
Investigation of Relationship between Contraction and Expansion Budget on Iranian Private Sector Investment Risks from 1981 to 2011

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ABSTRACT

This research surveys relationship between contraction and expansion budget on Iranian private sector investment risks from 1981 to 2011. The establishment of central banks by industrial nations aimed at money value retaining with gold standard and limited trade with other states which were using gold standard. To achieve this goal, central banks decided to determine as a part of gold standard the interest rates based on which charged their debtors and other banks. The gold standard almost requires monthly adjustment and settlement. This research showed that Iranian economic growth rate (5.1%) equals that of states with low income and is far to reach East Asia developing states (8.9). meanwhile it's a bit higher than average growth rate of developing states in Latin America (3.1), Middle East (4.3%), Africa (4.6), and Europe (5%). As well among selected states this rate for Iran is lower than states like china (10.3%), India (7.1%), UAE (5.8%) and Russia (5.5%), although being lower than states including Saudi Arabia (3.4%), Venezuela (3.9%), turkey (3.8%), Brazil (3.3%). Korea (4.4%), and Libya (4.3%). This comparison suggests that state average economic growth rate is relatively low. Many problems are indicated when investigating per capita production trend and Iranian economic growth rate as well as comparing it to other states. Low per capita production in Iran regarding state potentials makes the problem which suggests low economic welfare. Indeed, Iranian per capita production and thus economic welfare will grow up if economy experiences a long term of high economic growth rate and stability.

Keywords: Contraction, Expansion Budget, Private Sector Investment, Risk.

Introduction

The monetary policy is defined based on the relationship between interest rate (the money based on which one can borrow

money) within state economy and total amount of money supply. In order to impact on items like economic growth, inflation,

currency rate, and unemployment, the monetary policy enjoys various instruments to control one or both of these two items. Monetary authorities, in conditions that a certain state has exclusive money publication and/ or money publishing banks work connected to the central bank, are able to change the money supply and thus interest rate to accomplish objectives of monetary policy. Monetary policy is a process through which the monetary authorities of a country often control and harness the money supply aimed at interest rate adjusting in order to economic growth, relative sustainability and stability of prices and to decrease unemployment. There are generally two kinds of monetary policies; contraction and expansion, based on which money supply is adopted to accomplish special objectives within different conditions. Money, within contraction policy, is more than usual and challenging with unemployment within an economic recession by way of interest rate reduction hoping to attract merchant's confidence is to expand economic activities. The aim of inflation reduction within an expansion policy is to prevent asset values from dawn falling and deviation. Monetary policy is distinct from financial policy which is related to tax issues, governmental expenses, loans and liabilities and government credit affairs within the economy. Investments an economic growth and development engine is of great importance within all countries. More production and increased investments are required for economic growth. Within recent decades, about 12% of state domestic gross production has been dedicated to the investment which is not considerable comparing to countries like South Korea, turkey and Pakistan. (Hosseizadeh, Bahreini; 1383).

Trusting to announced monetary policy by policy makers is highly important. If activists of private sector (consumers and economic

institutes) believe that policy makers are decisive to decrease the inflation, they will predict price fall down in future (the way of their expectation formation is different issue. For example, compare logic expectations by adjusted ones). If a worker or staff expected prices to rise, he/ she would sign a high salary enabling contract with the employer to adjust these prices. Therefore, the salary expectation impacts a contract between employee and employer. Thus, the activists of private sector to obtain a low level inflation should believe that what is announced will indeed be reflected within coming policies. While determining the salary, lack of these beliefs within private sector agents' may result in high level inflation to be predicted and salary to rise. Salary rise would mean consumers' demand promotion (inflation coming from demand pressure) and economic institutes expenses to grow up. Therefore, if the announced policies of policy makers aren't acceptable, the policy won't have desirable effect and result.

Problem Statement

If policy makers believe that the private sector agents predicted low level inflation, there would appear incentives to adopt expansion monetary policies which lead to inflation swelling. As a result, they will expect high inflation (unless otherwise they can have their policies efficiency about low inflation to be accepted). This prediction is performed through adjusted expectations (salary determination method); therefore, there is a high level inflation (without any result in yield promotion). Thus, lack of private sector believe in policies will result in contraction monetary policy to fail. Adopted policies validation occurs in different ways. Independent central bank establishment is one of these ways aimed at holding the inflation in a low level (regardless of production level). Therefore, private sector's agents know that the inflation will be in a low

level because this policy is traced by an independent board. Central banks may create motives to accomplish these goals. For example, more budgets or remuneration makes bank manager to increase his reputation (reliability) and to commit firmly to policy goal. Reputation is a significant factor to perform monetary policy. But the idea of reputation shouldn't be misunderstood as commitment. While a central bank may have a desirable reputation because of good performance in monetary policy implementation, the very central bank may choose none of commitment forms (like determining a certain range for inflation). Reputation plays a major role determining this subject that up to what extent markets believe in a certain policy announcement to accomplish their goals but these implications shouldn't be considered similar. Also note that the policy maker under logic expectations isn't required to demonstrate his/her reputation through previous measures and policies. For instance, credibility of central bank manager may be derived from his ideology, career background and general accomplishments and etc. In order to remove some of damages associated to instability at the time of policy implementation (within a high inflation context), the central bank manager should in average stay far of inflation comparing to other economic members. Therefore, a central bank manager's reputation isn't necessarily related to his/her previous performance rather it's related to special organizational settings that can be applied by markets to form the inflation expectations. Credibility, in spite of extensive discussion about credibility which is associated to monetary policy, has been scarcely defined in a correct form. This lack of visibility may result in this idea that monetary policy isn't practical. For example ability to serve public interest is one of aspects of monetary policy credibility which is often related to central

banks. Another aspect is trusting in what central bank contracts with. While it's a public idea that central bank must not lie, there is an extensive disagreement regarding this issue that how can a central bank work serving public interests? Thus, lack of definition (agreed upon) can make people to believe that while central bank authorities wish their policies to be trusted in, they support another policy. There is a relationship between monetary policies an interest rates and credit availability. Monetary policy instruments have been included short term interest rates and bank reserves through monetary base. There have just been two forms of monetary policies for centuries: 1. Decisions about mint, 2. Decision for printing banknote to create credit. While interstates are being considered as a part of monetary value, they generally weren't in line with other forms of monetary policies. Monetary policy used to be seen as an executive decision and belonged to people having mint right. A price established by advent of vast network of trade between gold and silver and as well as local and foreign currency, this official price might have been guaranteed by law even if different with market price. Within 7th century, Jiaozi was Chinese banknote but never substituted with currencies and was used in line with copper coins. It was Yuan dynasty who used banknote as dominant money for the first time. Within last eras of Yuan dynasty regarding to deficiency of coin to provide war expenses they started to print exorbitant banknotes which ended in hyperinflation. Researcher seeks to investigate the effects of contraction and expansion budgets on Iranian private sector investors' risk.

Research Background

Soheili *et al.* (1392) had performed a research entitled "evaluation of different rates of inflation on economic growth rate and determining a threshold rate of inflation

in Iran in the form of non-linear models” and results are as following: There are different views regarding the effect of inflation rate on the economic growth rate. Some believe that the inflation rate and the economic growth rate are related negatively. Others believe that the inflation rate and the economic growth rate are related positively. Another group believes that there is a threshold for inflation rate. The relationship between inflation rate and economic growth rate is positive within rates lower than threshold. They have negative relationship within rates higher than threshold. Clarifying the way of relationship of these two variables is a significant issue in Iran that we practice in this paper. In this paper we investigated the relationship between the inflation rate and economic growth rate using periodic data of 1387-1389 applying a non-linear model. Non-linear model estimated results with CLS method indicate that there is a structural point of failure for inflation rate. It means that inflation affects growth rate in two points. Point of failure obtained for Iranian inflation rate is 10%. That is, inflation rates lower than 10% have positive and significant effect on growth but higher rates have negative effects on growth. Bigdeli and Bigdelu (1385) performed a study entitled “yield homogeneity and investment alternative opportunities risk in Iran” and results are as follows:

Investment is an economic- financial subject which is significant both from macro and micro perspectives. If one defined the investment as postponing current consumption to obtain more consumption opportunity in future, identifying opportunities by which one can obtain more money to spend in future would be much more important. In this study, studying historical data (monthly), we studied yield and risk of four investment opportunities (stock investment, gold, currency, and bank deposit) and based on yield and risk

interactions compared to each other. Results show that investor, within studied period, have gained much stock yield among alternative opportunities. Moreover, compared to risky investment opportunities (gold and currency), stock relative risk (per stock) is more favorable for investors.

Ahangari and Saadatmehr (1387) performed a study entitled “relationship between risk and investment I Iran” and results are as following:

Investment follows a set of variables in all nations among which the investment security is considered as one of the most important variables. In this paper, in order to investigate the effects of security on private investments we estimated private investment function. To calculate investment risk, complex risk index was used containing IBC institute annually published statistic. This research has been performed using self-explained vector model (VAR) by Yuhanson – Josiluscollective method on Micro fit software for time period of 1363-1384. The results indicated that the investment security has significant effects on private investment in Iran such that increasing one unit of investment risk index results in 0.22 billion Rials decrease in private investment.

Saadatmehr (1390) performed a study entitled “investigation for effects of security on private investment in Iran” and concluded that private investment function has been estimated to investigate the effects of security on investment in Iran. This research has been performed applying widely self- distributed lag model (ARDL). Results showed that the investment security have a significant effect on the investment in Iran both in long and short term such that one unit increase in risk rate makes the investment to decrease 0.42 and 1.88 billion Rials in short and long term, respectively. The error correction model results showed that changing the effective variables on investments after one year and

half casts its effect fully on the investments in Iranian economy.

Research Significance

By advent of England bank in 1694 which obtained the responsibility of bank note print and gold bankroll provision the idea of monetary policy as an independent entity was put forward. The objective of monetary policy was to preserve the value of coin mint, print banknote with equal value and to prevent coin flow. The establishment of central banks by industrial nations aimed at money value retaining with gold standard and limited trade with other states which were using gold standard. To achieve this goal, central banks decided to determine as a part of gold standard the interest rates based on which charged their debtors and other banks. The gold standard almost requires monthly adjustment and settlement.

Research Hypothesis

1. There is a significant relationship between private sector investment and expansion budget.
2. There is a significant relationship between private sector investment and contraction budget.

Research Theoretical Framework

Domestic gross production rate among macroeconomic performance indices is one of the most prominent; because this index indicates state economy scale and production capacity. Based on a definition, domestic gross production is total value of goods and services that are provided during a single year. One should bear in mind that people's level of welfare and enjoyment isn't merely determined through domestic gross production rather per capita domestic gross production works well in this case which indicates production level of each person per capital. Welfare of people in a state is indeed

influenced by domestic gross production and population which is reflected in per capita domestic gross production. An important question arise here is that how had Iranian economic historically performed regarding domestic gross production index, per capita domestic gross production and economic grow?

Domestic gross production in Iran during this historic period has experienced high fluctuation. Domestic gross production has in a rising mode changed from 44 thousand billion of 1338 to 242 thousand billion Realest the end of 1355. Indeed Iranian economy has swelled 5.5 times during 17 years. Production procedure was inversed in 1356 because of revolution and started to descend. Descending condition of production regarding the revolutionary period instability and after the war between Iraq and Iran started continued so that a 30% decrease happened that is 242 thousand billion Rials in 1355 diminished to 170 thousand billions at the end of 1360. This trend regardless of production promotion during 1361 and 62 continued until 1367 (end of war) but production took ascending way from 1368 and except for a three years period from 1372 to 1374 kept this trend until 1388 so that production rose to 519 thousand billion Rials in compared to 180 thousand billions of 1367. Actually, Iranian economy has been grown 2.9 times bigger during 21 years. But more is clarified when the per capita domestic gross production is being investigated particularly from economic welfare perspective. In this historic era, per capita production has experienced much more fluctuations than Iranian total production. Iranian per capita production, in an ascending manner from 1338 to 1355, has been increased from 2 to 7.2 million Rials. That is Iranian per capita production has been grown up 3.6 times during 17 years that implies considerable economic welfare improvement within this period. Per capita

production also inversed its manner and changed to descending form by the beginning of revolutionary atmosphere in 1356. In addition to total production descend regarding instability of revolutionary period and then war, population fast growth have intensified per capita production descending such that it moved from 7.2 of 1355 to 3.5 million Rials at the end of 1367 rendering 50%. But by 1388 regarding that the total production improved and the rate of population growth decreased during 70s and 80s the per capita experienced its again ascending manner except for a three years tem in which it decreased and this promotion continued until 1388 such that per capita production raised from 3.5 million Rials in 1367 to 7 million of 1388. Interestingly, per capita production level has during recent years met the level of 1355.

Iranian per capita income was equal to 45230\$ in 2009. Although it was higher than average per capita income of Middle East developing countries (3210 \$), it was far to match with world average per capita income (8581 \$). There is a large difference between Iranian per capita income and developed countries (37246 \$), North America (45365 \$) and UN (32838) such that developed countries in this regard are 7.5 times bigger than Iran; therefore, comparing to states with lower per capita income (507) Iran has a relatively suitable level but in case of developed countries even world average doesn't.

Growth Rate Performance of Iranian Economy

Economic growth rate along with domestic gross production level is one of the most important performance indices within macro economy. While production level and per capita income indicate welfare level, economic growth rate shows velocity of domestic gross production fluctuation and thus people's welfare level and enjoyment improvement or reduction velocity. Within

this period, Iranian growth rate has experienced drastic fluctuations.

Descriptions: Seasonal data for years before 1367 wasn't available.

Iranian economy has experienced high growth rate from 1339 to mid of 1365. Iranian economic growth rate has fluctuated in range of 5-17%. Within 17 years, its average rate was 10.5 which are considered very proper. Economic growth rate decreased intensively by 1356 when the revolutionary conditions cast the nation followed by war and the economic growth rate displayed negative values until the war ended except for 1361, 62, and 64. The growth rate appeared highly fluctuated also after war and experienced the range of -2.5 to 16% but the average economic growth rate was 5% after war until 1388. The economic growth rate experienced high fluctuation within reconstruction period. First, it showed an ascending manner until the end of 1369 reaching to 15% range, but fell down drastically in 1371 and fluctuated in the range of 0% or even negative values. Then it grew up again and also reached to 8% range in 1375 but faced reduction again. The economic growth rate was equal to 5.5% within 8 years of reconstruction. It was lower than 5% range in the first period of reforms and in the second period retained higher than 5% range. The economic growth rate average was totally 4.9% during 8 years of reforms. It grew up to 9% after reforms in 1385 but after that showed a descending manner. The economic grow rate raised again in 1388 and met 3.5% level and up until the end of year the average was almost 5.1%.

To provide a clearer picture of Iranian economic growth rate performance during the era after war, comparing it to other countries' may be useful. When comparing different states' economic growth rate note that according to economic growth theories, the more the economy grows to higher levels

of development, the more the economic growth rate decrease moderately. While within lower levels of development there is more potential to gain higher levels of economic growth. This was verified by last decade comparing moderate economic growth rate within countries with high income (1.7%), moderate (5.8%) and low (5.1%); thus, this analogy about Iran should be performed with countries in same level namely developing ones. While a 3% promotion is justifiable for a developed state like U.S, such promotion is considered as highly weak for a developing one as Iran.

Conclusion

As is seen Iranian economic growth rate (5.1%) equals that of states with low income and is far to reach East Asia developing states (8.9). meanwhile it's a bit higher than average growth rate of developing states in Latin America (3.1), Middle East (4.3%), Africa (4.6), and Europe (5%). As well among selected states this rate for Iran is lower than states like china (10.3%), India (7.1%), UAE (5.8%) and Russia (5.5%), although being lower than states including Saudi Arabia (3.4%), Venezuela (3.9%), turkey (3.8%), Brazil (3.3%). Korea (4.4%), and Libya (4.3%). This comparison suggests that state average economic growth rate is relatively low. Many problems are indicated when investigating per capita production trend and Iranian economic growth rate as well as comparing it to other states. Low per capita production in Iran regarding state potentials makes the first problem which suggests low economic welfare. The second problem is that in addition to low production, there isn't appropriate level for production growth rate and thus economic welfare growth speed. Finally the third problem is that economic growth rate is highly instable and fluctuated. But one should note that current low per capita production comes mainly from low economic growth rate of last decades which

mostly was negative. Indeed, Iranian per capita production and thus economic welfare will grow up if economy experiences a long term of high economic growth rate and stability.

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