As services catch up with goods, India needs balance

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India's services exports have of late been catching up with merchandise export. In January this year, the two were almost equalled at over $32 billion each. If the trend persists, this may give some credence to former Reserve Bank of India (RBI) Governor Raghuram Rajan's theory that the country should focus on the growth of services export and not mimic China to become a manufacturing giant – an attack on the government's production-linked incentive (PLI) scheme. However, the question is: will this trend persist once external conditions normalise?

Merchandise exports declined for the second straight month in January year-on-year due to adverse external conditions, while services exports showed a robust growth. While the export of goods declined 6.5 per cent in January on a yearly basis, services were estimated to have risen 49.05 per cent. "Goods exports will be driven by the level of commodity prices, which could continue to display volatility. Services exports will be driven by other factors such as demand for IT exports that may vary over business cycles as well as cross-border travel," ICRA chief economist Aditi Nayar said.

The advantage with services trade for India is that it has surplus in that account, which helps it to contain the current account deficit despite high trade deficit. For instance, though the trade deficit declined to a year low, it was still at $17.75 billion in January. On the other hand, surplus in services trade was at $16.48 billion in the month. This leaves just $1.27 billion in deficit on account of trade in goods and services for the month of January.

Rajan and Pennsylvania State University economist Rohit Lamba had in their article sought to emphasise the difference in economic environment and the nature of polity in India and China to bring home the point why New Delhi should focus on a services-led export strategy. China, they said, grew at a rapid pace initially by suppressing wages and consumption, and keeping borrowing costs in check by lowering the interest paid to households. Over time, China also created a more educated workforce and decent infrastructure and reduced tariffs. The initial part of China's strategy may be difficult and undesirable in a democratic India, they argued.

They believe that India can tap those services that could be exported at a distance by using technology, such as legal and financial advisory, education and telemedicine, provided the country protects privacy of data, reforms its education system, etc.

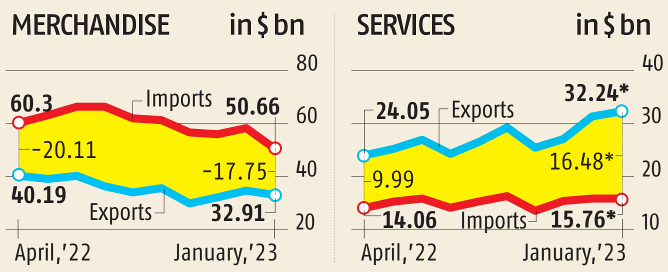
Bank of Baroda Chief Economist Madan Sabnavis said the country has to concentrate on both the components since there are opportunities that have to be leveraged.

"As India widens its manufacturing output, it can be geared to exports. Manufacturing is where most sustainable jobs are created and as we move along this path, we should look at exports as being an engine to fire," he said.

Services are definitely where the country has an edge but there is competition here, too, and therefore taking our feet off one pedal is not advisable, he said.

"At times politics can override this advantage where there can be curbs on outsourcing in different countries," Sabnavis said.

HOW THEY STACK UP



Note: *RBI estimates

Sources: Commerce department, RBI