Services Exports as Growth Engine*

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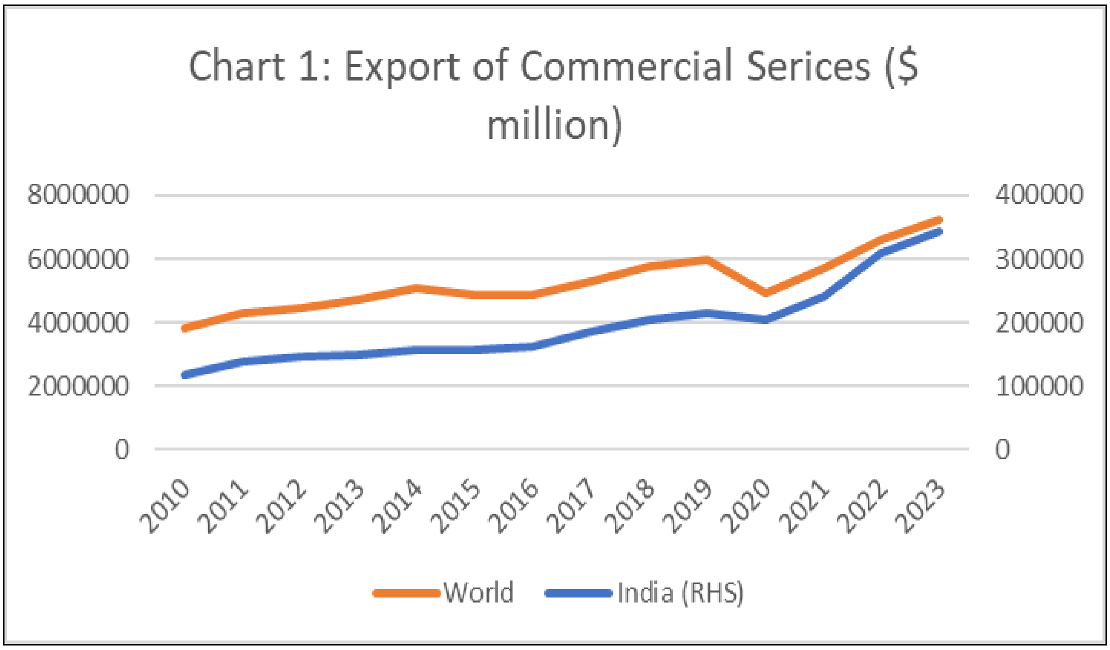
Interest in India's almost unique success as a services exporter in global markets persists. India's services export receipts rose from $95.8 billion in post-crisis year 2009-10 to $341.1 billion in 2023-24. Close to one half (47 per cent) of those exports were exports of software services, with business services accounting for another 24 per cent. Led by those sectors, India's share in global exports of commercial services has risen from 3 per cent in 2010 to 4.7 per cent in 2023. India has indeed done well in this area.

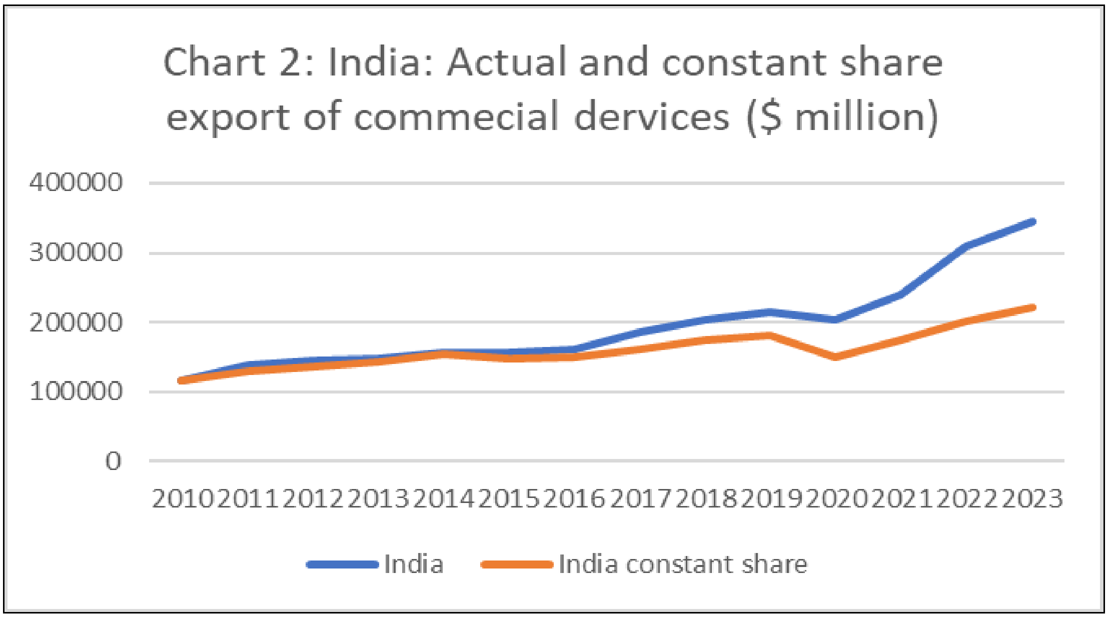
Charts 1 and 2 illustrate how the increase in global exports share has made a significant difference to India's performance as an exporter of services. Chart 1 tracks the revenues from the exports of commercial services in the case of India and the world, showing the degree to which India's services export growth has exceeded that of the world. Chart 2 shows what India's performance (relative to actual) would have been if its share had remained at the 3 per cent level it recorded in 2010. The ability to win larger shares of the global market, by retaining its competitive advantage, has been crucial to India's success.



But that does not necessarily justify the view that this success in services export is driving India's GDP growth in a way that makes its development trajectory unique. The criticism that the share of manufacturing in India's GDP has been (and remains) disappointingly low is discounted in this assessment, since the country is seen as pioneering an altogether different road to developmental success, in which labour absorbing services serve as the growth drivers.

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 GDP in 2022. Thus, the direct contribution to GDP of the 22 per cent increase in net services exports in 2021-22, for example, would have been just three-fourths of a percentage point.

Moreover, the service sectors that account for the rapid export expansion do not seem to be as labour absorbing as they are presumed to be. While services account for more than 50 per cent of GDP, they provide only around 30 per cent of all jobs. Most of those jobs are in the retail and wholesale trade sector and in other informal services. While overall employment is estimated at around 510 million and that in services is placed at around 160 million persons, the contribution of the information technology and business process management industries, which yields much of the export revenue, is estimated by one source at just 5.4 million. This means that the IT-related sectors that are responsible for around 7.5 per cent of GDP contribute only around one per cent of total employment and 3.4 per cent of services employment. This implies in turn that the multiplier effects on aggregate income of the services export boom cannot be too high.



The real benefit that the services export boom provides is the foreign exchange earnings it delivers. These reduce India's balance of payments vulnerability and increase the policy flexibility that the government enjoys. Foreign exchange receipts related to software exports and business process outsourcing are larger if we include remittances of savings of workers employed to provide onsite services to clients abroad. 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, though not all of these remittances came from workers providing software or business process outsourcing services onsite.

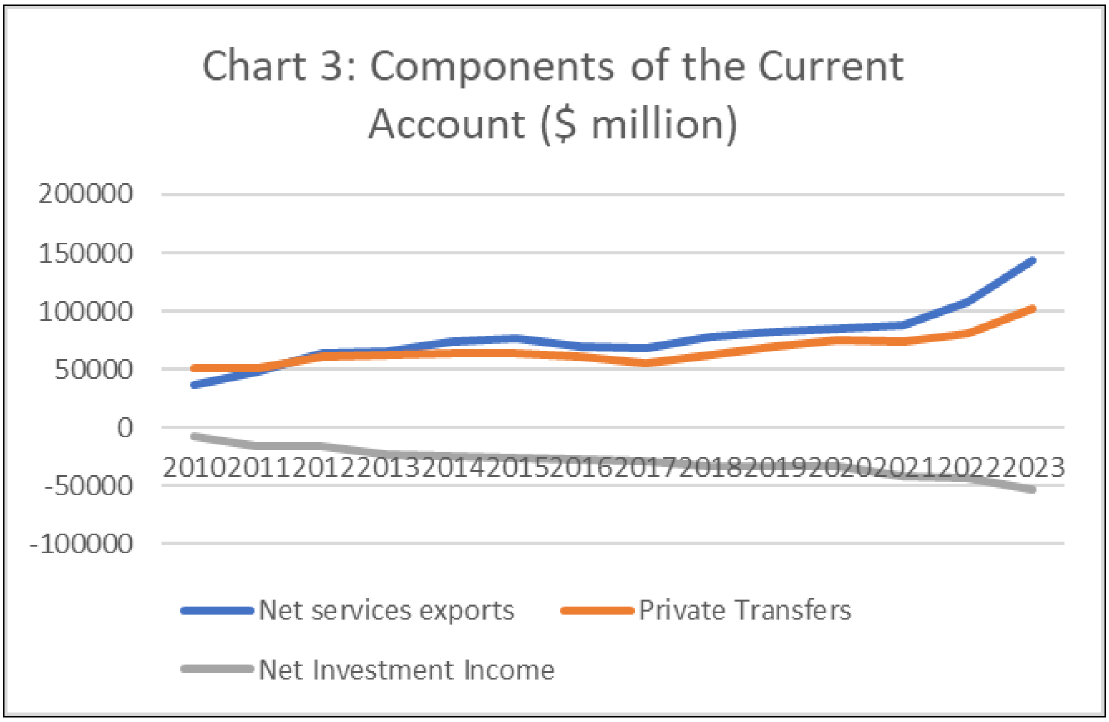
But here too, the role of the sector should not be exaggerated. Foreign exchange earned from net services exports amounted to just 2.1 per cent of the current account deficit recorded in 2023. The equivalent of more than a third of those earnings in that year was exhausted through net investment income payments to foreign investors repatriating surpluses from the country. The absence of caution with regard to the balance of payments effects of foreign direct investment, encouraged in part by earnings from services exports, erodes some of the benefit of those earnings. The outflows of net investment income payment seem to be gathering momentum (Chart 3).

Meanwhile, 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 from the 1980s. 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 dismantled as part of liberalization.

The result is now visible in the growing dependence on imports of computer hardware and the growing 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. In the first quarter of 2023, foreign brands like HP accounted for 33.8 per cent of PC shipments in India, Lenovo for 15.7 per cent, Dell for 13.9 per cent and Acer for 12.3 per cent.

Recent efforts at raising domestic production with subsidies has not helped. Among the 27 companies cleared for support under the production-linked incentive scheme are HP, Dell and Lenovo, which between them control much of 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 important producer of software products, with the Indian market being largely serviced by the likes of Microsoft, Acrobat, Oracle and SAP. As computerization proceeds, these tendencies would intensify, leading to increased foreign exchange leakages through imports, royalty payments and profit repatriation.



Thus, as time goes by, a substantial share of the foreign exchange realized through services exports is likely to leak out, eroding even the balance of payments benefits that the services exports currently offer. It is 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.

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