2012 2nd International Conference on Economics, Trade and Development
IPEDR vol.36 (2012) © (2012) IACSIT Press, Singapore

Challenges of Service-led Economic Development in India

Bharti Singh[1 +]

[1]Institute of Management Technology-CDL, Ghaziabad, India

Abstract. Many studies have raised doubts about the sustainability of service-led economic development in India. Most often it is stated that growth in manufacturing is required to give a boost to services, employment growth, income generation and trade balance. Low employment elasticity of services and non uniform growth of disaggregated services has been a cause of concern. The paper concludes that synergies from service-led growth pattern can be built through expansion of services in Micro, Small and Medium Enterprises (MSMEs) and Rural Non Farm Economy (RNFE) by promotion of entrepreneurship. Policy reforms to liberalise the service sub-sectors like trade (retail and wholesale), financial services and software services will help in faster growth through attraction of FDI.

Keywords: Services sector, Disaggregated services, Growth, India, FDI

1. Introduction

It is a known fact that as a country embarks on the path of economic development it experiences a structural shift. As growth took place in the currently developed economies of Europe and the North America they registered a rise in the contribution of the secondary sector rises in relation to the primary sector which initially is the predominant sector. With "industrialization" the secondary sector became a major contributor to GDP followed by the tertiary and primary sector and the economies transformed into developed nations in a period of 75 to 100 years (Kuznets, 1966). Thereafter, they registered "deindustrialiation" with the services sector being a major contributor to GDP followed by secondary and primary sector (Papola, 2005). In contrast to this growth pattern, the services sector in India has grown at a rapid rate compared to the growth of the secondary sector with the onset of economic development since 1950s. The fall in the share of the primary sector has taken 40 years that was achieved by the developed countries in 100 to 150 years and the services sector has grown at a rapid rate since 1990s.

Table 1: Average GDP Share (%) and Trend Growth Rate (% per annum)

	Primary		Secondary		Tertiary	
	GDP Share	Growth Rate	GDP Share	Growth Rate	GDP Share	Growth Rate
1950s	55	2.7	16	5.8	28	4.1
1960s	47	1.5	21	5.5	31	4.5
1970s	43	1.8	23	4.5	35	4.6
1980s	36	2.9	25	6.5	39	6.6
1990s	29	3.2	27	6.2	44	7.7
2000s*	19	2.7	20	7.2	61	9.8

Source: Reproduced from Joshi 2010
Note: Growth rates for 2000s are for 2002/03 to 2008/09

2. Observations of Service-led Growth

The services sector of India has shown a consistent rise in GDP share and growth rate since the take-off in the journey to economic development as shown in table no. 1. The share of services in GDP rose from

[+] Corresponding author. Tel.: +9818684568.
E-mail address: bharti0311@yahoo.com.

28% in 1950s to 61% in 2000s.This service-led GDP growth is due to high income elasticity of demand for services, use of service inputs in other sectors and rise in exports from the demand side while the supply side factors are trade liberalization and advanced technology (Gordon & Gupta, 2003, Banga, 2005, Joshi,2010). High input usage of services in other sectors, economic reforms and services exports led to a high growth of services in 1990s (Gordon & Gupta, 2003). Slow growth of manufacturing is another reason for this boost in the services (Banga, 2005, Li & Yang, 2008). Interestingly, Das, Banga & Kumar, (2011) attribute the growth in service sector in 2000s to increase in domestic demand (88 %) rather than external demand as the fall in external demand due to global economic crisis did not lead to a sharp decline in GDP growth rate. Another notable observation has been the convergence of share of services with the international levels (Eichengreen & Gupta, 2010).

2.1. Employment

The growth in employment in service sector has been low in fact referred as "jobless" by Gordon & Gupta (2003). Share of services in employment has not risen at the same pace as the share in GDP. For instance, employment elasticity of government services fell from 0.5 during 1983/84 – 1993/94 to 0.07 during 1993/94 - 1999/00, while of financial services from 0.92 to 0.73 (Banga, 2005). Business services, finance, real estate and insurance have shown highest employment elasticity (0.94) followed by trade, hotel and restaurant (0.59) and community, social and personal services (0.28) in the time period of 1999/00 to 2004/05 (Eichengreen & Gupta, 2010). World Bank (2004) estimates reveal that between 1993/94 and 1999/00 highest employment growth has been in telecommunications (33%) followed by computer related services (21%), other business services (12%) and retail trade (7.1%).

2.2. Trade

There has been a consistent rise in service exports, especially of software and computer related services, since 1990s as shown in table no.2. Increase in service exports has been due to advancement in technology and trade liberalization. Many non tradable service products became tradable due to technological improvement (Li & Yang, 2008). 'Services-led-growth strategy' – a concomitant of export-led-growth strategy has led to improvement in comparative advantage and export of commercial services during 1990 to 2005 (Joshi, 2010).

India's exports of aggregate services to the world are more responsive to income changes (3.22) rather than to price changes (0.56) and travel exports followed by finance and transportation are most income elastic exports (Das, Banga & Kumar, 2011).

Table 2: Share of Services Exports (%)

	Share in total services output of India	Share in GDP of India	World services Exports
1990-91	3.2	1.6	0.6*
1995-96	4.5	2.3	
2000-01	6.9	3.9	1.2*
2005-06	12.9	7.8	2.2*
2008-09	15.1	9.4	3.3*

Source: RBI, Handbook of Statistics
*For the years 1990,2000, 2005 and 2010 respectively from WDI, World Bank

2.3. Foreign Direct Investment

Since 1990s there has been an increase in share of services in inward FDI and outbound FDI. Study by Sen (2011) shows that there is a significant positive impact of FDI on services sector and the service sector growth has in turn a significant effect on GDP. Financial and non financial services (22%) computer hardware and software (9%), telecommunications (8%), housing and real estate (8%) have attracted largest share of FDI between April 2000- Jan 2010 (RBI Bulletin, 2010).

3. Contribution of Service Sub-sectors

The contribution to GDP and growth pattern of disaggregated services has shown a fluctuating pattern. Table no.3 depicts that business services, communication, banking and hotels and restaurant have shown a consistent rise in growth rate and contribution to the GDP. There was a decline in the growth rate of insurance, public administration & defense, legal services, real estate, personal services and storage form 1980s to 1990s. Their contribution to GDP in this time period has not shown a significant change except for real estate and railways. Growth of services in India has been broad-based, although it has been unusually rapid in modern services like communications, business services and services that are tradable internationally (Banga, 2005, Nikombarik, 2006, Eichengreen & Gupta, 2010).

Trade (retail & wholesale), software services and banking services should be given an impetus as they have a higher contribution to GDP , rising domestic demand, higher growth rates and boost productivity of the manufacturing sector, thereby leading to a sectorally-linked productivity spiral (Das, Banga & Kumar, 2011). Education and health care should be deregulated to meet domestic demand.

Table 3 Average Annual Growth Rate and GDP shares of Service Sub-sectors (%)

	1980s		1990s	
Service Sub-sectors	**Growth Rate**	**GDP share**	**Growth Rate**	**GDP share**
Business Services	13.5	0.3	19.8	1.1
Communications	6.1	1.0	13.6	2.0
Banking	11.9	3.4	12.7	6.3
Hotels & Restaurant	6.5	0.7	9.3	1.0
Community Services	6.5	4.3	8.4	5.5
Trade (Retail & Wholesale)	5.9	11.9	7.3	13.7
Other services	5.3	1.0	7.1	1.7
Transport	6.3	3.8	6.9	4.3
Insurance	10.9	0.8	6.7	0.7
Public Administration & Defense	7.0	6.0	6.0	6.1
Legal Services	8.6	0.0	5.8	0.0
Dwelling & Real Estate	7.7	4.8	5.0	4.5
Personal Services	2.4	1.1	5.0	1.1
Railways	4.5	1.4	3.6	1.1
Storage	2.7	0.1	2.0	0.1
Source: Reproduced from Gordon and Gupta (2004).				

4. Implications

Since the late 1980s much discussion has been taking place to assess whether the service-led growth of the Indian economy is sustainable or not. Bhattacharya and Mitra (1990) stated that, the deviation in growth rates of the three sectors may have negative impact on inflation, balance of payments and income distribution. Since there are strong linkages from services to industry (Hansda, 2001, Banga & Golder, 2004) the growth in manufacturing sector will give an impetus to services. To enhance growth synergies among sectors relatively stronger growth of services sector is undesirable as the input demand of services sector is industry intensive rather than agriculture intensive (Kaur, Bordoloi & Rajesh, 2009). Growth in the manufacturing sector is also desirable for trade balance and employment generation (Papola 2005). India must develop its manufacturing whose multiplier effect and impact on job creation are significant to meet the challenges of demographic profile and reduce poverty (Li & Yang, 2008).

Interestingly, estimates of correlation done by Eichengreen & Gupta (2010) between services growth with manufacturing growth show a decline (from 0.77 in period of 1951-65 to 0.30 in 1996-2008). No specific correlation was found between services growth and agriculture growth. They state that a small fraction of demand of services is manufacturing driven.

Conclusion 1: Economic policies should focus on the promotion of services in Micro, Small and Medium Enterprises (MSMEs) and the Rural Non Farm Economy (RNFE). Fostering of entrepreneurship through development of entrepreneurial skills, financing of entrepreneurial efforts and promotion of networking among potential entrepreneurs and their experienced counterparts with supportive policies in a market-based environment (Lal & Clement, 2005) can give an impetus in the aforementioned segments. Technology driven initiatives by the MSMEs and RNFE in these segments will help in a cumulative increase in output and employment in the long run. This will help in achieving the twin objectives of a higher growth in the manufacturing sector and decrease in the burden of population on land.

Services represent the fastest growing sector of the global economy and two-thirds of global output is derived from the service sector. With evolving technologies, services are tradable without any harm to environment and they can be easily transported via satellite without any CO2 emissions. It is estimated that the ratio of service trade to service output for developing countries has increased much faster than for developed countries (World Bank, 2004).

Conclusion 2: India should deregulate key service sub-sectors, like retail, financial services and real estate further to attract FDI and to promote services that are tradable.

5. References

[1] A. Das, R. Banga, D. Kumar. Global Economic Crisis: Impact and Restructuring of the Services Sector in India. ADBI. 2011. W. P. 311.

[2] A. K. Dutt, K. Y. Lee. The Service Sector and Economic Growth: Some Cross-Section Evidence, International Review of Applied Economics, Vol. 7 (3),

[3] A. K. Lal, R. W. Clement. Economic Development in India: The role of Individual Enterprise (And Entrepreneurial Spirit. Asia-Pacific Development Journal..Vol.12. No. 2005. 81-99

[4] B. Eichengreen, P. Gupta. The Service Sector as India's Road to Economic Growth? ICRIER, 2010. W. P. No.249.

[5] B.B. Bhattacharya, A. Mitra. Excess Growth of Tertiary Sector in Indian Economy: Issues and Implications. EPW, Nov. 3, 1990. Vol. 25: 2445-50

[6] C. Sen. FDI in the Service Sector - Propagator of Growth for India? Theoretical and Applied Economics. (2011), Vol. 18 (6): 141-156

[7] Central Statistical Organisation, National Accounts Statistics: Back Series, 1950-51 onwards

[8] D. Nikomborirak. A Comparative Study of the Role of the Service Sector in the Economic, Development of China and India (Revised report) Thailand Development Research Institute, Mimeo, 2006.

[9] G. Kaur, S. Bordoloi , R.Rajesh. An Empirical Investigation of the Inter-Sectoral Linkages in India, RBI, Occasional Papers. 2009. 30(1): 29-72

[10] J. Gordon, P. Gupta. Understanding India's Services Revolution, IMF Mimeo. 2003.

[11] R. Banga. Contribution of Services to Output, Growth and Productivity in Indian Manufacturing: Pre and Post Reform, W.P. 139, ICRIER, 2004.

[12] R. Banga. Critical Issues in India's Service-led Growth, W.P. 171, ICRIER, 2005.

[13] Reserve Bank of India, Handbook of Statistics

[14] S. Hansda. Sustainability of Services-Led Growth: An Input-output Analysis of Indian Economy. RBI Occasional Papers. Vol. 22 (1, 2, & 3): 73-118

[15] S. Joshi. From the 'Hindu rate of growth' to 'unstoppable India': has the service sector played a role? The Service Industries Journal. (2010), Vol. 30 (8): 1299- 1312

[16] S. Kuznets. Modern Economic Growth: Rate, Structure and Spread, New Heaven, Yale University Press, 1966

[17] T. S. Papola. Emerging Structure of Indian Economy: Implications of Growing Inter-sectoral Imbalances, 88th Conference, IEA, Vishakhapatnam, 2005

[18] World Bank (2004). Sustaining India's Services Revolution: Access to Foreign Markets, Domestic Reforms and International Negotiations. World Bank Group, South Asia Region, India

[19] Y. Li, B. Yang. Development Path of China and India and the Challenges for their Sustainable Growth. UNU-WIDER. 2008. Research Paper No. 2008/37.

Note: Some critics (like Dutt & Lee, 1999, Papola, 2005) have raised questions on the reliability of data available for the services sector. For example, Dutt & Lee (1993) state that the derivation of relationship between growth and service sector whether it is positive or negative depends on how the role of service sector is measured. But Eichengreen & Gupta (2011) are of the opinion that the expansion of modern service-sector employment is not simply disguised manufacturing activity. It is concluded that the study has to be made on the available data.