Leapfrogging into Services*

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Bypassing full-fledged industrialisation and depending on services for growth is not a bad idea says the International Monetary Fund. In the April 2018 edition of its World Economic Outlook, the IMF has endorsed a trajectory that India is known to have pursued in recent years. Characterised by an unusual process of structural transformation, that trajectory involves an early turn to services when the share of agriculture in aggregate output and employment declines with development. This contrasts with the traditional turn to manufacturing at relatively low levels of per capita income. In an India-type process, services rather than manufacturing would have to drive the transition from low to middle and high income status.

The IMF's endorsement is of significance to India because its development trajectory has in the past been seen as a failure. In 1960, industry contributed 37 per cent of GDP in Brazil, 45 per cent in China, around 25 per cent in South Korea, as compared with 19 per cent in India, Indonesia, Malaysia and Thailand. By 1985, the figures were 45 per cent in Brazil, 43 per cent in China, 36 per cent in Indonesia, 39 per cent in South Korea, 39 per cent in Malaysia, and 32 per cent in Thailand, but only 26 per cent in India. This persistently low level of the share of manufacturing in total output in India, which implied that the shift away from agriculture resulted in time in a rapid growth of services, was seen as a major developmental shortcoming.

The dominant perspective on the structural transformation associated with successful development was that it would be characterised by an increase in the share of output and employment in the manufacturing sector, and within the latter by an expansion of the scale of productive units. The IMF's case is that this is not true, or least not since the 1970s. Development could just as well be based on services, since the same results in the form of rising productivity and per capita income can be garnered through a services-led strategy.

A number of arguments are advanced in Chapter 3 of the World economic Outlook to support this view. Central to the IMF's case is the evidence that "even though output has outpaced employment in the manufacturing sector in most countries since the early 1970s", this has not been true at a global level, where manufacturing output has grown broadly at the same pace as employment. A faster growth of output relative to employment implies that output per worker or productivity is rising. The evidence suggests that, in most developing countries, the productivity increase needed to raise per capita incomes and catch up with the developed was led by manufacturing. If at the same time average productivity at the global level is stagnant, it must mean that productivity in manufacturing in the developed countries is falling.

According to the IMF, this country-wise heterogeneity is essentially because of the geographical relocation of industrial production to low wage countries "where output per worker tends to be lower", prior to such relocation. If higher productivity technologies move to locations where manufacturing productivity is low, average productivity must rise. The reasons for this geographical redistribution of manufacturing are many, including lower costs that facilitate more competitive production for global markets and the fact that, at the per capita income levels prevalent in the developing countries, increases in income raise manufacturing demand more than demand for services.

All this implies that, if for any reason, and as is true with manufacturing, more productive services emerge and grow in developing countries, that too should support the processes of rapid growth and catch-up. If this is happening, there is no need to privilege manufacturing above services as the ‘go to’ sector to accelerate the growth of nation-wide productivity and per capita income. In practice, since “some service industries have higher productivity levels and growth rates than manufacturing overall”, “the rise of services and the decline or leveling-off of manufacturing as a source of employment need not (necessarily) hinder economy-wide productivity growth.” While, “the manufacturing sector as a whole typically sees faster productivity gains than the service sector …, average productivity growth in services in many developing economies, including China, India, and some in sub-Saharan Africa, has recently exceeded that of manufacturing.

The IMF concludes that: “The main message that emerges … is that skipping a traditional industrialization phase need not be a drag on economy-wide productivity growth for developing economies.” So, rather than focus on emphasising manufacturing growth irrespective of context, developing countries need to focus attention on: (i) raising productivity in all sectors so as to accelerate growth; and (ii) training and skilling workers so that they can adjust to structural changes that necessitate shedding certain kinds of jobs and taking up opportunities in new areas.

There is one distorting factor here, which is the time period chosen, beginning with the 1970s. That was when the process of industrial relocation began, taking high productivity manufacturing to low wage countries. And that was when a range of new marketed services characterised by high revenues per person employed, and therefore high profits, had emerged and grown, especially in information technology-enabled and financial services sectors. That meant manufacturing productivity rose fast in low productivity locations and revenues per worker (or ‘productivity’) in services rose sharply in both developed and developing. However, if the analysis had turned to global trends in manufacturing and employment since the early history of capitalism, the rationale for privileging manufacturing over services would have been clear. The developed were the industrially advanced, which overcame the barriers to productivity increase in agrarian economies by building a large manufacturing sector. The underdeveloped were economies that were predominantly producers of primary goods and traditional manufactures like textiles. To ignore that period and focus on one during which investment and productivity advance in manufacturing was depressed because of an overall deflationary environment does lead to biased conclusions.

Yet, the IMF’s argument must be music to the ears of policy makers in India, where the failure to industrialise adequately has been followed by a sharp rise in the share of services in GDP in recent years. Though India ranks low in terms of per capita income, its share of services in GDP is approaching the global average. The official Economic Survey 2013-14 noted that: "India has the second fastest growing services sector with CAGR (compound annual growth rate) at 9 per cent, just below China's 10.9 per cent, during the last 11-year period from 2001 to 2012." It saw the services sector as being an important contributor to growth in the future as well.

However, the contribution of services to employment in India was significantly lower than the world average. As the Economic Survey noted, while at the global level services accounted for 65.9 per cent of GDP and as much as 44 per cent of employment in 2012, in India's case the sector, with 56.3 per cent of GDP, accounted for just 28.1 per cent of employment. This would imply that the relative per worker value added in services vis-à-vis the commodity producing sectors and construction was higher in India than elsewhere.

This does suggest that in recent years growth in services in India has been biased in favour of sub-sectors that are characterised by faster growth in "output" than in employment. In fact, this has led to the view that India is experiencing an unusual and virtuous growth led by services. That view has been based on two presumptions. The first is that it is modern services like financial services, software and information technology enabled services, communications services, business services, and productive services like transport, storage and communications that account for the bulk of the services sector. This is seen as rendering the privileging of manufacturing over services unwarranted in India's case. Second, services growth has been driven by India's success in software and IT-enabled services (ITeS) exports. This has been supported by the fact that India's share in world services exports has risen from 0.6 per cent in 1990 to around 3.5 per cent recently. In fact, presuming that services growth has been led by software and IT-enabled services, which are seen as knowledge and technology intensive services, some have argued that services growth is expanding the knowledge economy, and reflects a new kind of dynamism.

How true is this description? A calculation based on the National Accounts Statistics prepared by the Central Statistical Organisation (CSO) indicates that the set of services sectors that could be identified as "modern services"—banking and insurance, education, computer related services, research and development, health, communication, legal services and accounting—together accounted for only 16.6 per cent of GDP in 2012-13. Add on public administration and defence and the railways and the figure rises to 23.3 per cent. That still leaves well more than half of services GDP, amounting to 30 per cent of total GDP, unaccounted for. Trade, dominated by the retail trade alone accounts for 16 per cent of GDP. This makes the argument that services are reflective of a new dynamism in India that much less convincing.

Thus, while modern services do play an important role in the Indian economy, so do traditional unorganized services, which are known to be characterized by extremely low earnings, and which grow because of the inadequate employment opportunities in the primary and secondary sectors, especially those providing a reasonable wage and decent work conditions. With agricultural involution, or the settling of unemployed workers on land no more economically feasible, the services sector has become the sink for the unemployed. Yet tertiary sector employment in 2009-10 amounted to only 25 per cent of the work force, despite the fact that around 55 per cent of GDP came from this sector. This was possibly because low wage employment in traditional services that serve as a sink for the unemployed, but contribute little to GDP, combined with high productivity services that delivered substantially in terms of revenues but very little in terms of employment. India's service sector harbours many of its new dollar billionaires, as well as many of its most deprived.

Growth of that kind would not just be deeply inequalising but also limited in terms of its spillover effects on the rest of the economy. Privileging such growth and seeing in it the potential for developmental advance is to miss the nature of contemporary capitalism in both the developed and the developing world.

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