Chapter 89
Trends of FDI and Production in Service Sectors:
A Dynamic Panel Exercise with Indian Data

Madhabendra Sinha
National Institute of Technology Durgapur, India

Partha Pratim Sengupta
National Institute of Technology Durgapur, India

ABSTRACT

The chapter investigates the role of foreign direct investment (FDI) on performances of Indian services at sector level. Service sector is marked as one of the fastest growing sectors in India, contributing more than 65 percent of GDP. The maximum share of FDI inflows in India is also captured by service sectors. So FDI inflows can have significant impacts on services. We collect quarterly data of components of services from GDP estimates of Central Statistical Office (CSO) and monthly data of sector wise FDI inflows from DIPP over the period January 2009 to March 2016 in India. After matching the data series, we form a balanced panel for four basic service sectors as classified by CSO. The stochastic properties are looked into by carrying out LLC and IPS panel unit root tests. Empirical results from the estimate of Generalised Method of Moments (GMM) suggest that FDI Inflows enhance performances of Indian services.

INTRODUCTION

Service has been emerged as one of the largest and fastest growing sectors in the global economy, contributing more than 60 percent of global output, even larger share of employment in many countries (Hoekman & Mattoo, 2008) since last two and half decades. The growing share of services in global transactions has also accompanied the growth in service sectors. It is a fact that during the same time period trade in services has grown as fast as trade in goods is the cause of rise in international supply

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of services. The ratio of global trade in services to goods has increased to 27 percent in 2010 from 20 percent in 1980 (WDI, 2011). Service sector has also attracted huge amount of inflow of foreign direct investment (FDI). Sector wise data of FDI stock provided by UNCTAD (2015) highlighted that the prominent role of services in global FDI. The services has accounted for 63 percent of global FDI stock, more than twice of the share of manufacturing, at 26 percent in 2012. There is a shift of ongoing sector level composition of FDI from manufacturing to services because the share of services in global FDI stock has gained 14 percent with a corresponding decrease in manufacturing to 26 percent from 41 percent since 1990.

Like global economy, India has also experienced a major improvement in services led economic growth since economic reform. Indian services sector assumed a central role in its remarkable growth story and grew at an average annual rate of 8 percent during 1990s. According to Economic Survey 2014-15 published by government of India, service sector is contributing nearly 65 percent to the overall economic growth since 2010. There has been satisfactory growth in Indian service sectors like Information Technology, Business Process Outsourcing and Knowledge Based Activities. Further, productivity growth in India, unlike other regions of the world, has been the strongest in services (IMF, 2006; Bosworth & Collins, 2007). A common phenomenon in economic growth theory is service-led growth (Kuznets, 1957; Chenery, 1960). Traditionally a major part of demand for services comes from the secondary phase of growth in manufacturing sector. But the growth of Indian service sector is having an altogether different story, largely independent of manufacturing sector.

Along with a large-scale expansion of output and employment in the services sector, India's trade in services has also been an outstanding during the post-reform period. Due to various measures of economic reform, India's service trade has been growing rapidly since the early 1990s. Banga (2005) and Dash and Parida (2011) found that high growth in Indian service sector in 1990s relates to higher growth of trade in services. India's services trade has registered a remarkable growth of 19.7 percent, which was fairly higher than the rate of growth of goods trade (13 percent) during 1990-2010. According to Handbook of Statistics on Indian Economy published by RBI, there has been a rapid growth of India's trade in services in the past two decades. It reached to US$ 240 billion in 2010 from US$ 6 billion in 1980s. India's service export has not only grown more rapidly than its merchandise export, but also it has grown faster than global service exports. Contribution of India's trade in services to total trade has increased from 20 percent in 1980s to 30.4 percent in 2010. A substantial part of the growth of service export (21.7 percent) was in the post-reform period. India was having a negative balance of trade in services in 1980s and 1990s, but from 2004 it has been positive. Share of India's trade in services to world has increased to more than 3 percent in 2010 from less than 1 percent in 1980, while the same in goods trade has remained constant at around 1 percent.

During the period of post liberalization, India has not witnessed only higher growth of aggregate FDI inflow but also the sector wise composition of FDI has changed considerably. Services sector has absorbed a very little portion of FDI during the first decade of post reform period. According to narrow definition of DIPP, government of India, only 7 percent of total FDI inflow came into this sector. But the broad definition of service sector, includes telecommunications, construction, computer software, trading, transports, information and broadcasting, hotel and tourism, consultancy services, health services and education, has described the share of total FDI inflows has gone up to 44 percent during this period. In the second decade of the period of post economic reforms this share increased even further to 60 percent. Financial, construction, communications, power, computer software and trade services have attracted larger part of FDI inflows as compared to other sectors within services.

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