

## **THE ROLE OF SERVICE SECTOR IN GROWTH OF FOREIGN TRADE IN INDIA**

**\*Mrs. Meenakshi**

### **ABSTRACT**

Service sector also known as tertiary sector is essential for economic growth in any economy including India. It has emerged as the largest and fastest-growing sector in the global economy in the last two decades. The tremendous performance of Indian economy is attributable in a considerable manner to the spectacular dynamism shown by services sector. Rising urbanization, privatization and demand for services bring boom in Indian service sector. This sector continues to be a star performer and by contributing 59 per cent of GDP, it is enjoying first place among all sectors in Indian economy. In employment providing, this sector is occupying second place, next only to agriculture. Its respectable share in foreign direct investment (FDI) inflows as well as in total exports makes it the engine of economic growth. Keeping in above backdrop, the present study makes an analysis of service sector in Indian economy. The study confirms that service sector along with its sub-sectors has achieved tremendous growth over the year in Indian economy. Besides, their contributions in GDP, employment and exports are also rising considerably. To maintain and accelerate the growth & contributions of this sector & to develop it as a true engine of economic growth, there is logic & rationale of complementary investments in physical infrastructure as well as in human capital.

**Keywords:** Services, Economic growth, GDP, FDI, Exports.

---

**\* Lecturer of Economics, Saraswati College of Education, Panipat**

## **INDIAN SERVICE SECTOR**

Service sector also known as tertiary or residual sector is essential for economic growth in any economy including India. It has emerged as the largest and fastest-growing sector in the global economy in the last two decades. The pioneering work of Fisher (1935), Clark (1940) & Kuznets (1971) reveal that after countries get industrialized and reach in the advanced stage of economic development, the shares of manufacturing sector in national income & employment declines, while of services sector increases. The tremendous performance of Indian economy is attributable in a considerable manner to the spectacular dynamism shown by services sector. Rising urbanization, privatization and demand for services bring boom in Indian service sector. This sector continues to be a star performer and by contributing 59 per cent of GDP, it is enjoying first place among all sectors in Indian economy. In employment providing, this sector is occupying second place, next only to agriculture. Unlike the unskilled or semi-skilled nature of jobs in the agriculture sector, tertiary sector provides myriad job opportunities ranging from highly skilled to unskilled in a variety of activities. Its respectable share in FDI inflows as well as in total exports makes it the engine of economic growth.

Services as a category, gained importance during the first quarter of the twentieth century and their role in the process of economic development were largely captured by the 'stage theories of development'. Firstly, Fisher classified the economy into primary, secondary and tertiary sector. Later on Kuznets introduced the term 'services' instead of tertiary, there by bringing the sector into economic discussion (Kuznets, 1972).

The rest of the paper is organized as follows: Section II describes the components of Indian service sector. Section III provides an analysis of service sector in Indian economy and lastly, Section IV concludes the study with policy implications.

## **COMPONENTS OF INDIAN SERVICE SECTOR**

The service 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. Service may be defined as a type of economic activity that is intangible & is not stored and does not result in ownership. World Trade Organization (WTO) classifies services into two categories: change-effecting services (transformation services) and margin services. First refers to the activities of producers that change properties of consuming unit e.g. medical services, transportation, education & entertainment while later is defined as the change of ownership of goods, financial assets or other kind of services of institutional units.

Specific examples of these services are insurance, packaging, intellectual property rights and distribution.

However, service sector can be classified into four broad categories, viz. a) trade, hotels, and restaurants; b) transport, storage, and communication; c) financing, insurance, real estate, and business services; and d) community, social, and personal services. The following table shows the broad grouping of activities which can be considered to form part of the service sector.

**TABLE 1: CONSTITUANTS OF SERVICE SECTOR IN INDIA**

Service Sub-sectors	Activities Included
<b>1. Trade, Hotels &amp; Restaurants</b>	
1.1 Trade	Wholesale & retail trade in commodities both produced at home (including exports) and imported purchase & selling agent, brokers and auctioneers.
1.2 Hotels & Restaurants	Service rendered by hotel & other lodging places, restaurant, cafes & other such places.
<b>2. Transport, Storage &amp; Communication</b>	
2.1 Railways	
2.2 Transport by other means	Road, water, air transport & service incidental to transport.
2.3 Storage	Agricultural storage for agri produce, foodgrains, fertilizers, manure, etc. ; Industrial storage for industrial goods, import cargo, and excisable cargo; inland container depots (ICDs)/container freight stations (CFSs) for facilitating import/export trade; and special warehouses for cold and temperature controlled storage.
2.4 Communication	Postal, money order, telegrams, telephones, overseas communication services.
<b>3. Financing, Insurance, Real Estate and Business Services</b>	
3.1 Banking & Insurance	Banks, banking department of RBI. Post office saving bank, NBFI, employees PF & Life insurance, postal life & non life insurance

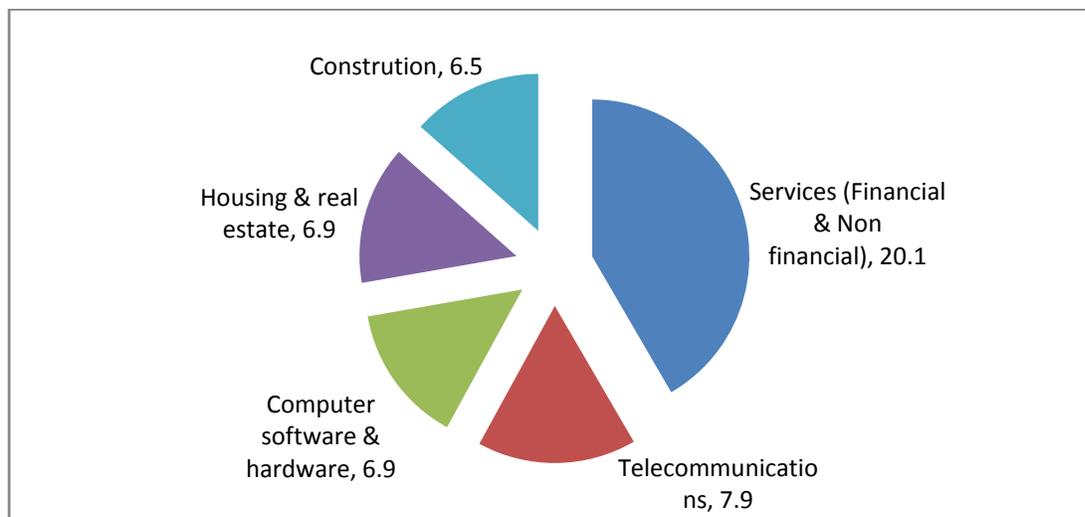
3.2 Real Estate, Ownership of Dwellings and Business Services	Business services include accounting, software development, data processing services, business and management consultancy, architectural, engineering and other technical consultancy, advertisement and other business services
<b>4. Community, Social and Personal services</b>	
4.1 Public Administration & Defense	
4.2 Other Services	Personal Services: Domestic laundry, barber, beauty shops, tailoring and others. Community Services: Education, research, scientific medical, health, religious & other community services. Others: Recreation, entertainment, radio, television, broadcast, sanitary services

Source: CSO

## SERVICE SECTOR AND FOREIGN TRADE OF INDIA

The growth and performance of the service sector depends up to a certain extent on foreign direct investment (FDI). The share of service sector including financial and non-financial services, construction development, telecommunications, computer hardware & software, and hotel & tourism in FDI equity inflows is around 41.9 per cent during 2000-11. If construction is included then the share rises to 48.4 per cent. The financial and non-financial services sector which falls purely in the services category is the largest recipient of FDI equity inflows with a 20.1 per cent share followed by telecommunications with 7.9 per cent share. Computer software & hardware and housing & real estate are receiving 6.9 per cent share each. And construction activities with 6.5 per cent share are next in importance. The following figure explores the percentage share of various services for the period 2000 to 2011 in total FDI equity inflows.

**FIGURE 2: % SHARE OF SERVICES IN FDI EQUITY INFLOWS (2000-2011)**



Source: Economic Survey, 2011-12, published by GOI.

Contributing a considerable part of exports, service sector becomes the pillar for Indian economy. India is the most dynamic exporter of services and ranked seventh in the world in both exports and imports of services in 2010. Growth of service trade during 1990's was around 6.5 per cent and its share in total trade was 24 per cent. Since 1990, there has been a consistent rise in service exports, especially of software and computer related services. India's services exports grew at a CAGR of 20.6 per cent during the period 2004-05 to 2010-11, compared to the 19.7 per cent CAGR of merchandise exports in the same period. In services sector, highest growth achievers are financial and business services which attained CAGR of 52.8 per cent and 29.2 per cent respectively for the same period. Being an important part of services, software is the major exporter, accounting for 41.7 per cent of total services exports in 2010-11. The credit for increase in service exports goes to the advancement in technology and trade liberalization. Many non tradable service products became tradable due to technological improvement. The coordination of service-led-growth strategy and export-led-growth strategy has led to improvement in comparative advantage and export of commercial services. The share of services exports in total output of services, GDP & in world services exports is shown in the following table

**TABLE 5: PERCENTAGE SHARES OF SERVICES EXPORTS**

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

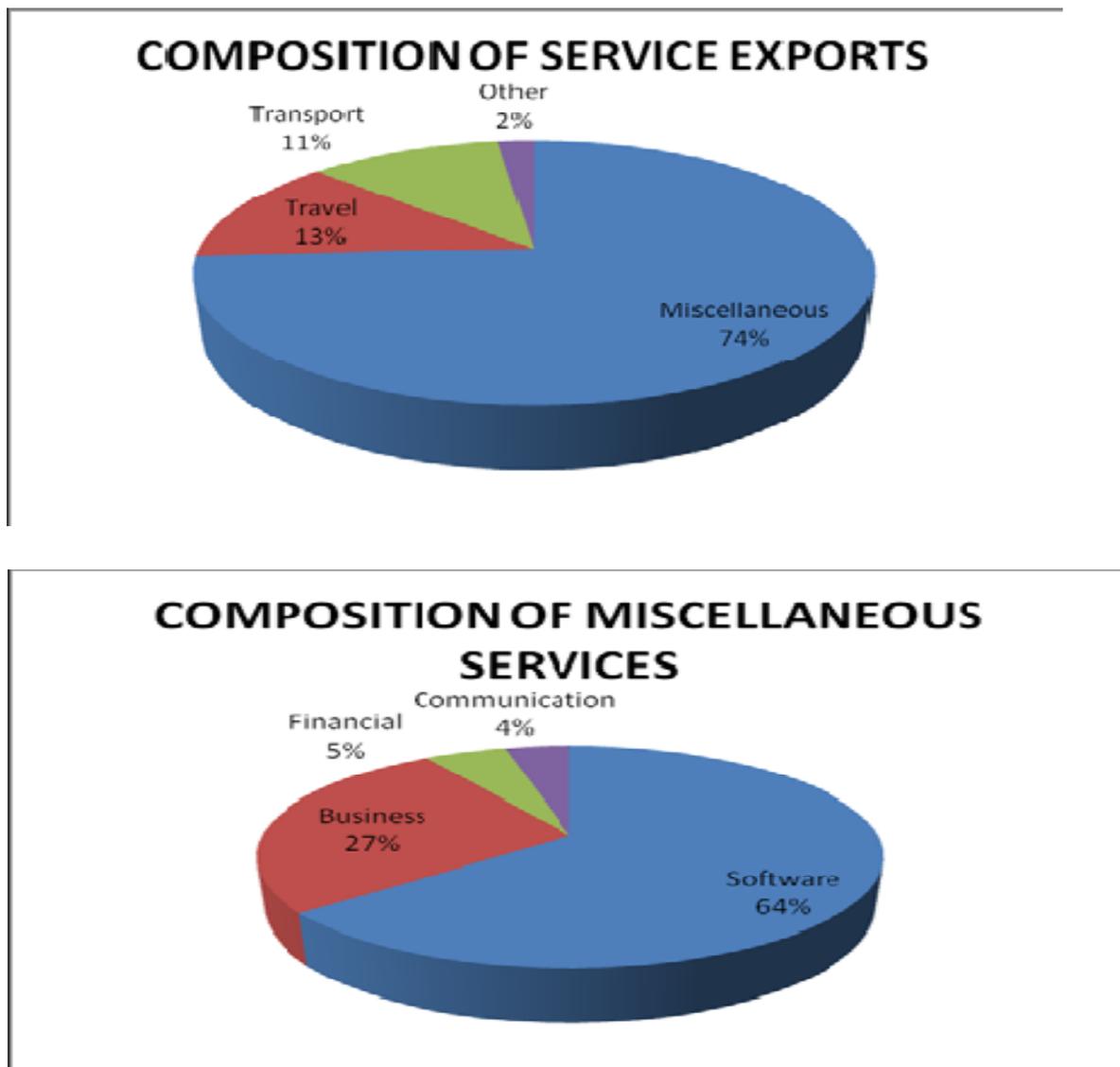
**Source:** Various Issues of Handbook of Statistics on Indian Economy published by RBI

The above table shows that the share of services exports in total services output of India have increased from 3.2 per cent in 1990-91 to 6.9 per cent in 2000-01 and further to 15.1 per cent in 2008-09. Services exports were 1.6 per cent of GDP in 1990-91 and climbed to 9.4 per cent in

2008-09 i.e. approximately six times rise. The share of Indian services exports in world services exports rose by over five times from 0.6 per cent in 1990-91 to 3.3 per cent in 2008-09.

India' service exports include miscellaneous, travel, transport and other services. In 2007, the percentage share of miscellaneous services in total service exports found to be 74 per cent in which the share of software services exports were highest i.e. 64 per cent. The following figure highlights the percentage share of various services in total service exports during 2007.

**FIGURE 3: COMPOSITION OF SERVICES EXPORTS IN 2007**



**Source:** Reserve Bank of India

The services sector is an uncharted sea throwing up many daunting challenges as well as opening up many exciting opportunities. The challenges in the path of service sector growth includes lack of social and physical infrastructure, IT infrastructure, agricultural and industrial sector reforms, rupee appreciation and US sub-prime crisis, etc. Besides, rising labor costs, rapid growth in demand for talented manpower/quality staff, high attrition rate, outsourcing backlash etc are some other limiting factors in the field of IT and IT enabled services (ITeS). Also, the growth of IT and ITeS has social, economic, health, ethical and environmental implications. Some other important challenges faced by this sector are following

- The immediate challenge for the services sector covering myriad activities is not only to maintain its present growth tempo but also to accelerate it.
- To retain and expand India's competitiveness in those services where it has already made a mark such as IT & ITeS and Telecommunications.
- Another challenge is to remove or ease domestic regulations in the different services. Removing or easing them can lead to dynamic gains for the Indian economy.
- To make some of the fair-weather services like business and financial services more stable and less vulnerable to external shocks.
- The challenge lies in making inroads into some traditional areas such as tourism and shipping where other countries have already established their selves, but where the potential for India is nevertheless very high.
- Making forays into globally traded services in still niche areas for India, such as financial services, health care, education, accountancy, and other business services where India has a large domestic market and but only a very small part of the full potential has been tapped.
- There are also challenges related to collecting better data and developing a better coordinated strategy to pull together all the dispersed information.

Regulatory improvements will also be important as many domestic regulations and market access barriers could come in the way of fully tapping this growth accelerating sector.

Addressing the above challenges and issues could further strengthen the services sector which is able to bring more inclusive and balanced growth in Indian economy.

### **CONCLUSION & POLICY IMPLICATIONS**

The present paper makes an analysis of Indian services sector through examining its growth and contributions in growth of Indian foreign trade. As financial & non-financial services and telecommunications services are attracting the largest FDI equity inflows, consequently services sector becomes the recipient of lion share in total FDI inflows. Similarly, in the total exports of India, a major proportion comes from this sector in which software services have the highest share. Thus, service sector which is dominant in terms of its growth & shares serves as an engine of growth for Indian economy.

To maintain and accelerate the growth & contributions of this sector, a comprehensive strategy is required to address the challenges faced by this sector. Since there are diverse sectors within services, the issues and policies cannot be separated into watertight compartments. In order to strengthen this sector, there is need of complementary investments in physical infrastructure as well as in human capital. Policy reforms should be initiated to liberalize the service sub-sectors like trade (retail and wholesale), financial services, and software services that will help in faster growth through attraction of FDI.

### **REFERENCES**

1. Bhowmik, R. (2000), 'Role of Services Sector in Indian Economy: An Input-Output Approach', *Artha Vijnana*, XLII (2), June, 158-169.
2. Clark, C. (1940), 'The Conditions of Economic Progress', London: Macmillan.
3. Francois, J. and Hoekman, B. (2010), 'Services Trade and Policy', *Journal of Economic Literature* 48, no.3: 642–92.
4. Government of India (2010-11, 2011-12 & 2012-13), 'Economic Survey of India'
5. Jensen, J. B. (2011), 'Global Trade in Services'. Washington: Peterson Institute for International Economics.

6. Joshi, S. (2008), 'Growth and Structure of Tertiary Sector'. New Delhi: Academic Foundation.
7. Papola, T.S. and Sahu, P.P. (2012), 'Growth and Structure of Employment in India', Institute for Studies in Industrial Development, New Delhi.
8. Reserve Bank of India (2011-12), 'Handbook of Statistics on Indian Economy'
9. Singh, B. (2012), 'Is the Service-Led Growth of India Sustainable?' *International Journal of Trade, Economics and Finance*, Vol. 3, No. 4, August 2012.