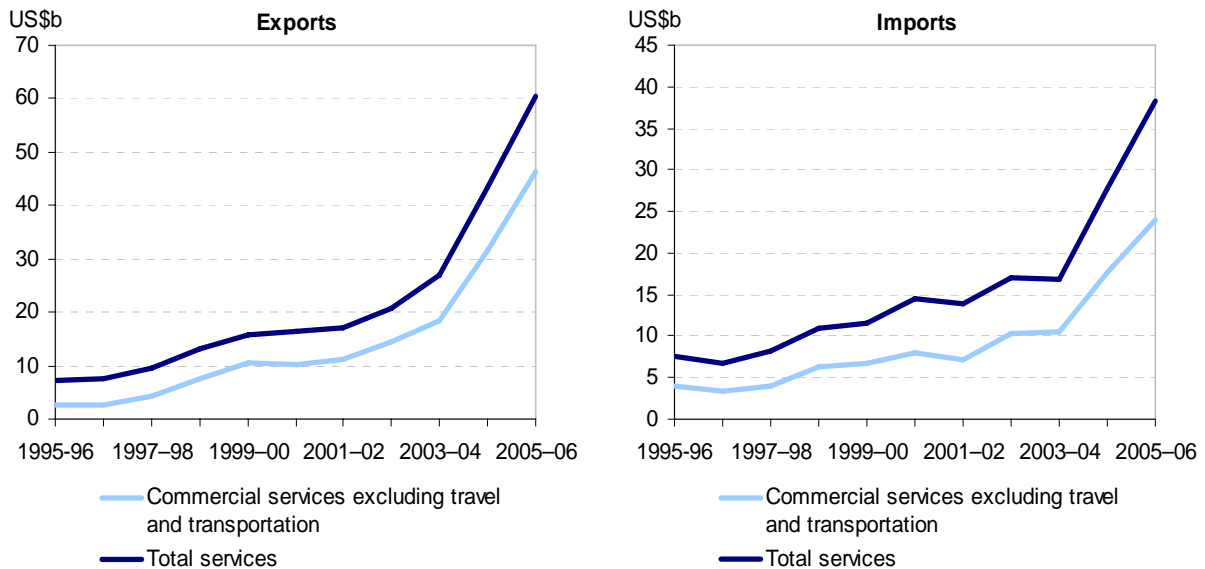


## India's services-led growth: emerging opportunities for Australian services providers

India's booming information technology (IT) and IT-enabled services sector has grabbed the headlines as the country's economic growth has surged. But as a new report from the Economic Analytical Unit points out, India's growth, if sustained, could offer opportunities for Australian services providers across a wide range of sectors, if they are prepared to think strategically and take a long-term perspective.

Figure 1: India's services trade



Note: 2005-06 data are provisional.

Sources: RBI 2005a for 1999-00 to 2005-06 data; RBI 2005b Table 146 for pre 1999-00 data.

Optimism abounds in India. Entrepreneurial spirit was unleashed by wide-ranging liberalising reforms that commenced in 1991. Traditional annual GDP growth rates of around 3.5 per cent are an increasingly distant memory. The Indian economy has shifted to a much faster growth trajectory, led by the dynamism of its services sector – particularly high-end, knowledge-intensive services exports. As India's exports of business services have exploded, so have its imports, reflecting a fundamental change in the way services are produced and delivered worldwide (**Figure 1**).

Essentially, economic activity in this area is mirroring familiar developments in the manufacturing sector. Production is becoming more fragmented. Specialised activities are taking place in diverse locations, resulting in a rapid increase in international services trade. India, with its strong IT/IT Enabled Services (ITES) sector has been a prime beneficiary, and this has been reflected in two-way trade, including with Australia.

Accordingly, Indian demand for Australian commercial services exports continues to grow rapidly, while our coal and gold are helping to fuel its fast-growing economy. Total bilateral trade exceeded \$10 billion for the first time in 2005-06, underpinned by \$7.4 billion of Australian merchandise exports and \$1.4 billion in Australian services exports to India. With a 23.2 per cent trend growth rate over the past five years to 2005-06, India has been Australia's fastest-growing services export market after China.

If much of the international commentary is to be believed, India has embarked on a long-term growth path. A chorus of recent long-term projections, citing India's growing workforce and the scope for it to increase productivity dramatically through technological 'catch-up' with the West, suggest that India could outperform all of the world's major economies over the next fifty

years.<sup>1</sup> By 2050 in market exchange rate terms, it could be the third largest economy in the world by a significant margin, trailing only China and the United States.

The realisation of these rosy projections is dependent on factors that cannot be plausibly predicted, such as the ongoing willingness and ability of Indian governments to sustain a reform program over long periods; the health of the international economy; new developments in technology; and the shape of the international trading system. And, as in any economy, there are likely to be hiccups along the way. Yet successful pursuit of India's current, services-led growth path toward the projected giant economy of 2050, taken together with a continuation of current developments in China, would profoundly shift the world's economic centre of gravity. And importantly for Australia, it would open a range of new opportunities for Australian services providers (SPs). This begs the question: how *might* it happen?

**India's services boom: a catalyst for sustainable growth?**

India has pursued an unusual growth path. Whereas the East Asian economies' success has largely been built on the development of export-

oriented manufacturing, India's recent growth has been driven by high-end, knowledge-intensive services exports. The rapid expansion of Information Technology and IT Enabled Services (IT-ITES) in India has garnered worldwide attention.

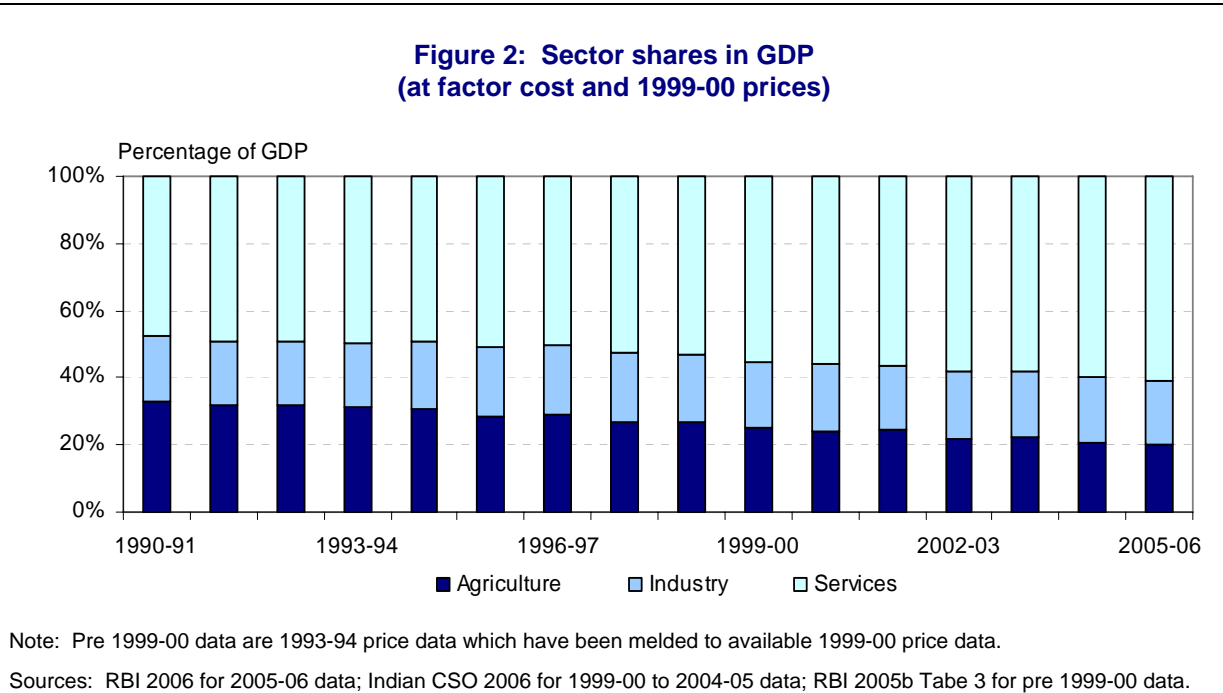
Services have consistently grown at a faster pace than the economy as a whole since 1991, when the reform effort was kicked off in earnest. They now occupy some 60 per cent of India's GDP, based on the WTO definition of services which includes construction (**Figure 2**). Manufacturing, by contrast, has maintained a stubbornly static share in the economy at around 20 per cent, while that of agriculture – still far and away the largest employer – has dwindled. Productivity growth in India, unlike virtually all other regions of the world, has been strongest in services.<sup>2</sup>

This is not to say that developments in other sectors are unimportant; nor that the profile of India's economy will remain static over time. There are already, for example, signs of an acceleration in the growth of India's manufacturing sector. But to date, it has been services that have led the way; and their sheer size within the economy means they will continue to have a critical role.

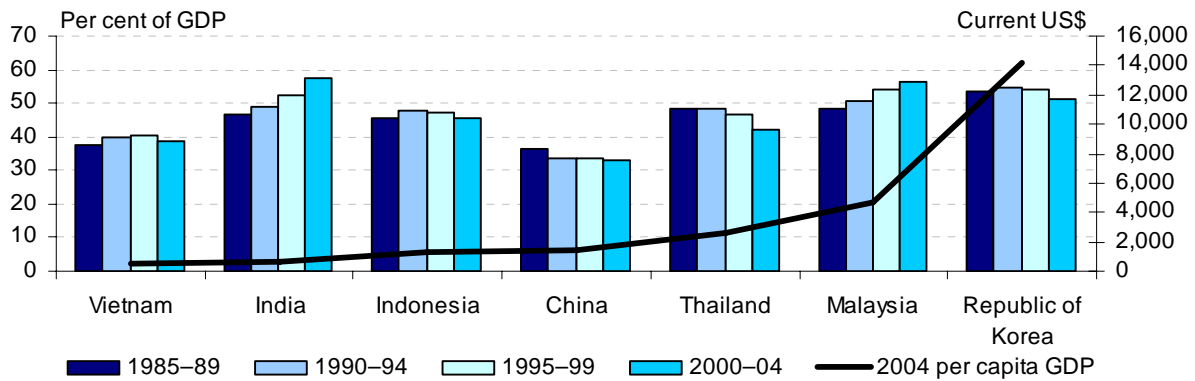
The services-dependent profile of India's economy is much closer to that which has typically been associated with middle-income developing countries (**Figure 3**). Yet in terms of per capita

<sup>1</sup> See for example, Goldman Sachs 2003, Dreaming with BRICs: The Path to 2050, Global Economics Paper No: 99, available at [www.gs.com](http://www.gs.com); Pricewaterhouse Coopers 2006, The World in 2050: How Big will the Major Emerging Market Economies Get and How Can the OECD Compete?, available at [www.pwc.com](http://www.pwc.com).

<sup>2</sup> International Monetary Fund (IMF) 2006, World Economic Outlook: Financial Systems and Economic Cycles, September 2006, available at [www.imf.org](http://www.imf.org).



**Figure 3: Services as a proportion of GDP (five year averages) and 2004 per capita GDP in selected Asian economies**



Notes: Services to GDP data are at constant prices in US dollars. 2004 services to GDP data for Thailand and Malaysia are not available. Pre 1999-00 services to GDP data for India are 1993-94 price data, which have been melded to available 1999-00 price data.

Source: United Nations Statistics Division 2006 for services to GDP data; Indian CSO 1999-00 to 2004-05 for services to GDP data on India; RBI 2005b Table 3 for pre 1999-00 for services to GDP data on India; IMF World Economic Outlook Database 2006 for 2004 per capita GDP data.

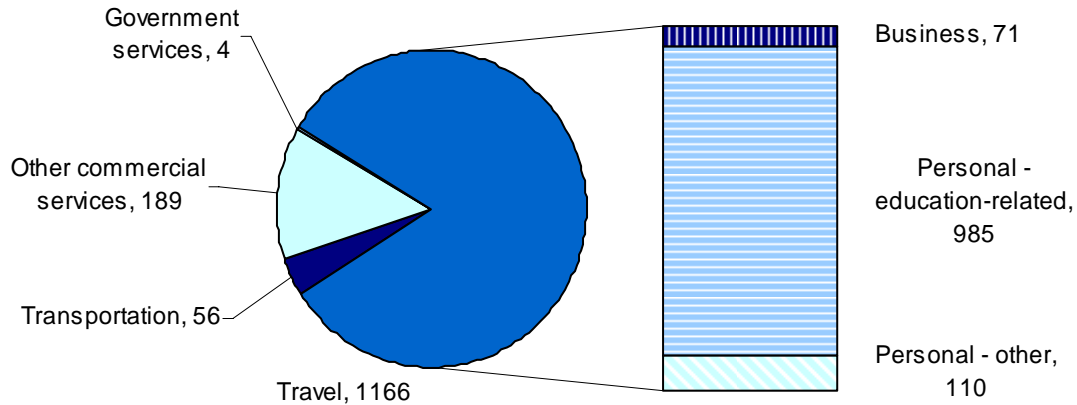
income India remains a poor country, with a huge and growing, but relatively low skilled, rural working class. The creation of vast numbers of appropriate jobs will be key if the reformist approach that has led to India's recent growth to be politically sustainable in the medium to long term. The key question for India therefore is whether the services-led growth – which to date has mainly been driven by very rapid expansion of what remains a relatively small part of the economy, particularly in employment terms – can feed into broader economic development and consequently to job creation on the necessary scale.

In the minds of many participants in the Indian economy, there is a plausible route by which services-led growth could continue to be a catalyst for India's economic growth. Put simply, this would involve growth of dynamic services export sectors such as Information Technology–Information Technology Enabled Services (IT–ITES), and the income that growth brings to the country, providing a major stimulus to domestic demand – both for production inputs and facilities, and for consumer products as rising incomes in the boom industries feed increased consumer demand. This should, in turn, catalyse reform and growth in other sectors –including construction, telecommunications, transport and power infrastructure financial services, education services, professional services, manufacturing, retail, hotels and restaurants. It is the consequent growth in these other sectors, particularly manufacturing, which might be expected to provide the bulk of the required jobs over time.

High-end, knowledge-intensive services such as IT–ITES are, and will continue to be, critical in attracting foreign investment, fuelling aggregate demand. Increasingly, these services are also assuming importance for the productivity-enhancing inputs they provide for other sectors of the Indian domestic economy. But within an overall framework of services-led growth, other services sub-sectors have important roles to play. A modern economy demands, for example, an efficient telecommunications infrastructure; adequate transport and power infrastructure; sophisticated financial intermediation; and an education system capable of supplying sufficient skilled labour.

Reform measures within these 'enabling' sub-sectors vary considerably. Foreign investment in banking and insurance remains heavily constrained, despite significant changes in the financial sector. Railways, roads, airports, and the power sector each impose constraints on growth, although reform and modernisation are under way. Some business services important to facilitating growth – such as legal and accountancy services – remain largely protected from foreign competition, as does the retail sector. As reform and growth continues in other areas, these and other sectors can be expected to come under further pressure to deregulate and modernise. Over time, such change will give rise to large-scale requirements for skills and capabilities that may not currently be available in sufficient quantities in India.

**Figure 4: Breakdown of exports of services to India 2005-06 (A\$ million)**



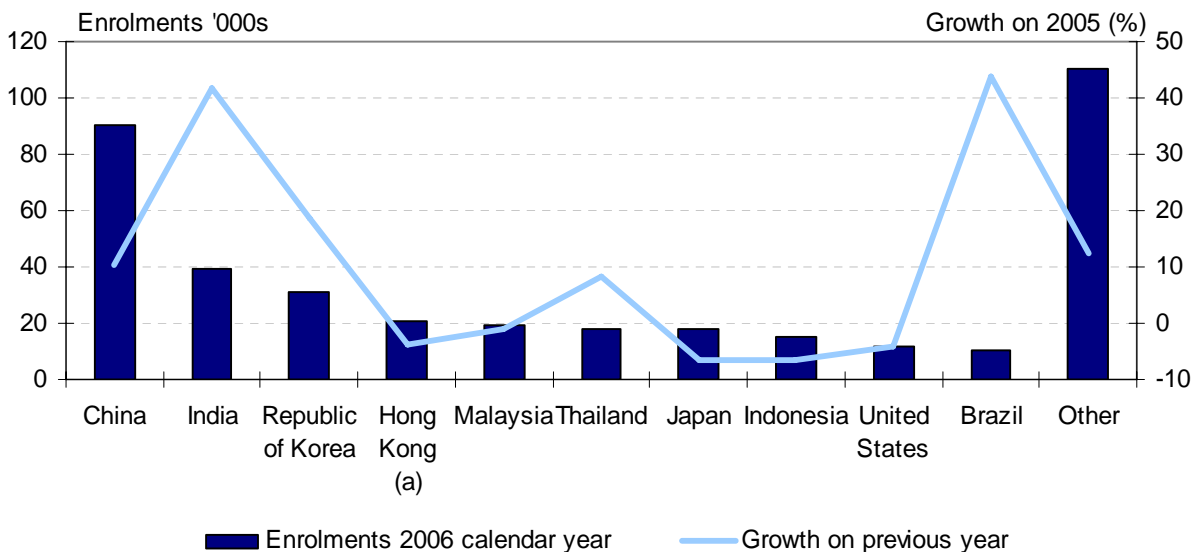
Source: ABS 2005b.

### Opportunities for Australian services providers

Australian services providers have already begun to capitalise on India's economic emergence. Australia currently runs a significant surplus in services trade in India, dominated by education exports – a direct spin-off from India's rapid growth (**Figure 4**). India is now the second-largest source country for international student enrolments in Australia (**Figure 5**). Visitor

numbers from India have grown rapidly in recent years. And Australian companies are taking advantage of emerging export opportunities in engineering, infrastructure design, healthcare and mining services. But the range and extent of changes that are foreseeable in the Indian economy as it develops over time suggest that Australian services providers should also be looking to a number of other sectors in considering how they might participate in India's ongoing growth.

**Figure 5: Australia's top ten markets for international student enrolments for the 2005 calendar year, and growth on previous year**



(a) Special Administrative Region of China.

Source: Australian Education International, Department of Education, Science and Training.

In relation to IT–ITES, India's role in creating and leading a 'tradability revolution' in services merits strong attention from Australian business. The most commonly highlighted aspect of this phenomenon has been the trend towards business process outsourcing and 'offshoring' of services to India. Despite high levels of publicity for the relocation of corporate functions to India by some major companies, the balance of bilateral services trade is firmly in Australia's favour

India's imports of business services are skyrocketing (**Figure 1**), as services production becomes more fragmented and specialised activities take place in diverse locations around the globe. Australia has very real strengths in this area and is well placed to participate in emerging services production networks – particularly in high-end services such as Information and Communications Technology (ICT)-enabled research and analysis.

Indian companies have made substantial investments in Australia's services sector, most notably in IT. While a key focus of the dozens of Indian IT companies operating in Australia is the provision of IT solutions to local companies, a number of these companies are also using their Australian subsidiaries to secure or help take advantage of global market opportunities – leading to high-quality employment opportunities for Australians. As the trend to deliver services through international networks develops, cooperation and collaboration between Australian and Indian firms to service third markets could expand to the benefit of both countries. It will be important for Australian companies to understand the export opportunities created by complementarities between Indian and Australian SPs in this area.

Australian companies also have significant expertise that could augment India's capabilities or meet India's needs in other areas, including infrastructure development and related consultancy services; telecommunications; financial services; tourism and travel-related services; film and television; sports and related infrastructure, particularly in the context of New Delhi's hosting of the 2010 Commonwealth Games; healthcare services; biotechnology; mining services; retail and logistics; and legal and accountancy services.

Perhaps the most striking example, however, is that of education and training. In 2006 there were more than 39,100 Indian student enrolments in Australian educational institutions (principally at tertiary level), an increase of 42 per cent on 2005. This relationship is growing rapidly and, given the skills India's development is likely to demand, there is ample scope for it to continue to grow in

the medium term – particularly as institutions take the opportunity to diversify their approaches to provision of education and training, including through the establishment of operations offshore and distance learning programs.

## India's business environment

The pattern of knowledge-intensive service-driven development which has been embarked upon by India could conceivably feed into broader economic development. That said, the jury will remain out for some time on whether the benign scenario of ongoing growth – and particularly increased employment across the Indian economy – will come to pass. Many other less optimistic scenarios are also possible. Work by the World Economic Forum in collaboration with the Confederation of Indian Industry, for example, produced three possible scenarios for the future of the Indian economy, only one of which leads unequivocally to strong growth and broad-based development – and one of which leads equally unequivocally in the opposite direction.<sup>3</sup>

The key question will be the ability of successive governments to sustain the momentum of reform. The success of reform in generating growth to date appears to have engendered a critical mass of political opinion that is in favour, in principle, of ongoing reform. But the devil, as always, is in the detail. Much can be, and has been, achieved through low-profile, administrative measures. However, achieving major necessary reforms remains difficult, particularly in flagship areas such as labour policy, privatisation, and foreign participation, whether through trade or investment.

While India presents as a potentially attractive market for many Australian businesses, it also poses significant challenges, especially for smaller Australian companies. Success demands significant investment of time and effort in understanding the business environment, and the tenacity and resilience to overcome setbacks or delays. Key challenges include power and transport infrastructure shortcomings, and barriers and burdens that exist both formally in the regulatory framework and informally in the way it is administered. Increasing automation of transactions; reduction in bureaucratic discretion over licences and permits; and the activities of a free, vocal and critical media have improved transparency for business, but feedback from businesses active in the Indian market continues to suggest that issues remain.

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<sup>3</sup> World Economic Forum (WEF) 2005, *India and the World: Scenarios to 2025*, presented by the World Economic Forum and Confederation of Indian Industry, available at [www.weforum.org/en/initiatives/index.htm](http://www.weforum.org/en/initiatives/index.htm).

Australian companies do nonetheless enjoy a degree of benefit from favourable Indian perceptions of their country. Indians perceive Australia as a safe, relatively reasonably priced and friendly destination for their children's education. English is widely spoken. Cricket, too, is a common factor, whose capacity to engender fellow-feeling should not be underestimated. There are significant people-to-people links, through migration and education, which represent

a potential asset when it comes to exploiting trade and investment opportunities. Recent efforts to broaden the base of the business relationships by federal and state government-led business missions to India have also helped raise Australia's profile and improve Indian awareness of Australian capabilities and expertise in a number of areas.

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*This article is an edited excerpt from the latest report by DFAT's Economic Analytical Unit launched in Melbourne on 14 March 2007.*

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### **INDIA'S SERVICES SECTOR: Unlocking Opportunity**

Optimism abounds in India. Entrepreneurial spirit was unleashed by wide-ranging liberalising reforms that commenced in 1991. The Indian economy has shifted to a much faster growth trajectory, led by the dynamism of its services sector – particularly high-end, knowledge-intensive services exports. Studies by a number of prominent analytical organisations are now projecting that India could outperform all of the world's major economies over the next fifty years. By 2050, it could be the third largest economy in the world by a significant margin. Such developments would profoundly shift the world's centre of economic gravity.

The report does not seek either to substantiate or to disprove these rosy projections. Instead we ask: *How might it happen?* Is there a plausible path from today's India to the projected giant economy of 2050? What opportunities might successful pursuit of that path generate for Australian services providers? And finally, what factors need to be taken into account along the way as Australian companies consider whether they should be seeking to participate directly in India's growth?

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