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Examining the Effects of Inflation and Unemployment on Economic Growth in Iran (1996-2012)

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Abstract

The present study examined the role of inflation and unemployment on economic growth from 1996 to 2012. In this study, the effect of inflation and unemployment on economic growth in two short-term and long-term phases was investigated and examined using Autoregressive Distributed Lag (ARDL) Model. Microfit version 4.0 and Eviews version 6.0 were used for model estimation. Model estimation results showed the significant and negative effect of inflation and unemployment on economic growth in long term, which indicated that inflation and unemployment decreased economic growth in long term. This issue revealed that authorities should diligently endeavor and plan to reduce and control inflation and unemployment. The results of this study can be used by all respected authorities in Iran, especially authorities of economic and social institutions, so that they could attempt to reduce and control unemployment and inflation in order to achieve economic growth

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Keywords: inflation ; unemployment; economic growth and ARDL approach

1. Introduction

In recent decades, main factors of economic growth were significantly studied. Meanwhile, inflation and unemployment and their impacts on economic growth were considerably investigated because these economic characteristics are explicitly highlighted in developing countries, particularly in Iran.

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Many scholars believe that controlling inflation and unemployment has a significant role in economic development of various societies, which was discussed by economists. However, the impact, effectiveness mechanism and short-term and long-term effects of inflation and unemployment on economic growth were not thoroughly examined. Therefore, it is essential to examine inflation, unemployment and their economic effects from 1996 to 2012.

2. Research Objectives

Given that economic growth and development are the main objectives of any economic system such as Iran, short-term and long-term effects of inflation and unemployment on economic growth should be examined. Better recognition of the effect of inflation and unemployment on economic development of the country and more appropriate allocation of resources and facilities could better control inflation and unemployment, which might result in an increase in economic growth and development. Thereby, short-term and long-term effect of inflation and unemployment on economic growth in Iran was discussed in this study.

3. Materials and Methods

In the first step, the concept and role of inflation and unemployment in economy were investigated through library studies. In the second step, data processing system, PDS, yearbooks of Statistics Center of Iran as well as balance sheets of the central bank were used for data collection. In the third step, econometric models were used to investigate the effects of inflation, and unemployment on economic growth.

For this purpose, static status of the model variables were checked with available tests[†]. In the next step, Auto – Regressive Distributed Lag (ARDL) Model was used in order to investigate and analyze both long-term and short-term relationships of inflation and unemployment with economic growth.

The study was organized as follows. In introduction, research objectives and methods are discussed. In the next section, the role of inflation and unemployment in theories of economic growth and development is investigated. In addition, a review of literature is given. In the next section, analytical model and model estimation results are presented. In the next section, conclusions is given.

4. Examining the Role of inflation and unemployment in economic growth and development

It is essential to identify and explain two concepts of inflation and unemployment in economy for economic decision-making. A significant part of economic literature is dedicated to this issue. Inflation refers to a sustained rise in general price level. Inflation can affect all aspects of a country through influencing economic growth, employment, investment, distribution of income and wealth, and even social and political conditions. Inflation and unemployment, i.e. stagflation, were the most economic problems in Iran in recent decades. As a result, there was no longer a successive relationship between inflation and unemployment. In such circumstances, implementation of monetary and fiscal policies for realization of policy-maker goals was no longer possible. Therefore, it is essential to implement infrastructure policies, which differ from conventional politics.

Involuntary job interruption and long-term unemployment with no opportunity to find a job rise when the labor market is not in equilibrium (labor wages do not match equilibrium wages in the labor market (Aram, 2003). In other words, unemployment occurs when labor cost (wage) is above final returns due to some reasons. In this case, unemployment rate would be regarded as a function of population growth rate (Kianmehr, 2006).

The relationship between inflation and unemployment in economy has always been controversial. Most economic studies in this field have been ambiguous and associated with confounding results. Although a negative relationship

[†] Since several model variables were static level, Johansen cointegration method could not be used. Instead, Auto – Regressive Distributed Lag Model was used.

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