INDIAN ECONOMY: CONTEMPORARY ISSUES AND COMPARATIVE ANALYSIS

Editors

Mani K P | Chacko Jose P

About the Book

India has completed seven decades of planned development; achievements are many, and deficiencies are plenty. The average growth rate, the best indicator for measuring economic progress made a moderately linear growth since 1990, became exponential since 2000 and currently (2020) slumping down due to different reasons, theory and policy. To add to the fuel, the pandemic attack of 2020, has significantly increased the "uncertainty" about the performance of the economy.

This book titled 'Indian Economy: Contemporary Issues and Comparative Analysis' has nineteen chapters which explore in detail the performance of the Indian economy, its sectors and sub-sectors in a critical way. The chapters are the outcome of doctoral research works and is rich with data and analysis. The chapters provide primary and secondary data which can provide valuable insights into the factors that have made the Indian economy unique.

The book provides an up-to-date overview of the current Indian economy and the reasons it has assumed its current form. For instance, chapter two examines the performance of the post-pandemic economy and challenges ahead. This book will be of great worth to students, professionals, and scholars requiring information on one of the most diverse of economies of the world.

This book is brought out in honour of Dr Mani K P and is a collection of research outcomes by his research scholars. Dr Chacko Jose P and Dr Mani K P have together compiled the essays.

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CHAPTER - 11
MULTIDIMENSIONS OF CHALLENGES AND OPTIONS FOR THE INDIAN SERVICE SECTOR

Chacko Jose P

INTRODUCTION – Service Sector and Economic Development

The world's economies took centuries to shift from traditional agricultural sector to the industrial sector, but the transformation to the services sector occurred much more quickly. Today the service sector is a significant component of any country's economy. It contributes a direct and substantial contribution to GDP through job creation. 'The growth of the services sector's output has led to employment growth' (Deloitte, 2018). It may be observed that for a majority of the world's economies, the services sector is by far the biggest employer. The service sector accounts for a considerable proportion of GDP in most countries, including low-income countries, where its contributes is often over 50 per cent of GDP. The sector also provides critical inputs for the rest of the economy. Service sector components such as health, education, water and sanitation are crucially relevant to achieving social development objectives. 'The service sector is an escalator for new economic growth' (Ehigiator, 2017).

When it comes to international trade of the products of the service sector, the theory of comparative advantage stills holds valid. For instance, India has a CA in computer and information services, Macao, Thailand and Turkey in travel services, China, Hong Kong, India and Taiwan in other business services, Korea in construction and transport services, and Singapore in financial and transport services (Cunha & Forte, 2017).

"A country-wise analysis of services contribution to total value-added yields similar findings. Except in a few major developing nations such as Indonesia, China, and India, the services sector contributed over 60 per cent of total value added in 2017 in all major economies" (Deloitte, 2018). The growth of the service sector has multiple benefits for the economy. 'A dynamic service sector can also contribute to Asia's quest for inclusive growth which includes broader swathes of the population in the growth process and spreads the fruits of growth more widely' (Noland, Park, & Estrada, 2012).

The rapid growth of the service sector is often attributed to the productivity differences between the primary, secondary and tertiary sectors. Following seminal work by Baumol in 1967, the rise is often attributed to growing productivity differentials between the economic sectors (Witt & Gross , 2020). Nevertheless, there are arguments that the service sector is unproductive. The misconception of services as being non-productive has led to the neglect of the service sector in both economic theory and applied economic researches (Adetokunbo & Edioy, 2020).

Another relevant theoretical argument is based on Kalodr's theory. The laws proposed by Kaldor consider that the industrial sector contributes to economic growth and affirm that the growth of this sector depends on the existing demand for industrial products. If this new law is corroborated, we have the initial evidences that the growth of the service sector contributes to the growth of the industry (Giovanini & Arend, 2018).

Growth Path of Indian Service Sector

India has got a distinctive position in the role played by service sector among fast-growing developing countries. While the counties that moved from developing to developed earlier grew by exporting labour-intensive manufacturing sector, India has relied to a considerable extent on services. India's services revolution has dazzled businesses in the rich world, turning Indian companies into global competitors and backwater cities such as Hyderabad into affluent, sophisticated technology centres (The Economist, 2011). 'A few countries, such as India and Sri Lanka, have broken the historical convention by heading straight to services without developing a significant manufacturing sector at all' (WTO, 2015).

However, there are concerns about the over-reliance of Indan economic growth in the service sector. "We conclude that sustaining economic growth and raising living standards will require shifting labour out of agriculture into both manufacturing and services and not just into one or the other. The argument that India needs to build up labour-intensive manufacturing and the argument that it should exploit its comparative advantage in services are often posed in opposition to one another. We argue that these two routes to economic growth and higher incomes are in fact complements, not incompatible alternatives." (Eichengreen & Gupta, 2011)

Global attention has been drawn to the unique growth path that India is following. In many countries, economic growth has signified a shift from agriculture to industries; in India, there is a shift from agriculture to the service sector. There is a view that liberalisation and reforms have contributed to the growth of the sector. With rising incomes, there is more discretionary consumption propelling the growth of services. The favourable elasticity of demand for services at high incomes has contributed to the growth of the sector. Technological progress and the availability of skilled human resources have led to the growth of the supply of services from information and communication technology, and ICT enabled services. Besides, developed countries outsource services leading to a rise in the growth of services. The modern emphasis on welfare and community services has also added to the demand for services. (Mukherji, 2013).

There have been suggestions that the precedence of the services sector growth in India is premature. 'It does not necessarily follow from the conclusions of historical studies of the Kuznets & Chenery, that the service sector dominance in countries like India is premature' (Nadkarni, 2012). Countries can exhibit the dominance of the service sector at different stages in their development. 'Different countries exhibit different sectoral elasticities of demand and different sectoral productivity growth rates in stages of their development. The transformation of an economy is explained by productivity increases on the supply side and income elasticities on the demand side' (Nadkarni, 2012).

Sustained high growth for a country requires macroeconomic stability which has three dimensions- low inflation, low current account deficit and modest fiscal deficit. At one level, all three are interrelated. India has had difficulty on all these fronts recently. Owing to the limited potential of the agricultural sector in bringing prosperity to a vast population, in the long run, the country should emphasise the creation of more jobs in the industry and service sectors. In this context, the creation of jobs in industry and services is critically important. India needs to shift half of it as workforce from agriculture to industry and services (Panagariya).

Growth via the service sector, bypassing a stagnant manufacturing sector leads us to the perusal of traditional economic route to growth suggested by conventional economic theory. In India, the relative stagnation of the manufacturing sector could be explained by the increase in imports resulting from the opening up of the economy. India had no choice in the matter, given that it was forced on the country by the WTO. Nevertheless, the trend of increasing dominance of the services sector started much earlier.

It is interesting to stylize a stereotype of structural transformation. At the outset of structural transformational labour and economic output are both concentrated in agriculture? The share of labour in agriculture exceeds the share in non-agriculture. Since labour productivity in agriculture is lower than in industry, during structural transformation, the GDP in labour productivity widens.

The experience of many economies in the post-war two eras has become increasingly divorced from this conventional depiction of an economy. Over the years, it is the service sector that has overtaken manufacturing as the leading sector of the modern economy. In many countries, it now constitutes more than 50 per cent of GDP and still grows faster than the manufacturing sector of the Indian economy.

The share of the middle class in the total population of India is rising and by 2025 will account for 59% of total consumption. With the increase in incomes, an increase in literacy and a young population, the consumption pattern is sure to change. An increase in demand for services like education, private healthcare providers, personal care and hotels and restaurants are likely to occur in the long run. The Indian market is large and unsaturated, and most services have been opened up for foreign investment. India wants to be a knowledge-based hub and is sure to drive the future growth of the service sector. India government projection shows that the sector will grow at a fast pace of 10% while the entire economy grows at 9.5%.

Massive amounts of value add can be created in services In India this is true of financial services, IT and others where most value addition is created. The flip side is that though services account for 60% of GDP, they do not contribute as much for job creation, accounting for just 15%of jobs. *In the Indian context, the focus has to be on intensive services, i.e. services which* absorb people, like tourism. India has a sizeable fraction of the population stuck in low productivity work. If India can create more jobs in manufacturing or high-value services, where productivity is much higher and if it can educate workers to do these jobs, it will be able to generate higher incomes for a considerable period through the movement of workers from low productivity sectors to high productivity sectors. There has been much debate about the capacity of the service sector to generate employment. It has been put forward that employment growth has not kept pace with income growth. The sector has the largest share of organised employment. Existing studies in labour productivity concludes that labour productivity is highest in the service sector; particularly in the decades after 1980. The skill content in both manufacturing and services has increased over time. Total factor productivity growth in India has been highest in the services sector.

The present paper tries to analyse the transformation of the Indian service sector. The sectors considered in the present study are fastest-growing subsectors such as IT & IT-enabled services, telecommunications, tourism, banking and educational sectors. Secondary data from various sources are used for the study.

It and it Enabled Services Industry

India, accounting for approximately 52 per cent of the US$ 124-130 billion market, is the world's largest destination for the information technology industry. The industry employs approximately 10 million Indians, both inside and outside the domestic territory of the country. The IT industry contributes significantly to the social and economic transformation in India.

The IT industry has significantly transformed India's image on the global platform. The sector has also catalysed economic growth by fueling the higher education sector, especially in the IT-related disciplines. One significant aspect of India's success in the IT and IT-related industries is India's cost competitiveness. The services provided by the Indian IT service providers is approximately 3-4 times cheaper than the developed countries.

The Indian IT and IT-enabled Services industry may be classified into four major segments such as (a) IT services, (b) business process management (BPM), (c) software products and engineering services, and (d) hardware. 'The Indian IT sector is expected to grow at a rate of 12-14 per cent for FY2016-17 in constant currency terms' (IBEF, 2017). "India continues to be the top offshoring destination for IT companies followed by China and Malaysia in second and third position, respectively. Emerging technologies present an entire new gamut of opportunities for

IT firms in India. Social, mobility, analytics and cloud (SMAC) collectively provide a US$ 1 trillion opportunity. Cloud represents the most massive opportunity under SMAC, increasing at a CAGR of approximately 30 per cent to around US$ 650-700 billion by 2020. Social media is the second most lucrative segment for IT firms, offering a US$ 250 billion market opportunity by 2020." (ASM Technologies, 2016)

Telecommunications Sector

Telecommunication has been recognized the world over as an essential tool for socio-economic development for a nation and plays a phenomenal role in the growth of various sectors of the economy.

Over the last several years, the Indian telecom market has shown overwhelming growth due to surging domestic demand. This was basically due to policy initiatives undertaken by the government. Efforts by the players of the Indian industry has managed the sector to emerge as one of the youngest and fastest-growing economies in the world today.

The fact that India is one of the world's fastest-growing telecom markets in the world has contributed as the primary driver for foreign and domestic telecommunication companies investing in the sector in India. Interestingly this is also considered as one of the most lucrative markets globally. This has resulted in massive investments being made in the sector both by the private and government sector in the last decade. Liberalization of the sector has led to rapid growth and has also helped towards maximization of consumer benefits. This is evident from a considerable fall in tariffs.

Meanwhile, the introduction of Mobile Number Portability (MNP) in India has made the Indian Telecom market more competitive, in terms of service offerings and quality. With lower voice tariffs and low ARPUs in India, the emergence of new technologies and advancements towards 3G amongst other reasons are motivating operators to shift their focus on VAS. Mainly, the past few years have been quite revolutionary for the industry as it witnessed the emergence of smartphones; GPS enabled sets, and 3G handsets. Initiatives to connect the rural masses are already visible with service providers tie-ups with content providers for services related to agriculture, weather and livelihood.

The emergence of the mobile as a communication tool has benefitted people across all sections of society. Mobile communication is expected to play a significant role in bridging the digital divide by connecting all sections of the nation. It has not only become the primary communication medium for people. It is being used for numerous uses across various domains such as banking transactions, making payments, as an educational and multimedia tool, etc. However, the urgent need is to deliver services that could enable efficient day-to-day life for the larger masses efficiently. It can be an efficient mode of spreading governance, and can also be used across verticals such as agriculture and healthcare. The rapid rise of high-end mobile phones (smartphones) has enabled the customers to access and utilize numerous software applications as utility or for entertainment. The rapid pace of growth in telecommunications makes it necessary to develop India as a global manufacturing hub.

India's telecom sector received US$ 1093 million in foreign direct investment (FDI) during the first quarter (April-November) of the financial year 2010- 2011. Today, telecom is the third major sector attracting FDI inflows after services and computer software sector. In the telecom sector, FDI up to 49% is allowed under automatic route and beyond that up to 74% is permitted through the Foreign Investment Promotion Board (FIPB), a government body. As per the current telecom services policy, the sector has 74% of equity on basic cellular, unified access services and other value-added services.

Tourism Industry

The Indian tourism and hospitality industry is fast emerging as one of the critical initiators of growth among the services sector in India. Tourism in India is a potential game-changer. It is a sunrise industry, an employment generator, a significant source of foreign exchange for the country and economic activity that helps local and host communities.

India's demographic dividend of a younger population compared to developed countries is leading to more significant expenditure on leisure services. Rising income levels and changing lifestyles, development of diverse tourism offerings and policy and regulatory support by the government are playing a pivotal role in shaping the travel and tourism sector in India.

The travel and tourism sector directly contributed INR 1920 billion to India's GDP in 2012, reflecting a growth CAGR of 14 per cent since 2007. This is forecasted to grow at a CAGR of 12 per cent from the estimated INR 2222 billion in the year 2013 to INR 6818 billion by 2023. In addition to the impact of economic activities directly related to the sector such as accommodation, transportation and entertainment, the total contribution of the sector also takes into account the indirect impacts of investment or supply chain activities and induced income impacts resulting from spending by employees directly or indirectly related to the sector.

While these numbers indicate direct employment supported by the tourism sector reflecting employment by hotels, travel agents, passenger transportation services or other restaurant and leisure employment, the total contribution including indirect and induced effects is expected to cause a multiplier impact on the economy resulting in more significant employment generation.

Education Sector

Education contributes to the growth of national income and individual earnings. Traditionally our efforts around education have focused on enrolment and not on children's learning. It is hardly surprising then that despite 97% enrolment, in class 1, only 35% reach class 12 and less than 20% enrol into higher education. Half of even those who graduate are unemployable in any sector. Any hope of reaping the demographic dividend lies in prioritising skill development. In 2008, National skill Development Corporation was established with the target of skill development for 500 million youth by 2022. A skill India scheme is being developed by the present government. Investments must be made for a strong technology backbone, focusing on hardware and software development across our school and higher education institutions.

Literacy is the first rung of the educational ladder. Literacy has for long been considered a prerequisite for development. It is a significant determinant in the achievement of our demographic goals, be it the reduction in infant mortality rates, maternal mortality rates or the fall in female fertility rates. The Sarva Shiksha Abhiyan (SSA) is then a national programme launched in 2001 to achieve universal primary education by 2007and universal elementary education by 2010. SSA has brought primary education to the doorstep of millions of children.

Higher education institutions are a significant source for providing the human capital required for knowledge production.

There is a general assumption among policy-makers that what is essential for economic growth and development is literacy, primary education and, at best, secondary education rather than higher education. Higher education does not figure on the poverty-reduction agenda of many developing countries and is not reflected in the Millennium Development Goals. Nevertheless, literacy and primary education rarely provide employment skills that can ensure a reasonable salary or standard of living. Although no longer the sole generators of knowledge needed for development, through their research and teaching, they help to produce expertise, manage development, engineer social transformation and preserve social values and cultural ethos.

Market outcomes are not favouring the expectations of the labour force.

Higher education and its quality is thus an economic parameter of development. Building up of such a system requires excellent vision, outstanding dedication and channelling of substantial economic resources. Apart from technical knowledge, and skills becoming factor inputs in production, there are many spillover benefits to the society at large, what we call as positive externalities. Higher education enables human beings to have a better quality of life in the sense that they are better equipped to appreciate and acquire culture in the broadest sense of the term. Human beings have the right to be open to great paintings, great music, theatre, poetry and the arts. Their life will be more prosperous, their appreciation of values keener and their awareness sharper, with education. Society moves forward with all the cultural and counters cultural trends generated in the process.

India has more than 3,000 years of cultural evolution with a continuous tradition of pursuing higher education through the opportunity was confined to a select few. The University of Nalanda, established in the year 427 AD, is one of the first great universities in recorded history. The university in its halcyon days attracted students from Japan, China, Korea, Indonesia, Tibet, Persia, Turkey, and Ceylon. Even in modern education, India has nearly 150 years of experience starting with the establishment of universities in Kolkata, Mumbai, and Chennai (Calcutta, Bombay, and Madras).

Though we can boast of a glorious past, the fact remains that the achievements of contemporary Indian universities are limited. The quality of higher education as judged by the list of 200 top-ranking universities prepared by the Times Higher Educational Supplement in October 2011 shows that India is nowhere near the picture. The top five leading institutions of higher education are all in America, followed by Britain. There are none from Asia in the top 20. Global ranking on investment in higher education as a percentage of GDP places India at the bottom rung. It is not strange that India is also among the bottom ten countries when we take development indicators like HDI, GDI or PQLI. To move forward with economic development that is sustainable and to have a better quality of life with better values, India should put greater emphasis on knowledge creation. In a world racing forward on knowledge power, India finds itself a non-starter.

Banking Sector

India has a diversified financial sector comprising commercial banks, insurance companies, non-banking financial companies, cooperatives, pension funds, mutual funds and other smaller financial entities at present India is one of the world's most vibrant capital markets.

The growth of the financial sector at present is pegged at 8.5% per year, and it is kept a stable rate by the well managed monetary and other macroeconomic policies. The size of the banking assets in India reached us$1.8 trillion, in FYI 14 and growing at a fast pace. The association of mutual funds India shows that the assets of the mutual fund industry have hit an all-time high of US $189.83 billion. During 2013-14, the life insurance industry recorded a premium income of $49.67 billion.

The functioning of the banking industry is changing the world over rapidly. However, in India, the banking system continues to be dominated by the public sector banks, which account for three-quarters of total commercial banking assets. The banking system is fragmented; except for the State Bank of India, no one bank holds more than ten per cent of total system assets. In most emerging economies, banks assets comprise well over 80 per cent of total financial sector assets. Nevertheless, these in developed economies such figures are significantly lower. Another significant deviation between the banking industry in developed and emerging economies is the degree of internationalization of banking operations.

The Narasimham Committee Report (1991) recommended several reform measures such as reduction of reserve requirements, deregulation of interest rates, the introduction of prudential norms, strengthening of bank supervision and improving the competitiveness of the system. The second Narasimham Committee Report (1998) too focused on issues like strengthening of the banking system, upgrading of technology and human resource development. "The major banking sector reforms comprise of modifying the policy framework; improving the financial soundness and credibility of banks; creating a competitive environment, and strengthening of the institutional framework. The improvements in the policy framework are aimed at removing and reducing the external constraints bearing on the profitability and functioning of commercial banks". (www.rbi.org.in).

The most significant achievement of the financial sector reforms has been the marked improvement in the financial health of commercial banks in terms of capital adequacy, profitability and asset quality with attention to risk management. Further, deregulation has opened up new opportunities for banks to increase revenues by diversifying into investment banking, insurance, credit cards, depository services, mortgage financing, securitization, etc. At the same time, liberalization has brought greater competition among banks, both domestic and foreign, as well as competition from mutual funds, NBFCs (non-bank finance companies), post office, etc. As banks benchmark themselves against global standards, there has been a marked increase in disclosures and transparency in bank balance sheets. (Amit, 2016)

Conclusion

India can follow a unique path by focusing on things we are already good at, like services, rather than aiming at a manufacturing revolution. India should aim at creating the environment for business to flourish and job intensive industries to grow. The possibility can be created by building connectivity, the infrastructure, enabling finance and quality education. The technological revolution has offered us a new path and made it possible for us to follow a novel growth trajectory (Rajan, 2015).

An incipient danger in analysing growth in India with data is the growth numbers. Frequent changes in the methodology which makes a farce of comparisons of data forces economists to acknowledge that the data is puzzling and do not reflect the ground reality. Data which misleads and confuses is ultimately a liability. An examination of the data suggests that the growth in the service sector has been more in the sub-sectors providing intermediate outputs rather than in the sub-sectors catering to final demand.

The percentage of output produced in the transport, communications and storage sub-sectors has also increased in the period 1990 to 2000. These two sub-sectors are more important as providers of intermediate inputs to production sectors. The current economic survey data reflects a change in methodology; the growth in GDP, last fiscal, 2014 ending March has been revised up from 4.7 to 6.9 as well, and forecast for growth next fiscal is revised up from 7.4 % to 8.5% following the change in figures. Frequent changes in methodology make the data far removed from ground reality so much so that the former chief economic advisor Aravind Subramanian himself confesses to being puzzled by the data. India is still a recovering economy and not a surging one or a roaring tiger (Subramanyam, 2015)

India needs a shift in focus. Our priorities have to be changed, and our form shifted from big dams and steel mills to knowledge creation and the generation of creative knowledge. The emphasis should be on people with ideas and capabilities. Giving livelihood jobs to millions is essential, but more critical become the chance to grab the opportunity of turning them into a qualified human resource. Creating awareness regarding the dangers of losing environmental quality is another of the pressing needs in India. Environment as an amenity, a luxury and a necessity should be appreciated. Environment degeneration, in the interests of economic growth, will soon lead to the stark reality that economic growth is not sustainable. A high-quality social infrastructure can be assured only with environmental protection. To realize this, the creation of a population with a strong knowledge base and social awareness is a prerequisite.

The sectoral contribution to GDP, sectoral shifts that occur as the economy progresses and the resulting structural transformation in an economy, is traditionally considered as an indicator of the economy's development. Economic growth expands the material base for social development. The extent, to which the latter can advance, however, depends not on growth alone, but the distribution of opportunities. The provision of social infrastructure in a country depends on the importance the country attaches to it and the financial provision the country is prepared to put up for it. In fact, along with physical infrastructure, the economic development of the country is defined by its social infrastructure.

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