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American Chamber of Commerce in India

AMCHAM

Compendium

of

Position

Papers

FOREWORD

AMCHAM is pleased to present the compendium of position papers on 14 sectors. AMCHAM is extremely grateful to PricewaterhouseCoopers for their support in preparing this compendium of position papers.

AMCHAM would also like to thank its respective Committee Members for their valuable inputs.

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AMCHAM
Position
Paper
on
Entertainment
& Media

Entertainment & Media

The Entertainment & Media (E&M) Industry is one of the fastest growing sectors of the Indian economy. It is riding on the back of economic growth and rising income levels that India has been experiencing over the past few years; a trend which is expected to consolidate and increase in the coming years.

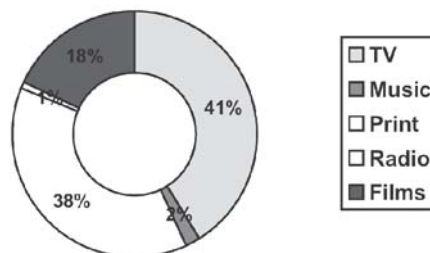
Current status of industry and its growth potential

The Indian economy continues to perform strongly and one of the key sectors that benefits from this fast economic growth is the E&M Industry. This is because the E&M Industry is a cyclically sensitive industry that grows faster when the economy is expanding. It also grows faster than the nominal gross domestic product (GDP) during all phases of economic activity due to its income elasticity wherein when income rise, proportionately more resources get spent on leisure and entertainment and less on necessities. Further, the consumption spending itself is rising due to rising disposable income on account of sustained growth in income levels and this also builds the case for a strong bullish growth in the sector.

The E&M sector in India is currently worth about USD 7 billion and is expected to grow at a compounded annual growth rate of 14 per cent over the next five years. The sector comprises of the following segments:

- Filmed Entertainment
- Television
- Music
- Radio
- Print (Primarily Newspapers & Magazines)

Indian E&M Industry constituents- 2004



In terms of players, this industry has traditionally been fragmented and has different players providing content in segment of films, television, radio etc. and another set of players providing delivery of the content using the medium of cinema theatres, television, radio etc. With technological advancements, this is rapidly changing with the content providers, in addition to their traditional delivery medium, now also providing their content to other delivery mediums and also customising content for newer mediums like mobile, internet etc.

Recent trends of Foreign Investment in the sector

Owing to the strong impetus for growth from the economic and demographic factors coupled with some regulatory corrections, the sector has recently witnessed increasing foreign investment in most segments of the E&M Industry especially the Print Media. Recent examples include foreign investment in English Dailies such as Hindustan Times and Business Standard by Henderson Global and Financial Times respectively. Vernacular Media too saw its share of foreign investment with its strategic equity investment by Independent News & Media in Dainik Jagran, a leading Hindi Daily.

In the broadcasting space, most channels beaming into India (such as Walt Disney, ESPN-Star Sports, Star, Discovery, BBC etc.) have established foreign investment subsidiary companies for content development and advertisement airtime sales.

In the television distribution space, foreign investment is primarily seen in the larger cable operators referred to as 'Multi-System Operators (MSO)' such as Hathway and Hinduja. In the television content space, the recent investment in Nimbus Communications by a foreign private equity player is seen as the start of significant trend of foreign investment in this space.

Existing FDI Caps

Activity	FDI Caps
Television/ Radio	
Uplinking hub, teleports etc,	49%
Broadcasting (News)	26%
Cable Network	49%
DTH	49% (Strategic Investment only 20%)
Terrestrial radio broadcasting / FM	20%
Print	
News	26%

Barriers to Foreign Investment in the sector

The industry members believe that a lot more can be achieved for the E&M industry with respect to foreign investment if certain sectoral policy barriers can be addressed.

Some of the issues that need to be addressed which commonly impacts all segments include:

1. **Discriminatory Foreign Direct Investment (FDI) norms:** FDI levels are not consistent in the media and communications industry and restrictions continue to negatively impact the availability of business opportunities for American media companies. At present, except for satellite television entertainment channels, foreign equity restrictions force all foreign companies to own minority interest in the media business, without any significant management control in operations. This is enumerated below:
 - Television Distribution DTH - 49% (strategic FDI only 20%); Cable 49% (Indian ownership can only be with Indian Citizens).

- Content (News) - Television & Print - 26%, Radio - Nil
- Content (Non News) - Television & Print - 100%, Radio - 20%

This contrasts unfavorably with 74% in telecom networks and 100% in Internet service providers.

2. **Level playing field with Incumbents :** Most sectors of the Indian E&M industry have traditionally operated under various agencies of the Indian Government, which were later opened to the private players in various stages. FM Radio is one such example where the incumbent All India Radio (AIR) was the sole player in the medium of both AM and FM radio broadcasting. Limited frequencies of FM broadcasting have been opened to the private players but with a licence fee, which, is not currently applicable to the incumbent AIR. Similarly, in television segment, all terrestrial broadcasting rights continue to be with the incumbent Doordarshan.
3. **Content Regulation :** A long-standing debate is on amongst the industry members on regulation of content. Some of the issues that need to be addressed in this sphere include:
 - Whether there should be a content regulator or should the industry be allowed self-regulation under a broad framework.
 - If there needs to be a content regulator, should the content regulator be independent of the carriage regulator.
 - Should the content regulations be consistent across all delivery mediums such as films, television, radio or print or different sets of regulation should be evolved for each medium.
 - What should be the working mechanisms of a content regulation in terms of enforcement, penalties for default from prescribed guidelines etc.
4. **Price Regulation :** As per a notification issued by TRAI, broadcast media pricing has been frozen for over a year, and is proposed in the Issues paper to remain frozen indefinitely (though TRAI did allow a 7% inflationary adjustment late in 2004) and subsequently a further 4% effective 1 January, 2006 Price controls limit a broadcaster's ability to shape their business model based on market demand and the competitive environment. Since the market has so far been efficiently regulated through competition, price regulation becomes a deterrent.
5. **Stringent Regulations :** Government of India have put in place a heavy handed regulatory regime for the pay TV industry, such as rate regulation, restriction on "exclusivity" content on any platform and mandatory sharing of identified sports content telecast with the government owned public broadcaster.
6. **Cross-Media Ownership Rules :** Media integration is an important tool in the hands of media industry which by its very nature could lead to anti-competitive behaviour hurting the entire value chain of the industry. The Government has been mulling over evolving cross-media ownership rules for which even a public draft has not been evolved as yet. Most sectoral policy documents allowing foreign investment is in-built with a compliance clause to such rules, as and when they are drafted. However, in the absence of any draft rules or an established time-frame for evolution of such rules, it hampers the long-term investment strategy of the potential foreign investor.

7. **Lack of empowered regulators:** At present, the Government has appointed an independent regulator TRAI for only the television and radio segments of the industry. Here too, the role of the regulator has been restricted only to provide its recommendations on segment issues to the Government, as a result of which several recommendations by the regulator have still not been acted upon by the Government. Some of the key recommendations include 'Issues relating to Broadcasting & Distribution of TV Channels' of which 'addressability in distribution' forms a significant part impacting the largest segment of television. Other pending recommendations include 'Digitalisation of Cable TV', 'Privatisation of Terrestrial Broadcasting', 'Licensing of Satellite Radio' etc.
8. **Lack of Transparency:** Massive underreporting of subscribers by local cable operator is very common. Today there are 61 million cable and satellite households but cable operators pay the broadcasters for 7-10 million only. The lack of transparency is a direct result of ineffective and discriminatory policies/regulations and political expediencies.
9. **Piracy:** The problem of piracy assumes a different proportion in a country such as India with an area of 3.3 million sq km. and a population of over 1 billion speaking 22 different languages and impacts all segments of the industry especially Films, Music and Television. Most of the credible efforts today to combat piracy have been initiated by industry bodies themselves. On the part of the Government, lack of empowered officers for enforcement of anti-piracy laws remains the key issue to the menace of piracy. This coupled with the lengthy legal and arbitration process is being viewed as deterrent to the pirates. The current Copyright Act too is dated in terms of technology improvements as most importantly it does not address needs of electronic media which is the medium of piracy today. The Draft of the Optical Disc Law to address the need for regulating piracy at the manufacturing stage is still lying with the Ministry for approval.
10. **Merging of the FII and FDI caps:** Some of the Industry members have the view that converting the current cap on Foreign Institutional Investment (FII) investment to Foreign Direct Investment (FDI) is not a very encouraging move by the Government. FII is primarily considered "hot money" and is invested by foreign funds to make quick returns unlike FDI, which is longer term in nature and is actually invested into the business. FDI in several cases is also accompanied with expertise (such as technology) being brought into the country that helps in the growth and development of the industry. An FII invests like a financial investor with the prime motive of quick appreciation of its invested capital rather than taking a longer-term view of the business, whereas an FDI investor is more in the nature of a strategic investor and is in the business for the long haul. The new policy does not recognize the needs of and create an environment to encourage strategic investors in making investments in the sector.
11. **Tax Treatment of Foreign Broadcasting Companies:** The tax treatment of foreign companies in broadcasting sector in India is emerging as the single most important policy issue deterring foreign investment in the country.

A major issue is in relation with taxation of satellite segment usage fee paid by broadcasters to foreign satellite companies. Tax assessing officers have attempted to treat such payment as royalty income and tax the same on source rule basis. Such satellite companies do not have any office or presence in India.

Another issue is in relation of foreign telecasting companies. These foreign telecasting companies do not have any office, business presence or operations in India. Tax assessing officers have been arguing that foreign telecasting companies have Permanent Establishment (PE) in India on account of their agents selling air-time space to Indian advertisers.

While various bilateral Convention for the Avoidance of Double Taxation does offer a process for remediation of double-taxation issues, however cases in past have dragged on for 5 years or more. The dramatic growth in the number of foreign broadcasting companies involved in double-taxation dispute cases in India is becoming well-known, and unless it is dealt with soon, could become a major impediment to the Indian Government's attempt to attract new investors.

In summary, developing a comprehensive and robust National Media Policy to address the above sectoral-specific issues will greatly benefit and encourage foreign investment in the sunrise E&M Industry.

AMCHAM
Position
Paper
on
Food
Processing

Food Processing

Executive Summary

In the Nineties, India moved from a food scarce to a food surplus nation. Today, it is the second largest producer of food after China. Around 26% of the GDP comes from the food and agriculture sector. The food processing industry includes all the processes, technologies and activities that enable the transformation of food from its basic and raw state to the edible form. Food processing ranks fifth in terms of its contribution to GDP. Yet, only 2% of the total food and vegetables produced in the country are processed. The wastages in the food sector are as high as 25% to 30%. Globally, over 50% per cent of the packaged food products come from just three regions the US, EU and Japan where this industry is highly evolved.

The government permits 100 per cent foreign direct investment (FDI) in food-processing sector, except in food retailing and plantations. Despite that, FDI of less than \$1 billion had come into this sector till FY 2003-04 (Rs 3,269 crore to be precise). Impediments to FDI are a plenty such as the land ceiling and procurement acts, ban on FDI in retail, poor supply chain and the lack of R&D and market intelligence in this industry. Unless the impediments to growth are not removed, the industry is unlikely to realise its potential and draw adequate FDI.

Current Scenario

- **Liberal FDI policy:** Automatic investment approval up to 100% foreign equity is allowed for most of food processing sector, except those items reserved for the small scale industry (SSI). A maximum of 24% foreign equity is allowed in SSI sector unless at least 50% production is exported.
 - Use of foreign brand names is now permitted with royalty payment limited to 1% of net domestic sales and 2% of net exports.
 - Most items can be freely imported and exported except for items in the negative lists for imports and exports. Capital goods are also freely importable, including second-hand ones in the food processing sector.
- **High production, high wastages:** India is amongst the largest producers of food (second only to China). But we waste about 50% of our fresh produce due to lack of proper processing and transportation facilities. While lack of processing facilities lead to wastage, many processing units operate at below capacity levels, due to non-availability of right raw material at the right time.
- **High priority status:** Food processing industry is one of the largest in terms of production, consumption, export and growth prospects. The government has accorded it a high priority, with a number of fiscal reliefs and incentives.
- **High growth rate:** Food processing industry grew at the rate of 8.5% per annum during 1996-97 to 2001-2002. The likely growth during the Tenth Plan period is projected at 8.8% and 11.9%.
- **Lack of self-regulation:** Due to the dominance of small players, self-regulation is missing from this industry. The whole thrust so far has been on inspection by inspectors and dependence on legal actions. Except for MNCs and a few domestic companies in the export business, the industry has been displaying a lax and non-responsive attitude towards international regulatory environments

like Codex and WTO. This has created an uncompetitive environment and increased operating costs. It has also affected the industry's image abroad.

- **Dismal picture on the world map:** The position of Indian food processing industry in the world is rather poor.
 1. According to The World Trade Report, 2004, between 1990 and 2002 India's **share of processed food exports** in the global market rose only by 1%, as compared to China, Indonesia, Malaysia and Thailand, whose gains in shares of processed over unprocessed agricultural exports in the same period were 14, 17, 28 and 11 percentage points respectively.
 2. The **share of the imports** of processed food in India at the same time increased from 20% in 1990 to 41% in 2002.
- **Globally the market is evolved:** At \$3.2 trillion, processed food sales account for about three-fourth of total world food sales. Trends in the Indian food market are reverse. This opens up opportunities for India in the global markets.
 1. In most countries, packaged food accounts for about two-thirds of all processed products' sales, with alcoholic beverages, soft drinks and hot drinks constituting the remaining one-third.
 2. Food markets are constantly evolving, driven not only by changes in consumer preferences, but also by technology, linkages between members of the food supply chains, and prevailing policies.
 3. Sophisticated supply chains and distribution channels are being adopted across different regions and national boundaries.
 4. Almost 1,000 new products are introduced in the supermarkets of the US and EU in a year. More than 50% of the US vegetable consumption is in the form of canned, frozen or dried forms.

Prospects

- **Potential to become a leading supplier to the world:** With the second largest arable land (16.1 crore hectares) in the world and diverse agro-climatic zones, India has tremendous production advantages. If leveraged optimally, these advantages can make India a leading food supplier to the world.
- **Can become a consumption hub:** With a population of 1.08 billion, growing at about 1.6% per annum, and favourable demographics, India is a large consumption hub for food products. The government estimates the food processing industry to increase from Rs 4,60,000 crore to Rs 1,350,000 crore by 2014-15 (at 2003-04 prices).
- **Requires investment:** In order to achieve the market potential, the investment required in capacity creation and setting up requisite infrastructure is Rs 99,700 crore until 2015 (Rs 59,700 crore between 2005 and 2010 and Rs 40,000 crore between 2010 and 2015). (Rabo bank Vision Document)

Challenges/Issues pertaining to FDI inflow

- **A long and fragmented supply chain** is the biggest bottleneck facing the sector. Comprehensive supply chain solutions are a key to achieving sustainable development of the sector in India.

- **Poor quality of raw materials:** Absence of the right quality of raw material for processing has been another major impediment. Most of the primary produce when processed gives a lower output in quantity and quality. As a result, orange juice manufactured in India is made from imported concentrates. Further lower productivity, highly degenerated seeds used by farmers for production, absence of proper extension practices etc. have also adversely affected the industry. This situation raises production costs.
- **Fragmented land holding pattern** of Indian agriculture increases costs and reduces efficiency. Land Ceiling Acts do not permit large holdings and therefore, corporate farming faces limitations.
- **Intermediaries raise costs:** India's food supply chain is rife with intermediaries who make up to 60% to 75% of the total margins for themselves in the absence of an efficient system.
- **Procurement is regulated:** In the case of certain crops, procurement is controlled. This increases the complexity of operating in the Indian market. In addition, the Agricultural Produce Marketing Committee (APMC) Act imposes transaction costs without adding any value to the process. This restricts the ability of international players to invest significantly in India. Sale of food and vegetables is regulated by APMC Acts. This leads to the following drawbacks:
 - a. **Discourages direct farming arrangements** between farmers and corporates who are keen to source appropriate quality raw material for their requirements. The APMC acts require such corporates to pay the *mandi* cess even if they are not utilizing the *mandi* infrastructure.
 - b. **Encourages intermediaries:** Commission agents in *mandis* have become extremely powerful. Often the farmer (who does not actually visit the *mandi*) is not paid the actual price fetched by his produce.
 - c. **Misappropriation of funds:** The *mandi* cess is intended to be used for maintaining and upgrading the *mandi* infrastructure; however, the funds are not always utilised for this purpose. The infrastructure at most *mandis* is far from adequate.

Very few states have so far amended their APMC Acts, and that too, in a limited way.

- **High incidence of taxes:** Taxes levied on packaged and branded food products continue to be very high. While in developed countries there is only one VAT rate applicable, in India taxes levied are multiple which increase the burden on the final retail price. In contrast, in most EU countries, the incidence of tax is well below 10%; and even in neighbouring China, the aggregate tax levied is 13% as against India's 25%-30%.
- **Cumbersome regulatory framework:** The rules and regulations for this industry straddle nine different ministries. These are concerned with the different aspects of food processing such as manufacturing, marketing, distribution and sale of specific articles of food. This has created a situation demanding multiple compliances and unwarranted confusions leading to procedural delays. As a result, operating costs have been high at every point and innovations get inhibited.
- **Lack of R&D facilities:** The Indian food industry requires world-class technologies to compete effectively with international products. Technology transfer has been an issue of concern for investors. There has been a severe lack of technocrats and technology transfer institutions to cater to the growing needs of the food processing sector.
- **Human resources:** There is lack of world-class managerial talent and entrepreneurship with adequate technical background in food sciences and technology.

Recommendations

- **Amendment of land ceiling acts** is essential to permit larger holdings by corporates for farming purposes. Likewise, government can also consider leasing wastelands to corporate houses for farming. This will improve land resource utilization and have a demonstration effect on neighbouring farms.
- **Amendment of APMC acts** is critical for strengthening the engagement of the organised private sector in food processing business.
- **Improve supply chain:** The industry's supply chain needs to focus on better application of pre-harvest and post-harvest technology systems, proper infrastructure systems, establishment of cold chain facilities to enhance shelf life, improvement in storage conditions, adequate cargo facilities at airports and seaports, sustainable marketing linkages, adapt better packaging technologies, more initiatives in backward and forward linkages, etc.
- **Allow corporate farming:** Since corporate farming is not allowed in many states, there is no sustained investment on the land, quality of the produce, application of modern agricultural techniques etc.
- **Allow FDI in retail:** The ban on FDI in retail is based on the premise that entry of large international players will displace existing employment and reduce bargaining power of farmers. However, there is empirical evidence from other countries (USA, China) which highlights that opening of the retail sector to FDI has enabled employment creation, disintermediation, increased farmer access to information and provided wider choice and cost savings to the consumer. The entry of global players will not only help drive India's food chain to new levels of productivity, but will also build large, profitable businesses.
- **Set up a nodal agency:** There is need for a nodal agency to act as a contact point for companies interested in export-oriented units, corporate wasteland farming, foreign investments etc.
- **Reduce tax incidence on food products:** Total incidence on any processed food product should not be more than 10%. Here are some measures that can help achieve that:
 - 1) The excise rate on all perishables should be exempt from cenvat and state VAT
 - 2) Excise on more shelf stable packaged products should be at a concessional rate of 8%
 - 3) Excise duty on all packaging material for food products should be reduced to 8%
 - 4) VAT should be nil for perishables, and 4% for the non-perishables.
 - 5) Customs duty on all food machinery and food packaging material should be at 5%. The system of giving concessions in bits and pieces to select type of machinery is only distorting the system.
- **Fiscal incentives:** The five-year income tax holiday for new units in the processed fruits and vegetable industry should be extended to 10 years and should also be made applicable to all processed food industries. Besides, all tariffs like power applicable to agri-processing industries should be charged at the agricultural tariff rate and not on general commercial rate.

AMCHAM
Position
Paper
on
Hospitality,
Leisure &
Tourism

Hospitality, Leisure And Tourism

Executive Summary

The hospitality, leisure and tourism industry in India comprises the hotel industry, the travel operator industry, airlines, car-rental agencies, amusement/entertainment parks etc. The industry provides employment to roughly 11 million people and is the second largest foreign exchange earner for the country. Due to favourable macro-economic factors and promotions by the states, this sector has been witnessing impressive growth rates of over 20% for the last two years. Though the sector is dominated by foreign players, the government needs to take several steps in order to encourage the inflow of more FDI. This includes allowing REITS, improving the infrastructure, lowering taxes and setting up a supportive regulatory framework.

Current Scenario

- **Large employer:** The industry is estimated to be US\$39 billion in revenues and is considered to be one of the largest employers of manpower (11 million people or 2.6% of total employment).
- **Second largest forex earner:** It is estimated to be India's second largest foreign exchange earner in net terms. India was recently ranked among the top five destinations by *Lonely Planet*.
- **Spectacular growth:** The tourism industry has witnessed splendid growth over the past two years, with both inbound and outbound travel moving ahead of targets. In 2004, visits soared 25% to more than three million. Some of the factors driving growth are strong economic growth, favourable macro-economic indicators and aggressive joint promotions by different states to boost tourism.
- **Occupancy on the rise:** Average period of stay has been increasing, resulting in higher occupancy and average room rates.
- **Lenient FDI policy:** At present, 100% FDI is allowed in the hotel industry, tour operators and car rental agencies. In the airlines business, 49% FDI is allowed.
- **Dominance of foreign players:** The tourism industry is characterized by the dominance of large foreign players. Foreign players are present across all segments of the hotel industry (from 5-star to 3-star). However, most of the presence is through management contracts with very few operating on the basis of equity partnerships. The travel operator business is also dominated by foreign companies. For instance, Kuoni Travel, the Swiss travel major, is the market leader in outbound and inbound travel.
- **Government's positive role:** The government has taken a number of initiatives to improve the prospects of the tourism industry.
 1. The government had planned an outlay of US\$ 600 million for the **10th Five Year Plan** (2002-07).
 2. The **Bangalore International Airport**, which is a € 265 million project, is in progress and the first phase is expected to be operational by 2007.

3. Bids have been invited for the **modernisation of Delhi and Mumbai airports.**
4. Fifteen per cent inland **air travel tax has been abolished.**
5. **Expenditure tax** for hotels has been removed.
6. The government has also taken steps for promotion of tourism through the '**Incredible India**' campaign.
7. The civil aviation sector has been liberalized further, with the **increase in the cap on FDI** from 40 to 49% (though foreign airlines are not allowed to pick up a stake in domestic aviation companies).
8. '**Open Skies**' policy has been allowed for APEC and SAARC Region.
9. Domestic airlines have been allowed to fly to **Western destinations.**

Prospects

- **Potential for growth:** India's travel industry is targeting five million visitors in 2005. The government's Tenth Five Year Plan has a target of doubling India's share of the world market to 0.62% (from the present 0.4%) which would translate into 5.6 million arrivals by 2007. The annual revenues from India's tourism industry are projected to increase to around US\$90 billion by 2014 from the current US\$39 billion.
- **FDI potential:** According to World Trade & Tourism Council (WTTC) the growth of capital investment in the Indian tourism industry over the next ten years is expected to be 7.7% compared to 6% for the rest of Asia. WTTC estimates a funding requirement of US\$ 30 billion for tourism in 2014. The capital investment estimated is the total investment by travel and tourism providers (the private sector) and the government agencies (the public sector) to provide facilities, equipment and infrastructure. Private investment would come in by way of domestic and foreign direct investment (FDI). The various sources of FDI could be corporates, international financial institutions, pension funds and private equity funds.

Challenges and issues impacting growth of FDI

- **Taxation:** High taxes render the Indian market uncompetitive for the overseas travellers. In India, the cost of travel and hotel facilities is high due to the high taxes levied on aviation turbine fuel, rooms, and food and beverages. These taxes account for a significant portion of the total travel cost and compare unfavourably with the lower taxes levied in competing destinations, discouraging tourists, especially leisure travellers.
- **Poor infrastructure:** Accommodation infrastructure has witnessed the slowest growth. The availability of hotel rooms is still only half of the number required to host even a modest target of 5 million visitors. According to industry sources, there is a requirement for an additional capacity of 100,000 rooms by 2009. The infrastructure and facilities provided at various airports in the country also need significant upgradation.
- **Non-affordable hotel rooms:** Hotel rooms in India cost around 30% more as compared to similar rooms in other countries in South and South-East Asia, while a premium segment hotel room is 25%-30% dearer.

- **Air connectivity:** Though better than in the past, air connectivity is still not comparable to that in other countries. International airfare to India is higher than that to Malaysia or Thailand since there are more scheduled carriers to these two countries and they also have a large movement of charter operations, which keeps competition high and air fares low. In addition, high landing charges, fuel taxes and high operational costs have resulted in high airfares in India.
- **Poor maintenance of heritage sites and other tourist spots:** Evidence shows that an integrated approach to tourism planning and management is now required to achieve the type of responsible tourism, which would sustain the position of culture, environment and biodiversity of the place being visited.
- **Ignorance:** There is a general lack of awareness on the country's tourism potential. Although the government is laying emphasis on promoting India as a tourist destination, there is a long way to go in order to compete effectively with other countries.

Recommendations

- **Develop suitable infrastructure:** Poor infrastructure is a big hurdle in the growth of this industry. And funding of major infrastructure for the tourism sector such as transport links, roads, railways, airports, energy and water treatment plants is an issue. This can be done by the following means:
 1. **User fees:** Evolve a consensus within the government that the user fees collected from the tourism sector has to be channeled into the development of basic infrastructure (including the protection of Indian heritage sites, roads, sewage plants, transport links and telecommunications).
 2. **Private-sector participation:** Promote private sector participation in building the required hotel capacity and other related service provisions.
 3. **Removing barriers** to the entry of private/foreign players and assisting liberalization.
- **Rationalise taxes:** The simplification and rationalisation of taxes in all sectors of the industry will give an impetus to this sector.
- **Reduce procedures:** The reduction of bureaucratic immigration procedures for foreign visitors and making use of growing technological systems to smooth the immigration/visa and border control procedures will also bring in more visitors.
- **Create REITs / REMFs:** Real Estate Investment Trusts or Real Estate Mutual Funds would release funds in the hands of hotel operators and help in creating liquidity for the sector. The government could look at removing some of the barriers in the creation of these funds such as putting in place a uniform stamp duty structure, not levying stamp duty on purchase by fund/ set-off against stamp duty paid, allowing funds exemption from annual property taxes, bringing about computerisation and dematerialisation of land records and modifications to the Rent Control Act.
- **Have a supportive regulatory framework:** The Centre and the State governments need to recognise that the economic and job-creation benefits of a strong and growing tourism sector can only be fully realised if a favourable and supportive regulatory framework is in place. This will, in turn, bring about the requisite funding including the foreign participation required for the sector.

AMCHAM
Position
Paper
on
Information
Technology

Information Technology

Executive Summary

India is increasingly becoming synonymous with information technology (IT). Over the last 15 years, the Indian IT-ITES Industry has grown tremendously -- from \$150 million in 1990-91 to more than \$28.2 billion in 2004-05. A Nasscom-McKinsey report projects India's IT industry to touch \$77 billion by 2008. The Indian IT-ITES industry is broadly categorized into IT services and software; IT enabled services (ITES), business process outsourcing (BPO) and hardware segments. India's quality and cost benefit advantages are cited as major differentiators for increasing IT outsourcing to India. Manpower costs in India are 70%-80% lower than in US and UK. Global corporations are generating cost savings in the range of 40%-60%, depending on the process offshored. All the factors appear favourable for the IT industry. The Union and the State governments have played a very positive role in the growth of this sector. Recognizing the growth potential in IT, the government considers IT as an agent that would transform every facet of human life, which will bring about a knowledge-based society in the twenty first century. All that's needed is continued thrust on this sector.

Current Scenario

- **High growth rate:** The industry continues to chart remarkable double-digit growth. During the last financial year, the industry grew by 31% with an industry aggregate revenue of \$28.2 billion.
- **Exports-driven growth:** Exports continue to be the mainstay of Indian IT-ITES, accounting for nearly 62% of the industry earnings in FY 2003-04, as per the Nasscom Strategic Review 2005. The IT-ITES industry accounted 29% of the country's exports in 2004-05.
- **Resurgent domestic market:** The domestic market grew at 30% in FY 2003-04. Growth has been boosted by strong domestic demand for IT services and ITES (especially from BPOs) and rapid growth in demand for PCs, fuelled by falling prices due to lower tariffs
- **Contribution to GDP:** The industry's contribution to the national economic output has nearly tripled - from 1.2% in FY 1997-98 to 3.5% in FY 2003-04. During 2004-05, its contribution to GDP has increased to 4.1%
- **Outsourcing:** India remains the world's leading destination for offshore outsourcing of IT and ITES services. A sustained leadership over other competing offshore sourcing destinations is driven by availability of a large pool of qualified, English-speaking manpower, and a focus on delivering quality at a significant cost arbitrage.
- **IT services and software lead the pack:** IT services and software continue to be the leaders, accounting for nearly 60% of the industry revenues in FY 2003-04. The domestic IT software and services segment recorded healthy growth in 2003-04 and 2004-05. The growth of domestic IT services market was driven by demand from verticals like banking, telecom, retail and BPO vendors. IT users targeted their enterprise application software spending on ERP, CRM, SCM and business intelligence packages in 2004.
- **IT spending in India is growing:** As per a survey conducted by Forrester on 700 Asia Pacific businesses and government agencies on their IT budgets and expenditures, the overall Indian IT

spending environment is rapidly expanding. Some of the key findings are :

- a. IT budgets have seen phenomenal increases in 2004 and are way ahead of their North American, European and APAC counterparts.
 - b. IT staffs are increasing in steps .
 - c. New IT investment is high.
 - d. Security and application integration tops list of priorities. It's followed closely by ERP package software implementation, spending on application software licenses and development. Server hardware is the focus of infrastructure interest.
- **R&D destination:** In a survey conducted by UNCTAD in 2004, India ranked as the 6th global R&D destination for countries. More than 100 trans-national corporations have established R&D facilities in India and over three-quarters of affiliates' R&D expenditures (\$61 million) were in non-manufacturing industries in 2002, compared to only about 20% in 1999, probably reflecting a focus on software development in the country.
 - **Shift towards small cities:** IT as well as the ITES sectors are showing increasing interest in setting up delivery centers in smaller cities and in cities not traditionally associated with the IT industry. The cities include Ahmedabad, Chandigarh, Mohali, Jaipur, Mangalore and Coimbatore. Moving into smaller cities has benefited the players by offering lower costs (both infrastructure and employee) and lower attrition rates
 - **Long-Term National IT Policy:** In May 1998, a national taskforce on information technology and software development was set up in order to formulate a long-term national IT policy and remove impediments for the growth of the infotech industry. The Long-Term National IT Policy aims to accomplish the following basic objectives:
 - a. **Info-infrastructure drive:** Accelerate the drive for setting up a world-class info infrastructure.
 - b. **Target ITEX-50:** With a potential \$2 trillion global IT industry by the year 2008, policy ambience will be created for the Indian IT industry to target for a \$50 billion annual export of IT software and IT services (including IT-enabled services).
 - c. **IT for all by 2008:** Accelerate the rate of PC/ set-top box penetration in the country from the 1998 level of one per 100 to one per 50 people along with universal access to internet/ extranets/ intranets by 2008.
 - **Positive steps taken by state governments:**
 - a. In the last few years, 18 state governments have announced **IT policies**. These policies focus on the key issues of infrastructure, e-governance, IT education and providing a facilitating environment for increasing IT proliferation in the respective states.
 - b. **IT promotion cells** have been set up in multiple states. Some state governments have set up single-window agencies for IT investors.
 - c. **Fiscal incentives** and regulatory support have been established for IT investors in some states. Procedures under existing labour laws have been simplified to ensure smooth operations. Self-certification is allowed for IT companies on various acts.

- **Poor use of IT by Indian businesses:** Indian businesses are yet to benefit from the expertise and technological innovation of the Indian IT industry in order to improve their productivity, efficiency and competitiveness at the global level. Though in 2003-04, the domestic IT industry witnessed a healthy growth of 30%, the size of the domestic market still remains very small.

Prospects

- **Fast paced growth:** According to a Nasscom-McKinsey report, annual revenue projections for India's IT industry in 2008 are \$77 billion out of which \$29 billion would be from IT services export, \$23 billion from ITES exports, \$10 billion from product and technology services and the rest from the domestic market. The largest growth segment is ITES, with huge potential in export as well as domestic market. The ITES segment is expected to grow from a current size of \$6 billion to \$23 billion by 2008. IT is projected to account for 7% of GDP and 35% of total exports by 2008.
- **Increasing offshoring:** There is a heavy downward pressure on IT budgets resulting in increase in off-shoring by companies overseas. Business process outsourcing, and particularly, off-shoring is increasing in order to reduce process costs. Large MNCs such as Accenture, CGEY, CSC are also establishing offshore development centers in India
- **Under-penetrated geographies and verticals:** There is tremendous scope for the Indian industry in regions such as UK, Canada, Germany, France, Japan and Korea which have not been exploited. Verticals like utilities, telecom services, retail and healthcare present huge opportunities
- **Higher end of the value chain:** There is a huge scope for the Indian industry to move up the value chain and provide value-added services.
- **Indian companies expanding abroad:** Indian companies are becoming global companies by setting up and acquiring delivery centers abroad. This would help in diversifying risk, managing backlash and gaining specific skill-sets.

Challenges/Issues pertaining to FDI inflow

- **Sectoral policy barriers:** Considering the growth potential of the country in the area of IT, structural policy changes have been made at the state level in order to provide regulatory support to the IT investors. While a number of states have announced their IT policies and have taken up different initiatives in the area of implementing e-governance, and augmenting the infrastructure, the extent of implementation of the policies varies from state to state. Key improvement areas in this regard are:
 - a. Augmentation of state-wide delivery backbone to support e-governance, e-commerce and an efficient government-citizen interface
 - b. Transition to an IT-enabled government
 - c. Proliferation of IT culture at grassroots
 - d. Availability of high quality infrastructure support
- **Challenges pertaining to people, processes, technology and geographies:** People, processes and technology are the key pillars for success of an IT organization. Increasingly, software delivery projects are implemented on an onsite-offshore mode involving teams from different geographies across the world. Some challenges before India are:

- a. Continuous improvement in knowledge management mandate technology skills enhancement initiatives
 - b. Recruiting and retaining high quality talent pool is difficult in this industry, given the number of opportunities and high attrition rate.
 - c. Continuous improvement in process and tool frameworks to meet competitive delivery requirements of global clients
- **Supply of skilled manpower may fall short:** Indian IT software and services market is expected to grow to \$50 billion by 2009, recording a CAGR of 27%. However, Nasscom estimates suggest that the supply of skilled IT manpower may fall short of requirements by 2009, if specific issues are not addressed and India's HR challenges successfully met.
 - **Taxes are playing havoc:** Taxes like the Fringe Benefit Tax (FBT) are causing havoc amongst companies. Most countries in the world are moving to a single tax regime. Multiple taxes require far more data management and overheads and leave scope for multiple interpretations, thus making business difficult. This tax is applicable to smaller firms. Big companies, which are hugely profitable, still get away without paying any taxes. This would result in creating entry barriers for new entrepreneurs which has been hallmark of success in the industry.

Recommendations

- **Improve infrastructure:** The government needs to improve the power, road, airport and other infrastructure, and fast. Poor infrastructure increases the costs of an IT firm and has a direct impact on its bottom-line. If India loses its cost advantage, FDI inflow into this sector will slow down.
- **Focus on education:** Industry surveys have also shown that while India is expected to be one of the few manpower surplus countries capable of meeting global requirements, the manpower is unlikely to be readily deployable on account of ineffective education and skills development. A 2001 World Bank study on science and technology manpower in India had shown that generic shortcomings in India's education system would be a hurdle in the path of quality IT manpower development. There is a lack of correlation and synchronization between the existing technical education system and the industry requirements. The government and various universities and educational institutions need to pay heed to this issue.
- **Tax the industry:** If the government is looking at this industry as a revenue base, then it should tax it just the manner in which it taxes other industries.
- **Encourage domestic software industry:** A Nasscom study has revealed that while in the developed countries, investment in IT capital of 10% increases GDP by 3.6%, in India, a 10% increase in IT capital increases GDP by only 1.6%. This establishes a correlation between the IT capital and its contribution to the GDP. As IT capital increases in an economy, it adds more to GDP. Strong domestic software industry is, therefore, critical to boost growth in the economy.
- **Strengthen the IPR regime:** The comfort of investors is generally high in economies where the IPR regime is strong. And the Indian government needs to take steps to strengthen the IPR regime.

AMCHAM
Position
Paper
on
Information
Technology
Enabled Services

Information Technology Enabled Services

Executive Summary

India has emerged as the most-preferred destination for Business Process Outsourcing (BPO) and Information Technology Enabled Services (ITES) in a very short span of time. The ITES-BPO industry took birth only in the early nineties, when global corporations like American Express, British Airways and GE had set up their offshore centres. Third party service providers like Daksh and Spectramind, which came in to the market in 1999-2000, were start-ups funded by venture capitalists. By 2001, the share of third party providers had grown to 57%. The Economic Survey of 2004-05 observes that the IT-ITES industry would be the key driver of growth for the software industry. In 2004-05, the ITES-BPO sector was \$5.2 billion in size and was providing employment to 350,000. According to Gartner Inc, India's revenues from BPO can touch \$13.5 billion by 2007, with global players contributing 65% of the revenues and domestic firms 35%. So the prospects for this sector are very bright. The inflow of FDI is only expected to rise, with companies moving up the value chain. Government's focus on improvement in infrastructure will ensure that investors don't get put off by the poor plight of India's roads and airports.

Current Scenario

- **Size:** There are over 400 ITES-BPO players in India. The ITES-BPO sector witnessed a growth of 44.5% to reach \$ 5.2 billion in FY 2004-05.
- **Exports:** According to Nasscom, the ITES-BPO exports are expected to clock revenues of \$7.3 billion in FY 2005-06.
- **Liberal FDI policy:** As per FEMA Regulations, FDI up to 100% (equity and preference shares) is permitted under the automatic route in shares of an Indian company engaged in the business of IT-enabled services. This means that no approval from either the government or the RBI is required for FDI in this sector. The investors are only required to inform the regional office concerned of RBI within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of issue of shares to foreign investors. The dividends on foreign investments are freely repatriable. However, 10% of the profits need to be transferred to reserves before declaring the dividend.
- **Sops for ITES-BPO:** The Central government also provides some incentives for the ITES-BPO sector. Government incentives for the ITES-BPO industry include abolition of licence fee for entry into the industry and introduction of export-oriented promotion schemes like software technology parks (STPs) and special economic zones (SEZs) that provide various tax incentives. Under the STP and SEZ schemes, investors get benefits such as single window clearance facility, duty-free imports, tax concessions till 2009 and a green card for priority services from all government departments. Under the SEZ scheme, the investors also get an additional benefit of extended tax concessions for the first 10 years.

- **Inflow of FDI:** The increase in acquisitions of ITES-BPO companies and the setting up of new captive units is leading to an increase in the inflow of FDI in this sector.
- **Captive units are being hived off:** Between 2001 and 2005, the market share of captive players increased from 43% to 64%. During this period, there have been instances of new captive units being setup and also of captive units being hived off and converted into third party providers. The prominent examples of captives being hived off include WNS Global Services (formerly a captive unit of British Airways) and, more recently, Genpact (formerly known as GECIS, a captive unit of GE).

Prospects

- **Growth in BPOs:** Global IT research and advisory firm Gartner Inc expects India's revenues from BPOs to touch the \$13.5-billion mark in 2007, with global players contributing 65% of the revenues and domestic firms 35%.
- **Consolidation in the offing:** According to Gartner, 70% of the top 15 Indian-owned BPO start-ups that offer customer call centre services will be acquired, merged or be marginalized, by year-end 2005. Examples of recent acquisitions include Wipro's takeover of Spectramind and IBM's takeover of Daksh.
- **Moving up the value chain:** There is a huge opportunity for the IT sector to move up the value chain. That has already begun to happen. Knowledge Process Outsourcing (KPO) is picking up and several KPOs are being set up across the country.

Challenges/issues pertaining to FDI inflow

- **Bureaucratic hurdles:** FDI in the ITES-BPO sector falls under the automatic route and no approval is required. However, the setting up of a new company by the foreign investor takes around 16-18 weeks and requires more than the 15 different clearances. In order to promote FDI, some states like Karnataka and Tamil Nadu have setup a single-window clearance system to make this process more investor-friendly.
- **Infrastructure:** Poor infrastructure in terms of roads, airports, public transport, electricity, water supply, sanitation and telecom has a negative impact on foreign investors. This coupled with power shortages and relatively high telecom bandwidth costs might deter foreign investors.
- **Backlash:** The growing perception in the outsourcing countries is that their jobs are being shipped outside and that outsourcing will create higher unemployment. The negative image of outsourcing might deter some foreign investors from setting up ITES centres in India. Managing the backlash from the outsourcing countries is one of the most important challenges facing the sector. There are more than 100 legislations pending in various states in the US attempting to discourage outsourcing.
- **Information security and privacy:** With recent cases of alleged information security breaches being reported widely by the Western media, concerns are being raised about the security of confidential customer data. Two cases of alleged leakage of confidential customer data have been

widely reported in the media. This has caused significant concern amongst the clients of India's ITES-BPO sector. Companies need to address this risk immediately in order to prevent further damage to the sector's reputation with regard to information security.

- **Security and terrorism concerns:** Even though this is not a major concern, security and terrorism are always on the back of the minds of foreign investors while taking a call on investments.
- **Difficulties in setting up offices:** Commercial land is becoming scarce in major cities. Development of office space is a concern area because acquisition of large tracts of land requires considerable liaison with the government.
- **Moving up the value chain:** Most of India's ITES-BPO work is for voice-based customer services. This service is at the lowest end of the value chain. Even though the revenues in this segment are increasing, the billing rates for these services are on the decline. In order to survive and grow, the sector needs to move up the value chain and start concentrating on high-end services like research and development, content development and data analytics. Companies also need to move towards providing end-to-end solutions to their clients.
- **Attrition and lack of specific skill sets:** The attrition rates in this sector are very high. This, coupled with the high cost of training of manpower, presents a significant challenge for the sector. Also, as the companies move into high-end work like R&D and data analytics, they need resources with specific skill sets. Though most of the employees in the sectors are graduates, they lack expertise in specific skill sets. So the companies need to incur higher costs in training the personnel and paying them higher salaries to prevent attrition of these trained resources.
- **Competition from other countries:** India has a very large English-speaking population, but so do other countries like Philippines, Malaysia, Mexico, Brazil, Ireland and Australia. In addition to this, some of the countries also have the advantage of multilingual capabilities to cater to English, Spanish, French and other languages. Some countries have cultural similarities with the client country and hence have an advantage over India. Foreign investors would want to setup a centre that caters to their offices and customers across the world.
- **Growing regionalism:** The local people of major cities like Mumbai and Bangalore have started demanding that companies give them preference in jobs even though they might not be suited for the job. The protests and demands have been on the rise and if companies are forced to employ under-qualified or unsuitable candidates, this might lead to problems in terms of quality and cost of the services.

Recommendations

- **Extend single-window clearance system across the country:** Single window clearance system reduces bureaucratic hurdles and brings down processing time. The facility should be extended across the country.
- **Improve infrastructure:** Poor power and road infrastructure increases the costs of an ITES-BPO organization and has a direct impact on its bottom-line. In order to encourage foreign investment,

the power, road and airport infrastructure needs to be improved. Ten new cyber cities need to be planned over the next five years, in order to keep pace with the growth rate in the ITES sector.

- **Curb terrorism:** The ITES industry is today the primary target of anti-social elements. The government, along with the police and the CBI, need to put better processes in place and nip terrorism in the bud.
- **Introduce legislation for data security:** Recent cases of alleged data security breaches have caused discomfort amongst the investors. The government should introduce stronger legislation for data security in line with international norms.
- **Focus on education:** Nasscom estimates suggest that the supply of skilled manpower in IT and ITES may fall short of requirements by 2009, if specific issues are not addressed. Therefore, the government needs to focus on education so that the country does not face a shortage of the "right" skill in this sector.
- **Have a legislation in place:** The existing labour policies need to be pruned and an exclusive IT/ITES legislation needs to be put in place that would look into aspects such as conditions of service.

AMCHAM
Position
Paper
on
Insurance

Insurance

Executive Summary

The entry of private players into the insurance industry since 2000 has resulted in immense growth. Both life and general insurance are growing at rates of 20% and above. Today, as a result of competition amongst 14 players in life insurance and another 14 in general insurance, products are bought and not sold. Awareness about insurance has increased. However, the penetration of life and general insurance continues to be low in comparison international benchmarks. Indian private insurance companies setup as joint venture between local players and foreign partners, seek to expand their equity base by infusion of additional foreign equity this is currently permitted under the present FDI norms. The immediate need of the industry is therefore a relaxation of the cap on foreign investment from present rate of 26% to 49% or 74%. Besides effort are also required to promote greater awareness about term insurance and whole life products so that insurance not bought only as a device to save tax but also to protect against unforeseen contingencies.

Current Scenario

- **High growth rate:** The industry has been witnessing spectacular growth rates with general insurance growing at 23% and life insurance at the rate of 22%-27%. During 2003-04, premium income increased by more than 150% in life insurance and 70% in non-life.
- **Low penetration:** The penetration of both life and general insurance in the country is low. Only 8 out of every 100 people in the country are insured for life. Over 80% of the insurable population in the country is not covered and penetration as a measure of GDP is only 2.3%.
- **Dominance of public players:** Even though life Insurance has 13 private players and general insurance has eight private players and six public players, much of the market is dominated by public players. It is anticipated that LIC will continue to be the largest insurer for life and will dominate the market with more than 70% market share, even five years from now.
- **Stringent investment norms:** Minimum share capital (net of preliminary expenses) required for setting up life and non-life insurance firms is Rs 100 crore. For setting up re-insurance companies, it is Rs 200 crore. Foreign equity capital is allowed up to a maximum of 26% in the total share capital. The capital includes indirect pro-rata FDI (from FIIs, NRIs and OCBs).
- **Health insurance:** Internationally, health insurance is an important constituent of the overall market for insurance products. However, till now no private insurance company has been set up in India which exclusively focuses on health insurance. This is basically because medical services in India are currently delivered by fragmented family owned facilities and facilities maintained by charitable trusts etc while in the West there is significant corporate investment in this sector, accordingly, international insurers fear lack of sufficient institutional safeguards at ground level which can lead to adverse claim experience. Premium in the health segment has however increased in last few years, and this itself is an indicator of the latent potential in this area.
- **Stringent norms for re-insurers:** Capital requirements for re-insurers are Rs 200 crore. This has been one of the deterrent to the entry of private re-insurance companies in the Indian market. Other

than the national re-insurer -- General Insurance Corporation (GIC) -- there is no other re-insurer in the country. Foreign operators are reluctant to establish reinsurance companies in India with the FDI cap of 26%.

- **FDI coming in:** As on March 31, 2004, foreign equity in the industry stood at Rs 801.4 crore. During 2004-2005, almost all insurance companies injected additional capital in order to make good the loss arising in the policyholders' account. This has further increased gross foreign direct investment in this sector.
- **Government's Role:** The Government has been considering certain important legislative/policy changes to attract more FDI in insurance. These are:
 1. There was a proposal in Budget 2004 to increase the foreign equity limit from 26% to 49%. However, the same requires an amendment to section 2(7A) of the Insurance Act 1938 for which necessary steps are required to be undertaken on an urgent basis by the legislature.
 2. The Government is to chalk out a road map for the proposed de-tarification in general insurance.

Prospects

- **Potential for FDI due to low base:** Since the penetration of insurance in India is extremely low, the potential for growth is immense. The entry of private players into the market since 2000 has resulted in rapid growth in the sector, which is expected to continue.
- **Avenue for more players:** Growth in insurance premiums requires additional equity capital to prudential reserve requirements. Higher FDI limit for the insurance sector would open up avenues for more players to enter the market, thereby making the industry more competitive and efficient. In case of the existing players who are presently unable to inject fresh funds due to the FDI norms, increase in foreign equity stake in this sector would facilitate increase in the equity base of private insurers.

Challenges and issues pertaining to FDI inflow

- **Equity participation by foreign JV partner limited to 26%:** The foreign JV partner brings into the company his expertise in the insurance field. However, they cannot acquire a majority stake in Indian insurance companies due to the current FDI norms. This is a big deterrent to growth of the industry.
- **Highly capital intensive industry:** The insurance industry is highly capital intensive since the gestation period is long. The establishment cost too is high. Several local players don't have deep pockets in order to make such huge investments into this business.
- **Drop in high-yield products:** Due to drop in interest rates over last three years, insurance companies have been forced to withdraw high and guaranteed return yielding products. As a result, many households (that used to view insurance as an investment) are now parking their savings in other avenues such as deposits, gold, provident fund and equity.
- **Lack of understanding of insurance products:** Many consumers still look for a high-yield from insurance products and don't treat insurance as a risk cover. Insurance companies need to spread awareness on the subject, so that consumers treat life insurance policies as a protection against unforeseen contingencies and not necessarily as an investment or a tax-saving tool.

- **Restrictions on tapping the NRI market:** Indian Insurance companies can't readily tap the NRI market for their products. In this regard it is recommended that the IRDA should announce a policy framework whereby Indian insurance companies can engage the services of insurance intermediaries recognised in other jurisdictions for obtaining referrals for potential Non Resident Indians policyholders by paying a commensurate fee/commission.
- **Restrictions on funding:** The regulatory framework does not allow insurers to tap any other avenue for funding their activities other than through capital infusion through the shareholders. The registration requirements prohibit insurers from resorting to borrowings to fund their activities.
- **Restriction on agent compensation in life insurance:** The current laws and regulations restrict the extent of compensation payable to agents. Furthermore, the entire compensation payable is variable. This makes it almost impossible to attract full-time agents and build a professional agency force.
- **High lapse rate:** The lapse rate in India is high and this leads to a drain on the capital of the insurer. Lapse control mechanisms, which include special campaigns for educating customers/ prospective customers, special revival campaigns, incentives to the marketing officials to control first premium lapses, and training for agents to emphasize upon need-based marketing of insurance products are all part of the strategies adopted by the insurers to control the lapse rates.
- **Cap on first year commissions:** Under the insurance act the maximum commission allowed to agents for procuring insurance business is regulated. The limits so prescribed need to be reviewed in the present context having regard the fact today insurance companies like to promote insurance agency as a full time career. Further, the insurers are keen to attract professionally qualified individuals like C.A, MBA etc into the distribution channel.
- **Bancassurance channel is not developing the way one would have expected.** This is one of the main reasons for low penetration of the life insurance business. There is a need for joint examination of the issues that hinder the growth of the bancassurance channel.

Key Recommendations

- **Relax foreign equity norms:** The cap on foreign equity stake for insurance firms should be relaxed from 26% to 49% or 74%. The government must also review regulations for establishing re-insurance companies. This will facilitate higher retention of premium within the country. In addition, it will also result in attracting reinsurance business from neighbouring countries, thereby moving India to the position of a regional reinsurance hub in Asia in due course.
- **Remove caps on agent compensation from the laws and regulation to facilitate professionalization of the sales force.**
- **End the tariff regime:** The government must put an end to the tariff regime for the entire tariff-controlled business segments (including motor insurance) and allow insurance companies to decide the premium based on the general market conditions.
- **Lowering the capital requirement** in the case of health insurers from the present level of Rs 100 crore could provide impetus for developing health insurance in the country.

AMCHAM
Position
Paper
on
Manufacturing

Manufacturing

Executive Summary

India is developing as a manufacturing hub to the global corporations. Be it in automobiles, consumer durables or technology, a fast growing number of MNCs have begun to see India as a viable manufacturing base. A host of multinationals like Ford, Hyundai, Suzuki, Delphi, GE, Matsushita, Colgate, Unilever, Nokia, LG, Kodak, Timex, and Whirlpool are sourcing products, components and services for their global operations from India. Several other MNCs plan to make India their export hub.

Delhi-based optical disc-maker Moser Baer (which grew from \$22 million to \$335 million between 1998 and 2004) is now the third largest optical media manufacturer in the world. The lowest cost manufacturer, it has presence in over 82 countries across the globe. India has become a major supplier of automobile components to the world. In 2004, 20% of Indian automotive production was exported to developed countries. The manufacturing sector is growing at a healthy rate and is drawing FDI too. However, India is continuing to lose out to countries like China. In 2004, the FDI inflow into India was \$5.33 billion. In contrast, the FDI inflow into China was \$60.63 billion. The government needs to have a comprehensive strategy in place, and offer a package to foreign investors, a la the China way, to draw in more FDI. Sorting out infrastructure hurdles, taxation, bureaucracy and labour laws related issues would help.

Current Scenario

- **Touching new heights:** The resurgence of India's manufacturing sector has been quite magical. Not only are profits soaring, the sector is fast spreading its tentacles abroad. Manufacturing exports from India grew 20% in 2003 over the previous year. In May 2005, industry grew at 10.8% for the first time in eight years, against 6.8% in May 2004. This is the highest monthly growth in nearly eight years. The manufacturing sector grew by 11.5% from 7.5% in the corresponding month last year. As per estimates, if India is to achieve an overall growth of 8% per annum, it is essential that both manufacturing and services grow at more than 11%, and agriculture at around 4%.
- **Cost advantages:** The cost of manufacturing many products in India has been found to be 30%-40% lower than that in the US and Europe. This cost and quality advantage is helping India emerge as a preferred sourcing hub for multinationals across the world. For example, Siemens sources many power transmission and distribution equipment components from India. Electronics manufacturing services (EMS) is also witnessing a lot of action. The EMS market in India is expected to be around \$4.57 billion by 2010. LG Electronics has closed its microwave oven plant in England and shifted manufacturing to its Ranjangaon plant near Pune. LG is looking at a turnover of \$10 billion from India in 2010.
- **Manufacturing hub:** Defying traditional knowledge that China is good for manufacturing and India for services, the manufacturing sector in India has been moving up the value chain and gathering bonus points along the way. While Hyundai is setting up a second car plant in the country, Toyota is exporting transmission systems from a new plant in Bangalore. The world's largest auto parts' maker, Delphi Corp, has relocated several product lines to India. So has Bosch, another auto parts giant. The phenomenon is not restricted to auto and auto-component firms alone. Companies like Unilever, Kodak, Whirlpool, Timex Watches, Cummins, Tecumseh, GE, ABB and Siemens are already sources products from their Indian plants for their global markets and companies like Nokia and Elcoteq Network Corporation are considering setting up plants in India to meet their global demand for mobile phones.

- **Change management:** India has a vast pool of talented engineers and management professionals who are equipped to take on challenges brought about by the implementation of new methods and systems in organisations. India is known for its pool of highly-skilled engineers who can take on precision-based tasks. India has more than 250 universities (over 900 colleges) and engineering colleges providing computer education at the degree/diploma level. The output of trained human power at the degree/diploma level has been consistently increasing since 1985 and touched a figure of 130,000 during the 2000. From a base of 6,800 knowledge workers in 1985-86, the number increased to 522,000 software and services professionals by the end of 2001-02 and 814,000 by 2004-05.
- **Higher returns:** According to CII, the average return on investment in India is over 19%, compared just over 14% for China. Higher returns are a reflection of the higher value-added manufacturing investment that India attracts. In high volume and relatively low technology manufacturing, China tends to be more competitive. But in lower-volume manufacturing, where technology use is more intensive, India has an upper hand.
- **FDI policy:** Manufacturing of most items falls under the automatic route of FDI. Some exceptions are items that require industrial licencing and items reserved for the small scale sector.
- **Fiscal sops:** The government has several tax-related industrial incentives for the manufacturing sector, including tax holidays, 100% deductible R&D and capital expenses, accelerated depreciation and exemptions or deferral of state sales taxes. A new Special Economic Zones Act has been legislated which provides for substantial fiscal benefits for units operating in SEZ, as well as, developers of SEZs.
- **Regional disparities:** According to the World Bank's Investment Climate Report 2004, over 80% of FDI in 2000-2003 went to Delhi, Maharashtra, Karnataka, Tamil Nadu, Chandigarh, Gujarat and Andhra Pradesh. The World Bank confirms that labour productivity and total factor productivity are much higher in these states. In contrast, states like Bihar, Uttar Pradesh and the North-East have lagged behind in attracting FDI.
- **Manufacturers on an expansion binge:** As per estimates, manufacturing companies are planning to invest as much as \$ 44.44 billion over the next two years.

Prospects

- **Growth potential:** According to a CII-McKinsey report, manufacturing exports from India are likely to grow to \$300 billion in 2015 from \$48 billion in 2003. The country would then have a 3.5% share of the world manufacturing trade. To reach the \$300 billion target, the industry has to clock a growth of 17% every year as against the 11% at which it is growing at present. Of the total \$300 billion, \$70- \$90 billion is expected to come from just four sectors - apparel, auto components, speciality chemicals and electricals and electronic products. India's exports in these sectors were \$10 billion in 2002. According to CSO estimates, the share of the manufacturing sector to GDP growth is likely to be 22% in the current year. It was a mere 14% in 1993-94.
- **Rich labour pool:** The labour pool is exceptionally rich, with nine million new entrants a year. It takes fewer days to fill skilled job vacancies in India than in either China or Brazil; remuneration costs are also at the low end of the emerging economy scale. India is marginally costlier than China for most senior managers, such as directors of HR and manufacturing, and CFOs. But costs are significantly less than in other emerging economies such as Brazil and Mexico.

Challenges/Issues pertaining to FDI inflow

1. **Labour laws are drag on business.** In India, the existing archaic and rigid labour laws are prohibiting companies to adopt flexible hiring policy. Only Mexico is considered equally restrictive. Rigidity in Indian labour laws is a key impediment to developing a robust manufacturing sector. In contrast, labour regulations in other countries allow greater flexibility in business operations while protecting worker interests. In most countries, the nature of employment is contract based, with clear stipulations for employment termination at the discretion of the employer, provided statutory severance benefits and notice period conditions are met. This allows firms to respond to business cycles in a flexible manner. Also, in India, location tends to determine the quality of labour relations.
2. **Multiplicity of taxes:** There are multiple taxes levied on Indian manufacturing companies, such as octroi, corporate tax, entry tax, VAT, customs duty etc. Some can be set off, others can't. This makes doing business in India cumbersome. Though corporate taxation rates have significantly come down in the last 15 years the top basic rate fell from 48% to 30% in 2005, they still continue to be on the higher side.
3. **Poor infrastructure:** India has the worst infrastructure amongst the emerging economies. This is affecting the manufacturing sector's ability to attract more business. Primary issues that needs immediate attention are:
 - **Electricity:** By far the most significant infrastructure constraint for the manufacturing sector is the unreliability of power supply. On an average, a company can expect nearly 17 significant power outages per month, against one per month in Malaysia and fewer than five in China. At the same time, the cost of power is high - about 50% higher than in China.
 - **Transport** is another infrastructural constraint. The high turnaround time at ports, the deterioration in rail system and the poor plight of roads and highways is costing companies dearly. India has very few four-lane highways and bad roads are affecting the competitiveness of Indian companies. They need to maintain higher inventories, spend more on transportation and face delays in shipping of their export consignments as a result of the poor plight of roads.
 - **Water:** The cost of water is 40% higher in India, than in Thailand. We need to have a plan for manufacturing hubs like Chennai that are facing acute water shortages.
 - **Natural gas:** India does not have piping networks in major parts of the country, including key manufacturing locations like Chennai and Bangalore. This is forcing companies to use more expensive alternative fuels, leading to an increase in the cost of operation.
4. **Discrepancies in inter-state regulations:** Regulations between states vary and discourage companies to operate freely across the country. This applies especially to industries like liquor and automobile industry.

Recommendations

- Completely **revamp labour laws** and existing legislation to provide flexibility to managements to change manning levels based on operating conditions, while protecting employees from exploitation.

- **Eliminate major market distortions** to ensure a free all-India market which allows build-up of manufacturing scale by abolishing preferential policies/reservations for SSIs in a time bound manner, standardising rules across industry “sectors” irrespective of ownership, eliminating barriers to free trade across the country and reducing infrastructural barriers.
- **Remove anomalies and allow FDI in the small-scale sector:** There is no import restriction on items being produced by the small scale sector. However, FDI in SSIs is discouraged. Such a policy is discouraging value addition in the country. The government must address this anomaly by allowing FDI in the small scale sector.
- **Enable quick business exit** to facilitate efficient resource reallocation and correct market distortions created by the operation of unviable businesses. The focus should shift away from mediation and consensus at each stage to urgency and speed in industrial restructuring. This would require revamping laws restricting redeployment of capital such as laws on sale of land etc. and increasing accountability of financial institutions.
- **Facilitate regulations to help cash-strapped companies raise funds:** Many regulations today discourage sick or cash-strapped companies from selling their illiquid assets to generate funds that can be ploughed back into the business. Several manufacturing industries today suffer from financial crunch for their working capital requirements but are sitting on illiquid assets, such as real estate. Financial institutions should be allowed to buy out such assets and lease the same back to these cash-strapped firms on a long-term basis, thereby immediately making illiquid assets liquid. **However, high stamp duties and other regulations act as major deterrents for such deals.**
- **Get think-tanks to formulate an India package:** In December 2004, the government had set up an Investment Commission. The Commission, constituted initially for three years, was to find ways of attracting FDI worth \$150 billion. Such a commission should chalk out an FDI strategy and package. For instance, in the auto sector, the advantages of doing business in India, the gains made by MNCs, the headway made by Indian auto and auto component firms, can be highlighted by the government. A comprehensive package, that would look at the cost of land, power, fiscal incentives etc, should be put together to attract foreign investors in each industry.
- **Have a “walk-in ready” project approach to FDI:** Unlike in China, where foreign companies can just walk in and set up their factories (all requirements, such as those pertaining to labour, power, approvals etc are taken care of by the government), in India, they have to run from pillar to post in order to arrange for these. China has factories, corporate parks and office infrastructure ready for foreign investors. India too should adopt such an “walk-in ready” approach to attract more FDI.
- **Work towards implementation of a single tax and common regulations in all the states:** Embedded taxes (such as taxes paid on inputs that haven't been set off) impact export competitiveness of the country since they increase the cost of the goods. India should work towards implementing a single goods and service tax (GST) that brings all types of taxes into its fold. This has to be implemented along with the withdrawal of all other taxes, both at the central and the state level. Similarly, apart from the Centre, which enacts major regulations, states are also implementing their own rules and procedures (like motor vehicle rules, safety regulations, labour regulations etc). These are often confusing and annoy businessmen.
- **Conduct refresher courses for bureaucrats** to help them understand modern business practices and achieve global competitiveness.

AMCHAM
Position
Paper
on
Medical
Equipment
& Devices

Medical Equipment & Devices

The healthcare industry is one of the beneficiaries of India's economic liberalization. The Indian market for medical equipment and supplies was valued at US\$1,260 million in 2004 and is expected to grow strongly. The market remains small, relatively speaking, ranking among the top 20 in the world with per capita spending of less than US\$1.

Continued investment in the rapidly developing private sector infrastructure, coupled with increased healthcare funding from the government, will see a steady increase in the market for medical equipment and supplies. According to an estimate the market will continue to grow by an average of 4.7% over the next few years, largely driven by health tourism and the size of the Indian middle classes.

The Indian medical equipment industry is expanding to meet growing domestic demand. Of a total Indian population of one billion, which is growing at a rate of 2.5 per cent per year, an estimated 100-150 million people demand high quality healthcare services at a competitive price. New hospital projects in the private sector have been incorporated in India to meet this significant demand. Favorable government policies and reduced import duties continue to support the growth of new healthcare projects in India. A successful medical insurance program encourages people to seek specialists' opinions and to use advanced medical diagnostic facilities like ultrasound scanners, MRI, CT scanners.

New specialty and super-specialty hospital facilities being planned in both the government and private sectors depend on the import of high-end medical equipment. Several international companies have now established manufacturing facilities in India to assemble equipment such as ultrasound scanners and mobile X-ray units for the domestic market and for export sales. These companies also import products and components as required for sales or manufacturing.

Current Situation

The Medical Equipment Industry in India is currently operating in a largely unregulated environment. Unlike its pharmaceutical industry counterpart, the few medical device regulations that are in place are unclear, variably and loosely enforced, and generally do not ensure the safety of products for the patients and others to use them. Recent developments that have been widely reported in the press such as the Maharashtra FDA Drug Eluting Stent (DES) issue reflect the current situation.

This is a rapidly evolving and developing industry worldwide but regulations in India have not kept pace. In this environment there is a lot of room for manufacturers of unproven technology with unknown safety and reliability to try their products on patients who do not have the knowledge or opportunity to question the safety of these products. Today, the Government is not in a position to be aware of products in the marketplace, let alone control them. In addition, the current situation means that local and global manufacturers face different levels of regulatory burden, thus affecting the operation of a fair and competitive market.

There are at least two problems that exacerbate the situation. Firstly, the global industry leaders are constantly developing and innovating, at a very fast rate. New medical technology has come onto the Indian market for which the existing regulations of the Drugs and Cosmetics Act 1949 are not designed to

consider. Regulators have been unable to keep up with this development, either in setting regulations in place or in applying and enforcing those regulations. In contrast, the established medical device regulatory systems in all of India's major trading partners have undergone significant revisions in the last 5-10 years to adapt to new technologies and to new public health issues. Secondly, there is a lack of resources at the level of the relevant Government bodies, both at Center as well as State, to ensure that not only the right and most appropriate regulation is adopted, but also that it is enforced fairly, uniformly and in a predictable and transparent manner. Both issues will need to be addressed in order to move forward.

Having the right regulations in place and enforced correctly is of primary concern to India so as to ensure that the people who seek benefit from healthcare products, i.e. the patients, are in turn also protected from harm. Furthermore, Indian Companies, who adapt to a new regime based on internationally harmonized requirements and practices, will be better equipped to compete seriously at an international level. An excellent example in the pharmaceutical industry itself is the spectacular success achieved by those Indian companies who have enthusiastically sought and achieved USFDA certification. Current Indian GMP norms etc are not appropriate to compete at the international level.

Our Position

We believe that patient safety should be the top priority for any set of regulations that is developed and enforced in India. At the same time, regulations should promote continuing investment in innovation and stimulate fair competition. We also believe that these regulations should be consistent and harmonized with the established regulatory requirements and practices in other major markets. Indian standards should be part of the common currency used worldwide, in the same way that USFDA and European Union CE marketing requirements are generally accepted global standards today. In addition, Global Harmonization Task Force (GHTF) guidance documents offer useful references as they reflect a consensus view of current best regulatory practices from regulator and industry experts in Australia, Canada, Europe, Japan, and the United States.

In order to achieve this, the following should be taken into account:

- Regulations should be designed with patient safety as top-of-mind
- The regulation governing Medical devices should be designed in consultation with Industry alongwith other interested parties as a partner and stakeholder in the future of Indian healthcare scenario.
- Regulations should be consistent within themselves and consistently applied right across the country and without respect to the national origin of products.
- Regulations should be developed and implemented in an open and transparent manner.
- Regulations should be guided by the principle of “least burdensome” requirements to achieve the intended public health benefits. They should also take into account both the public administrative resources available and public health priorities.
- To the maximum extent possible, India's regulatory requirements and practices should be harmonised with those of major trading partners.
- The regulatory system should focus not only on product characteristics, but also on the manufacturer's quality management systems (covering design, evaluation, manufacturing,

installation, and service) used to promote safety, consistency, and performance and reliability of those products. In the short term India's current requirements should be upgraded to accept conformity with GHTF/European/USFDA requirements as substantial evidence of conformity with India's requirements. In the longer term local Indian standards should incorporate these same standards, and become a benchmark against which other regional countries should be measuring themselves.

- For locally produced products, a local approval system should be set in place based on the GHTF/CE/FDA standards.
- Importation of products should be done in compliance with local Indian regulations and standards.

We believe that there are many benefits to be obtained from developing and enforcing such regulations:

- First and foremost, we are ensuring that patients are treated fairly and safely and promoting public confidence in medical technology.
- The Regulatory Authority can be satisfied that implementation challenge is the only issue facing it and can ensure its officers are suitably trained to the new requirements.
- There are knock-on benefits for locally produced products that comply with the new standards. Apart from the confidence of better results for their patients, local manufacturers of repute will also be in a much stronger position to compete in foreign markets.
- Strict and uniform implementation of these new requirements will also mean that only compliant and certified products will be available in the market (both imported and locally produced)
- An open and predictable regulatory system will stimulate continuing innovation in medical technology.

International Experiences

- Phased Approach Followed by Countries (e.g. Singapore, Hongkong)
Stage I (Immediate): Data Collection – Who are the companies? Number and Type of Devices Sold, Country of Origin, FDA/CE approval status etc. Draft regulation to be shared with industry and US/European Regulatory Bodies/Associations
Stage II (6-12 Months): Active Implantables : DES Pacemakers
Stage III (12-24 Months): Extension to other categories weighing patient risk vs speed to market
- Products approved by reputed International Organisations like CE, USFDA are accepted without further certification.

Recommendations

- A regulatory model which is simple, transparent and aligned with GHTF guidelines is welcomed by industry.
- There should be a wider representation from industry in the expert committee set up by the government

- A transition period of minimum 2 years should be allowed before a product is brought under regulation, to allow seamless change.
- Risk based device classification as followed in GHTF/European system should be the methodology.
- Organizations like AdvaMed and Eucomed should be consulted prior to creating new regulations in India.
- Registration process for medical devices should be revisited as current process is meant for drugs and pharmaceuticals.
- Products which are already approved in US, EU, Japan etc. should be permitted for use with the minimum regulatory requirements.
- Internationally recognized notified bodies should be recognized in India as well.

AMCHAM

Position

Paper

on

Oil & Gas

Oil & Gas

Current status of industry and its growth potential

Government of India's Vision 2020 document targets 8.5 to 9 per cent yearly growth in GDP during the first 20 years of the new millennium. In its quest to achieve and maintain this growth rate, India's need for energy is growing at an explosive rate. Large quantum of energy in the form of refined fuels and natural gas would be required for India to achieve such high GDP growth rates. India is sixth largest consumer of Oil in world accounting for 3.2% of the world's oil consumption. The Oil & Gas needs of the country are projected to be more than triple in next two decades.

India imports over 70% of its crude oil requirement accounting for over 30% of the country's total import. Indian Oil & Gas industry is estimated to be a USD 90 billion industry and is among the largest contributors to the GDP as well as exchequer. Its share represents over 16% of the GDP.

The sector can be divided into three distinct segments – Upstream comprising exploration and production (E&P) activities, Midstream comprising infrastructure such as pipelines and terminals, and Downstream comprising refining and marketing activities. While the segments are still dominated by National Oil Companies, private and foreign players are gaining presence.

Existing FDI regime

100% FDI is permitted under the automatic route except :

1. 26% divestment condition in case of actual trading and marketing of petroleum products
2. 26% FDI limit with FIPB approval in refining PSUs.

Foreign direct investment policy is liberalised to attract foreign investments. Status of Foreign investments in Oil & Gas sector is as follows:

- Upstream (Exploration & Production) – Cairn, Niko, BG, Hardy, Canoro, etc. – Over USD 4 bn
- Midstream (Storage & LNG) – Total, Shell, Gaz De France, – Over USD 1 bn
- Downstream (Lubricants) - Total, BP, ExxonMobil, ChevronTexaco – Over USD 100 million
- Recently, BP has signed letter of intent for investing over USD 700 million in setting up refinery in partnership with HPCL in India.

Issues impacting growth of Foreign Investment in the sector

Despite a liberalised FDI policy, India has not been able to attract significant foreign direct in Oil & Gas sector due to a variety of reasons. These are enumerated below:

All Segments

Ad-hocism in the Regulatory Regime: The oil and gas industry is capital intensive, and involves long gestation periods. To facilitate investment decisions, a long-term and stable regulatory regime needs to be in place. Unfortunately, in India, all segments of the industry are being regulated piecemeal, through executive instructions, notifications etc. It is essential to have an integrated and consolidated regulatory regime in place, which should enable oil and gas majors to take long term investment decisions.

Lack of Independent Regulator: The situation is further complicated by the fact that the Government wants to act as the Regulator. Even where there are supposed to be outside regulators (the DGH in the case of upstream, and the proposed Regulator in the Downstream Petroleum and Natural Gas Regulatory Board Bill), the Government wants the Regulators to act in accordance with its directives. If the Government were acting purely as a Sovereign in this regard, the situation would have been acceptable to some degree. But, since the PSUs/NOCs are still the major players in all segments of the oil and gas industry in India, the Government is the largest shareholder (and interested party). This dual role is a cause of great discomfort for international investors. The Government needs to don one mantle – either that of the Regulator, or the biggest stake-holder in the Indian oil and gas industry.

Upstream Segment

Exploration Activities: The current practice is to have annual bidding rounds under the National Exploration and Licensing Policy. One constant feature of the various NELP rounds has been its inability to attract the worldwide oil and gas majors. NELP V saw a break in this trend—where many majors submitted bids. However, none of them were awarded any of the blocks they bid for. The NELP bid evaluation system is generally considered the major stumbling block, as the present bid evaluation system gives more weight to the number of wells drilled, and their depth, rather than the technical competence of bidders. This leads to aggressive and speculative bids by domestic bidders. The situation is aggravated by the subsequent relaxations in the work programmes that many of these companies are able to procure from the concerned authorities. This arrangement puts at a disadvantage the approach of the oil and gas majors, whose approach is to put in realistic bids.

Regulatory approvals: New licensing terms have made the Indian upstream an increasingly attractive location for international oil companies, which enjoy 100% foreign ownership rights. However, the numerous Central and State approvals required for conducting operations in India is a time consuming and tedious process.

Downstream

Ad-hoc price control policy: In the Post-Administered Pricing mechanism era starting from April 1, 2002, the Oil companies are allowed to fix the prices of Petroleum products (except PDS kerosene and domestic LPG which are subsidized) based on Import Parity Pricing Mechanism. Although the oil marketing companies are granted freedom to fix retail selling prices of MS and HSD on fortnightly basis, in reality, the prices are revised only after clearance from the Ministry. The prices of petrol & diesel are therefore partially market-determined subject to modulation by the Government in view of the high and volatile international crude prices. This creates uncertainty in recovery of costs to foreign investors while operating in controlled market scenario.

Entry barriers: To qualify for marketing for transportation fuels, namely MS, HSD and ATF, the companies need to invest Rs. 2,000 crore (Over USD 450 million) in exploration and production, refining, pipelines or terminals. Very few foreign companies are eligible as per this criterion. There are few profitable green-field opportunities available in India to invest and meet qualifying criterion. This discourages new foreign companies who want to set up retail operations in India.

Natural Gas

Treatment of Natural Gas as an adjunct to the Petroleum Industry: Perhaps the biggest issue facing the natural gas industry is that it is treated as a part of the Oil industry. That associated wells produce both oil and gas notwithstanding, the two industries are very different, and there needs to be a separate regulatory regime for the Natural Gas sector. This is more so in the case of India, where both industries are at very different levels of maturity, and whose requirements are different. Merely adding "Natural Gas" to the proposed Downstream Regulatory Board Bill will not serve the purpose of the Natural Gas Industry.

Dual pricing:- Government of India fixes Producer price for Natural Gas produced by National Oil companies in India which creates significant differences between Natural Gas prices of National Oil Companies and that of imports leading to creation of uncompetitive Natural gas market.

Absence of Natural Gas Pipeline policy: Draft Natural Gas pipeline policy is in debate since last two years and have not been finalised. The GoI is yet to declare policy on who would be allowed to lay gas pipelines. A major investment is waiting in gas transportation sector as foreign companies need upfront clarity on policy before evaluating the gas transportation business in India.

Recommendations to attract foreign investments

All Segments

Stable Regulatory Frameworks to be enacted: All segments of the oil and gas industry need stable regulatory regimes, preferably in the form of laws enacted by Parliament to ensure their stability.

Independent Regulators to be appointed: The Government should ensure that Regulators are independent, and are not controlled by the largest stakeholder in the industry (the Government itself). Various measures that can ensure this would include:

- The Regulator and his office being funded by a levy imposed on the industry, with the Government having no control on the Regulator's budget (which would be subject only to the control of the CAG). Alternatively, the expenses of the Regulator and his office could be charged to the Consolidated Fund of India.
- Fixed tenure for the Regulator, with the provision that the terms of his service cannot be altered to his disadvantage once he enters office.
- Removal of Regulator to be only for well-defined acts that constitute misconduct or abuse of office, and the procedure to be sufficiently cumbersome to prevent its abuse on flimsy grounds.

Upstream

NELP with Open acreage licensing policy: While continuing with the NELP rounds, the system of open acreage could also be introduced. Companies desirous of bidding for certain blocks could make an offer without having to wait for the NELP rounds.

Data repository : In order to address the underground risks of investors, sufficient geo-seismic data needs to be provided for analysis of blocks on offer. India being poorly explored and the quality of data being poor, investors find it difficult to assess risks and hence are reluctant to bid.

Categorisation of blocks : Upstream companies possess varying degrees of risk appetite. We in India offer all categories of blocks under almost similar terms of bidding. This not only deprives incentivisation to companies who are ready to explore in high risk areas but also makes large, medium and small companies to compete with each other thereby resulting into unjust evaluation. Scientific categorisation of blocks providing room for all kinds of companies to bid is necessary.

Single window clearance: Single window clearances for all regulatory approvals should be provided efficiently to enable E&P companies to quickly mobilise resources and speed up their pace of operations.

Downstream

Enactment of Downstream Petroleum & Natural Gas Regulatory Board Bill: Enactment of Downstream Petroleum & Natural Gas will bring clarity in regulatory regime. Companies will have freedom to fix retail prices of transportation fuels as envisaged after abolition of administered pricing mechanism since April 1, 2002. This removes uncertainty in recovery of costs to foreign investors while operating in controlled market scenario.

Entry criterion for retailing transportation fuel: Qualification criterion for marketing transportation fuels of investing in Rs. 2,000 crore (Over USD 450 million) in exploration and production, refining, pipelines or terminals should be liberalised since there are few profitable green-field opportunities available in India to invest.

Natural Gas

Enactment of Natural gas pipeline policy : Enactment of Natural Gas pipeline policy will bring upfront clarity on policy which is of utmost significance in evaluating the gas transportation business in India.

Removal of distortions in gas pricing: Gas price setting mechanism should be decontrolled and left to vagaries of market which help creation of competitive Natural gas market. Natural gas whether domestically produced by National Oil Companies or Private players or imported regassified gas should be allowed to be determined by market forces. This will create level playing field and clarity in gas pricing.

AMCHAM
Position
Paper
on
Pharmaceuticals

Pharmaceuticals

Executive Summary

The pharmaceutical industry is one of the fastest growing sectors of the Indian economy. It has made rapid strides in the recent past and has witnessed a spate of corporate activity, including mergers and acquisitions, alliances, entry and re-entry of foreign players. On the investment front, there are no real issues that forbid foreign investment into the country, as there are no sectoral caps in this sector. Moreover, there are no specific barriers to privatization of a company in the pharmaceutical sector. The prospects for growth are also immensely bright and India's inherent cost advantages may make it a site for clinical trials. Simplification of legal procedures, transparency in drug pricing and some investor-friendly measures like setting dedicated SEZs for pharma may draw more foreign investment into this industry.

Current Scenario

- **Liberal FDI policy:** 100% FDI through the automatic sector is allowed in the pharma sector. Of late, the automatic route has also been made applicable to activities requiring compulsory licensing or involving the use of recombinant DNA technology and specific cell/tissue targeted formulations. Earlier, these required prior approval of the government.
- **High growth rate:** The market has been growing at a compounded annual growth rate of 8.7% over the last five years.
- **Global ranking:** India ranks 13th in the global league table, with sales of \$4.6 billion in 2004
- **Tax holidays:** A growing number of foreign multinationals have been attracted by the financial incentives given by the government of India, including tax holidays for companies based in underdeveloped areas and the deduction of capital R&D expenditure.
- **Dominance of local players over MNCs:** As of December 2004, only three foreign multinationals ranked in the top 10 companies in India, measured by sales. And between them, they had only 11.9% of the market.
- **Market dominated by generics:** Most of the local players are generics producers specializing in anti-infectives.
- **Cost advantages:** India has an inherent cost advantage over the developed countries. Besides, India's policies are consistent with the international practice and given the high patient population, India can emerge as a site for clinical trials.
- **Enviably global track record:** India has been fully adhering to its international obligations. The Indian Parliament has approved the third Patents (Amendment) Bill 2005 with the Rajya Sabha passing it on March 23, 2005, in compliance with the Trade-Related Intellectual Property Rights (TRIPS) agreement of the World Trade Organisation (WTO).

Prospects

- **Growth in market size:** The Economist Intelligence Unit predicts that the pharma market will increase to \$8.3 billion by 2009, from \$4.6 billion in 2004 - an increase of 80% in five years.

- **Scope for MNCs:** Most local players are generics producers specializing in anti-infectives. With increase in illnesses amongst the affluent and the aged, the demand for new, innovative drugs will rise. This is where the MNCs will find opportunities to set their base in India.
- **Global shop for clinical trials:** With the amendment in Schedule Y of the Drugs and Cosmetics Act, the existence of many other favourable factors such as huge patient population and the potential for cost saving, India can emerge as an ideal site for clinical trials.

Challenges and issues pertaining to FDI inflow

- **Govt interference on drug pricing:** One of the major issues faced by the Indian pharmaceutical industry pertains to price control and the attendant regulator's unpredictability. Recently, the Prime Minister's task force on drug affordability has recommended a drug law and has also suggested that a unified drug authority be set up for pricing and quality issues.
- **Leniency in implementation of patent laws:** A strict implementation of the Patent Act (passed by the Rajya Sabha in March 2003) along with ironing out of some associated outstanding issues is the key to growth. These issues include provision of data exclusivity and post-grant opposition.
- **Legal hassles:** There is need to review and remove the provision that allows third parties to oppose the grant of a patent even after they have been approved. Such a provision not only prolongs the exclusive right of the drug but also defeats the very purpose of the grant of patent.
- **Discriminatory policy:** There is discrimination against “mail box” applications whereby applications filed before January 1, 2005, will only accrue from the date the patent is granted. While a “mail box” application is pending, generic manufacturers can freely produce the same drug without fear of incurring any liability for damages.

Recommendations

- **Make drug pricing predictable and transparent:** There is a need to ensure that the interference of the government on the pricing of drugs is more predictable and transparent such that it enables the companies to make long-term plans.
- **Set up an FDA-like monitoring authority:** There is a need for a federal authority for monitoring the drug administration and quality control along the lines of the USFDA.
- **Increase the corpus for R&D:** With the implementation of “product patent”, the emphasis on research and development will be even higher than before. The government has tried to aide this by providing a corpus of Rs. 1.5 billion in the Budget for the year 2005-06, with the promise to review and increase this corpus in the next year. Such a promise needs to be fulfilled and a higher corpus fund should be provided for.
- **Set up dedicated pharma SEZs:** Special Economic Zones always draw more FDI. The government could consider setting up dedicated SEZs for the manufacture and export of pharmaceuticals.
- **Simplify legal procedures and norms:** The country's legal system should be simplified and various processes such as the registration of a company, obtaining regulatory approvals and other specific permissions should be done at a faster pace to enable the companies to carry out their operations smoothly.

AMCHAM

Position

Paper

on

Power

Power

Executive Summary

There is a strong need for FDI in power sector. Electricity is a key driver of economic growth and social development. At present, not only does the country suffer from an acute power shortage, but the per capita consumption of electricity too is very low. Besides, around 60% homes in rural areas still don't get electricity. With economic development, improvement in the quality of supply, and decline in population below poverty line, per capita electricity consumption is bound to increase. Even though the government has a liberal FDI policy in place, and several foreign players have made investments in the past, the investment climate in the country has not been conducive. As a result, many foreign players have sold of their stake and left the country in the past, to set up shops elsewhere. Today, the economy is clipping at a fast rate, and registering a healthy growth rate of 8.1% (in the first quarter of FY 2006). Electricity supply must grow faster than the expected economic growth of 7-8%. In fact, a failure to do so may jeopardise the prospects of economic growth itself.

Current Scenario

- **Power shortage:** In overall terms, we experience a shortage of 13% in peak capacity and 8% in energy terms. The shortfall is much higher in some states, and also, in the peak seasons. Besides, only 44% of households in rural areas are electrified, and additional capacity, as well as T&D investment is required to meet the government's new initiative to provide electricity access to all by 2012.
- **Low per capita consumption:** The per capita consumption is roughly less than half of China's and about a fifth of Brazil's.
- **Inefficient industry:** The electricity sector incurs a commercial loss of about Rs 25,000 crore per annum; a significant part of which is attributed to inefficient operation.
- **Liberal FDI policy:** The government has taken significant policy initiatives to improve conditions for attracting private investment and FDI into the power sector. Broadly, 100% foreign equity participation is allowed under the automatic approval route in all segments of the industry viz. generation (based on coal, gas, or hydro), transmission, retail distribution and power trading
- **Tax sops:** For large generation projects, the Mega Power Policy extends incentives, such as capital import duty concessions, and waiver of local levies to improve cost attractiveness. All power projects are extended a tax holiday viz. the Income Tax Act permits deduction of 100% of profits of the generation, transmission or distribution company, for a period of 10 consecutive years out of 15 years from commencement, or from undertaking a substantial renovation or modernisation of existing transmission lines.
- **FDI comes in, wanes away:** At different stages, the policy attracted considerable investor interest. In generation, a number of prominent foreign and domestic investors pursued various opportunities in the country, but only a fraction of that materialised. Incidentally, about 7000 MW of capacity was added by private investment. Distribution privatisation also attracted international interest initially, but soon waned, for various reasons but mainly due to concerns of continuing cash losses in the sector and the regulatory environment. Given this, and with better opportunities coming up in other parts of the world, investors moved away and sold their stakes.

- **Liberal framework evolved:** The Electricity Act 2003 provides a more liberal framework for development of the sector. The key provisions of the Act are:
 1. Generation, other than for large hydro projects, is de-licensed
 2. Open access of transmission and distribution networks
 3. Retail competition: Mandates that by July 2008 all consumers above 1MW are free to choose their supplier
 4. Rural power development: Generation and distribution de-licensed in rural areas
 5. Power trading and market development are recognised
 6. Strong anti-theft and malpractice provisions
 7. Functional unbundling of the integrated State Electricity Boards (SEBs) and setting up of Electricity Regulatory Commissions (ERCs) by States made mandatory

The Electricity Act provides the necessary framework for broader participation of the private sector and foreign players in the power sector. Apart from the incumbent utilities, the new partners in developments are expected to be captive generators, merchant plants, power traders, open access consumers, second licensees, rural network operators, franchisees, etc.

Prospects

- **Additional capacity required:** The government's blueprint for power sector envisages a capacity addition of 100,000 MW by 2012, and associated investment required for transmission and distribution network. Similarly, substantial capital investment is required in development of the national grid, renovation and modernisation of inefficient and ageing generation plants and network, for electrification of rural areas, and to improve adequacy, reliability and quality of power supply. The “investment” required is not all about financial capital. To plug this, the power sector, and specifically, the distribution companies must re-engineer their business processes, invest in modern IT systems for billing, MIS, tracking, energy audits etc., train their operating staff to improve their management, commercial and technical skills, and undertake such other performance improvement measures.
- **Need for private and foreign players:** The large capital and knowledge requirements cannot be met by the government alone. Further, given the magnitude of actual and opportunity loss, these investments and efforts must be brought in at the earliest. This requires a partnership, and private and foreign investment is necessary to meet the fast growing demand and to achieve global standards in operating efficiency and quality of supply.

Challenges and issues pertaining to FDI inflow

- **Electricity is a concurrent subject,** and there's considerable difference in the pace and approach adopted by state governments and state regulators in responding to the Act and to the sector requirements. This has had the effect of holding back states that are otherwise willing, and in fact keen to pursue more comprehensive reforms.
- **Financial non-viability:** State utilities' revenues cover barely 70% of costs; and government subsidy covers only a limited portion of the losses incurred. In part, tariffs have failed to keep pace

with costs. For example, in a large state, residential metered tariffs in 1992 covered the average cost of supply, but declined to cover only 52% by 2004. This results in a financial loss (to the utility), economic loss (from inefficient utilisation of subsidised supply), and loss of paying consumers (on account of cross-subsidy; the tariff state utilities charge industrial consumers is among the highest in the world).

- **Regulatory uncertainty:** The power sector is capital intensive, the investments have a long development and operational life, and a significant proportion of the cost structure is outside their control. Therefore, regulators need to provide a favourable environment to investors. Thanks to regulatory uncertainty in the past, several foreign players have sold off their stake and left the country. To attract investment, the regulatory framework must provide a fair opportunity to recover costs, mitigate risks, and provide stability for a reasonable period. These are fundamental requirements, and without this, no sizeable investment can be financed.
- **Lack of modern utilities and processes:** The Indian power sector is large– the sixth largest in the world in terms of generation capacity, and connects over 75 million registered consumers over a wide geography. To manage this efficiently, the utilities need modern processes, IT systems, professional management skills, and a staff trained to meet the emerging business requirements.

Recommendations

- **Competition in supply:** The supply business is intended to be competitive, with open access provided to licensees, captives and eligible retail consumers. However, the pace for retail open access is slow (>1MW by 2008), and constitutes about 10-15% of the total electricity demand; much of this qualifying only in the final year. The open access regulations, particularly, the cross-subsidy surcharge, is not only high and a barrier, but also its future evolution is not clearly defined.

Further steps are needed to achieve proper competition. This includes the following:

1. Discoms must functionally separate the wires and supply business, at least for the contestable portion of the market.
 2. Discoms must assess network congestion, and enhance transmission capacity accordingly.
 3. Uniformity and ease of imbalance arrangements (intra-state ABT).
 4. Run checks for non-discrimination to ensure discoms and competitive suppliers are on a level-playing field for wires business.
- **Establish power exchanges** to trade in power. These exchanges would reveal the “market price” at the time-of-day/ season. This will help signal better utilisation of capacity and entry of new generation, help discoms contract with generators on better risk sharing terms, and encourage regulators to permit market price as pass-through in tariffs (rather than contracted prices). This *interalia* will require investment to upgrade interface metering, communication, IT settlement systems, user interfaces, etc. For this, a nodal agency at the national level may require to be established.
 - **Encourage multi-buyer arrangements:** In separating the trading business, several states formed a single trading company, which presents no particular advantage. In contrast, a few states vested the power purchase agreements (PPAs) and generation contracts with the discoms – a so-called multi-buyer arrangement. The multi-buyer arrangement has the advantage of a bottom-up

development, and places accountability with the discoms, in entering into new PPAs and also operating existing contracts effectively. This helps achieve a more responsive behaviour that is based on its needs; and also encourages better utilisation of its contracted capacity and better load management.

- **Fuel issues:** The forecast capacity growth requires comparable arrangements on fuel side. The key requirements may involve development of a regulated gas supply and transportation business with open access; handling capacity for imported coal; and a move towards more competitive play in the domestic coal market.
- **Transmission development:** Transmission plays a key role in facilitating effective market competition. Investment is necessary in key corridors for evacuation and to develop a national market, and the wheeling should be cost-effective. Presently, the law permits only a minority private ownership in transmission, and joint ventures are of BOT format. A more proactive approach to attract private investment is needed (such as requiring the STUs to plan formally for system expansion, publish a statement of opportunities, and a regulatory requirement for competitive bidding, not only for new investments, but also for such operations that can be outsourced).
- **Unbundling:** The Electricity Act requires separation of transmission and trading business to ensure independence and non-discriminatory open access to all market participants. Distribution should be unbundled into multiple discoms. In the last decade, most state utilities experienced large growth; the number of recorded consumers grew by 55%, and power handled by 70%, while staff numbers remained at the same level. This strained the already inadequate systems, causing loss of management effectiveness and leakages. Smaller discoms can bring better attention to local customer needs, as well as address better focus on performance improvement.
- **Distribution performance improvement:** A number of steps are required to improve basic conditions in discoms for improving performance:
 1. Improve quality of information and transparency through a comprehensive system that captures key performance indicators from all utilities; revealing industry best practices and benchmarks.
 2. Build consensus and commitment of the State governments and SERCs for certain basic tariff reforms.
 3. State regulators should move away from annual tariff review (which is no improvement over the old approach) to a long-term performance-based regulation. This is a necessary condition for discoms to be able to attract any private investment.
 4. State governments and regulators must encourage rural franchisees and other opportunities for local entrepreneurship to be able to invest and provide expertise for managing rural access being created under Rajiv Gandhi Grameen Vidhytikaran Yojana (RGGVY) Scheme, and ensuring better governance, financial recovery and customer service.
 5. Invest in measures that make power distribution more efficient. This includes demand side management (or DSM), IT systems and efficiency improvement tools, web interfaces and communications, and other means of using IT to improve performance, public communication and customer service. Targeted funding support can help discoms rapidly build these capabilities.

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on
Real Estate

Real Estate

The real estate market in India is on a high growth curve. With the liberalization of the economy and the consequent increase in business opportunities, India's real estate sector has assumed growing importance. Added to this, favourable demographics have provided the necessary impetus for sustained growth.

Recent policy measures have opened up foreign investment in the real estate sector and as a result a large number of foreign investors are exploring opportunities in India. However, a more enabling regulatory environment would fully realize the potential for FDI in this sector.

Increasing Demand

National Housing and Habitat Policy has aimed at providing shelter for all by 2010. There is shortage of approx. 30 million dwelling units in the country which need an investment of approx. Rs.400,000 crores or approx. 80 billion US dollars including cost of services like water supply, roads, electricity, sewerage system etc.

All real estate sectors, residential, commercial and retail are currently witnessing huge growth in demand. The residential market is not only witnessing huge growth, thanks to easy availability of finance, but also the average age for ownership of new homes is declining drastically. Younger customers and nuclear families are creating fundamentally different customer segments. Similarly, the retail segment has the potential to grow exponentially, subject to impending Government Policy revisions with respect to FDI in retailing.

It is estimated that there has been an annual doubling in demand for office space. According to projections, demand from the IT/ITES sector alone is expected to be 14 million sq.m. (150 million sq.ft.) of space across the major cities by 2010. As foreign companies have invested investments in India's IT sector and call-centres in cities like Mumbai, the National Capital Region, Bangalore and Hyderabad, property development has surged and land prices have increased rapidly.

Real Estate Funds

In 2004, the government allowed foreign and domestic companies to operate real estate funds/pooled vehicles through the private equity fund route. This, combined with the boom in the real estate market in India has opened the doors for a host of realty funds. While most funds were initially floated by financial institutions/banks such as HDFC, ICICI Bank and Kotak Mahindra Bank, real estate developers like DLF Universal and even retailers like Pantaloon have now entered the arena. Most of the funds floated in the recent past have received a strong response from investors.

These real estate funds have been established as Venture Capital Funds (VCFs) with specific approval from the Securities Exchange Board of India (SEBI). VCFs are allowed to invest in domestic companies whose shares are not listed on a recognized stock exchange in India and are engaged in businesses as permitted under SEBI guidelines (real estate activity is permitted).

Legislation of The Special Economic Zones Act, 2005

The legislation of The Special Economic Zones (SEZ) Act, 2005 gives a long term and stable policy framework for development of hassle-free enclaves in India. The SEZ Act provides the umbrella legal

framework covering all important legal and regulatory aspects of SEZ development as well as for units operating in SEZs. SEZs are specifically delineated, duty free enclaves, deemed to be outside the customs territory of India. Units operating in SEZs enjoy a corporate tax holiday on export earnings, indirect tax exemptions and liberal exchange controls. The SEZ Act provides for substantive fiscal benefits to developers as well.

A minimum area size of 1,000 hectares has been prescribed for a multi product SEZ, whereas sector specific (such as Information Technology, Pharma, Textiles etc.) SEZs can be set up with a much smaller minimum area. Hence, SEZs have generated a lot of interest among real estate developers, Information Technology players and manufacturer-exporters in the country.

Regulatory Environment

Following the Union Cabinet's decision of February 24, 2005, on March 3, the Department of Industrial Policy & Promotion (DIPP) issued Press Note No. 2 which substantially liberalized guidelines allowing FDI up to 100% in Townships, Housing, Built-up infrastructure and Construction-development projects (including but not restricted to housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure).

As per the guidelines, for the automatic route to apply, the following conditions would have to be complied with:

1. *Minimum area*
 - a. In case of development of serviced housing plots, 10 hectares (25 acres)
 - b. In case of construction-development projects, built-up area of 50,000 sq.m.
 - c. In case of a combination project, any of the above two conditions
2. *Investment*
 - a. Minimum capitalization of:
 - US\$ 10 million for wholly owned subsidiaries
 - US\$ 5 million for JV with Indian partners
 - brought in within 6 months of commencement of business
 - b. Original investment cannot be repatriated before a period of three years from completion of capitalization.

The investor may exit earlier with prior approval from Foreign Investment Promotion Board (FIPB).
3. *Others*
 - At least 50% of the project to be developed within five years from the date of obtaining all statutory clearances.
 - Investor not permitted to sell undeveloped plots (where roads, water supply, street lighting, drainage, sewerage and other conveniences are not available).

The above conditions do not apply to SEZs, establishment and operation of hotels and hospitals and investments by non-resident Indians.

Tax Incentives for real estate development

A tax holiday is available to companies engaged in developing approved housing projects subject to such projects being approved prior to 31 March 2007 and the project being completed within four years from the year of approval. To be eligible for the tax holiday, the residential unit should have a maximum built-up area of 1,000 sq. ft. in Delhi/Mumbai urban areas (1,500 sq. ft. in other cities). Commercial area cannot exceed 5 per cent of total built-up area or 2,000 sq. ft. whichever is lower.

A tax holiday of 10 consecutive years (out of the first 15 years) is available for industrial & IT parks provided certain conditions attached are fulfilled, one of which is that the industrial park/ IT park needs to be notified prior to 31 March 2006.

A SEZ developer is entitled to a 10 year corporate tax holiday. In addition to the corporate tax holiday, the SEZ developer is also eligible for exemption from payment of dividend distribution tax, minimum alternate tax and long term capital gains tax on the transfer of shareholding in SEZ company.

Barriers for FDI in the real estate sector

Tax Policy: The Indian Government's tax policy is not in tandem with the Government's liberalisation initiatives being undertaken in the real estate sector. There are no substantial tax incentives for real estate development except in the limited circumstances mentioned above. Even in these situations, the tax incentive windows have a short life left.

Tenancy Laws : The prevailing tenancy laws in India are heavily tilted against the owners of the property. Under the Rent Control Act, some tenants continue to pay the same rent fixed in 1947. Protected tenants cannot be evicted and thus will never surrender their cheap tenancies. Rent controls and protected tenancies have resulted in the decrepit condition of buildings and “frozen” land in cities that would otherwise be available for modern residential/commercial use.

Urban Land Ceiling Regulation Act: The Central Government has repealed this law, but several state governments have not followed the lead. Repeal of this act will release more land into the market and lower the price of land, which accounts for about 50% of the price of real estate property in India.

The Urban Land Ceiling Act and Rent Control Acts have distorted property markets in cities, leading to exceptionally high property prices.

Land Titles: A high percentage (90%) of land holdings do not have clear titles and since the ownership is unclear, the land is off the market. Poor recordkeeping and complicated outdated processes must be modernized and made transparent. Land is generally non-corporatised and is typically held by individual/families. This restricts organized dealing and hinders transfer of titles. Legal processes for property disputes are time consuming.

Stamp Duties: Stamp duties continue to be high and in some states as much as 10-13 percent. The industry has repeatedly called for rationalization and lowering of stamp duties to global levels of 2-3 percent. High stamp duties deter compliance and lowering them would encourage sellers to pay the duties which would translate into increased revenues for the state governments.

Land use conversion: City urban planning projected smaller commercial plots and this, along with rigid building and zoning laws, makes it difficult to procure larger contiguous land areas (for example, for retail space). Land use conversion is both time consuming and complex.

Recommendations

In India's fast-growing economy, real estate has emerged as one of the most appealing investment areas for domestic as well as foreign investors. Once the Government puts into place land reforms and addresses the challenges facing the real estate sector, this sector has the potential to contribute immensely to the country's GDP. Some recommendations:

Rationalisation of Stamp Duties: Stamp duties must be brought down to the global standard of 2 to 3 per cent.

Uniformity in laws across states : Land and housing being a State subject, it is recommended the Central Government prepare model legislations which may be adopted by States so that there are no major variations according to the requirements of the State.

Expedite finalization of States' Master Plans and Zonal Plans: For foreign as well as domestic developers to plan their investments and projects, it is necessary that States' frame their Master Plans and Zonal Plans in a time bound manner.

Allow REITS: Real Estate Investment Trusts (REITs) have been an economic success story in countries like the U.S and U.K, offering liquidity, security and performance. Allowing REITs would enable investments by the small investor, the 'middle class' that drive India's economy.

Remove Ambiguities in the existing FDI guidelines: Some are illustrated as follows:

- i. The basic definition of “built-up area”, “commercial premises” and “built-up infrastructure” is unclear,
- ii. It is not clear whether the built-up area condition has to be fulfilled at the initial sanction stage or at time of completion.
- iii. It is not clear whether construction development project involving substantial renovation/modernization of existing assets would qualify for FDI or would only Greenfield projects qualify.
- iv. Minimum capitalisation has to be brought in within six months of the commencement of business of the company. In case of a construction activity, when would business said to have commenced, would it imply start of construction activities or the date on which agreement for construction/ acquisition of land is signed.
- v. Is the minimum capitalisation in relation to per project or per company? In other words, it is not clear what should be the minimum capitalisation of a company having more than one project? It is also not clear what would be the minimum capitalisation if a single large project is undertaken through two separate SPVs?
- vi. For sale of serviced plots, it is not clear as to whether the entire project would have to be completed or only the part which is to be disposed off.
- vii. It is also not clear, whether the foreign investor has a window to approach FIPB/ DIPP for a specific dispensation or clarification in respect of its project in India.

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Position

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on

Retail

Retail

Executive Summary

The Indian retail sector is predominantly unorganised. However, organised retail is growing at a fast pace. Thanks to apprehensions in some political circles, FDI in this sector is banned. Cumulative FDI flows to retail trade sector in the 20 largest developing countries amounted to \$ 45 billion in 1998 -2002 (about 7% of the total to these countries). As a result of India's restrictive FDI policy, almost nothing out of that came to India. A recent PricewaterhouseCoopers retail and consumer study, titled *From Beijing to Budapest: Winning Formats and Winning Brands*, has termed India as one of the most attractive destinations for retail investments. Almost every large retail chain in the world is keen to expand to India. And many large Indian corporate houses are actively planning to enter retailing. Some plan to do so in partnership with foreign retailers. Clearly retailing is poised to be the next sunrise industry. But the government needs to play the role of an enabler, and fast.

Current Scenario

- **Size:** The retail sector contributes 10% of the GDP and has an estimated market size of \$ 210 billion.
- **Not recognised as an industry:** Despite its size, the Indian retail sector has not been accorded an industry status by the Indian government.
- **Dominance of unorganised players:** The organised sector represents only 3% of the total size of the retail sector. Till recently, integrated retailing was almost non-existent in India.
- **Restrictive FDI regime:**

The current FDI regime permits the following trading activities:

1. Wholesale/cash and carry trading - 100% FDI under the automatic route
2. Trading for exports - 100% FDI under the automatic route
3. Trading of items sourced from small scale sector - 100% with FIPB approval
4. Test marketing of such items for which a company has approval for manufacture - 100% with FIPB approval
5. Single Brand product retailing - 51% with govt. approval

Prospects

- **Large youth population:** The retail opportunity in India is exemplified by a large and fast growing economy, the largest concentration of young population in the world and rapid urbanisation. This Indian middle class with a growing disposable income, estimated at 300 million, will drive the retail sector.
- **Benefits of opening up the sector to foreign players**
 1. **Will bring in capital:** Opening up of the retail sector will bring in much needed capital the Indian industry needs to expand rapidly.

2. **Will bring in best practices:** Entry of foreign retailers will cut short the time required for learning and adopting best practices, which will enhance overall productivity growth.
3. **Economic benefits:** There would be significant economic gains; the key ones being increased employment, efficient agricultural productivity and increased sourcing/exports from India.
4. **Backward linkages:** Apart from direct employment generated by the retail sector, we can expect employment generation from subsequent backward linkages.
5. **Employment in rural areas:** Almost 72% of the Indian population thrives on the agrarian economy. Growth in organised retailing will unleash opportunities such as non-agricultural employment to the rural youth and better quality of living for the existing agricultural society.
6. **Benefits to farmers:** Growth of organised retailing will result in disintermediation in agriculture and the food supply chain, as well as investments in upgrading technology and practices in the entire value chain, including production, packaging, grading, storage and logistics. This will reduce wastages and duplication of efforts and enable farmers to realise higher productivity and better prices.
7. **Better quality of products:** Consumers will get a wider variety and better quality of products at relatively lower prices.
8. **Sourcing from India will increase** manifold when global retailers are allowed to operate in the Indian market.

Challenges and issues pertaining to FDI inflow

- **Barriers to liberalisation of FDI policy:** There are misplaced apprehensions within a few political quarters. There is fear that FDI in retail will result in loss of employment. Experience of other transitional economies, particularly China, shows that in a growing economy like India, both modern and small traders would co-exist for at least the next 30 years. The net benefit arising out of FDI in retailing will outweigh the net cost, if any and such apprehensions need to be allayed.
- **Regulatory hurdles/challenge**
 1. **Too many permits required:** In the case of distribution services, numerous laws and regulatory systems that do not have contemporary relevance exist. Multiple bodies monitoring the sector obstruct its development. For instance, typically a retailer will have to get over 12 licences/ permits before opening one store.
 2. **Creation of intermediaries:** On the food supply front, development is hampered by well-intentioned regulations. For instance, every state has its own Agricultural Produce Marketing Committee (APMC) Act which prohibits contract farming and whole-selling of fresh produce outside designated mandis. The legislation for operation of market yard has resulted in the creation of a new set of regulatory agents overseeing the movement and sale of produce. It also requires contending with unionized labour and a regulated transportation system in the market yard. For a simple farmer delivering his harvest to the market yard, this has resulted in having to deal with significant red-tapism.

- **Domestic Industry barriers:**

1. **Lack of infrastructure:** The food supply chain in India remains fragmented and unorganised. If one looks at the Indian food chain, from the farm to the fridge, distribution of most food items involves multiple intermediaries, high cycle times and wastages during transportation and storage. Lack of distribution facilities and cold storages has led to inefficiencies in the food supply chain.
2. **Lack of proper last-mile distribution:** India lacks in the last-mile distribution segment. Modernising this segment of distribution is a must in order to achieve fast growth, and encouraging modern retailing is the only way to usher in this evolution.
3. **Lack of trained manpower:** The retail industry is in its formative years in India. Hence, it faces acute shortage of trained manpower. Large retailers, to supply their own requirements and to cater to the imminent lucrative demand, are establishing their own institutions.

Recommendations

- **Liberalize FDI policy:** FDI has acted as a catalyst in the rapid development of an efficient retail sector in several other countries. For instance, FDI in retail has been a key driver of productivity growth in Brazil, Poland and Thailand, resulting in lower prices and higher consumption. Allowing global retail participation in this sector will bring the expertise acquired by global players into India.
- **Grant industry status to retailing:** Industry status would make financing expansion projects easier and increase operational efficiency. It would also help in better regulation, which would be taken care of by a ministry/body. This will help improve the growth rate of modern retailing.
- **De-reserve SSI:** Reservation of large sub-segments like food processing has reduced the efficiency levels in these segments. Therefore, de-reservation will lead to increased competition and large scale operations, which in turn will improve efficiency levels.
- **Invest in distribution facilities:** Currently, growth of the retail sector is curtailed by lack of infrastructure. Investments into the last mile distribution segment are expected to be lucrative and most significant for growth of the retail sector.
- **Establish a world-class institution for retail management:** Almost all sectors have a good supply of manpower from acclaimed universities in India, except for the retail sector. As a result, this sector is likely to face acute shortage of manpower. This problem needs to be addressed soon.
- **Reforms in marketing of agricultural produce** will drastically reduce wastages, boost competitiveness and marketing efficiency of farmers, thereby improving their life, which was the actual intent of laws like the APMC Act.
- **Develop infrastructure:** With rapid transformation of retail expected soon, infrastructure will have to develop at the same pace, if not faster, in order to facilitate the growth. Major infrastructure required for moving goods from one place to another in an efficient manner, involves roads, the freight industry, railways, ports and shipping and pipelines, all of which are either managed or regulated by the government.
- **Undertake reforms:** Further legislative reforms, such as aligning existing policies, labour laws, taxation, and fiscal incentives for retailers, are required to keep the momentum of growth in the

AMCHAM

Position

Paper

on

Telecommunications

Sector

Telecommunications Sector

Current status of industry, status of foreign investment, FDI potential

India has already crossed the one hundred million mark in number of telephony access connections thus becoming the fifth largest network in the world after China, USA, Japan and Germany. Today, the telecom industry is one of the fastest growing sectors of the Indian economy with the private sector contributing a commendable share of over 50 per cent of the total access lines.

Consequently, over ten years, the overall teledensity has also increased from a meagre 1.3 in 1996 to the current over 9 access lines per hundred people. In spite of this increase, the existing teledensity of India is still much lower than world standards. This coupled with a population base of over a billion people is in itself a reflection of the tremendous growth potential that exists in this sector.

The telecom revolution in India is being led by the cellular sector which is adding nearly 2.0 million connections every month. This sector, besides contributing to doubling the teledensity in last 3 years, also offers the lowest tariffs in the world at about 2-3 US cents per minute. Cellular sector was the fastest growing sector in 2004-05 with over 60 per cent growth in revenues and up to 55 per cent growth in subscriber base.

At present, telecom is, perhaps, the most liberalised sector in India with successive Governments being equally bullish about the sector. The sector has progressively seen encouragement from the state for greater private sector participation. From opening up of the mobile segment in early 90s and the fillip provided by National Telecom Policy 1999 (NTP '99) to the Broadband Policy last year and the latest initiatives on increasing the foreign investment limits to 74 per cent are some of the positive signals being sent by the Government of India in this regard.

The telecom sector in India is reported to have attracted about USD 3 billion of foreign direct investment. Most of the investment has been in the severely competitive cellular services followed by investments in the telecom manufacturing sub sector. Going forward, the Government of India has set a target of 250 Million phones by 2007. This is expected to require an estimated investment of over US\$ 35 billion by 2007 alone.

Current FDI Policy

- 74 per cent in basic, cellular, paging, unified access, NLD, ILD, V-Sat, PMRTS, GMPCS and other value-added services.
 - 74 per cent is total composite ceiling (including strategic investors, FIIs, NRIs, FCCBs, ADRs / GDRs, convertible preference shares and proportionate foreign investment in Indian promoters/ investment/ holding companies)
- 74 per cent for telecom activities such as ISPs with gateways, radio-paging and end-to- end bandwidth.

- 100 per cent in ISPs not providing gateways, Infrastructure Providers providing dark fibre, electronic mail and voice mail. 26 per cent divestment of equity in favour of the Indian public in 5 years (provided these companies are listed in other parts of the world).

Current status of liberalisation w.r.t. WTO commitments

The Government of India has far exceeded all its commitments made to WTO in 1997 for various segments of the Telecom Sector, which is a laudable step given the complex democratic set up of the country and various compulsions surrounding such an operating set up.

The Access market has already been allowed to have unlimited number of players against the commitment of

- (i) One operator other than DoT (now BSNL)/MTNL in each service area for a period of 10 years from the grant of license and
- (ii) Two cellular service operators in each service area.

The current foreign investment cap is already raised to 74 per cent against the commitment of up to 25 per cent foreign equity for a private operator which should be a company registered in India.

The long distance (both national & international) markets have already been allowed to have unlimited number of players in contrast to the commitment of reviewing the opening up of national long distance and international long distance service beyond service area to competition by 1999 and 2004 respectively. In fact the ILD monopoly was terminated in 2002 itself, 2 years ahead of schedule of committed review.

Issues impeding growth of FDI and initiatives required

Foreign Ownership Norms

On December 14, 2005, India's Department of Telecommunications (DOT) released new conditions for the issuance of international (ILD) and domestic (NLD) long distance service licenses. They took effect on 1 January in large part; however, the aspects of concern to global telecom operators will take effect 01 March, 2006. The conditions include a welcome relaxation of foreign direct investment limitations, allowing up to 74 per cent foreign ownership. Such reforms should promote investment and competition, to the benefit of Indian consumers and businesses. However, the conditions also include restrictions on the remote management of telecommunications traffic, with regard to routing and the passing of user and infrastructure information to persons outside India which could render the apparent market opening all but moot.

Condition 5.6 of both the ILD and NLD licensing guidelines imposes a number of conditions in support of national security and law enforcement requirements. As major global network operators, AMCHAM's membership fully appreciates the security obligations that responsible carriers must necessarily bear. Such requirements should however be proportionate and applied to specific circumstances. Our core concerns are with the following obligations:

- 5.6(v): restrictions on the transfer of accounting, user and network information outside India
- 5.6(viii): restrictions on the international transit routing of domestic India traffic
- 5.6(ix): restrictions on remote access for maintenance or repairs from outside India

These conditions constitute a severe impediment particularly to the ability of ILD operators to serve their customers, and therefore to the development of competitive markets in India.

We are concerned because these conditions are inherently incompatible with the operational characteristics of global managed networks and the management of MNC accounts. The imposition of these conditions would have an immediate adverse impact on the operational integrity of all global network operations touching India, and would impede the ability of global carriers to service customers with sites in India. The unintended consequences would include jeopardizing India's critical information infrastructure and impeding the development of next-generation networks.

To our knowledge, there is no precedent in India or any other country to conditions of this scope and severity. They significantly exceed those imposed under US laws and/or license approval conditions. On this basis, it would appear that India's security concerns are capable of being addressed adequately without recourse to the imposition of these conditions.

These rules should be eliminated in entirety because of their harmful impact on all services touching India. If immediate complete removal of the rules is not achievable, then as an immediate step we propose that closed user group network services be excluded from the application of the provisions, because of the proportionately low national security concerns with closed user group communications as compared with mass market communications.

The following "exemption language," inserted next to the specified provisions, would clarify the scope of the rules and enable the effective supply of globally managed private network services to MNC customers with a presence in India: *"This provision does not apply to closed user group (private) network service providers."*

India can design more effective national security rules to govern telecommunications licensees without creating an unreasonably discriminatory or restrictive impact on foreign carriers and the economy. AMCHAM looks forward to working with U.S. and Indian government officials to this end.

India's Access Deficit Contribution (ADC) Regime

- In January 2003, India instituted an ADC regime to help fund its universal service programs. The Indian regulator TRAI should be applauded for taking steps to develop a robust and sustainable competitive telecommunications market in India, and indeed has a statutory obligation to facilitate competition and promote efficiency in the operation of telecommunications services. However, India's implementation of its ADC program has resulted in significant marketplace conditions that are counterproductive to its competitive goals.
- First, the ADC, which requires an additional per-minute charge for terminating domestic and international calls, institutionalizes an above-cost price floor that disincentivizes competition, prolongs inefficient network use by the incumbent, and fosters anti-competitive practices. Parties paying the ADC charge are prevented from competing effectively, particularly against ADC recipients, because they must pay a minimum higher price for services. Although the ADC fee has been modestly reduced since its implementation in 2003, the international charge is still approximately 9 cents per minute, which is far above the costs of actual termination and results in a very high floor for international settlement rates (12-15 times higher). In fact, this floor leads to international

termination rates that can easily be 5 times higher than the rates Indian carriers pay for calls terminating into the U.S. U.S. carriers send at least 5-10 times more traffic to India than they receive; consequently, the ADC has led to a situation where US carriers have the volumes, yet Indian carriers receive the discounts. Unfortunately, the most recently mandated ADC reductions were only partially passed through by Indian international carriers to US carriers.

- At the same time that the international ADC was reduced by 15%, the domestic ADC was reduced by 80%. Not surprisingly, this disparity has generated a large “gray” market in India. This market has flourished by taking advantage of the artificially high international ADC by disguising inbound international calls as domestic in origin. The gray market in India is estimated to be approximately 40% of all inbound international calls. This inevitable result from an above-cost ADC has driven revenue from legitimate bilateral international service providers and disservices TRAI's fundamental universal service goals. TDSAT, the Indian dispute settlement authority has given elaborate findings of gray market resulting from the ADC arbitrage in its Judgment of March 2005.
- On a positive note, the TRAI has drafted a revised ADC plan that apparently would remove the per-minute structure currently in place and incorporate a revenue sharing plan that could go a long way to addressing the current problems. Specifically, a revenue share plan would provide an equitable and non-discriminatory method fairly applied to the revenues generated by all industry players. This would allow greater transparency and ensure that contributions are not more burdensome than necessary. Removing the artificial rate floor now in place would also unleash competitive market forces to dramatically lower international termination rates. This plan would also be competitively neutral, as the subsidy would be borne by all suppliers proportionately, unlike the current structure, which unfairly burdens international carriers, by specifically targeting international customers.
- A revenue share plan would also help address the gray market issue. Implementing such a plan would eliminate the discrepancy between international and domestic termination rates and the resulting marketplace distortion.
- In parallel, TRAI should establish a mechanism to impose a termination rate price cap to guard against anticompetitive behavior by incumbents who may act to set termination rates at excessive levels once the regulated ADC rate is removed. A total cap on termination rates will ensure that the benefits of eliminating the ADC per-minute surcharge flow-through to end users, including US carriers and callers. Such a termination rate should be determined either equal to or as close as possible to domestic termination rates.

India's Spectrum Policy Requirements

- **Spectrum Adequacy:** Sufficient quantity of spectrum is needed for ensuring seamless growth of mobile communication
- **Efficient Use of Spectrum:** Efficient use of spectrum should be encouraged through all possible technological enhancements
- **Sufficient Spectrum:** Availability of enough spectrum for supporting mobile services in the country so as to meet government's teledensity objectives.

- **Technology Neutral Allocations:** Technology neutrality of spectrum allocation essentially leads to technology agnostic license, price and allocation criteria. The current allocations criteria are different for GSM & CDMA technologies.

An equal allocation criteria will foster a marketplace that will reward innovation, efficiency, and competition for the benefit of India's consumers and enterprises. This criteria will also promote and support enhanced services.

- **Integrated Approach** Realigning all existing criteria to support all kinds of service, including enhanced services (High Speed Data, Broadband, Mobile TV etc)
- **Ensure Service Flexibility**
 - By allowing deployment of enhanced services in all bands
 - By enabling choice of services and deployment timings
 - By ensuring policies that promote launch of new services

- **Spectrum for Wireless Broadband Access:** There is considerable demand for flexible, quickly deployable wireless broadband access (BWA). With the flexibility that wireless broadband access affords, a service provider can offer premium “on demand” high-speed connectivity or mobile broadband services with millions of users not only in Metro areas but also in rural and remote areas.

With the increasingly rapid rate of technology advancement, approaches that specify which technology may be used in a particular allocation risk becoming quickly outdated or obsolete. The Industry is committed to work with policy makers to ensure economically beneficial and efficient use of spectrum.

We believe a reasonable level of global harmonization for BWA can be achieved in the following spectrum bands:

- License-Exempt 2.4 and 5 GHz:
 - The frequency ranges of interest includes bands between 5.25 and 5.85 GHz. (The bands between 5150-5250 MHz is most commonly designated for low power, indoor applications which makes it of less interest to outdoor applications.)
 - In the 2.4 GHz and upper 5 GHz band (5.725- 5.850 GHz), many countries allow higher power output - 4 Watts vs. 1 Watt or less EIRP in the lower 5 GHz bands - which makes these band more attractive to BWA applications. Because in the majority of countries license-exempt spectrum is “free” to use, these bands are strategic for enabling grass roots deployments in underserved, low population density rural and remote markets. These bands are also targeted for longer range indoor & outdoor applications and thus benefits from higher allowable power output levels.
- Globally the industry is committed to promote wider release of upper 5 GHz band (5.725–5.850GHz) band in a harmonized and timely manner. The U.S. administration is considering proposals to increase power output in license exempt bands in rural areas to facilitate less costly deployments in under-served areas. Power outputs up to 25 Watts have been proposed.

- **Licensed 3.5 GHz:** The primary licensed spectrum allocated for BWA applications in this general vicinity lies between 3.4 and 3.6 GHz although there are some new allocations between 3.3-3.4 and 3.6-3.8 GHz. Bands between 3.4 and 3.6 GHz have been allocated for Fixed Wireless Access in the majority of countries. It will be essential to have a planned licensed development of this band for use by commercial operators with either 7 or 14 MHz bandwidth.
- **Licensed 2.5 GHz:** The bands between 2.5 and 2.7 GHz have been allocated to fixed and mobile services and have been identified for IMT 2000 applications stemming from decisions of the World Radio Conference 2000 – with the objective to widen the availability of these bands for fixed, portable and mobile broadband applications. Also prevalent in Southeast Asia (including Australia, South Korea & New Zealand), is the 2.3 GHz band, which some equipment manufacturers are expected to cover with their 2.5 GHz radios. We propose a technology neutral approach in use of this spectrum, particularly because many high data rate wireless services will be added to the IMT 2000 list of approved standards. These bands should therefore be used in a manner that allows license holders to deploy the most appropriate services and technologies for their market, as long as those solutions adhere to the regulatory requirements to support compatibility of services and deployments, and behave in a safe, fair and consistent manner.
- **New Bands of Interest in Lower Frequencies:** Radio waves propagate further the lower the frequency band, creating a direct relationship between the number of base stations required to cover a given service area. More specifically, the lower the frequency band, the fewer base stations are required. Since cost of deployment is one of the key factors to accelerating deployment of BWA, access to lower frequency bands is critical. There are many examples in developing nations of the use of lower frequency bands to increase teledensity. Availability of lower frequency bands for broadband access will similarly increase broadband penetration. Bands in the sub 1 GHz frequency range specifically bands currently vacant or used for analog TV spectrum in the < 800 MHz range are expected to become available as television stations transition from analog to digital broadcasting. It is imperative for India to take a leadership role in ensuring that its citizens benefit from the greatest choice of broadband access suppliers and the most cost effective broadband access services & devices.

Technical considerations: The BWA bands are planned for OFDM multiple carrier schemes and a Fast Fourier Transform (FFT) size of 2048 points has been selected. OFDM is a robust modulation that facilitates the possibility for non line-of-sight (NLOS) operation also. TDMA is currently anticipated as the multiple access mechanism with an option for OFDMA uplink sub-channelisation. OFDM can be scaled to operate within a variety of channel widths. Widths of 3.5 MHz, 7 MHz, 10 and 20 MHz have initially been selected as these are consistent with allocations and assignments in many regions around the world. Both FDD and TDD techniques are included. Both techniques offer specific characteristics that can be advantageous for service providers and are supported in the standards.

Freq Band (MHz)	Duplexing	Channelisation (MHz)
2500 - 2690	TDD /FDD	5/10/20
3400 - 3600	TDD/FDD	3.5/7
5725 - 5850	TDD	10/20

Strengthening the Institutional Framework

The Regulatory & Policy Institutional Framework comprises

- (i) Department of Telecom **DoT** (under the Ministry of Communication & Information Technology) responsible for policy formulation & licensing
- (ii) Telecom Regulatory Authority of India - **TRAI** having a mix of “recommendatory”, “regulatory” and “tariff setting” functions and
- (iii) Telecom Disputes Settlement and Appellate Tribunal - **TDSAT**, empowered with adjudicating disputes between various parties (licensor/ licensee/regulator/group of consumers, etc.).

Before the liberalization of the sector, there was an overlap between the way government exercises its role as shareholder of a state owned enterprise, developer of telecom policy, regulator of the sector and operator. Even after liberalization of the sector and creation of separate regulatory and dispute adjudication institutions, the sector has very often been marred with controversies over the powers/turf issues between institutions governing the sector. Enforcement powers are not clear enough, and too many issues are determined in court.

The prevailing situation wherein DoT is the shareholder of the largest telecom company in India and policy maker is creating a conflict of interest between its role as a sole shareholder and the role of ensuring overall growth of the sector. Such conflicts can have a significantly adverse effect on the level of investment in the sector and slow the pace of development.

The need of the hour is clear separation of roles, enforcement of measures to ensure both financial and operational independence of institutions and defined enforcement powers for the Regulator. Such measures will go a long way in establishing the credibility and robustness of the institutional framework and send positive signals to potential investors.

Bridging the Urban-Rural divide

There is a huge urban-rural divide in terms of deployment of lines vis-à-vis population that is getting served. Consequently, nearly 71 per cent of the Indian rural population are serviced by only 13 per cent of the total telephone lines in the country.

The required regulatory initiatives to promote rural telephony should focus on:

- (i) Creating a licensing policy that attracts competition in the rural areas which is currently served only by the incumbent
- (ii) Facilitate conditions such that market driven operators can offer quality based customised service offerings at market driven tariffs
- (iii) Mandate compulsory infrastructure sharing of available transmission backbone for lowering costs
- (iv) Reduce regulated costs like license fees, access deficit charges, duties, taxes etc for effective lowering of tariffs
- (v) Expedite creation of basic infrastructure like road and electricity etc.

Additionally, there is urgent need today to encourage telecom equipment & access devices manufacturing, both by international as well as domestic players, in India. Apart from generating wide spread employment, it will also help in lowering the high entry cost and increasing penetration amongst the masses. A rational indirect tax regime and duty structure would help a long way in achieving the desired objectives.

Sectoral Policy & Regulatory Initiatives

Telephony, especially wireless, in India has benefited from the time to time policy and regulatory interventions like introduction of revenue share license fee as part of National Telecom Policy 1999, implementation of calling party pays regime etc. However, a lot needs to be done to clear the uncertainties surrounding some of the other critical issues.

Spectrum is the life blood of a wireless sector, but the piecemeal manner in which it is allocated to the wireless operators in India definitely restricts efficient network planning and has consequent cost implications for the operators. The delay and non-clarity of viewpoint on allocation of the 3G spectrum is another case in point.

The various restrictions placed based on the nature of service specific license tend to limit the competition, in an otherwise very attractive sector. Not allowing wireless operators to connect their networks across telecom circles is not only stopping alternative long distance networks to emerge and but is also reducing the flexibility of the smaller wireless operators to offer competitive long distance tariffs in comparison large integrated players, restrictions for offering IP VPN services by Internet Service Providers (ISPs), restrictions on 'reselling', limited use of Internet telephony or other IP enabled services, etc. being some of the examples to illustrate the point.

TRAI has recommended hierarchical model for Unified Licensing for enabling a licensee to provide any or all telecom services by acquiring a single license. The services under unified license would include telephony, Internet, broadband, cable TV, DTH, TV & radio broadcasting, thus recognizing the convergence in technology that is increasingly blurring the difference between different conduit systems such as wireline, wireless, satellite etc. The acceptance of TRAI's recommendation in this regard would definitely be a positive indicator for the strategic/financial investor's world over.

Easing out the guidelines on intra circle M&A Guidelines, is likely to enable further consolidation and investment by strategic players in the booming telecom market in India. As per license conditions, no single company / legal person, either directly or through its associates, shall have substantial equity holding (equity of 10 per cent or more) in more than one licensee Company in the same service area for the same service. However currently, there exists certain cases wherein the above license condition is not being met effectively. This license condition also effectively prevents 'acquisitions' by existing players and such a clause can also potentially bring under the purview of these guidelines, any internal restructuring exercises undertaken by any of the business houses.

The various regulatory / fiscal costs (viz. revenue share license fee, service tax, sales tax, etc.) to the industry (in terms of the ultimate payout by a consumer) is estimated to be between 30-35 per cent of the total telecom service industry's revenues of over USD 17 Billion. The need is to recognize the capability of the telecom sector in facilitating the overall macroeconomic growth of the country rather than viewing it

as a direct revenue generator for the government and inhibiting its attractiveness and consequent growth by significant “per consumer payout” to the government.

The examples quoted above demonstrate that the need of the hour is the consistent implementation of a policy framework that is market driven, competition oriented, does not hinder technology benefits from being passed to subscribers and is overseen by light touch regulations.

Making India a Manufacturing base

Though the Government has started an initiative in this regard by rolling out a discussion on the proposed Telecom Hardware Policy, it is imperative that whenever such policy is announced some issues as set out below are addressed appropriately:

- **Policy of the Government of India to award the contract to the lowest price bidder :** though this seems to be a logical step from a pure economic perspective, it also has a folly of the low quality bidders entering the fray and in some cases being the selected parties. Since India is moving towards a scenario of making itself a manufacturing base (if not for the world, atleast for the South East Asian region), the focus should be on having the latest and the most technological advanced systems being set up in India. This will ensure that the investments in the technology would last for a much longer time and serve in India's interest.
- **Fiscal Policy does not encourage manufacturing :** Currently Government of India does not have an effective fiscal policy to attract global telecom equipment manufacturers to set up manufacturing base in India. No corporate tax holidays are given. Today, there are no incentives for manufacturing telecom equipment in India as compared to direct imports. This just adds to the woes of the foreign investor who is in any case struggling with bureaucratic delays, labor issues etc. The government should evolve a comprehensive telecom equipment manufacturing policy giving fiscal impetus attracting foreign equipment manufacturers to India. In effect, all telecom equipment manufacturers should enjoy deemed export status on domestic sales as do the supplies of goods to power projects, refineries etc.

Conclusion

The key tasks for the telecommunication sector are to provide telephone connections to the consumer on demand, extend the telephone network to all the villages and provide data services to the industry at reasonable and affordable costs.

Since telecommunications is a regulated industry, therefore, besides the factors impacting the demand-supply gap of its services, licensing and other regulations governing the sector have a critical impact on the attractiveness of investments in these areas.

The Indian Telecom industry has a great future, and the challenges mostly regulatory and those related to government policy, which, if addressed appropriately can pave the way for an explosive growth. The future of Indian consumers will be best served by a robustly competitive, technology-savvy industry facilitated by a stable policy and regulatory regime.

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