

Dynamics of India's Commercial Service Exports Since 1991

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Abstract

India espoused an outward orientation in July 1991 and instigated a gradual process of liberalization both in domestic sector as well as in foreign trade sector. During the two decades of reforms regime the role of foreign trade grown in India and remarkable changes came in its trade scenario. A noteworthy change during the post reforms regime is that India penetrates in global markets more rapidly for services trade than for goods trade. Considering this, on the eve of completion of second decade of reform, this study attempts to understand the dynamics and structure of India's commercial service exports in order to trace the impact of trade policy reforms on their composition. This study is exploratory in nature and utilizes secondary sources of data to draw out the inferences. After a detailed exploration of data the study finds out steep rise in the share of commercial service exports in total trade of India and a structural shift in its structure during the post reforms regime. The study advocates more entry level and domestic level reforms along with diversification in commercial service exports to gain further momentum and supports trade openness to gain competitive advantage for commercial service trade in the global market.

Keywords: Commercial Service Exports, Trade Openness, Trade Reforms, Competitive Advantage

Introduction

India initiated overarching reforms in the country in July 1991 to counter the worsening balance of payment condition at home as well as to face the challenges of globalization sweeping across the world. Consequent to these reforms, India's foreign trade policy scenario transformed which influenced the trends and patterns of foreign trade by varied ways. India's service trade sector, which was considered as non-tradable prior to reforms, exuberated during the post reforms regime. During 2000-2011 service exports increased by a CAGR of 23.4 per cent corresponding to merchandise export growth of 18.6 per cent (Economic Survey 2011-12).

India achieved 10th rank in export of services worldwide, while got 20th place in world merchandise exports during 2010 (WTR 2011). India's commercial service exports increased more than 25 fold in value terms, from 4.6 billion US dollar in 1991-92 to 95.8 billion US dollar in 2009-10. Therefore, viewing the increasing penetration of India in global service markets during the reforms regime, it is imperative to analyze the composition of commercial service exports of India to trace the impact of trade policy reforms and to provide some suggestion for future trade sector reforms pertaining to the growth of the commercial service exports.

Review of Literature

Given the growing importance of service trade in total trade of India during the post reforms regime, many studies have been carried out and specific arguments have been presented in different directions to analyze its performance. Rajan and Sen (2002) delineated the role of services trade in overall export growth of India. Panagriya (2004) outlined the liberal initiatives of Indian trade policies since 1991 and assessed their impact on service trade. De and Raychaudhuri (2008) provided a brief overview of India's service trade in order to examine its role in delivering pro-poor growth. Kowalski (2009) examined service trade dynamics of India in order to evaluate the economic implications of trade policy reforms.

Pailwar and Shah (2009) conducted a study for the period 1980-2006 to analyze the evolution of trade specialization in service trade of India using various measures of comparative advantage. Prasad & Sathish (2010) examined major policy issues such as domestic policy, domestic regulation and market access issues affecting India's service sector. However, author identified a need to provide an overview of India's commercial service exports during the post-reforms regime in order to trace the impact of trade policy reforms on its role and structure.

Objectives and Methodology

The objective of the present study is to analyze the dynamics and structure of India's commercial service exports during the post-reforms regime in order to trace the impact of trade policy reforms on composition of commercial service exports and to derive some policy implications regarding trade policy reforms.

The information required for the present study has been taken from secondary sources such as Economic Surveys of Government of India, Various Trade Policy Documents by Ministry of Commerce and Trade, Trade Policy Reviews of World Trade Organizations, World Trade Indicators by World Bank. Moreover, various specialized journals, related research work and internet search engines have been used. The data have been presented in tabular form, in terms of absolute figures as well as percentages. Different types of growth rates and ratios have been calculated. Along with it, the relative competitiveness of commercial service export is reviewed with the help of the Revealed Comparative Advantage (RCA) index. The RCA index has been calculated based on following equation:

$$RCA = (X_{iw}^k / X_{iw}^{\Sigma k}) / (X_w^k / X_w^{\Sigma k}), \text{ where}$$

X_{iw}^k is country i's world exports of merchandise/services k; $X_{iw}^{\Sigma k}$ is country i's total exports, X_w^k is world exports of merchandise/services k; and $X_w^{\Sigma k}$ is world's total exports. If the estimated RCA index of a sector is found to be greater than one, then it is considered as globally competitive (Balassa, 1965).

Structure of the Study

The study has been divided into four sections. The second section dwells briefly the policy initiatives taken by government of India for promoting service exports during post reforms regime. Third section briefly discusses the growing importance of commercial service exports in India's total trade and evaluates the structure of commercial service exports. Last section summarizes the results of analysis and presents some policy directives for future growth of India's commercial service exports.

Trade Policy Initiatives for Promoting Service Exports

There are different regulations and protectionist measures that affect service trade directly or indirectly. These measures can be divided broadly into two groups. First are entry level restrictions such as constraints on foreign direct investment and second are operational level restrictions such as licensing requirements and interference in ways of business management. Indian Trade policy reforms focused on both these restrictions to some extent.

In the Export-Import policy, separate focus provided to export of services after realizing their future growth potential. The schemes for export promotion available to merchandise exporters extended to service exporters. Various export incentives schemes such as Export Promotion Capital Goods (EPCG) Scheme, Special Advance Licensing Scheme, Export-Oriented Units (EOUs), Electronics Hardware Technology Parks (EHTPs), Software Technology Parks (STPs) and Biotechnology Parks (BTPs), Market Development Assistance (MDA) Scheme, Star Export Houses introduced or advanced to service sector. An export house status granted to tourism industry for the expansion of a new dynamic services sector.

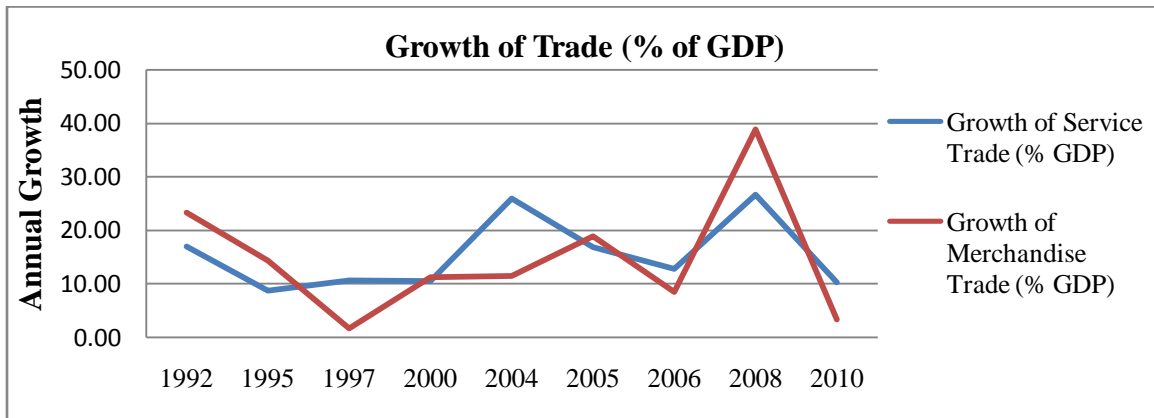
During the post reforms regime several initiatives were taken to simplify the rules and procedures and to improve the speed of transaction. These steps include introduction of electronic data interchange (EDI) system in May 1995; extension of automated customs clearance system; introduction of Risk Management System (RMS) program in Dec. 2005; use of a National Import Data Base (NIDB) by DGCI&S since Dec. 2002etc.

Year Wise Policy Initiatives of Government taken to Promote Service Exports Since 1991

- During 1991-92 the scope of services export enlarged and the rate of replenishment of service exports increased from 10 per cent to 30 percent of net foreign exchange earnings. In March 1992, Liberalized Exchange Rate Management System (LERMS) introduced.
- During 1993-94 a new scheme called the 'Export Promotion Capital Good' introduced for the Services sector which permits import of capital goods on concessional rates for export purposes. Full convertibility of rupee on trade account announced in 1993-94 budget.
- Specified professional services counted towards the granting of Export/Trading/Star Trading House status. Current account convertibility of rupee introduced in 1994-95 budget to facilitate exports.
- During 1997-98 export houses exempted from paying the Minimum Alternate Tax (MAT). Retention limit increased from 15 per cent in 1991 to 50 per cent in October 1997 under Exchange Earners' Foreign Currency (EEFC) account scheme in case of exporters and for other export organizations.
- During 1998-99 export credit interest rates reduced to 9 percent from 11 percent and special additional duty of 4 percent exempted under all export promotion schemes.
- During 1999-00 recognizing the potential of service exports a new chapter included in EXIM policy for such exports.
- Foreign Exchange Management Act (FEMA) introduced on June 1, 2000.
- During 2002-03 medium-term exports strategy (2002–07) underlined the need for a radical strategy to promote service exports in which India has a comparative advantage.
- During 2004-05 a duty free import facility provided for service sector to boost such exports. A 'Served from India Scheme' introduced in 2004 for all service providers with total foreign exchange earnings of at least Rs 1 million in the previous or current financial year.
- During 2006-07 a 'Services Export Promotion Council' set up to promote exports of services by Ministry of Commerce & Industry, Government of India.
- During 2008-09 higher support provided to service exporters for market and product diversification and additional resources granted under the Market Development Assistance (MDA) and Market Access Initiative (MAI) schemes.
- During 2010-11 zero duty EPCG scheme and Duty Entitlement Passbook (DEPB) scheme extended. Scrip's issued under Served from India Scheme (SFIS) can now be used for payment of duty on import of Vehicles, which are in the nature of professional equipment.

Dynamics and Structure of Commercial Service Exports

Services export is outpacing the growth in merchandise export, which is a reflection of comparative advantage of India in favour of services. The share of service trade in total trade and particularly service exports in total exports is increasing steadily during the post reforms regime (Table 1). Contrarily, the share of good exports in total exports is decreasing i.e. from 78.08 percent in 1995-99 to 61.23 percent in 2006-09. The exploration of data further shows the growing resilience of Indian service exports as its share has reached to 38.77 percent in 2006-09 from 36.26 percent in 2005-08 despite of the global financial crisis of 2007.



Source: Created from data of World Trade Organization Statistics Database and World Development Indicators, World Bank.

Table 1: India's Share of Goods and Service Exports in Total Exports

	1995-99	2000-04	2005-08	2006-09
Goods trade share of total trade	77.47	72.00	71.47	71.16
Services trade share of total trade	22.53	28.00	28.53	28.84
Goods exports share of total exports	78.08	71.11	63.74	61.23
Services exports share of total exports	21.92	28.89	36.26	38.77

Source: Compiled from World Trade Indicators Database, World Bank, 2010-11

India's commercial services exports i.e. total service export excluding government services can be divided in two broad categories namely traditional and non-traditional. Traditional sector comprises transportation and travel services¹ which are low value added services and requires high physical infrastructure base. Non-traditional sector includes other commercial services² which are knowledge, skill intensive services and demands larger technological base. A major structural change in service exports is the dominance of non-traditional category in total export. In the decade of eighties traditional service sector i.e. transportation and travel exports were the main parts of service exports structure of India (Table 2). In 1981, they both occupy a total of 65 per cent share in total commercial services trade, while 55 per cent in 1991 and only 25.1 percent in 2011. Their loss in share is the gain of 'other commercial service' category which now has a share of nearly 75 per cent in total commercial service exports.

Table 2: Commercial Services Export of India (Percentage)

Year	Total Commercial Service Exports	Transportation Exports		Travel Exports		Other commercial Service Exports	
	Growth	Growth	Share	Growth	Share	Growth	Share
1981	-7.9	2.1	17.3	-17.6	48.5	4.4	34.2
1985	4.7	3.5	15.7	22.0	27.4	-1.7	56.9
1990	12.6	12.9	20.8	7.6	33.8	16.6	45.4
1995	12.1	10.3	28.0	13.6	38.2	12.0	33.9
2000	14.5	7.3	12.3	15.0	21.6	15.7	66.1
2005	37.6	31.6	11.0	21.4	14.4	42.2	74.6
2009	-13.2	-5.1	11.9	-5.9	12.0	-15.4	76.1
2010	33.1	20.7	10.7	27.2	11.5	36.0	77.8
2011	20.4	35.1	12.1	36.6	13.0	15.9	74.9

Source: Calculated from data of World Trade Organization Statistics Database. Data in US Dollar at Current Prices. * Share in Total Commercial Service Exports.

India is gaining comparative advantage in non-traditional category since 1995 but at the same time losing revealed comparative advantage in traditional areas (Table 3). Calculated RCA indices (Balassa 1965) supports the argument given by a plethora of studies (Rakshit, 2007 and Karmakar, 2008) that India has been gaining revealed comparative advantage in emerging areas such as financial services, and information and communication technology, but losing advantages in traditional areas such as transport, travel and tourism services. These results are also equivalent with the study of Kowalski (2009), who analysed India’s services export performance in detail with the help of selected trade indicators such as sectoral RCA and intra-industry trade (IIT) indicators. The analysis shows that India has a strong comparative advantage in computer and communication services.

Table 3: Estimated RCA Scores for Commercial Service Exports from India

Year	Transportation	Travel	Others
1981	0.48	1.76	0.95
1992	0.81	1.37	0.81
1995	1.09	1.11	0.85
2000	0.53	0.67	1.48
2004	0.51	0.56	1.48
2009	0.59	0.47	1.40
2010	0.51	0.45	1.45
2011	0.59	0.51	1.39

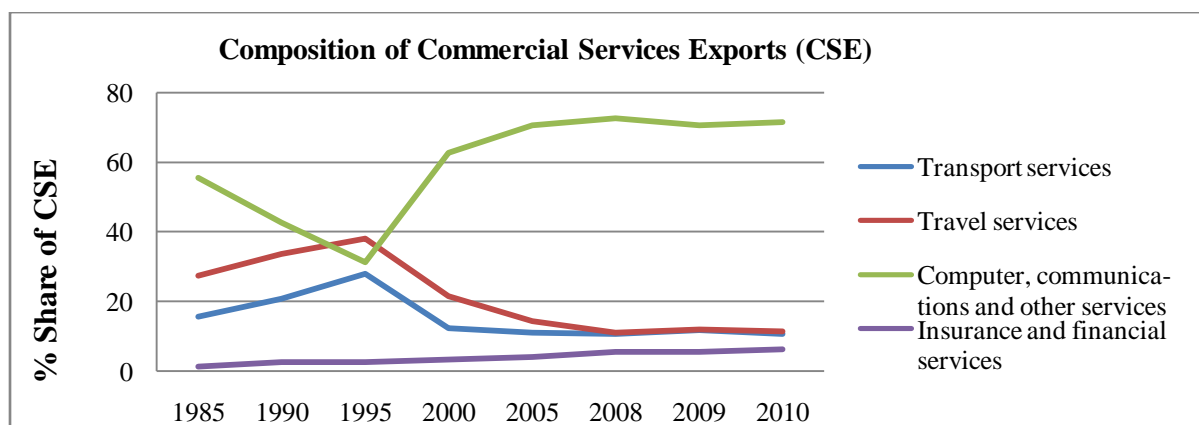
Source: Calculated from data of World Trade Organization Statistics Database.

Nowadays, India is a leading exporter in other commercial service trade, holding third position behind EU and US, with 4.9 percent share in world commercial service trade in 2010 (Table 4). Contrarily, the share of transportation and travel services in world commercial service trade are 1.7 percent and 1.5 percent respectively in 2010. It depicts that the growth in share of service exports during post reforms regime is due to the emergence of several new services sectors under other commercial service category.

Table 4: Structure of Commercial Service Exports

		Transportation	Travel	Other Commercial Service
Value (Billion\$)	2010	13.2	14.2	95.9
Share in World Commercial Service Trade	2005	1.0	1.1	3.1
	2010	1.7	1.5	4.9
Annual Percentage Change	2005-10	18	14	20
	2008	28	10	25
	2009	-5	-6	-15
	2010	21	27	36

Source: International Trade Statistics, 2011. World Trade Organisation.



Source: Created from data of World Development Indicators, World Bank.

Table 5: Composition of Other Commercial Service Exports (Percent Share*)

	2000	2003	2006	2009	2010	2011
Communication Services	5.65	6	4.1	2.1	1.47	1.47
Financial Services	2.61	2.27	4.43	5.19	6.26	6.01
Computer & Information Services	–	–	–	47.34	–	44.32
Telecommunication Services	2.83	3	2.05	1.05	0.74	–
Construction Services	4.74	1.71	1.16	1.19	0.55	–
Insurance Services	2.43	2.53	2.09	2.17	1.86	–

Source: Calculated from data of World Trade Organization Statistics Database.

*Note: Percent Share of Other Commercial Service Exports

Exploration of data under the ‘other commercial service exports’ category reveals that the share of communication services, construction services, and insurance services has declined in total service exports while the share of financial services along with computer and information services has improved (Table 5). The most remarkable sector in other commercial sector has been computer and information services, whose share in India’s services exports is now almost half of India’s services exports.

Now, India is a leading exporter of computer and related services, including software installation and data processing, and a major supplier of back office processing services, such as abstracting and indexing, data processing, legal transcription, telemarketing, and website design (TPR, 2011). Though there can be both demand and supply side factors behind this substantial export performance of software sector yet as highlighted in the 11th five-year plan document, government policies including deregulation (such as tax exemption, reduction of tariffs on software from 114 per cent to Zero, amendment of the copyright law etc.) and incentives as the right time in right measures facilitated the growth of the Indian software industry and exports since the nineties.

Conclusions and Policy Implications

This paper divulges that during the post reforms regime India achieved revealed comparative advantage in ‘other commercial service’ export category particularly in financial, telecommunications, and information technology services. To grow further, India can take the advantage of abundance of high skill labour as well as growing technological infrastructure in the country and diversify in different areas such as consultation services, entertainment services, legal services, accountancy services, insurance services, satellite mapping services, and research and development related services.

The study point out that India’s comparative advantage is reducing in traditional services sector i.e. ‘transportation and travel services’, which is a cause of concern as these two sectors have been a significant part of India’s total commercial service exports. Banga (2005) also illustrated the importance of these sectors by stating that developing countries have a comparative advantage in transportation and tourism services so these economies should exploit their geographical location and natural endowments maximum. Thus, to reap the benefits of traditional sector the reasons of this decline should be explored and measure should be taken to enhance the share of these services. One perceptible reason of this decline is significant bearing of traditional sector services on physical-infrastructure available in the country.

To improve the infrastructure, the study advocates a liberal policy for Foreign Direct Investment (FDI) in industries engaged in creating export infrastructure and policy promoting technology innovation in the field of Electronic Data Interchange (EDI) and e-commerce. Along with it, financial sector reforms are necessitated to remove procedural bottlenecks in getting adequate finance, to control inflation and to safeguard to our exporters against dollar fluctuations.

India initiated different trade policy reforms to promote service exports such as liberalization of exchange restrictions; opening access to foreign competition by liberal FDI rules in crucial sectors such as banking, insurance, telecommunications, retail, and higher education; disinvesting state-owned or controlled service providers; and simplification of rules and procedures for exporters. These policy reforms contributed in increasing competitiveness of service providers in terms of prices and quality. Many other studies (Hoekman, 2008; Nielson, 2004) also recognized trade liberalization as one important channel for improving services performance both for developed and for developing countries. Considering present and past inferences, the study advocates that the ambit of trade policy reforms should be widened and deepened further by adopting a single uniform tariff, rationalizing and bringing down varied duties & taxes, and instigating regulatory policy corrective measures to improve competitive advantage of service trade.

Notes

1. Transportation services covers sea, air and other including land, internal waterway, space and pipeline transport services that are performed by residents of one economy for those of another (International trade Statistics, 2011). Travel includes goods and services acquired by personal travellers, for health, education or other purposes, and by business travelers (International trade Statistics, 2011).
2. As defined in Balance of Payment Manual 5(BPM5) released by IMF other commercial services corresponds to Communication Services, Construction Services, Insurance Services, Financial Services, Computer and Information Services, Royalties and License Fees related Services, Other Business Services such as trade-related services, operational leasing , and miscellaneous business, professional and technical services, and Personal, Cultural and Recreational Services.

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