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Revealed comparative advantage of India's export trade in services: An analysis

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Abstract

As a matter of fact the growth of Indian Economy is attributable to the dynamism shown by service sector and this sector has been the star performer. The share of service sector in GDP has increased from 17.2% in 1951 to 59% in 2013. Now the cause of the concern is that *can growth of service sector sustain without diversifying India's services export basket?* The present paper attempts to evaluate the growth and performance of India's export trade in services as well as comparative advantage in services at sub sector. Since the study is descriptive in nature therefore in order to achieve the objective of the paper the data have been collected and compiled from various secondary sources. The data have been analyzed by using the technique of revealed comparative advantage and growth rate. The study finds that India's average share of world exports of services was high during post reform period. India enjoys a comparative advantage in exports of communication services and is a leading exporter among the top five exporters in the world in 2005. India has also shown RCA in IT industry but however the RCA in case of computer and information services has been declining.

Keywords: Services, Export, Revealed Comparative Advantage, Growth rate

Introduction

In this era of liberalization, all nations are concerned with increasing the quality of life of their citizens which mainly comes from the macro-economic prosperity. Thus, increasing Gross domestic Product is the most important objective of any economy. As a matter of fact, trade in services is different from trade in goods. Services are invisible, intangible and cannot be stored. As there is simultaneous production and consumption of services therefore services are referred as experience goods¹. Considering the growing significance of service sector particularly in the aftermath of reforms the paper analyses service trade in India, its composition, revealed comparative advantage of various sub sectors of service sector^[2]. The growth of Indian Economy is attributable to the dynamism shown by service sector and this sector has been the star performer and India's exports have grown at a compound annual growth rate of 19.34 % per annum and imports have registered 15.91% growth. The share of service sector in GDP has increased from 17.2% in 1951 to 59% in 2013^[3].

Review of Literature

Different economists like Baumol (1967), Hill (1977), Bhagwati (1984), Gordon and Gupta (2003), Karmakar (2005) have made rich contribution regarding conceptualization of services. Trade in services is fast growing and comprised about 20% of the total world trade in 2001(WTO, 2001). Balassa (1977)^[1]. undertook a study of the comparative advantage pattern of industrial economies for the period 1953 to 1971 using RCA technique, came up with 16 the results that showed, as the diversification of exports tends to increase due to more technological development a setback takes place at higher levels. Moreover General Agreement on Trade in Services (GATS) was formulated in 1995 as the first set of international rules for the international trade in services. The share of services trade as a percentage of total trade in India in 2001 was about 30% which is more than world average (WTO, 2001).

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¹ Conceptualisation of Services, Baumol (1967)

² Burange. *et al.* (2010) "India's Trade in Services".

³ Economic Survey of India 2012-13.

The growth in services exports has been 22.7% and India's comparative advantage in services exports is more than goods and it is increasing (World Bank, 2004). India has comparative advantage in Mode 1 and Mode 4 type of services (Das, 2006). The concept of Revealed comparative Advantage (RCA) was developed by Balassa in 1965 whereas the concept of comparative advantage was used by Ricardo and Heckscher-Ohlin to explain the basis of international trade. Dash (2005) analyzed the economic implications of outsourcing for US and India. Makoto (2007) investigated the comparative advantage of US trade in services by using RCA. Paliwar and Shah (2009) have used various measures of comparative advantage to analyze growth of trade in Indian service sector.

Objective of the Study

The present paper attempts to evaluate the growth and performance of India's export trade in services as well as comparative advantage in services at sub sector.

Research Methodology and Data Issues

Since the study is descriptive in nature therefore in order to achieve the objective of the paper the data have been collected and compiled from various secondary sources. The data have been analyzed by using the technique of revealed comparative advantage and growth rate. Although the service sector occupies prominent place in the world economy but there is lack of proper method of measurement, collection and classification of data in transaction of services. In India data regarding service sector is available at high level of aggregation which is an obstacle for in- depth analysis. The data on direction of trade of services in India is not available. All these limitations restrict the scope of the study. The paper uses two datasets:

- IMF balance of payments data (1980-2007) including transportation services, travel services and Other Commercial Services (OCS). As the services like financial ,legal, computer,insurance etc.are gaining importance therefore these services need attention.
- Fifth edition of Balance of payment Manual (BPM5) comprising of four modes of services in GATS framework.

Attempt has also been made to evaluate India's exports from 1980-2007 and this period has been classified into two categories i.e. pre-reform period (1980-1991) and post-reform period (1991-2007). The annual compound growth rate (ACGR) for the period 1980-2007 is computed as per the log-linear method.

To determine the competitiveness in service trade and to determine whether the sector is globally competitive, the relative competitiveness of services trade will be examined using Balassa's revealed Comparative Advantage ^[4]. Index (1965). According to Balassa, comparative advantage is revealed by the relative export performance of individual product categories.

The RCA index is given by formulae as,

$$RCA_{cg} = X_{cg} / X_c \cdot X_{wg} / X_w$$

Where;

RCA_{cg} = Revealed comparative advantage of country c in product g.

X_{cg} = exports of commodity g by country c;

X_c = total exports of country c.

X_{wg} = world exports of commodity g;

X_w = total world exports.

Accordingly, country c exhibits revealed comparative advantage in the export of good g if RCA_{cg} is greater than one.

India's Export of Services

It is a sorry state of the affair that India's share in the world export of services was very small and it continued to be less than one percent until 1998. In the area of financial services, sectoral level of negotiation took place and various member countries achieved improved commitments with larger scope of participation. It was the period between 1999 and 2006 that India's share in world export of services remained more than one percent and it was 2.71% in 2006 and it fell to 2.65% in 2007 which realized the need for a well-planned approach towards services ^[5]. China's share in world exports of services crossed that of India at 3.3% in 2006 and India was placed at the 10th rank (WTO 2007).

Table 1: The following table shows India's share of world exports of services during pre-reform period and post-reform period.

Period	India's Average share of world exports of services (%)
Pre-reform Period (1980-1991)	0.72
Post-reform Period (1991-2007)	1.21
Total Period (1980-2007)	0.99

Source: IMF Balance of Payments data, Fifth edition of BOP Manual

Clearly India's average share of world exports of services was high during post reform period. Talking about ACGR of India's exports services, it was 12.85% whereas it was 8.56% in case of world exports. The entire growth in India's service exports took place in post-reform period at 19.34 %. The following table shows a comparative study of trend in ACGR of exports of services of India and world during pre-reform period and post-reform period:

Table 2: Trend in ACGR of exports of services of India and World (%)

	Pre-reform period 1980-91		Post-reform period 1991-2007		Total period 1980-2007	
	India	World	India	World	India	World
Transportation	8.39	5.8	12.9	6.92	10.9	6.51
Travel	3.51	11.89	10.8	6.54	8.05	8.48
OCS	0.72	9.62	25.5	10.25	15.7	10.02

Source: IMF Balance of Payments data, Fifth edition of BOP Manual

Although transportation and travel services have seen higher growth in the post-reform period but it is the OCS category which is acting as star performer in the growth of India's exports of services and ACGR in the category of OCS was 15.77 %. During 1980 OCS comprised 30.16 % of India's total service exports but by 2006 this share increased to 77.93 % of

⁵ Burange. *et al.* (2010) " India's trade in services ",The Indian Economic Journal, vol 58, No. 2 July-Sep 2010.

⁴ If the RCA index for a particular service is greater than 1 then it signifies that the country has a revealed comparative advantage of that service.

India's earnings from services whereas OCS contributed 50.74% of total world service exports in 2007 [6]. India enjoys comparative advantage in exports of OCS category as it is more human-intensive sector. Therefore it is the human factor which is contributed India's growth in the service sector.

• Transportation

The trade of goods is largely affected by better transportation services. As per United Nation, transportation includes ship, air and other transport of passengers and goods. In India's total service export in 1980, exports of transportation services did not have any significant share which further declined in 2007 and this decline is due to the growth of OCS category in the export basket of services. During post-reform period this category has experienced high growth as far as India is concerned because increased economic activity has resulted in more trade and use of transportation services. Transportation services did not show any comparative advantage in pre-reform and post-reform period except the period 1994 to 1996. US, Japan and The European Union have combined share of 60 % in 2006 whereas India's share was only 1.22% and china had share of 3.3% as per WTO, 2007. India's RCA index remained less than one for the entire period of study except the period of 1994 to 1996. So far OCS category is concerned, RCA index remained more than one for the most of the period under study.

• Travel

Travel services include collection of goods and services consumed by travelers in foreign countries during their stay of less than one year. India was placed at 65th position out of 130 countries on travel and tourism competitiveness [7]. India has natural and cultural resources and many heritage sites and for this reason as well as for price competitiveness resulting into the fact that the number of foreigners arriving in India has more than doubled between 1991-2007. In spite of this rise, India's share in world tourist arrivals is 0.55 % in 2007.

Table 4: The following table shows the growth of Foreign Tourist arrivals in India.

Year	Growth rate of Foreign Tourist Arrivals (%)	Year	Growth rate of Foreign Tourist Arrivals (%)
1994	13.79	2001	-7.76
1995	15.16	2002	-5.31
1996	8.38	2003	30.07
1997	9.34	2004	24.62
1998	0.71	2005	19.01
1999	5.28	2006	18.07
2000	1.05	2007	12.62

Source: IMF Balance of Payments data, Fifth edition of BOP Manual

Due to faulty government policy and relaxing attitude of Indian Airline Industry, India lost its RCA in the travel category by 1997. India fails to attract foreigners due to poor infrastructure, unhygienic and dirty surroundings (Marcelo, 2003). India has to go a long way which is clear from the fact that number of hotels approved by Ministry Of Tourism is as low as 1437 with a total of 84327 rooms as on December 31, 2007. But India has great potential in providing a variety of travel services due to low cost of highly skilled professionals [8].

⁶ IMF Balance of Payments data, Fifth edition of Balance of payment Manual.

⁷ The World Economic Forum Report, 2008 & UN Service Trade Manual

⁸ Planning Commission, Govt. Of India, 2008

• Other Commercial Services

This category has shown RCA in 21 out of 27 years which the study covers and it is because of the availability of English speaking and cost effective workforce. In India, the manpower cost is almost 1/10 of the developed countries. Due to shift system in India, the companies are able to provide round the clock services to its clients. India has able to provide better results in the IT/BPO sectors due to privatization of the telecom sector and favorable government policies. The countries like China, Mexico, Canada, Philippines and Malaysia can give India competition if essential steps are not taken.

Table 3: RCA Index of India's service Exports (EBOPS Classification)

Services	2000	2001	2002	2003	2004	2005
Transportation	0.55	0.59	0.60	0.58	0.50	0.45
Travel	0.75	0.69	0.63	0.75	0.60	0.48
Communication	3.65	2.28	2.06	1.85	1.84	1.78
Insurance	0.92	0.87	0.66	0.52	1.02	0.96
Computer & information	21.11	20.0	19.9	17.2	16.7	14.5

Source: IMF Balance of Payments data, Fifth edition of BOP Manual

India enjoys a comparative advantage in exports of communication services and is a leading exporter among the top five exporters in the world in 2005 as this sector has shown RCA more than one since 2000. India has also shown RCA in IT industry but however the RCA in case of computer and information services has been declining.

Conclusion

The upshot of the above is that during post reform period india has emerged as a leading services provider and India's growth in trade services has surpassed the growth in world trade. India's success story is led by OCS category and as per EBOPS classification there is unparalleled importance of computer services in india's export basket. Along with OCS india has shown RCA in export of other services also. Therefore india needs to diversify its attention regarding service categories and need of the hour is that quality of services provided to tourists should be improved. The change in the global scene and other economic and political factors are responsible for growth in India's service sector rather than well planned programme or a policy. Without developing a long term perspective India cannot sustain its growth of service sector.

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