International Research Journal of Marketing and Economics
Vol. 2, Issue 10, Oct 2015 IF- 2.988 ISSN: (2349-0314)

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SERVICES-LED GROWTH IN INDIA: HOW SUSTAINABLE?

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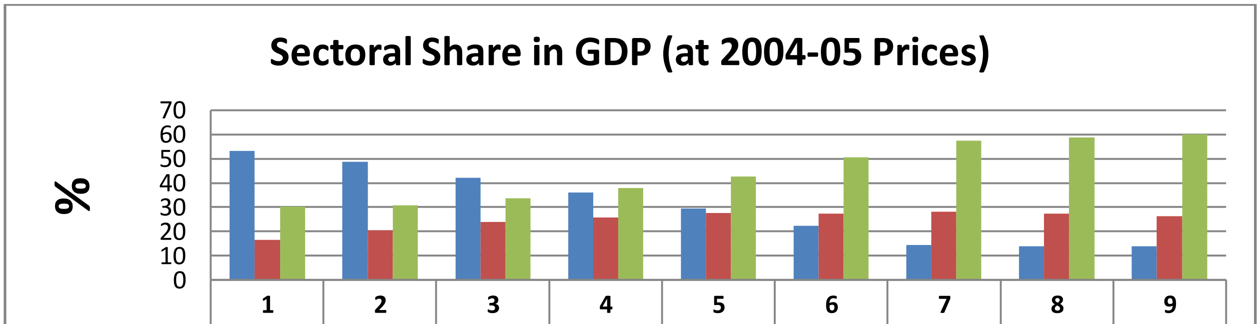
ABSTRACT

In the recent past the growth of Indian economy is attributable to the dynamism shown by service sector and this sector has been the star performer by contributing 59.9% of GDP in 2013-14. It is engine of growth as it has respectable share in foreign direct investment inflows as well as total exports. The positive and high correlation between growth rate of GDP and Services is statistically significant and the dependence of growth rate of GDP on growth rate of services is also significant. The reason for the growth of service sector in India includes splintering, demand side impetus to growth, technological advancement and interdependence of industrial and services growth. The dynamism shown by services sector has led to the speculation whether India would chart out such a growth path which is leapfrog from agriculture sector to directly service dominated economy without intermediation of the industrial sector. Some economists have shown serious sign of interrogation about the sustainability of the 'services-led growth' as they feel that without fast growth of agriculture and industrial sector, this growth of service sector cannot be sustained, whereas some are of the opinion that 'services-led growth' is sustainable. The present paper attempts to study the growth of service sector in India and its sustainability.

Keywords: GDP, FDI, Sustainable, Service Sector

Introduction

The economists like Fisher (1939), Clark (1940), Rostow (1960) and Kuznets (1971) have maintained that the development is a three-stage process and service sector is associated with the third stage of the development. Service sector or tertiary sector is engaged in those activities which help in the development of primary and secondary sectors. It provides support in the production process and it includes banking, insurance, trade, communication etc. The Indian economy has grown at a robust rate during the last few years and the reason for this is the strength of the service sector. The share of the service sector in GDP of India has increased from 30.3% in 1950-51 to 59.9% in 2013-14. There has not been much change in the share of industry in GDP since 1980-81 and entire decline in the share of agriculture has been due to a rapid increase in the share of the services – from 38.0% of GDP in 1980-81 to 42.7% in 1990-91 and further to as high as 59.9% in 2013-14. The significant fact is that during the period of economic reforms (post 1991 period) the share of the services has increased very rapidly. The contribution of services to GDP growth would have been still higher if construction were included under services instead of industry.



	1	2	3	4	5	6	7	8	9
Agriculture	53.1	48.7	42.2	36.1	29.6	22.3	14.4	13.9	13.9
Industry	16.6	20.5	24	25.9	27.7	27.3	28.2	27.3	26.2
Services	30.3	30.8	33.8	38	42.7	50.4	57.4	58.8	59.9

Source: RBI, Handbook of Statistics on Indian Economy 2013-14

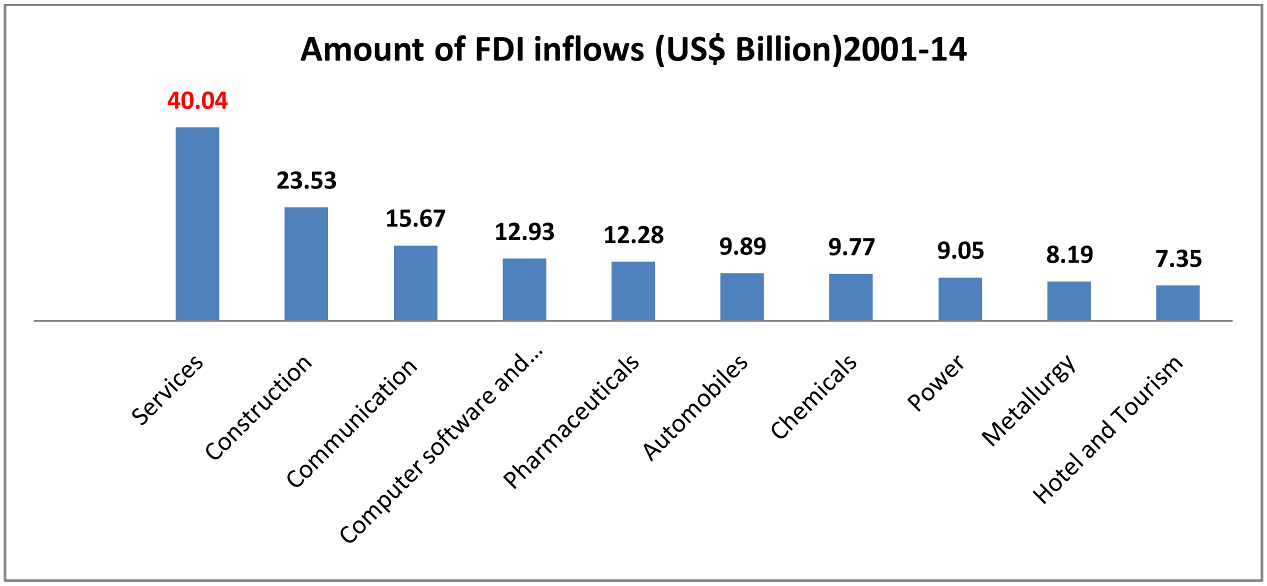
FDI Inflows in Services Sector

FDI inflows in services is the highest with 40.04 US$ billions i.e. 17.96% during 2000-14. Construction is the second largest sector attracting 10.56% of the total FDI inflows. Telecommunication sector in India is now one of the fastest growing sector and is attracting 7.03% of the total FDI inflows.

Table 1: Sector-Wise FDI Equity Inflow in India during 2001-14

Sr. No.	Category	Amount of FDI inflows (US$ Billion)	% with total FDI inflows
1	Services	40.04	17.96
2	Construction	23.53	10.56
3	Communication	15.67	7.03
4	Computer software and hardware	12.93	5.80
5	Pharmaceuticals	12.28	5.51
6	Automobiles	9.89	4.44
7	Chemicals	9.77	4.38
8	Power	9.05	4.06
9	Metallurgy	8.19	3.67
10	Hotel and Tourism	7.35	3.30
	TOTAL ALL SECTORS IN INDIA	223.02	----

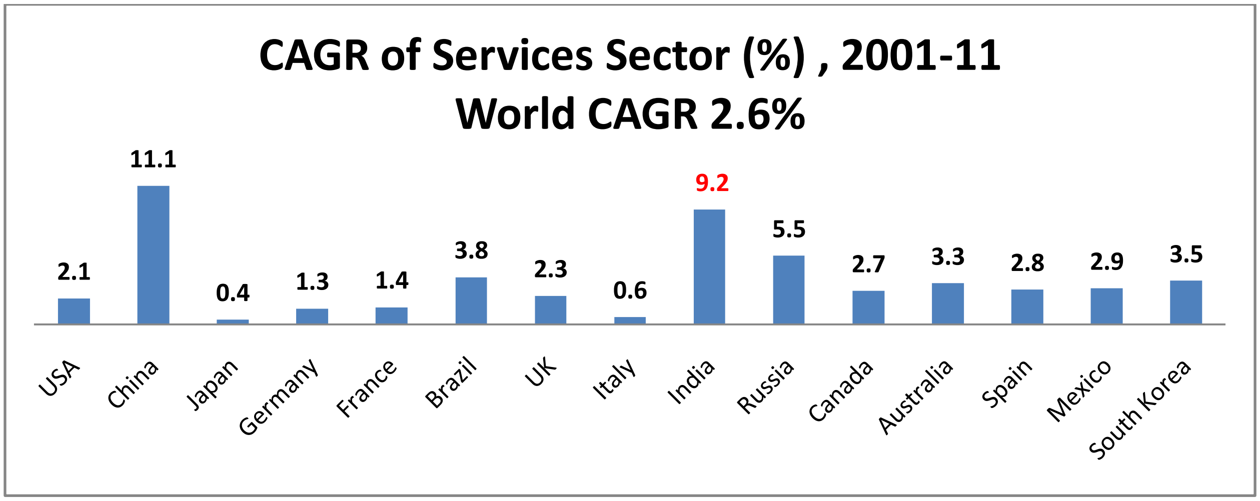
Source: RBI's Bulletin March 2015 (Table No. 34-FOREIGN INVESTMENT INFLOWS).



Source: RBI's Bulletin March 2015 (Table No. 34-FOREIGN INVESTMENT INFLOWS)

International Comparison

The service-centric growth attained by Indian Economy in recent years has its unique position. It becomes essential to make an international comparative analysis of India's services sector. The following graph shows Compound Annual Growth Rate (CAGR) of 15 countries for the period 2001-11.



Source: UN National Accounts Statistics

Clearly the CAGR of India is 9.2% for the period 2001-11 which is second highest (first is China with CAGR 11.1%) among the selected 15 countries. The CAGR of the whole world is 2.6% for the same period.

Objectives

The objectives of the paper are:

- To study the significance of the association between growth rate of GDP and growth of service sector in India.
- To study various reasons for the rapid growth of the service sector in India.
- To study the sustainability of services-led growth in India.

Research Methodology

Since study is descriptive in nature therefore secondary source of data has been used such as Economic Surveys of India, RBI bulletin, online data base of Indian Economy, journals, articles, newspapers, etc. SPSS software has been used to study the association between growth rate of GDP and growth rate of service sector in India.

Review of Literature

- **Sunil Jain and T.N. Ninan (2012),** in article "Servicing India's GDP growth" observed that the contribution of communication services and banking services to GDP growth is increasing and significant.

- **Rafiq Dossani(2010),** in his article “Software Production: Globalisation and its implication” alleges that in India, the State did not just neglect the industry in the initial phases of development, it was actively hostile towards it.
- **Shankar Acharya (2010) ,** in his article “ Macroeconomic Performances and Policies, 2000-08” argued that the contribution of services to GDP growth would have been still higher if construction were included under services instead of industry.
- **Nirvikar Singh (2010),** in his article “Understanding India’s Service-led Growth” observed that splintering(specialization) essentially made no contribution to growth during 1990’s.
- **Arvind Panagariya (2008),** in his article “India: The Emerging Gaint” argued that size and growth of service sector is key area for employment generation but it is not happening in India.
- **Suresh D. Tendulkar (2007) ,** in his article “India’s Growing services sector: Database Problems and Issues” observed that whether India would chart out such a growth path which is leapfrog from agriculture sector to directly service dominated economy without intermediation of the industrial sector.
- **Shankar Acharya(2002),** in his article “ Services Not The Real Saviour” argued that services are hugely important, but they cannot, by themselves, assure rapid and sustained growth of the Indian economy.
- **Report on Currency and Finance(2002),** contends that in general services sector appears to be highly growth inducing with positive externalities for other sectors, making services a catalytic agent of growth.

A) Studying the Significance of the Association between Growth Rate of GDP and Growth of Services Sector in India

After 1990-91, the contribution to GDP growth by the services sector begins to outpace its sectoral share. The Indian economy has grown at a robust rate during the last few years and the reason for this is the strength of the service sector. The share of the service sector in GDP of India has increased from 30.3% in 1950-51 to 59.9% in 2013-14. The contribution of services to GDP growth would have been still higher if construction were included under services instead of industry[1]. Now it becomes imperative to study the significance of the association between growth rate of GDP and growth of service sector in India. The following table shows the growth rates of GDP at factor cost and Services Sector during planning period:

Table 2: Growth rates of GDP at factor cost and Services Sector during Planning period

Period/Plan	**Growth Rate GDP at Factor cost**	**Growth Rate of Services Sector**
1951-1980	3.5	4.5
1981-1990	5.8	6.6
1991-2000	5.8	7.5
1992-1997 Eighth Plan	6.6	7.3
1997-2002Nineth Plan	5.5	7.9
2002-2007Tenth Plan	7.6	8.8
2007-2012Eleventh Plan	8.0	9.4
2011-2012	6.7	6.6
2012-2013	4.5	7.0
2013-2014	4.9	6.9

Source: RBI, Handbook of Statistics on Indian Economy 2013-14

SPSS OUTPUT FILE

Correlations

		Growth rate GDP	Growth rate Services
Growth rate GDP	Pearson Correlation	1	**0.823****
	Sig. (2-tailed)		.003
	N	10	10
Growth rate Services	Pearson Correlation	**0.823****	1
	Sig. (2-tailed)	.003	
	N	10	10

**. Correlation is significant at the 0.01 level (2-tailed).

[1] Shankar Acharya's observation in his article " Macroeconomic Performances and Policies(2010)".

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.823[a]	**0.677**	.637	.83652

a. Predictors: (Constant), Growth rate Services

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	11.731	1	11.731	16.764	.003[b]
	Residual	5.598	8	.700		
	Total	17.329	9			

a. Dependent Variable: Growth rate GDP

b. Predictors: (Constant), Growth rate Services

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	**-0.298**	1.534		-.194	.851
	Growth rate Services	**0.853**	.208	.823	4.094	.003

a. Dependent Variable: Growth rate GDP

- SPSS output file clearly shows that there is positive and high correlation (0.823) between growth rate of GDP and Services. The p-value 0.003 is less than level of significance 0.01 therefore it can be concluded that the association between growth rate of GDP and Services is **significant.**
- Moreover R square is 0.677 which means around 68% changes in India's growth rate of GDP are explained by the changes in growth rate of services. Since the value of R square is more than 0.6 therefore it can be concluded that model is more reliable.
- The regression equation of growth rate of GDP(X) on growth rate of Services(Y) is **X = -0.298+0.853Y** and the value of regression coefficient of growth rate of GDP on growth rate of Services is **significant** as the p-value 0.003 is less than level of significance 0.01.

Hence, results show that the dependence of growth rate of GDP on growth rate of Services is **significant.**

- ANOVA is one of the important applications of F –test and is used to test the overall strength of the model under study. Since p-value 0.003 is less than level of significance 0.01, therefore it may be concluded that regression equation of growth rate of GDP on growth rate of Services is **significant.**

B) What Explains Rapid Services Growth in India?

The rapid services growth in India is attributable to many reasons and some of them are:

- **Demand-Side Impetus to Growth**

The data shows that in private consumption the share of services has increased to 31% in 2000-01. It showed an increase of 8% which indicate that the pace has quickened up in 2000s. The data clearly shows demand side impetus to growth of services. Sunil jain and T.N. Ninan are of the opinion that this demand side impetus will continue and become stronger in future also. They stressed on the fact that the private expenditure will increase on the services like communication, education, medical care and health.

- **Splintering**

As economy matures, it leads to increasing specialization because industrial units outsource some activities like accounting, research and development, legal and security services etc. The process of specialization is termed as '*splintering*' by Bhagwati(1994). Splintering leads to growth in the share of services in GDP even when GDP itself is not growing. This is because of the fact that the jobs outsourced will now be counted as service sector contribution to GDP rather than being counted in manufacturing value added(Kravis,1982). But Nirvikar Singh (2006) ,by using input-output coefficients, argued that splintering made no contribution to growth during 1990s and in case of domestic splintering, when specialization leads to efficiency improvements, it may reflect a positive economic change.

- **Technological Advancement**

Service sector growth in India is also attributable to the technological advancement whereby new products and activities emerge. The technological advancement has positive impact on the growth of services sector as there is increasing use of ATMs, credit cards etc. in banking sector, internet in case of IT sector and expansion of cellular phone services in telecom sector.

- **<u>Interdependence of Industrial and Services Growth</u>**

The study conducted by Banga and Goldar(2003) revealed that there is interdependence of industrial and services growth. The study showed that although service inputs contributed little to the production of the registered manufacturing sector during 1980s i.e. 1% of output growth but the contribution of services has shown a significant increase in 1990s i.e. 25% of output growth.

- **<u>Role of Policy Liberalization</u>**

The growth of services sector has been significantly boosted by the policy of liberalization. The share of <u>*communication services*</u> in GDP has increased considerably because of the fact that telecom liberalization began in 1994.The number of telephone subscribers increased to 933.02 millions in 2014 from 76.54 million in 2004. Indian telecom network is now second largest in the world after China. Tele density has increased to 75.23% in 2014 from12.7% in 2006. The <u>*banking sector share*</u> in GDP which was 3.4% in 1990 has increased to 6.7% in 2011. The share of <u>*private sector bank income*</u> in all bank incomes has increased to 25% in 2007 from 5% in 1995. Just within seven years of the opening up of the <u>*insurance sector*</u>, 24 private firms brought in Rs.9625 crores as capital. Talking about <u>*IT services*</u>, the proportion of IT sector in national GDP has increased to 8% in 2012-13 from 1.2% in 1997-98.

C) Sustainability of Services-led Growth in India

The dynamism shown by services sector has led to the speculation whether India would chart out such a growth path which is leapfrog from agriculture sector to directly service dominated economy without intermediation of the industrial sector. Some economists have shown serious sign of interrogation about the sustainability of the 'services-led growth' as they feel that without fast growth of agriculture and industrial sector, this growth of service sector cannot be sustained, whereas some are of the opinion that 'services-led growth' is sustainable. Therefore, the sustainability of services-led growth has two versions:

1) Optimistic Version

- **Ejaz Ghani** argues that industrialization is not the only route to economic development. Services-led growth could be the other route. Presently, more than 70% of the global output is accounted by services sector and it is the largest sector in the world and the services-led growth is sustainable. The basis characteristics of the services have been altered by the service revolution as services can now be produced and exported at lower cost. There is huge room for catch-up and convergence, therefore the developing economies can sustain services-led growth.

- Telecommunication and IT are two sub sectors of the services sector in India which have contributed significantly to the growth of GDP in the recent past. The number of telephone subscribers increased to 933.02 millions in 2014 from 76.54 million in 2004. Indian telecom network is now second largest in the world after China. Tele density has increased to 75.23% in 2014 from12.7% in 2006. There is substantial scope for further expansion in the telecom sector as a vast market is still untapped. The IT exports now accounts for 20% of the total exports and there are spillovers from the IT services industry to ITES. **Nirvikar Singh** argues thatthere are linkages and spillovers from ITES to sub-sectors like construction and transportation which not only stimulate demand but bring in new expertise through creating a different set of requirements and expectations. As IT applications spread to new areas of activity, scope for further expansion in the IT sector is bound to happen.
- The export of services is yet another source of growth and the exports of services have increased to \$151.5 billion in 2013-14 from \$ 4.6 billion in 1990-91. The exports of software and ITES-BPO was about \$69.3 billion in 2001-12 which was 48.7 % of exports of services. Moreover as per the estimates of National Association of Software Services Companies(NASSCOM), the global BPO market is about \$ 150 billion. Therefore there is huge market for the growth.
- With the growth of the economy new services are going to emerge with the existing services. India has potential to attract large number of patients from abroad due to the availability of cheap medical facilities. Education services could well emerge as a driver of GDP growth in the future. Moreover the financial service is yet another potential area which would stimulate growth in India.

2) Pessimistic Version

- Past experience does not support the contention that services sector is leading sector as during the nfirst four decades of the economic planning the services sector grew slower than the industrial sector. It was only during ninth plan period 1997-2002 that services sector growth was 7.9% p.a. far outstripping industrial growth at 4.3% p.a. **Acharya** argued that the growth of services sector during ninth plan was partly due to spurious growth attributable to massive government wage hikes and partly due to the rapid growth of the IT sector from a low base. Moreover the rate of growth of industrial sector was higher than the services sector during tenth plan.

- The doubts can be raised about the reliability of the official estimates of services output and their growth as there is considerable presence of heterogeneity in the services sector. The data for this sector and the methodology of estimation of the output of this sector are much weaker than for the commodity producing sectors.
- For the period 1965-99, all the seven fastest growing countries named Botswana, China, Singapore, Thailand, Malaysia, Indonesia and republic of Korea have experienced that the growth rate of industrial sector as higher than the services sector.
- Low employment creation in the services sector cannot substitute for the industrial job. Formal services sector such as banking, insurance, finance, communication and IT have relatively low employment intensity because employment in these sectors require at least a college level education whereas employment in manufacturing requires only on-the-job training.

Conclusion

The upshot of the above is that in the recent past the growth of Indian economy is attributable to the dynamism shown by service sector and this sector has been the star performer. It is engine of growth as it has respectable share in foreign direct investment inflows as well as total exports. The positive and high correlation between growth rate of GDP and Services is statistically significant and the dependence of growth rate of GDP on growth rate of services is also significant. The dynamism shown by services sector cannot be maintained if such growth path is a leap frog from agriculture sector to directly service dominated economy without intermediation of the industrial sector. India must walk on two legs named as traditional industry especially unskilled-labor-intensive manufacturing and modern services such as software and communications. The need of the hour is that government must strengthen each leg through a set of policy initiatives so that services-led growth in India is sustainable.

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