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Growth of the Service Sector

What are the economic reasons behind industrialization and postindustrialization?

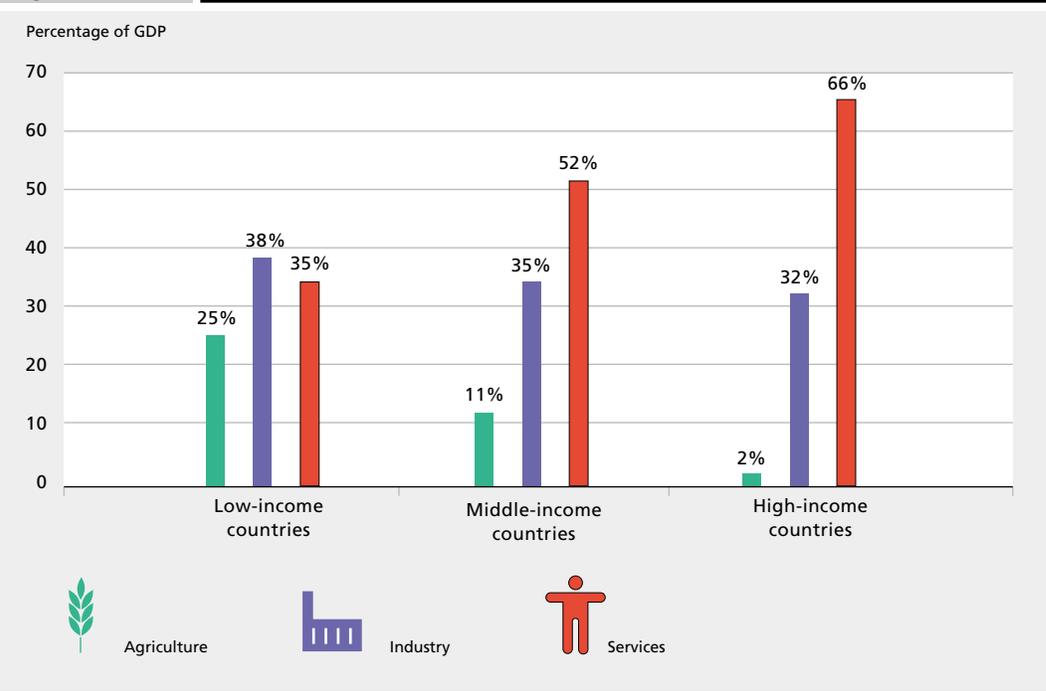
Everything that grows also changes its structure. Just as a growing tree constantly changes the shape, size, and configuration of its branches, a growing economy changes the proportions and interrelations among its basic sectors—**agriculture, industry, and services** and between other sectors—rural and urban, public and private, domestic- and export-oriented (Chapters 10, 11, and 12). Are there common patterns in how growing economies change? Which changes should be promoted and which should be discouraged? Think about

these questions while reading this chapter and the three that follow it.

Industrialization and Postindustrialization

One way to look at the structure of an economy is to compare the shares of its three main sectors—agriculture, industry, and services—in the country's total output (Figure 9.1) and employment.¹ Initially, agriculture is a developing economy's most important sector. But as

Figure 9.1 Sectoral structure of world economies, 1995



income per capita rises, agriculture loses its primacy, giving way first to a rise in the industrial sector, then to a rise in the service sector. These two consecutive shifts are called **industrialization** and **postindustrialization** (or “deindustrialization”). All growing economies are likely to go through these stages, which can be explained by structural changes in consumer demand and in the relative labor **productivity** of the three main economic sectors.

Industrialization

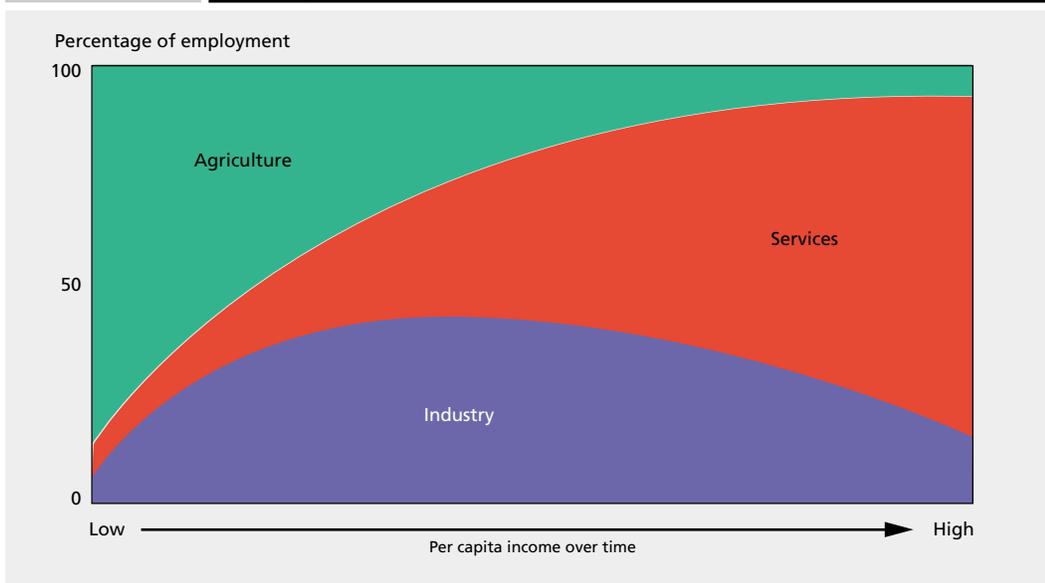
As people’s incomes increase, their demand for food—the main product of agriculture—reaches its natural limit, and they begin to demand relatively more industrial goods. At the same time,

because of new farm techniques and machinery, labor productivity increases faster in agriculture than in industry, making agricultural products relatively less expensive and further diminishing their share in **gross domestic product (GDP)**. The same trend in relative labor productivity also diminishes the need for agricultural workers, while employment opportunities in industry grow. As a result industrial output takes over a larger share of GDP than agriculture and employment in industry becomes predominant.

Postindustrialization

As incomes continue to rise, people’s needs become less “material” and they begin to demand more services—in health, education, entertainment, and

Figure 9.2 The changing structure of employment during economic development



How can growth of the service sector help make development more sustainable?

many other areas. Meanwhile, labor productivity in services does not grow as fast as it does in agriculture and industry because most service jobs cannot be filled by machines. This makes services more expensive relative to agricultural and industrial goods, further increasing the share of services in GDP. The lower mechanization of services also explains why employment in the service sector continues to grow while employment in agriculture and industry declines because of technological progress that increases labor productivity and eliminates jobs. (Figure 9.2). Eventually the service sector replaces the industrial sector as the leading sector of the economy.

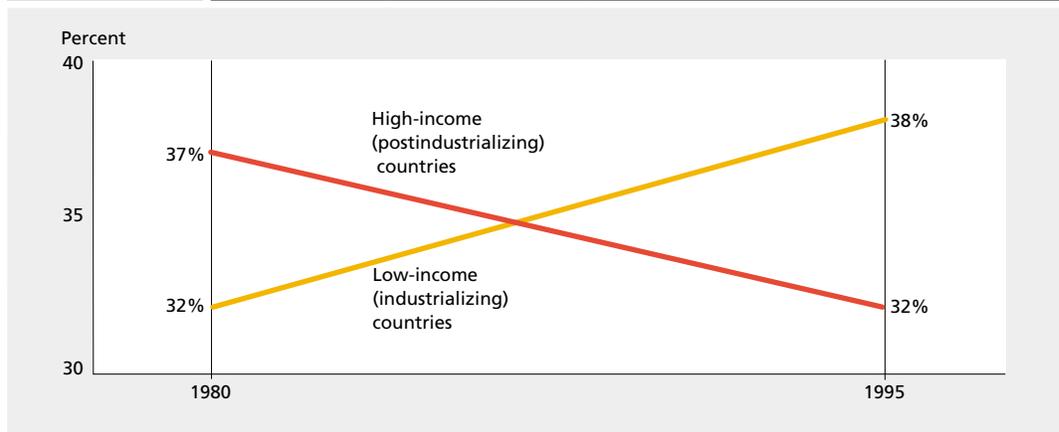
Most **high-income countries** today are postindustrializing—becoming less reliant on industry—while most **low-income countries** are industrializing—becoming more reliant on industry (Figure 9.3). But even in countries that are still industrializing, the service sector is growing relative to the rest of the

economy (Data Table 2). By the mid-1990s services accounted for almost two-thirds of world GDP (Map 9.1), up from about half in the 1980s.

Service Sector Growth and Development Sustainability

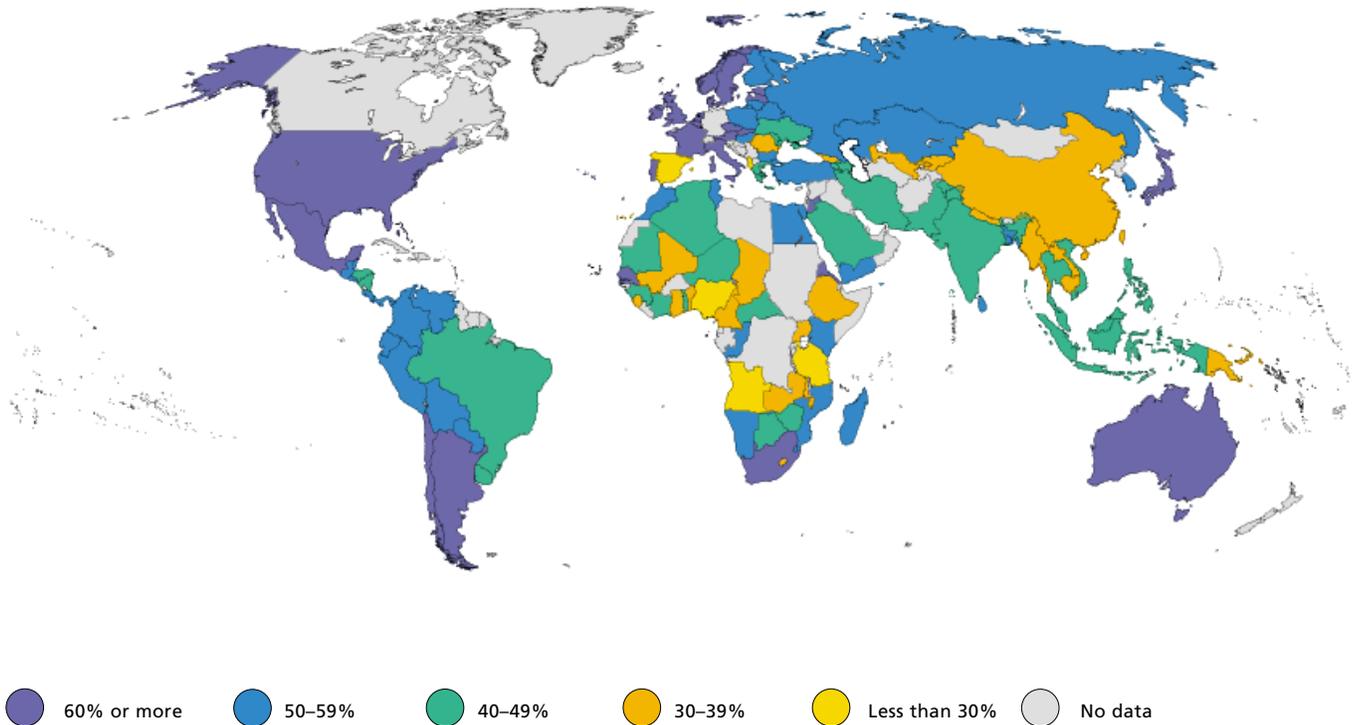
The service sector produces “intangible” goods, some well known—government, health, education—and some quite new—modern communications, information, and business services. Producing services tends to require relatively less **natural capital** and more **human capital** than producing agricultural or industrial goods. As a result demand has grown for more educated workers, prompting countries to invest more in education—an overall benefit to their people. Another benefit of the growing service sector is that by using fewer **natural resources** than agriculture or industry, it puts less pressure on the local, regional, and global environment.

Figure 9.3 Industrial output as a percentage of GNP, 1980 and 1995



Map 9.1

The share of services in GDP, 1995



Conserving natural capital and building up human capital may help global development become more environmentally and socially **sustainable**. Growth of the service sector will not, however, be a miracle solution to the problem of sustainability, because agricultural and industrial growth are also necessary to meet the needs of the growing world population.

Challenges for Transition Economies

In formerly planned economies the service sector was previously underde-

veloped because governments controlled supply and failed to respond to growing demand for services. In addition, many modern services that play an important role in market economies—such as financial, business, and real estate services—were not needed under socialism. During these countries' transition to market economies, their service sectors have grown rapidly to meet previously unfulfilled demand and the needs of the emerging private sector.

Growth of services in transition economies is particularly important

because it allows these economies to employ a share of the educated **labor force** that might otherwise be unemployed due to the economic crisis. So, in addition to continued public support for health and education, growth of services can help formerly socialist countries preserve the stock of human capital that will be crucial to their postindustrial development.

Think of the service industries that you consider particularly important for your country's sustainable development from

different perspectives—economic, social, and environmental.

Note

1. Agriculture here refers to crop cultivation, livestock production, forestry, fishing, and hunting. Industry includes manufacturing, mining, construction, electricity, water, and gas. Services cover all other economic activities, including trade, transport, and communications; government, financial, and business services; and personal, social, and community services.