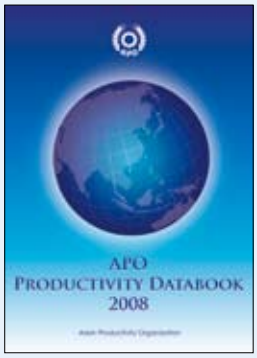
Reading productivity and economic trends

Part 6: The evolving role of the service sector

Eunice Y.M. Lau, visiting research fellow at Keio Economic Observatory, Keio University, and Koji Nomura, Associate Professor at Keio Economic Observatory, Keio University



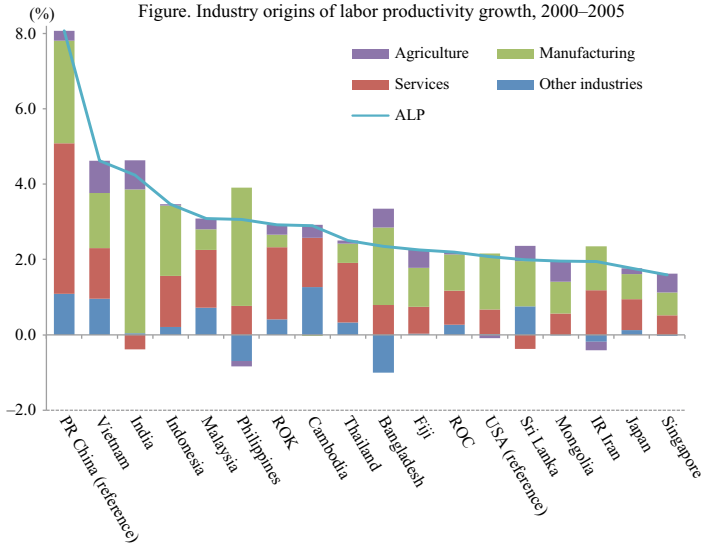
Traditionally, technological advances tend to favor manufacturing more than services, resulting in the former sector being the engine of productivity growth in an economy. Services, in contrast, have been perceived as the technologically stagnant sector. If its relative claim on resources in the economy is rising, overall productivity growth will be dragged down to the rate prevailing in the stagnant sector. When this so-called Baumol's disease takes root, economic growth is doomed to decline.

In recent years, however, a cure for Baumol's disease has started surfacing in empirical evidence, which points to the emerging capability of some service industries to capitalize on information and communication technologies (ICT) and achieve productivity growth. J.E. Triplett and B.P. Bosworth (*FRBNY Economic Policy Review*, September 2003) declared that, "Baumol's disease has been cured." This assertion was based on their findings that in the USA, labor productivity growth in the service industry equaled the economywide average in the latter half of the 1990s, driven by an unprecedented surge in total factor productivity growth. In short, services are no longer the sick industries in terms of productivity growth.

The pervasive nature of ICT has meant that its impact is not reserved for manufacturing but also can transform service industries. ICT is also seen as a disruptive technology, productive assimilation of which often requires a major overhaul of business practices. The role of ICT in service industries is twofold. First, it provides an enabling technological platform to create and launch new service products. As ICT fundamentally improves the efficiency of data and information processing, its effective exploitation not only leads to an expansion of product possibilities but also creates new business formats and new industries selling service functionality. Second, by providing a cost-effective, time-efficient, borderless medium to store, present, and transmit information, ICT networks together with digitalization have helped make information and knowledge more marketable and breach the physical barrier of national boundaries. If supported by trade liberalization efforts, the international market offers these IT-using service industries new business opportunities and scope to reap economies of scale, which are unavailable to traditional services.

The service sector accounts for the biggest share of total value added in Asian countries, independent of their stage of development (Table 8, *APO Productivity Databook 2008*). The accompanying figure shows contributions of the service sector to labor productivity growth during 2000–2005, which were particularly prominent in India, accounting for just under 90%. At 5.8% on average per year, services were the sector with the highest labor productivity growth in India. This is consistent with the well-documented economic surge of India in the 1990s via its IT-based high-tech information services, which flourish on human rather than physical capital. By providing new ways to compete, modern ICT has allowed India to take an unusual path in economic development, bypassing a stage when manufacturing steers. Rather than being a laggard sector, service industries can be a leading sector driving productivity growth and development if ICT can be successfully assimilated and exploited.

Figure. Industry origins of labor productivity growth, 2000–2005



Group	Agriculture (%)	Manufacturing (%)	Service (%)	Other (%)
1	1.1	24.0	68.9	6.1
2	7.3	30.9	47.9	13.9
3	14.3	21.1	50.6	14.1
4	28.0	15.5	42.9	13.6
USA	1.0	12.4	77.6	9.0

Group 1 (countries with >70% of per-capita PPP-GDP level relative to the USA): ROC, Singapore, Japan; group 2 (20%– ≤ 70%): ROK, Thailand, Malaysia; group 3: (8%–<20%): PR China, India Indonesia, Sri Lanka, Fiji, IR Iran, Philippines; group 4 (<8%): Cambodia, Vietnam, Lao PDR, Bangladesh, Mongolia, Nepal, Pakistan.