06	% change
Tourist Arrivals (numbers)	July-August	630438	563124	12.0
Railways Freight (million tonnes)	July-August	115.54	102.93	12.3
Cargo Handled at Major Ports ('000 tonnes)	July-August	71479	67468	5.9
Production of Commercial Vehicles (numbers)	July	42194	32100	31.4
Telephone Connections (millions)	July-Sept.	29.94	14.66	104.2
Broadband Connections (millions)	July-Sept.	0.47	0.43	9.3
Aggregate Deposits (Rs. Crores)	July-August	4440178	3670484	21.0
Bank Credit to Commercial Sector (Rs. Crores)	July-August	3509637	2747840	27.7

Source: NCAER Database on Infrastructure

increased from 50 percent to 54 percent between 2001-02 and 2005-06. During the same period, share of Trade, Hotel, Transport & Communications segment in total services increased from 45 percent to 49 percent while the shares of other two segments have come down. The pattern is not surprising given the relatively sharp rise in the telecommunications sector in the recent past.

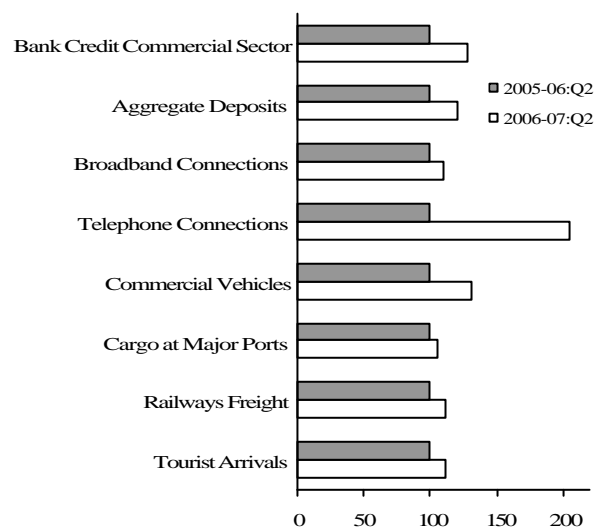
Trends in the Second Quarter (July-September) of 2006-07

Different indicators of performance of services sector during the second quarter of year 2006-07 are given in Table S.3. Data relating to telephone connections are available for all the three months (July-September). On the other hand, data on production of commercial vehicles, which is a proxy for the growth in road cargo transportation, is available only for the month of July 2006. The data on the remaining indicators of service sector output are related to July and August 2006.

Among all the indicators, the performance of telecommunications sector, i.e., growth in the number of telephone subscribers experienced 104 percent hike over the corresponding period of year 2005-06. The other parameter of information and communication technology, the number of

broadband connections, indicates a lack of matching performance in the broadband data transmission segment.

Growth of Performance Indicators for Services (%change, Y-o-Y)



Bank credit to the commercial sector maintained a healthy growth of 28 percent despite the hike in lending rates. At the same time, aggregate deposits also registered 21 percent growth.

Production of commercial vehicles clocked 31 percent growth in July 2006 over July 2005. Among all the indicators, cargo handled at major ports registered the lowest growth rate of 5.9 percent. Thus, majority of the service sub-sectors have experienced

significant growth rate. The strong momentum of service sector growth is therefore continues to hold.

Major Developments during July-September 2006-07

We now present some of the major developments in the service sector in the second quarter of the current financial year 2006.

Telecommunications

The Telecom Regulator, TRAI, has come out with its recommendations on the allocation and pricing of spectrum for 3G (3rd Generation) and broadband wireless services on September 27. The regulator has considered CDMA 2000 EVDO and WCDMA as 3G technologies while GSM and CDMA 2001X RTT as 2G technologies. 3G technologies support increased data communication with more than 144 kbps speed while 2G systems mainly provide voice communication. TRAI's recommendations are based on the premise that allocation of 3G spectrum should not be treated in continuation of 2G spectrum. This contradicts TRAI's May 2005 recommendation that 3G spectrum allocation to the existing operators should be viewed as an extension of 2G spectrum. TRAI attributed this change in its approach to the availability of extra spectrum, earlier occupied by defence, for 2G operations.

A number of principles are invoked by TRAI in this context. These are: maximization of consumer interest, efficient use of spectrum, ensuring neutrality of technology, recovery of costs of re-framing spectrum, competition, keeping level playing field etc. The reserve price set by TRAI is approximately Rs. 1000 to 1100 crore for one block of 2x5 MHZ of spectrum.

At the outset these recommenda-

tions are based on the perception that 'telecommunications is an opportunity area for additional general resource mobilisation' as pointed out by Rakesh Mohan Committee on infrastructure a decade back. The government policies should consider telecommunications as a major element of infrastructure for growth and development. The spectrum auction fee works against the affordability of more efficient data transmission services. To add to this, e-governance, e-education, e-commerce and a whole range of applications of information and communication technology require faster data transmission services in rural areas. In fact the assumption that there is 'large unmet demand only for voice communications' and therefore 2G services can survive by meeting the demand in rural areas is not appropriate. It is analogous to restricting the USO coverage to the fixed telephone services while keeping cellular services out of its purview. Therefore, in order to bridge the digital divide between urban and rural areas, an approach that sees communications as one of the contributors of growth, needs to be adopted.

In the interest of bridging digital divide between urban and rural areas and also in order to reap advantages of ICT applications, 3G services should be rolled out in rural areas as much as in urban areas. This requires concessions and support from USO Fund for network creation in rural areas. Moreover, the approach of treating 3G separate from 2G while allocating spectrum limits the competition among cellular service providers. Assigning different bands of spectrum for different 3G technologies instead of evolving a common standard as in the European Union would act against future growth of the sector.

Railways

Task Force on Dedicated Freight Corridors

The Planning Commission established a task force on 30-6-2005 for examining the organizational structure for freight corridors. The task force recommended setting up a special purpose vehicle (SPV) jointly by Indian Railways and the bulk freight transporters. The SPV owns and maintains the tracks and provides non-discriminatory access to qualified freight operators. It will neither own/lease any rolling stock nor will do any freight business. The investment required for the proposed two dedicated freight corridors between Delhi-Mumbai, and Delhi-Howrah at present is estimated as Rs.22,500 crore. The SPV would raise an equity amount of Rs. 7,500 crore and the remaining Rs. 15,000 crore would be raised from debt. The new freight corridor is not expected to be used for dedicated high speed-passenger trains as the corridor dedicated for passenger trains give relatively lower returns on capital than in the case of freight.

Civil Aviation

In the post 2001-02 liberalisation the civil aviation sector registered impressive growth rates. All the three segments of civil aviation viz., aircraft movement, number of passengers, and cargo movement have been

registering higher growth rates after 2001-02. During the first quarter of 2006-07 the civil aviation traffic achieved impressive growth. Growth in domestic sector is higher when aircraft and passenger movements are taken together. International cargo movement has grown significantly higher than domestic cargo movement. The relevant figures are given in Table S.4.

Roads

Towards making the PPP policy in roads sector a success, the Government has (a) simplified policies with transparent procurement procedures, (b) standardized model concession agreement, (c) allowed 100 percent FDI in the roads sector, (d) provide encumbrance free site for construction, (e) viability gap funding up to 40 percent of project cost based on competitive bidding, (f) complete tax holiday for any 10 consecutive years of 20 years of concession period, (g) duty free import of modern equipment etc.

The first phase of the national highways development programme (NHDP) all works have been commissioned. About 89 percent of 7498 kms. of length to be completed under NHDP Phase I was completed till the end of September 2006. As for the available work at present under PPP mode, the Government has earmarked 175 contracts for covering a length of 15803 kms with an estimated cost of Rs. 76,544 crore in

Table S.4: Annual Growth in Civil Aviation Sector in India
(in percent)

Years	Aircraft Movement	Passenger Traffic	Cargo Movement
2001-02	4.10	-4.90	1.00
2002-03	9.90	9.40	14.60
2003-04	14.4	11.60	9.10
2004-05	11.9	21.50	19.80
2005-06	16.8	23.70	9.70
2006-07 (up to June end)	29.0	38.10	11.70

Source: Ministry of Civil Aviation, Government of India.

NHDP phases of II to V. These contracts fall under different stages of and are to be completed by March 2008. The details of these contracts are given in Table S.5.

Table S.5: Opportunities Available for Private Sector Participation in Roads Sector as on 30-9-2006

Phase of NHDP	Length (kms.)	Cost (in Rs. Crores)
Phase II	714	4655
Phase III	7177	46794
Phase IV	5064	7039
Phase V	2848	18056
Total	15,803	76,544

Source: Presentation made by Secretary, Dept. of Road Transport & Highways, on 7-10-2006 at Vigyan Bhavan.

Present Status of USO Fund

The Indian Telegraph Act defined USO as the obligation to provide access to basic telegraph services to people in rural and remote areas at affordable and reasonable prices. With this objective, the USO Fund (USOF) came into effect from 1.4.2002. Contributions to USOF come from the universal service levy, which is presently 5% of the adjusted gross revenue earned by all the operators except pure value added service providers. Later, on 9-1-2004 the Indian Telegraph Act 1885 was amended to provide the USOF a statutory non-lapsable status. The Fund is to be utilized exclusively for meeting the Universal service Obligation and the balance amount credited to the Fund will not lapse at the end of the financial year. Credits to the Fund shall be through parliamentary approvals. The Rules for administration of the Fund were notified on 26.3.2004. The Fund has identified six types of services for its financial support. The implementation of Universal Service Obligation is through a multi-layered bidding process.

As regards the USO services, a mix of 'universal access' and 'universal service' objectives have been targeted. The 'Universal Access' policy aims at increasing access to public basic telecommunications services such as village public telephones in rural or remote villages. The 'Universal Service' policy focuses on ensuring that the cost of telephone services remains affordable to all people including low-income families and people living in uneconomic areas. Universal service and universal access policies have been pursued in both the developed and developing countries. The implementation status of the USOF during the last four and half years of its existence may be summarized as:

1. Support for maintaining village public telephones (VPTs) in 5.20 lakh revenue villages out of the total 6.07 lakh such villages identified in 1991 Census. Out of these 5.2 lakh villages, 5.11 lakh villages were won by BSNL and 9,171 by six private operators.
2. Support for the replacement of the 1.84 lakh VPTs working on Multi Access Radio Relay technology by forward looking technologies. M/S BSNL Ltd. emerged as the sole service provider involved in this activity.
3. Support for providing second VPT called as Rural Community Phone (RCP) in villages with population more than 2000 was provided. Out of the total 46,253 villages identified for providing RCPs, 24,794 villages are to be covered by M/s BSNL and the remaining 21,459 by M/s Reliance Infocom. Ltd.
4. Support for providing public telephones in 66,822 of villages yet to be provided with telecom services was finalised on 10.11.2004. M/s BSNL emerged as the successful bidder of these facilities.
5. Besides these four types of public facilities, presently the USOF is in the process of inviting tenders for providing Public Tele- information Centres (PTICs) and High Speed PTICs in about 76,000 villages all over the country.

The support from the USO Fund was equated to the net cost defined as cost minus revenue. In the case of telephone facilities that were installed prior to 1.4.2002 i.e., date of implementation of the USO Fund, only operating expenses were considered as the cost component for USO support. For the facilities that were installed/replaced from 1.4.2002 onwards, both capital recovery and operating expenses were taken into account. As for the capital cost, only the cost of access network or the last mile was taken into account. The last mile was defined as the portion of the network that lies between the line card in the exchange and the cus-

tomers premises equipment, which is the non-traffic sensitive part of the network.

The above approach of subsidy that was based on the recommendation of the TRAI, has to some extent resulted in limited interest and competition in the bidding for USO support. In many remote and rural areas of the Country, telephone network was to be laid afresh in order to provide telephones with USO support. This involved in huge investments in backhaul and switches along with access loop. However, TRAI's recommendation on USO restricted the definition of capital cost to the access network. It did not cover the investments taken place in backhaul and telephone switching equipment. Therefore, a significant part of the capital cost is left uncovered. The private operators due to the absence of their network roll out in rural areas, did not participate in the bidding for USO subsidies in many areas. On the other hand BSNL too had to invest in improving the backhaul and telephone switching equipment besides access loop in many rural areas in order to provide reliable services as stipulated in the USO agreement and may have limited the progress of universal access.

As regards the support to the rural private telephones, household direct exchange lines (private telephones) installed prior to 1.4.2002 are treated differently from those provided after that date. There are about 1.865 million rural household DELs installed prior to 1.4.2002; they are being given support towards the differential in TRAI prescribed rentals and rentals charged by the Service Providers for the period upto 31.1.2004. With regard to the DELs provided after 1.4.2002, they are eligible for support from USOF based on the representative rate calculated taking annualised capital recovery, operational and maintenance costs and revenues, if they fall in the 1685 identified high cost SDCAs¹. Out of the 1685 SDCAs identified as eligible for subsidy M/S BSNL won the bids for 1267 SDCAs, while the private operators won the bids for 418 SDCAs. As per the Agreement conditions, the Service Provider should provide at least 100 lines per Secondary Switching Area (SSA) within six months. Thereafter all the wait listed subscribers are to be provided with a telephone connection on demand. The implementation of this service would hopefully help achieve the teledensity target in rural areas.

The USO Fund has newly put forward the idea of creating a shareable backbone telecom network in rural areas with support from the USO in order to providing cellular services in rural areas. Financing backbone network in rural areas will be made eligible for USO support. Support from the USO Fund will be given only for shareable infrastructure and not on the basis of cost per line of selected services. The support includes costs of passive infrastructure items like real estate (land rentals and building construction) and active network components that include towers (BTS, BSC and MSC), transmission system (OFC or microwave), power facility and backup, air conditioning etc. The support is given to the service provider who is selected through bidding. The successful bidder is given exclusivity period after which the infrastructure has to be shared with other operators. The ownership of the network thus created could be a joint ownership of USO Fund and successful bidder. This method will help accelerate roll out of cellular mobile services in rural areas that in turn would increase rural teledensity by providing choice to rural subscribers.

1 SDCA stands for Short Distance Charging Area, which is co-terminus with an administrative Taluk/ Tehsil. There are 2648 SDCAs in the country.