

# An Economic Superpower in the making India On The Move In The Fast Lane

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Far-reaching economic reforms have helped India to break free from the shackles of socialist past and burst into the fast lane of economic growth. Globalization has further fuelled its pace. Exim Bank Chairman and Managing Director T.C. Venkat Subramanian, has a ringside view of the working of the economic reforms and their catalytic impact on the overall progress of the country. As an institution, Exim Bank's own role has been exemplary in boosting exports, especially in the IT and ITES sector. Venkat Subramanian takes an analytical look at: The Indian Economy in the Current Global Scenario: Potential and Challenges.

## INTRODUCTION

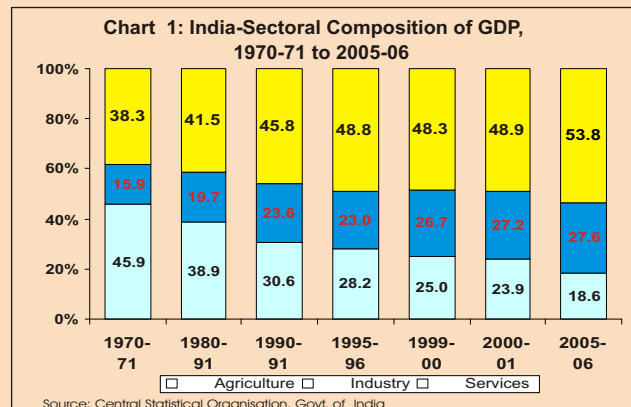
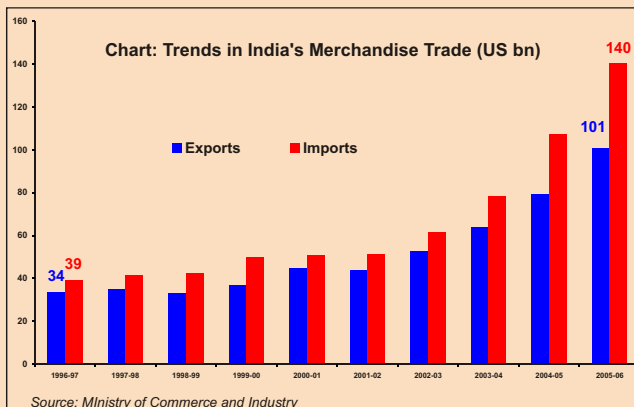
Reflecting strong macroeconomic fundamentals and a policy direction, India today has emerged as a vibrant economy, with growth rate among the highest in the world. The sustained buoyant economic performance, coupled with the enhanced competitiveness, particularly in overseas markets, augurs well for the Indian economy to position itself as a major force in the global scenario. The impressive annual average GDP growth rate of 8.1 percent during the last three years, viz. 2003-04 to 2005-06, has been on account of robust activity in the manufacturing and services sectors, supported by increasing resilience in the agriculture and allied sectors.

On the external front, India's merchandise exports crossed the US\$ 100-billion mark during 2005-06, accompanied by sustained rise in services exports. The increasing globalisation of the Indian economy has been clearly brought out by WTO data wherein India's share in global merchandise trade and service has risen in recent years,

thereby attesting to the increasing external competitiveness of Indian companies. Concomitantly, India is also increasingly emerging as a global investor, with many Indian companies making their presence felt across various regions of the world.

As a result of the buoyancy in India's merchandise trade in recent years, the share of India's foreign trade to GDP, a measure of the openness of the economy, has also witnessed an increase. During the period 1990-91 to 2005-06, the share of exports to GDP has risen from around 5.7 percent to 12.7 percent, and from 7.4 percent to 17.7 percent in the case of imports. Increased activity in domestic manufacturing sector has led to sharp rise in non-oil imports. Despite widening of the trade balance due to strong industrial growth and high global oil prices, however, buoyancy in services exports has limited the impact on the current account balance.

## STRUCTURAL TRANSFORMATION OF THE INDIAN ECONOMY & SERVICES SECTOR



A notable feature of the dynamics of structural transformation of the Indian economy in recent years has been the rising contribution of the services sector (that includes substantial value-added and skill intensive services such as software) to the overall output of the economy. Between 1970-71 and 2005-06, the share of services in GDP increased from 38.3 percent to 53.8 percent (Chart 1). It is important to note that the growth of the services sector has imparted the much needed buoyancy to the overall growth of the Indian economy, particularly during times of adverse agricultural shocks and industrial slowdown.

More importantly, the services sector has emerged as the fastest growing sector in terms of exports, with implications for productivity, employment, trade and fiscal prospects for the economy. This has its reflection in India's services exports, which have risen from US\$ 4.6 bn in 1990 to as much as US\$ 67.6 bn in 2005 (Table 1), with the country emerging as the 10<sup>th</sup> largest services exporter (up from 16<sup>th</sup> position in 2004). In fact, the share of India in global services exports at 2.8 percent in 2005 is much higher as compared to the share in global merchandise exports (0.9 percent). Table 2 presents the trends in share of leading global services exporters during 1990 to 2005.

**Table 1: Leading Exporters in World Trade in Commercial Services (US\$ bn)**

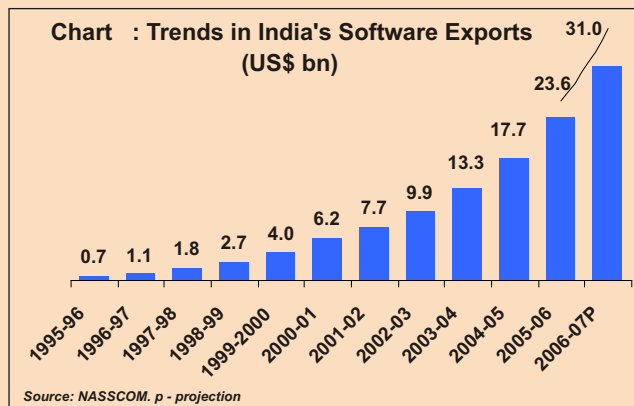
Rank in 2005	Country	1990	2000	2001	2002	2003	2004	2005
1	United States	132.9	277.3	269.1	272.6	282.5	318.3	353.3
2	United Kingdom	53.8	115.0	109.6	123.1	129.5	171.8	183.4
3	Germany	51.5	82.8	86.9	99.6	111.7	133.9	142.9
4	France	66.3	80.3	80.0	85.9	98.0	109.5	113.7
5	Japan	41.4	68.3	63.7	64.9	70.2	94.9	106.6
6	Italy	48.6	56.0	57.1	59.4	72.8	82.0	93.4
7	Spain	27.6	53.2	57.8	62.1	76.4	84.5	91.2
8	China	5.7	30.1	32.9	39.4	44.5	62.1	81.2
9	Netherlands	28.5	48.4	50.1	54.6	64.1	73.0	75.0
10	<b>India</b>	<b>4.6</b>	<b>17.5</b>	<b>20.8</b>	<b>23.3</b>	<b>24.9</b>	<b>39.6</b>	<b>67.6</b>
11	Hong Kong	18.1	38.7	39.4	43.3	43.2	53.6	60.3
12	Ireland	3.3	16.6	23.3	28.1	35.3	46.9	54.7
	<b>Global Exports</b>	<b>819.6</b>	<b>1472.2</b>	<b>1487.2</b>	<b>1561.1</b>	<b>1763.0</b>	<b>2125.0</b>	<b>2415.0</b>

**Table 2: Leading Exporters in World Trade in Commercial Services (% share in global exports)**

Rank in 2005	Country	1990	2000	2001	2002	2003	2004	2005
1	United States	16.22	18.84	18.09	17.46	16.02	14.98	14.63
2	United Kingdom	6.56	7.81	7.37	7.89	7.35	8.08	7.59
3	Germany	6.28	5.62	5.84	6.38	6.34	6.30	5.92
4	France	8.09	5.45	5.38	5.50	5.56	5.15	4.71
5	Japan	5.05	4.64	4.28	4.16	3.98	4.47	4.41
6	Italy	5.93	3.80	3.84	3.81	4.13	3.86	3.87
7	Spain	3.37	3.61	3.89	3.98	4.33	3.98	3.78
8	China	0.70	2.04	2.21	2.52	2.52	2.92	3.36
9	Netherlands	3.48	3.29	3.37	3.50	3.64	3.44	3.11
10	<b>India</b>	<b>0.56</b>	<b>1.19</b>	<b>1.40</b>	<b>1.49</b>	<b>1.41</b>	<b>1.86</b>	<b>2.80</b>
11	Hong Kong	2.21	2.63	2.65	2.77	2.45	2.52	2.50
12	Ireland	0.40	1.13	1.57	1.80	2.00	2.21	2.27
	<b>Global Exports</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

Source: WTO

At the heart of this exceptional growth in services exports lies software exports. The Indian software industry, which has grown at an amazing pace, is a successful player in the international software market and enjoys the benefit of a good reputation, auguring well for future growth. During 2005-06, India's software exports are projected to touch US\$ 31 bn, registering an impressive CAGR of 37.2 percent in the last 10 years. Further, in the services sector, India is at the forefront of the unfolding new area of knowledge economy, with large pool of scientific & creative human resources and R&D facilities.



India has emerged a major computer software provider in the world. India possesses one of the largest pools of scientific and technical manpower in the world which is English speaking, coupled with relatively good quality and low cost of software professionals. Indian software industry is dominated by services, both offshore and onshore.

## POTENTIAL OF THE INDIAN ECONOMY

Recent findings of various reputed international institutions, such as AT Kearney, World Economic Forum, among others, corroborate the potential of India in the emerging global trade and investment configuration. Not only does India figure among key economies, but India's standing among potential and emerging economies has also improved, reflecting the strong economic fundamentals and attractiveness of the economy.

### Potential as an Investment Destination

The Indian economy is now well recognized as an attractive destination for investment and a large and growing market for business, and India's ranking in this regard has also improved in recent years. For instance, India's ranking in AT Kearney's FDI Confidence Index moved up one notch to second position after China in 2005, ahead of US, UK, Poland and Russia, while India is the leading economy as regards AT Kearney's 2006 Global Retail Development Index, ahead of Russia, Vietnam, Ukraine, China and Chile, an indication of the country's large and growing retail market.

The above findings are validated by the recent Global Competitiveness Report 2005-06 of the World Economic Forum, wherein India's Global Competitiveness Index has

risen five notches to 50 in 2005, to stand above Poland, Mauritius, Egypt, Mexico, Brazil and Russia. Underlying this upbeat trend is the Business Competitiveness Index wherein India's ranking at 31 stands much higher than those for Thailand (37), Italy (38), Brazil (49) and China (57).

More recently, IMD World Competitiveness Yearbook 2006 has ranked India at 29 in the World Competitiveness Ranking, representing a significant rise of 10 places from that in 2005. As a result, India's ranking in 2006 is higher not only as compared to other emerging economies such as Czech Republic (31), Thailand (32), Slovak Republic (39), but also higher than major industrialised economies such as Scotland (30), France (35), Spain (36), and Greece (42).

## Emerging Indian Multinationals

The increasing trend in India's overseas investments attest to the increasing capability of Indian companies in venturing overseas. India's approved overseas investments have increased by more than five-fold from US\$ 556.6 mn during 1996-97 to US\$ 2.80 bn during 2004-05. At the same time, actual overseas investments have also risen nearly eight-fold from US\$ 204 mn to US\$ 1.60 bn during the same period.

The surge in investment outflows from India witnessed in recent years would attest to the expanding base of domestic firms, which are able to compete globally, reflecting increasing quality and cost competitiveness to sustain long-term domestic and international growth. Focus on core competencies, increased R & D efforts and enhanced technological know-how have underlined this development. At the same time, access to markets, natural resources, distribution networks, foreign technologies and strategic assets like brand names have motivated Indian companies to increasingly look outward in their endeavours to internationalise their operations. Further, the shift in the pattern of financing overseas investment, from equity outflows from the host country towards re-invested earnings, is an indicator of the increasing confidence of Indian firms in internationalisation. Indian enterprises are also increasingly using mergers and acquisitions (M&As) to venture overseas.

While globalization of the world economy has fostered the outward orientation of Indian companies, significant policy liberalisation and renewed support in recent years have provided the impetus in this direction. Removal of ownership restrictions in overseas ventures, introduction of automatic clearance route wherein the limit of overseas investment has been continuously enhanced, among others, have facilitated the recent surge in Indian overseas investments.

## GLOBALISATION OF THE INDIAN ECONOMY AND EXIM INDIA'S ROLE

Providing a comprehensive range of products and services to Indian companies in their internationalisation efforts has been the primary objective of Export-Import Bank of India (Exim India). The pivotal and catalytic role the Bank plays in facilitating and promoting India's project exports, supporting Indian firms in setting up joint ventures and

wholly owned subsidiaries in overseas markets, providing advisory and support services to outward-oriented Indian firms, among others, constitute the Bank's endeavours in this direction.

Over the past two decades, increasing number of contracts have been secured by Indian companies in West Asia, North Africa, Sub Saharan Africa, South & South East Asia, CIS and Latin America, with the support of Exim India. These projects facilitate and support infrastructure development in host countries, thereby contributing to overall economic development. The range of project exports now being undertaken by Indian project exporters is a reflection of the technological maturity and industrial capabilities in the country. This serves to indicate the growing sophistication of Indian exports providing visibility to the Indian technical expertise and project execution capabilities in overseas markets.

With a view to catalyze globalization of Indian businesses, to enhance credibility and acceptability of Indian ventures overseas, and to facilitate trade-flows between India and host countries, Exim India actively supports Indian companies to set up joint ventures/wholly owned subsidiaries in target market overseas, both in industrialized and emerging economies, in diverse sectors. These overseas ventures facilitate value addition, contributes to capacity building and capability creation in host countries.

### **India's Software Exports and Exim India**

With India having emerged as a major global software provider, and the robust growth in software exports witnessed in recent years, it would be appropriate to highlight the role of Exim India in this regard. Exim India has been associated with the development of the Indian software industry since 1986. The Government of India, in its first ever policy formulation for software exports in December 1986, designated Exim India as the principal agency through which imports of computer hardware and allied services could be financed in foreign currency.

Exim India has in place a financial package for software exporters to comprehensively address their financial requirements, which encompass term loans for capital expenditure, equipment finance to cover the costs of acquisition of advanced computer systems with related software, project finance for the setting up or expansion of software development facilities, and working capital finance to software exporting units. In order to support the industry move up the value chain towards products, Exim India has in place a programme for financing software product development, as also for financing R&D by software exporting companies for a range of activities including setting up of R&D centres, development of new tools and technologies.

Exim India provides financial support to software companies for implementing strategic export marketing plans aimed at developing/ enhancing presence in identified target markets, and also supports software exporters in securing international quality certifications

such as ISO 9000, TickIT, various levels of CMMSEI which would enhance their credibility and dependability in overseas markets. Further, the Bank provides term loans to Indian companies to part finance their equity contribution in ventures overseas. With a view to meeting the growing requirements for trained manpower, the Bank also has in place a lending programme for setting up/expansion of software training institutes by established software exporting companies.

### **Exim India and Grassroot Enterprises**

In line with the roadmap for India's international trade, set in place by the Foreign Trade Policy 2004-2009, which envisages effective contribution of international trade to overall economic development by providing special thrust on employment generation particularly in semi-urban and rural areas. Exim India, as part of its agri business initiative, has been endeavouring to assist exports of products from rural and small and medium enterprises (SMEs). Towards this end, Exim India has partnered with select NGOs in different states, in order to provide an institutional support mechanism for providing international market access to products from rural grassroot enterprises.

### **GLOBALISATION AND CHALLENGES**

Building competitiveness and sustaining it is a high priority both for developed and developing countries. With increasing globalisation, Indian companies will have to continuously adapt themselves to successfully counter increasing competition. Alongwith foreign competition, domestic demand will shift to better quality products, reducing the market share of Indian companies. Given the dynamic changes characterizing key export industries and the rising competition among countries, the need to continuously move up the value chain and improve the attractiveness of locational advantages is a challenging task for policy makers in developing countries.

Many Indian firms already enjoy a preeminent position in several products. These firms have excelled in quality and cost competitiveness to sustain long-term domestic and international growth. Therefore, in order to face increased domestic and global competition, it is imperative for firms to concentrate on core competencies, and gear R&D efforts and technological know-how towards this end.

Meeting challenges on the policy front also assumes importance in a global economy. The effectiveness and efficiency of firms is facilitated by the nature of policy environment under which firms operate, and whether macro-economic policies allow them to achieve the requisite economies of scale and allocative efficiency in production. In an increasingly inter-connected global economy, it is imperative to ensure that macroeconomic policies are geared towards reducing uncertainties and risks. This would require ensuring internal and external stability in the economy through maintaining sustainable policies and putting in place a proper safeguard system against adverse international shocks and limiting exposure to risks.