IMPACT OF FDI IN SERVICE SECTOR ON INDIAN ECONOMY

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ABSTRACT

Foreign Direct Investment (FDI) conveys great advantages to India. The performance of service sectors has impact to overall economic growth. The Primary and secondary sector of economy may benefit from their interaction with foreign services suppliers through spillovers of management, organizational, marketing, or technological knowledge. However the level and composition of FDI, to be allowed is a challenge that needs to be addressed. The regulator must be in place, who can ensure level playing field to all player: Local & Foreigner.

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The growth and composition of Services sector is regarded as mirror of country's economic progress. The service sector has become important for many economies in the world and very important particularly for India. While for the medium and long term, it is important to accelerate the growth of industrial sector particularly manufacturing sector to catch up with the growth of services sector and maintain a decent and stable growth of agricultural sector. The services sector has been a major and vital force steadily driving growth in the Indian economy for more than a decade.

The contribution of the services sector to the Indian economy has been manifold: In 2010-11, the sector contributed 55.2 per cent share in gross domestic product (GDP), growing by 10 per cent annually, employing about a quarter of total employment, accounting for a high share in foreign direct investment (FDI) inflows and over one-third of total exports, and recording very fast (27.4 per cent) export growth through the first half of 2010-11.

The share of services in India's GDP at factor cost (at current prices) increased from 33.5 per cent in 1950-1 to 55.1 per cent in 2010-11 and to 56.3 per cent in 2011-12 as per Advance Estimates (AE). If construction is also included, the service sector's share increases to 63.3 per cent in 2010-11 and 64.4 per cent in 2011-12. With a 16.9 per cent share, trade, hotels, and restaurants as a group is the largest contributor to GDP among the various services' subsectors, followed by financing, insurance, real estate, and business services with a 16.4 per cent share. Community, social, and personal services with a share of 14.3 per cent is in third place. Construction, a borderline service inclusion, is at fourth place with an 8.2 per cent share.

According to IMF, FDI (foreign direct investment) is an "investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of investor, the investor's purpose being to have effective voice in the management of the enterprise" The debt crisis and the Asian financial crisis have showed that FDI was more stable in difficult periods than other forms of capital inflows.

Foreign Direct Investment makes impact at Micro and Macro levels. At Micro level, it can cause structural changes in economic and industrial organisation. The market can become either more competitive or a monopolistic one in which the TNC can exploit its market power to raise prices and make an adverse impact on the consumer. At Macro level Firstly-it enhance the productivity through introduction of new technology which in turn benefits the host economy only. The developing economies which are capital starved can take advantage of the available technological spillovers to improve upon their competitiveness. Secondly- It provides the host countries with the access to large foreign markets because they have an established brand name and well developed distribution channel. This leads to creation of an export base for the developing nations. Thirdly- It promote manufacturing competitiveness and local capabilities.(FDI, technology, development and competitiveness. They can either boost competition tendencies or drive out local firms to gain market power. TNCs can help restructure and upgrade competitive capabilities in import substituting activities as well. Lastly- It contribute positively to the efficient and productive utilization of resources in the host economy. A direct investment in the country gives ownership advantages and reduces the transaction costs which it would have incurred if it was located outside host economy.

During the early development phase of any country, expansion of output in manufactured goods precedes growth in the services sector. As a country progresses further manufacturing often takes a back seat, giving way to the services sector in terms of both output and employment, and manufacturing firms themselves become increasingly service centric in order to remain competitive. We may argue that the decline in manufacturing and corresponding shift to services is unsupportable in the long run as services depend critically on manufacturing for their demand. Although this argument may be applicable for certain services such as retailing and transportation, it does not entirely hold for many other services. IT in particular India has also liberalized the FDI policy in the past decade. Services sector has received the greater proportion of FDI, the leading industries attracting FDI being telecommunications, automobiles and Information & technology. In the case of the Indian economy, the conventional wisdom of development do not hold good, it seems to have been turned upside down, with the services sector taking a substantial lead over manufacturing. In India’s case, there are positive spillovers from services growth to manufacturing, through income, demand, technology, and organizational learning.

According to a report by ASSOCHAM 2012 on India’s experience with FDI: role of a game changer, following sectors showed increased competition effects when opened to FDI Telecommunications – “The liberalization process that took place and the subsequent policy initiatives has paved the way for influx of private players. The regulatory body overseeing the functioning of the sector is The Telecom Regulatory Authority of India (TRAI) and its main objective is to ensure a level playing field that encourages greater but fair competition so as to provide the consumers a better ambit of services at an affordable price. The Indian government has relaxed the limits on FDI into the sector considerably which has led to an increase of foreign capital into the sector.

In 2002 the equity caps for foreign investment was lifted and since then the automobile industry has witnessed a healthy growth in inflow of investments. With rising competition to attract customers the companies now design their products suitable to consumer’s requirements. Better and diversified products due to competition effects add to consumer welfare. Information Technology sector has been opened to 100% FDI. This has become one of the sunshine sectors in India due to evolving better quality products as a result of competition. No evidences of a TNC accumulating market power have been found.

In developed and developing countries alike, the main recipients of FDI have been profit-seeking producer services which range from network-intensive services such as electricity, telecommunications, and transport to finance and business services. These sectors are characterized by the facilitating and intermediating role which they play for downstream user firms. Thus, producer service sectors are an intricate component of a country's business environment.

The global economic and financial crisis had a dampening effect on overall FDI flows. FDI in services, which accounted for the bulk of the decline in FDI flows due to the crisis, continued on its downward path in 2010. FDI in all main service industries (business services, finance, transport and communications, and utilities) fell, although at different rates. Overall, FDI projects in the services sector declined from US$ 392 billion in 2009 to US$ 338 billion in 2010, resulting in its share in sectoral FDI declining from 33 per cent to 30 per cent in this period.

Business services declined by 8 per cent compared to pre-crisis levels as multinational companies, who are outsourcing a growing share of their business support functions to external providers, downsized their operations due to economic slowdown. Transportation and telecommunication services also suffered equally in 2010 as the industry's restructuring was more or less complete after the round of large mergers and acquisition deals before the crisis, particularly in developed countries. FDI in the financial industry experienced the sharpest decline and is expected to remain sluggish in the medium term. Over the past decade, its expansion was instrumental in integrating emerging economies into the global financial system, bringing substantial benefits to host countries' financial systems in terms of efficiency and stability. Utilities were also strongly affected by the crisis as some investors were forced to reduce investment or even divest due to lower demand and accumulated losses.

FDI plays a major role in the dynamic growth of the services sector though the ambiguity in classifying various activities under the services sector poses difficulty in the measurement of FDI inflows into this sector. The combined FDI share of financial and non-financial services, computer hardware and software, telecommunications, and housing and real estate can be taken as a rough estimate of FDI share of services, though it could include some non-service elements. This share is 41.9 per cent of the cumulative FDI equity inflows during the period April 2000-December 2011. With the inclusion of the construction sector (6.5 per cent), the share of services in FDI inflows increases to 48.4 per cent. If the shares of some other services or service-related sectors like hotels and tourism (2.02 per cent), trading (1.94 per cent), information and broadcasting (1.60 per cent), consultancy services (1.21 per cent), ports (1.04 per cent), agriculture services (0.91 per cent), hospital and diagnostic centres (0.72 per cent), education (0.30 per cent), air transport including air freight (0.27 per cent), and retail trading (0.03 per cent) are included then the total share of cumulative FDI inflows to the services sector would be 58.4 per cent. Following the general trend in FDI inflows, FDI inflows to the services sector (top five sectors including construction) have also slowed down in 2009-10 and 2010-11, with negative growths of -7.5 per cent and -42.5 per cent respectively in rupee terms. Though the year 2011-12 (April-December), seems to reverse the trend of negative growth.

India's services sector has been resilient even during the tumultuous years of the global economic crisis maintaining a steady growth of around 10 per cent. This happened even when overall GDP growth dipped sharply to 6.7 per cent in 2008-9. The impact of the global crisis was, however, evident in the trade, hotels, and restaurants and construction categories and with lagged effect in real estate / ownership of dwellings and business services in 2008-9 and 2009-10; and to some extent in banking and insurance in 2009-10. 10.71 Moving forward in 2011-12, though there is slight moderation in services growth to 9.4 per cent (as also in 2010-11), as it is due to the steep fall in growth of public administration and defence services reflecting fiscal consolidation of the government. In fact growth in 'trade, hotels & restaurants, transport, storage and communication' is more robust at 11.2 per cent and retail-sector growth is expected to be more robust in 2012-13.

Internationally India has not fared bad in terms of share of service sector in GDP. India's performance in terms of this indicator is not only above that of other emerging developing economies, but also very close to that of the top developed countries. Among the top 12 countries with highest overall GDP in 2010, India ranks 8 and 11 in overall GDP and services GDP respectively. While countries like the UK, USA, and France have the highest share of services in GDP at above 78 per cent, India's share of 57 per cent is much above that of China at 41.8 per cent. In 2010 compared to 2001, India is the topmost country in terms of increase in its services share in GDP (7 percentage points) followed by Spain and Canada (5.3 percentage points each), the UK (4.5 percentage points), and Italy (3.2 percentage points). In terms of compound annual growth rate (CAGR) for the period 2001-10, China at 11.3 per cent and India at 9.4 per cent show.

In emerging economies where manufacturing firms are constrained by cumbersome business environments, it is particularly relevant to understand how the performance of service sectors can be improved and how that supports business development and, thus, overall economic growth. FDI is a potentially powerful means to achieve such improvements as it might increase the quality and variety of services available as well as lower their cost. Manufacturing firms may benefit from their interaction with foreign services suppliers through spillovers of management, organizational, marketing, or technological knowledge.

FDI has proved to stimulate economic growth and development in many of the countries including India. It not only promotes capital formation but also improves the quality of capital stock. In order to promote competitive markets developing nations must reduce restrictions on FDI. We need to learn from the experiences of successful countries. The ultimate motive should be to minimize the "bads" and maximise the "benefits". The benefits from FDI tend to be maximized when foreign investors operate on an even and competitive playing field. A competitive and even playing field creates incentives to upgrade productivity throughout the economy; countries also need domestic actors capable of responding to these incentives. This implies that the domestic labour force must be capable enough of taking advantage of the skills upon which these firms have an edge.

Thus the government should act as a "facilitator" rather than a "provider". We should try to create a conductive environment for make Foreign Direct investments in India more attractive. We can introduce FDI in our economy through a gradual process such that the local enterprises get time to adapt to the new competitive era and absorb the technological spill over that these TNCs bring in along with them. There is no dilemma in allowing FDI into the different sectors of the economy. There is no doubt that government has a major role to play. The level and composition of FDI that should be allowed is a challenge that needs to be addressed. There could be policies that can allow us to extract maximum benefits from foreign investments that outweigh the losses we suffer from them.

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