Rural Structural Transformation: The Case of the Services Sector in India

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This paper examines whether any of India’s high-productivity, high-income growth in the services sector is occurring in rural India, and if so, to what extent. It addresses three questions: (a) While India has experienced high economic growth led by the services sector over the last decade, to what extent has rural structural transformation taken place? (b) How has the Indian services sector performed in the context of the General Agreement on Trade in Services and how is this reflected in rural India? (c) To what extent has the rural workforce gained from the IT revolution?

The most dynamic sector in the last decade globally has been the services sector. India is said to have outpaced a number of countries with its growth in the services sector, powered by software and business process outsourcing (BPO) services. A large share of the export growth in the country is also fuelled by the growth of the services sector.

The increase in services sector was visible even in the 1990s. There was, however, a debate on this growth as to whether this was growth-led or low-productivity residual employment crowding into the sector due to poor agricultural growth and the slowing down of the manufacturing sector. However, in the beginning of 2000s, India had gone through an economic boom and the services sector was clearly surging ahead. What concerns us in this paper is whether much, or any, of this high-productivity, high-income growth in the services sector is occurring in rural India.

This paper addresses three questions in the paper.

1. While India experienced high economic growth led by the services sector, to what extent has the structural transformation in rural areas taken place?

India has seen a spurt in the export of services. How does the Indian services sector perform in the context of General Agreement on Trade in Services (GATS)? How is this reflected in the rural scenario?

The information technology (IT) and BPO revolution is considered as the engine of the recent growth in the services sector. To what extent, has the rural workforce gained from this revolution?

1 Structural Transformation

1.1 Growth and Share of GDP and Employment

According to the Planning Commission (2008), the “Report of the High Level Group on Services Sector”, the services sector has been the key driver of the fast growth of the Indian economy in recent years. The Indian economy grew at a rapidly increasing rate from nearly 6% in 2001 to 9.7% per annum in 2006-07; the services sector outstripped this growth rate in most years. Since 2005, services sector growth had been closer to 11% per annum (National Accounts Statistics (NAS)). The services sector was seen as the new engine of growth, replacing manufacturing (Dasgupta and Singh 2005). India’s performance was also contrasted with that of China where industry, with an emphasis on mass production, led to the country’s rapid growth (Li et al 2003).

A traditional structural change was also not visible in India. Even in 2000, the services sector contributed nearly half of India’s gross domestic product (GDP). The share of services grew...
to nearly 60% of India's GDP in 2008-09. The share of agriculture (a primary sector) fell sharply from 25% of GDP in 1999-2000 to 17% in 2008-09, while industry maintained its position with about 25% (NAS).

While the share of GDP in agriculture fell rapidly from 25% in 1999-2000 to 26% in 2004-05, and to 17% in 2008-09, the share of employment fell from 60% to 57% only during 1999-05. In rural areas, nearly three-fourths of the workforce is still dependent on the agricultural sector as the main source of livelihood, with industry and services each constituting 13% of the share of employment. Industry and services have grown in the rural sector as well. Indeed, while the agricultural sector has a large share of employment with a low share of income, it is the services sector that has more than a 50% share of GDP, while employing only a quarter of the workforce in India. The services sector has been dynamic and productive, and has helped sustain India's high growth rates in the last decade.

2 India's Export in Services in the Context of GATS

The Indian services sector has experienced rapid integration with the world economy. India's export in services increased dramatically in the last decade, from $16 billion in 2000 to nearly $73 billion in 2006 (Reserve Bank of India 2006). It grew by an average annual rate of 12% during the same period. The growing direct foreign investment (FDI) flows to the services sector also facilitated India's integration into the world economy (Chanda 2007). India has shown global competitiveness in Mode 1 that is cross-border supply of services, primarily in computer and IT-related services and BPO. However, its share in the world trade in services is minuscule, rising from 1% in 2000 to 2.7% in 2006. With the rapid growth in services in the past few years, India's export in services outdid its import in services since 2004, obtaining a trade surplus in the current account (Reserve Bank of India 2006).

With the advent of this new technology, an interesting shift has occurred in the composition of India's export of services, a move away from traditional sectors like transport and travel to new sectors like software and business services. The rise in IT-related software and non-software services began around 1997 and picked up sharply in 2000 (Figure 1). Among these new services, software accounted for the largest share, nearly 45% of all exports in 2008. Among the non-software miscellaneous services, business services had the largest share, nearly 20% of all exports in 2006-07, which declined slightly in 2008-09. The other components were financial services and communication, which rose to 4.2% and 3.2%, respectively in 2006-07 (Figure 2).

Trade via Mode 3 implies commercial presence through movement of capital. In recent years, India's outward FDI (OFDI) is steadily increasing and dominated by exports of services particularly by non-financial services such as communication, software and business services (Pradhan 2011). Services sector's share increased from 18.1% in 2000-01 to 30.2% in 2005-06. Some Indian companies are setting up subsidiaries in segments like software and health.

3 Growth of the Services Sector and Its Composition

The Planning Commission (2008) noted that while the growth of the services sector was broad based, certain services such as communications, of which telecommunication was the principal component, and insurance and banking grew more rapidly. We found that while the overall growth in GDP in services was closer to 11%, that of communications was nearly 26%, and that of banking and insurance was 15% in 2007-08 (NAS).

Further, the overall share of the services sector in GDP grew from 49% to 57%. The share of the traditional sectors such as trade, hotels and restaurants and transport remained stagnant while that of communications and banking and insurance sectors grew. These latter segments are the new dynamic services.

The nature and delivery of communications has seen major changes under the new policy measures regarding the IT industry. Finance, insurance and business services have benefited from new technologies.

4 Rural Transformation

Economic diversification has been occurring in the various sectors in India, which is a clear evidence of dynamic structural change. To what extent is this reflected in rural areas? Or, is the dynamism, particularly in the modern services sector, restricted to urban areas? A rise in the share of the services sector is often followed by a subsequent rise in total employment. In the Indian case, services sector-led growth has failed to create a significant number of jobs in the economy (Bangar 2006). While we had noted a faster rate of growth of services in GDP in India, we found that the growth of employment was higher in industry than in services (Table 1, p 198). This could imply that, on the whole, the services sector is more productive than the industry sector. Overall, employment growth in services was marginally lower in urban areas (2.5%) compared to rural areas (2.6%) in the period 1993-94 to 2007-08 (Table 1).

In the industry sector, employment in the construction industry grew the fastest. In the services sector, employment...
growth was highest in rural and urban areas in the dynamic new sectors of communications, finance and business services. In the recent period in these dynamic sectors, growth in employment was lower in urban compared to rural areas. It would appear that the new and modern industry with rapid export growth potential was growing more rapidly in rural and urban areas, but more productively in urban areas.

5 Share of Rural in Total Income and Employment

The NAS does not report the rural-urban composition of net domestic product ( NDP) on a yearly basis. It generally reports the rural composition only when there is a series of changes in the GDP estimation. We, therefore, were able to get estimations of the share of rural in total NDP for the years 1970-71, 1980-81, 1993-94, 1999-2000 and 2004-05 (Table 2). At the aggregate level share of rural area in the NDP had been shrinking from 62% in 1970-71 to 54% in 1993-94 and it reduced further to 48% in 2004-05. Agriculture, forestry and fishing were confined almost entirely to the rural areas, and these sectors had declined only marginally, as may be expected, over the period 1970-71 to 1999-2000. Thereafter, agriculture increased its share by around 2% points in 2004-05, while forestry and fishing continued their previous declining trend during the same period. Within industry, the share of rural manufacturing in total NDP rose from 25% to 42% between period of 1970-71 and 2004-05. Within rural manufacturing, the share of rural income in both the organised and unorganised sectors appeared to have risen. It seems that manufacturing was increasingly becoming a rural activity or the main source of income for the rural people. The share of income from construction in rural areas remained more or less constant. The share of utilities increased from 30% to 45% in 1999-2000 and then declined to 33%.

The sectoral transformation in income is more prominent in the services sector. Among the traditional services trade, hotel and restaurant maintained its share at around 30% from 1980-81 to 1999-2000 and then drastically jumped to 41% in 2004-05. The other traditional services such as railways retained their contribution to the rural income since 1980-81. The rural share of other transport services fluctuated, growing sharply in 2004-05. The share of storage sector declined continuously to 14%.

The dynamic and new services sectors that we identified earlier showed a marked decline in their share in income in the rural areas. The share of the communication sector in NDP in rural areas declined from 35% to 17% in 2004-05, the lowest level since 1970-71. The share of banking and insurance declined from 19% to 14% during 1970-71 to 2004-05; and that of real estate and business services declined from 48% to 36% during 1970-71 to 2004-05 (Table 2). Other personal services, such as education and health, showed a significant decline in their share in income in rural areas, falling from 42% in 1980-81 to 36% in 2004-05 and the share of public administration and defence declined from 34% to 16% during the same period. Except trade, hotel-restaurants and transport; the share of other services segments either declined or remained unchanged.

This raises questions about the nature of the structural transformation occurring in India. Is this new rr-led communications and services industry mainly concentrated in urban areas? Does...
this imply that rural India is not sharing the fruits of the new services sector-led growth of the economy?

A similar shift in the share of employment in the services sector is also noted. The share in total rural employment in manufacturing declined marginally and the share of traditional services such as trade and hotels and restaurants remained more or less the same during the period from 1993-94 to 2007-08 (Table 3).

The share of employment in rural areas in the dynamic sector of communications fell from 42% to 34%, and that of banking and insurance fell from 30% to 18%, in the same period (Table 3). It would appear that the share of both income and employment in the new sectors led by the dynamic export-oriented growth was restricted to urban areas. Hence, we would argue that the benefits of this rapid growth in more productive and high-income-earning sectors were not obtained in rural areas.

6 IT Revolution in Rural India

The analysis of the growth in exports, incomes and employment in the Indian economy has led us to believe that the most dynamic segments of the economy are the IT-led sectors of communications, banking and insurance, and business and professional services. The latter include both IT-enabled services (ITeS) and BPOs. We also found that these segments are growing faster and more productively in urban areas compared to rural areas.

It has been argued that the IT labour market has been deepening and thickening (Basant and Rani 2004). Labour market deepening occurs through extension and penetration into new areas, when diversity in the demand and supply of skills is enhanced. With increasing specialisation and expanding scale, the demand for skills in specific segments grows, which is referred to as thickening. To what extent have these processes in the IT-related skilled labour market growth occurred in rural areas?

The number of IT workers has been growing. IT workers can be classified on the basis of occupation and industry. The overall share of IT workers in rural areas was very low, being 11% in 2004-05 and declining since 1993-04 (Table 4). Furthermore, the distribution of IT occupations into computing professionals computing assistants/operators shows a striking difference in the nature of the work performed by IT workers in urban and rural areas. In urban areas, nearly a third of IT workers were professionals even in 1993-94, while they accounted for nearly 9% in rural areas in 2004-05 (Table 5). IT workers in rural areas were employed as less qualified data processing or machine operators. However, a change can be detected in recent years with more skill-intensive IT jobs such as programming and system analysis indicating a distinct increase in the share in rural areas (Table 4). The share of computing professional was around 9% in 2004-05 which surged to 28% in 2007-08, while the share of IT assistant and operators saw decline from 91% to 71% in this period (Table 5).

The lack of diversity in IT-related occupations in rural areas as compared to urban areas is also noted in the classification by industry groups. The variety of industries in which IT workers were engaged in rural areas were restricted to manufacturing, business services, public administration, and more recently, trade and communications (Table 6, p 200). Furthermore, while the proportion of IT workers in the manufacturing sector in rural areas increased, the proportion of those in the business services sector declined. More recently, in 2004-05 and 2007-08, some new areas of IT penetration were noted in rural areas, mainly in finance, insurance and computer-related activities. Thus, small changes in the nature of activities and penetration of IT into the rural areas are noted in the past few years.

Overall, it appears that the process of labour market deepening and thickening occurred mainly in urban areas. However, in recent years a slow transformation of the IT sector or the movement of IT workers into varied industries in rural areas has been observed. The IT and BPO industry is slowly moving into and recruiting employees from small towns and large villages, as such labour is found to be cheaper and this improves profits.
The most dynamic sector in the last decade globally has been the services sector. India is said to have outpaced a number of countries with its growth in the services sector, powered by software and BPO services. A large share of the export growth in the country is also fuelled by the growth of the services sector. We identified communications, banking and insurance, and business services as the most dynamic segments of the services sector. It appears that the share of both income and employment in these new sectors was restricted to urban areas. However, the economic growth in the more productive and high-income-earning services were not obtained in rural areas. However, the workforce has not gained much from the labour market deepening in the IT sector. We, therefore, argue that the benefits of rapid economic growth in the more productive and high-income-earning services were not obtained in rural areas. However, the signs of change are visible in the structure of incomes and employment in rural areas in the recent years. It remains to be seen if these changes become strong enough to create more dynamism in rural India and structurally transform it.

NOTES
1 A more detailed version of this paper is available as Institute of Rural Management Anand, Working Paper No 223, December 2010. This version of the paper has however been updated to include data for 2007-08.
2 Computed from unit-level records of NSS (National Sample Survey) 50th, 55th, and 61st rounds.

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Bang, Rashmi (2006): “Statistical Overview of India’s Trade in Services” in Rupa Chanda (ed.), Trade in Services and India: Prospects and Strategy (New Delhi: Centre for Trade & Development (Centad) and Wiley India).