UNIT 10 SERVICE SECTOR

Structure

10.0 OBJECTIVES

After going through this unit, you will be able to:

- state the meaning of service sector;
- make distinction between service sector and other sectors;
- discuss the composition of service sector;
- explain the performance of service sector;

- describe the key service industries;
- identify the export prospects of the service sector;
- appreciate the prospects of growth of the service sector;
- identify the problems being faced by the sector; and
- comment on the future prospects of the sector.

10.1 INTRODUCTION

We have come a long way from the days of physiocrats and mercantilists when agriculture and trade in goods respectively were the engines of growth of economies. Production and trade in services have come to the forefront. In modern economies, service sector performs many important roles. **First,** it represents a major share of the developed economies and is increasingly integrated in the overall production system. **Second,** it plays an active role in market integration and globalisation. **Third,** the creation of employment, value added, income and exports is increasingly related to the good performance of the services. In India, the service sector has evolved continually over the past thirty years, modifying the structure of employment and the composition of value added. It constitutes a large part of the Indian economy both in terms of employment potential and its contribution to national income. The sector covers a wide range of activities from the most sophisticated in the field of Information and Communication Technology to simple services pursued by the informal sector workers, for example, vegetable sellers, hawkers, rickshaw pullers, etc. Currently, this sector accounts for over 50 per cent of the value added. However, despite its growing weight, the share of the working-age population employed in services remains low.

10.2 SERVICE SECTOR: CONCEPT AND MEANING

The economy has basically three sectors. **First,** the primary sector comprising of agriculture, fishing, and extraction such as mining. **Second** sector is the secondary sector comprising of manufacturing. **Third** sector is the tertiary sector also referred to as service sector.

The basic characteristic of service sector is the production of services rather than end-products. Services are intangible goods which include attention, advice, experience, and discussion. These are used to enhance productivity, performance, potential and sustainability. The production of information is also regarded as a service. However, some economists like to classify services relating to the information service in a fourth sector, now known as the quaternary sector i.e., the sector that comes after the third and just before the fifth in position.

The tertiary sector involves the provision of services to other businesses. Services may involve the transport, distribution and sale of goods from producer to a consumer, pest control, entertainment or hotel industry. The goods are transformed in the process of providing the service. However, the focus is on people interacting with people and serving the customer rather than transforming physical goods.

The composition of GDP of an economy explains the relative significance of the different producing sectors. When a country is in a state of underdevelopment, primary sector makes the largest contribution to the national income. As the country grows and gets developed, the contribution of the industrial and service sectors gradually increases.

The explanation for this shift is as follows:

Income elasticity of demand for agricultural products is relatively low; as a result, with rising levels of income, the demand for agricultural products relatively declines and that for industrial goods increases and, after reaching a reasonably high level of income, demand for services increases sharply. Accordingly, the shares of different sectors in the national product get determined by the changes in the pattern of demand. On the supply side, agriculture, being mainly dependent on a fixed factor of production, namely land, faces a limit on its growth and is subject to early operation of the law of diminishing returns. Industry, specially manufacturing, on the other hand, offers large scope for use of capital and technology, which could be augmented almost without limit with human effort. The same applies to services where application of technologies seems to offer much larger scope.

10.2.1 Composition of GDP

For the past few decades, there has been a considerable shift from the primary and secondary sectors to the tertiary sector in the Indian Economy. The tertiary sector is now the largest sector of the economy and is also the fastest-growing sector. Examples of service sector employment include: Government, hospitals, public health, waste disposal, education, banking, insurance, financial services, legal services, consulting, news media, hospitality industry (e.g. restaurants, hotels, casinos), tourism, retail sales, franchising, real estate, and sales.

10.3 COMPOSITION OF SERVICE SECTOR IN INDIA

In India, the national income classification given by Central Statistical Organisation is followed. In the National Income Accounting in India, service sector includes the following:

1) Trade, Hotels and Restaurants (THR)

   1.1 Trade

   1.2 Hotels and Restaurants

2) Transport, Storage and Communication

   2.1 Railways

   2.2 Transport by other Means

   2.3 Storage

   2.4 Communication

3) Financing, Insurance, Real Estate and Business Services

   3.1 Banking and Insurance

   3.2 Real Estate, Ownership of Dwellings and Business Services

4) Community, Social and Personal Services

   4.1 Public Administration and Defense (PA & D)

   4.2 Other Services

Table 10.1: India's GDP at factor cost: Industry-wise growth rate.

Industry	2005-06	2006-07	2007-08	2008-09	2009-10 (P)	2010-11 (QE)
1. Agri, forestry & fishing (Primary Sector)	**5.1**	**4.2**	**5.8**	**0.1**	**1.0**	**7.0**
1.1 Agri	5.5	4.1	6.3	–0.3	0.7	7.8
1.2 Forestry & logging	1.8	3.3	1.4	1.9	2.8	2.9
1.3 Fishing	5.9	6.6	5.8	2.7	3.0	3.0
2. Mining & quarrying	**1.3**	**7.5**	**3.7**	**2.1**	**6.3**	**5.0**
3. Manufacturing	**10.1**	**14.3**	**10.3**	**4.3**	**9.7**	**7.6**
3.1 Registered	12.1	15.8	10.1	5.9	11.7	7.8
3.2 Unregistered	6.5	11.6	10.7	1.3	5.4	7.1
4. Electricity, gas & water supply	**7.1**	**9.3**	**8.3**	**4.6**	**6.3**	**3.0**
5. Construction	**12.8**	**10.3**	**10.8**	**5.3**	**7.0**	**8.0**
Secondary Sector (Industry)	**9.7**	**12.2**	**9.7**	**4.4**	**8.4**	**7.2**
6. Trade, hotels & restaurants	**12.2**	**11.1**	**10.1**	**5.7**	**7.8**	**9.0**
6.1 Trade	11.6	10.8	9.8	6.7	8.3	9.1
6.2 Hotels & restaurants	17.4	14.4	13.0	–3.3	2.8	7.7
7. Transport, storage &	**11.8**	**12.6**	**12.5**	**10.8**	**14.8**	**14.7**
7.1 Railways	7.5	11.1	9.8	6.7	8.3	9.1
7.2 Other means	9.3	9.0	8.7	5.3	7.2	8.4
7.3 Storage	4.7	10.9	3.4	14.1	8.7	7.9
7.4 Communication	23.5	24.3	24.1	25.1	31.7	27.2
8. Financing, insurance, real estate & business services	**12.6**	**14.0**	**12.0**	**12.0**	**9.4**	**10.4**
8.1 Banking & insurance	15.8	20.6	16.7	14.0	11.3	14.5
8.2 Real estate, ownership of dwellings & business services	10.6	9.5	8.4	10.4	7.8	6.9
9. Community, social & personal services	**7.1**	**2.8**	**6.9**	**12.5**	**12.0**	**4.5**
9.1 Public administration & defence	4.3	1.9	7.6	19.8	18.2	1.3
9.2 Other services	9.1	3.5	6.3	7.4	7.2	7.3
Tertiary Sector (Services)	**10.9**	**10.1**	**10.3**	**10.0**	**10.5**	**9.3**
Total gross domestic product at factor cost	**9.5**	**9.6**	**9.3**	**6.7**	**8.4**	**8.4**

P: Provisional; QE: Quick Estimates

Source: CSO.

The services sector has been the most dynamic sector of the Indian economy, especially over the last two decades or so. Table 10.2 below shows the changes that have been taking place in the composition of GDP over the last few decades.

Table 10.2 below shows sectoral shares in India's national income and their Growth Rates during the era of planning in India.

Table 10.2 : Composition of Gross Domestic Product and Growth Rates (at constant prices).

	Primary		Secondary		Tertiary	
	Share	Growth Rate	Share	Growth Rate	Share	Growth Rate
1950-51 to 1959-60	56.0	2.3	16.0	5.7	28.0	4.1
1960-61 to 1969-70	47.8	2.5	21.1	6.5	31.4	4.9
1970-71 to 1979-80	42.8	1.3	22.8	3.7	34.4	4.5
1980-81 to 1989-90	36.4	4.4	25.0	6.8	38.6	6.6
1990-91 to 2000-01	28.6	2.9	27.1	5.9	44.3	7.6
2001-02 to 2007-08	22.9	3.2	20.4	6.1	56.7	8.5
2001-11 to 2010-11	16.5	2.6	18.7	4.2	64.8	9.2

Note: Till 1999-2000 at 1993-94 prices, and beyond at 1999-2000 prices.

From a low level of 27.5 per cent of GDP in 1950-51, the share of services increased to about 60.0 per cent in 2011-12. Between 1950-51 and 1990-91, the share of Services Sector in GDP rose by only 13.1 percentage points, which is an increase of about 0.3 percentage points per annum. However, between 1990-91 and 1999-2000, the share had increased by 7.3 percentage points, which is an increase of 0.8 percentage points per annum. Clearly, the rate of growth was significantly higher in the 1990s. As we will see below, the sector maintained rapid growth in subsequent decade also.

Check Your Progress 1

1) What do you mean by service sector? How is it different than the industrial sector?

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2) Mention in brief the components of the service sector in India.

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3) How does economic growth affect composition of national income?

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10.4 KEY SERVICE INDUSTRIES

10.4.1 Information Technology and Business Process Outsourcing (IT-BPO) Services

Over the past decade, IT-BPO services have emerged as key contributors to India's export earnings, investment, employment and overall economic and social development. Competitive labour costs, English language skills, technical expertise, political stability, favourable tax rates and a reputation for high-quality services have driven the sector's rapid growth. IT-BPO revenue in India has been increasing by leaps and bounds with the industry growing at an average annual rate of about 31 per cent. The industry employed approximately two million people within India, employment growth being estimated at 24 per cent. The seven largest IT-BPO firms accounted for nearly 50 per cent of the industry's export revenues and nearly 35 per cent of employment. Yet most firms in the industry are small: nearly 90 per cent of firms have annual revenues of less than $10 million while accounting for about 17 per cent of the industry's labour force. The leading IT services firms are Tata Consultancy Services (TCS), Wipro, Infosys, Hewlett-Packard India, and IBM India, while the top BPO firms are Genpact, TCS BPO, WNS Global Services, Wipro BPO, and First source Solutions.

Factors Affecting Demand

Factors affecting demand for India's IT-BPO services include economic and financial conditions in key export markets, the relative attractiveness of competing providers, and changes in the domestic market for outsourced IT-BPO services.

Factors Affecting Supply

Workforce challenges and government incentives affect the industry's supply of services. Among the former, attrition, wage inflation, and skill levels pose particular challenges. High attrition tends to undermine the quality of services and to boost costs for recruitment and training. And attrition is a problem for India: a recent study found that nearly 60 per cent of call center employees in India had less than one year of tenure, compared to less than 30 per cent in the United Kingdom, United States and Canada. In order to reduce attrition, firms have raised wages Pay in the IT-BPO sector was increasing.

10.4.2 Telecommunication Services

Sweeping liberalisation and deregulation undertaken by successive governments over the past decade have transformed the Indian telecommunication services industry from a market dominated by a few government-controlled entities into one characterised by a large number of private sector rivals and high levels of competition. Such competition has resulted in declining service prices, which have, in turn, led to rapid market growth. Since 2004, for example, the total number of telephone subscribers grew at a compound annual growth rate (CAGR) of 43 per cent to approximately 900 million, causing total telephone subscriber penetration to increase 70 per cent. This growth was driven almost entirely by the private mobile telephone segment, which account for approximately 93 per cent of India's total telephone connections.

Leading Indian telecommunication service companies are Aircel, Maxis, Apollo Group, Bharat Sanchar Nigam Ltd. (BSNL), Bharti Airtel Bharti Telecom Group, Pastel Ltd, Indian Continent Investment Ltd , HFCL Infotel, Himachal Futuristic Communications Ltd, Idea Cellular Birla TMT Holdings, AT Birla Nuvo, Hindalco Industries, Grasim Industries, Loop Mobile BPL Communications, Capital Global, Gypsy Rover, Mahanagar Telephone Nigam Ltd. (MTNL) Government, Reliance Communications Anil Dhirubhai Ambani Group, Sistema Shyam TeleServices Sistema, Spice Communications Modi Wellvest, Telecom Malaysia, Tata Teleservices Tata Group, NTT DoCoMo, Tata Communications (VSNL) Tata Group, Vodafone Essar Vodafone Group.

10.4.3 Internet Services

Although Internet subscribers in India have grown at an annual rate of approximately 24 per cent during the last decade, a subscriber base of 18 million and Internet penetration of approximately only 1.5 per cent by the end of 2011 make India one of the world's least-developed Internet markets. In general, the proliferation of Internet services in India is hampered by high levels of poverty, particularly in rural areas, and associated low levels of personal computer ownership. Internet subscriber growth over the past decade has been driven almost entirely by the adoption of residential broadband Internet services, which grew at a CAGR of 153 per cent from 135,000 subscribers in 2004 to 8.1 million at the beginning of 2012. In India, broadband Internet services are predominantly delivered over fixed-line networks (i.e., DSL service), as opposed to delivery via cable television networks. India's Internet services market is in a state of flux, with more than 750 licenses issued over the past few years, while 450 licenses have been revoked. As of December 2011, only about half of India's licensed Internet Service Providers (ISPs) had launched Internet services. The top five ISPs in India, measured by market share were BSNL (56 per cent), MTNL (15 per cent), Bharti Airtel (8 per cent), Reliance Communications (8 per cent), and Hathaway Cable and Datacon (2 per cent); all other ISPs each accounted for less than 2 per cent of the market.

10.4.4 Energy Services

India is the fifth largest electricity producer in the world, behind the United States, China, Japan and Russia. During the last decade, India has increased the quantity of electricity it produced by more than any other country in the world, aside from China. Demand, however, has increased at an even faster rate, resulting in a shortage of electricity and frequent power outages during peak hours. In addition to a shortage of generation capacity, India faces significant challenges in electricity transmission and distribution. Due to the lack of an integrated national transmission system, India sometimes experiences simultaneous electricity surpluses in some areas and deficits in others. It is estimated that India losses annually 198 billion kilowatt-hours due to distribution losses, which is more than double the total electricity production of neighbouring Pakistan. These losses account for 26 per cent of total electricity output, which is nearly three times the global average for distribution losses. Additionally, India's per capita consumption of electricity is lower than the average for every region in the world except South Asia. This reflects India's relatively low level of urbanisation compared to other lower-middle-income countries, among other factors. The consequences of these inadequacies for industries and individuals are severe. Electrical equipment is damaged and burns out more quickly as a result of outages and fluctuating voltage, workers are idled during blackouts, and businesses need to invest in costly diesel generators.

10.4.5 Air Transport Services

India's air passenger transport market is relatively small, accounting for only 2 per cent of airline traffic worldwide. Indian airlines transport approximately 61 million passengers per year, more than 80 per cent of whom are domestic travellers. Operating revenue for India's air transport industry is roughly $9.0 billion, and the number of workers employed in the sector is nearly 60,000. Although India's air transport industry has experienced substantial growth over the past one decade, such growth has been slowed by the recent financial crisis. Despite the current downturn, growth potential remains as the young and increasingly affluent Indian population selects air transport over other modes of domestic travel.

Major airlines in India are Indian Airlines, Alliance Air, Go Airways, Indigo Airlines, Jet Airways, Kingfisher Airlines, Paramount Airways and Spice Jet Airlines.

10.4.6 Education Services

In the year 2011, India's higher education system has 563 universities, out of which 44 central universities, 285 state universities, 129 deemed universities and 106 private universities*. Nevertheless, both the quantity and quality of services supplied by India's higher education system are insufficient to meet demand from eligible students and their prospective employers. A small portion of India's higher education institutions is renowned for producing graduates who are adequately prepared for advanced degree programmes, research or employment in scientific, technological or commercial fields in India and abroad. However, most of India's universities and colleges lack the financial resources, authority and flexibility to equip graduates with the skills demanded by India's expanding business and technology sectors. Many students from India, therefore, pursue higher education opportunities abroad. With about two-thirds of the population of India under age 25, national and state government funding priorities for education for the 20-year period through 2005 centered on increasing participation in elementary education (grades 1 through 5), especially among the population segments with relatively low levels of participation in education. Despite India's progress in recent years in making elementary education more available – especially to historically underrepresented segments such as girls and children in eastern India, and culturally disadvantaged groups – substantial numbers of students continue to exit the education system at every level. As a result, only about 13 per cent of 18- to 24-year-olds in India had enough prior education to advance to higher education in 2011. The 12th five-year plan (2012–17) has elevated the policy and fiscal priorities of higher education relative to other levels of education.

10.4.7 Financial Services

The Indian financial services industry is a strong contributor to the nation's economy, accounting for approximately 5.5 per cent of GDP and creating jobs at a steady pace. There are approximately 1 million jobs in the Indian banking sector, and according to one industry estimate, that figure had the potential to grow to about 2.5 million by 2020. India's sustained economic growth has created an expanding middle class with disposable income and increasingly sophisticated financial services needs. Indian households save an average of 32 per cent of their income, yet less than half of that money has made its way into the formal financial system. Furthermore, many Indian businesses are rapidly expanding their domestic and

* en. wikipedia.org

foreign operations and need access to financing. While most developed, and many developing, countries have experienced upheaval in their markets as a result of the global financial crisis, India's financial system has not been seriously impacted. This is largely because Indian banks did not have significant exposure to subprime markets. Indian regulators tend to be conservative, and state-owned banks have had their capital augmented by the government when necessary, though the global liquidity shortage that followed the financial crisis did affect Indian banks' lending levels. All of these factors combine to make the Indian banking industry highly attractive to global banks seeking new growth in developing markets. However, the market is not fully open to foreign participation, and foreign firms that do have a domestic presence face a number of hurdles in competing with their Indian counterparts. Top 10 commercial banks by loan advances are State Bank of India, ICICI Bank, Punjab National Bank, Bank of Baroda, Bank of India, Canara Bank, IDBI Bank, HDFC Bank, Union Bank of India and Central Bank of India.

Check Your Progress 2

1) Name four key service sector industries in India.

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2) State two important factors that determine the demand for IT services.

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3) State two important factors that determine the supply of IT devices.

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10.5 PERFORMANCE OF SERVICE SECTOR IN INDIA

Performance of service sector in India can be assessed with the help of three parameters as follows:

1) Sectoral composition of GDP Growth
2) Employment contribution of Service Sector
3) Productivity Growth in Service Sector

10.5.1 Sectoral Composition of GDP Growth

The share of each of the Primary, Secondary and Tertiary Sector in India's GDP and their relative rate of growth is shown in Table 10.1.

It would be seen that over the period, the primary sector's share has fallen by 40 per cent, while those of the secondary and tertiary sectors have increased. This trend is projected to go further in wake of liberalisation of the economy. This may happen primarily because of the following factors: (a) reduced restrictions on private sector involvement in areas like software development and information services, (b) technological advances, and (c) lower fixed capital requirements.

It would be seen from Table 10.2 that the rate of growth of the secondary and tertiary sectors has been more than double than that of the primary sector, with the secondary sector having an edge over the tertiary sector during the first two decades. In the subsequent decade, the tertiary sector grew faster than either of the other two sectors. During the 1980s, when all the three sectors were growing at a faster rate, the secondary sector was the fastest. Subsequently, the tertiary sector has been growing the fastest. (To an extent the growth of the services sector may have been overstated as new technologies and competitive pressures have led to widespread outsourcing of non-core activities by manufacturing firms, which then show up a services growth. Also, one suspects that in the system of National Accounts, services are a residual category that ends up including some household and cottage sector production activity. Nevertheless, there is no denying the importance of the growth momentum generated by the services sector).

As a result, the service sector has become the growth-driver in the Indian economy. It is clear from the data given below:

Table 10.3: Sectoral percentage contribution to Increase (in GDP_{FC}).

Sectors	1951-52 to 1960-61	1961-62 to 1970-71	1971-72 to 1980-81	1981-82 to 1990-91	1992-93 to 1996-97	1997-98 to 2010-11
Primary	45.2	35.1	27.2	24.2	20.3	12.7
Secondary	23.7	26.5	25.6	28.6	30.9	23.6
Tertiary	31.3	38.4	47.2	47.2	48.8	64.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

Presently, about two-thirds of the incremental growth in the Indian economy can be attributed to the tertiary sector.

This pattern of structural change in Indian economy has deviated from the development pattern of Western and South East Asian economies. Those economies experienced first a shift from primary to secondary sector and only in their advanced stage did they experience a significant shift in favour of tertiary sector. That pattern of development enabled them to transfer growing labour force from primary to secondary sector. In India, this has not been possible because secondary sector has not expanded fast enough to absorb growing labour force. The unskilled and uneducated rural masses have continued to struggle in the primary sector and those who have been forced out by economic, social and political factors have joined the urban slum sector. Moreover, the sharp increase in the share of tertiary sector in GDP in India has occurred at a much lower level of per capita income than that in the developed countries when they experienced a similar expansion.

This pattern of growth underlines the link between the growing poverty and unemployment and the inadequate growth of manufacturing and building activity in the country.

10.5.2 Employment Contribution of the Service Sector

The sectoral distribution of workforce in India during the period 1983 to 2009-10 reveals that the structural changes in terms of employment have been slow in India as the primary sector continued to absorb 54.9 per cent of the total workforce even in 2009-10, followed by tertiary and industrial sectors (25.5 per cent and 19.6 per cent) respectively. There has been disproportionate growth of tertiary sector, as its share in employment has been far less when compared to its contribution to GDP.

It is important to understand that, within the services sector employment growth rate is highest in finance, insurance, and business services, followed by trade, hotels and restaurants, and transport etc. The community, social and personal services occupy the last rank in growth rates of employment.

Further, there was a sharp drop in labour absorptive capacity of growth in the economy (employment elasticity of growth) from 0.40 to 0.15 during post-reform period (1993-94 to 1999-2000) initially, reflecting the phenomenon of jobless growth. However, during 1999-2000 to 2009-10 period the employment elasticity of growth registered an increase from 0.15 to 0.51.With the exception of one sub-sector of tertiary sector i.e. transport, storage, communication all other sub-sectors of services sector exhibited an increasing trend in employment elasticities and thereby overall elasticity of employment increased from 0.15 to 0.51.

10.5.3 Productivity Growth in Service Sector

The process of acceleration in growth started in 1980s rather than in 1990s. Of the 2.4 percentage point increase in the rate of economic growth that took place in the post-1980 period, about 40 per cent is accounted for by a faster growth in TFP in services. The three sectors viz. agriculture, industry and services have witnessed acceleration in the growth rates of output, output per worker and total factor productivity (TFP) in the post-1980 period. However, the increase is more marked in case of services. Partially, the spurt in growth rate is attributable to productivity growth in certain sub-sectors of services sector. It has been noticed that growth rate in output per man is highest in case of PA &D and other community social and personal services (4.2 per cent p.a), followed by transport, storage, communication (3.3 per cent pa), trade , hotels, restaurants (2.9 per centpa) and banking, insurance, real estate and business services. The acceleration in growth rate of output per worker in PA &D and other community, social and personal services might have resulted from the downsizing of the public sector because of privatisation and hikes in the salaries of the central and state government employees from time to time (i.e due to accounting reasons). Whereas productivity growth in THR has derived stimuli from surge in demand for such services with a subsequent expansion in these activities. Part of the productivity growth in the services sector might be an outcome of application of IT services. Despite increase in growth rate of labour productivity in service sector, measurement of service sector output and productivity are still debatable issues.

10.6 EXPORTS OF SERVICES

Exports of services supplement the merchandise-exports as a source of foreign exchange earnings. Services encompass telecommunications, transportation, tourism, banking, insurance, construction, computer-related services and professional ones. But as with trade in goods, the nature of services, too, is daily changing, acquiring fresh dimensions. Trade in services, and high technology industries are also virtually symbiotic.

10.6.1 World Trade in Services

World trade in service exports has taken a big leap forward with service exports growing at a rate of 10 per cent in recent years. There are factors both on demand and supply sides that have contributed to this trend.

On the ***demand side***, world trade in services is certain to accelerate in the coming years with advances in generic technology of computers and telecommunications. It is considerably influenced by the emerging demand for a whole range of business services due to innovations, new technology, sophisticated buyer needs, opening of new markets, service-based inputs and globalisation strategies.

On the ***supply side,*** the factor that has contributed most to growth in world trade in services is that many services which were earlier in-house activities of business firms, for instance legal services – are getting highly specialised and are splintering off to outside business firms possessing the required expertise.

The lead in the growth of service trade is likely to increase in the new millennium due to the expected expansion of the freer market supported by the WTO agreements on telecommunications, information technology and financial services. Their cross-border trade is estimated already at $100 bn, 210 bn and 50 bn, respectively.

10.6.2 India's Exports of Services

India's exports of services are valued at about $100 billion annually. These form about 2.7 per cent of world's total exports of services. (Apparently, India's share in world's exports of services is more than the share of India's merchandise exports in world's total merchandise exports.)

These are in the form of four modes of services delivery as defined in the WTO's General Agreement on Trade in Services (GATS). Mode 1 refers to cross-border supply, for instance call centres. Mode 2 relates to consumption aboard. Medical care, education and tourism are few of the services delivered by this mode. Mode 3 refers to commercial presence, where delivery requires FDI, for instance banking and financial services. Mode 4 refers to movement of natural persons, where services are delivered by individuals travelling to other countries, eg., IT professionals.

Balance of Trade in Services

The present trends indicate that there is not much parity between service exports and imports. This is especially true of items like transportation and business services coupled with a factor service like investment income. The latter has grown fast on account of interest and service payments on foreign loans and credit. As a result, trade in services has suffered from trade deficits, and these deficits have been widening.

10.6.3 Determinants of Exports of Services

A recent study identifies the following as the principal determinants of exports of services:

i) Travel receipts have been mainly dependent on expansion of tourist facilities in the country.

ii) Transportation receipts have been dependent on merchandise exports originating from the country.

iii) Insurance receipts have been dependent generally on exports of merchandise.

iv) Receipts of repatriation of international investment income have been mainly dependent on growth of world economy.

v) Professional, technical and other services receipts abroad have been mainly dependent on development of the expertise in the country.

10.6.4 Need and Prospects to Push Exports of Services

Trade deficits on account of services may further widen if service exports do not respond appropriately to the technology inflows from abroad. The impact of these deficits will be felt on BOP and external value of rupee. Hence, it is important that India should make efforts to reap the benefits of booming services the world over.

India's competitive advantages in selected services can be identified and targets and incentives may be fixed at the micro level with appropriate support for marketing and other infrastructure. Two kinds of services which India can vigorously pursue for exports are tourism and business services based on its respective strength as a tourist attracting country and large inventory of skilled human resources. For this to happen, it is necessary to learn in terms of flexibility, customised operations, technologies and global strategies from the service provide of the north.

India has a comparative advantage in Mode 1 as captured by outsourcing activities, Mode 3 as seen in increasing outward investment by Indian companies in US, UK and other developed and developing countries markets and Mode 4 as captured by movement of Indian software professionals in the US, EU, etc.

The most ambitious area is that of software exports. If software exports continue grow to at the present pace – admittedly a big if – they will by 2015 total $ 150 billion. Even at that level, they will constitute no more than one per cent of global software production, so from that view point, the target is not excessively ambitious.

SWOT analysis of India's services exports, as presented below, indicates clear possibilities for these exports to surge ahead.

Table 10.4: SWOT analysis of India's Services Exports.

Strengths	Weaknesses
Economical wage and other bills, and the favourable time-zone difference between Indian and Western cities	Traditional, labour constrained financial system
Trained/skilled, English speaking, younger manpower	Still developing telecommunications
Well-established financial network	Higher inflation (Consumer prices)
Promotional fiscal and Exim policy	Regional disparities
Opening up of world markets	Technological lag
Euro-zone as one market	Low telecommunication intensity
Global business links and FDI possibilities	Rigid labour situation
Emerging conclaves with good image	Restricted capital account compared to all competing countries

Threats and weaknesses have to be given due attention, particularly technological upgradation to augment competitiveness.

Our services performance should make us think the way we look at WTO. If we have a natural space in the services arena, our misplaced concerns in agriculture and merchandise trade should not compromise our interests in services.

10.7 CAUSES OF RAPID INCREASE IN TERTIARY SECTOR

The tertiary, i.e., the non-commodity sector, has been growing at a much faster rate than the commodity sector. This in essence means that income generated in the process of circulation grew at a much faster pace than that in the directly productive process, and thereby resulting in an increase in the share of the non-commodity sector. This trend can be attributed to a number of factors, among which, the more important are as follows:

i) A very important factor has been the advent of information technology and the knowledge economy. This has enhanced the growth of the high productivity segment of the services sector as well as a variety of service activities involving low productivity activities catering to a large mass of people.

ii) A large part of the service sector consists of infrastructure such as banking, insurance, finance, transport and communication and social and community services such as educational and medical facilities. An urgent requirement of development is the proper expansion of infrastructure to cater to the needs of other sectors of the economy and the expansion of the social and community services for the well-being of the people.

iii) Public services grow more rapidly where national Governments have significant role in planning and production in the economy as a whole. In fact, the 'visible hands' of the modern governments as reflected in the government policies and in the expansion patterns of the national and international authorities during the last few decades are directed towards the creation of fast economic and social infrastructures.

iv) Operation of the demonstration effect as a consequence of the growing mobility due to expanding foreign trade, tourism and cultural and educational tours is another important factor.

v) Increasing urbanisation may be regarded as another cause of expansion of the service sector in the economy. In fact, urbanisation is closely associated with a rise in demands for infrastructure services such as communications, public utilities and distribution services. A substantial change in the private consumption pattern of the economy is observed with increasing urbanisation. Many new goods and services enter into the consumption basket.

vi) Tourism is becoming more and more international as knowledge is being spread through television and Internet, and modern technology has made air transport and hotel accommodations quite comfortable. Tourism, in turn, has promoted all types of services.

vii) With the increasing complexities of modern industrial organisation, manufacturing industries have become service oriented. This has been reflected in the increasing functions of accounting, finance, legal services, advertisement, marketing, public relations etc. Because of the prevalent labour laws, these services are being increasingly outsourced, so that growth in industry is actually being counted as growth in services.

In addition to the above factors, an increase in the share of the non-commodity sector in the GDP can also be attributed to slow growth in the commodity producing sector. While a part of this is explained by difficulties inherent in bringing about a fast rate of growth in the primary sector, a part is undoubtedly due to the failure of the secondary sector and its major component, which is manufacturing and construction, to grow at the much faster rate that was necessary to give the commodity sector a comparable status with the non-commodity sector in the growth rate.

10.8 PROSPECTS AND OPPORTUNITIES

Both domestic and international factors augur well for the growth of services sector in India.

10.8.1 Domestic Factors

Some of the important factors can be briefly stated as follows:

i) As real per capita GDP grows, demand for services increases more than proportionately and this, in turn, reinforces GDP growth itself.

ii) Within the services sector, demand for producer and government services, which constitute mainly intermediate consumption, have strong multipliers effects on real GDP.

iii) The growth of such dynamic service activities, which are intensive users of communication and information technology, will generate employment opportunities on a rising scale.

iv) The process of economic growth has itself led to the emergence and expansion of new series such as advertising, publicity, marketing, etc. These sub-sectors provide essential service inputs to other sectors in the economy, thereby developing strong linkages with the rest of the economy.

v) Efficient delivery of services increases the productivity of both labour and capital in the economy as a whole. In general, services sector appears to be highly growth inducing with positive externalities for other services making service a catalytic agent of growth.

10.8.2 International Factors

Some of the recent global developments which provide opportunities for substantial growth are as follows:

i) The fastest growing segment of services is the rapid expansion of knowledge-based services, such as, professional and technical services. India has a tremendous advantage in the supply of such services because of a developed structure of technological and educational institutions and lower labour costs.

ii) Progress in IT is making it increasingly possible to unbundle the production and consumption of information-intensive service activities. These activities – research and development, computing, inventory management, quality control, accounting, personnel administration, secretarial, marketing, advertising distribution and legal services — are performed in all economic sectors.

iii) Unlike most other prices, world prices of transport and communication services have fallen dramatically. The cost of communication is becoming independent of distance. India's geographical distance from several important industrial markets is no longer an important element in the cost-structure of skill-based activities.

iv) India does not necessarily have a low-cost producer of certain types of goods (e.g., computers or discs) before it can become an efficient supplier of services embodied in them (e.g., software or music). It is possible now to provide value added services without waiting to 'catch up' in technology for production of sophisticated equipment or products.

v) The decline in the share of manufacturing in the output of rich countries implies a relative decline in their demand for industrial raw materials and fuels. It means that growth in exports of developing countries in the future will depend less on natural resources endowments and more on efficiency in providing services and service-intensive goods.

vi) The aging of population in the developed world implies that the demand for services will continue to grow.

As a result of the above developments, the sources of comparative advantage of nations are vastly different now from what they were 50 or even 20 years ago. And, there are very few developing countries which are as well placed as India to take advantage of the phenomenal changes that have occurred in production technologies, international trade, capital movement and deployment of skilled manpower. It is now possible for India to take advantage of a virtuous circle of higher growth, higher capital inflows and higher domestic incomes and savings, which in sum can lead to further growth.

Check Your Progress 3

1) Mention in brief the important causes of the growth in services sector in India.

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2) State in brief the important domestic factors that favour the growth of service sector in India.

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3) State in brief the important international factors that favour the growth of service sector in India.

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10.9 IMPLICATIONS

The expansion in the service sector has wider implications for population, employment, and trade prospects of the economy, some of which are as follows:

a) The growing share of the services sector points to the need for policy initiatives towards introducing greater competition and efficiency in this sector so as to ensure its sustained contribution to exports (especially software) and to higher long-term growth.

b) The gains in productivity in the agricultural and industrial sectors resulting from technological progress and innovation will have the effect of shifting employment away from the non-service sector to the services sector. This may also indicate a shift in real expenditures from commodities to value added services.

c) The services sector constitutes a tax-base with vast but unexploited potential, and therefore its growth has long-term implications for the fiscal policy.

10.10 LIMITATIONS

However, the service sector, as at present, suffers from low productivity and quality in spite of fairly large investment in technology.

The sector faces multiple challenges for sustained growth over the years. A number of services where India enjoys comparative advantages experience lack of clear policy thrust. A number of services in India are either predominantly associated with the government or are not liberalised enough to ensure growth through organised private initiatives. Services like professional, legal, postal, accountancy and insurance need further liberalisation to harness their potential.

Unless sustained efforts are put in to improve these, with the increasing importance of the services in wake of structural adjustment and liberalisation in the economy we may get into two alternate scenarios.

a) Economic and social position of workers in the service sector will steadily go down — since real incomes cannot be higher than productivity for any extended length of time. This means economic stagnation and consequent social tensions; or

b) The workers in this sector will use their numerical strength to get wages higher than their economic contribution justified. This will impoverish others — reducing everyone's income and increasing unemployment.

10.11 NEED FOR AN INTEGRATED POLICY

To make services-led growth more widespread and sustainable, it is important to systematically and simultaneously remove those constraints from which the sector suffers presently. To do this, a coherent integrated services policy (in line with the agricultural and industrial policies) needs to be developed. Reforms in services in India have evolved in an ad hoc manner rather than as part of an overall strategy. Consequently, the depth and pace of reforms lack uniformity across sectors. Given the strong inter-linkages between different services, opening a particular services sector may not yield results if not backed by corresponding reforms in other complementary services. Such an integrated services policy should also define the sequence as well as the pace of reforms to be undertaken simultaneously in different services. Liberalisation should be followed in a phased manner accompanied by social polices in sectors that have surplus labour so as to avoid creating unemployment and social unrest. This will go a long way in sustaining the dynamism of services-led growth. The details about the integrated policy will be discussed in Unit 23.

10.12 LET US SUM UP

From the preceding analysis, it is evident that the Indian economy is becoming a service-driven economy more in terms of output than employment. The pre-reforms period was a period of high employment growth and rapid economic progress. The tertiarisation process was dynamic and growth-driven. However, in recent years, much of the rise in the service sector is because of lack of employment opportunities in other sectors of the economy. As a result, a large proportion of the service sector jobs created during this period are of distress in nature – petty jobs taken up by the workers in the sectors like trade, hotels and restaurants – pushed out by agriculture and not absorbed by manufacturing. There has also been creation of a handful of high-income jobs in the sectors like financing, insurance, real estate and business services that has been growth-driven leading to accentuation of inequalities. A clear hierarchy exists within the service sector not only in terms of employment growth or output growth but also in terms of the dynamism of the growth process. Moreover, high-productive and high-income segments like financing, insurance, real estate and business services within the services are experiencing faster growth in terms of output. On the other hand, low-productive and low-income segments viz. trade, hotels and restaurants are experiencing rise in terms of employment. These factors should be kept in mind while drawing policy for the development of the service sector. Having found out the factors affecting the service sector, it is important to note that priorities are essential. While trying to move rapidly towards more open and competitive service markets, at both national and international levels, it is necessary to foster new employment opportunities in the service sector. A conducive fiscal environment and improvements in the functioning of labour markets and institutions are essential to adjust globalisation and the shift to services in the Indian economy. A well functioning service sector provides important opportunities to strengthen employment and productivity. It also helps in strengthening the capacity of the country to adjust to economic globalisation and to the growing importance of services and to its future growth. A comprehensive strategy is thus required to address the service sector challenges, which is well suited to the Indian economy.

10.13 EXERCISES

1) How is the tertiary sector of an economy different than the other sectors in the economy? What role does the tertiary sector perform in the development process of an economy?

2) "The sequence of the growth process in India is different than what most of the other countries experienced during the transition from a developing to a developed nation". Examine this statement and account for the causes of rapid growth of the tertiary sector in India.

3) Examine the prospects and challenges faced by the service sector in India.

4) Examine the nature of foreign trade in services in India. Also examine the prospects of exports of services from India.

10.14 SOME USEFUL BOOKS

Basu Kaushik (ed.) (2010): *The Oxford Companion to Economics in India*, Oxford University Press, New Delhi.

Joshi Seema (2008): *Growth and Structure of Tertiary Sector in Developing Economies.* Academic Foundation, New Delhi.

Dhingra Ishwar C. (2012): *The Indian Economy Environment and Policy*, Sultan Chand, New Delhi.

Kumar Nagesh and Joseph K.J. (2010): *International Competitiveness and Knowledge-based Industires in India,* Oxford University Press, New Delhi.

10.15 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Section 10.2

2) See Section 10.3

3) See Section 10.3

Check Your Progress 2

1) See Section 10.4

2) See Sub-section 10.4.1

3) See Sub-section 10.4.1

Check Your Progress 3

1) See Section 10.7

2) See Sub-section 10.8.1

3) See Sub-section 10.8.2