INDIA'S TRADE IN FINANCIAL SERVICES: A DECADAL STUDY

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Abstract

Financial Services are defined as a bundle of intangible utilities aimed at satisfying the needs of users. Financial Services bridges the gap between savers and those who need funds. The service sector in India has been witnessing a boom in recent times. In addition to the strong growth in ITES, the Indian financial services sector is considered to be stable and progressive, and has been a major beneficiary of India's growth story. The growing attractiveness of the financial services has triggered the entry of global majors. Aggressive plans of incumbents coupled with the entry of new players are expected to further drive the growth of sector. Liberalization, privatization and Globalization have further strengthened the financial services in India. The Financial Services sector in India has emerged as a mature and sophisticated system which is inherently strong, functionally diverse and displays efficiency and flexibility. This is a sector which is further expected to witness increasing consolidation, sophistication and maturity in future. As compared to other developed markets, the Indian financial services sector is largely under penetrated with a huge potential for growth keeping in consideration government thrust on liberalization on one side and rising income, increasing awareness of financial products, strong equity market growth on the other. Indian Financial Services sector provides very promising investment for global investors. The current paper is aimed to study India's trade in financial services from the year 2000-2010. An attempt will be made to present the trade patterns in financial services in the said decadal period with the help of the statistical methods like CAGR(compound annual growth rate).The current paper is aimed to study India's trade in financial services from the year 2000-2010.An attempt will be made to present the trade patterns in financial services in the said decadal period with the help of the statistical methods like CAGR(Compound Annual Growth Rate).

Keywords: Financial services, Economic growth, CAGR, Foreign trade.

Introduction:

India is among the fast growing economies of world and services sector has been a major contributor to India's GDP and growth. India's trade in services has increased overtime and services account for the largest share in India's FDI inflows and outflows. Unlike other countries, where economic growth has led to a shift from agriculture to industries, in India there has been a shift from agriculture to the services sector. In fact, today, services sector in India represents an essential component of competitive and knowledge-based economy accounting for 57.2% of GDP. Although there are other emerging markets where the share of services in GDP exceeds the share of manufacturing, India stands out for the size and dynamism of its service sector. The service sector in India has been witnessing a boom in recent times. In addition to the strong growth in IT/ITeS, the Indian financial services sector is considered to be stable and progressive, and has been a major beneficiary of India's growth story. The growing attractiveness of the financial services has triggered the entry of global majors. Aggressive plans of incumbents coupled with the entry of new players are expected to further drive the growth of the sector. The financial services sector is composed of users and providers of financial services and the government agencies that regulate them. Financial services can be categorized into two groups, namely fund based activities and non fund based activities. Fund based activities are those where there is involvement of funds like underwriting, portfolio management, venture capital, private equity, structural finance etc. Non funds based financial services are those where intellectual property is used and advices are offered. A fee or commission is charged for rendering services. Financial Services are defined as a bundle of intangible utilities aimed at satisfying the needs of users. The bundle of institutions that make up an economy's financial system can be seen as "the brain of the economy", providing the bulk of the economy's need for many functions. Financial Services bridge the gap between savers and those who need funds. A financial service is useful in identification of resources for efficient allocation, providing constant evaluation of allotted resources and providing liquidity to investors. The financial services sector plays a critical role in any modern economy. Financial services are key inputs in the production of all that a nation produces, brings to market, and trades in, whether goods, ideas, and services. The Financial Services sector in India has emerged as a mature and sophisticated system which is inherently strong, functionally diverse and displays efficiency and flexibility. This is a sector which is further expected to witness increasing consolidation, sophistication and maturity in future. As compared to other developed markets, the Indian financial services sector is largely under penetrated with a huge potential for growth keeping in consideration government thrust on liberalization on one side and rising income, increasing awareness of financial products, strong equity market growth on the other. In Financial year '09 the contribution of financial services sector to India's GDP was 15% which is the second-largest component after trade, hotels, transport and communication all combined together (FICCI 2010). Indian Financial Services sector provides very promising investment for global investors. Since the beginning of reforms in 1991, major reform initiative has been taken in the field of investment, trade, financial sector, exchange control simplification of procedure etc. India's share of services exports in the world exports of services, which increased from 0.6 percent in 1990 to 1.0 in 2000 and further to 3.3 percent in 2011, has been increasing faster than the share of merchandise exports in world exports (India budget.nic.in).Among the top 15 countries with highest overall GDP in 2011, India ranked 9th in overall GDP and 10th in services GDP. A comparison of the services performance of the top 15 countries in the eleven-year period from 2001 to 2011 shows that the increase in share of services in GDP is the highest for India (8.1 percentage points) followed by Spain (UN National Accounts Statistics ,2013). Rupa Chanda conducted a study in 2005 and found that liberalization of financial services across countries has in turn been prompted by the growing recognition of the need to have an efficient and globally competitive financial sector with international practices and standards, and a high quality and wide range of financial services that enables efficient intermediation of financial resources. Another study finds that liberalization, privatization and globalization have further strengthened the financial services in India (Sudha et al, 2010).

Statement of the problem:

India is mainly an importer of financial services, mainly through the mode of commercial presence. Thus, most of the constraints to India's trade in financial services are in terms of domestic policies that limit foreign participation in this sector and also regulate operations by foreign entities in this sector, i.e., market access and national treatment barriers. The most important market access restriction in India's financial services sector is in the form of FDI ceilings/prohibitions and the type of foreign commercial presence/form of legal entity permitted, both of which limit the scope for entry by foreign players. The external factors which constrain India's financial service exports are mainly in the form of prudential regulations, such as minimum capital requirements, reciprocity requirements, i.e., authorization for starting operations being subject to the host country's financial institutions receiving reciprocal treatment in India, data protection requirements and directives in order to protect individual privacy with regard to the storage, processing, and transmission of personal data, and restrictions in the form of economic needs tests and local staffing requirements affecting the movement of natural persons in the financial sector. Financial sector is both a catalyst and one of the main beneficiaries of an FTA. The financial services sector in India has liberalized very slowly. Most Indian banks are government owned, and entry of foreign banks remains highly regulated. State owned banks control 80% of the banking system. In the last decade a series of reform measures have been undertaken in the banking sector, including restructuring of public sector banks. In the Insurance sector in India, prior to 2000, all insurance companies were government owned, except for a number of private sector firms providing reinsurance and brokerage services. Government monopoly ended in 1999, when the Indian parliament passed the Insurance Regulatory Development Authority (IRDA) Act. Besides cap on foreign investment of 26 percent, restrictions like minimum capitalization norms, funds of policy holders to be retained within the country, compulsory exposure to rural and social sectors and backward classes. The current paper focuses on the domestic reform issues pertaining to India's financial sector so as to make this sector globally competitive and efficient and to face the challenges and exploit the opportunities arising from multilateral liberalization. The sustainability of impressive growth of Indian economy has been questioned in the wake of some challenges in the form of lack of social infrastructure, physical infrastructure, and IT infrastructure.

Objectives:

1. To assess the current status of India's foreign trade in services especially financial services.
2. To suggest the measures and policies towards increasing India's share in financial services.

Methodology:

Tools of Analysis:
Various statistical tools like CAGR (Compound Annual Growth Rate) and other simple statistical techniques such as averages have been used to elicit the results and arrive at the conclusions.

Sources of data:
The database used for the study has been drawn from various secondary sources. The secondary sources include the official websites of RBI (Reserve Bank of India), World Bank, WTO (World Trade Organization), etc. Moreover, research papers published in various journals have also been consulted towards augmenting the research review of the paper.

Literature Review:

EXIM Bank of India (1999) in "Exports of Financial Services" concluded that overall, India is a very small global player in exports of financial services. However, according to our study, India has export potential in certain segments, such as financial consulting, but this potential is largely untapped. For instance, some specialized institutions have rendered consultancy services to other developing countries, such as CRISIL in credit rating services, EXIM Bank in institutional infrastructure for exports, State Bank of India in commercial banking, and HDFC in housing finance. But there are many more private and public institutions that could offer such consultancy services in the financial sector. Strategic alliances between Indian financial institutions and international consulting firms could considerably expand the scope for such exports of financial services.

Sen and Vaidya (1999) in "The Process of Financial Liberalization in India" explored that the role of the financial services sector has grown in the economy, mainly due to the growth of the banking and non-banking segments. According to CSO (Central Statistical Organization) statistics on the sectoral distribution of GDP, the share of banking services in total value added in services increased from 6.3 percent in the 1980s to 11.2 percent in the 1990s and was close to 12 percent in 2001-02.

Alexei Kireya (2002) in "Liberalization of Trade in Financial Services and Financial Sector Stability" concluded that liberalization has generally been conducive to stability because of the mutually reinforcing nature of existing international rules and practices.

World Bank (2004), India's exports of financial services has been growing in recent years and constitutes a rising share of total services exports. In 2001-02, India's exports of financial services were $780 million (3.8 percent of total services exports), up from $296 million (3.1 percent of total services exports) in 1997/98. World Trade Organization, Services Statistics Database: India explored that the Indian financial services industry is a strong contributor to the nation's economy, accounting for approximately 5.5 percent of GDP in 2007 and creating jobs at a steady pace.

Dr. Seema Joshi (2008) explored in "Service Sector in India's Economy: Performance, Problems and Prospects" that India is called the 'services hub' of the world. Various sector specific measures have been taken by Govt. of India to promote the sun-rise sectors like financial services. The author remarks that on the tourism front, it is 'Incredible India', but on the economic front, it is 'Opportunity India'.

Government of India-Planning Commission (2008) in "Report of the High Level Group on Services Sector" concluded that driven to a significant extent by the liberalization measures of the 1990s, the financial sector has witnessed robust growth. However, its penetration in India remains low relative to many markets, with bank credit/ GDP at under 50.0%, overall insurance premium/ GDP at under 5.0% and general insurance premium/ GDP at under 1.0%.

Kavaljit *et al* (2009) in "Rethinking Liberalization of Banking Services under the India-EU Free Trade Agreement" concluded that without major changes, a liberal entry of European banks facilitated by the proposed India-EU trade agreement is likely to further constrict the access to banking services in the country geographically, socially and functionally.

Reserve Bank of India, Database (2009) explored that the country's largest bank is the State Bank of India (SBI), which held 18 percent of market share as measured by loan advances in FY 2009. SBI is listed on the Indian stock exchange, but is majority owned by the central bank, the Reserve Bank of India (RBI). RBI is also the majority owner of 8 of the top 10 domestic banks in India, though the second largest bank in India—ICICI—is privately held. State-owned banks maintain the largest presence in consumer markets, accounting for 90 percent of all bank branches in the country.

Barry Eichengreen *et al* (2010) concluded in "The Service Sector as India's Road to Economic Growth?" that India is distinctive for the rapid growth of its service sector---high tech information, communication and business (financial services) in particular. However, a dispute arises as to whether the service sector provides a route out of poverty for the masses. In addition, some say that the high skill and education requirements of modern service sector (financial, business) jobs make them an impractical destination for masses. The author argues that the skilled-unskilled mix of the manufacturing and service sector, each taken as a whole, is not as different as commonly supposed. Polygreen (2009) describes how modern service sector jobs are now migrating from India's urban centre's to its small towns and rural villages, creating employment for semi-skilled workers. Finally, the author concludes that employment in modern service sector (financial) can be a route out of poverty not just for the few and not just for urban residents.

Robert M. Stern (2010) in "Trade in Financial Services---Has the IMF been involved constructively?" concluded that the pace and effects of financial liberalization have been determined to a large extent by the terms and timing of the negotiations for WTO accession.

Economic Survey 2010-11 finds out financing, insurance, real estate, and business services to be the largest group accounting for 16.7 per cent of the national GDP in 2009-10.

T.P. Bhat (2011) in "Structural Changes in India's Foreign Trade" remarks that services accounted for 20 per cent of India's exports in 1990 and in 2008 it has accelerated to 59.2 per cent.

Mina Mashayekhi (2012) in "The Contribution of Trade in Financial Services to Economic Growth and Development" traced out that among the major financial services exporters (2010), India occupies 8th position out of top 10 with a share of 1.5%.

World Development Report finds out that the fast pace of growth of service exports is reflected in the rising share of India in global markets for tradable services. Starting from ½ percent of the global demand for services in the early 1990s, it raised to 1.1 percent in 2000, 2.0 percent in 2005 and 3.3 percent in 2010.

Barry Eichengreen and Poonam Gupta (2012) in "Export of Services: Indian Experience in Perspective" marks out that the value of exports of services is reported by the Reserve Bank of India (RBI) separately for traditional and other services (where traditional services include such things as travel, transportation and insurance). Exports of modern services such as software, other business services, financial services and communications were clubbed together with other services until 1999-2000, after which the RBI reported software exports separately. The author shows the composition of exports of services at ten year intervals, and indicates that the share of exports of modern services in the total rose from 44 percent in 1991 to 63 percent in 2000/01 and further to 74 percent in 2010/11. The author shows similarly that the share of modern services (software, other business services, communications and financial services) in the country's total export basket has increased from about 8.7 percent in FY1991 to 20 percent in FY 2000 and to 26 percent in FY 2012.

EIU, *Country Finance: India*, (2009) lists that the foreign banks have expanded their offerings and now compete with domestic banks in both the commercial and retail banking spheres. Citigroup (United States) is the largest foreign bank operating in India, with 1.55 percent of total market share, followed by Standard Chartered Bank (United Kingdom), HSBC (United Kingdom), and ABN Amro Bank (Netherlands), with 1.35, 1.21, and 0.82 percent of market share, respectively.

RBI, "India's Balance of Payments Developments," RBI Monthly Bulletin, October 2009, marks out that since opening its financial services market to foreign participation in the mid-1990s, India has become an increasingly attractive market for exporters of financial services, while its domestic banks actively pursue opportunities for growth in overseas markets. In FY 2009, 13 percent ($3.9 billion) of India's miscellaneous services exports were in financial services, while financial services constituted 12 percent ($3 billion) of miscellaneous services imports.

India's Services Trade:

India's services trade comprises of India's Services' exports and India's services imports. The detail description of these is given in the following pages:

India's Services Exports

India's services export growth has been faster than that of merchandise exports with the export of services growing at a CAGR of 23.6 per cent during 2001-2 to 2011-12, while merchandise exports grew at a CAGR of 21.4 per cent during the same period.

India's Export of Services

Commodity group	**Percentage share**		**CAGR**
	2001-02	**2011-12**	**2001-02 to 2011-12**
Travel	18.3	13.0	19.4
Transportation	12.6	12.8	23.8
Insurance	1.7	1.8	24.8
GNIE	3.0	0.3	-0.8
Miscellaneous	64.4	72.0	25.0
Software Services	44.1	13.7	23.5
Non-Software Services	20.3	28.3	27.8
Of which: Business services	3.0	18.2	47.9
Financial services	**1.7**	**4.2**	**35.2**
Communication	4.4	1.1	7.8

services			
Total Services Exports	100.0	100.0	23.6

Source: Computed from RBI data. GNIE = Government Not Included Elsewhere

India's Services Imports

India's services imports have been growing at the CAGR of 18.9 percent during 2001-02 to 2011-12.

India's Import of Services

Commodity group	**Percentage share**		**CAGR**
	2001-02	**2011-12**	**2001-02 to 2011-12**
Travel	21.8	17.6	16.4
Transportation	25.1	20.9	16.8
Insurance	2.0	1.9	18.3
GNIE	2.0	1.0	10.7
Miscellaneous	49.0	58.6	21.1
Software Services	4.9	1.6	6.5
Non-Software Services	44.2	56.9	22.0
Of which			
Business services	10.9	34.2	33.4
Financial services	**9.1**	**10.2**	**20.2**
Communication services	2.7	2.0	15.5
Total Services Imports	100.0	100.0	18.9

Source: Computed from RBI data.
GNIE = Government Not Included Elsewhere

<u>Composition of India's Services Exports:</u>

India's emerging services trade sectors are no more traditional sectors like transport, travel and tourism services. It is financial services, information and communication technology services presently dominating India's services export basket.

Composition of India's Services Exports

Major components	Value 2000	Share 2000 (%)	Value 2005	Share 2005 (%)	Value 2010	Share 2010(%)
	(US$ billion)		(US$ billion)		(US$ billion)	
Transport	1.98	11.86	5.75	10.95	13.25	10.70
Travel	3.46	20.74	7.49	14.26	14.16	11.44
Communication	0.60	3.59	1.57	2.98	1.41	1.14
Construction	0.50	3.01	0.35	0.66	0.52	0.42
Financial	0.28	1.65	1.14	2.18	6.00	4.85
Insurance	0.26	1.54	0.94	1.79	1.78	1.44
Computer & information services of which	4.73	28.33	21.87	41.64	56.70	45.81
Computer services	4.63	27.76	21.71	41.33	56.11	45.34
Information services	0.09	0.57	0.16	0.31	0.59	0.48
Total services	16.69		52.53		123.76	

Source: Calculation based on RBI, 2007 and International Monetary Fund, 2008

Composition of India's Services Imports:

Growth in India's services imports was equally high particularly from 2000/01 to 2005/06, which was mostly driven by communication, construction and insurance services. Even though the decline in transport services imports was quite steep, transport and travel services together still share about one third of the country's services imports.

Composition of India's Services Imports

Major components	Value 2000	Share 2000 (%)	Value 2005	Share 2005 (%)	Value 2010	Share 2010 (%)
	(US$ billion)		**(US$ billion)**		**(US$ billion)**	
Transport	8.70	45.36	20.68	43.73	36.36	44.05
Travel	2.69	14.02	6.19	13.08	9.41	11.40
Communication	0.10	0.55	0.42	0.88	1.19	1.45
Construction	0.13	0.66	0.60	1.27	0.09	1.20
Financial	**1.28**	**6.66**	**0.87**	**1.84**	**6.79**	**8.22**
Insurance	0.81	4.24	2.33	4.93	5.00	6.06
Computer and information services of which	0.58	3.01	1.27	2.68	2.53	3.07
Computer services	0.00	0.00	1.05	2.22	2.18	2.64
Information services	0.00	0.00	0.22	0.46	0.36	0.43
Personal, cultural & recreational services	0.00	0.00	0.10	0.22	0.47	0.57
Total services	19.19		47.29	100	82.54	

Source: Calculation based on RBI, 2007 and International Monetary Fund, 2008

Insurance Services:

With the participation of foreign and private players in insurance sector after the implementation of Malhotra Committee recommendations, there has been a stiff competition to provide efficient services by the private players with innovative products. The Indian insurance has a total of 47 insurance companies including life (23) as well as general (24) (non life) insurance companies. Among financial sector reforms, the reforms related to insurance have shown tremendous results in terms of life and non life insurers 'growth and still a lot of potential lies in whole insurance segment. Bank assurance schemes initiated by banks with their insurers are becoming popular day by day. The insurance density of life insurance sector had gone up from USD 9.1 in 2001 to USD 47.7 in 2009. Similarly, insurance penetration of life sector had gone up from 2.15 per cent in 2001 to 4.60 percent in 2009. The penetration of non-life insurance sector in the country remains near-constant for the last 9 years at around 0.60 per cent. However, there is a marginal increase in density, which has increased from USD 2.4 in 2001 to USD 6.7 in 2009.

Insurance Penetration and Density in India

Year	**Life**		**Non-life**		**Industry**	
	Density (USD)	**Penetration (%)**	**Density (USD)**	**Penetration (%)**	**Density (USD)**	**Penetration (%)**
2001	9.1	2.15	2.4	0.56	11.5	2.71
2002	11.7	2.59	3.0	0.67	14.7	3.26
2003	12.9	2.26	3.5	0.62	16.4	2.88
2004	15.7	2.53	4.0	0.64	19.7	3.17
2005	18.3	2.53	4.4	0.61	22.7	3.14
2006	33.2	4.10	5.2	0.60	38.4	4.80
2007	40.4	4.00	6.2	0.60	46.6	4.70
2008	41.2	4.00	6.2	0.60	47.4	4.60
2009	47.7	4.60	6.7	0.60	54.3	5.20

Insurance Density is measured as Ratio of Premium in US$ to total population

In sslife insurance business India ranks 9th among the 156 countries. The life insurance premium in India grew by 10% (inflation adjusted). However, during the same period, the global life insurance premium had contracted by 2%. The share of Indian life insurance sector in global market was 2.45% during 2009, as against 1.98% in 2008. The Non life insurance sector witnessed a marginal growth of 1.6% during 2009. However, its performance was better when compared to global non life premium, which contracted by 0.1% during the same period. The share of Indian non life insurance premium in global non life insurance premium remained very low at 0.465 and India ranked 26th in global non life insurance premium.

Share and Rank of India in World Services Export

Year	Top exporter country	Top exporter's share	India's share	India's rank
Transportation				
2000	USA	13.3	0.6	32
2010	USA	9.2	1.7	17
Travel				
2000	USA	18.1	0.6	30
2010	USA	13.7	1.7	18
Communication				
2000	Grenade	50.6	1.9	10
2010	Grenade	15.2	1.4	14
Construction				
2000	Japan	20.6	1.9	13
2010	China	17.6	0.6	24
Insurance				
2000	Grenade	21.3	0.9	18
2010	UK	23.0	1.8	12
Finance				
2000	USA	24.6	0.4	22
2010	USA	26.3	2.2	9
Computer and information				
2000	USA	18.4	17.1	2
2010	India	26.9	26.9	1

Source: UN Service Trade Data

RESULTS AND DISCUSSIONS:

The following results are summarized:

- Looking back at the first decade of 21st century i.e.,2000-2010, we believe that this decade indeed can be called as ---India's Decade of Development.
- In the last decade, the share of services has surpassed the combined share of agriculture and industry making it the most important contributor to the country's output.
- The research paper makes it clear enough to mark Indian economy as the service economy. Although there are other emerging economies where the share of services in GDP exceeds the share of manufacturing, but India stands out for the size and dynamism of its service sector.
- There are variations in growth and performance of different sub-sectors of services. Services such as IT, telecommunication and financing services have contributed to the high growth of the services sector. Even during the global slowdown, the services sector remained resilient to external shocks Trade in services has been growing rapidly in the past 2 decades(1990-2010).India's services exports not only grew more rapidly than the country's merchandise exports but it also grew faster than global services exports.
- India's rank in financial services exports stood at "9" in 2010 as against "22" in 2000.This achievement makes the sector globally competitive and efficient to face the challenges and exploit the opportunities from multilateral liberalization.
- The financial services sector plays a critical role in every modern economy. The financial services sector in India has emerged as a mature and sophisticated system which is inherently strong, functionally diverse and displays efficiency and flexibility.
- It may be concluded from the above discussion that India's potential for services economy is matchless as there is burgeoning middle class with enhanced aspirations and changing consumption patterns. The services led Indian economy will definitely propel into higher trajectory in near future.

SUGGESTIONS:

The following suggestions are put forth:

- The Indian government's policy focus is on agriculture and manufacturing. In the post –liberalization period, services sector has largely been left to grow on its own. There is no nodal ministry at the centre for some services sectors like retail while for others like transport and energy there are multiple ministries with conflicting interest. Multiplicity of regulatory bodies creates multiplicity of regulations and multiple clearance requirements.
- India is one of the few countries which have FDI restrictions on a number of services sectors such as banking, insurance etc. This is restricting the ability of the country to attract FDI.

- India's service s trade facilitation positively affects India's services exports. India suffers from poor quality of services trade infrastructure. Researches show that 1% improvement in services trade facilitation measures leads to 2% increase in services exports in India.
- India should reduce the trade transaction costs by removing barriers to services trade.
- Reducing government's stake in financial sector institutions by divesting government ownership in public sector banks and reducing public sector dominance in various segments like insurance and mutual funds.
- Moving towards a single regulator for financial services as opposed to the current multiplicity of regulators for different segments.
- Tapping the huge foreign business by Indian Insurance companies by encouraging them to venture outside India.
- New banking products /services should be automatically approved, provided that the banking institution satisfies a number of overall regulatory criteria e.g. Islamic banking.
- Operational zing offshore financial centre's by removing hurdles. The report on Implementation Model for free Ports in India has suggested the setting up of offshore Banking units in SEZ's.
- Including climate change related financial schemes/instruments as climate change issues are gaining in importance.

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