Advances in Business in Asia

Advances in Business in Asia: The Opportunities, Threats, and Future Trends of Businesses in China, India and the ASEAN Countries

Edited by

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Table of Contents

PREFACE

The Asian Forum on Business Education (AFBE) was initially founded in Bangkok in 1992. It is a not-for-profit organisation that provides focus on business and business education in the Asia region by way of an online journal and annual conferences (see http://www.afbe.biz).

This book series represents selected papers from the conferences conducted by AFBE, which are co-hosted by universities in the various countries of the Asia region. Conferences pertain to a stated theme; the sub-title of this volume has been derived from the AFBE conference conducted in May 2010 in Bangkok, Thailand, and hosted by Mahasarakham University.

As readers will observe from the papers included, eminent academics have presented a broad array of issues associated with the opportunities and threats for business in China, India, and the member countries of the Association of South-East Asian Nations (ASEAN). The introduction draws together the diversity of issues by suggesting that global capitalism is itself threatened within the context of considerable future opportunities for entrepreneurial business activity, and also suggests that academia around the world has generally failed to adequately influence the debate.

We hope that readers will find interest in the topics covered, as well as reflect upon the dangers posed to the future of the macro-environment within which we all find ourselves indelibly embedded.

—Professor Dr Brian Sheehan
President
Asian Forum on Business Education

Chapter One

Introduction: In Search of a Middle-Path for Globalisation

Victor Egan and Chris Perryer

China, India, and the ten member countries of the Association of South-East Asian Nations (ASEAN) (i.e., Singapore, Malaysia, Thailand, Indonesia, the Philippines, Vietnam, Laos, Cambodia, Brunei, and Myanmar) together account for about 40 percent of the world's population, and about 10 percent of global GDP. By the middle of the 21st-century, the outputs of China and India are expected to exceed those of the US and EU. What effect this shifting configuration will have on the world is merely speculative, but one thing is certain – the world will be very different in terms of economic and geo-political influences.

The emergence of China from 1978, and India since the 1980s, is strongly correlated to the globalisation of products and services that became the ubiquitous paradigm in global economics. It emerged post-World War II as world leaders sought to forge a new era of interaction based on cooperation, inclusiveness, and a less zero-sum approach. At the international level, the General Agreement on Tariffs and Trade (GATT) provided the basic parameters of interaction from 1947. GATT morphed into the World Trade Organization (WTO) in the 1990s, which then continued the work to foster trade liberalisation; the Doha Round being the most recent forum for trade negotiations.

The emergence of GATT at the international level highlighted the need for an apposite economic framework for nation-states. To this end, the eminent economist Paul Samuelson (1948) was the philosophical architect of the ‘mixed economy’ model of economic organisation. He imagined the role of government was to fill the gap in market failures, such as in the areas of inequality, public infrastructure, education, and the provision of macroeconomic stability. In other words, the progress of communities, Samuelson contended, was dependent on a mix of free-market capitalism, moderated by appropriate government intervention.

The mixed economy paradigm was dominant until the global economic woes of the 1970s led to the rise of ultra-free-market libertarianism, harbouring the thesis that governments are incompetent and untrustworthy, and hence, should be excised from the provision of public goods. This view was academically assisted by small government advocates such as Frederick Hayek (1965) and Milton Friedman (1982), and put to practice in the 1980s by Ronald Reagan in the US and Margaret Thatcher in the UK.

After three decades of inexorable global capitalism, we are now confronted with a Manichean conundrum; "some remarkable successes, some disturbing failures, and a collection of what might best be called running sores" (Saul 2005, p.3). The 2008 Global Financial Crisis (GFC) is one such 'running sore' that furnishes insight into an international system that has disaggregated itself from communities; it demonstrates that the world has achieved a level of interconnectedness that now exceeds the reach of national economic policies and international architecture (Spence 2011).

What has become patently obvious from the GFC is that Paul Samuelson was, indeed, correct - markets fail; sometimes badly, and hence, require appropriate government intervention. Sach (2011) goes further in arguing that the GFC was not simply a short-term market failure, but rather a more fundamental enigma from several decades of moral decay in the social fabric of Western societies. The outcomes of this moral decay have been increasing inequality, ecological duress, and the marginalisation of citizenry. As Stiglitz (2010, p.295) notes, "the failures of our financial system are emblematic of broader failures in our economic system, and the failures of our economic system reflect deeper problems in our society". What Stiglitz (2010) alludes to is a fracturing of community that has led to the renunciation by the privileged and parvenu of all moral responsibility to the indigent, and indeed, to society as a whole (Homer-Dixon 2006; Sachs 2011). Chomsky (2011, p.5) reflects that "privilege yields opportunity, and opportunity confers responsibilities"; responsibilities that have been abrogated within a system devoted to profligate hedonism.

Perhaps the most insidious fiction perpetrated by global capitalism is the illusion that anyone is capable of becoming wealthy. But there is room at the top for merely a few, and few have the aptitude, intelligence, character, and/or luck to claim a place (Foley 2010). The recent 'occupations' of Wall Street, London, and Sydney, to name just several of the 'occupied' locations in over 80 countries around the world are indicative that a growing number of citizens are becoming wise to the fiction. Such 'occupations' are testament to an economic system that is heavily biased towards the “comfortably endowed” (Galbraith 1994, p.264), and in which the '99% majority' appear to benefit marginally at best. The 'occupy' movements are well cognisant that too many citizens have been subject to austerity programs and unemployment, while governments have provided bail-outs to financial institutions, and tax relief to the wealthy and powerful. To add further to the malignity of the ‘occupiers’, the term 'too big to fail' has worryingly gained currency in the contemporary economic and political lexicon – a dangerous dialogue, indeed, since it propels the idea that some corporations will only ever be permitted to win, irrespective of incompetent managerial decision-making or morally bankrupt behaviours.

Globalisation has also been stigmatised by graft and corruption, which serve to further bias a highly distorted economic system. An examination of Transparency International’s Corruption Perception Index indicates that China, India, and the countries of ASEAN vary significantly in the ranking and scores of the perceived prevalence of corruption (TI 2011) [US included for comparison]:

Country	**Rank**	**Score**
Singapore	1	9.3
US	22	7.1
Brunei	38	5.5
Malaysia	56	4.4
China	78	3.5
Thailand	78	3.5
India	87	3.3
Indonesia	110	2.8
Vietnam	116	2.7
Philippines	134	2.4
Laos	154	2.1
Cambodia	154	2.1
Myanmar	176	1.4

Rank order, unfortunately, masks the real parlous state of global corruption. When viewed from the perspective of scores, it becomes apparent that only 2 countries out of the ASEAN 10 plus China and India score above 5.0; the point separating the 'highly clean' from the 'highly corrupt', and indicative of what Transparency International refers to as “a serious corruption problem” (TI 2011).

In response to the concatenating polemics of globalisation, Sachs (2011) calls for a “revitalisation of civic virtue” (p.x) by the corporate world, with a focus on the triple bottom-line of efficiency, fairness, and sustainability. Sachs (2011) also reminds us that the market economy is a sophisticated “human contrivance” (p.46), rather than a figment of evolution from the natural order. As such, the market economy requires continual intervention and innovation.

A dominant source of the theoretical framework for intervention and innovation might reasonably be expected to emanate from the academic world. However, along with abrogation of social responsibility by governments and powerful individuals under free-market libertarianism, business academia has also failed to provide the theoretical framework and moral compass so desperately needed, either because of collusion within the mainstream business milieu [those Chomsky (2011, p.5) refers to as “conformist intellectuals”], or more likely because of its emasculation by self-indulgent irrelevance to, and disconnect from, the real world of business and community. Business schools have become seduced in their quest for rankings, status, and enrolments (see, for example, Armstrong 2005; Augier & March 2007; Bennis & O’Toole 2005; Pfeffer & Fong 2002). Business academia has been complicit, described as an “incestuous, closed loop” (Hambrick 1994, 13) that maintains a quixotic compulsion to embrace certitude from contextually-isolated intellectual edifices (Currie et al. 2010; Gosling and Mintzberg 2006), and then fails to reach into the world of business practitioners for the dissemination of practical knowledge (Reed 2009); a pervasive example of what Saul (1992, p.575) insightfully refers to as the “folly of professional dialects”.

Building on Kay’s (2003, p.323) rather platonic observation that “capitalism should be replaced by something nicer”, considerable socio-psychological dialogue has ensued in an attempt to resolve the societal decay succinctly observed by Sach (2011), Stiglitz (2010), Homer-Dixon (2006), and a plethora of others. The spiritual perspective of societal progress fosters the notion of moderation and a middle path by all stakeholders. The developments include 'spiritual capital' (Zohar & Marshall 2004), 'social economics' (O'Boyle 1999), 'Buddhist economics' (Schumaker 1973), and 'sufficiency economy' (Piboolsravut 2004).

Spiritual Capital

Zohar and Marshall (2004) offer ‘spiritual capital’ as an alternative to the darker side of market capitalism. They suggest focus on spiritual capital would provide the necessary transition from a purely profit, wealth, and power ideology, to include a sense of community, as well as humane values, such as honesty, trust, and responsibility.

Social Economics

Calvinism provided the religious undergirding for the economic libertarianism that has formed the basis of American life and the global economic system. The basic creed inculcates the idea that business and career success, materialism, and conspicuous consumption are divine signs that one is in favour with the Christian God. The corollary to this creed is that disdain should rightfully be heaped upon the indigent, since their situation is the axiomatic result of laziness, lack of motivation, and decadence (Klein 1985). In contrast to the doctrinal teachings of Christianity, the practical outcome of US-style Calvinist fundamentalism has been a withdrawal from the morality of caring, concern, and empathy for fellow citizens. Social economics prompts the view that the 'invisible hand' of the market does not protect the common good, nor does it lead to decent social outcomes for all citizens. An effective and sustainable economic system requires "the 'visible hand' of government to work with the 'invisible hand' of the markets" (Thanawala 2002, p.673).

Buddhist Economics

The Western ideology of social economics has its Eastern counterpart in, what Schumacher (1973, p.48) articulates as "Buddhist economics". Buddhist theology advocates a moderate 'middle path' between the sensual pleasure of egocentrism and self-mortifying asceticism. In the corporate environment, Buddhist economics focuses on developing employees to their full potential, creating team-orientedness, the satisfying of needs (rather than unconstrained wants), and respect, consideration, and honesty for all stakeholders (Holmes 1997; Schumacher 1973). By reinvigorating ethical and moral considerations in neoclassical Western economic thought, Buddhist economics aspires to achieve economic ends by constraining demand and managing supply (Alexandrin 1993).

Sufficiency Economy

Buddhist economics is the socio-religious underpinning of Thailand's 'sufficiency economy' philosophy. The message delivered in a speech by His Majesty King Bhumibol Adulyadej in 1974 was reiterated following Thailand's economic crisis in 1997, and later encapsulated in the definition provided by the National Economic and Social Development Board (NESDB) of Thailand in 1999:

> " 'Sufficiency Economy' is a philosophy that stresses *the middle path* as an overriding principle for appropriate conduct by the populace at all levels. This applies to conduct starting from the level of the families, communities, as well as the level of nation in development and administration so as to modernise in line with the forces of globalisation. 'Sufficiency' means moderation, reasonableness, and the need of self-immunity mechanism for sufficient protection from impact arising from internal and external changes. To achieve this, an application of knowledge with due consideration and prudence is essential. In particular, great care is needed in the utilization of theories and methodologies for planning and implementation in every step. At the same time, it is essential to strengthen the moral fibre of the nation, so that everyone, particularly political and public officials, academics, businessmen at all levels, adhere first and foremost to the principle of honesty and integrity. In addition, a way of life based on patience, perseverance, diligence, wisdom, and prudence is indispensable to create balance and be able to cope appropriately with critical challenges arising from extensive and rapid socioeconomic, environmental, and cultural changes in the world" (NESDB 1999, cited in Piboolsravut 2004, p.128).

In essence, then, sufficiency economy entails moderation of needs, mutual reliance and cooperation, harmony between economic activities and the environment, and self-immunity from exogenous shocks (He 2006). The philosophy is based on a middle path between the needs of community and individuals, and between markets and the environment. In practical terms, individuals are advised to avoid excessive consumption and focus on basic needs, corporate enterprises should avoid over-expansion and focus on productivity, and government intervention should focus on the protection of community and environment (Crispin 2006).

For corporations and individuals, the opportunities in the Asia region over the coming years are considerable, but so too are the challenges and threats. Globalisation, as an economic theory, is presently at risk of becoming a sclerotic artefact of an era in which political leaders and citizens became beguiled by the illusion of prosperity for all. Reflective analysis of thirty years of globalisation now attests to an awkward truth of persistent discontent and conflict, pollution and climate change, and the cold realisation that wealth and power are the preserve of a few. On the other hand, the main benefit of the economic system for citizens has devolved into meretricious consumerism in the constant search for perfunctory happiness; the "enchantment of imminence", as described by Foley (2010, p.34). There was surely something inordinately simplistic, and even absurd, in the belief that individual greed and self-interest could be harnessed for the common good without consequence to community.

Economists remain divided on whether more or less government control is the way forward (Homer-Dixon 2006); politicians align according to ideological bents; and uncertainty prevails for all as to how the economic system should reform. But uncertainty leads to choice, and choice means opportunity – opportunity to resolve the ‘disturbing failures’ and ‘running sores’ that continue to grow in scale and scope.

As a means of resolution, we contend that there is dire need for a middle-path; for moderation; for equilibrium, whether by a “revitalisation of civic virtue” (Sach 2001, p.x); a rebirth of 'spiritual capital' (Zohar & Marshall 2004), or a shift towards 'social economics' (O'Boyle 1999), 'Buddhist economics' (Schumaker 1973), or 'sufficiency economy' (Piboolsravut 2004). There is far too much at stake to ignore the increasing cadre of marginalised citizenry, and continue abated on the same market fundamentalist course as has been the case since the 1980s.

The dialogue thus far has furnished thoughts and provocations on the promised opportunities and ensuing threats of global capitalism. The papers in the current volume have been included to provide more specific insights into issues that impact on business in China, India, and the member countries of ASEAN.

T. Prasanna provides an insight into the impact of the WTO’s General Agreement on Trade in Services (GATS) on foreign direct investment in India since 1995. He outlines many of the expected longer-term benefits for India, such as employment opportunities and technology transfer, and annunciates inhibiting factors with which the Indian government must grapple in order to achieve the full realisation of those benefits. Prasanna’s paper points to the significance of government to the well-being of economies. However, in the case of India, it is more about moderating the bureaucracy than extending the reach of government bureaucrats.

Kanitsorn Terdaopong and Yang Yin expose issues associated with small and medium size enterprises (SMEs) in China, finding a propensity in Chinese SMEs for short-term debt, rather than long-term debt so common in Western companies. Additionally, and perhaps understandably, they found that unhealthy Chinese SMEs were characterised by excessive short-term debt, which leaves them highly vulnerable in times of economic downturn.

Paul Hughes provides an insightful case study of the process to establish an international joint venture (IJV) start-up involving an American entrepreneur, Thai operators, and Indian analysts. Issues with IJVs are particularly salient to global capitalism due to both their proliferation, and their problems. For example, studies suggest that perhaps 30-70 percent of IJVs perform somewhere between unsatisfactory and complete failure (Buttery & Buttery 1994; Killing 1983). Moreover, IJVs can also provide an inhibition to company growth. For example, Sony and Ericsson recently dissolved their IJV for the manufacture of mobile phones with Sony acquiring Ericsson's 50 percent stake. Sony perceived a strategic advantage in gaining full control, and hence, the ability to integrate the mobile phone business with its other products, thus enhancing operational efficiencies in engineering, network development, and marketing (Virki 2011).

Mark Speece, Jonathan Lee, and Jun Han explore the machinations of *guanxi* in China. Indeed, Asian economic growth since the 1950s has been largely built on such relational networks that have provided the basic institutional medium for political, social, and economic activities (Hamilton 1996; Pyatt et al. 2001; Yen 2002). Lee et al. (2001) identified three different types of Chinese *guanxi* relationships:

- *Expressive ties*: Relationships that are permanent and stable, personal and affective; applies to family, relatives, and old friends.
- *Instrumental ties*: Relationships that are temporary and unstable, impersonal and utilitarian; applies to unknown others.
- *Mixed ties*: Relationships that are somewhat permanent and stable, but are elastic and may change; characteristic of general business linkages; based on reciprocity of favours or *renqing,* and the social regulatory mechanism of ‘losing face’.

Another relational principle characteristic of the Chinese in South-east Asia is the formation of close ties with local politically-influential elites; referred to as 'pariah entrepreneurship' (Riggs 1966), 'ersatz capitalism' (Yoshihara 1988), and 'the dark side' of Asian business (Backman 1999). For example, the Board of Directors of the Kuok Group (the most successful firm in Malaysia by the 1990s) included a judicious array of aristocrats, military generals, and senior public servants (Heng 1993). Likewise, the rise of the Bangkok Bank in Thailand from the 1950s can be directly correlated with the early involvement of military generals and senior bureaucrats as Board members and executives (Mackie 1993). In a similar vein, Robison (1993) describes the networks of patronage evident in Indonesia, which involve bureaucrats and Chinese-owned corporate groups, and which have led to monopolies, corruption, and market distortions.

In other words, *guanxi* has always been a vague concept, built more on pragmatism than strict adherence to social mores. Speece, Lee and Jun conclude similarly; in their case study, good customer service was the precursor to the development of *guanxi*, rather than the other way around.

Chris Perryer, Geoffrey Soutar, and Catherine Jordan researched ethical attitudes of Western tertiary educated people in seven countries, including Singapore, Indonesia, China, the Philippines, Australia, the US, and the UK. They examined two specific ethical attitudes: (1) self-advancement at the expense of co-workers; and, (2) misuse of organisational assets. Their findings indicate considerable differences across the countries, and pose as many questions as they provide answers. While the US, the UK, Singapore and China were relatively close on perceptions about the ethicality of personal advancement at the expense of co-workers, with China and Indonesia closely behind, the Philippines sample suggested that this posed much less an ethical problem. The US, UK, and China samples had similar attitudes to the ethicality of misusing organisational assets, with Singapore more relaxed, Australia even more relaxed, and the Philippines again seeing little by way of ethical hindrance. The surprise on this dimension was Indonesia, with that sample indicating very strong ethical attitudes. Perryer, Soutar, and Jordan argue that this may be an artefact of the common Western education of the sample, and discuss the implications for theory and practice.

Victor Egan's paper on recessionary effects and business constraints on small firms in Vietnam highlights the threat posed to heavily interconnected economies in times of global recession; a perversity of global capitalism that punishes nation-states merely for being part of the system. Egan found that the 2008 GFC effected retail sales by an average decline of 32 percent across the respondent companies. In addition, business constraints, including strong competition, high government taxes, poor infrastructure, and lack of skills of both employees and owners, were reported as hindrances to business efficiency in Vietnam.

Ma'Mum Sarma and Marthin Nanere present a paper comparing conventional and Sharia banks in Indonesia. Sharia banks have been of growing significance in Islamic countries in general, and rapidly growing in Indonesia since 1992, representing a more ethical alternative to the conventional Western model, which the GFC exposed as fickle and malignant. Sharia banks provide a degree of internalised regulation by promoting religious values as a mechanism to counter the dark side of global capitalism.

Rachaya Indanon provides a case study involving rice farmers in Thailand, noting the responsibility of the Thai government for positive intervention particularly in times of economic hardship. The paper reinforces the critical part played by the 'visible hand' of government in tempering the hardship of disadvantaged citizens.

Finally, Jitisa Roenjun and Mark Speece review the role of religiosity for Thai women in small business. The women were followers of the Buddhist reform movement, *Kuan Im Bodhisattva*. The authors found positive outcomes from a religious teaching based on gender equality. The women used Buddhist values in practice, closely approximating the application of the 'sufficiency economy' philosophy of living.

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CHAPTER TWO

IMPACT OF THE GENERAL AGREEMENT ON TRADE IN SERVICES (GATS) ON FOREIGN DIRECT INVESTMENT (FDI) IN SERVICES IN INDIA

T. PRASANNA

Abstract

The four key items on the agenda for the Hong Kong ministerial meetings in 2005 were services, agriculture, Non-Agricultural Market Access (NAMA), and differential treatment for developing countries. The draft of the Hong Kong declaration agreed on 18 December 2005 speaks about further liberalization in Mode 3; that is, the `commercial presence' category of service providers. This will usher in increased Foreign Direct Investment (FDI) in a vast gamut of service sectors, such as banking, insurance, construction, engineering, tourism, education, telecommunication, and computer-related and professional services. It also provides for removal or substantial reduction of economic needs tests, 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 sectors to the optimum, and maintain regulation aimed at economic growth.

Introduction

The presence of efficient services in infrastructure is a precondition for economic success. Services, such as telecommunications, transport, banking, and insurance, supply strategically important inputs to all other sectors of the economy. The global economy is gradually becoming dominated by the service sector. The importance of this sector can be judged by the fact that world trade in commercial services amounted to

US$1,440bn in 2001, which is equal to 23 percent of goods trade. The sector represented well over 60 percent of global GDP by 2006. In India, during 2006-7 the service sector accounted for 55.1 percent of the country's GDP, and provided employment for 26 percent of the total workforce, while industry, which had a share of 26.4 percent of GDP, employed 22 percent. About 52 percent of the Indian workforce is employed in the farming sector, which contributes 18.5 percent of GDP.

Most of the rapid growth in the service sector is attributed to the growth in information technology and business process outsourcing services. However, telecommunications, the financial sector, and the tourism and travel industry have also shown a rapidly increasing growth curve. Considering that services accounted for 5 percent of global trade at US$1.54tn in 2002, the services sector will play an increasingly significant role in India's economic development.

Since 2004, India's share of global trade has increased significantly. According to trade statistics published by the World Trade Organization (WTO), India's share in total world trade (which includes trade in merchandise, services, and agricultural produce) has increased from 1.1 percent in 2004 (i.e., the initial year of the new Foreign Trade Policy 2004-09) to 1.5 percent in 2006. The WTO statistics show that India has emerged as one of the dynamic suppliers of services in the world, and in 2010 was ranked 21st in export of services and 27th in service imports. India software exports account for 48 percent of total service exports (NASSCOM). However, the need to move faster assumes greater importance, considering that countries like Hong Kong, Singapore, and the South Korea have a share of 2.9 percent, 1.8 percent, and 1.9 percent respectively in 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 FDI inflows into the Indian economy. Given the service sector's role in facilitating India's interconnectedness with the global economy, the WTO's General Agreement on Trade in Services (GATS) has high significance for India. GATS provides India with a framework to liberalize services trade in modes and activities where it has a comparative advantage. 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 (i.e., mode 4 of GATS).

The Indian economy, since 1991, has opened her door in a systematic way to global capitalist forces. This has its impact on all sectors. FDI flows have increased enormously to India. FDI involves the transfer of financial capital, technology, and other skills to the host country, and contributes to entrepreneurship, and managerial, professional, and technical expertise (Brewer 1989). The host economy benefits from the additional economic 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 stimulates economic growth, and often has a larger impact than domestic investment.

Objectives

The objective of this paper is, with respect to India:

- To analyze the progress of the pattern of growth of FDI in service sectors;
- To estimate the prospects of growth of FDI in service sectors;
- To identity the sector which is attracting more FDI;
- To suggest policies for increasing FDI flows; and,
- To identify the factors that hinder growth in service sectors.

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. GATS came into existence as a result of the Uruguay Round of negotiations and entered into force on 1 January 1995, with the establishment of the WTO. The main purpose for the creation of GATS was to create a credible and reliable system of international trade rules, which ensure 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 India and other countries:

- **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.

- **Employment Opportunities**

  The growth in trade in services promotes employment within the country so as to absorb disguised unemployment from agriculture. There will also be wide opportunities for professionals to work internationally.

- **Consumer Choice**

Consumers, in a real sense, will be ‘kings’ as they receive a variety of choices with better quality. The competition will lower prices and provide wider choices for consumers.

- **Technology Transfer**

Services liberalization encourages 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 services into 12 sectors (which are subsequently divided into 161 sub-sectors): (1) Business (including professional and computer services); (2) Communication; (3) Construction and engineering; (4) Distribution (e.g., commission agents, wholesale and retail trade and franchising); (5) Education; (6) Environment; (7) Finance (including insurance and banking); (8) Health; (9) Tourism and travel; (10) Recreation, cultural and sporting; (11) Transportation; and, (12) Other services not elsewhere classified.

Modes of GATS

GATS provides for four modes of supply of services: (1) Cross-border; (2) Consumption abroad; (3) Commercial presence; and, (4) Presence/movement of natural persons.

Mode 1

Cross-border supply refers to a situation where the service flows from the territory of one member country into the territory of another. For example, an architect can send his architectural plan through electronic means; a teacher can send teaching material to students in any other country; a doctor sitting in India can advise his patient in the US through electronic means. In all 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 a consumer of a service moves into the territory of another member country to obtain the service. For example, tourists utilising hotel or restaurant services abroad; ship or aircraft repairs or maintenance services abroad.

Mode 3
Commercial presence implies that service suppliers from a member country establish a territorial presence in another member country with a view to providing 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 supplies services.

Mode 4
Presence or movement of natural persons (i.e., 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 (for example, doctors, engineers, consultants, and accountants). However, GATS covers only temporary movement and not citizenship, residence, or employment on a permanent basis in a foreign country.

The GATS Agreement enforces two types of general obligations on the part of the signatories:

- **Most Favoured Nation Treatment:** Under the MFN treatment a country is obliged to provide a treatment to 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 commitments, subject to review.
- **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.

India as a Destination for FDI

There are a number of reasons cited as important for India becoming an important FDI destination: (1) A middle-class of 350 million and over 1 billion consumers as a whole; (2) India is located between central Asia and south-east Asia with huge markets; (3) Labour is relatively cheap; (4) Strong technical manpower that can be hired cheaply; (5) Unexploited abundant natural resources; (6) Determination of the government to carry forward the economic reforms; and, (7) India has the second largest

English speaking scientific and technical manpower resource base in the world.

Hence, there is vast scope for increase in FDI in services in India. The service sectors play a crucial role in generating employment. The top five biggest job creators in India are (Malini Goyal 2006); (1) IT and ITES; (2) Banking and finance; (3) Retail; (4) Hospitality and travel; and, (5) Telecommunications.

FDI Ownership Caps

Indian FDI laws have taken a more liberal approach by specifying ‘a negative list’ of sectors with limited levels of FDI. Very few sectors (e.g., agriculture) completely prohibit foreign ownership. The Indian government has even opened the defense industry to limited foreign participation. Many sectors allow 100 percent foreign ownership, including software, non-bank corporations, roads, general manufacturing, pharmaceuticals, airports, tourism/hotels, and courier services. Other sectors allow between 26 percent and 74 percent foreign ownership. The government is gradually liberalizing the FDI regime, recently increasing FDI limits on defense, telecommunications, and insurance. Table 1 shows the FDI regimes across the various services sectors.

If we compare the openness in Indian policy, in terms of the sphere of operations, with the policies of major competing countries, we find that in China FDI is encouraged in manufacturing and agricultural activities. Another country that has opened agriculture to FDI is Thailand. However, FDI is not permitted in agriculture and mining in many other competing Asian countries. Generally, manufacturing industries are open to FDI in all countries in Asia. In the case of service industries, there are wide variations. In China, all service industries (except hotels) are closed to foreign investment. On the other hand, in Thailand, FDI is permitted in almost all service industries. India, like most other Asian countries, stays in between the two extreme policy stances.

The most striking feature of the present liberalization policy in India is the freedom provided to the level of foreign equity participation. In the earlier policy phases, the attitude was quite rigid with respect to foreign equity ownership and control. It was insisted that FDI should be accompanied by technology transfer agreements. In addition, foreign ownership exceeding 40 percent of equity was granted only in exceptional cases. In striking contrast, under the liberalization policy, it is now not necessary that FDI is accompanied by foreign technology agreements.

Moreover, FDI is given automatic approval up to 51 percent foreign equity in the listed priority industries, which cover most manufacturing activities, including software development and those related to hotels and tourism. Besides, there is no upper bound limit for foreign equity, even 100 percent foreign equity is permitted with prior approval. Permission is given freely to 100 percent foreign equity in the power sector, and wholly export-oriented industries, all manufacturing activities in special the economic zone in the telecommunication sector for internet service providers, infrastructure providers, and electronic mail and voice mail. Further, the government has developed a liberal approach towards non-resident Indian (NRI) investment: NRIs and overseas corporate bodies (OCBs) can invest up to 100 percent in the real estate sector and in certain other high priority industries. Clearly, the change in the government's attitude is basic in the sense that FDI is also looked to as a channel of financial resources for investment independent of foreign technology transfer and foreign majority equity. Hence, foreign control is freely allowed to attract FDI inflows into priority industries.

South Korea is the only other country, where an automatic approval system exists, though it is confined to minority interests under certain conditions. South Korea has a well-defined regulation governing FDI and its "negative list system" with prohibited and restricted sectors, reflects the stability and transparency so important to an attractive FDI policy.

By 2007, India had emerged as the second most-attractive location for global FDI; next only to China, and ahead of the US and Russia. There was a three-fold increase in FDI inflows during 2006-07 over the previous year. FDI inflows reached US$6.6bn as against US$3.7bn over the corresponding period the year prior, reflecting the continuing pace of expansion of domestic activities, a positive investment climate, and a long-term view of India as an investment destination. The services sector was in the forefront accounting for 34.2 percent of the total inflows during this period, followed by the construction industry with a share of 20.6 percent. While Mauritius continued to be the dominant source of FDI to India, Singapore replaced the US as the next important source. Table 2 shows yearly FDI inflows to India between 1991 and 2006.

Table 1: Maximum Foreign Ownership

Service Sector	Maximum foreign ownership
Mining and exploration	100% all ventures, except diamonds where the limit is 74%, and coal which is reserved for public sector and captive private mines
Advertising and films	100% films; 74% advertising
Ports	100% BOT projects; 74% non-BOT Projects
Professional (except legal)	51%
Automobiles	51%
Banking	74%
Non-banking financial	51-74%
Telecommunications	49-74%
Petroleum refining	26% public enterprises; 49% domestic private companies
Insurance	26%
Defense	26%
Real estate	0% except for 100% in townships, resorts, hotels, housing and commercial premises.
Print media	0% print media; 20% broadcasting; 49% non-resident Indian investment
Agriculture	0%
E-commerce; internet	100%
Airport	74%
Manufacturing	100%
Insurance	26%
Mass rapid transport	100%
Pharmaceuticals	100%
Courier	100%

Table 2: Yearly FDI Inflows: 1991-2006

Year	Amount FDI Inflows	
	Rupees million	US$ million
1991-1992	409	167
1992-1993	1,094	393
1993-1994	2,018	654
1994-1995	4,312	1,374
1995-1996	6,916	2,141
1996-1997	9,654	2,770
1997-1998	13,548	3,682
1998-1999	12,343	3,083
1999-2000	10,311	2,439
2000-2001	12,645	2,908
2001-2002	19,361	4,222
2002-2003	14,932	3,134
2003-2004	12,117	2,634
2004-2005	17,138	3,755
2005-2006	34,316	7,751
Total	**171,114**	**41,107**

Source: Compiled from relevant years Indian Economic Survey

Table 3 demonstrates the important sectors which received more FDI flows between 1991 and 2006 were business services that received 16.2 percent, followed by the transportation industry which received 10.19 percent, financial and non-financial services which received 9.52 percent, and telecommunications which received 9.38 percent. Others included food processing, pharmaceuticals, consultancy, engineering, textiles, and tourism.

Banking

As at 2011, there were 27 public sector banks in India, and entry of foreign banks remained highly regulated. State-owned banks control 80 percent of the banking system. 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. As of September 2004, 35 foreign banks with 217 branches were operating in India. Five US banks now have a total of 16 branches in India. They operate under restrictive conditions including tight limitations on their ability to add subbranches. FDI in banking is slowly being liberalized, and the foreign equity ceiling has been raised to 74 percent from 49 percent for investment in private banks. FDI in state-owned banks remains capped at 20 percent. Foreign investor voting rights are capped at 10 percent in private banks and 1 percent in state-owned banks Foreign banks may operate in India through only one of three channels; branches, wholly owned subsidiary, or up to 74 percent ownership in a private Indian bank.

Table 3: Sectorial FDI Inflows: 1991-2006

Service Sector	Percent FDI inflows
Business	16.2%
Transportation	10.2%
Financial and non-financial	9.5%
Telecommunications	9.4%
Food Processing	3.6%
Pharmaceuticals	3.2%
Consultancy	1.6%
Engineering	1.5%
Textiles	1.3%
Trading	1.1%
Tourism	1.1%
Other	41.3%

Source: Relevant Issues of SIA Newsletter, Ministry of Industries and Commerce

Audiovisual and Communications Services

The Indian government has removed all the barriers to the import of motion pictures, although US 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 2002 allows the Indian government to put in place the Conditional Access System (CAS) 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 government suspended implementation of CAS pending review by a regulatory authority. The