



Services Sector in India: Issues and Way Forward

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Services Sector in India's GDP and Employment

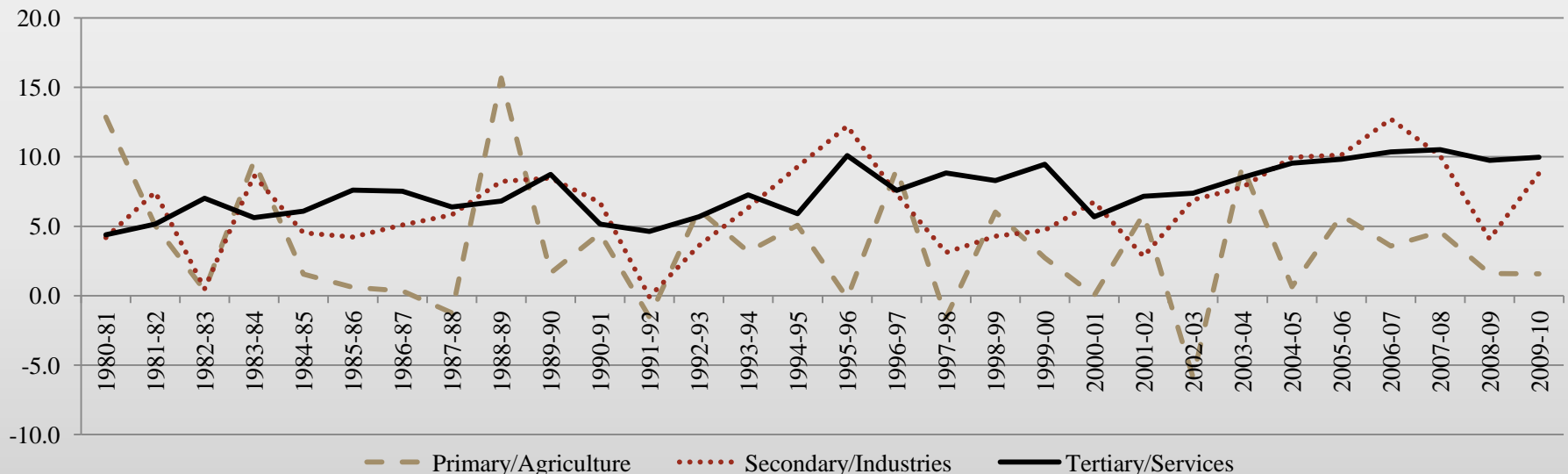


Decadal Average of the Year on Year Share of the Different Sectors in India's GDP for the Period 1950-2010 (in %)

Total Employment in Different Economic Activities in India (in %)

Sector	1950-60	1960-70	1970-80	1980-90	1990-2000	2000-10	Sector	1993-94	1999-00	2004-05	2009-10
Agriculture	55.3	47.6	42.8	37.3	30.9	21.8	Agriculture	62.8	61.7	58.5	53.2
Industry	14.8	19.6	21.3	22.3	23.3	24.5	Industry	15.2	15.9	18.1	21.5
Services	29.8	32.8	35.9	40.3	45.7	53.7	Services	22.0	22.4	23.4	25.3

Percentage Growth Rate of different Sector (1951-2010)



Issue 1: India, an outlier?



- ▶ Until 1981, India was a **negative outlier** as share of services in value added and employment was below other countries and after economic reforms it became a **positive outlier** in terms of value added but continued to be a **negative outlier** in terms of share in employment (Kochhar et. al. 2006)
- ▶ Large proportion of employment concentrated in the unorganised sector
 - ▶ Services accounted for 62% of the total organised sector employment – within services, 80% of employment in unorganised sector
 - ▶ Within services wholesale and retail trade is the largest employer, followed by transport, storage and communication, which are largely unorganised
 - ▶ The share of organised services sector employment in public sector has declined – from 86% in 1993-94 to 75% in 2009-10
 - ▶ Within organised sector, public sector dominates employment in services, private sector has not been very successful in generating organised services sector employment

Issue 2: Classification and governance structure



- ▶ Difference in global (UNCPC) and Indian (NIC) classification – as per NIC construction is not a part of services sector, classification of direct selling, e-commerce by DIPP and NIC
- ▶ Disaggregated data is not available for many services
- ▶ Quasi federal governance structure
 - ▶ Multiplicity of regulatory bodies
 - ▶ Multiple regulations
 - ▶ Multiple licenses and clearances
 - ▶ No nodal ministry– retail and construction

Issue 3: Heterogeneity across States



- ▶ Difference across different states within India
 - ▶ Share of services in state GDP of Bihar, Delhi, Kerala, etc. was higher than all India average while Chhattisgarh and Himachal Pradesh was lower
 - ▶ The growth rate of services for states like Arunachal Pradesh and Sikkim is higher than all India average, while Andhra Pradesh, Karnataka and Rajasthan is lower
 - ▶ The share of public sector services including administration service is growing in laggard states while private sector services is growing in fast-growing states
 - ▶ Fast growing states have seen a decline in the growth rate of manufacturing sector and a rise in growth of services
- ▶ Differences across services sectors
 - ▶ Transport, storage and communication and trade, hotels and restaurants have grown faster than overall service sector growth
 - ▶ In terms of labour productivity in services, there are vast differences – post, telecommunication, hotel, restaurants and trading have shown a large increase in productivity growth, social sectors like health and education has low productivity

Concern: Inclusive Growth

Issue 4: Regulatory restrictions



- ▶ Slow reform process in India
- ▶ Regulations do not take in account technical developments (communication services)
- ▶ Lack of comprehensive regulations for providing integrated services (transportation sector)
- ▶ Sector specific regulations required in new services (direct selling, cloud computing)
- ▶ Independent regulator vs. no regulator and multiple regulators (electricity)
- ▶ Timing of Regulations
- ▶ Non transparent government procurement system and price preferences to PSUs
- ▶ FDI restrictions – restrictive conditions on foreign investors, which cannot be monitored and are non-transparent

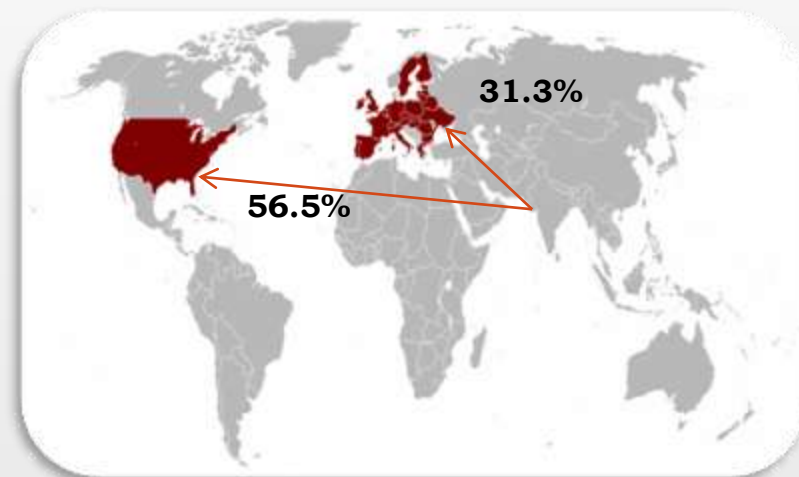
Issue 5: Trade concentration



- Trade largely comprise of a **few services** and is concentrated in a **few markets**

RCAs for Services Sub-sectors (1990-2010)

Sectors	1990	2000	2005	2008	2010
Communications	0.0	1.7	1.3	1.0	0.5
Computer and information	0.0	10.1	9.9	8.6	7.9
Construction	0.0	1.6	0.3	0.3	0.2
Financial services	0.0	0.3	0.3	0.5	0.7
Government services	0.1	1.5	0.3	0.2	0.2
Insurance	1.4	0.9	1.0	0.7	0.7
Other business services	2.0	1.1	1.0	0.9	1.0
Personal, cultural and recreational services	0.0	0.0	0.2	0.6	0.3
Royalties and licence fees	0.0	0.1	0.1	0.0	0.0
Transport	0.8	0.5	0.5	0.5	0.5
Travel	1.1	0.7	0.5	0.5	0.5



Services accounts for largest outward investment, negotiations focus on Mode 4 and 1



Issue 6: Taxes and subsidies

- ▶ High corporate tax – around 30-40% compared to 17% in Singapore and 25% in China
- ▶ Variations in taxes across states – increases cost and restricts pan-India operations
- ▶ In some cases taxes result in use of inefficient technology – multi-axle vehicle *vs.* single-axle vehicles
- ▶ Retrospective tax, GAAR
- ▶ Cross-subsidization and wrong subsidies leading to misallocation of resources – passenger tariff *vs.* freight tariff
- ▶ Multiple policies – SEZ *vs.* manufacturing clusters and Department of Commerce *vs.* Ministry of Finance

Issue 7: Why have we not become a knowledge-based economy?



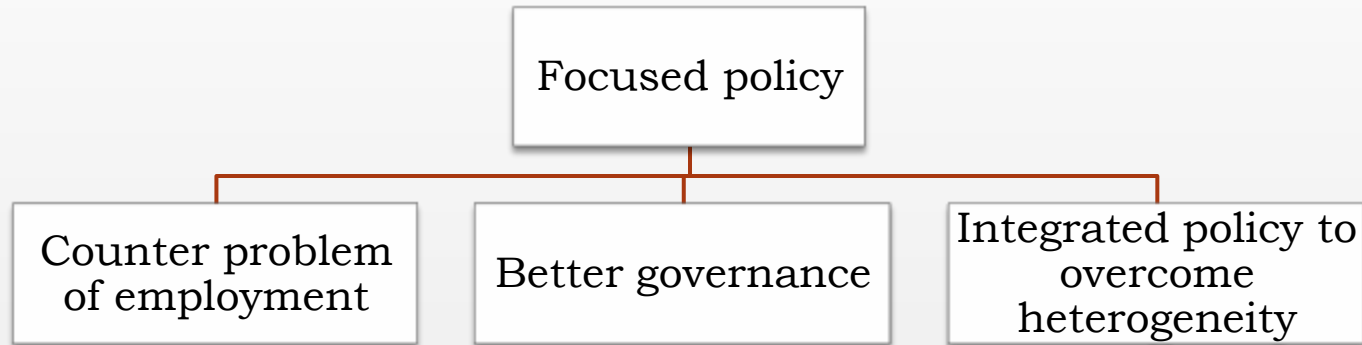
- ▶ In India, R&D expenditure is low – both in terms of its proportion to GDP and in comparison to the rest of the world
 - ▶ R&D expenditure is 0.8% of the GDP
 - ▶ India ranks below Brazil and China in terms of capacity for innovation
 - ▶ Share of private sector R&D is 0.25% of the GDP compared to 1.2-2% in developed and emerging markets
- ▶ Low ICT penetration, literacy rate
 - ▶ India has 1.53 internet subscribers per 100 inhabitant in 2010 compared to 8.35 in China and 35.68 in Korea
 - ▶ Low adult literacy rate (62.8%) compared to China (94%) and Korea (100%)
- ▶ Past policies focused on higher education

How can services sector lead to an inclusive growth?

Pending reforms...



Reform 1: Service sector focus in policymaking



- ▶ Lay down long-term and short-term strategy for each sector
- ▶ Long-term focus to encourage growth of organised sector employment and modernisation of unorganised sector
- ▶ PPP to design academic courses and training programmes to facilitate skill development, improve accreditation process
- ▶ Take in account evolving nature of service sector – link with other sectors
- ▶ Policies can focus on state-specific requirements
- ▶ Clearer definition, based on international definition
- ▶ Centralised system of data collection at disaggregated level

Reform 2: Regulatory reforms



- ▶ Nodal ministry at the centre
- ▶ Centre can have model regulation, states can implement
- ▶ Need for sector specific regulator should be examined and independent regulator should be appointed
- ▶ Privatisation should be accompanied by transparent and non-discriminatory regulations
- ▶ FDI liberalisation should be technology neutral and should not distinguish between domestic and foreign companies

Regulatory reforms contd.



- ▶ Speed up the process of reforms
 - ▶ Tax related reforms such as goods and services tax (GST), Direct Tax Code Bill, 2010 are long pending
- ▶ Government Procurement Bill
- ▶ Cross-subsidization should be minimised
- ▶ Subsidies should be targeted to the poor and needy
- ▶ Removal procedural hurdles by implementing single window clearance

Reform 3: Trade diversification



- ▶ Focus on export through all four modes of services trade and across a number of sectors – identify few sectors with potential and new markets
- ▶ Government should focus on diversifying markets – pursue external policies
 - ▶ Signing trade agreements with major trading partners, mutual recognition agreements, bilateral investment treaties and double taxation avoidance agreements
- ▶ Offer liberalisation commitments on a reciprocal basis
- ▶ Develop consensus on negotiating services agreement
- ▶ Implement domestic reforms to benefit from trade agreement

Reform 4: Transforming India into a knowledge based economy



- ▶ Encourage R&D investments through public private partnership
- ▶ In-house innovation and R&D can be encouraged through fiscal incentives
- ▶ Offer benefits to companies that tie-up with education institutes for R&D
- ▶ Incentives can be offered for setting up IT infrastructure in rural areas and development of content in local language
- ▶ Low cost consumer equipments like laptops, tablets and personal computers can support IT penetration

Thank you

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