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IMPACT OF FDI IN SERVICE SECTORS IN INDIA: AUGMENTATION, DRIFTS AND SUSTAINABILITY CONCERNS

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ABSTRACT

The existence of efficient services in infrastructure is prerequisite for economic triumph. The services such as telecommunication, transport, banking & insurance supply strategically important inputs for all the sectors in the economy. The world economy is dominated by service sector. The importance of service sector can be judged by the fact that 67.2% of world GDP in 2013 is contributed by services. The contribution of the services sector in India is 55.2% to its GDP providing employment for 25.4% of the India's work force. India is the 12th place in the world based on the contribution of services to their respective economies. United States top the table followed by Japan and China in the list of service sector contribution to their economies and thereby to the world service GDP. Though China's GDP is three times more than India and hence service sector share despite being 39.2% is far ahead of India in absolute terms. China (10.5) followed by India (8.9%) are fastest growing economies in the world. When the world was reeling under recession, all the top twelve economies of the world registered negative growth in services, but China (9.4%), India (6.8) and Brazil (2.6%) registered positive growth in services. FDI flows have increased enormously to India. FDI involves the transfer of financial capital, technology and other skills to the host country FDI contributes to capital, technology, and entrepreneurship, managerial, professional and technical expertise.

KEYWORDS: Work Force, Services Sector, GDP, Employment, Economic Development, World Trade

INTRODUCTION

The existence of efficient services in infrastructure is prerequisite for economic triumph. The services such as telecommunication, transport, banking & insurance supply strategically important inputs for all the sectors in the economy. The world economy is dominated by service sector. The importance of service sector can be judged by the fact that 67.2% of world GDP in 2013 is contributed by services. The contribution of the services sector in India is 55.2% to its GDP providing employment for 25.4% of the India's work force. India is the 12th place in the world based on the contribution of services to their respective economies. United States top the table followed by Japan and China in the list of service sector contribution to their economies and thereby to the world service GDP. Though China's GDP is three times more than India and hence service sector share despite being 39.2% is far ahead of India in absolute terms. China (10.5) followed by India (8.9%) are fastest growing economies in the world. When the world was reeling under recession, all the top twelve economies of the world registered negative growth in services, but China (9.4%), India (6.8) and Brazil (2.6%) registered positive growth in services.

Recession ate the world trade in services by 12%. The world's import and export growth in services fell to 12% (WTO: International Trade Statistics, 2013). In 90s and first two quarters of 2000s there was a rapid growth in the service sector. It is attributed to the growth in the information technology and business process outsourcing services, along with the telecommunication, financial sector and the tourism & travel industry. But in 2014 three broad categories of commercial services namely transport, travel and other commercial services witnessed the decline in export growth. (WTO: International Trade Statistics, 2013) considering that services accounted for 5 per cent of the world trade at US$ 3.35 trillion (in 2014), the service sector will play an increasingly significant role in India's economic development.

India's share in merchandise world trade rose from 0.7% in 2000 to 1.1% in 2004 and further it increased, despite recession to 1.4% in 2013, which has taken India to the 21st largest exporter in the world (WTO: International Trade report 2014). The experts attribute India's rising share in world trade to a shift towards better quality and high-value products. 38% of the total exports by India is in services. The WTO statistics show that India has emerged as one of the dynamic suppliers of services in the world and is ranked 12th in commercial export of services and in commercial service imports. India software exports account for 48% of total service exports. (National Association of Software and Service Companies – NASSCOM) however the need to move faster assumes greater importance, considering that even smaller countries like Hong Kong, Singapore, and the Republic of Korea have a larger share in the global services trade.

The service sector has also played an important role in attracting foreign capital, with key producer services accounting for a growing share of foreign direct investment (FDI) inflows into the Indian economy. Given the service sector's role in facilitating India's integration with the world economy, the WTO's General Agreement on Trade in Services (GATS) has significance for India. GATS provide India with a frame work to India's main source of comparative advantage in services is its labour endowment. The country has the potential to export labour-intensive services at all skill levels, through cross-border movement of service providers, (mode 4 of GATS).

The Indian economy, since 1991, has opened its door in a systematic way to LPC forces. It has its impact on all the sectors, FDI flows have increased enormously to India. FDI involves the transfer of financial capital, technology and other skills to the host country. FDI contributes to capital, technology, entrepreneurship, managerial, professional and technical expertise (Brewer 1989) the host economy benefits from the additional economy activity, creating employment and tax revenue. Entry by foreign firms can also increase competition in domestic markets, reduce monopoly profits, and stimulate quality upgrades of products and services by all firms in the sector. FDI also stimulate economic growth and has a larger impact than domestic investment.

OBJECTIVES

The objectives of this paper are to study:

1. To analyze the progress the pattern of growth of FDI in service sectors
2. To estimate the prospects of growth of FDI in service sectors
3. To identify the sector which is attracting more FDI in service sector
4. To suggest policies, if any for increasing FDI flow in the service sector.
5. To identify the factors that hinders the growth in service sector.

The GATS is playing a crucial role in stimulating trade and development by seeking to create a predictable policy environment wherein the member countries voluntarily undertake to bind their policy-regimes relating to trade in services. The General Agreement on Trade in services (GATS) came in to existence as a result of the Uruguay Round of negotiation and entered into force on 1 January 1995, with the establishment of the WTO. The main purpose for the creation of the General Agreement on Trade in services (GATS) was to create a credible and reliable system of international trade rules, which ensured fair and equitable treatment of all countries on the principles of non-discrimination.

The growth of trade in services is expected to lead to the following benefits which will increase the economic performance of the nation:

1. **Greasing the wheels of development** The access to world-class services in developing countries helps exporters and producers to capitalize on their competitive strength in the goods and services they are selling.
2. **Employment opportunities**: The growth in trade in services promotes employment within the country so as to free the disguised unemployment from the agriculture. There will also be wide opportunities for the professionals overseas.
3. **Consumer choice**: Consumer in real sense will be the king as he will be getting variety of choices with better quality. The competition will lower prices and provide wider choice for consumers.
4. **Technology transfer:** the services liberalization encourages the foreign direct investment (FDI) flow into the economy. Such FDI generally brings with it new skills and

technologies that spill over into the wider economy in various ways.

The WTO secretariat has divided all the services into the following 12 sectors.

- Business services (including professional and computer services
- Communication services
- Construction and engineering services
- Distribution services
- Education services
- Environment services
- Finance (including insurance and banking) services
- Health services
- Tourism and travel services
- Recreation, cultural and sporting services
- Transport services
- Other services not elsewhere classified.

GATS provides for four modes of supply of services: cross border supply, consumption abroad, commercial presence, and presence/movement of natural persons.

Mode 1: cross border supply refers to a situation where the service flows from the territory of ne member country into the territory of another member country. For instance: a doctor sitting in India can advice his patients in America through electronic means. Teacher delivers his lectures to students of any country through internet. In both these cases, trade in services takes place and this is equivalent to cross-border movement of goods.

Mode 2: consumption abroad refers to a situation where consumer of a service moves into the territory of another member country to obtain service. For example, a tourist using hotel or restaurant services abroad; a ship or aircraft is undergoing repair or maintenance services abroad.

Mode 3: Commercial presence implies that service suppliers of a member country establish a territorial presence (a legal presence) in another member country with a view to providing their services. In this case, the service supplier establishes a legal presence in the form of a joint venture/ subsidiary/representative/branch office in the host country and starts supplying services.

Mode 4: presence or movement of natural persons (this only refers to export of manpower) covers situations in which a service is delivered through persons of a member country temporarily entering the territory of another member country. Examples include independent service suppliers (e.g. doctors, engineers, individual consultants, accountants, etc.) however, GATS covers only temporary movement and not citizenship, residence or employment on a permanent basis in the foreign country.

The GATS agreement enforces two types of general obligations on the part of the signatories namely MFN and Transparency.

1. **Most favored nation treatment:** under the MFN treatment a country is obliged to provide a country, which is no less favorable than the treatment it provides to any other country (i.e., if a GATS member country offers certain privilege to any other country, whether it be a member or not, it has to extend the same treatment to all GATS member countries). However, GATS allows member countries to undertake exemptions to this clause, in initial commitment, subject to review.
2. **Transparency:** this clause requires every country to publish all measures of general applications that affect the operation of the agreement. This clause is extremely important for traders doing business in a foreign country, as they are often not aware of the laws and regulations of the other country.

Reasons for increased demand for growth in services

1. Efficient services benefit the consumers.
2. The increase in the demand for efficient service attract more FDI in services, it in turn helps the creation of more employment, more income, more purchasing power, more savings, so on. And Keynes multiplier effect come into operations there by increasing national income.

India as hot destination for FDI in services

The following reasons can be cited as the important reasons for India becoming the important FDI destination.

1. A 350 million strong middle class and over 1003 million consumer community as a whole.
2. It is located between west Asia and south Asia on both sides with huge market.
3. Labour is relatively cheap.
4. Strong technical manpower which can be hired cheaply.
5. Unexploited abundant natural resource.
6. Determination of the government to carry forward the economic reforms.
7. India has the second largest English speaking scientific and technical manpower resource base in the world.
8. India is the ocean of natural resources, to name few:

a) 7500 km of coastline with exclusive economic zone of two million square kilometers.
b) 28000 kilometers of rivers and three million hectares of reservoirs of fresh water lakes.
c) India produces 84 minerals of which four are fuel minerals, 11 metallic, 49 non-metallic and 20 minor minerals.
d) Second largest producer of rice, third largest producer of wheat.
e) India is also important source country for low and semi-skilled service providers in services like construction, domestic work, and transport operations. It also has the potential to export labour-intensive services through technology-enabled data, voice, and information flows, i.e., cross-border supply (mode 1 of GATS).
f) India's global competitiveness is also striking. In recent years, the country has accounted for 70% of all specialty occupation (H-1B) visas granted by the US in computer services. Overall, Indian professionals across services as diverse as accountancy, engineering, consulting, medical and management accounted nearly half of all H-1B visas granted to foreigners in the US in the late 1990s.

Hence, there is a vast scope for increase in foreign direct investment in services in India.

Hence today service sector is also playing a crucial role in generating employment too. The five top biggest job creators as made out by the survey from India Today (Malini Goyal, feb 27, 2008) are 1) IT and ITES, 2) Banking & Finance 3) Retailing 4) Hospitality & Travel 5) Telecom. All the five top biggest job creators are from the service sector.

YEARWISE FDI INFLOWS

Table-1

Sl.No.	Year	Amount of FDI inflows	
		In rupee Crore	In US $ Million
	2002-2003	10733	2463
	2003-2004	18654	4065
	2004-2005	12871	2705
	2005-2006	10064	2188
	2006-2007	14653	3219
	2007-2008	24584	5540
	2008-2009	56390	12492
	2009-2010	98642	24575
	2010-2011	123025	27330
	2011-2012	123120	25834
	2012-2013	88520	19427
	2013-2014	91986	22295

Source: compiled from relevant years economic survey

India, in 2007 has emerged as the second most-attractive location for global foreign direct investment (FDI) next only to China, ahead of the US and Russia, says an AT Kearney report. There was three-fold increase in FDI inflows during 2008-09 over the previous year; FDI inflows touched US$ 6.6 billion as against US$ 3.7 billion over the corresponding period last year, reflecting the continuing pace of expansion of domestic activities, positive investment climate, and long-term view of India as the investment destination. Service sector was in the forefront account for 34.2 per cent of the total inflows during this period, followed by the construction industry with a share of 20.6 per cent. While Mauritius continued to be the dominant source of FDI to India, Singapore replaced US as the next important source of FDI.

SECTOR-WISE FDI INFLOWS RECEIVED

The important sectors which received more FDI flows from 2008 -2013 are the business services encompassing transportation industry, service sector, telecommunication, food processing industry, drugs and pharmaceuticals, consultancy services, miscellaneous & engineering, textiles, trading, and hotel and tourism.

Table-2

Sl.No	Sector	Cumulative inflows (April 2004 – October 2013)	% to total inflows
1	Service sector (financial and non-financial)	136639 (30562)	20%
2	Telecommunication (Radio, Paging, Cellular Mobile, Basic Telephone Services)	56909 (12519)	8%
3	Computer Software and Hardware	48455 (10879)	7%
4	Housing and Real estate	48405 (10853)	7%
5	Construction Activities (Including Roads and Highways)	43505 (9711)	6%

Source: compiled from the relevant issues of SIA newsletter, Ministry of Industries and commerce.

BANKING

At present there are 26 public sector banks in India with 74806 branches, 82 regional rural banks with 15486 branches. State-owned banks control 87.35% per cent of the total commercial branches. The Reserve Bank of India has granted operating approval to 25 new foreign banks or bank branches since liberalization by issuing new guidelines in 1993. By the end of 2013, there were 35 foreign banks with 310 branches operating in India. By 2013, five U.S. banks have a total of 16 branches in India. Foreign direct investment (FDI) in banking is slowly being liberalized and the foreign equity ceiling has been raised to 74 per cent from 49 percent for investment in private banks, FDI in state owned banks remains at 20 percent. Foreign investor voting rights are capped at 10 percent in private banks and one per cent in state-owned banks foreign banks may operate in India through only one of three channels; branches, a wholly owned subsidiary, or up to 74 percent ownership in a private Indian bank.

AUDIOVISUAL AND COMMUNICATION SERVICES

The Indian government has removed all barriers to the import of motion pictures, although U.S companies have experienced difficulty in importing the film/video publicity materials and are unable to license movie-related merchandize due to royalty remittance restrictions. The legislation by the parliament passed in December 2006 allowed the GOI to put in place the conditional access system for cable television whereby television subscribers would be required to install set-top-box decoders to view premium channels. In March 2004, in the face of considerable distributor and consumer resistance, as well as confusion surrounding pricing issues and other rules, the GOI suspended implementation of CAS pending review by a regulatory authority. The government of India permits FDI of up to 49 per cent in Indian cable networks and companies that uplink from India. Total foreign investment in direct to home (DTH) broadcasting has been restricted to 49 percent, with FDI ceiling of 20 percent on investment by broadcasting companies and cable companies. At present, news channels are permitted to have up to 26 per cent foreign equity investment. As of August 2005, they must also ensure that a dominant Indian partner holds at least 51 percent equity. In addition, operational control of the editorial content must be in Indian hands.

CONSTRUCTION, ARCHITECTURE AND ENGINEERING

Many construction projects are offered only on a non-convertible rupee payment basis. Only government projects financed by international development agencies permit payments in foreign currency. Foreign construction firms are not awarded government contracts unless local firms are unable to perform the work. Foreign firms may only participate through joint ventures with Indian firms.

TELECOMMUNICATIONS

The national telecommunication policy allows private participation in the provision of basic (including cellular) and value-added telecommunications services. Foreign equity in value added services is limited to 51 percent. For basic services, the limit was 49 percent, but was raised to 74 percent in February 2010. The government holds a 26 percent position in the international carrier, VSNL, a 56 percent position in MTNL, which primarily serves the Delhi and Bombay metropolitan areas, and a 100 percent position in BSNL, which provides domestic services throughout the rest of India. BSNL and MTNL have been emerged, but the disinvestment in BSNL has been resisted by the trade unions in BSNL.

DISTRIBUTION SERVICE

Indian distribution services sector is still in its infant stage. The developed countries retailing contributes towards 14-20 percent of the total employment, in India it is only 6-7 per cent. One of the reasons for lower contribution of the sector to GDP is that the sector is unorganized and highly fragmented with majority of outlets having very low profit margins.

Table-3

Share of retailing in total employment in selected countries	
Country	**Share of retail in total employment (%)**
India	6-7
China	6
Poland	12
Brazil	15
USA	11.7
Korea	18
UK	11
Malaysia	7

A survey by the research group ORG found that in 19 consumer goods categories 1,378 brands and 2,579 individual products entered the Indian market between 1990 and 1996. With increase in product based, chain retailers now have better sourcing options and average margins. In fact, over the past decade India has strengthened its positions as a sourcing hub for many large international apparel and home –furnishing retailers. In February 2004, walmart, the world's largest retailer, opened a global sourcing office in Bangalore to facilitate the sorucing of products from India.

Global consultancies such as KSA technopark and McKinsey have made various projections on the growth of retailing in India. KSA technopark projected that organized retailing would grow steadily at a rate of 6 per cent with the size of the industry increasing from Rs. 5,500 crores to around Rs 35,000 crores by the end of 2005. FDI is allowed up to 100 per cent in cash and carry wholesale segment. Under this metro of Germany has entered India and has 2 outlets in Banglore. The Wal-Mart in joint collaboration with Bharthi has 2 outlets in Delhi under cash and carry segment.

RETAILING

In Doha Round of talks India received requests from many countries including Korea, US, China, Singapore, Brazil, etc. to open up the retail sector. Retailing is one of the few sectors where FDI is not allowed in the Doha Round of negotiations. But trading partners pressured India to open up this sector.

The Government though decided to allow FDI in retail from 15th November 2014. It withdrew it following the stiff resistance from the opposition parties and trade associations. But franchises are allowed to set up businesses on a case-by-case basis; many foreign retailers have entered the Indian market through this route. As compared to other services sectors such as IT and education, the penetration of franchising in retailing and its success rate 46 is much lower.

The largest Indian retailer, food world, has a total sale of US $60 million. This is less than one-sixth of the sale of a single Carrefour hyper market. Retailing in single brand is allowed up to 100 per cent since 2014.

REAL ESTATE

FDI is not permitted in the real estate sector. The construction sector growth is restricted because of complex tenancy laws, rent control, high stamp duties and poor enforcement of building regulations issues like minimum acreage development, minimum capitalization requirements and a three year lock in period before repatriation of proceeds limit the attractiveness of this sector to foreign firms. There is no cap on FDI in the health sector but foreign individuals are prohibited from providing services for profit and are subject to the registration requirements of the respective medical associations in India. Professional services like accountancy, legal and other service sectors like retail distribution, postal and rail transport services are closed to foreign participation. The bar council and a foreign service provide so enrolled must belong to a country which allows Indian nations to practice in their country. FDI is not permitted in this sector and international law firms are also not authorized to open their offices in India.

INDIAN FUTURE MARKET

India has submitted requests to our trading partners in computer related services, Architecture services, Health services, Audi-Visual services, Tourism services, Maritime services and financial services. A brief sector wise description of the requests that India has made to its trading partners and the ones it has received from them are available at the we-site of the Department of commerce. India has circulated its initial offer in ongoing services negotiations under the WTO general Agreement on trade in Services (GATS) in January 2008.

BARRIERS TO FOREIGN SERVICE PROVIDERS IN INDIA

A sector wise analysis shows India has to liberalize many sectors.

- In few sectors through GATS commitment is to allow FDI of 51%. India has liberalized up to 100% through the automatic route with the exception of B2B electronic commerce where FIPB approval is required and foreign promoters are required to disinvest 26% of ownership.
- Lack of Government will in bringing labour laws.
- Excessive Bureaucratic regulations.
- Poor quality infrastructure.
- The Indian Government continuous to prohibit or severely restrict FDI in politically sensitive sectors such as agriculture, retail trading, railways and real estate.

SERVICE SECTOR WILL SUSTAIN IN INDIA

At present, India has one of the largest road networks in the world, aggregating to about 3.31 million kilometers. National Highways in the country at present is about 65,569 km. India is one of the fastest growing mobile phone markets in the world and may foreign companies are competing to enter into Indian market and make their presence in growing telecom sector in India. According to Telecom Regulatory Authority of India, the number of telephone subscriber base has touched 671million during the month of June 2013.

The introduction of competition in the telecom sector has led to a dramatic drop in tariffs. In particular, GSM tariffs have dropped from Rs. 14.5/minute in March 1998 to Rs. 0.50/minute in 2010. National Long Distance (NSD) and International Long Distance (ILD) rates have also dropped dramatically by the shift away from a monopolistic market to a competitive market.

CONCLUSION

The four key items on the agenda for the Hong Kong ministerial were services, agriculture, Non-agricultural market access (NAMA) and special and differential treatment for developing countries.

The draft of the Hong Kong declaration agreed on December 18, 2012, speaks about further liberalization in Mode 3, that is, the commercial presence category of service providers. This will usher in increased FDI in a vast gamut of service sectors such as banking, insurance, construction and related engineering, tourism, education, telecommunication, computer related and professional services. It also provides for removal or substantial reduction of economic needs tests in countries such as relaxing the norm that local employment should be generated. India should utilize the opportunity, the liberalization has provided, in attracting the FDI in services sector to the optimum and regulate it towards growth.

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