# Does the Rise of the Post-industry Service Economy mean that Developing Countries can skip Industrialisation and Develop their Economies through Service Sector Development?

Lola Mariam Alli[1]

**Abstract**

An economy is said to be in a post-industrial state, when the share of manufacturing to GDP falls in favour of the service sector. Several industrialised economies are experiencing a shift from structural transformation as employment shares move away from the manufacturing sector toward the service sector. Given that such countries continue to experience economic growth beyond this transition, tends to challenge the traditional model of growth and development. Thus, can developing economies such as Nigeria's grow given a dominant service sector? This paper seeks to answer this research question. It argues that although the service sector is an important player in the development of an economy, most countries cannot achieve sustainable growth and development without a strong manufacturing base, and the success of the service sector relies heavily on the existence and success of a strong industrial sector.

## Introduction

There is a considerable difference between the past experience of industrialised economies and the present-day challenges of emerging economies in the quest of achieving sustainable economic growth and development. Today, the free market ideology dominates economic policy and planning, and for latecomers, especially African countries, industrialisation seems like a tougher goal to achieve. There is a growing concern that despite the industrial success of today's rich countries, their past experiences are no longer applicable given the current global institutional and international economic order that restricts policy freedom. Consequently, some argue that the rise of the 'post-industrial service economy' implies that developing countries can skip industrialisation for a post-industrial service economy.

A post-industrial service economy, is one where the share and role of industrial activities to GDP shrinks in favour of the service sector. It is important to note, however, that the definition of a post-industrial society leads to the mistaken conception that industries are not as important in today's economy. One must first ask, what is the role of the manufacturing and service sectors in the so-called post-industrial era. This question has become highly debated in recent times as industrialised economies experience a transition in employment away from the manufacturing industry towards the service sector (at a certain level of per capita income). Given that many of such countries have continued to grow, many wonder if developing countries can challenge the traditional model of development through industrialisation by pursuing a service sector led development model.

Declaring that we live in a post-industrial economy, is taking a Western-centric perspective. After World War II, the global economic structure of trade shifted significantly, with manufacturing becoming less important in the developed world. For example, the share of services in the 17 most developed economies grew from 43% in 1950 to 70% in 2005 (Szirmai, 2012).

[1]Consultant Research Economist for the 'Global Economic Dynamics' team at Bertelsmann Stiftung, Germany

In the developing world, the situation is rather different. From 1950 to 1980, all 67 developing countries saw their average share of manufacturing increase (ibid). This growth in manufacturing activities continued in several Asian countries through to the 2000s, which signifies a significant change in the global industrial map. Yet, the deindustrialisation in substitution for service sector-led growth is not a phenomenon for just advanced economies. Palma's (2008) empirical study shows that this transition started in the 1960s for developed countries, and was followed by the fast-growing East Asian economies in the 1980s and finally, the middle-income countries including Latin American countries, India, China and South Africa in the 1990s.

Rawthorn and Wells (1987) argued that the share of employment in manufacturing, follows a curvilinear path relative to income. Employment in manufacturing increases as incomes rise and then decreases post achieving higher levels of per capita income. Using this model, Palma's analysis provides a useful account of the inclusion of developing countries in the deindustrialisation process, post-1990. The original graph plots the employment share of manufacturing for developed countries. If data on the share of manufacturing in developing countries is also plotted on the same graph, the curvilinear shape shifts downwards from its original peak. Put simply, the shift of labour out of manufacturing in middle-income countries since 1990, reduces the income level at which global employment shares of this sector, begin to decline. At this stage, one can assume that developing countries can and have bypassed the industrialisation phase of development. Furthermore, even in the rich countries, the term post-industrial may be questioned. In proportional terms, there are fewer people employed in factories and more employed elsewhere, which has changed the structure of labour. In the economic terms, however, this does not stand. In fact, it is what Ha-Joon Chang (2011) calls the 'optical illusions' of de-industrialisation.

An optical illusion occurs, when, for example, the fall of the share of manufacturing in total output is not as a result of declining production (in absolute terms). Instead, this can be explained by a reduction in prices of industrial goods relative to the price of services, which is due to faster growth in the sector's productivity, measured in outputs per unit of inputs. Does this mean that we are consuming more services? No. Rather, in relative prices, services are becoming more expensive, therefore raising its share in total income. If the relative price effect is taken into consideration and the share of each sector is measured by constant prices, the decrease in the share of manufacturing is not that sharp. Chang (2011) shows that in the case of Britain. The observed decrease in manufacturing from 1955 to 1990, if measured in relative prices, is on the magnitude of 40% whereas if measured in constant prices, the decrease is of only 10%. In fact, in some countries, such as the US, Switzerland, Finland and Sweden, what is seen is an increase in the share of manufacturing.

The growth of the services sector is also partially an illusion, caused by changes in statistical classification. One of such is the outsourcing of non-central activities such as catering, cleaning, technical support and security guards. What was previously delivered in-house is now outsourced. Therefore, the service sector output increases without an actual increase in service activities. The other statistical change occurs by a change in the categorisation of some companies. As Chang (2011) explains, some manufacturing firms that have their share of services become predominant apply for an alteration in the classification of their activities. As such, part of what should be accounted as a manufacturing output is, then, computed as part of the service sector. There is empirical evidence to support the role of industrialisation as an engine of growth. In fact, very few of the today's advanced economies have achieved high and sustainable living standards without a strong manufacturing sector. Such countries are particularly rich in natural resources especially oil and gas or resources for tourism or are very small financial havens with small populations including Qatar, Seychelles and Monaco. What is questioned is whether the increasing importance of service-led growth in economic growth literature is applicable in today's developing countries.

India is often used as the star example for service-led growth – the 'office of the world'. Indeed, the service sector has captured a good share of GDP since 1990, and India has successfully increased its foreign exchange earnings by exporting services including customer service, ICT, accountancy, and so on. On the other hand, China is seen as the 'workshop of the world'. Thus, several authors have praised the services sector as the new frontier for growth in emerging economies. Dasguta and Singh (2005), for example, argue that the rise of ICT has improved the tradability of the service sector, giving the possibility for services such as call-centres and software to be provided from far away. The authors' claim that the share of the Indian software exports, which were almost 20% of the total share of the exports for the period of 2000 and 2004, was expected to increase to 30% by 2008. They argue that between 2004 and 2011, the surplus in services, equivalent to 0.9% of the Indian GDP covered only 17% of the deficit in the trade of goods, equivalent to 5.1% of the GDP. However, this is not sustainable on the long-term, and points to a need for India to address its trade balance issue. In addition, services as a share of international trade has been stable at a low percentage of 20 points between the 1990s and 2016, which shows that the issue of low tradability still remains an obstacle for having services as a major contribution to the balance of payments.

A more important fact, is that the services that have experienced the highest growth in the last decades, are highly dependent on the demand of the manufacturing sector. Services such as transport, ICT, management consulting and finance all have major manufacturing clients. That said, the service sector has a role to play in economic development. In South Africa for example, although the service sector is less important as a driver of productivity, the quality and cost of service inputs into manufacturing affects economic productivity and competitiveness. Furthermore, the service sector is an important source of labour absorption, acting as an 'employer of last resort'. While the manufacturing sector can generate growth, it has failed to absorb sufficient labour to tackle the country's high level of unemployment and underemployment.

A second example of a positive role played by the service sector is in the case of the UK. The British process of de-industrialisation, which started in the 1970s, has progressed at a "continuous and alarming pace" (Chang, Andreoni, Kwan, 2013), with an average decrease on the manufacturing value added as a share of GDP of 2.4% per annum for the period of 1990-2010. The rise in the exports of knowledge-based services since the 1990s played an essential role in stabilising the balance of payments, covering the country's manufacturing trade deficits. What is uncertain, however, is whether the knowledge-based services will be able to sustain a healthy balance of payments in the long run, if the industrial base continues to shrink. This is unlikely as knowledge-based services such as engineering and design rely on their connections with the manufacturing sector to gain insights from the production process. A decrease in the manufacturing sector would mean a decrease in the quality of the services developed, leading to a consequent loss in export earnings and, in the long run, could lead to lower standards of living.

As for the challenges and perspectives for developing countries, it is important to briefly explain that the process of de-industrialisation is not bad per se. De-industrialisation may occur in a 'positive' way, in which the process is a normal result of sustained economic growth and industrial dynamism, occurring in an already developed country. The patterns of structural changes in the developing world are different from the ones experienced by now developed countries. The main contrast, is that the share of services in the economy of the former group was already larger than that of the manufacturing industry, in the 1950s and 1960s. The process of de-industrialisation in several developing countries occurred at a much lower level of per capita income, than the one observed historically for today's rich countries, in a process called premature de-industrialisation.

Planning an economy in services from early on generates a slower long-term productivity growth rate, than the one of an economy based on manufacturing. Moreover, the economic structure of countries such as Nigeria threatens to erode society itself. Not only has productivity in the years since the 1990s has been falling, but, according to the NESG (2018), 'Nigeria's economic growth pattern can be simply explained by the phrase "service-led growth"'. To illustrate this, the services sector has contributed over 60% to real GDP since the early 2000s, while the industrial sectors including manufacturing and construction have accounted for only 15% (ibid). This is a major economic crisis upon which inadequate attention has been placed.

In addition to the different economic structure of developing countries, the global context of today is also distinct from what it was before. As pointed out by Palma (2008), as globalisation advances, developing countries seem less willing to implement policies and use their degree of policy-freedom. This is caused not only by a significant contraction in the space for industrial policy implementation (by the influence of the World Trade Organisation and other trade and investment agreements), but also by a shift in domestic economic ideologies. With the rise of global value chains there was a transformation in what was perceived as the "right" path towards economic development for today's developing countries. Now, the mainstream discourse claims that developing countries should shift efforts into joining such chains - by liberalising trade and investment, thus attracting transnational and multinational corporations. Trade liberalisation, however, exposes latecomer economies and local industries to unfair competition, leading to premature de-industrialisation as experienced in many developing countries today especially African countries.

In conclusion, there are good reasons to question the assumption that we live in a 'post-industrial age'. With the growing importance of knowledge-based services, manufacturing has become less prominent in current mainstream economic discourse. There is, however, strong empirical evidence, as well as theoretical arguments, that point to the fact that manufacturing is still central to economic development. As discussed, the benefits of the manufacturing sector and its growth-generating properties are several. It is the main source for technology-driven productivity growth in modern economies; it functions as the 'learning centre' of capitalism; it allows for productivity growth in other economic sectors; it influences organisational innovation across sectors; it generates demand for high productivity activities in other industries; and it has higher tradability than other sectors, generating higher export earnings (Chang, Andreoni & Kwan, 2013).

The role of other sectors in economic development should not be neglected. A dynamic agricultural sector and the availability of financial and transport services are key to successful industrialisation. To state, however, that developing countries can skip industrialisation and develop their economies through service sector development simply does not correspond to the reality that developing countries are faced with, and there exists just a handful of exceptions to the general rule that countries need a strong manufacturing sector in order to develop their economy. I would argue that to rely on services as a driver for growth is, ultimately, an uncertain development path.

The fact that all of today's rich countries developed their economies through industrialisation, while the poorest countries all have a negligible manufacturing sector is perhaps the strongest testament to this claim. Neglecting history may have lasting negative effects for those countries looking to prosper and upgrade their economy.

# References


Chang, H-J. (2011) 23 Things They Don't Tell You About Capitalism. London: Penguin Books.

Chang H-J., Andreoni, A., Kwan, M. L. (2013) International Industrial Policy Experiences and the Lessons for the UK. On: Future of Manufacturing Project: Evidence Paper 4.

Dasgupta, S., Singh, A. (2006) 'Manufacturing, Services and Premature Deindustrialization in Developing Countries: A Kaldorian Analysis', UNU-WIDER, Research Paper N. 2006/4

Dasgupta, S and Singh, A. (2005) 'Will services be the new engine of economic growth in India?', CBR Working Paper, No. 310, University of Cambridge, September 2005 (Subsequently published in a revised form in Development and Change, 2006).

NESG (2018) 'Growing Beyond Numbers: Will Nigeria's Growth Be Inclusive in 2018 and Beyond?', NESG Macroeconomic Outlook.

Palma, G. J. (2012) 'Deindustrialization, Premature Deindustrialization and the Dutch Disease', The New Palgrave Dictionary of Economics.

Rowthorn, E. R., and Wells, R. J. (1987) Deindustrialisation and Foreign Trade. Cambridge: University of Cambridge Press.

Szirmai, A. (2012) 'Industrialisation as an Engine of Growth in Developing Countries, 1950-2005', Structural Change and Economic Dynamics, vol 23, no. 4.

UNECA (2016) 'Transformative Industrial Policy for Africa', United Nations Economic Commission for Africa.