Chapter 3

Concepts And Framework of Trade in Services: A Theoretical Review

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1. Introduction

The forgoing chapter dealt with the genesis as well as the architecture of a god-sent institution named as World Trade Organization (WTO). The chapter also succinctly dwelt upon the various agreements of the WTO’s constitution, incorporating the arenas enfolded by Indian economy under the WTO’s umbrella. The present chapter purports to delve into conceptual aspects of the services. The chapter scans whether the standard kit of international theories, pertaining to services have acted as guiding torch at the realm of trade and investment or not. It further peeps into the ingredients stimulating the growth of services and also presents at length accounts as regards the role of services at the developing countries’ domain.

Trade in Goods was hitherto acknowledged as the sole forte of global trade and commerce, but the fag end of twentieth century witnessed the emergence of trade in services making dent at the landscape of international trade. More than the change in the pattern of goods, the change in favor of services in foreign trade was manifested. The service sector in vogue envelops a wide range of areas and activities. It spread beyond the conventional arenas of finance, transport, communication and tourism to young dynamic arenas such as information technology and electronic commerce. Nascent and emerging areas such as environmental and educational services are also constituents of this sector in the modern era. The sheer heterogeneity as well as spectrum of services transcends the
hitherto static attributes of non-storability, non-tradability and intangibility.¹

2. Concepts of Services

While reviewing the galore studies presented on services, there is still a debate as to the varied concepts of services. The classical economists characterized services as product of labor that perish at the moment the labor is performed, giving an air of intangibility.² Adam Smith in his momentous work titled “wealth of Nations” made a demarcation between ‘productive and unproductive labor where the former was linked in producing vendable commodities while the work of latter perished at the very instant of production.³ Fridrich List, while contemplating the evolution of the growing economy, defined its ultimate stage as “commerce-inclusive stage attributed by a significant share of service sector in production and in consumption.⁴ Colin Clark brought out that services, as a residual approach, encompass those activities that are not covered under primary and secondary sector.⁵

Allan Fisher and Colin Clark were the pioneer in sketching demarcation line among the primary, secondary and service sectors. Hill (1977)⁶ differentiated between goods and services on the basis of attributes attached with them. He highlighted that the producers of service can neither store nor accumulate service, focusing that service has to be exhausted as they are produced. Hill had traced out three attributes of services. One, as a transaction between separate economic unit, second, as a activity adding value to goods, third, as a level of contact
between the buyer and the seller superceding the extent entailed in goods transaction.

Shelp Stevenson, Truit and Wason (1984)\textsuperscript{7} distinguished five different categories of services associated with stages of development, which are enumerated below:

- At the first rung are the unskilled personal services such as housekeeping services and street vending service.
- At the second stage, skilled personal service which emerges on account of escalation in pace of industrial revolution. It is on the account of Industrial revolution that led to germination of government services and social services.
- At the third stage, complexities and sophistication get injected in industries. As a result, skilled services are entailed, which get executed by legal, accounting firms, banks and insurance companies.
- At the fourth stage, it is the industries that dispense affluence among the mass and thereby facilitate ground for consumable services in the form of travel and entertainment.
- Lastly, the initiation of technology and breakthrough innovation paved the trajectory of high technology services.

Baumol (1985)\textsuperscript{8} designed three major classifications for services. These are stagnant services like haircuts, progressive personal service like electronic communications and asymptotically stagnant impersonal services, which are blend of the first two like computation involving computer software and hardware. The studies by Bhagwati (1984, 1985, 1987)\textsuperscript{9} were the one that broke new grounds in the services literature. Bhagwati revealed that the spurring of service sector gets nourishment on account of transportation of economic activity. The incessant technical and structural changes paved the way for continuous
activities during which services splinter off from goods and goods in turn splinter off from services. Further, the splintering process is linked with disembodiment effect. Bhagwati further deliberated that the services from goods splintering process generally spawned service activities which are technically progressive and possibly capital intensive, whereas the goods from services splintering process reveals the disembodiment effect, most oftenly leaving a residence of service activities which are technically unprogressive and generally labor intensive. Stern and Hockman (1988)\textsuperscript{10} focused that services can be (i) complementary to trade in goods (ii) substitute for trade in goods unrelated to goods. (iii) Unrelated to goods.

Hirsch (1989)\textsuperscript{11} deliberated as to why services are demanded? Hirsch opined that service is procured to facilitate any of the following objectives:

- Instant benefits (e.g., travel, entertainment, haircuts etc.)
- Enhancements of user's consumption benefit capacity by reducing the cost-benefit ratio per product transaction (e.g., transport communication, financial service, insurance, etc.)
- Enhancement of user's productive capacity by reducing the cost-benefit ratio per unit of output (e.g., transport, training business service, medical services).

Melvin (1989)\textsuperscript{12} classified services into three forms. Firstly there are contact services that entail double coincidence of time and space, such as medical services. Secondly there are substitution services, where personal contacts, may be opted for, but close substitutes may be provided through intermediation. Intermediary services are those necessitated for market-clearing. Thus a good number of studies above have thread bare
examined and reviewed the various modes of services. To sum up, it can be cogently inferred that services mirror the following principal attributes:

- Non-transferability and non-storability
- Heterogeneous and feasible in production.
- Add value to goods.
- Residual activities not encompassed in agriculture and manufacture.

In nutshell, it can be perceived that the services can be classified in a number of ways, such as, Intermediate and final services, Market and non-market services, Distribution, Producer, Social and personal services and Capital-intensive, human-capital-intensive and knowledge-intensive services.

3. **Frame work of Trade in Services**

A country's international trade encompasses both visible and invisible items, such as merchandise goods, factor services and non-factor services. International trade in services is the supply by residents of one country to demanders resident in another country of services that are not incorporated in goods (other than in the paper, film, disks and the other used to record and transfer the service). The receiver of the service, may be a person like (a haircut, entertainment or transport), a legal entity, such as (a company or government insurance or banking) or objects such as airplanes (for repairs or airport services) or merchandise (for transport). For some of the trade in services transactions, it is indispensable that the receiver of the services
is close to the supplier, like in the case of surgery and repairs, tourism and transport services. On the other hand, there are international service transactions that are supplied without the nearness of supplier. Such services are architectural and computing services, boarding entertainment, which can be communicated through mail or by electronic means.  

The principle of trade in services is not as forthright as the concept of trade in goods. The main reason owns to its identification. On one hand there is national accounts system, which is useful for examining the relative importance of the services sector to the national economy, whereas the country’s balance of payments reveals classification of services for the purpose of examining international trade in services. Table-1 presents a comprehensive account as regards identification of services sector.

Services contain factor and non-factor services. Factor services or factor income include incomes on direct investment, portfolio investments, re-invested earnings on direct investment, whereas non-factor services comprise a wide range of economic outputs such as advertising, banking, data processing, engineering and construction, education, insurance, leasing and transportation. For the purpose of balance of payments accounting, as published by IMF and its member counties, non-factor services are broadly grouped into travel, transportation, insurance and technology.
Table 1

Identification of Services Sectors

<table>
<thead>
<tr>
<th>Balance of Payments</th>
<th>National Accounts</th>
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<tbody>
<tr>
<td>1. Goods and Services</td>
<td>1. Primary</td>
</tr>
<tr>
<td>b. Services</td>
<td>3. Services Sector</td>
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Tradable Services

- Construction
- Transportation services
- Travel Services
- Communication Services
- Insurance Services
- Financial Services
- Computer and Information Services
- Royalties and license Services
- Personal, Cultural and recreational Services
- Other Services, Private (including real estate)
- Government Services

Non-tradable Services

- Electricity, Water, Gas
- Ownership of Dwellings

2. Income: Investment income and Compensation of employees

3. Currents Transfers

Most economists have categorized international transaction in services into three groups.

- Cross-border or separated trade analysis to trade in goods.
- Transactions that entail the movement of the producer to the location of demander (demander-located services) and
- Transactions that imply the movement of the consumer to the location of provider (provider-located service) \(^{16}\)

Sampson and Snape (1985) \(^{17}\) and Sapir and Winter (1994) were the pioneers in revamping the designing of international trade in services. Their classification of international transaction in services rests on the impediment on the physical location of producer and consumer in achieving the transactions.

- Services transactions sans the movement of producer and consumer of service.
- Services transactions for which the consumers move across the boundaries to the infeasible producer.
- Services transactions that are attained by the temporary movement of factors of production across national border while the consumer does not move.
- Services transactions by means of permanent local establishment via a foreign affiliate of a firm emerging from a different country.

The institution of World Trade Organization (WTO) formed in April 1994 and came in force in January 1995, under its cardinal wing named as General Agreement on Trade in Services (GATS) has imbibed the above cited brainchild of Sampson and Snape (1985) and Sapir and winter (1994). The GATS has recognized the flow of services through four routes. In WTO Jargon these are called as modes of supply.

Mode 1: Cross border supply
Mode 2: Consumption Abroad

Mode 3: Commercial Presence

Mode 4: Movement of Natural persons

For enhancing the clarity on services, the United Nations has brought out the central product classification (CPC). This classification rests on products and picks out more than 600 services products. The CPC classification is now applied as reference for the identification of services under the GATS and also expresses the services components in the balance of payments as recommended in the IMF’s Balance of Payments Manual (IMF 1993).

United Nations International Standard Industrial classification (ISIC) has enriched the lexicon of trade in service. The comprehensive categories of services are electricity, gas and water; construction, whole sale and retail trade; hotels and restaurants; transport, storage and warehousing; post and telecommunications; financials institutions; insurance; real estate; business services; machinery and equipment rental and leasing; public administration and defense; sanitary an social services; social and related community services (including education, research and scientific institution, radio and television broadcasting, entertainment services); and personal and household services.  

4. **Skills Needed for Trade in Services**

Trade in services encompasses galore services under its ambit. Different traded services necessitate particular services.
a. **Low-skill Services.** They demand generally not very high levels of formal education, fundamental knowledge of relevant language. Data entry; call centers are some of the low-skills services.

b. **Medium-Skill Services** – Services included under this ambit calls for specialized training, more advanced skills. Ticketing, billing and accounting services are some of main medium-skill services.

c. **High-Skill Services** – Such services comprising advanced skills at high levels of specialization, often with strong educational background. Technology system design, new software development and animation are some of main high-skill services.

5. **Conceptual Review of Trade and Foreign Investment: Theories and approaches**

5.1. **Theories on International Trade**

With the concept of self-sufficiency becoming passé, the process of economic linkage in world economy has become driving anthem in today's business world. In consonance to global trade scenario, the globalization of services have also proliferated with high pace. Thereby this escalation of services has advanced the pace of discourse on multifaceted issues pertaining to trade and investment in services. The international trade theories have shed light on providing correspondence to warranting interrogations like why do countries import goods that can be produced domestically? How much to trade? With whom to trade?
Under this backdrop, it is quite topical to sift through whether the theories of trade and investment that have their bearing on goods (merchandise) are able to fetch analogous applicability on services' realm. Some of the prominent trade theories that have been in vogue in the realm of trade are briefly reviewed in the succeeding paragraphs.

a. **Mercantilism**

   The mercantilism theory was promulgated for the benefits of colonial powers. This trade theory paved the foundation stone of economic thought from the period 1500 to 1800. The theory holds that a country's wealth was gauged by its holding of treasure, mostly in form of gold. The theory also advocates that countries should export more than they import and receive their trade surplus in form of gold from the country that runs in deficits.

b. **Smith's Theory of Absolute Difference in Costs.**

   The theory recommends that each country should specialize in production of those commodities, which it can produce more cheaply than others and exchange for those commodities which cost less in other countries.

c. **Ricardo's Theory of Comparative Difference in Costs.**

   The theory states that it is comparative difference in costs that govern trade relations between two countries. Production costs differ in countries on account of geographical division of labor and specialization in production. The essence of the theory follows that each country should specialize in the production of
those commodities in which it has the greatest advantages or the least comparative disadvantage.

d. **The Productivity Theory**

The productivity theory focuses toward the indirect dynamic benefits from international trade. By widening the size of the market, international trade makes a greater use of machinery, foster inventions and innovations. Larger volume of market enhances the labor productivity and facilitates the trading country to enjoy increasing returns, lower costs and thereby attain the economic development.

e. **The Theory of Opportunity Costs**

The theory presents a simplified version of general equilibrium model of international trade. It throws light on the vital role of factor substitution in trade theory and examines pre and post trade situations under cost increasing and decreasing opportunity costs.

f. **Mills Theory of Reciprocal Demand**

It reveals the country’s demand for one commodity in terms of quantities of the other commodity that it is prepared to give up in exchange. The theory states that it is reciprocal demand that governs the terms of trade, which ultimately influence the relative share of each country.

g. **The Heckcher – Ohlin Theory**

The Heckscher-Ohlin theory advocates that the main determinant of the pattern of production, specialization and trade among regions is the relative availability of factor
endowments and factor prices. The theory recommends that the main ground of trade between regions is the difference in prices of commodities based on relative factor endowments and factor price.

h. **The Kravis Theory of Availability**\(^{26}\)

The theory states that the commodity composition of trade is designed by "availability". Trade takes place in only those goods that are not available at home. This theory provided two statements. Firstly country will import those products, which are not available at home turf. Secondly, export those products that have more supply than demand.

i. **Linder's Theory of volume of Trade and Demand Pattern**\(^{27}\)

The theory states that the country will export its commodities to those economies whose income levels and demands are in consonance with those of exporting country. This is known as 'preference similarity'. Thus the theory insists that trade zooms between those countries that mirror same capital labor ratios and per capita income level.

j. **Posner's Imitation Gap or Technological Gap Theory**\(^{28}\)

Posner theory advocates technological change as an incessant process, which holds the pattern of International trade. When the technological innovation takes the form of production of new good in one country, it leads to the limitation gap and creates demand gap in other country. The intensity and volume to which trade will flow between the two countries rests on the net effect of the demand lag and imitation gap.
k. **Vernon’s Product Cycle Theory**\(^{29}\)

This theory continues to act as a beacon for firms to innovate new products in all countries of the world. The theory reveals that the comparative advantage shifts away from innovating industries and makes their home in countries that becomes exporters rather importers of new products.

l. **Kennen’s Theory of Human Capital**\(^{30}\)

By incorporating the value of human capital in production process, the theory gave recognition and respect to human being. The theory reveals that investing in education creates human capital. The theory also advocates that the application of capital to labor force will enhance the rate of return on physical capital.

m. **Emmanuel’s Theory of Unequal Exchange**\(^{31}\)

The theory sheds light on the variances of development between the developed and developing countries. The theory states that the main reasons for economic inequality between developed countries and least developed countries is on account of differences in techniques of production and difference in wages which lead to unequal exchange in trade.

n. **The Vent-For-Surplus Theory**\(^{32}\)

The theory provides light in exploring; as how colonial’s under developed economies were able to shake hands with foreign trade. The theory states that the underdeveloped countries generally have some products in surplus, once the domestic demand is quenched. This surplus becomes tradable
items. The vent-for-surplus approach has a limited scope of applicability.

**o. Theory of Country Size**[^33]

The theory advocates that countries with large areas are more likely to have varied climates and are bestowed with more natural resources in comparison to smaller countries.

**p. Country - Similarity Theory**[^34]

This theory holds that once a producer has developed new product in response to observed market conditions in home market, it will turn to market that are expected to match more similarity to those at home.

**q. Theory of Dependence**[^35]

This theory forms a continuum with independence at one extreme, dependence on the other and interdependence somewhere in middle. As per this theory, no countries are located at the either extreme of this continuum; however, some tends to form cluster to one extreme than the other. In the case of independence, a country would have no assistance on others for any goods, services or technologies. In case interdependence, there occurs the development of trade relationship on the basis of mutual need. Whereas, in of dependence, many developing countries have relied too heavily on other countries.

**r. Theory of Endogenous Growth**[^36]

This theory states that run counter to the ideas of conventional neoclassical economies regarding the role of state in economy and the institutional framework of economic

[^33]: Page 33
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activities. The theory highlights the highly uneven distribution of wealth in the international economy.

s. The New Economic Geography

The theory takes into consideration factor mobility and falling costs of transportation between periphery and core regions. The interactions of increasing returns, decreasing transportation costs and factor mobility can lead to further agglomeration or concentration of economic activities within core region.

t. Strategic Trade Theory

The central theme of new strategic trade theory (STT) is that firms and governments can act strategically in imperfect global market and improves its country’s balance of trade and national welfare. The theory posits that some markets are characterized by imperfect or oligopolistic competition. This theory departs from conventional trade theory in its assumption that certain economic sectors are more important than other for overall economy.

Above documented trade theories have very cogently audited the genesis of elevation of trade from domestic level to international landscape. It can be categorically deduced that the Ricardo’s theory of comparative advantage and Heckcher-Ohlin of endowment factor theory had encapsulated the quintessential of all the theories cited above. Both these theories advocate that the trade get nourishment in a country on account of their low opportunity cost and relative endowments of land, labor and capital and their relative costs.
Scanning the proliferation of services through the lens of these enumerated trade theories, it is revealed that it is only on these very grounds that have made nations unconquerable in respect of selected trade in services. Swish firms are invincible in banking, logistical services and security services. Singapore had revealed her forte in ship repair, part and terminal services. America is miles ahead in hotel and other service industries. Thus, notwithstanding, the cardinal variance in the inherent-attributes of goods and services, the kit of international trade theories have transcended these incompatibilities and have convincely enveloped trade in services too. Thereby the trade in services mirrors the trade in goods in adhering to the rules of comparative advantage.

5.2. Theories of Foreign Investment viz-a-viz Services

The growth of the foreign direct investment (FDI) has superseded that of global output and trade. The contemporary trade and investment reports manifest that under the FDI umbrella, the share of services investment in the global annual flow has been over 50 per cent in the late 1990s'. Thus it is self-axiomatic to note the prowess of the services. The hitherto attributes of non-tradability in services is perceived to be staple determinant in making FDI as a dominant mode of delivery for many services. There are number of services that necessitate the interaction between the producers and the consumers and frequently these services have to be utilized and exhausted simultaneously with production. As a result, they cannot be transported and therefore are traded across borders. Acknowledging this potent of FDI in services, WTO has
categories FDI as one of the routes of trade in services named as Mode 3 (commercial Presence). Mostly, FDI in services encompasses knowledge capital, materializing in shape of managerial services, engineering services, financial services, marketing services and information services and similar services.\(^{39}\)

The trade in services has enhanced the stride of FDI. FDI in services has brought out positive effects on the consumers of final services and also on the producers seeking intermediate services. FDI in services has improved the provision of services in terms of supply, cost, and quality of services. The FDI in services has facilitated the expansion of capital-intensive services such as telecommunication. The most notable support of FDI in services to the developing countries is in the transfer of technology. FDI in services has led to proliferation of TNCs and MNCs. The services TNCs has thrown open new modes of doing business, with latest pricing structure, better information management processes.

Under this backdrop an endeavor to scan the framework of foreign investment is made. To examine the determinants and effects of foreign investment, a large number of studies have been conceived.

In a milestone study, (Agarwal) analyzed the different facets relating to foreign direct investment theories under perfect market conditions. The study highlighted on differential rates of return, portfolio diversification and market size. Further, it encompassed theories under imperfect market conditions. A
number of deliberations on the subject have been made in same fashion. Kojima and Ozana (1984) distinguished between micro and macro model of foreign direct investment. Boddewyn (1985) has categorized the theories according to conditions or circumstances for foreign direct investment.

There are a number of theories that have been germinated to elucidate the rationale of FDI activities. Few theories on foreign investment have been culled and appreciated below. Theories have been bifurcated under two classifications, namely The Perfect Market Conditions and The Imperfect Market Conditions.

A. Theories of Foreign Investment under Perfect Market Conditions.

(i). Differential Rates of Return\(^{40}\): It relates to the shifting in the pouring of capital from low rate of return countries to high rate of return countries. The decision in respect to investment is gauged by weighing the marginal cost of capital with the marginal return. Investment decision will be inclined toward other countries, rather than home countries provided that the marginal return is higher than that at home along with the posit that the marginal cost of capital is at par.

(ii). Portfolio Diversification Theory\(^{11}\)

This theory is acknowledged as an improved version of differential rate of return on account of encompassing the risk factor. As per this theory, foreign direct investment is acknowledged as international portfolio diversification. Various efforts were made to gauge the mettle of this theory. One
approach was to delve the share of foreign direct investment going to a group of countries by relating it to the average return on these investment and the risk associated with these investment gauged by the difference of the average return.

(iii). Output and Market Size Approaches

The output and the market size approaches pertain to foreign direct investment. The output approach encompasses the variable of output, while market approach envelops the host country’s GDP or GNP as the proxy for sales potential. The new classical model of domestic investment theory accords the importance of output for foreign direct investments, while the relevance of host country’s market size has been postulated rather than drawn from theoretical model. Despite, without sound theoretical backing, a large number of empirical papers have appreciated the market size of the host country. Some authors have differentiated between external and internal determinants of foreign direct investment with market size being an external factor and sales of foreign subsidiaries as internal factor. The empirical test upholds the notion of association of higher level of sales by foreign subsidiary and of the host countries income growth with higher foreign direct investment.

B. Theories of Foreign Investment under Imperfect Market Conditions

The theories discussed above were sans imperfect market conditions. Hymer was the first researcher to shed light on the view that the structure of market and specific attributes of firm play a vital role in elucidating the foreign direct investment.
i. **Industrial Organization**

The industrial organization theory rests on the study of structural imperfections. Structural imperfections assist the multinational firm in enhancing its market strength, economies of scale, advantages of knowledge, distribution network, product diversification and credit advantages. The industrial organization theory draws light toward the problems that the multinational firm encountered when its operation get started. These difficulties encompass difficulties of managing operation, customer preferences technological standard. The merits of multinational firms are the brand name, talent, and superior technology, economies of scale. Grahman and Krugman(1989) applied this theory in rationalizing the growth of foreign direct investment in the United States.

ii. **Internationalization Theory**

The study on transaction costs gave rise to the internalization theory of foreign investment. The internalization theory shed lights on the existence of foreign direct investment as a result of firms replacing market transaction with formal transactions. This is a way of avoiding market imperfection for intermediate inputs. Modern business follow may activities in addition to the daily activities of producing goods and services. Other activities include marketing, Research and Development and training of labor that are related with the flows of knowledge and expertise. As per this theory, the internalization of markets beyond the national boundaries leads to the formation of multinational firm that result in the foreign direct investment.
The internalization theory is also termed as general theory of foreign direct investment.

iii. Eclectic Theory

Dunning, who amalgamated the gist of three theories i.e., location theory, internalization theory and industrial theory coined up this theory. As per this theory, the extent, pattern and growth of value added activities by transnational corporation (TNC) hinges on their competitive superiority to local firms. The advantages include ownership, locational and internalization advantages (OLI), i.e., propensity for a firm to invest in foreign location depends on a combination or three elements.

- Its ownership of core-completeness or specific intangible assets that enhances competitive advantages.
- Locational advantages that would derive from a transfer of operations on to a new region.
- Internalization advantages that may accrue to such investing firms.

The eclectic approach explains that all the foreign direct investments can be studies with the help of above three conditions. This theory also proclaims that the advantage of this theory is subject to change over a period of time.

iv. Oligopolistic Reaction Theory

Knickerbocker stated that foreign investment by one firm leads to similar investments by other big firms in the industry in order to maintain their market share. In the same background Hufbauer (1975) stated that owning to enhanced industrial concentration, the competitors strive among themselves to achieve cost or marketing advantages over each other. An
implication of this hypothesis is that the process of foreign direct investment by multinational firm is self limiting and owing to the invasion of each other’s home market, it shall spur the competition and reduce the intensity of oligopolistic reaction.

v. **Yo and Ito in (1998)**

Yo and Ito analyzed the factors, which stimulates initial investment by multinational corporations. The upshot of their study stated that the foreign direct investment is fostered by movement of competitors related to host countries and firm related factors. The study further stated that the firms in oligopolistic industries contemplate their competitor activities and make decision on foreign direct investment on the same economic parameter.

In fine, it can be deduced that the theories of investment have shed light on different micro and macro economic factors that impinge foreign investment including FDI. There are number of endogenous and exogenous determinants that influence the decision of making FDI. The gist of all these theories bare out that the production transcends the border, when a combination of ingredients from both the countries are cheaper, or better, or unavailable in one of the countries.

Keeping the attributes of the theories as touchstone, a look on important determinants of FDI in services is made. While delving into the determinants of FDI in services, it is brought out that the market size is an important factor for inward FDI in most of the countries. The FDI in services get into those destinations that have large market size. In the same manner,
the rules governing the FDI policies of the host government is also considered as an important factor for the FDI inflow. Competitive advantage is also an important factor upon which the service FDI hinges upon. With the increase in international competition in services, the flow of services FDI enhances. Another determinant for services FDI is the oligopolistic reaction. Oligopolistic reaction means that the firms follow their competitors in setting up of their units.

The study by Gray and Gray (1981), Rugman (1981) and UNCTC (1980), Schroth and Korth (1988) have corroborated that the market size is a significant determinant for FDI in services. Studies done by OECD (1982, 1987) and Walter (1985) have demonstrated the factor of host policies as an important factor for FDI in services. It has been testified by a number of studies that oligopolistic reaction has increased the flow of services FDI. These determinants were the essences of various theories of foreign investment, for example, eclectic theory (Dunning 1988), internationalization theory, (Buckley and Casson 1976), oligopolistic reaction (Knickerbocker 1973). Thus, it can unarguably be appreciated that the determinants of FDI in services follow the canons identified by different theories of foreign investment. Hence, the theories of foreign investment are befitting on the landscape of FDI in services.

6. **Ingredients Propelling the Growth of Services**

Global studies have corroborated and thereby acknowledged that services are the new millennium's most sought after sector. The burgeoning pace of this sector is
attributed to a number of ingredients. Some of the very cardinal determinants are analysed and incorporated in this part of the chapter.

On account of rapid transformation and development in IT and telecommunication, it has become viable to carry out services over long distance at inexpensive costs. Under this backdrop of ever-growing embodiment of information technology, services like education, medical have became tradable in nature. With the enhancement in scope to contact with distant consumers through the proliferation of telephone and on-line data communications, it has become quite easy to reach out for buyer not only of domestic but foreign countries also.

The growing competition in business has made the services even more significant and vital as the success of the firm hinges on the facilitating specialized form of financing and after sales facilities. The spate of cross-border movement of MNCs is also accelerating the pace of trade and investment in services. With the advent of liberalization, services have shifted from being a part of cost to revenue generators in private service. Liberalization facilitates the flow of foreign factor, which in turn increase, the scale of activity.

Privatization has encompassed services like waste disposal, telecommunication, health care and education under its ambit. As the cost effectiveness has become the watchword, outsourcing has started mushrooming at the national and international level. Large scale outsourcing of the production stages i.e., the supply of a formerly in-house-produced inputs, have also increased the
pace of trade in services. Bhagwati (1984) had coined this term as a splintering process. The outsourcing of services has made services available at economical rates, right time and of best quality. Modern technology and latest management techniques have penetrated in service sector. Thus the services are able to unravel the contemporary global business intricacies.

Another factor leading to rise in service is the proliferation of multi-unit firms. These firms work with systematization and standardization in catering to the services. These firms are able to enjoy economies of scale in number of areas of business. The multi-unit firm is able to conduct informal and formal R&D. With more technological progress, services have been playing a greater role in coordinating their production.

The betterment and extension of transportation have evolved new trajectory for the service companies. Services companies have been able to build a web of contact with suppliers. All the activities are well coordinated. Services companies are able to disseminate the strategies in affiliates units. The modern travel has facilitated the firm’s service provider to services.

It is acknowledged that the demand for the services in the total intermediate demand by manufacturing firm grows with the development of economy. The current blending of services and manufacturing goods has escalated the growth of services. It has increased the pace of productivity and has spurred the competitiveness in companies. Higher ingredients of services have brought greater degree of specialization and have improved
the productivity in manufacturing services. Services have helped the manufacturing sector in imbibing new innovation, which has increased the production capacity of firms. It has been proved that with the increased expenditure on producer services, the efficiency of production spurs. The fast demographic change has also fortified the growth of services. Owing to more disposable amount of money, populaces have started yearning for better quality of life. Leading urbanization has led to breaking up of joint family activities, thereby have led more sophistication in personal service.

7. Trade in Services –A Developing country’s Perspectives

It is quite pertinent to note that the developing countries are themselves a heterogeneous group of economies ranging from rapidly growing Asian economies, hardly growing African economies and very slow moving least developed economies.\textsuperscript{50} Services, like manufacturing have been demonstrating their potent in escalating the pace of developing countries' economies. A glance at the domestic echelon of developing economies reveals that services are in multifarious forms. Transport services have played a crucial role in developing countries. Transport services have been instrumental in transportation of passengers and freights; it has also promoted other services of developing countries. Distribution services have played crucial role to the functioning of a modern market economy. Distribution services facilitate alliance between producers and consumers. Distribution services have led to better allocation of resources. Construction and consultancy services have facilitated the infrastructural developments and a transfer of technology.
financial services has stimulated the economic activity of developing countries. This sector also acts as a medium in channeling resources to all sectors of economy, thereby contributing toward the long-term growth and efficiency. Better financial services have brought spillover effect on other services.

The role of trade in services in developing countries may not be in uniformity on account of variance in their capacity to imbibing the prescription of liberalization. Nevertheless, from general perspective, it is workable to calibrate the role of trade in services in the development of the developing economies. The global trade statistics communicate that the developing countries besides having an edge in certain types of clothing, steel, shipbuilding, footwear and food products have also comparative advantages in certain services, like, for example, tourism, professional services and construction services. This comparative advantage stems up owing to ample resource of labor with requisite skill. It is recognized that with the opening of trade in services, developing countries have been able to upgrade their roads, airports etc. Upliftment of these services has ameliorated their competiveness and simultaneously has enhanced the development prospects of economies. It has been endorsed that with the opening of trade in services, countries have been able to bring down the prices of services and has enhanced the quality as well as broadened the range of consumer selection. The manufacturing firms of developed countries have of late, started outsourcing those services that were previously provided in house, on account of availability of cheap labor in the developing countries. Developing countries
have started capitalizing their inherent attributes of geographical location and natural endowment. Off shoring of services such as call center, business processes outsourcing is gathering pace in developing countries on account of time zone location as a part of vital link for 24-hour business transactions. It has been witnessed that those developing countries that have signaled green to trade in services have seen greater product and process innovation at their landscape. Thus it has been cogently acknowledged that as the pace of globalization in the developing countries have escalated; trade in services has provided opportunity for the developing economies in carving niche under the global trade ambience. Fact-finding studies have attested that proportionally higher services exports are the hallmarks of high growth economies.

8. Conclusion

The global studies have corroborated the prowess of services sector. A number of studies have endorsed the Petty’s law which advocates that as the pace of economy stems up, a noticeable shift of population from agriculture to manufacture and from manufacture to services shall take place. The current chapter has documented very succinctly the basic framework of services. The chapter has revealed that owing to insufficient literature on the theory of trade in services, the gist of theories of goods has unlocked the rationale behind the proliferation of services. But it is quite pertinent to note that service sector with the attributes of non-transportability and intangibility along with fast changing characteristics, desperately entail for a new theory of trade in services. Similarly, the theories of investment in goods
have been able to decode the genesis of FDI in services but with
the surge of non-equity form of foreign involvement in the form of
licensing, management contracting, it is of paramount
significance to bring out new theory for investment in services.

Under the new economy, international success in services
has become as vital to nations as that of manufacturing.
Services have increased the level of productivity and growth of
economy. Services have encapsulated a large share of
employment in nations. The opening of services to international
competition has become green pasture for MNCs and TNCs. The
succeeding chapter envelops the patterns and configurations
pertaining to contemporary services from the global realm as well
as from Indian points of view.

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