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Inflation: Service Sector

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- **Introduction**

Inflation is a situation wherein there are continuous increases in the price level of goods and services in an economy over a period of time. In a lay man language inflation, could be defined as too much of money charged for few goods or products. When generally the price rises, unit of currency buys fewer goods and inflation also reflects on reduction in purchasing power of per unit of money. Inflation is usually calculated by annualised percentage change in a general price index (normally the consumer price index) over time.

India is considered to be the large market that doesn't have a monetary policy framework. This is one of the main reasons why India mostly faces rise in inflation after the financial crisis. Common factors for inflation are GDP deflator, regional inflation, historical inflation, asset price inflation.

Most of the economists today have a low or a steady rate of inflation. Low or negative rate in inflation reduces the hardness of recession by allowing the market to adjust more quickly in a down turn and reduces the trap which prevents from monetary policy from stabilizing.

An increase in the general level of prices indicates a decrease in the purchasing power of the currency. That is, when the general level of prices rises, each monetary unit buys fewer goods and services. There are two types of effects negative and positive. Negative effect has high or unpredicted rates which can be harmful for the economy which includes cost push inflation, hoarding, social unrest and revolts, hyper inflation, allocate efficiency menu costs, business cycle etc. Positive effect includes Labour-market adjustments, discount rate, savings to money holders, Instability with deflation, financial market inefficiency with deflation and many more.

- **Few terms of inflation**

Disinflation: A decrease in the rate of inflation, say, from 3% in 2013 to 2% in 2014. Here, if a good costs you Rs. 100 in 2013, it'd cost you Rs. 103 in 2014 and Rs. 105.06 in 2015.

Deflation: Also known as negative inflation. it is a decrease in the general price level of goods and services. If the deflation rate is 2% for 2014, a good costing Rs. 100 in 2014 would cost Rs. 98 in 2015.

Hyperinflation: An extreme case when a country experiences very high and rapidly accelerating rates of inflation. This rapidly erodes the real value of the nation's currency.

People resort to holding relatively stable foreign currencies at such times, since the local currency would be used to make pyramids or be swept off the streets

- **Service sector**

The services sector has been a major and vital force steadily driving growth in the Indian economy for more than a decade. The economy has successfully navigated the turbulent years of the recent global economic crisis because of the vitality of this sector in the domestic economy and its prominent role in India's external economic interactions.

India's accelerated economic growth in recent years has been a focus of significant policy discussion and analysis. The services sector has played a pivotal role in this acceleration. Growth in services picked up in the 1980's and accelerated in the 1990's. Since then, it has become a dominant contributor to economic growth. The prime movers of the growth in services are hotels and restaurants, communication and banking and business services (computer related services, renting of machinery, accounting and research development) with recorded growth rates above 10 per cent on the average from the 1990's. There is a vast literature in economics supporting complementarily between the industry and services sector. Fast growing services like trade and transport, which are also called producer services, reflect the complementarily between industry and services sectors. Also, the importance of infrastructure in facilitating services is well recognised. We have conducted a regression analysis to test whether such a complementarily exists and the extent of such complementarily between the services and the two sectors of manufacturing and infrastructure. We have also looked at the impact of public investment in infrastructure on private investment in services.

On the service sector growth and inflation, it has been argued that a rapid growth in the services sector tends to push up the rate of inflation since the services is not a commodity producing sector. Thus, the growing complementarily between the industrial and services sectors augurs well for the medium-term growth performance of the Indian economy. The analysis also show that fears about the inflationary effect of services sector growth appear to be unfounded.

- **Inflation and Service Sector**

Inflation has a direct impact on wages. When the workers have to be paid more, it gets reflected in the high cost price of the product. However, in services there might be some slack. Inflation reduces the profit margin.

With this margin narrowed down, the companies have to pare profits that ultimately get reflected in their share prices. This leads to the investors withdrawing their invested money and go to other locales, other products or producers that offer higher dividends.

Services sector is the biggest employer with wage component of their product the highest. Agriculture if it is labour-intensive like in India, is affected by inflation and there will be a general shift to mechanised farming. In industry, when the wage bill goes up, it might lead to lay-off, retrenchment or sacking swelling the ranks of unemployed. This is bad for economy. To circumvent such undesirable effects and to reign in unemployment rate, governments and banks will be forced to take drastic economics measures.

It all can take the country into recession which is unpalatable to any government worth its salt. Redistribution of wealth suffers a serious jolt with the bottom most rung of the population having to spend higher proportion of their wages on food. In the market the real value of stock and shares and government notes gets eroded Among fast growing developing countries, India is distinctive for the role of the service sector.

Where earlier developers grew on the basis of exports of labour-intensive manufactures, India has concentrated on services. Although there are other emerging markets where the share of services in GDP exceeds the share of manufacturing, India stands out for the size and dynamism of its service sector. Sceptics have raised doubts about both the quality and sustainability of the increase in service sector activity.

They have observed that employment in services is concentrated in the informal sector, personal services and public administration, activities with relatively little scope for productivity improvement and limited spillovers. They worry that the rapid growth of service sector employment simply reflects the outsourcing to service sector providers of activities previously conducted in house by manufacturing firms; in other words, it is little more than a relabeling of existing employment than new jobs.

They thus question whether shifting labour from agriculture directly to services confers the same benefits, in terms of productivity growth and higher living standards, as the more conventional pattern of shifting labour from agriculture to manufacturing in the early stages of economic development. We find that the growth of services in India has been broad-based, although it has been unusually rapid in modern services like communications, business services and financial services. In practice, services that are tradable internationally have grown fastest.

- **Conclusions** :
  - This article has considered several explanations for the high rate of price inflection in service industries relative to manufacturing in spite of the difficulties of capturing qualities changes in services.
  - The principle of wages and price differentials between services and manufacturing seems to be the growth of demand for the services against a back ground of the low labour mobility between manufacturing and services.
  - The implication of this model appeared to be more in the line with the behaviour of wages than an alternative model that traced the inflection differential to underlying difference in productivity growth between the two sector.

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