

Chapter 1

The importance of services in a potential EU–India FTA

Services contribute more than 70 per cent of the EU's GDP and two-thirds of its total employment. For India, the sector accounts for half of India's GDP and its importance as an employer has been growing over time, rising from 20 per cent of total employment in 1995 to 32 per cent in 2003. The same holds true of trade in services, which has also witnessed rapid growth in both economies. Services trade accounts for a fifth of all trade for the EU while for India this share is even higher. Table III.1 summarises these data. It demonstrates how important services are from the perspective of any FTA between the EU and India.

Table III.1. Summary data on the significance of services

Indicator	EU (1995)	EU (2003)	India (1993)	India (2003)
Agriculture, value added (% of GDP)	2.9	1.9	28.2	20.9
Industry, value added (% of GDP)	29.2	26.4	28.1	26.2
Services, value added (% of GDP)	67.9	71.7	43.6	52.9
Employment in agriculture, (% of total employment)	6.3	4.2	66.7	55.7
Employment in industry, (% of total employment)	32.2	28.7	12.9	12.2
Employment in services, (% of total employment)	61.2	66.8	20.3	32.1
Services exports (% of total exports)	20.5	21.8	17.8	28.3
Services imports (% of total imports)	21.8	21.8	21.3	27.4

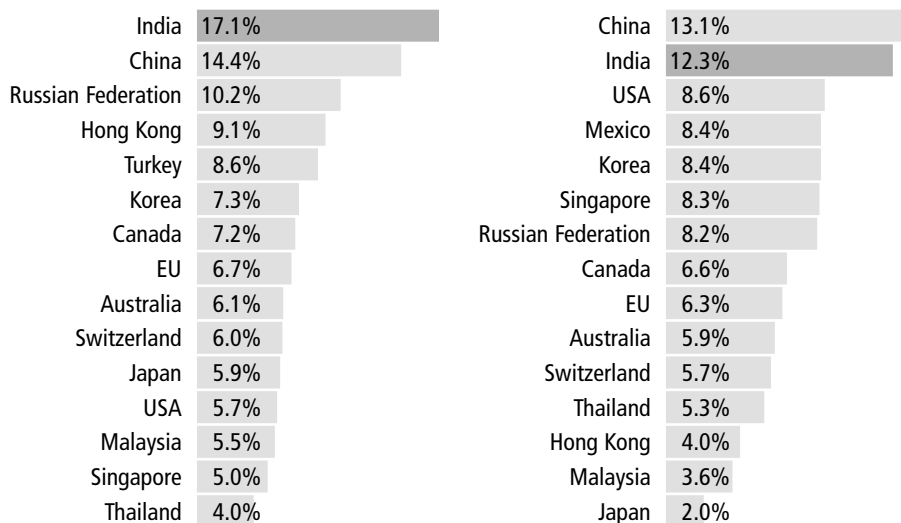
Source: World Bank, WDI online

Looking at services trade more closely, India experienced the fastest growth of services exports amongst the top 15 services exporters in 2003 over the period 1993–2003, with this growth exceeding 17 per cent per annum (see Figure III.1 below). This growth rate is more than two-and-a-half times greater than the growth of EU services exports over the same time period, and is significantly higher than that of the Quad (US, EU, Canada and Japan), China and all major South East Asian economies. The picture is similar for services imports with the exception that China exhibited the fastest growth rate of services imports amongst the top 15 services exporters in 2003, with India in second place. Again, over the last decade, India's services imports have grown almost twice as fast as those of the EU and faster than those of the Quad and all major South East Asian economies. (Gasiorek et al., 2007)

Figure III.1. Top 15 service exporters and importers in 2003

India's service exports have grown fastest over the last decade amongst the top 15 service exporters in 2003

India has the second fastest growing services imports over the last decade amongst the top 15 service importers in 2003



Source: Gasiorek et al. (2007)

Considering next the composition of services trade in these two economies, we find that India's services exports to have changed dramatically over the last decade, both in terms of value (a huge increase of 708 per cent from US\$9.4 to US\$76.2 billion) and structure – see Table III.2 below.

Table III.2. Composition of India's service exports 1997/8, 2006/7

Category (figures in US\$ million)	1997–8	2006–7	Growth rate	% share	
Travel	2,914	9,123	213.1%	31%	12%
Transportation	1,836	8,050	338.5%	19%	11%
Insurance	240	1,202	400.8%	3%	2%
Government services	276	250	–9.4%	3%	0%
Communication	171	2,099	1,127.5%	2%	3%
Construction	101	332	228.7%	1%	0%
Financial	296	2,913	884.1%	3%	4%
Software	1,760	31,300	1,678.4%	19%	41%
News agency	156	334	114.1%	2%	0%
Royalties, copyright & licence fees	21	97	361.9%	0%	0%
Management	549	7,346	1,238.1%	6%	10%
OBS	0	12,390		0%	16%
Other services	1,109	745	–32.8%	12%	1%
Total	9,429	76,181	707.9%	100%	100%

Source: Reserve Bank of India Bulletin 2008; own calculations

The most significant change in export structure has occurred in the share of software services – up from 19 per cent in 1997/8 to 41 per cent in 2006/7. Travel and other services have witnessed the other major changes, wherein shares have come down from 30 and 12 per cent in 1997/8 to 12 and 1 per cent, respectively, in 2006/7⁵⁷. On the whole, five sub-sectors comprise the majority of services exports in India – software, travel, transportation, management and other business services (OBS⁵⁸). These made up more than 75 per cent of all services exports in 1997/8, going up to 90 per cent in 2006/7. In terms of growth rates, software, management and communication services have grown more than 10 times during this period.

Changes in EU-15 services exports, on the other hand, have not been comparable to those of India. In terms of value, services exports increased by 97.5 per cent from US\$560.8 to US\$1107.6 billion, and the structure has not changed by much (see Table III.3 below). Travel, transportation and other business services accounted for 77.5 per cent of all EU-15 services exports in 1996, and 71.6 per cent in 2005. The other sub-sectors make up for the remaining quarter of all EU-15 services exports, and within these, communication, financial and computer-related services have shown appreciable growth rates.

Table III.3. Composition of EU-15 service exports 1996, 2005

Category (figures in US\$ million)	1997–8	2006–7	Growth rate	% share	
Transportation	134.4	238.6	77.5%	24%	21.5%
Travel	171.2	265.7	55.2%	30.5%	24%
Communication	9.1	28	209.2%	1.6%	2.5%
Construction	22.5	23.9	6.7%	4%	2.2%
Insurance	14.4	23.8	65.5%	2.6%	2.1%
Financial	28.5	93.2	227.1%	5.1%	8.4%
Computer-related	9	58.1	544.2%	1.6%	5.2%
Royalties and licence fees	18	46.3	156.5%	3.2%	4.2%
OBS	128.8	289.6	124.8%	23%	26.1%
Personal etc.	5.6	11.5	104.5%	1%	1%
Govt	15.2	20.5	35%	2.7%	1.9%
Services not allocated	4.1	8.5	109.2%	0.7%	0.8%
Total	560.8	1107.6	97.5%	100%	100.9%

Source: OECD Stats Online; own calculations.

While this discussion gives us an idea of the importance of the services sector for the EU and India, a more interesting exercise for the purposes of this chapter is to ask how globally competitive the two economies are in the export of these various services. To do this, we calculate indices of Revealed Comparative Advantage (RCA) for various services sub-sectors within services overall. Given that disaggregated data for services are available only for a few categories at the global level, we calculate the RCA with respect to the total for the OECD countries and India over the last decade⁵⁹.

The RCA indices reported in Table III.4 and Table III.5 below indicate that, as expected, India has a massive comparative advantage in the export of IT services as well as a significant one in exporting communication services, the latter primarily comprising telecoms exports. Both these sub-sectors are largely driven by private enterprise operating on relatively competitive markets. They are also amongst the most-liberalised sectors in the Indian economy in terms of market access to foreign investment. The interesting difference, however, emanates from the extent of state intervention, government policy and regulation in these services. Indian IT is said to have flourished primarily on account of the

Table III.4. EU's RCA Index in Services vis-à-vis (the OECD+India)

Category	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Transportation	1.0	1.1	1.1	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Travel	1.0	1.0	1.0	1.0	1.0	0.9	1.0	1.0	0.9	0.9
Communication	0.9	0.9	0.9	1	1.2	1.2	1.1	1.1	1.2	1.2
Construction	1.2	1.1	1.2	1.2	1.3	1.3	1.2	1.2	1.2	1.2
Insurance	1.2	1.2	1.0	1.2	1.1	1.2	1.2	1.2	1.1	1.1
Financial	1.2	1.2	1.1	1.2	1.3	1.2	1.0	1.0	1.0	1.0
IT	1.2	1.1	1.2	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Royalties	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.6	0.6	0.6
OBS	1.2	1.1	1.2	1.2	1.2	1.2	1.1	1.1	1.1	1.1
Personal etc.	0.8	0.7	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7
Govt	0.7	0.6	0.6	0.6	0.6	0.6	0.8	0.8	0.8	0.7

Source: OECD Statistical Indicators; own calculations.

Table III.5. India's RCA Index in Services vis-à-vis (the OECD+India)

Category	1997	1998	1999	2000	2001	2002	2003	2004	2005
Transportation	0.9	0.7	0.5	0.6	0.6	0.6	0.6	0.5	0.5
Travel	1.0	0.7	0.6	0.7	0.6	0.6	0.7	0.6	0.5
Communication	1.0	2.2	3.3	3.5	2.0	1.8	1.7	1.5	1.3
Construction	0.3	0.4	1.0	1.7	0.4	0.5	0.9	0.6	0.2
Insurance	1.3	0.9	0.7	0.9	0.8	0.6	0.5	0.7	0.8
Financial	0.7	0.4	0.4	0.4	0.3	0.5	0.2	0.2	0.3
IT	10.0	9.1	8.3	11.7	11.0	11.0	10.0	8.2	8.2
Royalties	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.1
OBS	0.4	0.3	0.3	0.1	0.1	0.2	0.2	0.6	0.7
Personal etc.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.2
Govt	0.8	1.3	1.2	1.4	1.1	0.5	0.3	0.3	0.2

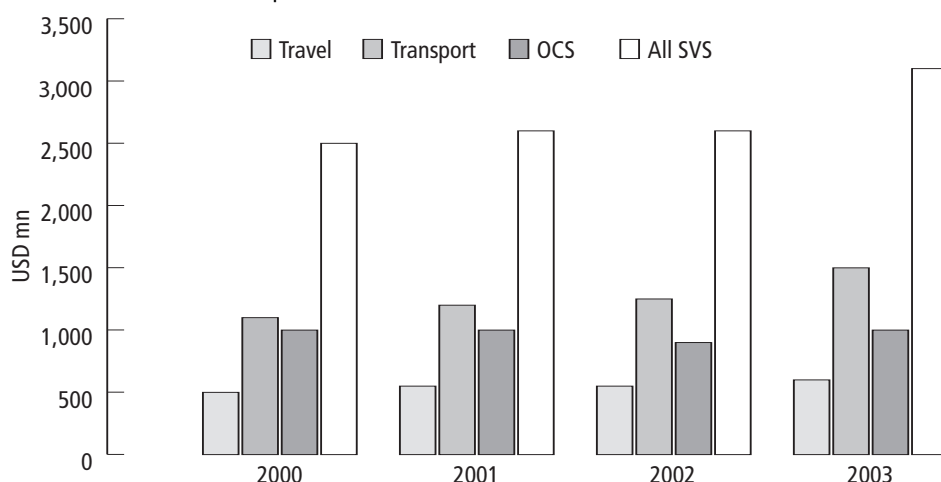
Source: Reserve Bank of India Bulletin 2008, OECD Statistics Online; own calculations.

sector being ‘forgotten’ by Indian policy makers and continues to operate without a regulator even now⁶⁰. On the other hand, India has always had a National Telecom Policy especially in the aftermath of the New Industrial Policy, 1992 and this sector also has an independent regulator in the form of the Telecom Regulatory Authority of India (TRAI). The EU, on the other hand, has an RCA in communication, construction, financial, computer-related (CRS) and other business services (OBS).

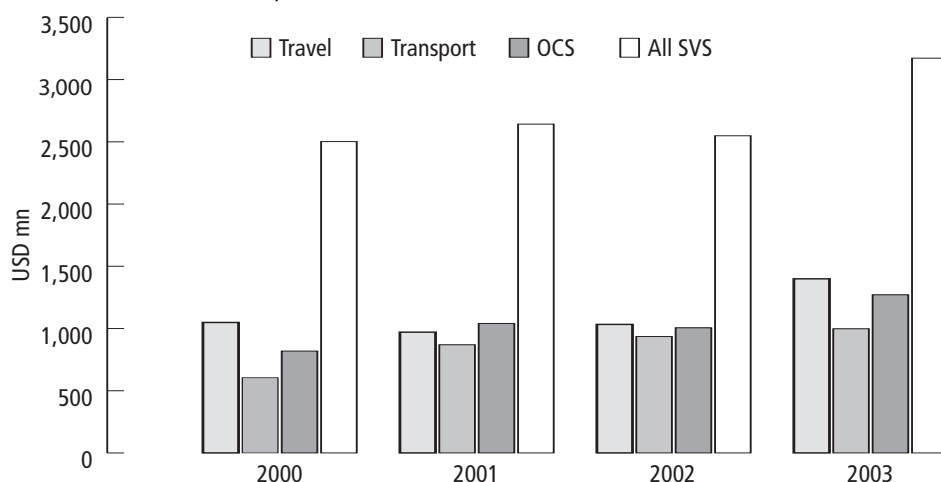
In terms of EU–India bilateral services trade, unfortunately only very crude data are available: they distinguish only travel, transportation and other commercial services (‘OCS’) and, until 2002, the EU data comprise only the 15 Member states. They are shown in Figure III.2. The first chart depicts India’s services exports to the EU and the second India’s imports from the EU.

Figure III.2. EU–India bilateral trade in services

India and EU–15: Services exports



India and EU–15: Services imports



Source: Gasiorek et al. (2007)

The share of other commercial services (OCS) in exports and imports is roughly the same and increasing slightly overtime. India exports more transport than travel services to the EU and these exports have been going up, while the situation is exactly the opposite in terms of India's imports from the EU. As noted above, before 2003, the EU data are based on 15 Member states, but when the 10 accession countries are added in for 2003, it makes little difference: India's services exports to the ten new members are only \$17 million and imports from them only \$25 million.

Putting things in perspective, India's bilateral services trade with the EU both ways is approximately €4.7 billion, which accounts for a fourth of India's global services trade but a mere 1 per cent in the case of the EU. Thus, as for goods, the EU is much more important in India's services trade than vice-versa though India's bilateral services trade with the EU is more important in terms of its relative importance to each trading partner than bilateral goods trade (by way of comparison, India's bilateral goods trade with the EU both ways makes up 18% of India's total goods trade with the rest of the world, but only 0.6% of the EU's total goods trade with the rest of the world).

Notes

- 57 A major reason for the big change in the contribution of other services exports to the total is their coverage – with a more detailed breakdown of services exports available since 2004–05. This category largely comprises unclassified services, while in the preceding period they also included advertising, rentals, office maintenance, prizes, exhibitions and the like. The latter are now clubbed together under OBS.
- 58 The RBI Bulletin provides a more detailed breakdown of services exports since 2004–05 compared to the preceding period. The table therefore reports no value for OBS in 1997–98. OBS is a broad category that includes merchanting, trade-related, operational leasing, legal, accounting and auditing, advertising, research and development, architecture and engineering, agricultural mining, maintenance of offices abroad, environmental, personal, cultural & recreational services and refund and rebates. The two major services categories within these are architecture and engineering and maintenance of offices abroad which accounted for 8% and 3%, respectively, of total services exports in 2006/7.
- 59 The RCA index for a given sector is calculated here by taking the share of a particular sector's exports in India's total exports of services, and dividing this by the ratio of OECD and India's exports in this sector to the total services exports of the OECD and India. An RCA index with value greater than unity indicates a comparative advantage in the sector, while a value less than unity indicates a comparative disadvantage. In this analysis, we need to use the OECD and India as a comparator instead of the rest of the world because disaggregated breakdown of services exports is not available for the rest of the world as for the OECD and India. Thus, the OECD and India is the biggest sample for a comparator that we can have. In any case, the combined services exports of the OECD and India made up more than 75% of global services exports in the last decade.
- 60 For instance, see Joseph, K.J. and Harilal, K.N. (2001), Joseph, K.J. (2002).