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# UNIT 11 FEATURES OF SERVICE SECTOR\*

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## 11.0 OBJECTIVES

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After reading this unit, you will be able to:

- delineate the constituents of the ‘services sector’;
- outline the two basic features of ‘services sector’;
- discuss the trend in the sectoral share of GDP over the period 1950-2014 in India;
- compare the recent (2013-17) growth profile of services sector with that of agricultural and industrial sectors;
- explain the features of major constituent sub-sectors of the broad services sector in India ;
- write a note on ‘informal services sector’; and
- present an international profile of employment-GVA shares of services sector with its implications for policy challenges in India.

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## 11.1 INTRODUCTION

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No industry can be set up in an area where roads/banks are not available. A product purchased cannot be used well if its after sale service is not

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\* Ms. Vishaka Goyal, Asst. Professor, Sharda University

guaranteed. Some Services or the other is thus inevitably required to support the two principal sectors of the economy viz. agriculture and industries. On the basis of total range of economic activities, therefore, the economy is classified into three sectors viz. the primary sector, the secondary sector and the tertiary or the 'services sector'. The 'primary sector' refers to those activities which are based on the products derived from natural resources like agriculture, mining, forestry, fishery and other products which are directly derived from nature. The 'secondary sector' produces finished goods by infusing a value addition to the products of primary sector used as raw material. The secondary sector requires the use of heavy machinery to process/manufacture different goods. The third leading sector of the economy is the 'services sector' which does not produce any tangible goods, but performs crucial services or actions that cannot be seen, felt, tasted or touched as objects or goods. It comprises different industries like warehousing, transportation, information, investment, banking, insurance, etc. The sector is also known as tertiary sector as it is the third tier in the three sector classificatory framework of an economy. Since it supports other sectors, it is important for an economy to develop this sector. The range and responsibility of this sector is much widespread as services touch the lives of every person, every day be it in the field of food services, communications, travel, amusement parks or critical service required for human development viz. education and health services. The process of human capital formation made by the latter two sectors (which together constitute the 'social sector') is going to determine the real output of the other two sectors viz. the primary and the industries sector. Schools, colleges, hospitals, skill development centres all come under this sector. Services are needed both for the corporate as well as the household sector. With this background, let us now proceed to know in more detail about the 'concept and scope' of 'services sector'.

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## 11.2 CONCEPT AND SCOPE

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Service industry or 'services sector' is made up of entities that earn their revenue through selling products or offering services. It comprises retail, transportation, distribution, etc. crucially needed for industrial development. It includes services of sectors engaged in the task of converting human beings into 'human capital'. The sector is largely a non-commodity producing sector different from the primary and the secondary sectors. The basic characteristic of services sector is 'non-transferability' which means the services are produced either for a particular person or for a group of people. For instance, banking service is produced either for an individual person or for a particular firm. A bank operates for a number of persons but the services provided for each individual is exclusive to each other. Hence, services rendered for each individual is a customised service which cannot be transferred by the recipient to any other person. The characteristic of non-transferability can be seen in other sectors like health and education. One cannot transfer the benefits of health and education acquired by an individual to others as they

need to be acquired by each individual independently. We can relate the characteristic of non-transferability of the other services sectors like transportation, communication, etc. in a similar manner. Implication of this feature (non-transferability) of services sector is heterogeneity. This means that services are produced differently for different persons/firms or services cannot be produced in a bulk to be distributed evenly for all.

Another feature of services sector is 'non-storability'. This means these services cannot be stored for future use. Unlike in the manufacturing sector where stocks are maintained to meet unexpected future demand, services cannot be stored to meet future needs. For instance, consultations of a doctor can vary from disease to disease and from individual to individual. The nature of consultancy may depend on the skill or competency of a doctor and on health parameters of an individual. The same medicine can be reactive for same disease in different individuals. This is the reason that skilled manpower is the basic requirement for the development of services sector. However, recent developments in communication technology is a boost to the growth potential of services sector as services can now be provided to people located in distant locations. A doctor can give his consultation by interacting with his patient over video-call or a chartered accountant can give his advice to his clients in a similar manner. The services sector can thus extend its services beyond the national boundaries. There is not only a growing market for services but there is an increasing dominance of services in economies worldwide. The tremendous growth and economic contribution of the services sector have drawn increasing attention to the issues and problems of the services sector industries. With globalisation, the services sector has emerged with a diverse approach with the service organisations ranging in their size and operations [from huge international corporations (e.g. airlines, banking, insurance, telecommunications, hotels, freight transportation) to a vast array of locally owned and operated small businesses like restaurants, laundries, taxis, etc.].

### 11.2.1 Share in GDP

At the time of independence, the share of services sector in the GDP of India was less than 30 percent (Table 11.1). Over the next 30 years, it increased gradually to touch 40 percent by 1980. As a newly independent country, India was predominantly agrarian. Hence, the share of agriculture in GDP was also the highest (more than 50 percent in 1950). Over the years, its share in India's GDP has come down by more than 30 percent (16 percent in 2019). The corresponding share of industry has increased from about 15 percent in 1950 to about 30 percent in 2019. Presently, the share of services sector is the highest among all the three sectors of the economy (54.3 percent in 2019). In other words, the primacy of place occupied by agriculture in 1950 is since replaced by the services sector. But this is only about the GDP share but not the employment share (in employment agriculture's share has come down from 70+ percent at the time of independence to 43 percent in

2019 whereas services sector's has increased from about 15 percent to 32 percent).

**Table 11.1: Sectoral Share in GDP (%) – 1950-2019**

Sector	1950	1960	1970	1980	1990	2000	2014	2017	2019
Agriculture	55.3	47.6	42.8	37.3	30.9	21.8	20.7	18.2	16.1
Industry	14.8	19.6	21.3	22.3	23.3	24.5	28.3	28.4	29.6
Services	29.8	32.8	35.9	40.3	45.7	53.7	51.1	53.3	54.3

**Source:** National Income Accounts.

**Note:** Base for 2014-19 is 2011-12 prices and for previous years it is at 2004-05 prices.

### 11.2.2 Growth Profile

In terms of inter-sectoral growth (Table 11.2) particularly in the more recent years (2013-19), both agriculture and industry have doubled their growth (agriculture from 1.4 percent in 2012-13 to 2.7 percent in 2018-19 and industries from 3.6 percent to 7.5 percent). The intervening year of 2015-16 was marked by a higher growth rate for both the industries and the services (the former by 9.5 percent and the latter by 9 percent). This shows that the two years of 2016-17 and 2017-18 were unfavourable for the performance of both these sectors in general. Two major factors identified by several studies for this slowdown are the effect of demonetisation and implementation issues of GST. The low per-capita income in Indian agriculture, owing to higher share in employment but declining share in GDP, has compelled people to look for alternative avenues of employment in the non-farm sector in general. With the efforts of government on education and training of the masses, and policies pursued to promote non-farm activities, the workforce has shifted from agriculture to non-agricultural occupations. There is a decline of 17 percent employment in agriculture over 2000-2019 (from 60 percent in 2000 to 43 percent in 2019). This decline is almost equally absorbed by the other two principal sectors i.e. 8.5 percent by industries and 8.2 percent by services (vide Table 3.4, Unit 3, Course BECE 145).

**Table 11.2: Growth Rate (%) of Principal Sectors in India**

Sector /Year	2012-13	2015-16	2018-19 (PE)
Agriculture	1.4	2.1	2.7
Industries	3.6	9.5	7.5
Services	7.9	9.0	7.6
<b>GVA (%)</b>	<b>5.4</b>	<b>8.0</b>	<b>6.6</b>

**Source:** Economic Survey 2019-20, Vol. 2, Table 1.5 B, page A 13.

**Note:** PE = Provisional Estimates.

Factors Contributing to Services Sectors' Performance and Continued Issues Associated with the Sector: Ever since the introduction of new economic reforms in 1991, the services sector has experienced a stimulus for its growth. This is on account of policy impact like increased privatisation, removal of FDI restrictions and streamlining of the approval procedures. These reforms gave new opportunity to the services sector to work in the globalised world. The international exposure became an important factor to contribute for the growth of the services sector in India. Technological progress has also made its contribution in this regard. Thus, availability of skilled manpower, coupled in particular with the developments in communications sector, contributed to India's taking advantage of outsourced services from the developed to the developing countries. In other words, India could offer comparative advantage in terms of wages and skilled manpower. The growth of India's services sector, its rising contribution to GDP and its increasing share in trade and investment are thus the principal reasons why, unlike other countries where economic growth led to a shift from agriculture to industries, the structural shift in India took place straightaway from agriculture to the services sector. This is despite the fact that our educational standards had been producing school leavers, under graduates and higher level professionals at a sub-optimal (called non-employable) level. This recognition, revealed from many surveys and reports, led to focused measures of reform being taken in the education sector in India. As a result, as per the India Skills Report of 2019, the all India level employability of B. Tech. and B. E. graduates has improved to 63 percent in 2018 from its level of 42 percent in 2017. Similar improvements have been there in other professional programmes like MBA. Among other factors, initiatives introduced in providing market driven training programmes have contributed to this shift. An internship linked certification of graduates from these programmes has been identified as being at the core of this structural change.

**Check Your Progress 1** [answer within the space given in about 50-100 words]

- 1) State the two basic characteristics of the 'services sector'. Which of these two characteristics imply heterogeneity in services produced and why?

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**Service Sector**

2) Due to the very nature of services sector, which particular factor is more crucial for its development? And what changes have come about in this respect recently?

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3) In comparison to 'industries', how would you rate the growth of services sector over a long term time frame?

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4) What factors have contributed to the surging ahead of services sector particularly in the post-reform years of 1990s?

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5) What factors have contributed to higher growth by some constituent sub-sectors of services sector than some other constituent sectors of services in India?

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6) What does the short term more recent growth trend of major sectors in India reveal?

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## 11.3 CONSTITUENT SUB-SECTORS

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The services sector comprise of sub-sectors like: (i) trade, hotels and restaurants; (ii) transport, storage and communication; (iii) financial, real estate and business services; and (iv) public administration, defence, law and order and judiciary; etc. A more popular term ‘trade in services’ has recently entered literature in the context of WTO. Let us first know more about the important sub-sectors of services sector first.

### 11.3.1 Trade and Transport Services

Trade refers to sale and delivery of products or service. When such trade is based in different countries it becomes ‘international trade in services’ which mainly constitutes ICT (Information and Communication Technology) services. ICT services have increased Indian exports many fold providing an increase in India’s trade surplus. Service exports have contributed to inclusive economic growth by increasing the number of well-paid jobs and by reallocating labour to high-productivity sectors. They have also increased tax revenues of the government which enables government to spend more on development works. This has also stimulated domestic demand for goods and infrastructure owing to increased per-capita income of workers in such services. An important sub-category of trade is the ‘transport sector’. This sector comprises of roadways, ports, highways, rail and aviation. Transport services have domestic as well as international demand. Aviation sector has good potential under the new FDI norms in India for boosting the growth of ‘tourism sector’. Hotels and restaurants are another major sub-sector linked to the ‘tourism sector’. All these sub-sectors of the larger ‘services sector’ have one thing in common i.e. they have immense potential for innovation and growth.

### 11.3.2 Financial, Real Estate and Business Services

The financial sector constitutes the banking sector, stock exchange and insurance sector. Since the year 2001, the banking sector has grown at a compound rate (i.e. average annual compound rate) of 10-12 percent per annum. In particular, the ‘mutual funds’ segment of this sector has yielded a return of 9 to 12 percent over the period 2016-18. India’s life insurance business ranks fifth among the largest global markets with a growth rate of more than 20 percent. The non-life insurance sector (e.g. automobiles) has grown at 15 percent. The insurance sector was opened up for private investment in 2016 and the market has become competitive with the entry of global players. This has contributed to strengthening its risk management capability. With ever growing demand for housing and commercial space, stimulated by rapid urbanisation, the Indian real estate sector has become one of the fastest growing sectors of the emerging markets. It has attracted significant participation of foreign investors. Another major sub-sector is the ‘business and professional services’ which includes computers, research and

development (R&D), accounting and legal services. This sector too has both international and domestic demand. The share of business services in India's GDP has registered a combined growth rate of 13.5 percent in 2011-12. Among business services, R & D occupies the second position in India's GDP with growth being consistently high (around 20 percent). India has competitive advantage in R&D with active involvement of both public and private sectors.

### 11.3.3 Public Administration, Defence and Other Services

In modern democracies, public services are undertaken by civil servants and are motivated by the demand for services of the growing society. National defence is one such service which requires huge public expenditure. In 2013, India has approved an increase in FDI limits of defence sector for the first time. Since then there is remarkable growth in this subsector. In 2017, the annual real GVA in public administration and defence services sector was 11.3 percent of GDP. This was 6.9 percent in 2016. The sub-sector of 'public administration' is a stagnant sector with its average growth rate on the sector having remained more or less the same since the 1980s. This means the above increase from 6.9 percent to 11.3 percent (in just one year) is entirely due to the defence sector increase. The composition of these three sectors in the overall GVA (i.e. considering their total GVA as 100 percent) is: trade, hotels, transportation and communications (47 percent), financing, insurance, real estate and business services (27 percent) and personal services (26 percent). If we consider the share of these three sub-sectors in the total economy's GVA (i.e. by taking primary + secondary + tertiary as 100 percent), their respective percentage shares in 2017 is: trade, hotels, etc. (7.3 percent), financial, real estate, etc. (6.5 percent) and public administration, defence, etc. (11.2 percent). In other words, in 2017, the three sectors together accounted for 25 percent of GVA to the country. Note that here we are talking of GVA which is 'value of output minus value of input' whereas when we talk of 58 percent share of services sector to GDP we are considering only the 'value of output'.

As said earlier, in the context of WTO, the term 'trade in services' refers to the 'Agreement on Trade in Services'. The Agreement defines the services in terms of four modes of supply. The first mode covers services supplied from one country to another (e.g. business processing outsourcing services). The second mode covers individual consumers or firms making use of some services in another country (e.g. international tourism). The third mode covers a foreign company setting up subsidiaries or branches to provide services in another country (e.g. a bank setting up a branch overseas). The fourth mode covers individuals travelling from their country to supply services in another country (e.g. a consultant travelling abroad to provide an IT service).



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## 11.4 INFORMAL SERVICES SECTOR

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Formal (or organised) sector of economy is defined as those business entities which are governed by the rules and regulation of the government and pay taxes. Such rules relate to protecting the employees social security needs (e.g. minimum wages, paid holidays, health coverage, old age pension, etc.). There is a large segment outside this formal sector called the informal (or unorganised) sector which operates outside the government's rules and regulation and pay no taxes. Both in organised and the unorganised sector, every employee has different contract. For instance, in a private limited company some employees are the permanent staff while many others are daily wagers. The services of daily wagers can be terminated on any day and come under the informal sector of employment. Similar can be the case of small partnership firms where only few employees have formal terms of employment while most others would be informal employees. While formal employees have job security, medical facilities, social security (pension) provision from the employer, those working as informal employees do not enjoy such benefits.

Many people are compelled to work in this sector due to lack of training/formal education and opportunities. But the sector is important not only because it generates income-earning opportunities for a large number of people but also, in the process, contribute significantly to the GDP of the country. The sector thereby plays an important role in poverty alleviation. The National Commission for Enterprises in the Unorganised Sector (NCEUS) has defined the informal/unorganised sector as all unincorporated private enterprises owned by individuals or households engaged in the sale and production of goods and services operated on a proprietary or partnership basis and with less than ten workers including self-employed workers. Examples of such informal occupational services sector category include: midwives, domestic workers, fishermen, barbers, vegetable and fruit vendors, cobblers, news paper vendors, etc. Together, they constitute a large proportion of the total workforce employed in the country. Informal sector plays a significant role in both the rural as well as the urban economy. Among the segments providing their services to urban consumers we can identify occupational categories like: tailors, physically handicapped self employed persons, rickshaw pullers, auto drivers, carpenters, electricians, plumbers, tannery workers, etc. The composition of total employment (combined of all three sectors) in the organised vs unorganised sector in India was in the proportion of 13 : 87 in 2004-05. This position had changed to 17 : 83 in 2011-12 . This shows an increase in organised sector employment from 13 percent in 2004-05 to 17 per cent in 2011-12 with a corresponding decline in informal employment from 87 to 83 percent. The proportions indicated are as per the two NSSO rounds for 2005 and 2012. The corresponding change in the distribution of formal and informal workers in the services sector alone (between 2005 and 2012) was from 4.7 percent to 5.8 percent for formal

workers and from 18.7 percent to 21.0 percent for informal workers. Thus, there is a marginal increase of formal employment (i.e. an increase of 1.1 percent) as compared to a far larger increase in the informal employment share (i.e. an increase of 2.3 percent). The results of NSSO surveys are often available with a substantial time lag and the proportions indicated are illustrative of the broad trend.

#### **11.4.1 Intermediate Services Sector**

Dynamic services sectors, such as engineering and research and development, have seen rapid productivity growth globally in recent years. Most of such services are helping the manufacturing sector and are thus part of final goods. In particular, research and development (R&D) helps contribute to develop new products as well as upgrade the existing ones. In this sense, R&D services contribute to cross-border services in and are intermediate services in nature. For instance, a mobile phone can be considered as trade in goods. It is a tangible good used by final consumers. But without the contribution from service industry, the mobile phone industry has no existence. We all have seen frequent changes in the models and features of mobile hand-sets. For their manufacturing, many components are supplied by tiny units employing less than 10 workers in the informal sector establishments. Once they are finally made, transport and logistics services help the products to reach their final destination. Modern day products are thus bundles of value added goods with contribution from many services sector enterprises and workers. There are some services which are directly consumed by final consumers but many services need not have the nature of a tangible product. They are in the nature of pre and after sale services.

#### **11.4.2 Employment**

Agriculture continues to be the predominant occupation for more than 45 percent of the total workers in India. A large section of them belong to the informal sector i.e. agricultural labour or belonging to the small and marginal farmer class. The employment share of the services sector is in the range of 25-30 percent (Table 11.3) in India. If we compare the trend of employment in services sector in India with that in other developed and developing countries, the share of employment in the services sector in India is observed to be the lowest. A noticeable trend in this regard is that there is a convergence in the share of GDP and employment in other countries but it is not so in India. India is thus a total outlier with its share of services sector's share in GDP being nearly two times that of its employment share (it having touched close to 58 percent for some years). This implies a far higher level of labour productivity in the services sector relative to that in the other two sectors i.e. the primary and the secondary sectors. While this by itself is not adverse, the indirect implication for increasing the productivity levels of primary and secondary sector activities gets underscored here. Some of the other implications are as follows.

**Table 11.3: Inter-Country Profile (%) of Contribution of Services Sector in Gross Value Added and Employment**

Country	GDP (2015)	Employment (2016)
India	53.2	28.6
China	49.7	42.4
Mexico	60.4	61.2
Brazil	72.0	68.9
United Kingdom	79.9	80.0
United states of America	79.3	80.0

Source: ILOSTAT database.

Owing to the services sector’s six-plus percent annual growth rate over the last several decades, there is a continuous increase in the middle class segment (estimated to be about 200 million people) in India. This has been increasing the demand for semi-luxurious goods and educational services at primary, secondary and higher secondary levels. The implementation of the Goods and Services Tax (GST) is expected to create a common national market reducing the overall tax burden. This is expected to reduce costs in the long run resulting in reduction of prices of services. This is a favourable trend with multiplier benefits for growth and production of services sector. However, there are disparities in ‘access to services’ for large proportion of the poor in India who do not have access to basic services like health and education. This needs due policy attention on social sector expenditure and outcomes. The share of services sector in India’s total trade is higher than the global average and India is figuring among the top 10 WTO member countries in services exports and imports. This calls for enhancing India’s export competitiveness in services sector with appropriate strategies on the policy front.

**Check Your Progress 2** [answer within the space given in about 50-100 words]

1) State the constituents of trade and transport sector.

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2) What are the constituents of ‘financial sector’?

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3) Mention the sub-constituents of ‘business and professional services’.

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4) What has been the extent of reduction in the proportion of informal sector workers in the Indian economy?

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5) What is meant by ‘intermediate services sector’?

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6) What is a particularly noticeable trend in the employment structure of ‘services sector’ in India when viewed from an international perspective?

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7) What are the three major implications for policy in light of higher growth trends of ‘services sector’ in India?

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## 11.5 LET US SUM UP

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The 'services sector' comprise of many sub-sectors of which the three major ones are: (i) trade, communications and transport; (ii) financial, real estate and business services; (iii) public administration and defence. Many of these sub-sectors have shown very good growth potential in recent years. Even as a whole, the services sector in India has maintained a consistent growth rate of 6.2 percent average over the last 7 decades. This has further steepened during the post 1990s and 2000s in which many of the sub-sectors have grown at rates in the range of 10-20 percent. As a result, the share of the services sector in India's GDP has touched 58 percent (for some years) from its share of 30 percent in 1950. Such huge growth potential needs harnessed by appropriate government policies and public expenditure. This requires expansion of infrastructure and social sector spending.

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## 11.6 KEY WORDS

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**Gross Value addition** : It is the measure of the value of final goods and services produced in an industry or sector of an economy.

**Gross domestic Product (GDP)** : It is a monetary measure of the market value of all the goods and services produced in a country during a financial year.

**Foreign Direct Investment (FDI)** : Refers to investment made by a firm or individual in one country in businesses located in another country generating physical asset.

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## 11.7 SOME USEFUL BOOKS AND REFERENCES

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- 2) Kaushik Basu (ed), (2010). The Oxford Companion to Economics in India. Oxford University Press, New Delhi.
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- 4) Bhagwati, Jagdish N. (1984). "Splintering and Disembodiment of Services and Developing Nations", The World Economy, Volume 7, Issue 2, pages 133–144, June 1984.
- 5) Hansda, S. K. (2001). "Sustainability of Services-led Growth: An Input-Output Analysis of Indian Economy", RBI Occasional Working Paper, Vol. 22, No. 1, 2 and 3.

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## 11.8 ANSWERS/HINTS TO CHECK YOUR PROGRESS EXERCISES

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### Check Your Progress 1

- 1) Non-transferability and non-storability. Non-transferability implies heterogeneity because it means each individual has to be serviced differently and not in a combined manner for a group.
- 2) Skilled manpower supply of a continuing nature is the most important factor. But due to technological advancement particularly in the ICT sector, national boundaries are proving no more barriers to services sector's expansion and growth.
- 3) Growth rate is calculated to the base. A low base helps achieve higher growth initially. The 0.4 percent increase is on a continually ever increasing size of GDP. The long term growth profile of industries and services, over the period 1951 to 2015, is close to each other (6.1 percent for industries and 6.2 percent for services). Despite this seemingly close growth rate, this is also indicative of a faster growth over higher bases by the services sector as opposed to relatively slower growth of industries over lower base values.
- 4) Privatisation, removal of FDI restrictions and streamlining of the approval procedures.
- 5) Technological progress and significant government expenditure.
- 6) That the 'services sector' has kept up its faster pace while there is improvement in the agricultural and the industries sector too.

### Check Your Progress 2

- 1) ICT, road, rail, ports, highways, aviation, hotels and restaurants and tourism.
- 2) Banking, stock exchange and insurance.
- 3) Computers, research and development (R&D), accounting and legal services.
- 4) From about 90+ percent in the 1990s to about 47 percent in 2005.
- 5) They refer to services provided by tiny enterprises and are in the nature of pre and after sale services.
- 6) That there is no convergence between its share in employment and contribution to GDP. There is a huge divergence with employment being in the range of 25-30 percent and contribution to GDP from services being 58 percent.
- 7) Boost the productivity of primary and secondary sectors in order to reduce the inter-sector productivity levels, expand social sector spending so as to meet the demand for semi-luxury and educational services and adopt policies for reducing disparities in 'access to services' by large sections of poor and to enhance India's export competitiveness.