Indian IT hits a Speedbump

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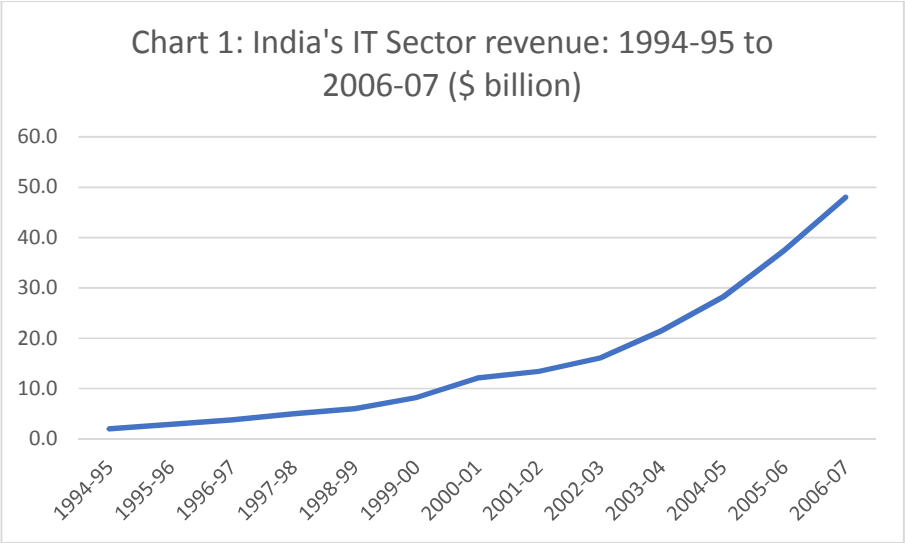
Industry association, NASSCOM, long-accustomed to talking up the prospects of the IT industry to justify special treatment from the government, has declared that the industry's export revenues would, at best, grow at around 7-8 per cent in financial year 2017-18. That is pretty bad news for an industry that had routinely clocked high, double-digit export revenue growth rates, and for which export revenues constituted an overwhelmingly large share of total revenues. But the prediction does not come as a surprise, given the sector's recent track record. According to data from the Reserve Bank of India, the rate of growth of the combined exports of software and IT-enabled services had fallen from 20.8 per cent in 2012-13 to 14.9 per cent in 2014-15 and to a low of 7.3 per cent in 2015-16.

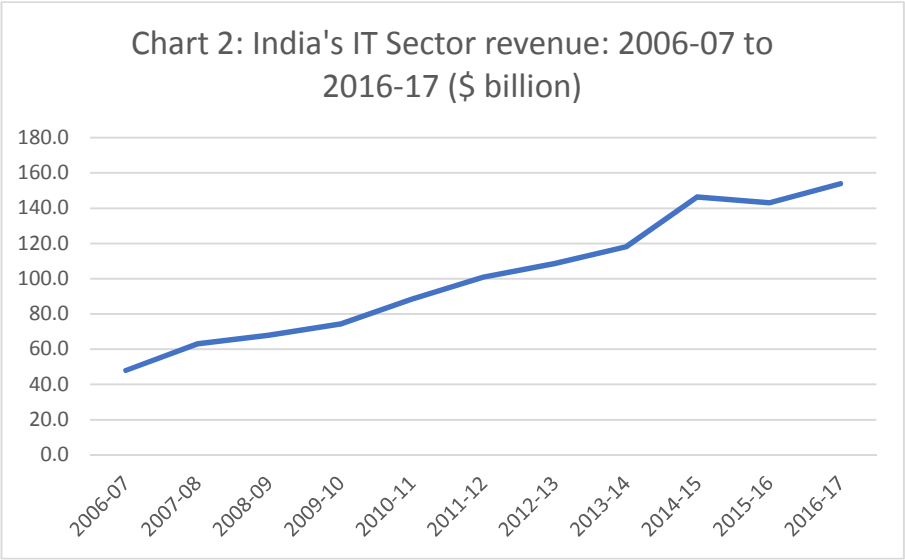
The industry's recent performance marks the end of an era. Growth soared during the decade starting the mid-1990s, though the average annual growth of close to 30 per cent was influenced by the low base the industry started from (Charts 1 and 3). But those rates, while triggered by the Y2K problem, were recorded precisely at a time when the Indian government had embraced a neoliberal strategy. That made the industry the showpiece of India's economic reform and the symbol of India's 'economic prowess'. Profits did even better than revenue growth, given the tax benefits and infrastructural support provided by the government to an industry that rode on India's cheap skilled labour. In the event, the IT sector became the site for breeding many of India's post-reform billionaires.

However, starting from around the time of the global financial crisis, and influenced by the global recession that followed, growth began to slow (Chart 2). Moreover, since 2014-15 that growth has turned almost flat by historical standards (Chart 3). As Chart 4 makes clear, a slowdown in export growth was an important factor influencing the overall performance of this export-dependent sector. This suggests that the specific nature of India's IT prowess accounts for the reversal of the industry's fortunes. IT growth was based on exploiting an outsourcing opportunity in low-cost niches, triggered by the cost-cutting imperatives facing the corporate sector in the US and elsewhere.

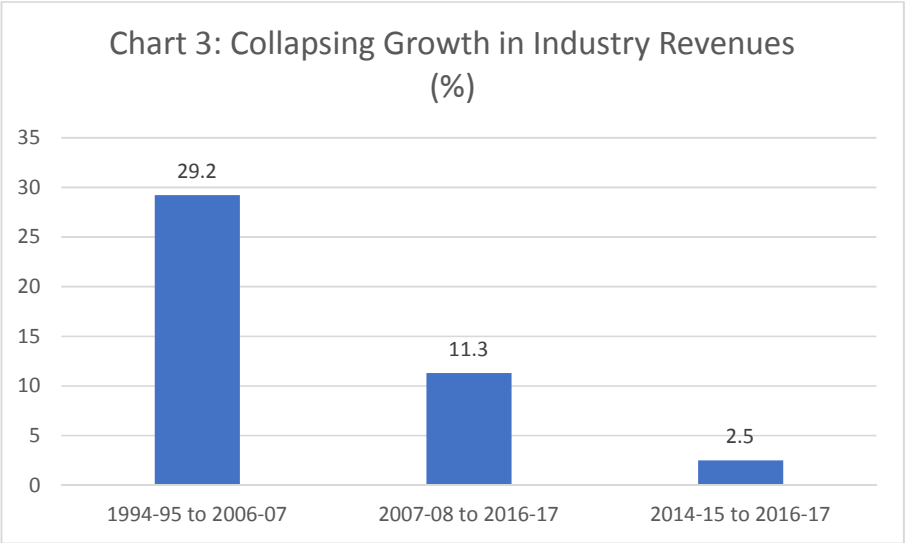
There were factors that made the model vulnerable. First was the concentration of exports by destination. An overwhelmingly large share of exports were directed to the US market, with the EU following at a distant second. In 2000, the

US market accounted for close to two-thirds of India's IT exports and the EU for about a quarter, and even in 2015-16 the US came in first with 62 per cent of the industry's exports and Europe second with 24 per cent. Not much had changed.



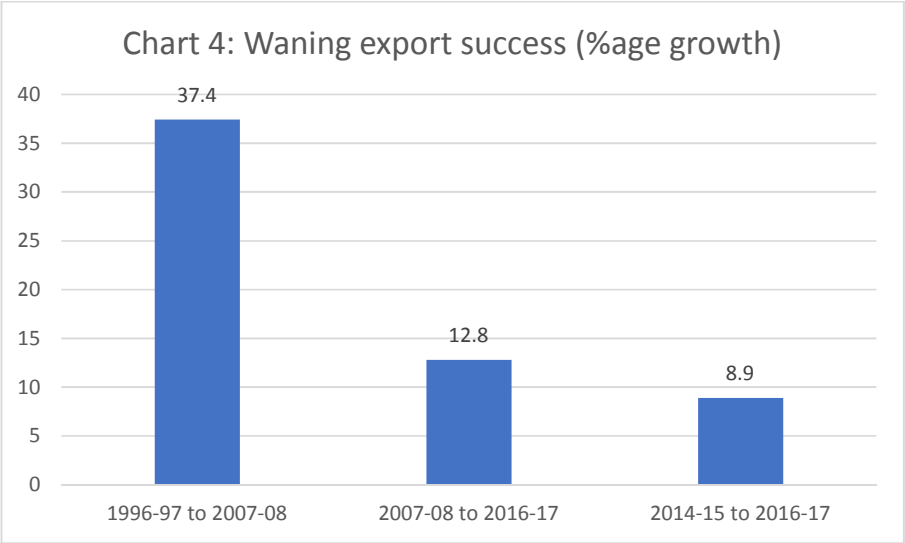


Secondly, software services (or code writing and customization of different levels of sophistication) and IT-enabled services, rather than IT products, accounted for an overwhelming share of revenues. Remaining competitive in those areas required sustaining relative cost advantages by limiting wages and squeezing profit margins. This made the industry susceptible to competition from new locations and could sap its limited employment generation because of pressure to opt for automation of the routinized activities that constitute an important part of these operations.



It is, therefore, not surprising that developments during and since the global crisis of 2007-08 have been posing challenges to the industry. As the financial crisis in the US affected mainly the developed countries, the main markets of the industry have turned volatile. In the event, demand growth has been sluggish, making it difficult for an industry that had lost the advantage of a "small base" to grow at all, let alone sustain the high rates of growth characteristic of its early years.

Unfortunately for the industry, even after a decade there is no sign of a robust recovery from the global recession. In addition to sapping demand, that has also triggered forms of protectionism in the developed countries, especially the US. Onsite provision of services by Indian firms to clients in the US is becoming more difficult and/or costly to deliver. The US administration argues that such provision is based on the misuse of the H1-B visas to import cheap labour to undertake work that can be performed by local (but more expensive) labour. According to the *Financial Times* quoting a senior administration official, "(m)ore than 80 per cent of the workers now on H-1B visas earn less than the US median wage for their jobs," and "(j)ust 5 per cent have earnings in the highest wage tier." On those grounds, the rules regarding H1-B visa numbers and minimum salary requirements are being modified, leading to loss of business or lower profits. Simultaneously, efforts are underway to persuade and/or pressure US clients to abjure offshoring, even if they find the need to outsource certain activities.



Thus, while India's foray into software and IT-enabled services exports was remarkable, that growth has been slowing considerably. Meanwhile, the resort to automation of routinized operations is reducing the demand for workers by the IT industry. According to NASSCOM, hiring over the last financial year was down to 150,000 additional jobs as compared with 230,000 three years earlier. In volume terms the IT sector has not been a major employer, with the sector's contribution to GDP way ahead of its contribution to employment. But this was one sector where employment was being created that could at least partly absorb the large number of job-seekers delivered annually by India's demographic profile dominated by the young. Sluggish demand and automation are limiting this contribution of the industry.

Since the IT and It-enabled services industries were among the few sectors outside of finance and real estate that were flourishing under liberalization, the deceleration in their growth marks the end of an era for the industry and a turning point in India's post-liberalisation growth record.