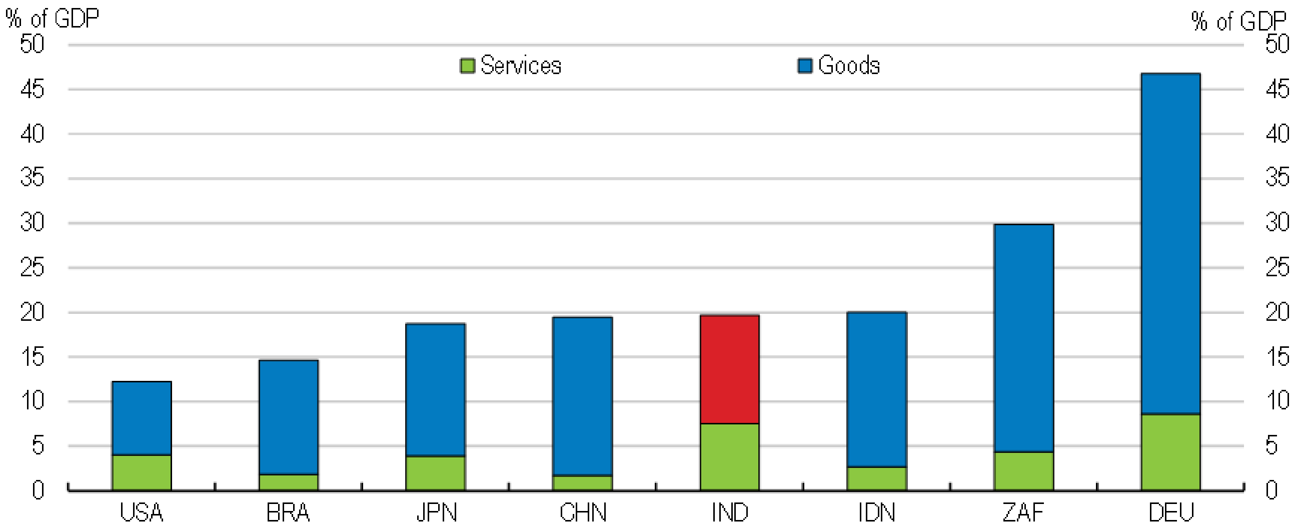
India’s export performance: the goods and services nexus

By Isabelle Joumard, India Desk, OECD Economics Department

The government aims at **making India an export hub**, to help boost job creation. The export-to-GDP ratio has risen fast since the early 1990s and now stands broadly at par with China (Figure 1). The large share of services in total exports however stands out: while India has performed very well in exporting IT services, exports of goods have lagged behind. Exports of labour-intensive manufacturing products could grow faster and contribute to job creation. The 2019 OECD Economic Survey of India discusses policies to make India’s exports more competitive.

Figure 1. India’s export-to-GDP ratio is relatively high, with a tilt towards services

2018



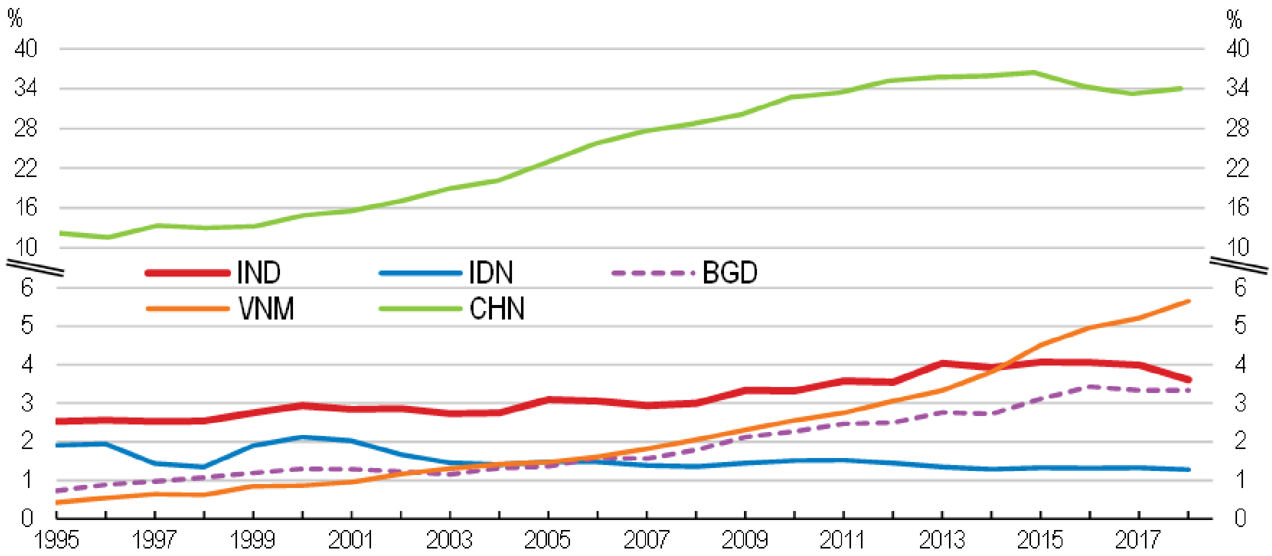
Source: World Bank, World Development Indicators database.

Performance of services exports has been stellar. India's share of world services trade more than quadrupled from 0.5% in 1995 to 3.5% in 2018 and India has become a major exporter of business services, notably in the Information, Communication and Technology (ICT) sector. Medical and wellness tourism is also performing well, with patients seeking high-quality medical treatment at competitive prices in some Indian hospitals.

Exports of goods have displayed mixed results. India has gained market shares for some skill- and capital-intensive goods, including pharmaceuticals and refined oil. However, performance in exporting textiles, leather and agricultural products has disappointed. Looking at the labour-intensive components of the textile sector (including garment) provides an illustration: Vietnam now has a larger market share (Figure 2).

Figure 2. Exports of textile, garment and footwear: losing market share

Countries' share in world textile exports



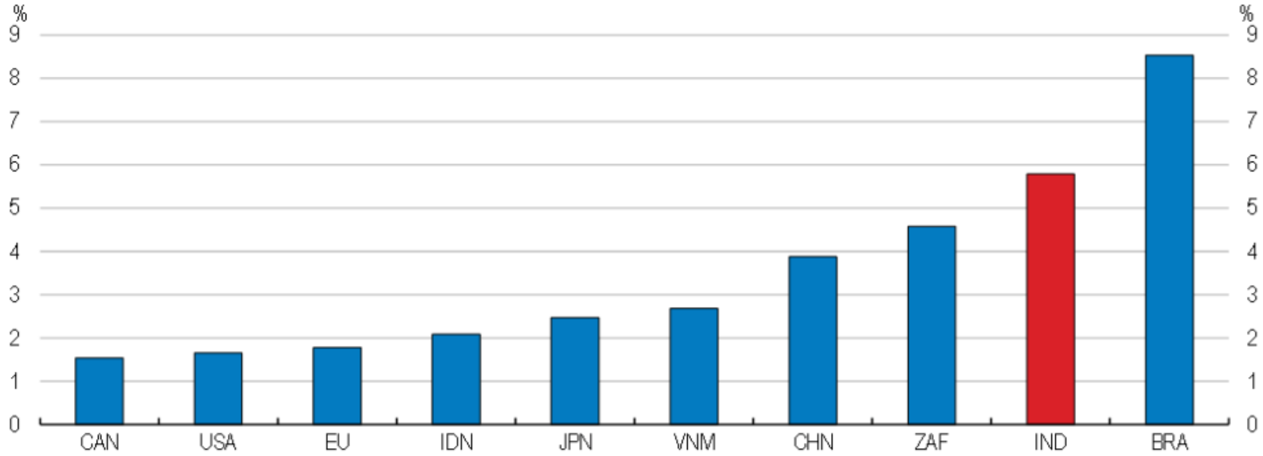
Note: Low-technology textile including garment and footwear.
Source: OECD calculations based on UNCTAD data.

Domestic factors partly explain the relatively low performance of labour-intensive exports. Labour regulations are more stringent for industries and large firms. This creates incentives for firms to stay small, making it difficult to exploit scale economies. Electricity prices are also relatively high and transport infrastructure bottlenecks persist despite recent improvements. This hampers the competitiveness of manufacturing goods which tend to be more intensive in energy and transport than services. The length and costs to acquire land, combined with relatively high financing costs, are further weighing on firms' competitiveness.

Barriers to trade also play a role. Import tariffs on goods declined substantially in the 1990s and 2000s. They have been raised again since 2017 and are relatively high (Figure 3). Expensive imports of intermediate products, due to import duties, can penalise Indian exporters if they do not receive the full compensation for the duties paid on inputs – this is often the case in a sector like the apparel sector where small enterprises account for the lion's share. The complexity of India's tariff structure further raises administrative and compliance costs. Overall, import duties run against the objective of making India an export hub.

Figure 3. Effectively applied tariffs are relatively high

Effectively applied tariffs, 2017

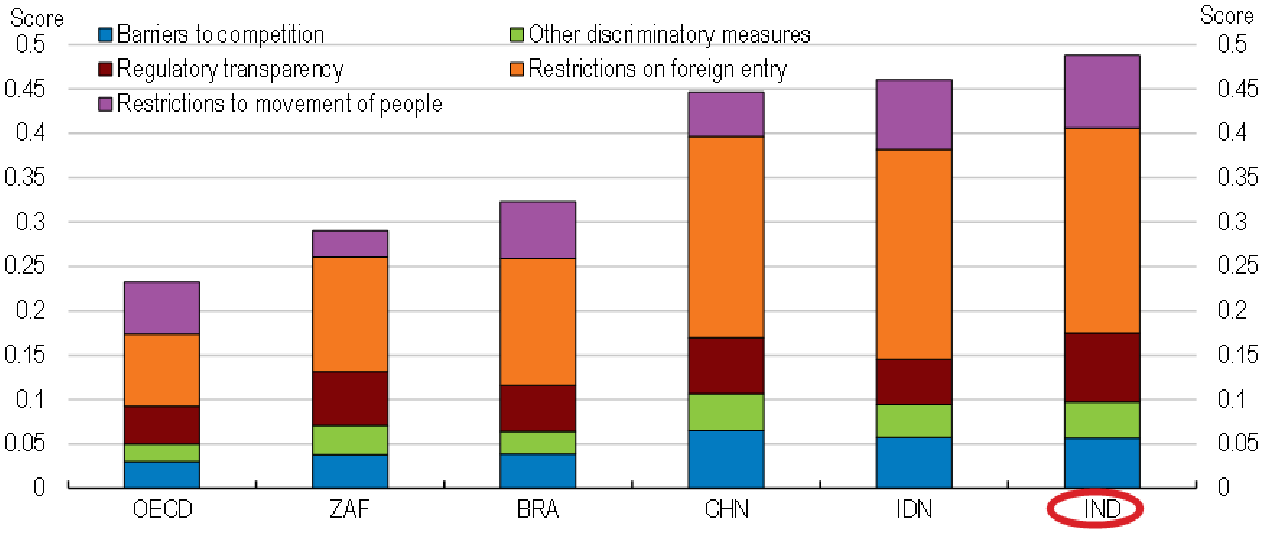


Note: Data show weighted averages of effectively applied tariffs, whereby the tariffs are weighted by the import value of each product.
Source: UNCTAD Trade Analysis Information System (TRAINS) data extracted from the World Bank, World Integrated Trade Solutions.

Trade in services also faces some restrictions, with local suppliers protected from foreign competition (Nordås, 2019; OECD, 2017). Only Indian nationals are allowed to practise as lawyers or architects. Services trade restrictions, as assessed by the OECD, are also relatively high in the banking, insurance, rail and air transport, and telecommunication sectors (Figure 4). Because services are key inputs for the manufacturing sector and support participation in global value chains, stringent regulations on services are weighing on manufacturing costs and thus on export performance.

Figure 4. Services trade restrictions, as measured by the OECD, are relatively stringent

OECD Services Trade Restrictiveness Index, 2018



Note: The STRI takes values between zero and one, one being the most restrictive. OECD refers to an unweighted average.
Source: OECD, Services Trade Restrictiveness Index database.

OECD simulations suggest that **India would be a major beneficiary of a multilateral reduction in barriers to services trade** (OECD, 2019b). Better priced services intermediates would foster a rapid expansion of production and job creation in the manufacturing sector. It would further support wages for low-skilled workers. Simulations also reveal that, even in the absence of a multilateral agreement, the economy would gain from a unilateral liberalisation of trade and investment (Joumard et al., 2020).

India could make exports a new growth engine. India's trade prospects are relatively positive as it has specialised in sectors which will likely be in high demand in the future (e.g. ICT services, pharmaceuticals and medical devices) and in fast growing destinations (with a large share of its exports to emerging market economies). To unlock its potential to seize market shares in the labour-intensive manufacturing segment, India should modernise labour and land regulations, address infrastructure bottlenecks and open up further the services sector to trade and investment. Better and less expensive services – financial, marketing, distribution, legal, transport, etc. – will increase competitiveness in the manufacturing sector, boost job creation and meet the aspirations of women and new comers on the labour market.

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Structural reforms are key for a more prosperous and inclusive India

by Laurence Boone, OECD Chief Economist, Isabelle Joumard and Christine de la Maisonneuve, India Desk, OECD Economics Department

Income has increased fast in recent years and millions of Indians have been lifted out of poverty. India has also become a key player in the global economy. **The implementation of an ambitious set of reforms has supported economic activity** and helped put a break on inflation and on both fiscal and current account deficits. Reforms such as:

• The Goods and Services tax replacing a myriad of indirect taxes.

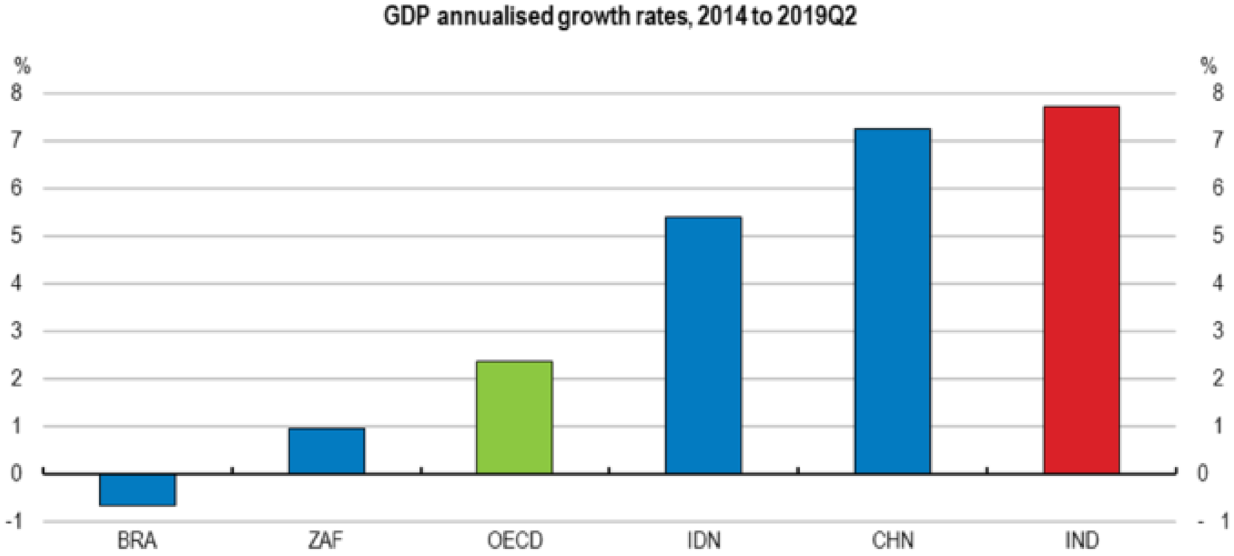
• A leaner corporate income tax structure bringing India more on par with peers.

• The Insolvency and Bankruptcy Code speeding up the reallocation of resources from declining firms and industries to those with more promising prospects.

• Electricity reached all villages in 2018 and;

• Almost 100 million toilets have been built since 2014.

Figure 1. Income has grown steadily



Source: OECD Analytical Database.

Nevertheless, economic activity is slowing down and challenges remain, notably:

• The creation of quality jobs has not matched the number of new comers on the labour market, resulting in under-employment and rising unemployment. Women and the youth are most affected.

• Nearly 90% of jobs are informal without job protection

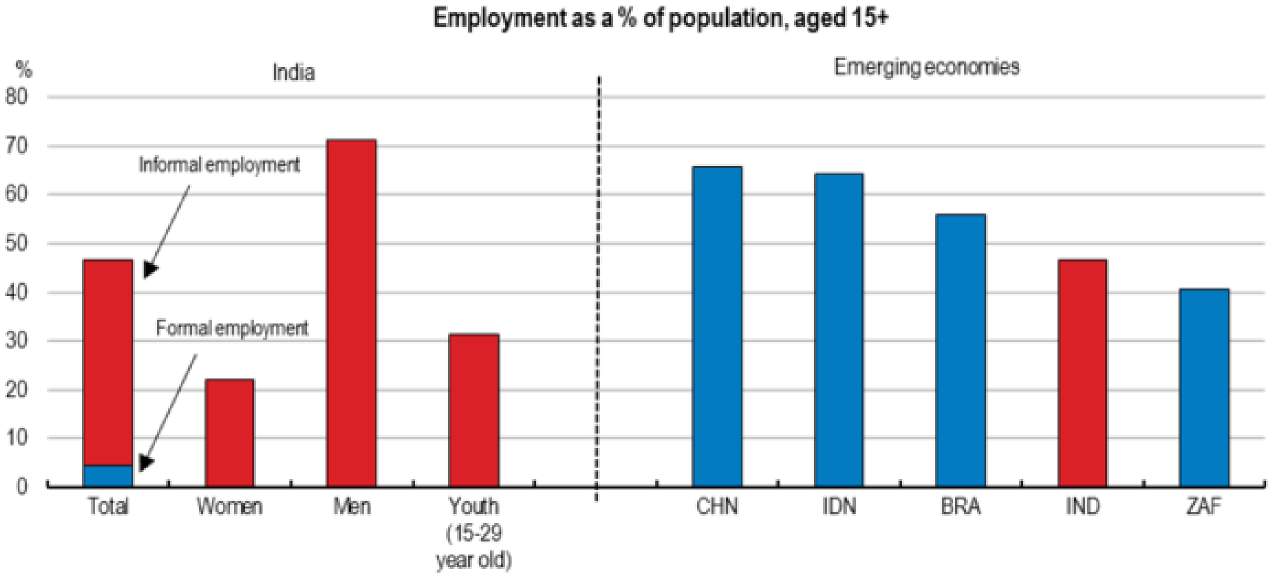
• Inequality in wealth and in access to public services remains wide.

• A large share of the population suffers from severe air pollution.

• Corporate investment as a share of GDP no longer declines but has failed to rebound.

• Construction has weakened despite large housing and infrastructure needs.

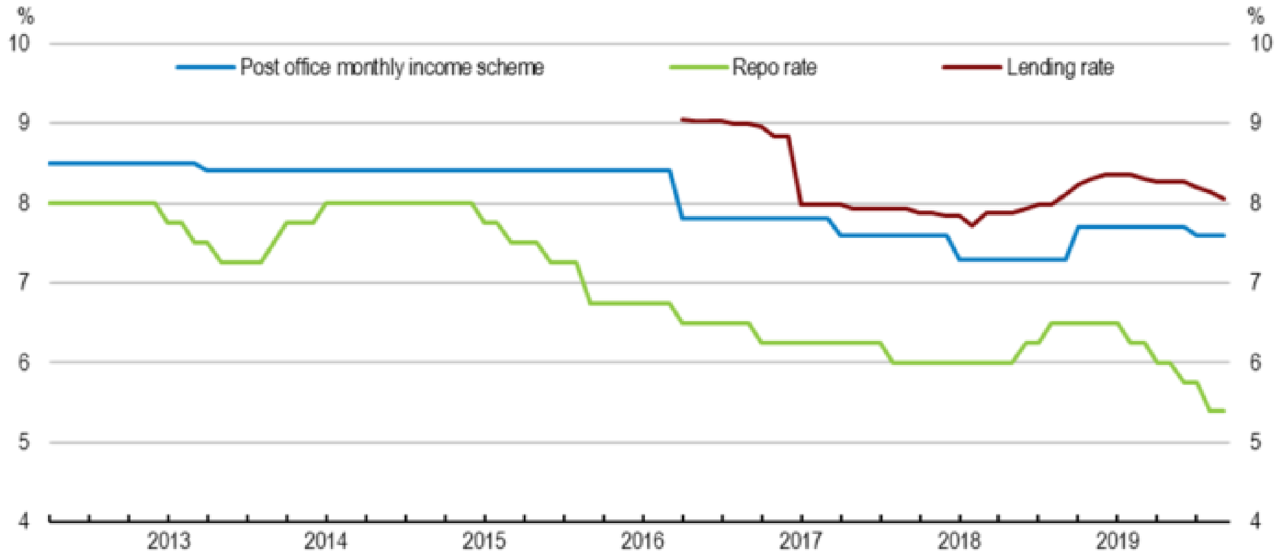
Figure 2. India needs to create more and better quality jobs



Source: National Statistical Office; World Bank.

Boosting incomes with macroeconomic policies has limits. Policy interest rates can be cut further but their impact on lending rates is limited by high administered deposit rates. Large non-performing assets in financial companies' balance sheets also weigh on the supply of loans. The already high public sector borrowing requirements and debt to GDP ratio limit the government's ability to support demand.

Figure 3. The accommodating monetary stance is yet to be fully transmitted



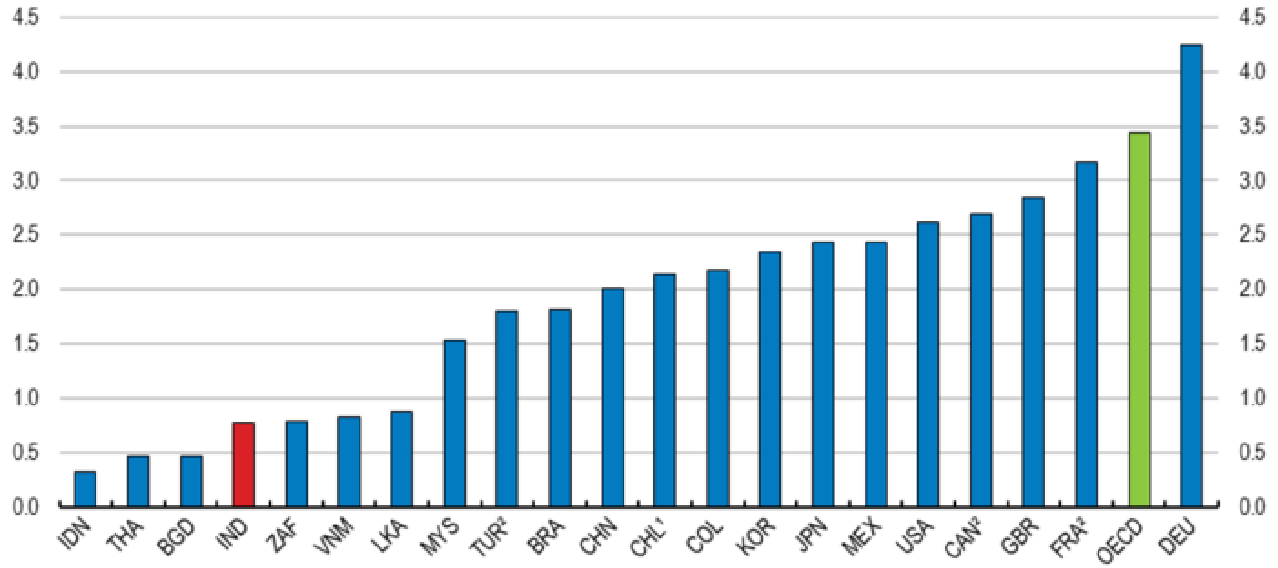
Note: The post office monthly income scheme is for deposits between INR 1,500 and 450,000 for single accounts and 900,000 for joint accounts. It is one of the small savings schemes, government-operated, used exclusively to finance central and state government debt. Interest rates on deposits from small savings schemes are set by the government.
Source: Reserve Bank of India.

Boosting growth and making it more inclusive require accelerating the pace of structural reforms. Slower growth in partner countries and geopolitical uncertainties have recently taken a toll on economic activity. However, remaining constraints to create jobs and grow businesses – including the ongoing stress in the financial sector – also play a role. Already passed reforms should be fully implemented, e.g. by adding new judicial personal and benches to hasten bankruptcy proceedings. Labour, land and financial regulations should be modernised to attract investors and create more quality jobs and income. It is a critical moment, with opportunities to seize as companies around the globe are considering relocating their production sites in the wake of changing input costs and trade tensions.

The full benefits of structural reforms take time to unleash while costs are often born upfront. Setting a timetable by which government actions could be assessed may help avoid a political backlash. People losing from the reforms may need support to adjust (e.g. skilling programmes) or income support.

Figure 4. The number of doctors is low

Practising doctors per 1000 people, 2018 or latest available year



Note: OECD refers to an unweighted average of latest available observations. Panel B: 1. Data refer to all doctors licensed to practice, resulting in a large over-estimation of the number of practising doctors. 2. Data include not only doctors providing direct care to patients, but also those working in the health sector as managers, educators, researchers, etc. (adding another 5-10% of doctors).
Source: OECD/WHO, Health at a Glance: Asia/Pacific 2018; OECD, Health database.

Delivering better public services and social protection for all Indians is also key to promote wellbeing.

India should train more doctors and nurses to meet the population’s needs. It should also build a sound and fair retirement system. Putting more public resources on health and social transfers will require rebuilding fiscal space. Two avenues should be considered. On the spending side, further reforms should help raising the effectiveness of existing schemes, by better directing support to those in need, and containing public enterprises’ financing needs. On the revenue side, there is scope to mobilise additional revenue from property and the personal income tax (OECD, 2017).

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Efficient, Equitable and Enforceable: three "Es" for reforming India's tax system and better finance public services

By Isabelle Joumard, Head of the India desk, OECD Economics Department

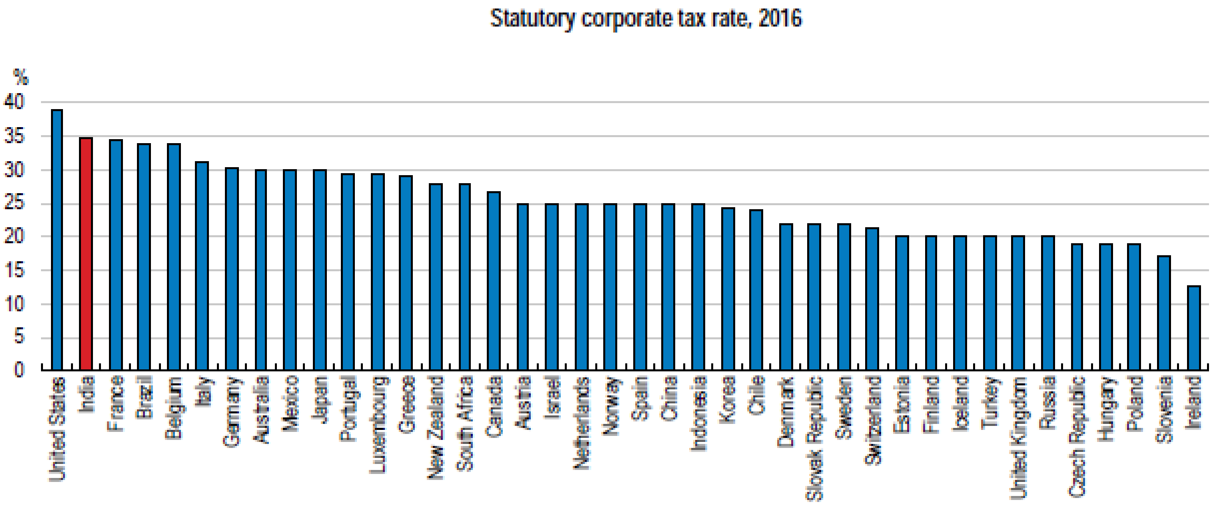
Promoting inclusive growth in India requires improving social and physical infrastructure. Public spending needs are large: only 40% of the population had access to sanitation facilities in 2015; public spending on health is just above 1% of GDP, compared to 7% on average in OECD countries and 3% in the other key emerging economies; only a small fraction of the population contributes to a retirement scheme. More than 20%

of the population (almost 270 million persons) lived with less than USD 1.9 a day in 2011.

India needs to raise more tax revenue to finance access to better quality public services for all while putting the relatively high public debt-to-GDP ratio onto a declining path. Implementing the landmark Goods and Services Tax (GST) – a national value added tax – will promote the competitiveness and productivity of Indian companies. While the GST has been designed to be revenue-neutral, at least in the short- and medium-run, it should be complemented by a comprehensive reform of income and property taxes to raise additional revenue and make the overall tax system more efficient, equitable and enforceable.

Efficiency of taxes could be increased through lower rates and a broader base. Although the statutory tax rate on companies is high (Figure 1), various special rates, exemptions, deductions, rebates, deferrals and credits result in much lower effective tax rates and create a bias against labour-intensive activities. The government’s plan to reduce the corporate income tax rate from 30% to 25% while removing most exemptions is most welcome. That said, different tax regimes for small enterprises and social security contribution requirements – only companies with more than 20 permanent employees have to pay- continue to generate disincentives for firms to grow and create quality jobs.

Figure 1. The corporate income tax rate is high

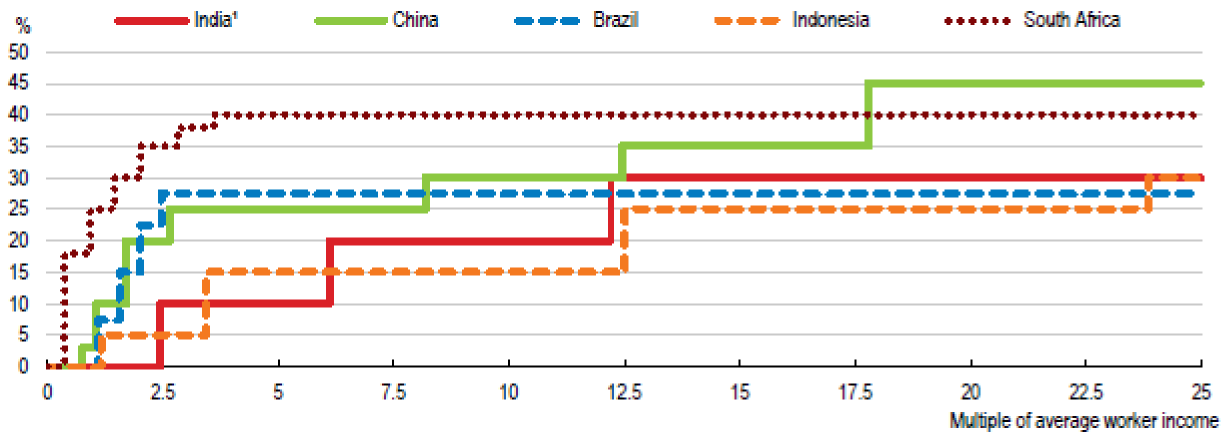


Source: OECD Tax database; and Deloitte.

Equity is an issue. Less than 6% of the population pay the personal income tax, which is a very low share by international standards. An individual does not pay any income tax until income is around 2½ times the average wage in the organised/formal sector, a much high level than most other emerging economies and OECD countries (Figure 2). Personal income tax is also reduced by generous tax concessions (e.g. mortgage payments) which benefit the rich more. There is no tax on agricultural income of large-scale farmers. Estimates presented in the *2017 OECD Economic Survey of India* suggest that bringing the personal income tax schedule in line with other emerging economies and scrapping tax concessions would increase personal income tax revenue by about 50%. Property taxes could also raise more revenue. Inheritance taxes are virtually absent, despite the extreme concentration of wealth in the hands of a few, while revenue from real estate taxes stands at about 0.2% of GDP which is well below the level in OECD and other BRIICS countries.

Figure 2. The personal income tax embodies little progressivity

Statutory marginal personal income tax rates by income, FY 2014-15



1. The average worker income is for the organised/formal manufacturing sector as reported in the Annual Survey of Industries.

Source: Annual Survey of Industries; OECD Taxing Wages 2015; and Ministry of Finance of India.

Enforceability could be improved to enhance public perceptions of the tax system fairness. The government has taken several measures to reduce tax evasion, such as penalties for not filing returns or filing with inadequate asset and income disclosure. India has also taken steps to prevent base erosion and profit shifting. In particular, the treaty with Mauritius – more than 20% of FDI position – was renegotiated in 2016, giving India a right to tax capital gains channelled through Mauritius from April 2017. However, proliferation of tax concessions and lack of clarity of tax regulations raise compliance and collection costs. Ensuring clarity and certainty in tax legislation and employing more skilled tax officers would strengthen the tax administration and make the system fairer and more effective.

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