

**AN ANALYSIS OF SERVICES SECTOR IN INDIAN ECONOMY**

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**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.*

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## I. INTRODUCTION

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.

## II. 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.<br>Community Services: Education, research, scientific medical, health, religious & other community services.<br>Others: Recreation, entertainment, radio, television, broadcast, sanitary services.   |

Source: CSO

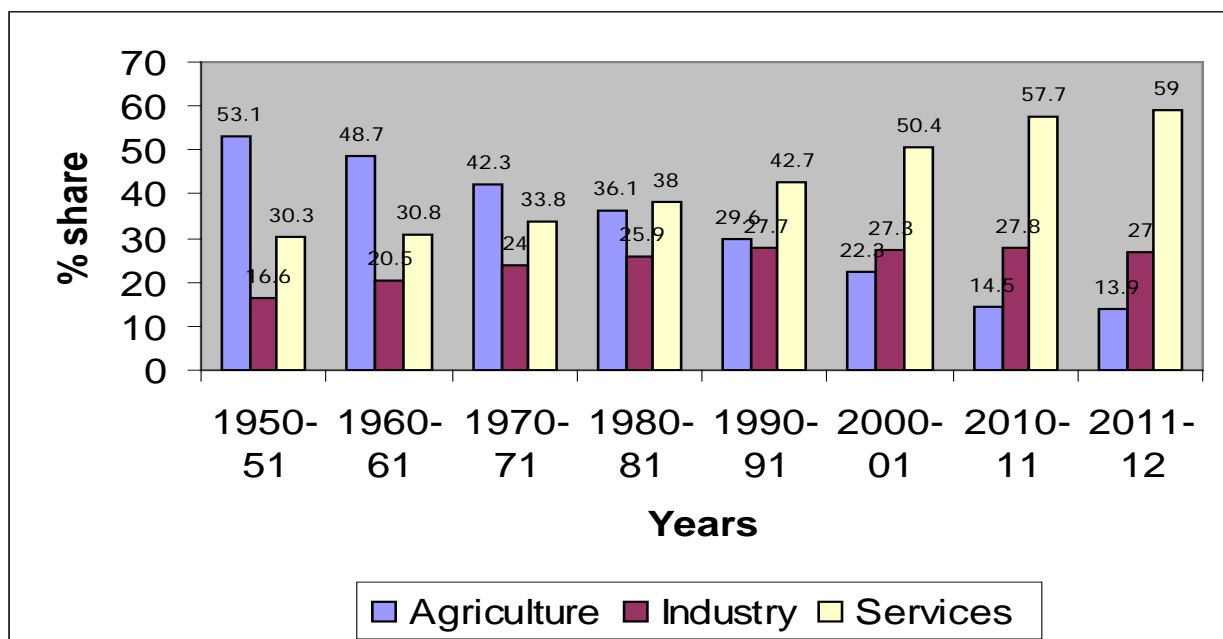
### III. ANALYSIS OF SERVICE SECTOR IN INDIAN ECONOMY

The emergence of services as the most dynamic sector in Indian economy has been a revolution. Services growth picked up in the eighties, accelerated in the nineties and since then it proves to be the major growth driver of our economy.

The services growth was attained before the full development of industry, with the net result that per capita income from this sector exceeded per capita income of agriculture and industry sectors by more than fifty per cent. The services sector growth rate at constant prices has always been above the overall GDP growth rate since 1996-97 except for 2003-04. During 2004-05 to 2011-12, the compound annual growth rate (CAGR) of the services sector GDP stood at 10 per cent thus leaving behind the 8.5 per cent CAGR of overall GDP for the same period.

With double-digit growth in the second half of the 2000s, service sector is continuously playing crucial role in overall development of Indian economy. The contribution of the services sector in GDP has increased from 30.3 per cent in 1950-51 to 38 per cent in 1980-81 and further to 59 per cent in 2011-12. However, in 1980-81, the service sector has overtaken the agriculture on the basis of GDP share and since then it became the primary contributor of GDP. Similarly, industry sector whose share in GDP has remained in the range of 16 to 28 per cent over the years got second rank in terms of its contributions. The entire decline in share of agriculture has been balanced by an increase in share of the services sector. Thus, the resilience of the economy to shocks owe to the services sector which has the largest share and most consistent growth performance. The changes in relative shares of agriculture, industry & service sectors in GDP over the years is shown in the following figure

**FIGURE 1: PERCENTAGE SHARE OF MAJOR SECTORS IN GDP OF INDIA**



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

The appreciable performance of service sector is due to its some fast growing sub-sectors. Such two broad sub-sectors viz. transport, storage and communication; and financing, insurance, real estate and business services, comprising many dynamic services have performed well with growth of 14.7 per cent and 10.4 per cent, respectively in 2010-11. Only community, social and personal services have registered a low growth of 4.5 per cent due to base effect of fiscal stimulus in the previous years, thus contributing to the slight deceleration in the growth of the services sector. Another important sub sector i.e. trade, hotels, and restaurants, whose growth slowed in 2008-09 and has recovered moderately in 2009-10. In the year 2010-11, only communication and banking & insurance have registered a double-digit growth i.e. 27.2 and 14.5 per cent respectively.

Software which has grown at 21 per cent CAGR for the period 2004-05 to 2010-11, is one sector in which India has achieved a remarkable global brand identity. Similarly, tourism - a major item in India's services, has witnessed significant growth in recent years. During the period 2006 to 2011, the compound annual growth rates of foreign tourist arrivals (FTA) and foreign exchange earnings (FEE) from tourism were estimated to be 7.2 per cent and 14.7 per cent respectively. Besides these, the potential and growing services include many professional services, infrastructure-related services, and financial services.

Trade, hotels and restaurants and financing, insurance, real estate, and business services are the largest groups accounting for 16.9 per cent and 16.4 per cent respectively of the national GDP in 2010-11. The community, social, and personal services category accounts for a 14.3 per cent share, followed by transport, storage, and communication which accounts for a 7.7 per cent share for the same period. The performance of service sub-sectors in terms of their annual GDP growth rate & their percentage share in national GDP is presented in the following table

**TABLE 2: SERVICES SUB-SECTORS -ANNUAL GROWTH AND % SHARE IN GDP**

| Service Sub-sectors↓/Year→                       | 2005-06             |                | 2008-09             |                | 2011-12             |                |
|--|---------------------|----------------|---------------------|----------------|---------------------|----------------|
|  | GDP Growth Rate (%) | % Share in GDP | GDP Growth Rate (%) | % Share in GDP | GDP Growth Rate (%) | % Share in GDP |
| <b>1. Trade, Hotels &amp; Restaurants</b>        | <b>12</b>           | <b>16.7</b>    | <b>5.7</b>          | <b>16.9</b>    | <b>6.2</b>          | <b>18.0</b>    |
| 1.1 Trade  | 11.6                | 15.1           | 6.7                 | 15.3           | 6.5                 | 16.6           |
| 1.2 Hotels & Restaurants                         | 17.4                | 1.6            | -3.3                | 1.5            | 2.8                 | 1.5            |
| <b>2. Transport, Storage &amp; Communication</b> | <b>11.8</b>         | <b>8.2</b>     | <b>10.8</b>         | <b>7.8</b>     | <b>8.4</b>          | <b>7.1</b>     |
| 2.1 Railways                                     | 7.5                 | 0.9            | 7.7                 | 0.9            | 7.5                 | 0.7            |
| 2.2 Transport by other means                     | 9.3                 | 5.7            | 5.3                 | 5.5            | 8.6                 | 5.4            |

|   |             |             |             |             |             |             |
|---|-------------|-------------|-------------|-------------|-------------|-------------|
| 2.3 Storage   | 4.7         | 0.1         | 14.1        | 0.1         | 9.4         | 0.1         |
| 2.4 Communication   | 23.5        | 1.6         | 25.1        | 1.4         | 8.3         | 0.9         |
| <b>3. Financing, Insurance, Real Estate and Business Services</b> | <b>12.6</b> | <b>14.5</b> | <b>12.0</b> | <b>15.9</b> | <b>11.7</b> | <b>16.6</b> |
| 3.1 Banking & Insurance   | 15.8        | 5.4         | 14.0        | 5.6         | 13.2        | 5.7         |
| 3.2 Real Estate, Ownership of Dwellings and Business Services     | 10.6        | 9.1         | 10.4        | 10.3        | 10.3        | 10.8        |
| <b>4. Community, Social and Personal services</b>                 | <b>7.1</b>  | <b>13.5</b> | <b>12.5</b> | <b>13.3</b> | <b>6.0</b>  | <b>14.0</b> |
| 4.1 Public Administration & Defense                               | 4.3         | 5.6         | 19.8        | 5.8         | 5.4         | 6.1         |
| 4.2 Other Services  | 9.1         | 7.9         | 7.4         | 7.5         | 6.5         | 7.9         |
| <b>Construction</b>   | <b>12.8</b> | <b>7.9</b>  | <b>5.3</b>  | <b>8.5</b>  | <b>5.6</b>  | <b>8.2</b>  |
| <b>Total Services*</b>  | <b>10.9</b> | <b>52.9</b> | <b>10.0</b> | <b>53.9</b> | <b>8.2</b>  | <b>55.7</b> |
| <b>Total Services#</b>  | <b>11.1</b> | <b>60.8</b> | <b>9.4</b>  | <b>62.4</b> | <b>7.9</b>  | <b>63.9</b> |

**Source:** Economic Survey, 2010-11, 2011-12 published by GOI. \*Excluding Construction # Including Construction

The above table reveals communication is the achiever of highest GDP growth over the years except 2011-12. Public administration & defense and storage experienced the considerable growth in their GDP in 2008-09 while for the same year hotels & restaurants faced the negative growth. However, the services sector growth has fallen in 2011-12 in comparison of 2005-06. Besides, the table also highlights that the trade dominates all other subsectors in terms of its contribution in Indian GDP which is 16.6 per cent in 2011-12. While the second place is of real estate, dwellings & business services whose share has increased from 9.1 per cent in 2005-06 to 10.8 per cent in 2011-12. The shares of railways, other transport means, communication and hotels & restaurants in GDP is found to be declined over the years while of all other sub-sectors it has increased. The financing, insurance, real estate and business services have achieved significant growth in GDP share during 2005-12.

In terms of employment providing, the service sector is indispensable. Although the agriculture sector is the dominant employer but service sector is occupying second place as an employer. The share of services in employment till 1990s did not rise at the same pace as its share in GDP. Consequently, employment growth in service sector had been low, and termed as jobless.

But presently, the services sector is the principal source of employment in urban areas. During 1993-94 to 2004-05, there was a sharp fall in the share of the primary (agriculture) sector in employment. The resultant rise in share of employment of the other two sectors was almost equally divided between the secondary (industry) and tertiary sectors. As per the National Sample Survey Organization's (NSSO) report on Employment and Unemployment

Situation in India 2009-10, on the basis of usually working persons in the principal status and subsidiary status, for every 1000 people employed in rural and urban India, 679 and 75 people are employed in the agriculture sector, 241 and 683 in services sector (including construction), and 80 and 242 in the industrial sector, respectively. The sector wise percentage share in employment is presented in the following table

**TABLE 3: SECTORWISE PERCENTAGE SHARE IN EMPLOYMENT\***

| Year    | Agriculture | Industry | Services |
|---------|-------------|----------|----------|
| 1972-73 | 73.9        | 11.3     | 14.8     |
| 1977-78 | 70.9        | 12.6     | 16.5     |
| 1983-84 | 68.6        | 13.8     | 17.6     |
| 1987-88 | 64.9        | 17.0     | 18.1     |
| 1993-94 | 64.5        | 14.3     | 21.2     |
| 1999-00 | 60.3        | 16.2     | 23.5     |
| 2004-05 | 57.0        | 18.2     | 24.8     |
| 2007-08 | 55.9        | 18.7     | 25.4     |
| 2009-10 | 51.3        | 22.0     | 26.7     |

**Source:** Economic Survey, 2010-11, published by GOI. Various rounds of NSS data on employment and unemployment, \*Usual Principal and Subsidiary Status (UPSS)

The above table explores that percentage share of services sector in total employment is increasing since 1972-73. Though the employment percentage in agriculture sector is highest in comparison of other sectors yet its share is declining continuously. However, the services sector is the second largest employer after agriculture for Indian population. Within the service sector, the contribution of its sub-sectors in employment is shown in the following table

**TABLE 4: PERCENTAGE SHARE OF SERVICE SUB-SECTORS IN EMPLOYMENT**

| Year | Trade, Hotels & Restaurants | Transport, Storage & Communication | Financing, Insurance, Real Estate & Business Services | Community, Social & Personal services |
|------|-----------------------------|------------------------------------|---|---------------------------------------|
| 1961 | 29.24                       | 11.13                              | 1.53  | 58.10                                 |
| 1971 | 30.14                       | 14.43                              | 2.84  | 52.60                                 |
| 1981 | 31.83                       | 14.66                              | 2.25  | 51.26                                 |
| 1991 | 36.10                       | 13.66                              | 2.25  | 48.00                                 |
| 2001 | 37.21                       | 15.65                              | 7.56  | 39.59                                 |
| 2004 | 39.27                       | 14.47                              | 8.51  | 37.74                                 |

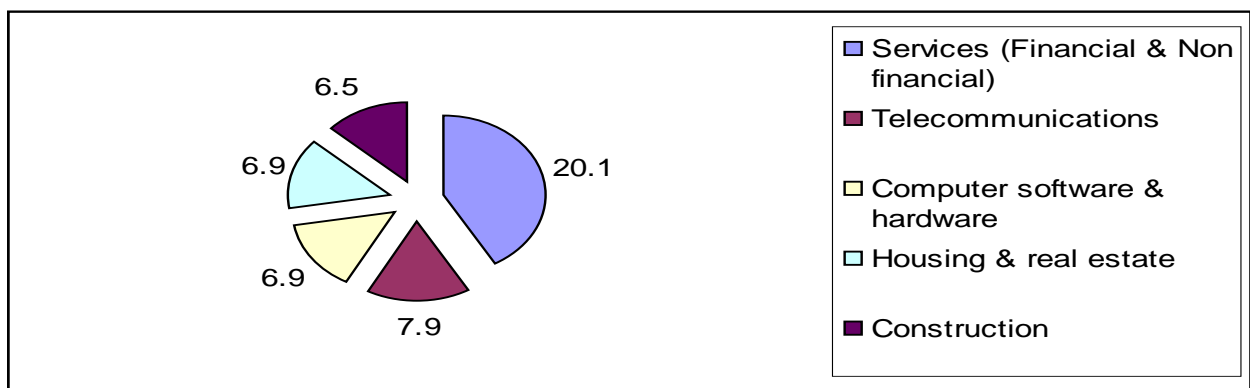
**Source:** Various rounds of NSS data on employment and unemployment

It is clear from the above table that community, social & personal services is the primary contributor of employment till 2001. But, in 2004 the percentage share of trade, hotels & restaurants in employment was highest i.e. 39.27 per cent. Except community, social &

personal services, the percentage share of all other subsectors in employment have increased over the period. Consequently, service sector is gaining primary position in its employment contribution.

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

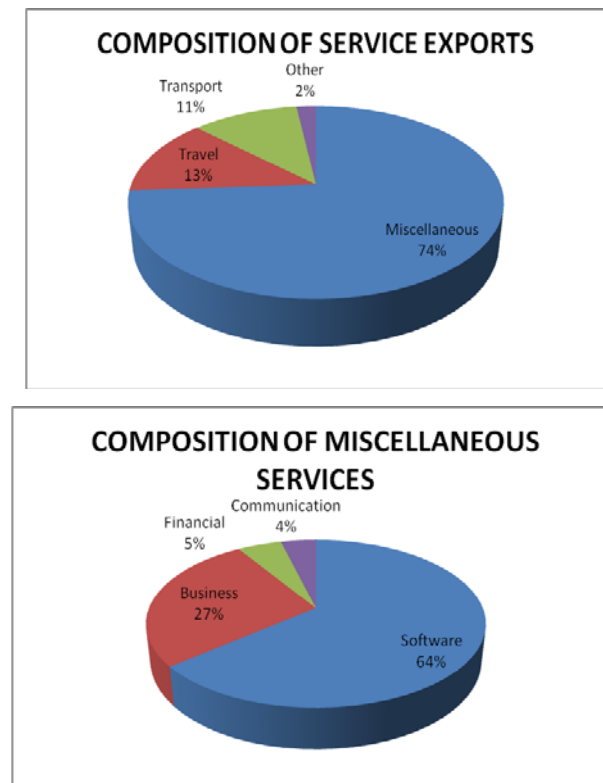
**TABLE 5: PERCENTAGE SHARES OF SERVICES EXPORTS**

| 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.

#### **IV. CONCLUSION & POLICY IMPLICATIONS**

The present paper makes an analysis of Indian services sector through examining its growth and contributions in the economy. The study confirms that services sector have grown at the significant rate in comparison to other sectors. Its growth rate is found to be higher than growth of overall GDP. Rising share of this sector in GDP over covers the poor performance of agriculture sector. As a service sub-sector, trade is dominant all in terms of its contribution in Indian GDP. The employment percentage in service sector as well as in industry sector is rising while in agriculture, it is falling continuously. A large proportion of Indian population is still engaged in agriculture sector and the next largest employer is service sector where trade, hotels & restaurants and community, social & personal services are the significant generator of employment. 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.

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