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Trade-off Between Inflation and Unemployment for BRICS Countries – Dead or Alive?

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ABSTRACT

This paper attempts to investigate the existence of unique trade-off between inflation and unemployment in BRICS countries during the current scenario. Using the yearly data of inflation and unemployment rates of BRICS countries from 2001 to 2010, the existence of tradeoff has been examined by using different statistical tests like correlation test, regression analysis test, t-test, ANOVA test. By applying all the tests, it is found that there exist poor positive correlation between inflation and unemployment for BRICS countries, showing that there is absence of trade-off between inflation and unemployment in BRICS countries.

KEYWORDS: Inflation, unemployment, Phillip curve, trade-off, BRICS Countries

A. Introduction

"Unemployment and inflation still preoccupy and perplex economists, statesmen, journalists, housewives, and everyone else..."

James Tobin

What James Tobin noted in the 1970s still holds true until today. Over the last two decades one of the most striking phenomenon for many developed and developing countries is rising and prolonged long term unemployment. On other hand many countries have experienced short run tradeoff between inflation and unemployment. The existence of short run tradeoff between inflation and unemployment can be used by policy makers for making significant policy decisions aimed at controlling inflation or unemployment. So this is an area creating research interest to study the existence of short run trade of between inflation and unemployment as explained by Phillip curve.

The Phillip curve shows inverse relationship between rate of inflation and rate of unemployment. Stated simply, the lower the unemployment in an economy, the higher the rate of inflation and higher the unemployment lower the inflation.

This paper is aimed at studying the existence of short run tradeoff between inflation and unemployment in BRICS countries including Brazil, Russia, India, China and South Africa. The paper is organized as follows: A brief introduction is followed by a review of theoretical and empirical literature, and a discussion of research methodology, sources of data and statistical tools and techniques used in the research study. Subsequently results derived and findings are discussed at length and finally conclusion is offered.

B. Literature Reviews

This section covers review of literature from some of the important research papers, studies and articles as published by different authors.

1) N. Gregory Mankiw (2000) concluded that inflation unemployment trade off has secure place in economics. Monetary policy influences unemployment, at least temporarily, and determines inflation, at least in the long run. He also concluded that The so-called "new Keynesian Phillips curve" is appealing from a theoretical standpoint, but it is ultimately a failure. It is not at all consistent with the standard stylized facts about the dynamic effects of monetary policy, according to which monetary shocks have a delayed and gradual effect on inflation.

2) Ravindra H. Dholakia and Amey A. Sapre (2011) their study at tempted to answer the question whether a trade of f exists between inflation and unemployment in India. They concluded that a trade of f does exist in the choice between inflation and unemployment in the short-run in the economy. The findings show that the conventional Phillips remains absent even on account of control ling for supply shocks, but clearly emerges as we incorporate the extended part into the basic Phillips curve framework.

3) Andrew Atkeson and Lee E. Ohanian (2001) in their research found that for the last 15 years, economists have not produced a version of the Phillips curve that makes more accurate inflation forecasts than those from a naive model that presumes inflation over the next four quarters will be equal to inflation over the last four quarters.

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5) Ricardo Llaudes (2005) in his study found that unemployment duration matters for inflation dynamics, and that the long-term unemployed have a smaller effect on inflation. Moreover, the impact of the long-term unemployed is not found to be uniform across countries. He also concluded that information on unemployment duration can help improve the policy maker's assessment of the dynamics of inflation.

6) Tobias Linzert (2005) analyzed how wage growth has been related to unemployment in euro area countries. Found that not only did macroeconomic shocks and labor market institutions individually affect equilibrium unemployment, but also the interplay of shocks and institutions was identified as an additional channel through which the movement of the euro area unemployment rate can be explained. Moreover, an increase in the availability of venture capital has been found to reduce unemployment.

7) Jon W. Eller and Robert J. Gordon (2002) concluded that, low inflation in the late 1990s can be completely explained by a decline in the NAIRU, due largely to structural changes in labor markets, and to a set of beneficial supply shocks that have effects that are quantified. The hypothesis that "The Phillips Curve is Dead" has been rejected, both in statistical tests that allow the coefficient on unemployment in the inflation equation to shift toward zero in the 1990s, and in the continuing evidence of a strong and robust positive relationship between the inflation rate and the rate of capacity utilization as an alternative measure of economy wide "tightness."

C. Research Methodology

This section of research paper includes an overview of research methodology adopted for conducting research.

1) Objective of the study

The primary objective of this study is to investigate the existence of short run tradeoff between inflation and unemployment in current scenario for the BRIC countries including Brazil, Russia, India and China. In this study an attempt has also been made to determine the effect of inflation on unemployment in short run.

2) Data and Methodology

The research study has been conducted by taking the figures of rate

of inflation and unemployment rate of the selected countries for the period 2001 to 2010. The inflation and unemployment figures have been obtained from various sources like CIA world fact book and indexmundi.com etc. The relationship between inflation and unemployment is studied by using following statistical tools like,

- Pearson correlation coefficient
- Regression Model
- t – Statistics to test the significance of the slope of the regression line
- f – Statistics to test the significance of the regression model

3) Hypothesis

H0: Correlation between inflation and unemployment is not significant ($r = 0$)

H1: Correlation between inflation and unemployment is significant ($r \neq 0$)

H0: Slope of regression model is equal to zero ($b1 = 0$)

H1: Slope of regression model is not equal to zero ($b1 \neq 0$)

D. Empirical Results

This section includes data interpretation and analysis of relationship between inflation and unemployment for BRICS countries by using statistical tests mentioned in research methodology.

1) Correlation and Regression Test

Country	Correlation			Regression
	Calculated Value	Tabulated Value	Hypothesis	R Square Value
Brazil	0.5382	0.4444	Null Rejected	0.171792897
Russia	0.1096	0.4444	Null Accepted	0.012031492
India	0.3522	0.4444	Null Accepted	0.124077069
China	0.09282	0.4444	Null Accepted	0.008616643
South Africa	0.09129	0.4444	Null Accepted	0.008334183

Result of correlation test show that null hypothesis for all countries except Brazil has been accepted. This means that there is no significant correlation between inflation and unemployment for all the BRICS countries except Brazil. Looking at the degree of correlation, it is highest for Brazil (58.32%) and lowest for South Africa. The average correlation for all the BRICS countries is 23.68%. Except Brazil for all other BRICS countries there exist poor positive correlation between inflation and unemployment during short run. Presence of positive correlation itself shows the absence of trade off between two variables under study. So correlation test proves absence of short run trade off between inflation and unemployment for BRICS countries.

Average R-Square value for all the BRICS countries is 0.06497. This means that average 6.49% variability in unemployment can be predicted by variability in Inflation, showing very low impact of inflation on unemployment. The low impact of inflation on unemployment again proves absence of short run tradeoff between inflation and unemployment for BRICS countries. R Square value is highest for Brazil (17.17%) and is lowest for South Africa (0.83%)

2) T-Test and ANNOVA Test

Country	T – Test			F – Test (ANNOVA)		
	Calculated Value	Tabulated Value	Hypothesis	Calculated Value	Tabulated Value	Hypothesis
Brazil	1.28818465	2.306	Null Accepted	1.659419692	5.32	Null Accepted
Russia	0.312128327	2.306	Null Accepted	0.097424093	5.32	Null Accepted
India	1.064529762	2.306	Null Accepted	1.133223613	5.32	Null Accepted
China	0.263689733	2.306	Null Accepted	0.069532275	5.32	Null Accepted
South Africa	0.259294822	2.306	Null Accepted	0.067233804	5.32	Null Accepted

Calculations in above table show that null hypothesis is accepted for both T-Tests and F-Test for all the BRICS countries. This means that the regression model is not adding to the explanation of the variation of dependent variable, showing poor ability of inflation in predicting unemployment. So result of T-Test as well as F-Test also proves absence of short run tradeoff between inflation and unemployment for BRICS countries.

E. Empirical Findings

This section reports the empirical findings of different tests.

1. From the correlation test it has been found that there is positive poor correlation between inflation and unemployment during 2001-2010 in BRICS countries
2. Results of Regression test reveals that the inflation is having low impact on unemployment for BRICS countries during the study period.
3. By applying t – test and f – test it has been found that regression model is not adding to the explanation of variation of dependent variable (Unemployment) for all the BRICS countries.

F. Conclusion

This paper examines the existence of short run tradeoff between inflation and unemployment for BRCIS countries by taking inflation and unemployment data for the period of 2001 to 2010. After applying different tests we find that there is poor positive correlation between inflation and unemployment for all the BRICS countries. As the presence of positive correlation proves absence of trade off between two variables it can be concluded that inflation unemployment tradeoff for BRICS countries is no more alive.

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