Multi-year Expert Meeting on Trade, Services and Development

Eleventh Session

Room XVII, Palais des Nations, Geneva

10-12 July 2024

Contribution

Services Exports as a Growth Engine to India

Mr. Sriram Chekuri
Economist
India

SRIRAM CHEKURI

SERVICES EXPORTS AS A GROWTH ENGINE TO INDIA

ABSTRACT

International trade is the exchange of capital, goods, and services across international borders or territories because there is a need or want of goods or services. Expanded trade and investment in services can result productivity growth and act as a key channel for the dissemination and adoption of innovative new technologies. A conducive and encouraging business climate for domestic and foreign services providers consequently improves the inclusive efficiency of limited resources.

The flow in services exports provides to an alternative path to development. However the indication presents a complex picture in the Indian economic scenario. Renowned economists of the world including Mr Raghuram Rajan advocating our Governments that service exports only can improve India's GDP which is on the raising path since crisis year 2009-10. All nations noticed our unique success as a services exporter in global markets persistently. The same is evident from the fact India's services export receipts grown from $95.8 billion in post-crisis year 2009-10 to $341.1 billion in 2023-24, literally 3.5 fold increase in a span of one decade plus.

Undoubtedly half of those exports were exports of software services and one fourth is from business services accounting. These sectors, accelerated India's share in global exports of commercial services from 3 per cent in 2010 to 4.8 per cent in 2023. However, as of now, in a country where services contribute more than 50 per cent of GDP, net revenues from services exports amounted to just 3.4 per cent of the same GDP.

Visibly the prospects look brighter with improved performance of various sub-sectors like Tourism, Medical Treatment, Hotel, Hospitality, Construction Services, Real estate, IT-Business Process Management & E-commerce. Share of manufacturing in India's GDP had been and remained lamentably low is often facing criticism due to alarming growth in youth unemployment. That's

why few left oriented economists are prevailing to continue and even start large scale Public Sector Undertaking's in Public-Private Partnership (PPP) mode so as to absorb labour force as the growth drivers.

Moreover, the service sectors that account for the rapid export expansion cannot be labour absorbing. While services account for more than 50 percent of GDP, they provide around 30 percent of total jobs in the nation. Mainly those jobs are in the retail and wholesale trade sector and in other unorganised services. India's overall employment is estimated at 510 million but in services sector it is placed at 160 million persons. This means that the IT-related sectors which are contributing for 7.5 percent of GDP provide employment to only 1 percent of total employment and 3.4 percent of services employment. This implies in turn that the multiplier effects on aggregate income of the services export is not aptly suited for India.

The World Investment Report 2022 of UNCTAD places India as the seventh largest recipient of FDI in the top 20 host countries. In FY 2022 India received the highest-ever FDI inflows of US$ 84.8 billion including US$ 7.1 billion as FDI equity inflows in services sector. To facilitate foreign investment, various measures have been taken by the Government, such as the launch of the National Single-Window system, a one-stop solution for approvals and clearances needed by investors, entrepreneurs, and businesses.

Apparently the real benefit that the services export boom provides is the solid earnings of foreign exchange. Naturally these reduce India's balance of payments vulnerability and increase the policy flexibility that GOI enjoys. Aggregate private transfers, consisting mainly of remittances from Indians working abroad, was at $102 billion, equal to 70 per cent of the earnings from services exports. That was the other important source of balance of payments resilience. Foreign exchange earned from net services exports amounted to just 2.1 per cent of the current account deficit recorded in 2023. Ironically more than a third of those earnings in that year was exhausted through net investment income payments to foreign investors as dividends repatriating surpluses.

India is beginning to pay a price for its software success. Attracted by the opportunity of emerging as a software exporter, the government decided to liberalise imports of hardware unlike use of Chinas selective local make mandatory. This was a departure from the recommendation of the Homi Bhabha committee of 1968 that India must develop the capability to meet the inevitable growth in demand for computers other than mainframes, from domestic production. The protection afforded to the hardware sector in pursuit of this objective was loosened as part of liberalization. Hence the result is now visible in the growing dependence on imports of computer hardware. Simultaneously the increased presence of assemblers of foreign brands of computers in the country. The import of computer hardware has more than doubled from $6.89 billion in financial year 2016-17 to $14.14 billion in 2022-23. Foreign brands like HP accounted for 33.8 per cent of Packing Credit shipments in India, Lenovo for 15.7 per cent, and Dell for 13.9 per cent and Acer for 12.3 per cent in these imports.

Of late the efforts made by Government of India to raise domestic production with subsidies has not largely helped. Among the 27 companies cleared for support under the production-linked incentive scheme are HP, Dell and Lenovo, which are controlling the domestic market. Such foreign players are more likely to depend on imported components and to repatriate profits, which would further add to foreign exchange outflows of investment income.

Finally, India is not an ace producer of software products, with the Indian market being largely serviced by the likes of Microsoft, Acrobat, Oracle and SAP. As computerisation proceeds, these tendencies would intensify, leading to increased foreign exchange leakages through imports, royalty payments and profit repatriation. Thus, as time passes on, a substantial share of the foreign exchange realised through services exports is likely to leak out, eroding even the benefits in balance of payments the services exports currently deriving. It is high time India uses the benefit of these earnings to diversify activity within and outside of services, including into new export lines to retain the flexibility that foreign exchange access ensures. India must be strong enough to compete in the world market with our standard hardware products.

In this context, it is imperative for India to step up investment in education, health and research and development. Such a focus enables to be front runner in new technology intensive manufacturing of 2030s and 2040s. The key to such a strong future competitive India is huge investment in Science, Technology, Engineering, Management (STEM) education along with Researchand Development in all frontier areas of Science and Technology. As a first step in this direction, all faculty positions across India from Elementary Schools, High Schools, Colleges including government aided colleges, medical colleges, Universities and IITs, IISERs, CSIR, Agricultural Research and other laboratories across India.

My paper delivers six vital messages.

1. Services trade is extremely forceful and provides significant prospects for developing counties. Services trade has been the most dynamic component of world trade for the last two decades. Such dynamism provides developing and least-developed economies significant opportunities for export-led growth, economic diversification, inflows of foreign direct investment (FDI), leverage for policy making and integration into global value chains.

2. Services trade promotes greater inclusiveness, particularly for female and young workers and entrepreneurs as well as micro, small and medium-sized enterprises (MSMEs). In 2021, 59 per cent of employed women worked in the services sector, and 9 out of 10 services firms were MSMEs. Presently the services sector generates half of global employment worldwide. Interestingly service sector causing two-thirds of world GDP – more than the combined shares of agriculture and industry. These changes in the structure of the global

economy challenge long-held perceptions of the services as a less desirable path to economic growth and development compared to manufacturing.

3. Trade in services has become substantially digitalized. Powered by advances in information and communications technologies (ICT), exports of commercial services tripled between 2005 and 2023. By virtue of exports of digitally delivered services fastest growth is apparent, thus increasing to almost four-fold. In the same time, developing economies accounted for an augmented share of global services trade, whereas least-developed economies' exports of commercial services grew more than four-fold between 2005 and 2023. In few other developing economies also the growth is more than tripled. The expansion of developing economies' exports is increasingly tied to services supplied across borders through digital means. Remarkably developing economies account for an increasing share of non-traditional service exports. Such gains disprove the export distrust that long saturated earlier discussions of services trade and inclined to limit developing country engagement in negotiations, particularly at the WTO.

4. Most of the pressing Global challenges can be tackled by the Services sector only. Noteworthy opportunities in the services sector still remain to be seized by developing nations. Barricades to trade remain a hindrance in different sectors and means of supply. Nevertheless, services trade policy has an important role to play in reducing trade costs, improving the performance of services, attracting FDI, boosting supply-chain resilience and increasing manufacturing productivity and ultimately all other exports. Consequently services trade policies play a significant role in strategies to promote

development. Furthermore, there is a growing acceptance that services – and services trade – will prove central to easing the most pressing global challenges. These include benefits offered by a rapidly digitalizing global economy, facilitating timely access to critical goods and services in response to pandemics and natural disasters, addressing food security by adopting the latest technology in agricultural practices, facilitating the transition to a decarbonized global economy, and designing and deploying green technologies.

5. Improved commitments on services trade can bring key benefits to economy. Although services sector reforms are mainly undertaken by governments at the domestic level through autonomous policy measures, binding commitments in trade agreements represents a key policy complement. While services trade barriers impose significant costs, uncertainty stemming from the absence or relative paucity of binding commitments carries additional costs. Improving the level of binding commitments in services trade can send positive signals to investors about nations business and investment climate. Boosting WTO members to bind their best commitments from preferential trade agreements could provide a major pep talk to multilateral trade diplomacy – without requiring any additional liberalization undertakings – as commitments undertaken in preferential settings are typically implemented on a non-discriminatory (i.e. most-favoured-nation treatment) basis. The complementary role played by legally binding commitments in trade agreements can help to prevent protectionist backsliding and lock-in prevailing degrees of openness. The scope for unduly discretionary or arbitrary trade action can be reduced through increased transparency and policy predictability. Economies stand

to benefit from the significant development gains of reviving the WTO’s market access negotiations on services.

6. An Assistance for Trade roadmap for services can help tackle key challenges familiarising international cooperation to the novel realities of services trade calls for increased levels of Aid for Trade. This support should be directed to strengthening the capacity of developing economies to design and implement services trade reforms and supply competitive services to global markets. Many developing and least-developed economies find it difficult to conduct domestic policy reforms and negotiations in services trade. Just not because of the diverse nature of the service economy, but due to the regulatory intensity that characterizes it. Constraints in policy formulation and regulatory enforcement as well as in supply-side capacities cause absolute delay in implementation. An approach in which Aid for Trade support reinforces efforts to enhance international cooperation, reduce trade costs and improve the transparency and predictability of trading conditions could provide momentum to the services trade policy agenda – particularly at the UNCTAD and WTO. A “trade in services for development” initiative could help to mobilize a coherent Aid for Trade package in services, targeting five key challenges:

(i) Highlighting data gaps in services trade;

(ii) Assistance in greater participation of developing and least- developed economies in policy discussions on trade in services;

(iii) Solidification of regulatory frameworks and institutions;

(iv) Promoting diversification, particularly that offered by digital services trade; and

(v) (v) Addressing key supply-side constraints and improving the services-related skills of workers.

Notable fact is from 1990 to 2017, developing countries increased their share of global exports from 16 percent to 30 percent. Amazingly in the same period, the global poverty rate fell to one fourth (from 36 percent to 9 percent). Perhaps all countries have not benefited equally, but overall, trade has generated extraordinary prosperity, helping to lift more than one billion out of the 8 billion global population from the clutches of the poverty in the past few decades.

Trade has multiple benefits. Trade leads to faster productivity growth, especially for sectors and countries engaged in global value chains (GVCs). These links allow developing countries to specialize in making a single component, like tyres, rather than a finished product, like a luxurious car. GVCs give them access to foreign technology, know-how, and investment. Trade eases the diffusion of technologies that reduce greenhouse gas emissions and support adaptation – such as solar panels and wind turbines or drought-resistant seeds. Consumers enjoy a greater variety of goods and services at lower cost, though some firms and workers in individual sectors may see their livelihoods at risk through increased competitive pressures.

The global trade system should address legitimate concerns about national security and reliable access to key goods, but not at the expense of development. It must distinguish between subsidies that provide public goods, like electric cars, and those that distort trade and disadvantage trade partners. Rules on the protection of intellectual property must ensure that subsidized technologies are made widely available. Exporters of food and other key goods must refrain from imposing restrictions in times of crisis; importers should permanently reduce or eliminate import tariffs to ensure adequate supply in good times and bad.

Trade in services drives the exchange of ideas, know-how and technology, although it is often restricted by barriers such as domestic regulations. Trade in services records the value of services exchanged between residents and non-residents of an economy, including services provided through foreign affiliates established abroad. This indicator is measured in million USD and percentage of GDP for exports, imports and net trade. Services include transport (both freight and passengers), travel, communications services (postal, telephone, satellite etc.,), construction services, insurance and financial services, computer and information services, royalties and license fees, other business services (merchant services, operational leasing, technical and professional services etc.) cultural and recreational services, and government services not included in the list above.

Services are shaping how trade contributes to economic growth and development. The world economy has in recent decades undergone structural shifts brought on by rapid technological developments that have made services one of the most dynamic sectors. The services sector has been the main source of economic growth since the 1990s and services today dominate the production and employment landscape of economies at all levels of development (Nayyar and Davies, 2023). Subsectors such as logistics, finance and information and communication technologies (ICT) are essential to the functioning of modern economies. Services have long comprised many of the fastest growing sectors of the world economy – such as business services, healthcare, entertainment and ICT services.

Beyond their rising importance in domestic economies, services are also an increasingly prominent feature of cross-border exchanges. Services had long been the most dynamic component of international trade and investment prior to the COVID-19 pandemic and the world has since borne witness to how services offer growing export opportunities, including for developing and least-developed economies, as digitalization and the ability to deliver services remotely remove barriers to trade which can arise from the limited size and challenging geography of economies and ease trade within and across borders.

Services were severely impacted by the pandemic, with business closures and social distancing measures exacting a heavy toll on the sector. Health-related measures adopted to slow the spread of the virus, including restrictions on cross-border mobility, led to an unprecedented collapse of services trade, which declined across all regions. The impact was more severe for services involving face-to-face interactions. Services trade in the travel sector decreased 81 per cent soon after the Carona attack. However, post Pandemic, slowly but steadily trade in general and services trade in particular is increasing.

At the same time, ICT services were key in ensuring economic and trade resilience and in speeding up pandemic recovery efforts. A sustained rebound in services trade and investment will be critical to global recovery prospects. Trade and investment policies in services are essential to harnessing the sector's growth and development potential. However, maximizing the benefits requires a rethinking of the central contribution that services trade plays in the development process. Furthermore, interest in tackling the barriers to trade and investment in the sector needs to be revived at the global level. The ability of services firms and suppliers to operate outside domestic markets holds the key to promoting growth, deepening integration and speeding up efforts to diversify economies. Economic diversification can be fuelled not only by growing opportunities for services exports but also through the greater use (and sourcing) of competitively priced services as inputs in other sectors. Services contribute centrally to the operation of cross-border production networks, such as regional and global value chains. When measured in valued added terms, services account for 50 per cent of world trade.

Services trade offers significant and multifaceted development impact. Services offer a direct route for developing economies to diversify their exports away from a limited range of products and commodities. Services led export diversification can also boost resilience by reducing exposure to commodity price volatility. Improved access to high-quality modern services is also critical to the operation of cross-border production networks and fundamental to economy-wide productivity gains. The trade facilitating role that services play as intermediate inputs is a key determinant of improved export performance of other sectors such as manufacturing and agriculture. Moreover, high-value services and services exports are creating new well-paid jobs for young people and professionals in developing economies. Services trade is associated with inclusive growth, given its positive impacts on the employment prospects of women workers, the youth and entrepreneurs as well as on micro, small and medium-sized enterprises. Advancing the United Nations Sustainable Development Goals requires effective access to a host of services, ranging from health and education to finance, transport and logistics services. Policy measures governing trade and investment in telecommunications and computer services are key determinants of enhanced digital connectivity, while trade in environmental services strengthens efforts to combat climate change and improve environmental stewardship. Services represent the future of trade. Developing economies have already made important inroads in leveraging services trade, but much remains to be done to fully realize the sector's development promise. There is a need to re-ignite international cooperation in the services sector. Such efforts need to expand trade and investment, reduce trade costs, bring about greater transparency and predictability on trade policy regimes and, ultimately, increase the participation of developing economies in policy deliberations and negotiations on services trade. Further, data must be able to move more freely and securely across borders to support digital trade and realize the growth potential for inclusion and jobs. Deepened international cooperation on services trade requires more Aid for Trade, as domestic reforms and international negotiations in sectors subject to considerable regulatory scrutiny are still challenging for many developing economies. A “Trade in Services for Development” initiative could support deeper international cooperation by mobilizing resources for technical assistance and capacity building. The WTO Secretariat and the World Bank Group stand ready to help governments realize the full development potential of trade in services. Services account for the largest share of global economic activity, generating more than two thirds of GDP, employ the most workers and are the source of most new job creation, especially for female and young workers. Services spur growth through the key intermediation role they play as inputs into the production of other

Executive summary:

International trade in Goods and Services boosts the competitiveness of the countries. Goods and Service markets are mutually reinforcing. The economy-wide ubiquity of services means that services, play a key role in the export competitiveness of businesses in all sectors. Productivity gains in extractive industries, agriculture and manufacturing are all shaped by the ease of access to efficient services and infrastructure. Improved access to quality and affordable services can enable developing economies to integrate globally. Diversification, and hence a more varied range of services exports, will increase resilience to unexpected economic events and promote the pursuit of more sustainable development paths. Beyond their rising importance in domestic economies and their key role as intermediate inputs, services are also an increasingly prominent feature of cross-border exchanges.

Expanded trade and investment in services can spur productivity growth and act as a key channel for the dissemination and adoption of new technologies and know-how. A conducive business climate for domestic and foreign services providers therefore improves the overall efficiency of resource use. By contributing to improved performance in the sector, services trade policies also represent a critically important means of achieving the United Nations Sustainable Development Goals, contributing in the process to alleviating poverty and increasing shared prosperity. Elevating the policy attention paid to services requires that domestic and international policies be brought up to speed with the reality of the global services economy. For trade policymakers, this means intensifying cooperation to overcome obstacles that hinder trade and investment in services. At the domestic level, continued efforts need to be directed to putting in place business and regulatory environments conducive to the supply of more efficient and competitively priced services. At the global level, stepped up cooperation could entail renewed efforts to provide greater transparency and predictability to services trade regimes, building on advances registered in the latest generation of deep preferential trade agreements. Moving in this direction could provide a major boost to restoring the primacy of the multilateral trading system in matters of services trade governance at a time when calls for its reform and reinvigoration have gained wide currency.

China and India doubled their share of global commercial services exports from 2005 to 2022, from 3.0 per cent to 5.4 per cent, and from 2.0 per cent to 4.4 per cent, respectively. With regard to global commercial services imports, the shares of Asia, Latin America and the Caribbean, and the Middle East increased, while those of Africa, Europe and North America declined. The expansion of trade in commercial services was fuelled by advances in ICT, perhaps best exemplified by the global expansion of the Internet, which has boosted opportunities for the remote supply of services (including across borders), such as professional, business, audio-visual, education, distribution, financial and health-related services. The future of trade lies in services.