

5th International Conference on Leadership, Technology, Innovation and Business Management

Inflation and Economic Growth: A Dynamic Panel Threshold Analysis for Turkish Republics in Transition Process

Celil Aydın^a, Ömer Esen^b, Metin Bayrak^c,^{a*}

^{a,b} *Mus Alparslan University, Mus, 49250, Turkey*

^c *Ataturk University, Erzurum, 25240, Turkey*

Abstract

This study investigates the influence of inflation on economic growth for five Turkish Republics (Azerbaijan, Kazakhstan, Kyrgyzstan, Uzbekistan, and Turkmenistan) that are in the transition period through dynamic panel data analysis based on threshold. Study results indicate that there is a nonlinear relationship between inflation and growth rate; the threshold for the influence of inflation on economic growth is 7.97%, and an inflation rate above this threshold has a negative influence on economic growth while an inflation rate below this threshold has a positive influence on economic growth. These results show that a high inflation rate will have a considerable influence on economic growth. In this regard, it is important to achieve sustainable growth which plays a crucial role in increasing the efficiency of implemented monetary policies and assuring stability. Therefore, political and economic decision-makers in transition economies do not ignore the concept of threshold within the scope of monetary policy while determining the target inflation rate in their efforts to deal with inflation.

© 2016 The Authors. Published by Elsevier Ltd. This is an open access article under the CC BY-NC-ND license

(<http://creativecommons.org/licenses/by-nc-nd/4.0/>).

Peer-review under responsibility of the International Conference on Leadership, Technology, Innovation and Business Management

Keywords: Threshold, Inflation, Economic Growth, Dynamic Panel

1. Introduction

Relationship between growth and inflation is one of the most debated and addressed issues within the historical development process of economy. Growth and inflation, which are highly influential on determining macroeconomic targets and assuring stability in an economy, are two of the main issues handled and prioritized almost in all schools of economics. In today's world, an economy that achieves no or inadequate growth is always associated with important problems such as poverty, unemployment and low welfare. Inflation, on the other hand, leads to a lot of negative influences discussed by economists. Regardless of the level of development, growth and price stability are considered

* Corresponding author. Tel. + 90-542-899-1045

Email address: celil.aydin@atauni.edu.tr

the basic performance criteria in all countries. Price stability and employment problems in an economy must be solved so that stability is assured. From this perspective, growth is one of the main phenomena contributing to employment.

The sound functioning of economic life and the sustainability of balances in an economy depend, above all, on a regular and stable structure of macroeconomic variables that make up the general economic structure. Any imbalance in the macroeconomic variables that constitute the general structure of economy negatively influences the general structure of economic life. Thus, a stable macroeconomic structure is the prerequisite for economic growth to be continuous and stable (i.e. for countries to enter in the process of sustainable growth and make it permanent) (Ercan, 2002; Yıldırım, 2003). A sound economic structure, and thus, a sustainable economic growth performance largely depend on price stability (Tari and Kumcu, 2005).

As a general definition, price stability refers to a low and sustainable inflation rate that does not influence individuals' investment, consumption, and saving decisions and preferences. The important point here is preventing the general level of prices from increasing or decreasing more than specific limit values. Price stability is the basic condition for ensuring economic and social stability in the medium and long term and assuring sustainable development. Economic, political and social structures of a country may seriously suffer if it fails to establish price stability in its economy.

Inflationary environments make it difficult to build up prospective saving, investment, production and consumption decisions, and environment of increasing uncertainty prevents economic growth. Savings, which are planned to be used for financing the development of countries in environments where inflation is volatile and thus uncertainty regarding inflation is high, are used in speculative areas for obtaining more return rather than for real investments or production. That has a negative influence on economic growth by causing real investments in economy to shrink.

In addition, while inflation brings about a fall in real investments by reducing the profit of producers on one hand, it wears off their purchasing power on the other hand. Thus, price stability in an economy confronts us as an important factor increasing growth potential to turn economy into a developed, more efficient and functional one. On the other hand, increases in the general level of prices not only negatively affect consumption, investment and growth by increasing unambiguity, but also widen the gap between income groups more by disrupting social distribution of income (i.e. causing a deterioration in the distribution of income against fixed income groups) (Şiriner and Doğru, 2005). In general, economies with high inflation rates have lower average growth rates in comparison to those with price stability. Therefore, price stability, which has important influences on investment and consumption, must be ensured for a steady and sustainable growth. All in all, ensuring price stability will bring about economic stabilization, lead to a high and sustainable increase in growth, and consequently improve people's quality of life.

The influence of inflation on growth has been frequently discussed in economy literature for a long time. The content of such discussions has varied by the period (conjuncture) undergone by the world economy. State started to play an active role and implement interventionist policies after the great depression in 1929 in both developed and developing countries. As policies increasing aggregate demand were implemented, both production and inflation increased. Inflation was not considered a problem in that period. It was even thought that inflation had a positive influence on growth.

When the monetary system called Bretton Woods, which was indirectly gold-indexed ended in the 1970s, it was started to be discussed how the value of money whose supply was completely left to the control of central banks would be preserved. In that period, a rapid monetary expansion was experienced in many countries including developed countries. As a result of monetary expansion, inflation rates reached double-digit numbers. High inflation and low growth environment resulting from debt crises and supply shocks undergone in the 1970s and 1980s began to strengthen the idea that there is an inverse relationship between these variables. In addition, the fall in growth rate along with continuing increase in inflation rate in many countries made the argument that inflation positively influences growth was controversial.

Price stability as an economy policy became number one target in many developed and developing countries in the course of time. In that period, it was accepted by all segments that a strong and sustainable economic growth in the long term is possible only if price stability is achieved. As a matter of fact, today, the central banks of a lot of countries directly or indirectly target inflation in order to ensure price stability and determine their policies accordingly. This is because, as the 2008 global crisis emerged in countries which had achieved price stability and when it was understood that price stability was not enough to ensure an automatically steady economic growth, the relationship between inflation and growth started to be investigated again.

Today, the generally accepted view is that inflation has a negative influence on growth in the medium and long term. Nobody argues that making prices steady is something wrong or is not of priority. However, what is optimal

Download English Version:

<https://daneshyari.com/en/article/5126348>

Download Persian Version:

<https://daneshyari.com/article/5126348>

[Daneshyari.com](https://daneshyari.com)