FDI and Trade in Services Towards Sustainable Economic Growth: An Empirical Evidence from India

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ABSTRACT

The paper empirically investigates the inter-linkage between FDI inflow and international trade in service sector in India. Service sector emerges as the fastest growing sector worldwide during current phase of globalization, contributing more than 60 percent of output and almost 35 percent of trade in global economy. The sector also accounted for 63 percent of global stock of FDI. With hosting a large amount of FDI inflow, Indian service sector is also identified globally due to its substantial improvement in growth and export in international market. So there needs a study to explore the theoretically established causal relationship between FDI inflow and international trade in services towards sustainable and service led economic growth in India. The authors collect monthly data from DIPP, Government of India and RBI over a globally witnessed emerging period from January 2009 to June 2016 and apply ADF and PP unit root tests followed by least square estimation after testing the seasonal effects. Their findings imply unidirectional causality between FDI inflow and export Indian services.

KEYWORDS

FDI, Indian Economy, OLS Estimation, Service, Sustainable Growth, Trade, Unit Root Test

INTRODUCTION

Sustainable economic growth has been an emerging topic of discussion and further research nowadays where the role foreign capital in terms of FDI inflows in the process of international trade at sector level is a debatable issue in the transitional as well as developing economies like India, where very few specific sectors like services lead the economic growth, which is also linked with export patterns of those sectors. With the lack of capital stock, poor technological base of production is also another factor for impinging upon growth in developing countries. In this situation FDI inflow can mitigate various constraints of growth to some extents by bringing foreign capital with modern technology, organizational structures and managerial techniques (Prakash & Balakrishnan, 2006). The UNCTAD (2015) reported that global inflow of FDI has been decreased by 16 percent whereas the developing countries have accounted for a record 55 percent of global FDI inflows, reached their highest level ever at US$ 681 billion with a 2 percent increase in 2014. The report has also pointed out that starting from a baseline of less than US$ 1 billion in 1990; India ranked the eighth position and recorded an outstanding increase in FDI inflows reached at US$ 34 billion with 22 percent increase in 2014. During the period of post liberalization, India has not witnessed only higher growth of aggregate

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FDI inflows but also the sector wise composition of FDI has changed considerably. Service 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 sectors, include telecommunications, construction, computer software, trading, transports, information and broadcasting, hotel and tourism, consultancy services, health services and education, have 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.

During the last two and half decades, service sector has emerged as one of the fastest as well as largest growing sector in the world economy, contributing more than 60 percent of global output, even larger share of employment in many countries (Hoekman and Mattoo, 2008). The increasing share of services in global transactions has also accompanied the growth in service sectors. The 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 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 sectors have also attracted huge amount of FDI inflows. Sector wise data of FDI stock provided by UNCTAD (2015) highlighted that the prominent role of services in global FDI. The services have accounted for 63 percent of global FDI stock, more than twice 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 been increased by 14 percent with a corresponding decrease in that in manufacturing sectors from 41 percent to 26 percent during post reform period.

India has also experienced a major improvement in services led economic growth since economic reform. Indian service sector assumed a central role in its remarkable growth story and grew at an average annual rate of 8 percent during 1990s like global economy. 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, knowledge based activities and business process outsourcing. Additionally, productivity growth in India, unlike other parts of the world, is the strongest in services (IMF, 2006; Bosworth and 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.

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 along with a large-scale expansion of output and employment in the service sectors. 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
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