

**THE ECONOMIC AND SOCIAL  
RESEARCH INSTITUTE**

Memorandum Series No. 158 .

INFLATION AND UNEMPLOYMENT

(Paper delivered to the Conference of the European  
Financial Executives Association, Dublin, 20 May 1983)

by

Kieran A. Kennedy  
Director, Economic and Social Research Institute

May 1983

Price IR£2

**Confidential: Not to be quoted  
until the permission of the Author  
and the Institute is obtained.**

## INFLATION AND UNEMPLOYMENT

### Unemployment

In 1982, there were 10½ million persons unemployed in the EEC, equivalent to three times the entire population of this country. This represented a fourfold increase on the figure of 2½ million in 1973, immediately prior to the first oil shock. While unemployment rates are very high in all countries, nevertheless there are considerable inter-country differences (Table 1). Belgium had the highest rate, 13.9 per cent in 1982, and Germany the lowest, 6.8 per cent (apart from the special cases of Greece and Luxembourg). Ireland, with 12.1 per cent in 1982, is at the upper end of the scale. However, unemployment has always been above-average in Ireland, and in fact the *increase* in the unemployment rate here since 1973 has so far been less than in the EEC as a whole, and very much less than in countries such as Belgium, the United Kingdom, Denmark and the Netherlands. In other EEC countries such as Germany and France, the rise in unemployment would have been greater were it not for the return of "guest-workers" who were not EEC nationals to their countries of origin.

In 1983, unemployment is forecast to rise further in all EEC countries, adding more than another one million persons to the already high EEC total.

### Employment

As may be seen from Table 2, total employment in the EEC is now less than it was in 1973. The largest declines in the period 1973-81 were experienced in the United Kingdom and West Germany.

Ireland experienced the largest increase in employment in the EEC in this period - a quite remarkable achievement given that Ireland has one of the largest agricultural sectors where employment invariably declines. The fact that Ireland still suffered a large rise in unemployment owes much to the fact that it has by far the largest growth of population and labour force in the EEC.

It will be noted from the last column of Table 2 that *industrial* employment fell substantially in the decade 1970-80 in the EEC as a whole, with particularly large declines in Belgium, the UK, Denmark, West Germany and the Netherlands. Only two countries experienced substantial increases in industrial employment, Ireland and Greece - both of which are much less developed industrially than the other EEC countries. The relative behaviour of industrial employment, therefore, reflects not merely cyclical factors but deeper structural influences associated with the different stages of economic development.

### Price Inflation

Consumer prices in the EEC in 1982 were more than 2½ times higher than in 1973. Again, although all countries experienced an acceleration in inflation, there was considerable variation among countries (Table 3). At the low end, Germany had an average rate of less than 5 per cent per annum, while at the other end Greece headed the list with a rate more than four times higher, 21.1 per cent. Not far behind Greece, however, were Italy with 17.2 per cent and Ireland with 16.2 per cent. In 1983, price inflation is expected to fall in all EEC countries, partly due to the decline in the price of oil and other commodities.

The inflation rate experienced in Ireland has pushed up consumer prices almost fourfold within the space of the last nine years, whereas the German rate involved only a 50 per cent rise in prices over the same period. These different price movements, of course, tend to be offset by movements in the opposite direction in exchange rates. The second column of Table 4, however, shows that when allowance is made for exchange rate changes, consumer prices in Ireland rose significantly more over the past nine years than in any other EEC country except the UK.

### Causes

Inflation and unemployment are not the only major difficulties which troubled the EEC economies since 1973. There were also the problems of slower economic growth, large public sector borrowings and balance of payments deficits. These were experienced in different degrees and at different times in different countries, depending largely on the domestic policy responses to the two oil price shocks of 1973/74 and 1979/80. The problems were all the harder to bear because expectations were so high, due to experience in the quarter century, 1948-73, during which real GNP per capita in Europe rose by as much as it had done in the whole of the previous two centuries.

It is important to remember, however, that inflation and unemployment were both on the rise in many countries in the years immediately preceding the first oil price shock in late 1973. The major influences involved were the growing rigidity in wages, prices and public expenditure; and the slowness in structural

adaptation to cope with new technologies and competition from the newly-industrialising countries. It would be quite wrong therefore to imagine that the oil price increases *alone* were the villain of the piece or that the present decline in oil prices will automatically transport us back to the nirvana of the nineteen-sixties.

Nevertheless, the two oil shocks did greatly exacerbate the underlying structural problems. These large price increases represented a double blow: they were both *price inflationary* and *demand deflationary*. They therefore produced at one and the same time rising prices, slower growth, higher unemployment and larger balance of payments deficits. In the response to the first oil price increase, many governments attempted to offset the adverse effects on the growth of output and employment. But they achieved only partial success and added the further problem of large public sector borrowing.

The response to the second oil price increase was very different in the major economies. Fiscal and monetary policies were restrictive because of fears about the prospects for price inflation, balance of payments and public sector deficits. This approach appears at last to be achieving success in bringing down inflation rates, and to a much lesser extent in securing a shift from real wages to profits, by which means it is hoped to encourage a self-sustaining expansion in investment. But the other side of the coin is that the policy has prolonged the depression and added further to the already high unemployment levels. Those countries like Ireland which tried to buck the

system by maintaining an expansionary fiscal policy have moderated the unemployment rise but at the expense of postponing the adjustment in prices, wages and the public sector deficit. This adjustment is now inescapable and will be painful - particularly if the world economy does not recover - in terms both of reduced real income and rising unemployment. But if the world economy picks up strongly, the adjustment will probably be less painful than it would have been in the last three years - and in that event the ultimate verdict on Irish economic policy in recent years may eventually be less adverse than most of us have held up to now.

### Cures

It is difficult to disagree with the conclusions of a recent OECD study that 'the sequence of the two oil shocks suggests that, as far as activity and inflation are concerned, no way has yet been found for the OECD economy to come through such an event unscathed'.<sup>1</sup> There is, however, some evidence of the beginning of an improvement in world economic conditions. The US economy is reviving and is forecast to be growing at close to 5 per cent by the end of 1983, and there are some signs of a turnabout in the UK and Germany. The fact that no fresh energy crisis is imminent, and that profitability is improving, give added grounds for hope of a revival.

It is not yet clear, however, how strong the recovery will be or how long it will last. No one is entirely satisfied that price

---

1. J. Llewellyn, "Resource Prices and Macroeconomic Policies: Lessons for Two Oil Price Shocks", OECD Working Papers, No. 5, April 1983.

inflationary impulses have been scotched. Furthermore, even with sustained recovery it will take many years to make substantial inroads on the appallingly high unemployment levels. The truth of the matter is that no economist or politician anywhere in the world has come up with a way of reconciling high employment and low inflation on a sustained basis. While making no claim to propound such a solution here, one can at least specify some of the essential elements of such a solution, which seem to me as follows:

(i) *Coordinated International Action.* No one country, no matter how large or how resolute, can tackle this issue on its own: indeed, paradoxically a small country, if it were sufficiently resolute and flexible, would have a better chance of doing so - as the example of Switzerland shows. A resumption of growth of output is essential to solving unemployment and could help to raise real incomes in a non-inflationary way through increased productivity. But the maintenance of output growth in countries generally requires a general growth in demand. Each country acting alone will be reluctant to lead off this process, since if its lead is not followed, it will end up with an unsustainable balance of payments position.

(ii) *Flexibility in Prices, Wages and Public Expenditure.* A co-ordinated expansion of demand on its own, however, while it would do much to solve unemployment would not necessarily bring down inflation and could very well make it worse. The asymmetries that have emerged in prices, wages and public expenditure - whereby they can readily be increased, but rarely reduced - must also be confronted. No two of the main protagonists - employers, unions

government - can hope to provide a solution to the unemployment-inflation dilemma without the co-operation of the third.

(iii) *Efficiency in Investment and Public Expenditure.* While in the short-run any increase in demand through investment or public expenditure is likely to boost activity, in the medium to long-term it matters a great deal how effectively the resources are applied. Wasteful investments or public expenditures inevitably bring inflationary pressures in their train, and ultimately damage employment prospects. The efficient allocation of public expenditure is not simply a matter for politicians and administrators, but involves voters also.

(iv) *Generalisation of the Benefits of Technological Change.* If the fruits of technological change are largely appropriated by existing workers and employers, then the potential gains in lower prices and higher employment will be stultified.

### Conclusions

It will be clear that a satisfactory long-term resolution of the inflation-unemployment dilemma will involve an extension of the conventional boundaries of economics to take account of social and political variables - not only at national but also at international level. Moreover, no resolution of the problem can be expected to settle the matter for all time, since every era will bring to light new dimensions of this perennial dilemma. For in the final analysis the problem is ultimately the outcome of



an argument about the appropriate distribution of income, and that argument, in one form or another, is likely to exist as long as mankind itself.

TABLE 1

Unemployment Rates in the EEC

	1973	Change 1973-82	1982	1983 Forecast
	%	%	%	%
West Germany	1.0	+ 5.8	6.8	8.9
France	1.8	+ 6.5	8.3	8.9
Italy	4.9	+ 5.5	10.4	11.3
Netherlands	2.3	+ 8.2	10.5	13.3
Belgium	2.9	+ 11.0	13.9	15.4
Luxembourg	0.0	+ 1.2	1.2	1.8
United Kingdom	2.4	+ 9.0	11.4	12.2
Denmark	0.7	+ 8.4	9.1	10.0
IRELAND	5.6	+ 6.5	12.1	14.7
Greece	n.a.	n.a.	5.0.	5.2
EEC TOTAL	2.4	+ 7.2	9.6	10.6

TABLE 2

Employment in the EEC, 1973 and 1981

	1973	1981	1973-81	Industrial Employment 1970-1980
	'000	'000	% change	% change
West Germany	26,201	25,145	- 4.0	- 12.2
France	20,774	20,965	+ 0.9	- 6.0
Italy	19,057	20,672	+ 8.5	+ 2.4
Netherlands	4,538	4,922	+ 8.5	- 10.5
Belgium	3,746	3,669	- 2.1	- 17.7
Luxembourg	150	160	+ 6.3	- 1.6
United Kingdom	24,611	23,054	- 6.3	- 15.1
Denmark	2,385	2,431	+ 1.9	- 13.3
IRELAND	1,060	1,151	+ 8.6	+ 20.8
Greece	3,191	3,356	+ 5.2	+ 29.6
EEC TOTAL	105,713	105,525	- 0.2	- 8.5

TABLE 3

Rates of Increase in Consumer Prices in EEC

	1963-73	1973-82	1983 Forecast
	% p.a.	% p.a.	% p.a.
West Germany	3.6	4.9	3½
France	4.6	11.3	9
Italy	4.6	17.2	14
Netherlands	5.7	7.0	3
Belgium	4.2	8.1	7½
Luxembourg	3.7	7.6	9
United Kingdom	5.6	14.7	7
Denmark	6.4	11.0	8
IRELAND	6.7	16.2	10
Greece	3.8	21.1	22
EEC TOTAL	4.6	11.6	8½

TABLE 4

Consumer Price Changes in Other EEC Countries Relative  
to Ireland 1973-1982

	Relative Price Index	Relative Price Index, adjusted for Exchange Rate Changes
	IRELAND = 100	
West Germany	40.0	75.5
France	68.8	80.5
Italy	108.5	81.0
Netherlands	47.8	85.8
Belgium	52.5	77.4
Luxembourg	49.9	75.6
United Kingdom	83.9	109.4
Denmark	66.2	82.8
Greece	119.6	86.8