



Economic Premise

MAY 2010 • Number 14

54595

The Service Revolution

Ejaz Ghani and Homi Kharas

The growth experience of India and other South Asian countries suggests that a “Service Revolution”—rapid income growth, job creation, gender equality, and poverty reduction led by services—is now possible. What is a service revolution? Can services be as dynamic as manufacturing? Can latecomers to development take advantage of the globalization of services? Can services be a driver of sustained growth, job creation, and poverty reduction? What kind of policies and institutions do developing countries need to benefit from services-led growth?

Both China and India have been recognized for rapid economic growth. However, their growth patterns are dramatically different. China has a global reputation for exporting manufactured goods, and India has a reputation for exporting modern services. Indeed, India has sidestepped the manufacturing sector and made the leap straight from agriculture into services. The differences in growth patterns between China and India are striking and raise big questions in development economics. Can developing countries jump straight from agriculture into services? Can services be as dynamic as manufacturing? Can services growth be a driver of job creation and poverty reduction?

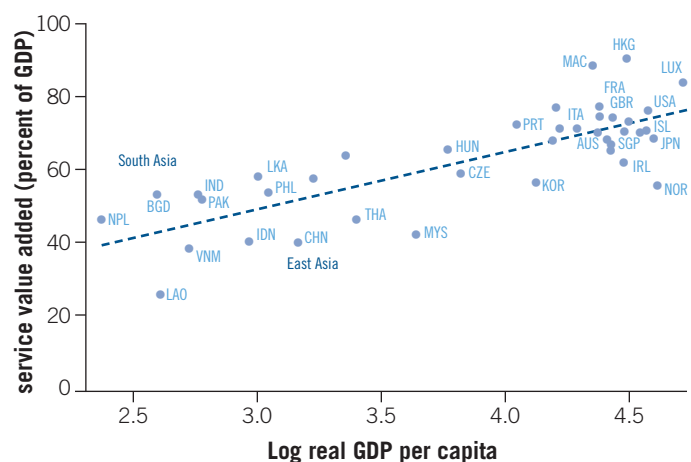
Growth

Figure 1 compares the GDP shares of services value added in China, India, and countries of the Organisation for Economic Co-operation and Development. The share of the services sector in India and other South Asian countries is much bigger than in China or other East Asian economies, given the country’s stage of development.

India’s growth pattern in the 21st century is remarkable because it contradicts a seemingly iron-clad law of develop-

ment that has held true for almost 200 years, since the start of the Industrial Revolution (Chenery 1960; Kaldor 1966). This law—which is now conventional wisdom—says that industrialization is the only route to rapid economic develop-

Figure 1. Comparing the Contributions of the Manufacturing and Services Sectors to GDP in China, India, and OECD Countries, 2005



Source: Ghani 2010.

ment for developing countries. It goes further to say that, as a result of globalization, the pace of development can be explosive. But the rule holds that the potential for explosive growth is specific to manufacturing only (UNIDO 2009). That is no longer the case.

Figure 2a compares real GDP growth with services value-added growth in some 136 countries between 2000 and 2005. Each point on the graph represents one country. The positive relationship between the two variables implies that countries with high growth in services also tend to have high overall economic growth or, conversely, that countries with high overall economic growth have high services growth. One cannot identify causality from this relationship.

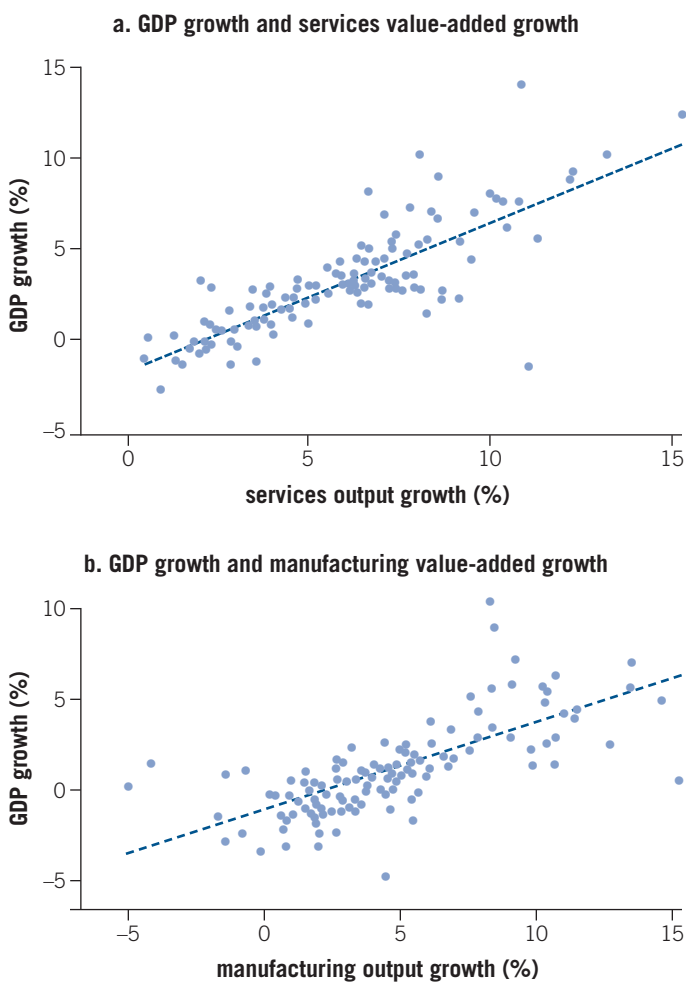
Figure 2b depicts the relationship between manufacturing growth and overall economic growth. Again, there is a positive relationship. Comparing the two graphs, it is clear that the slope is steeper in figure 2a. That fact suggests that

if the relationship is causal, then the effect of services growth on aggregate economic growth seems to be stronger than is the effect of manufacturing growth.

The trend over time to a higher services sector share in GDP shows that higher real growth in services has not been offset by price declines. There is no Dutch disease, whereby the price of a service falls with an increase in its supply (Baumol 1967). India has a higher share of services and more rapid growth in its services sector than does China, although the latter is richer and has grown faster. That fact suggests that services are responding not simply to domestic demand (which would be higher in China), but also to export opportunities (Ghani and Kharas 2010).

India's experience shows that growth has been led by services exports, that labor productivity levels in services are above those in industry, and that productivity growth in services sectors in India match labor productivity growth in manufacturing sectors in China. Furthermore, services-led growth has been effective in reducing poverty in India.

Figure 2. GDP and Value-Added Growth in 136 Countries, 2000–05



Source: Ghani 2010.

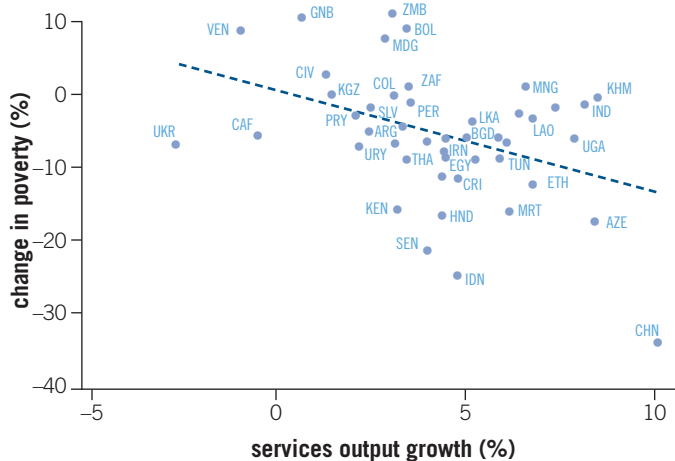
Note: Each point in the both charts corresponds to five-year growth for a specific country. GDP growth rates control for level of initial income per capita. All values are in constant 2000 U.S. dollars. Growth rates are compounded annual averages. The sample consists of 136 countries.

Poverty

We find that for a sample of 50 developing countries, growth in the services sector is more closely correlated with poverty reduction than is growth in agriculture. Visually, we can plot the change in poverty between 1990 and 2005 against the growth of services (figure 3). The negatively sloped line indicates the strong association between services output growth and poverty reduction for our sample of developing countries.

These results are further confirmed when we examine the impact of sectoral growth patterns on poverty reduction within India, using a panel of Indian state data from 1994

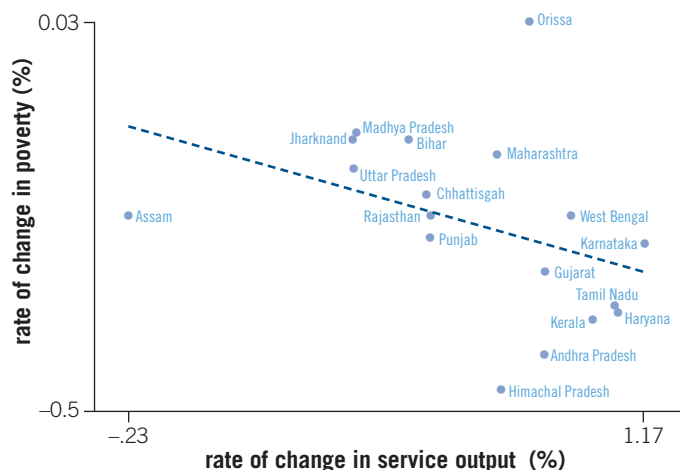
Figure 3. Change in Poverty and Growth in Services Output, Selected Countries, 1990–05



Source: World Bank, *World Development Indicators*.

Note: Illustration presents change in poverty between 1991 and 2005, after controlling for initial level of poverty.

Figure 4. Contribution of Services Output Growth to Poverty Reduction, Indian States, 1994–2005



Source: Ghani 2010.

to 2005. Our results show that the growth trend in the services sector among Indian states is associated with a decrease of almost 1.5 points in the trend of the head count poverty rate during the sample period. In fact, the services sector is the only sector showing a statistically significant association with a reduction in poverty. Similar results are found when differentiating into rural and urban poverty. Services sector growth is strongly associated with a reduction in both urban and rural poverty rates. Some states—such as Andhra Pradesh, Kerala, and Tamil Nadu—have experienced a significant decrease in urban poverty that is associated with an increase in their services sector share of GDP (figure 4).

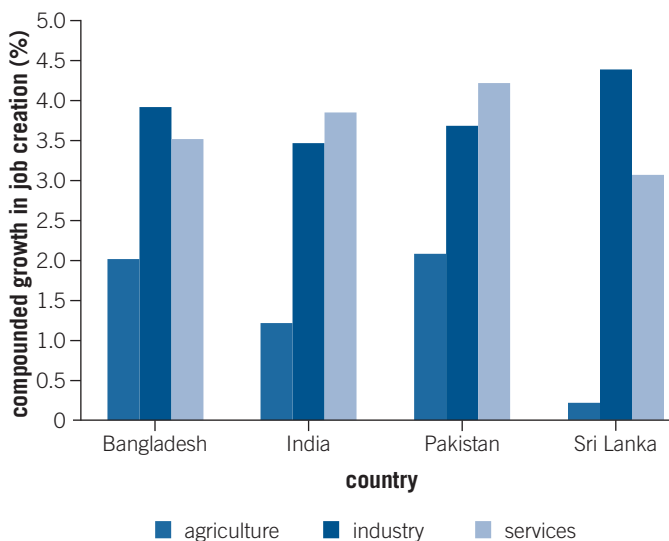
Services help lessen poverty through two channels. Directly, they provide the largest source of new job growth. Indirectly, they provide the income that, when spent, drives further demand for goods and services and for the jobs to produce them. Figure 5 shows that the services sector in India has had the fastest growth in the number of jobs created in recent years. In addition to direct job creation, some estimates suggest that the indirect effect of a growing services sector can be larger than its direct effect. For instance, India’s information technology industry association (NASSCOM) estimates that for every job created in the information technology sector, four additional jobs are created in the rest of the economy because of the high levels of consumption spending by professionals employed in this sector.

Job Creation

Services jobs are good jobs. Wage growth has been higher in India’s services sector than in manufacturing and agriculture over recent years (figure 6). Manufacturing wages fell in the early 2000s in both rural and urban areas, despite rapid economic growth; but services sector wages in utilities, trade,

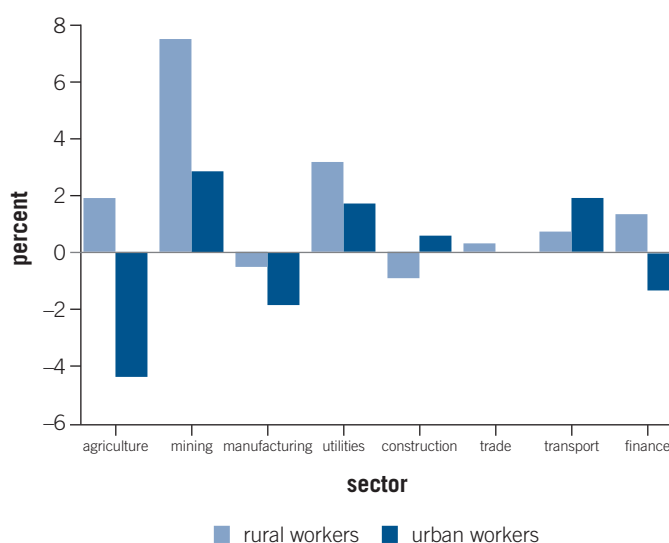
transport, and even rural finance improved. For many sectors, in fact, wages in rural areas may have increased faster than those in urban areas, possibly reflecting the rising rural-

Figure 5. Job Creation Rates in Agriculture, Industry, and Services Sectors, Selected Countries, 1990–2006



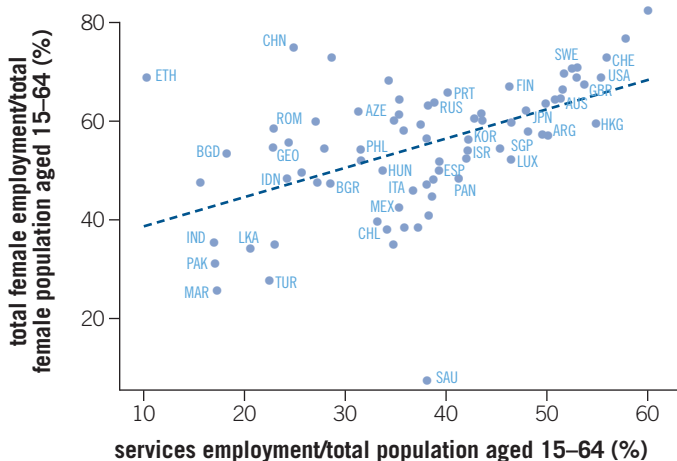
Sources: Bangladesh: “Key Findings of Labour Force Surveys,” http://www.bbs.gov.bd/dataindex/l_force_05.pdf; and various editions of the *Statistical Yearbook*. India: Sivasubramonian (2004) for earlier years and Bosworth, Collins, and Virmani (2007) for the more recent period. Pakistan: International Labour Organization’s LABORSTA, 2008; and State Bank of Pakistan (2005). Sri Lanka: up to 1989, International Labour Organization’s Key Indicators of the Labour Market; from 1990 onward, various editions of “Labor Survey Reports.”

Figure 6. Growth in Average Daily Earnings, India, 1999–2000/2004–05



Source: Kundu and Mohanan 2009.
 Note: “Agriculture” includes agriculture, forestry, and fishing; “mining” includes mining and quarrying; “utilities” includes electricity, gas, and water supply; “trade” includes trade, hotels, and restaurants; “transport” includes transport, storage, and communications; and “finance” includes financial intermediation, real estate, and business.

Figure 7. Female Employment Goes Hand in Hand with Increased Services Employment, 2005



Source: Ghani and Kharas 2010.

urban migration taking place in India. This internal rural-urban migration and links between rural and urban labor markets allow the modern impersonal services sector in India to contribute to overall poverty reduction, even though modern services are concentrated in urban areas.

Currently, South Asia suffers from one of the lowest female labor force participation rates in the world. Only about one third of all working-age women in India, Pakistan, and Sri Lanka actually are working or looking for work. Internationally, countries with high employment in services tend to have the highest participation of women in the labor market (figure 7). The development of services industries, therefore, brings new workers into the labor force, making the contribution to aggregate growth even larger.¹

The employment of women has a special role in reducing poverty. Incomes of households where women have jobs are significantly higher. Higher household incomes and enhanced economic status for women in turn reduce the number of children per household, drive higher levels of education and health care for those children, and increase household savings and the ability to accumulate assets that generate additional income.

Is Services-Led Growth Sustainable?

But can services-led growth be sustained? Yes, because the current globalization of services is only the tip of the iceberg (Blinder 2006). Services is the largest sector in the world, accounting for more than 70 percent of global output. The “Service Revolution” has altered the characteristics of services. Now services can be produced and exported at low cost (Bhagwati 1984). The old ideas of services being nontrans-

portable, nontradable, and nonscalable no longer hold for a host of modern impersonal services that are moved across borders over the Internet, digitized and stored electronically, and scaled into giant global businesses. Developing countries can sustain services-led growth because there is enormous space for catching up and convergence.

India’s development experience offers hope to development latecomers. The marginalization of Africa during a period when China and other East Asian countries grew rapidly led some people to wonder if latecomers were doomed to failure. Many economists considered the poorest people—the “bottom billion”—to be trapped in poverty (Collier 2007). The process of globalization in the late-20th century led to a strong divergence of incomes between those people in economies that industrialized and broke into global markets and the bottom billion people in some 60 countries where incomes stagnated for 20 years. It seemed as if the bottom billion would have to wait their turn for development until the giant industrializers, like China, became rich and noncompetitive in labor-intensive manufacturing.

The promise of the Service Revolution is that countries do not need to wait to get started with rapid development. There is a new boat that development latecomers can board. The globalization of services provides alternative opportunities for developing countries to find niches beyond manufacturing where they can specialize, scale up, and achieve explosive growth—just like the industrializers. The core of the argument is that as the services produced and traded across the world expand with globalization, the possibilities for all countries to develop on the basis of their comparative advantages expand. Comparative advantages can just as easily be in services as in manufacturing or, indeed, in agriculture.

Note

1. In this regard, services play a role similar to labor-intensive manufacturing exports in East Asia. There, garments and electronics assembly jobs have been filled largely by women moving out of low-productivity self-employment on family farms.

About the Authors

Ejaz Ghani is an economic adviser in the South Asia Poverty Reduction and Economic Management Network at the World Bank; Homi Kharas is a senior fellow at the Brookings Institution and a former chief economist of the East Asia and Pacific Region at the World Bank, Washington, DC.

This note is a summary of *The Service Revolution in South Asia*, published by Oxford University Press.

References

- Baumol, William J. 1967. "Macroeconomics of Unbalanced Growth: The Anatomy of Urban Crisis." *American Economic Review* 57 (3): 415–26.
- Bhagwati, Jagdish N. 1984. "Splintering and Disembodiment of Services and Developing Nations." *World Economy* 7 (2): 133–44.
- Blinder, Alan S. 2006. "Offshoring: The Next Industrial Revolution?" *Foreign Affairs* 85 (2): 113–28.
- Bosworth, Barry, Susan M. Collins, and Arvind Virmani. 2007. "Sources of Growth in the Indian Economy." Working Paper W12901. National Bureau of Economic Research, Cambridge, MA.
- Chenery, Hollis B. 1960. "Patterns of Industrial Growth." *American Economic Review* 50 (4): 624–54.
- Collier, Paul. 2007. *The Bottom Billion: Why the Poorest Countries Are Failing and What Can Be Done About It*. Oxford, UK: Oxford University Press.
- Ghani, Ejaz, ed. 2010 *The Service Revolution in South Asia*. New York: Oxford University Press. <http://www.us.oup.com/us/catalog/general/subject/Economics/Developmental/Regional/~~/dmlldz11c2EmY2k9OTc4MDE5ODA2NTExMQ==>.
- Ghani, Ejaz, and Homi Kharas. 2010. "The Service Revolution in South Asia: An Overview." In *The Service Revolution in South Asia*, ed. E. Ghani, 1–32. New York: Oxford University Press.
- Kaldor, Nicholas. 1966. *Causes of the Slow Rate of Economic Growth of the United Kingdom*. Cambridge, UK: Cambridge University Press.
- Kundu, Amitabh, and P. C. Mohanan. 2009. "Poverty and Inequality Outcomes of Economic Growth in India: Focus on Employment Pattern during the Period of Structural Adjustment." Presentation at the Organisation for Economic Co-operation and Development's seminar, "Employment Outcomes and Inequality: New Evidence, Links and Policy Responses in Brazil, China and India," Paris, April 8. <http://www.oecd.org/dataoecd/60/42/42560797.pdf>.
- Sivasubramonian, S. 2004. *The Sources of Economic Growth in India: 1950–1 to 1999–2000*. New York: Oxford University Press.
- State Bank of Pakistan. 2005. *Handbook of Statistics on Pakistan Economy 2005*. Karachi, Pakistan.
- UNIDO (United Nations Industrial Development Organization). 2009. *Industrial Development Report 2009: Breaking In and Moving Up: New Industrial Challenges for the Bottom Billion and the Middle-Income Countries*. Vienna, Austria.