

# Unemployment in Ireland: A Survey of Features and Causes

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Unemployment in Ireland: A Survey of Features and Causes

by

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Abstract

This paper examines the problem of unemployment in Ireland. A brief description of the main distinctive features of the structure of Irish unemployment is presented. Based on up to date literature, the possible causes behind unemployment are reviewed. Empirical studies that have quantified the contributions of different determinants to the increase in Irish unemployment are also surveyed. The paper concludes with some policy suggestions.

JEL Classification Numbers:

E24, J64

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1/ This paper was initiated while the author was in the European I Department. Comments from Paul Cotterell, Martin Fetherston, Ramana Ramaswamy, Ethan Weisman, Peter Wickham, the Central Bank of Ireland and the Irish Department of Finance are appreciated.

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## I. Introduction

Unemployment is the most crucial macroeconomic problem facing the Irish economy--one that is even more acute than in other European countries. As in the rest of Europe, the rate of unemployment rose sharply in Ireland during the last twenty years. The rate of unemployment hovered around 5 percent during most of the 1960s, and as the Irish economy was hit by the terms of trade and other shocks of the 1970s, the unemployment rate started to increase (Chart 1). The most dramatic increase was during the period 1979-1987, when the unemployment rate rose 10 percentage points to 17 percent. In spite of the reduction in unemployment brought about by favorable economic activity during the 1988-90 period, the unemployment rate remained well above its historical average. The relative slowdown during the early years of the 1990s afflicted the labor market once more, and the rate of unemployment rose again. By 1993 the unemployment rate was 16 percent of the labor force, very close to the postwar maximum reached in 1987, falling subsequently during 1994.

Except for the latest economic downturn, the unemployment rate had reached a new maximum at every business cycle's trough, and during economic activity peaks it has never fallen below the corresponding level for the previous peak. The fact that recessions seem to have left permanent effects on the rate of unemployment is commonly postulated as evidence of history dependence or hysteresis in the labor market (Blanchard and Summers, 1986 and 1987). In other words, changes in the actual unemployment rate seem to have increased over time the underlying nonaccelerating inflation rate of

unemployment (NAIRU). <sup>1/</sup> Some of these features are shared by most countries in the European Union (EU). However, the unemployment problem seems to have increased disproportionately in Ireland (Walsh, 1993a). In fact, by 1993 Ireland had the third highest unemployment rate in the OECD area, just behind Spain and Finland.

This paper examines the nature of unemployment in Ireland. The assessment of the unemployment problem, based on up to date literature relating to Ireland, is intended to be instructive, particularly from a policy point of view. A brief description of the main distinctive features of the structure of Irish unemployment is presented in Section II, focusing on both the characteristics of the supply and the demand for labor. The most commonly cited economic factors behind the unemployment problem in Ireland are reviewed in Section III. This section also surveys the results of some empirical studies that have quantified the contribution of different determinants to the dramatic increase in Irish unemployment. Against this background, Section IV concludes with some policy suggestions.

## II. Characteristics of the Unemployment Problem in Ireland

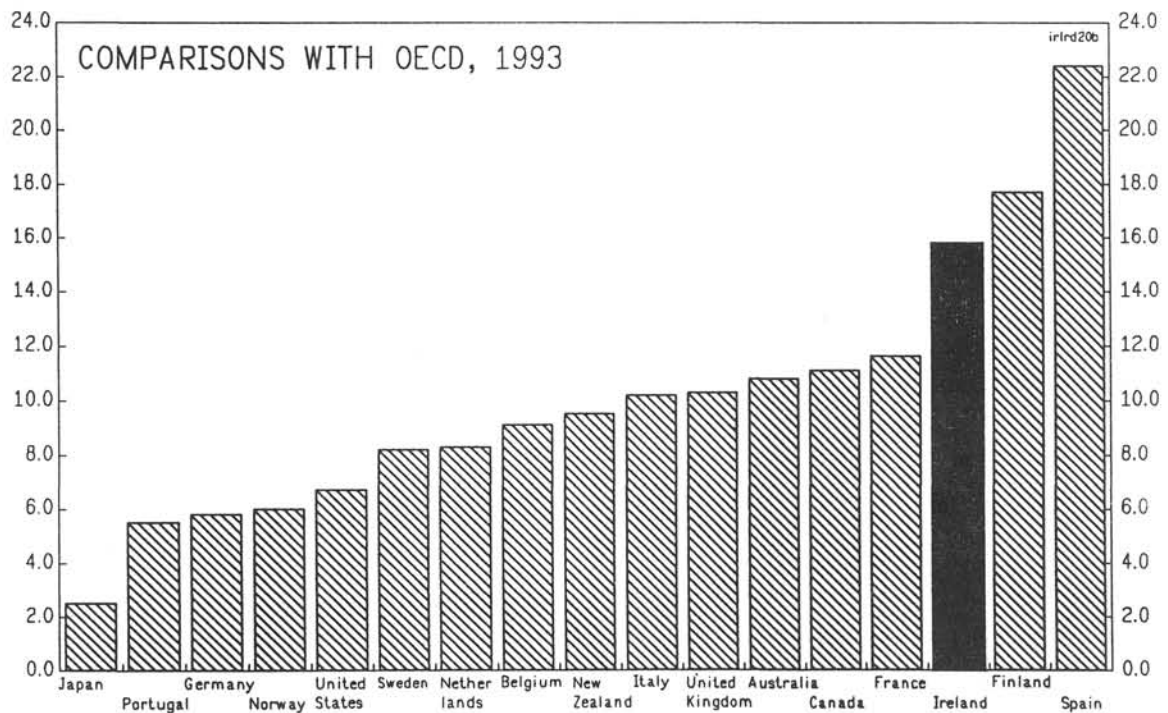
### 1. Labor force

Increases in the labor force are determined by three factors: the natural growth in population, participation rates, and net migration patterns (Chart 2). All of these determinants are distinctively important

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<sup>1/</sup> Layard, Nickell and Jackman (1991) estimate that the natural rate of unemployment in Ireland rose from 6 percent during 1960-68 to 13 percent during 1980-88.

CHART 1  
IRELAND  
UNEMPLOYMENT  
(In percent of total labor force)

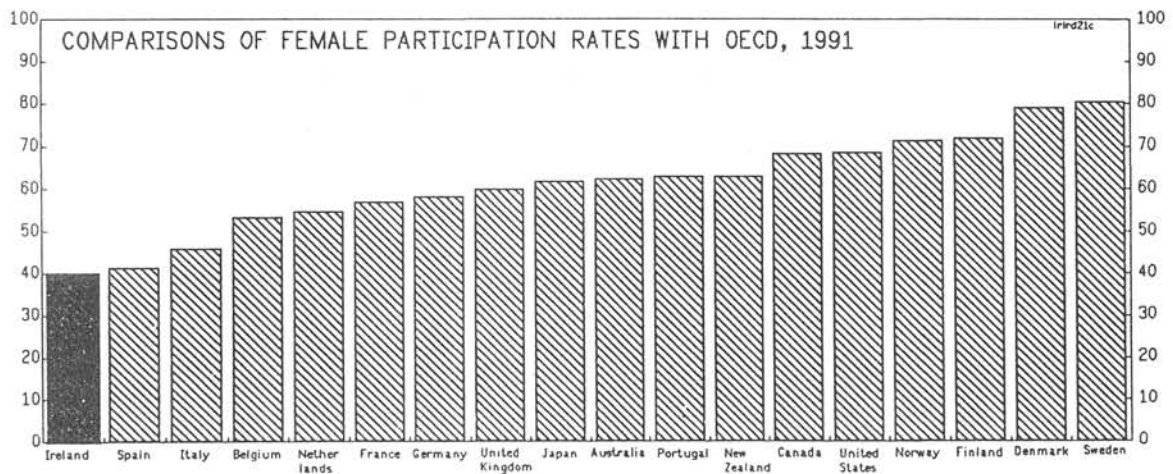
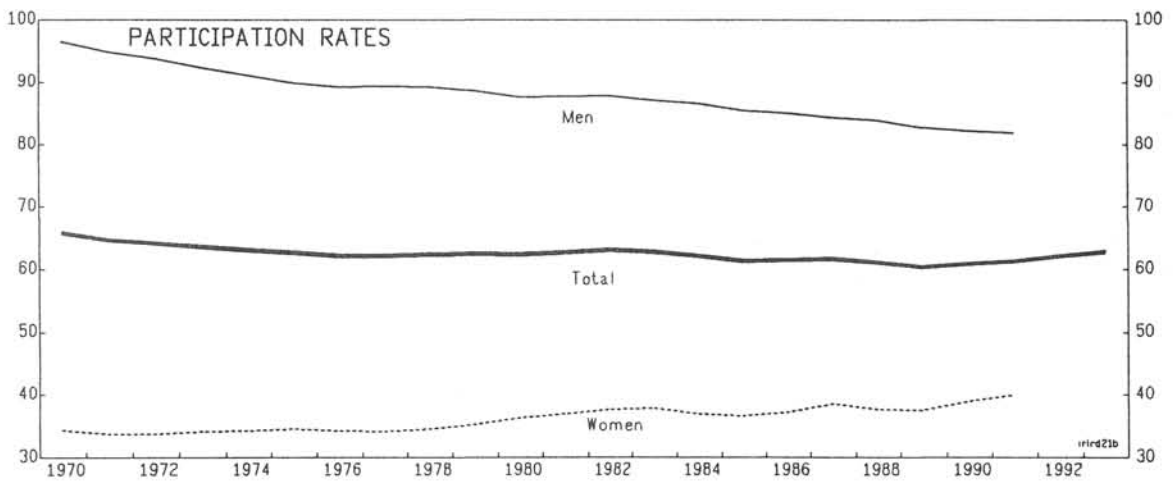
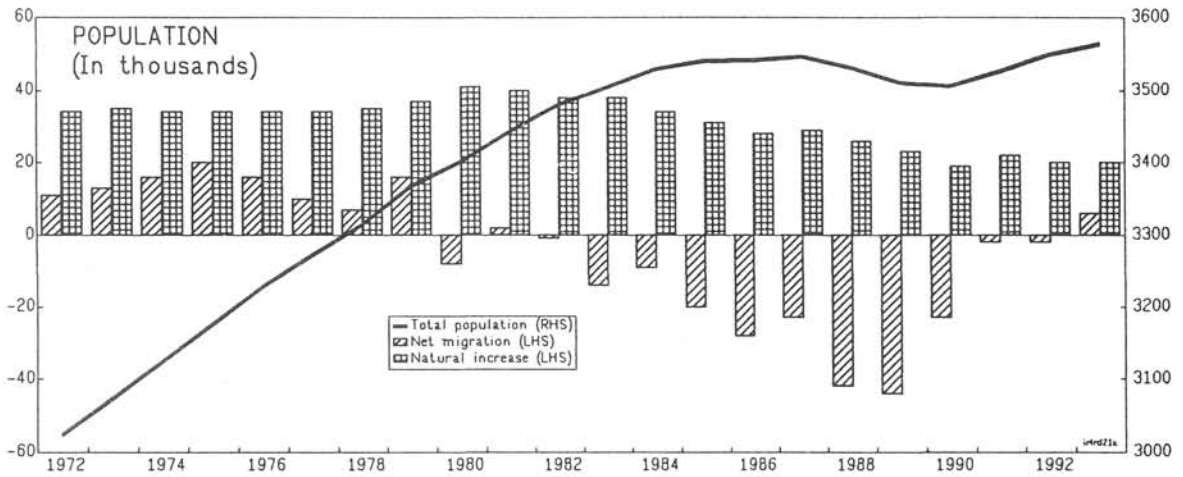


Sources: Data provided by Irish authorities; OECD, Quarterly Labour Force Statistics.

1/ First nine months.



# CHART 2 IRELAND LABOR FORCE DETERMINANTS



Sources: Data provided by Irish authorities; OECD, Quarterly Labour Force Statistics.

in the case of Ireland. A common--though as shown below, not always accurate--perception is that Ireland is characterized by strong population increases, low participation rates and high outward migration.

The natural population growth rate--i.e. births minus deaths--has been steadily declining in Ireland, mostly as a consequence of the sharp fall in the birth rate during recent decades. Just during the last decade, the birth rate fell from 2 percent of the population in 1982 to 1.5 percent by the early 1990s, although this is still slightly above the EU norm. On the other hand, the death rate has remained around 0.9 percent of the population during this recent period.

The other determinant of population growth is net migration. Ireland has had a long tradition of outward migration--mostly to the United Kingdom and the United States--which served as a "safety valve". During the 1970s, however, Ireland actually experienced inward migration due to adverse external economic conditions and a strong expansion of domestic employment, mainly in the public sector. Nevertheless, with less favorable domestic labor market conditions during much of the 1980s, a strong outward migration resumed. The most recent economic slowdown in the main destinations in the early 1990s then reduced Irish emigration once again.

Taking into account the natural increase and the net migration, total population in Ireland grew at an average of 1.1 percent per annum during 1975-85. However, since 1985 the total population of Ireland has been roughly stable (at about 3.5 million inhabitants) largely as a consequence



of the increased emigration. 1/ The dependency rate (i.e. the percentage of population outside the 15-64 years age category) has continued its declining trend and for the last four years it has been just below 40 percent. This rate is still significantly higher than the 33-34 percent of the European Union and the United States. The main reason that is attributed for the high dependency rate is that the bulk of emigrants tend to be in the 15-44 years age categories whereas a larger proportion of immigrants are economically inactive (McGettigan, 1992).

As in other OECD countries, participation rates in Ireland have observed a different behavior for the male and female components of the population. Male participation has experienced a declining trend during the last decades, and the male labor force is now around 82 percent of the (working-age) population. On the other hand, female participation has steadily grown during the last twenty years and the latest figures put it at 40 percent of the (working-age) population. 2/ However, one important consideration which may influence the behavior of the Irish labor force in the medium-term, is the fact that female participation in Ireland nevertheless remains the lowest in the OECD area.

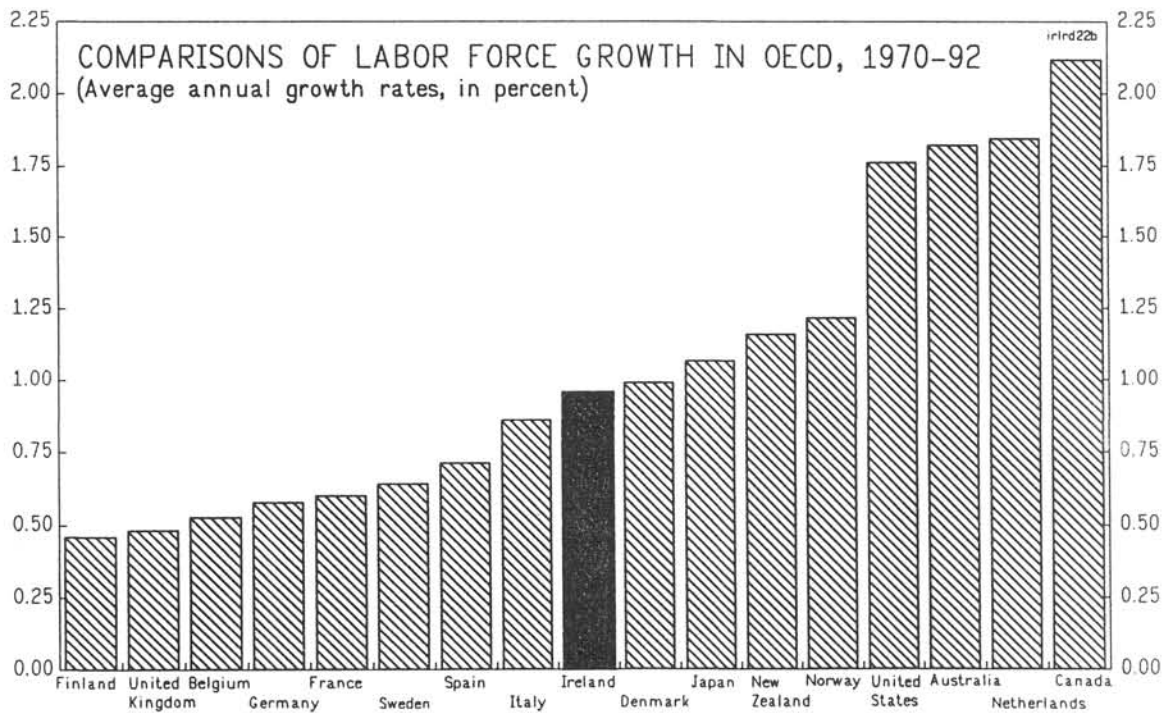
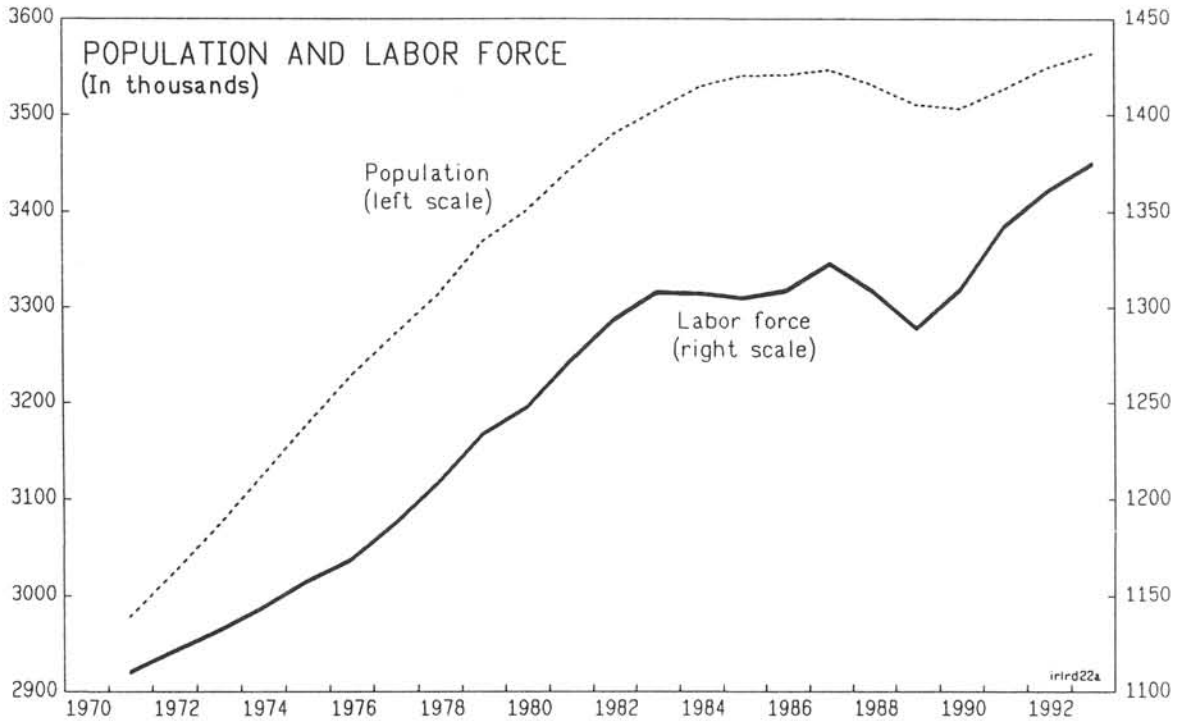
The total effect of these forces is reflected in the evolution of the labor force (Chart 3). In spite of the relatively high natural increase in population, outward migration has kept the population and the labor force growth very close to what has been experienced in other OECD countries. It

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1/ The population aged 15-64 followed a similar pattern, albeit growing at a higher 1.4 percent per annum during 1975-85 and then roughly stabilizing at about 2.1 million.

2/ For an empirical analysis of the main determinants of labor force participation rates see Walsh (1993b).

CHART 3  
IRELAND  
LABOR FORCE



Sources: Data provided by Irish authorities; OECD, Quarterly Labour Force Statistics.

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can be seen that the growth in Irish labor force is below that experienced in Australia, Canada, the United States, and even some other European countries, such as the Netherlands, Denmark, and Spain.

## 2. Employment

To a large extent, the unemployment problem in Ireland during the last two decades has been engendered by the disappointing generation of employment. While the labor force has continued to enlarge, the level of employment has not expanded in the last fifteen years (Chart 4). This lackluster performance of employment is even more dramatic when the growth of output in Ireland is compared with developments in other economies. Ireland has outperformed both the OECD and the EU averages in terms of the growth of output, but until recently has lagged behind in terms of the employment content of this growth. <sup>1/</sup> In fact, a scatter plot of selected OECD countries reveals that Ireland had one of the highest rates of output growth during 1979-90, but it was also the only country with a negative average growth of employment during that same period (Chart 5). Since 1989 the overall employment performance of the Irish economy has improved somewhat.

The sectoral breakdown of employment in Ireland follows similar trends observed in other industrial countries, but with some distinctive features. In spite of the steady declining trend in agricultural employment, this sector still accounts for a substantial share of employment in Ireland (Chart 6). In 1993 agriculture accounted for 13 percent of total

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<sup>1/</sup> The higher growth of output also reflects an increase in Irish labor productivity as the economy develops and catches-up with the rest of the EU.

employment, which is among the highest in the EU. The level of industrial employment has basically remained flat during the last twenty years, while the only sector in which employment has actually expanded is the services sector, especially since 1990. It is noteworthy that the expansion of employment in services has been mostly associated with an increase in female employment .

Manufacturing employment in Ireland, has been marked by the different behavior of the traditional and the modern manufacturing sectors. In spite of the large expansion in terms of output and exports of the modern high-technology manufacturing sectors--such as electronics and pharmaceuticals--their share of manufacturing employment is still very low. Employment in traditional manufacturing, while steadily declining, still accounts for almost three times as many jobs as employment in the modern manufacturing sector.

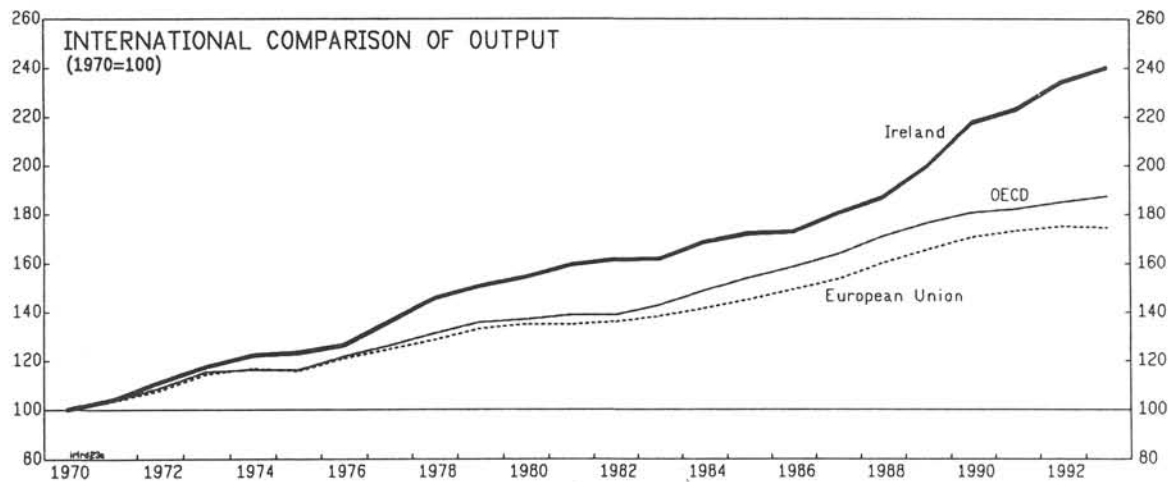
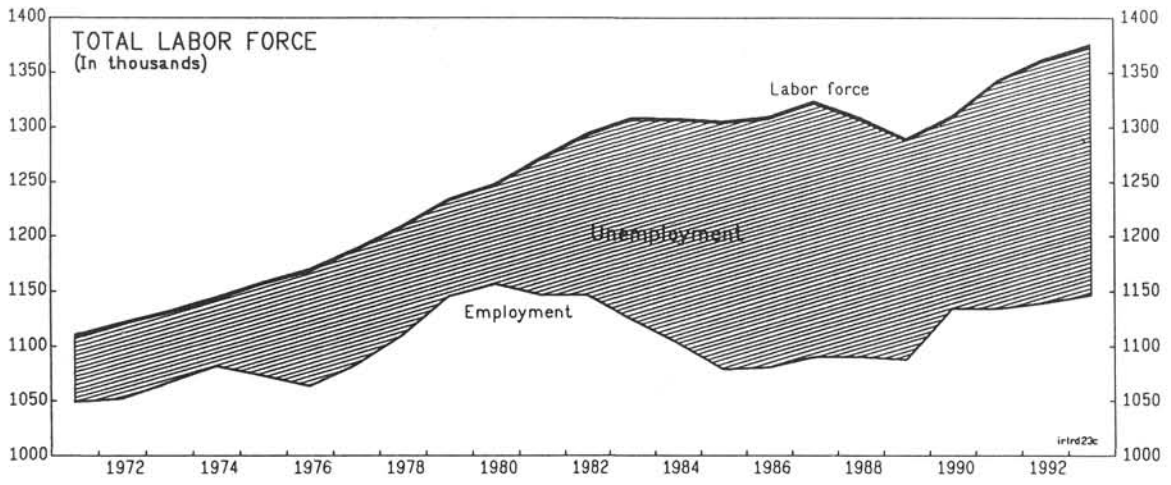
Employment in the public sector still accounts for more than 20 percent of total employment in Ireland. Driven by the fiscal consolidation of the last decade, employment in state-sponsored bodies and local authorities has followed a downward trend since 1982. Similar behavior was initially observed for Exchequer financed employment but since 1990, it is the only component of public sector employment to have expanded. Half of the increase in Exchequer financed employment in the public sector is accounted for by the category of public administration and defense.

### 3. Structure of unemployment

According to the latest Labor Force Survey, as of April 1993 there were 230 thousand unemployed in Ireland, of which 74 percent were males and

CHART 4  
IRELAND

## EMPLOYMENT AND OUTPUT



Sources: IMF, World Economic Outlook; and data provided by Irish authorities.

Chart 5. OECD: Output and Employment, 1979-90  
(Annual percentage changes)

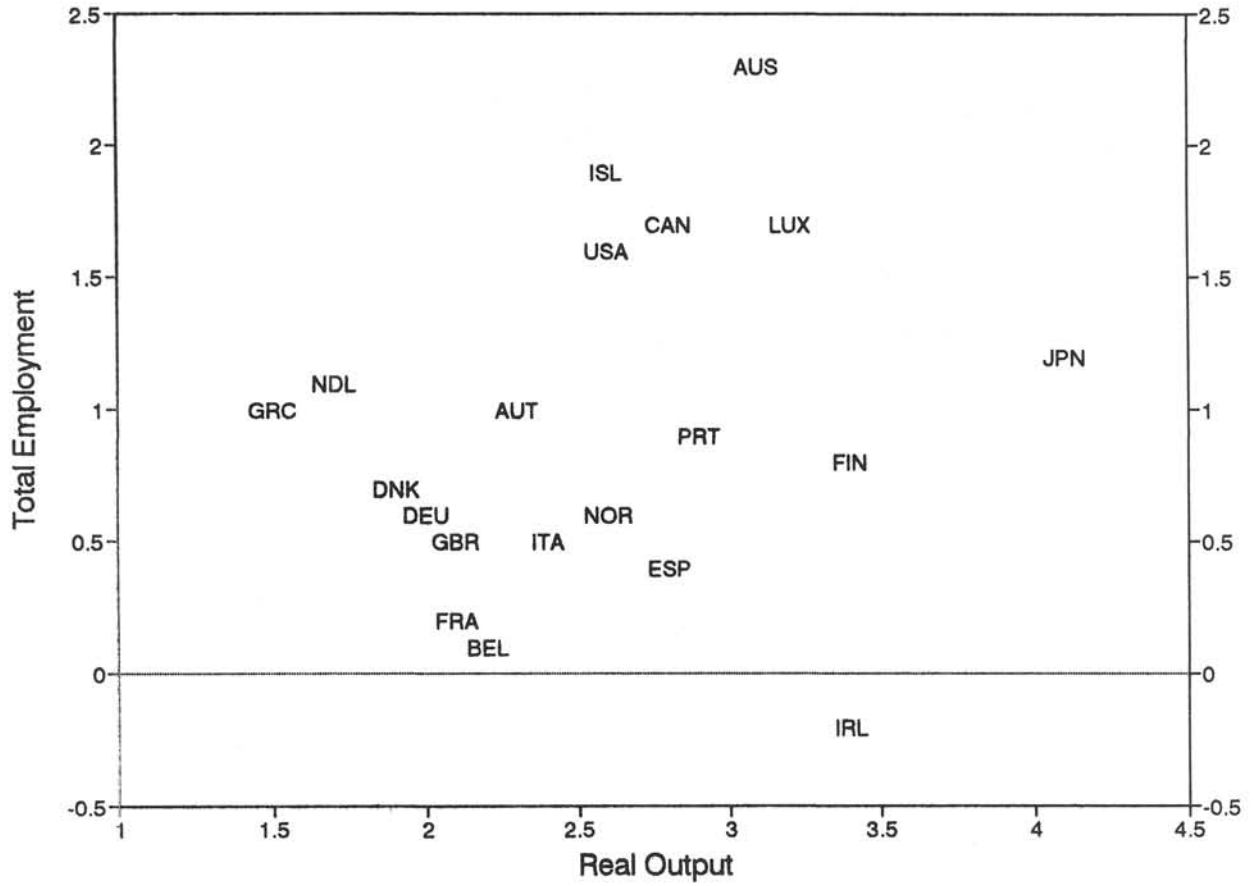
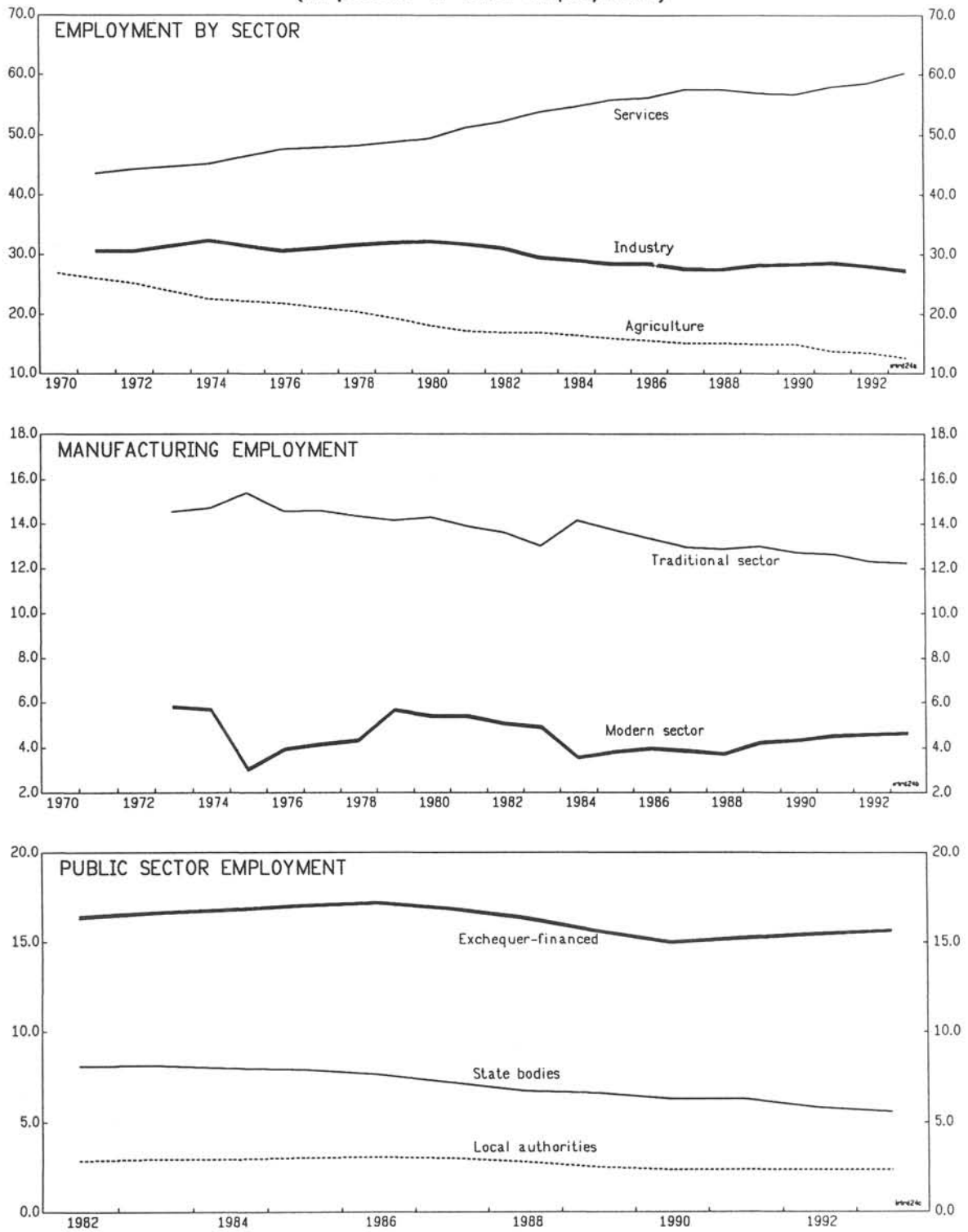




CHART 6  
IRELAND

# COMPOSITION OF EMPLOYMENT (In percent of total employment)



Sources: Central Statistical Office, Labor Force Surveys, and Quarterly Industrial Inquiry.

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26 percent were females. This attribute of the gender composition of unemployment makes Ireland the country in the OECD--followed closely by the United Kingdom--with the highest share of male unemployment. The male unemployment rate in Ireland is also higher than the female unemployment rate (Chart 7).

Another important characteristic of Irish unemployment is its allocation by levels of educational attainment. The distribution of unemployed in Ireland is heavily skewed towards those with lower levels of educational attainment, and presumably also with diminished skills. In fact, by 1989 the unemployment rate of persons with only primary education was almost 10 percentage points higher than those with secondary education. This highly skewed distribution of unemployment contrasts with the more even distribution observed in the rest of the OECD. At the same time, a lower proportion of persons with university education were unemployed in Ireland than in the OECD.

The age structure of the unemployed differentiates Ireland from other OECD countries. The problem of youth unemployment also afflicts Ireland, although with relatively less severity than the rest of Europe. It is true that there are more unemployed in the 15-24 age years group than in the 25-64 age years cohorts. Nevertheless, reflecting the international mobility of younger workers, the proportion of older workers among the unemployed is among the highest in the industrial world.

Another notable characteristic of unemployment in Ireland is the high proportion of long-term unemployment. The share of long-term unemployed (i.e. those unemployed more than one year) rose steadily from around 30 percent of the total unemployed in 1982 to more than 60 percent by 1991

(Chart 8). This fact is reflected in an increasing average duration of unemployment spells, making unemployment a quite persistent phenomenon. A related issue is the breakdown of unemployment into its inflow and outflow components. Rising inflows to unemployment during the late 1970s and early 1980s can explain a large fraction of the increase in the share of long-term unemployment given the stable hazard rate (i.e., escape rate) from unemployment in Ireland (Breen and Honohan, 1991). In spite of the higher inflows into unemployment, the Irish economy still registers one of the smallest inflows relative to other OECD countries (Chart 9). At the same time, however, Ireland has one of the lowest outflow rates, which implies a very small escape rate from unemployment.

### III. The Causes of the Rise in Irish Unemployment: A Selected Survey

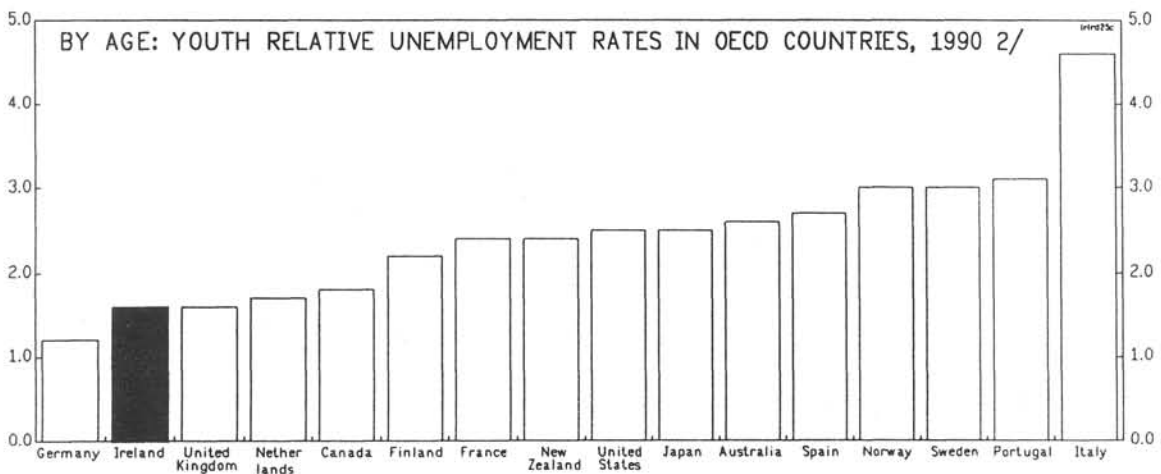
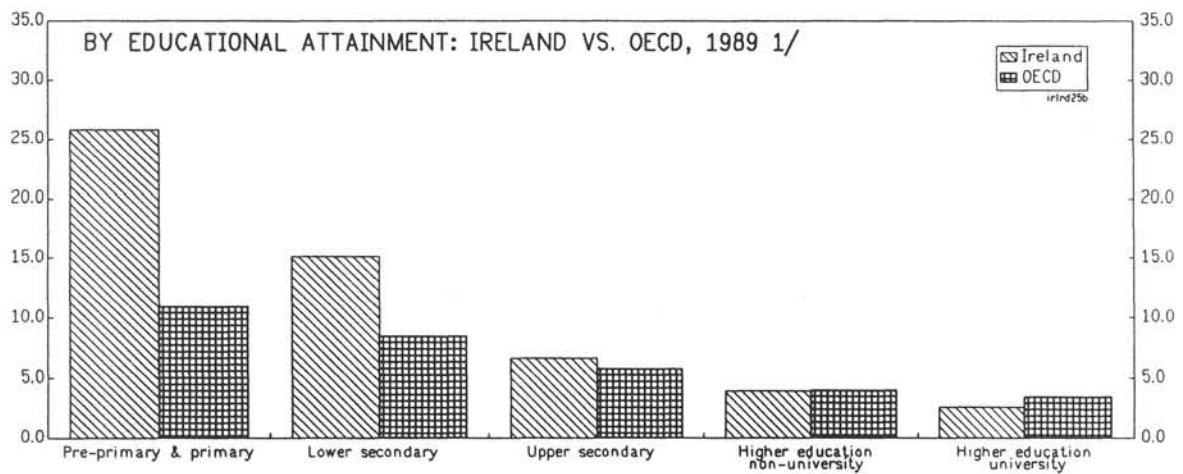
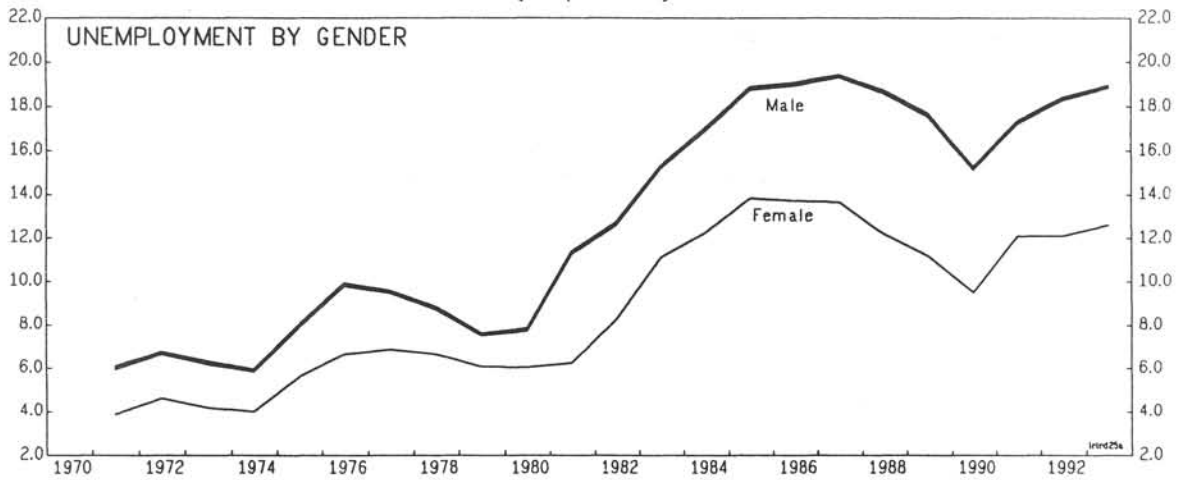
#### 1. Factors contributing to unemployment

The unemployment problem in Ireland has generated substantial attention in the academic literature. <sup>1/</sup> There seems to be a consensus that the reasons that explain Irish unemployment can be broadly classified into two main groups. On the one hand, some unemployment determinants are external to Ireland in the sense that they reflect developments in the world economy. On the other hand, some determinants relate to factors that are mostly domestic to Ireland, including some factors that can be subject to various degrees of control by economic authorities.

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<sup>1/</sup> For surveys of the literature see McGettigan (1992) and Geary (1992).

CHART 7  
IRELAND  
STRUCTURE OF UNEMPLOYMENT  
(In percent)

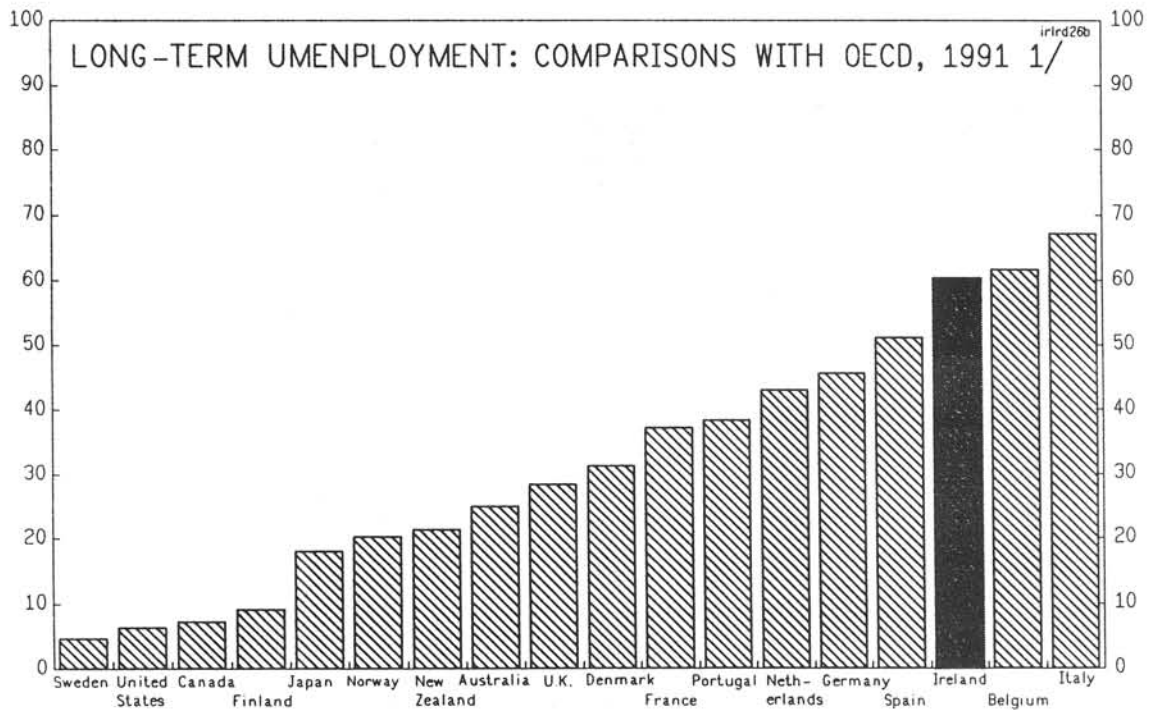
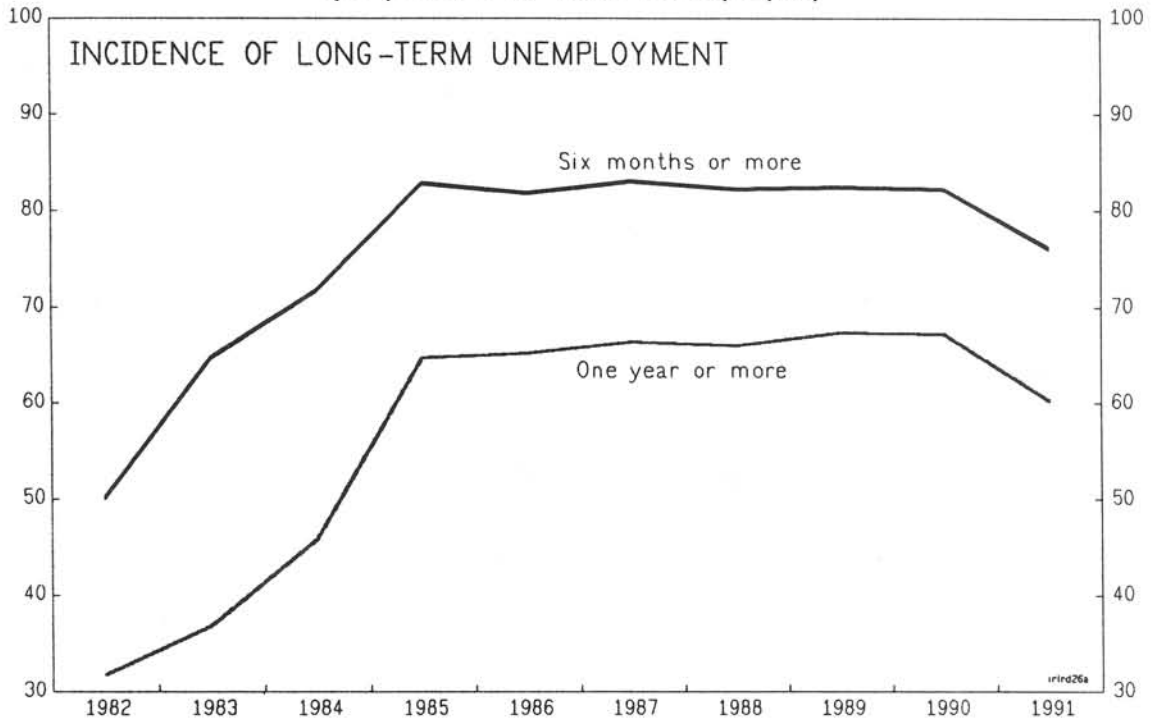


Sources: OECD, High and Persistent Unemployment: Assessment of the The Problem and Its Causes, 1993; and data provided by the Irish authorities.

1/ Adult population aged 25-64.

2/ The youth group comprises the 15-24 age cohorts but it varies in some countries. Data for Germany corresponds to 1987 and for Ireland to 1989.

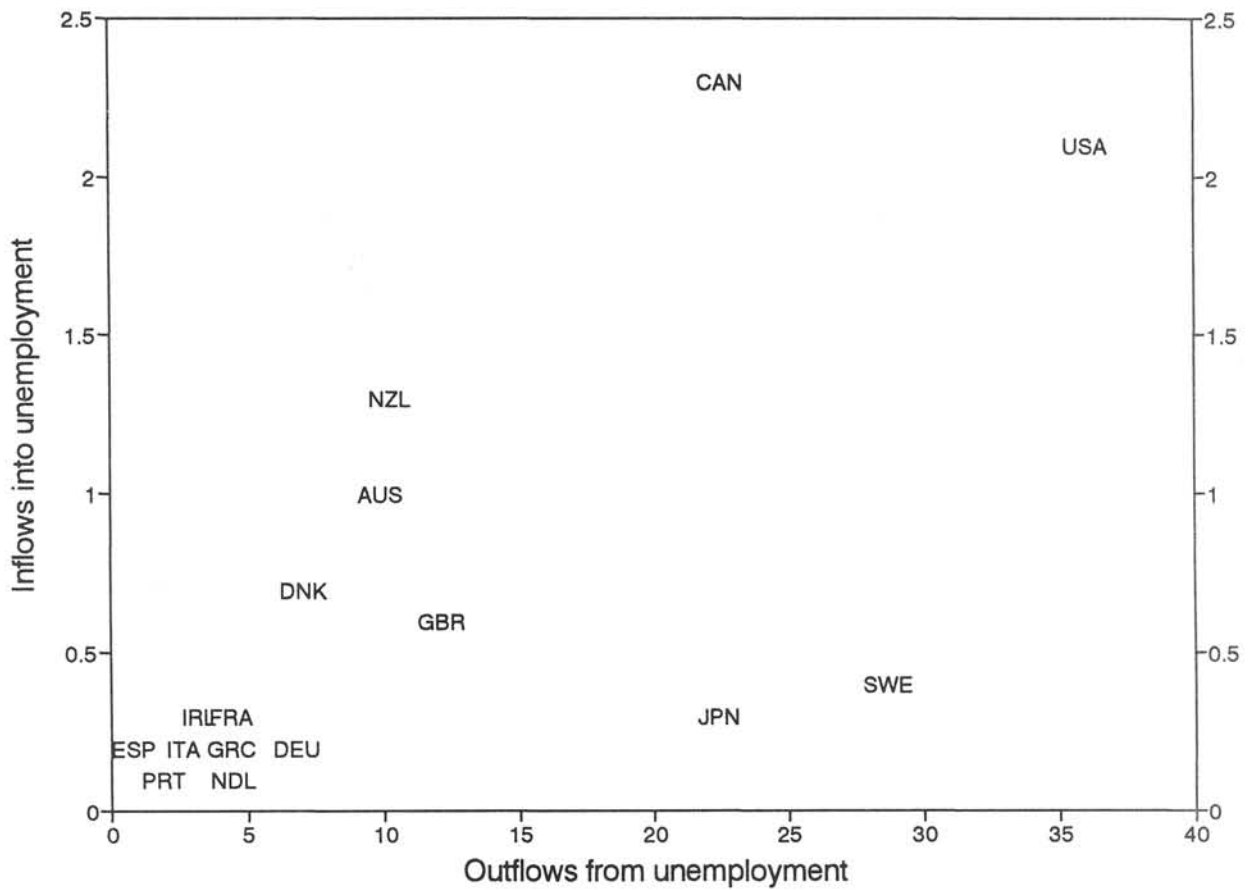
CHART 8  
IRELAND  
DURATION OF UNEMPLOYMENT  
(In percent of total unemployed)



Sources: Data provided by Irish authorities; OECD, Quarterly Labour Force Statistics.

1/ twelve months and over.

Chart 9. OECD: Unemployment Inflows and Outflows, 1990-91  
(Percentage of source population)





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In current discussions of unemployment in Ireland, the prevalent view is to interpret the experience of rising unemployment, as in other European countries, as the outcome of a series of exogenous adverse shocks (both external and domestic) which have been compounded by rigidities and other imperfections in the Irish labor market. As a consequence of this ratcheting up, the persistence of unemployment has been exacerbated and the structural component of unemployment has been increased. In other words, hysteresis effects have made unemployment very stubborn to downward adjustments.

a. External factors

Three important developments in the world economy have been advanced as reasons behind the rise of Irish unemployment, especially during the 1970s and early 1980s: the worsening of the terms of trade, the increase in international real interest rates, and the unemployment problem in the United Kingdom (Chart 10). The first panel in Chart 10, showing the inverse of the terms of trade, illustrates the first external factor. The increase in commodity prices, especially oil, meant a deterioration in Ireland's terms of trade of around 30 percent from 1973 to 1981 leading the important rise in unemployment by slightly more than a year. However, the correlation of the terms of trade with the unemployment rate was not as strong once the terms of trade started to improve after 1981 since the unemployment rate remained stuck above 14 percent.

A second external factor found frequently in the literature as an explanation of Irish unemployment is the increase in international real interest rates. High real interest rates in world markets at least

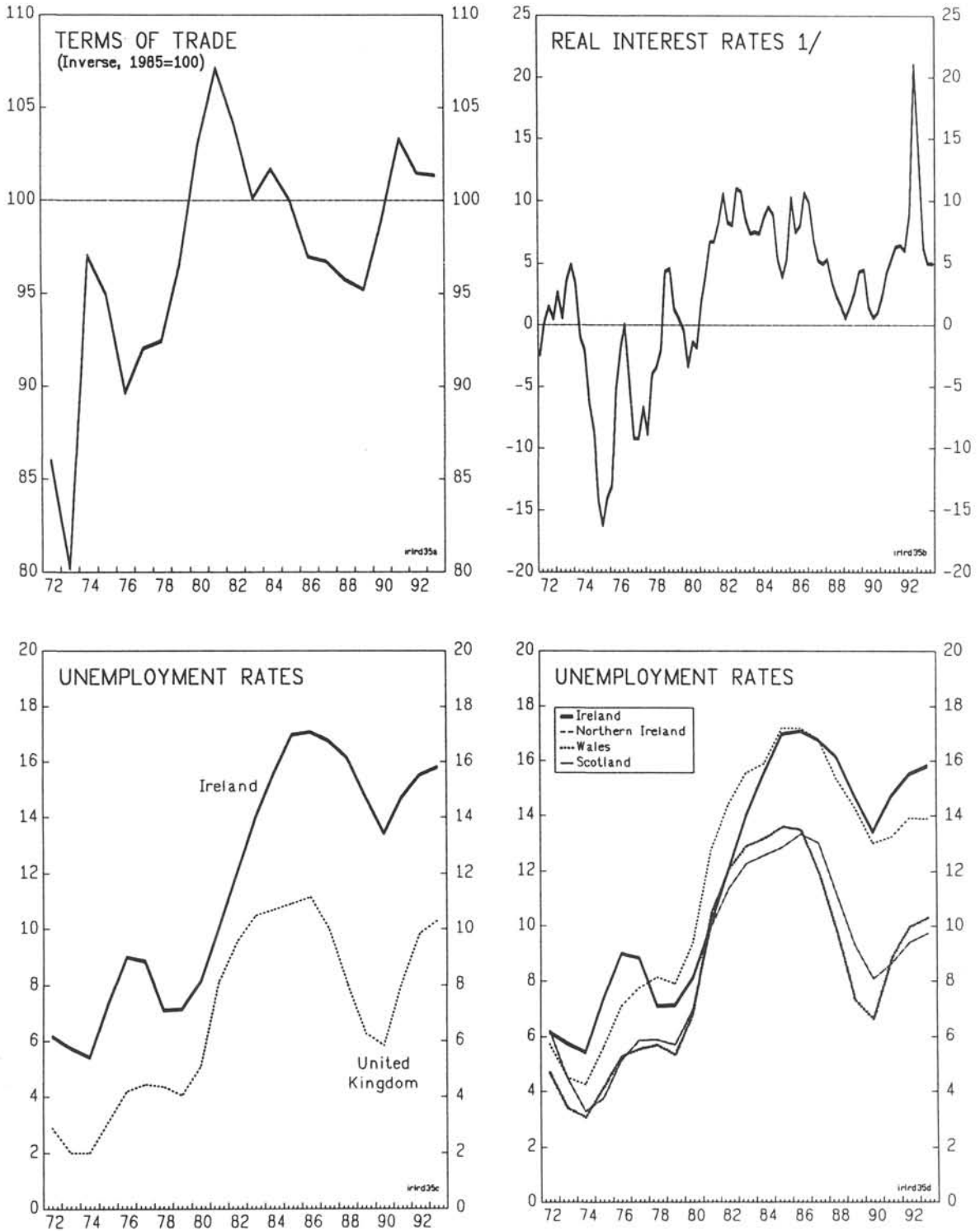
partially fed back into Irish interest rates, dampening economic activity and reducing employment. However, to some extent the increase of Irish real interest rates also reflected disinflation efforts pursued through the participation in Exchange Rate Mechanism (ERM) of the European Monetary System (EMS) (Dornbusch, 1989).

A third external influence that appears frequently in Irish discussions of unemployment, are developments in the United Kingdom given that the two countries have well integrated labor markets (Honohan, 1992a). Employment conditions in the United Kingdom are an important determinant of the decision of Irish workers to migrate and thus to participate or not in the Irish labor force. Therefore it is not surprising to find a strong positive correlation of the unemployment rates in the two countries, although the Irish unemployment rate is always higher than the rate registered in the United Kingdom. As the unemployment rate in the United Kingdom increased during the late 1970s and early to mid-1980s, so did the Irish unemployment rate. The integration of the labor markets is confirmed by the evolution of specific United Kingdom regions whose unemployment rates track even closer the Irish unemployment rate. However, with the probable exception of Northern Ireland, United Kingdom unemployment rates experienced larger falls during the late 1980s than the one registered in Ireland.

b. Domestic factors

Although it is still hotly debated in the literature, the prevalent view is that the necessary process of macroeconomic adjustment and disinflation during the 1980s to previous shocks may have also taken a toll on unemployment. The external current account experienced a deficit

CHART 10  
IRELAND  
EXTERNAL FACTORS  
(In percent)



Source: Department of Finance, Economic Statistics; data for Great Britain provided by the CSO (U.K.).

1/ Three-month Dublin Interbank rate minus four-quarter percentage change in CPI.

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of almost 15 percent of GNP in 1981, while the Exchequer Borrowing Requirement (EBR) was 16 percent of GNP that same year (Chart 11). The macroeconomic adjustment undertaken resulted in a turnaround of the current account to a surplus position in 1988, while the EBR fell to just above 3 percent of GNP. The selected strategy of fiscal consolidation of the early 1980s, as discussed below, is considered to have been a major recessionary shock behind the rise in Irish unemployment between 1979 and 1986. <sup>1/</sup>

The Irish strategy of anchoring disinflation to the ERM was successful in reducing the rate of consumer price increases from 20 percent in 1981 to 2 percent by 1988. However, this strategy was also associated with an important appreciation of the real exchange rate (almost 18 percent during 1981-86) and to a significant increase in the relative price of nontradable goods. This loss of competitiveness led to a reduction in the demand for labor in the traded goods sector, especially in traditional manufacturing, and thereby exacerbated the unemployment problem (OECD, 1987; Leddin, 1990). After its peak in 1986--which roughly coincides with the peak in the unemployment rate--the real exchange rate stabilized at a somewhat lower level.

As regards structural or microeconomic factors influencing unemployment, relative factor prices have been strongly distorted by fiscal and industrial policies in a manner that inhibited employment creation. As part of the fiscal consolidation of the early 1980s, the Irish authorities

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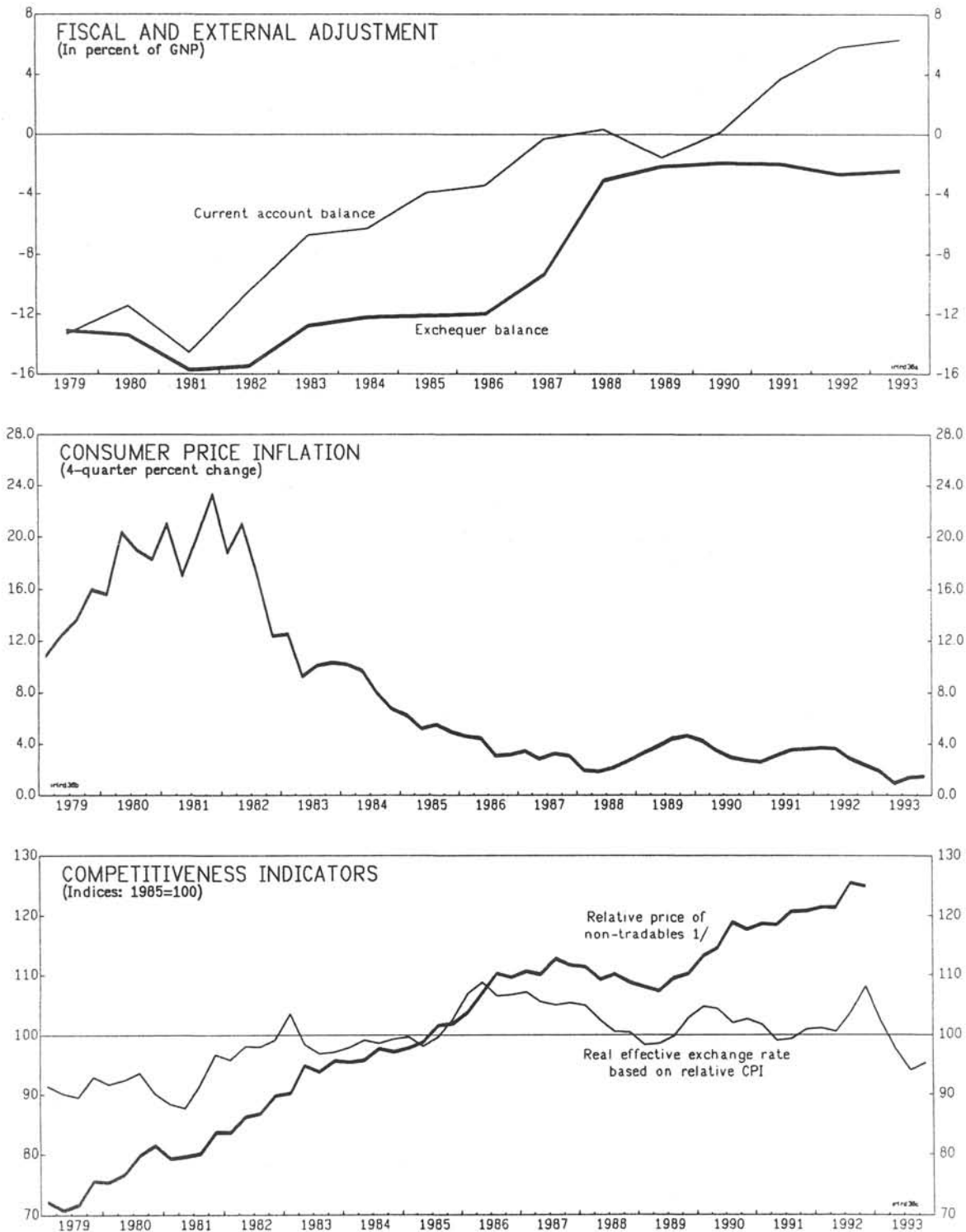
<sup>1/</sup> There is an extensive literature on the stabilization and adjustment experience in Ireland. See, among others, Dornbusch (1989), Alogoskoufis (1992), Geary (1992), Giavazzi and Pagano (1990) and Honohan (1992b).

implemented sharp tax increases (both direct and indirect) as well as raises in social insurance contributions. A direct consequence of these measures was an important increase in employment costs and a reduction in net earnings. In other words, the ratio of total labor costs to take-home pay--defined as one plus the tax wedge--was amplified drastically during the first half of the 1980s (Chart 12). A higher tax wedge affected both the demand and the supply of labor: greater labor costs directly reduced the quantity demanded for labor while lower take-home pay reduced the incentive to work and increased calls for higher wages. On both counts employment was curtailed.

Moreover, since the 1980s Irish governments have been committed to maintain if not improve the purchasing power of welfare benefits. As a consequence of this policy, unemployment benefits have risen both in real and relative terms. For example, as shown in the second panel of Chart 12, weekly payments corresponding to long-term unemployment assistance rose more than 60 percent in real terms during 1979-93 (Callan and Nolan, 1992). In relative terms, unemployment related benefits have risen faster than average earnings in manufacturing during the same period, contributing to the increase in the replacement ratio (i.e. unemployment related benefits as a fraction of employment net income). Although actual replacement ratios vary a lot depending on the level of gross income, number of dependents, and other eligibility criteria for the different welfare payments, all replacement indicators registered substantial increases during the early 1980s, diminishing somewhat in recent years. The effect on unemployment came through the supply of labor, since generous unemployment benefits reduced the opportunity cost of unemployment. This increased the fall-back



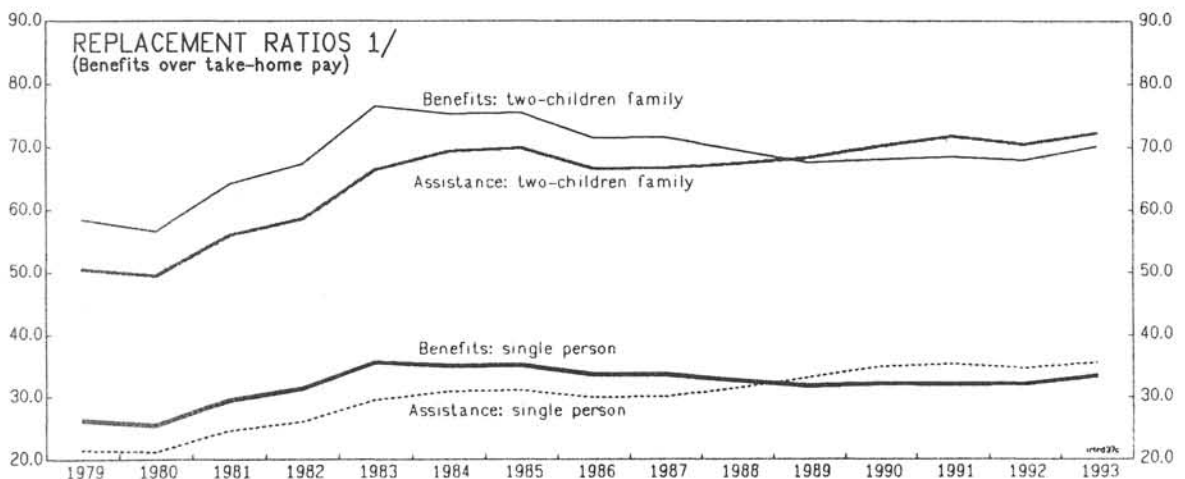
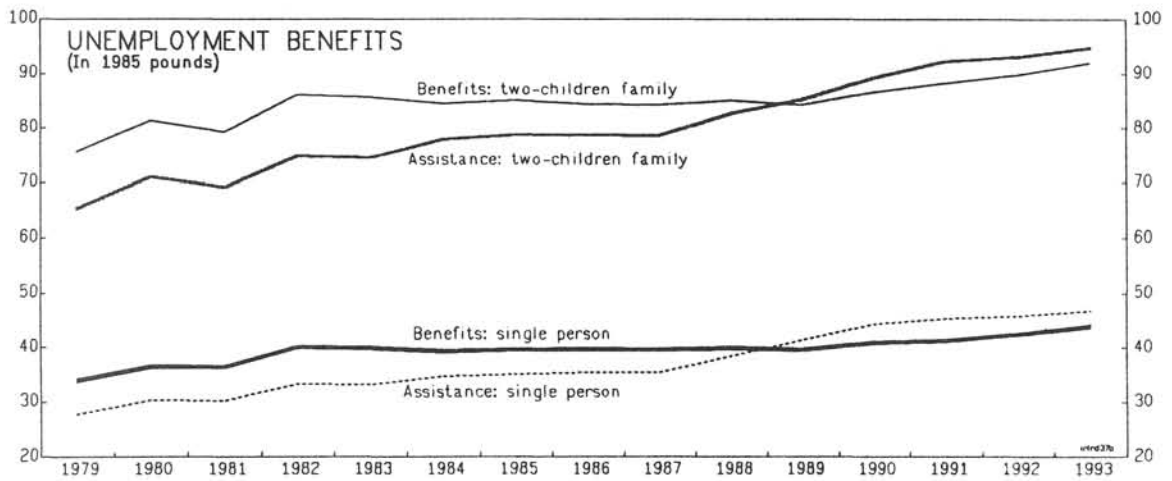
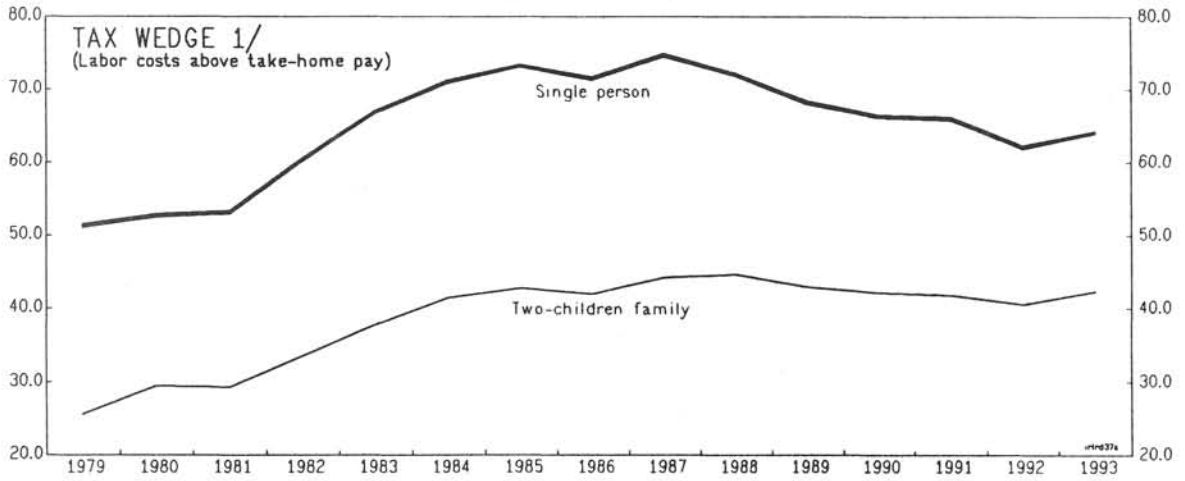
CHART 11  
IRELAND  
ADJUSTMENT, INFLATION, AND COMPETITIVENESS



Source: Department of Finance, Economic Statistics; and IMF, Information Notice System.

1/ Services price index over wholesale price index.

CHART 12  
IRELAND  
TAX WEDGES AND UNEMPLOYMENT BENEFITS  
(In percent)



Source: OECD, The Tax/Benefit Position of Production Workers; and staff calculations.

1/ Calculated from gross earnings of an average production worker.

position of the unemployed (reservation wage), increased their potential wage demands, reduced the incentive to actively seek employment and prolonged unemployment spells. Moreover, generous unemployment benefits also raised the incentives to participate in the labor force and enroll in the live register (Walsh, 1993b). Compounding the effects of relatively generous unemployment benefits was the indefinite duration of unemployment assistance in Ireland.

Industrial policy has also introduced distortions that affect the creation of employment. It has been traditionally oriented towards granting a selective treatment of the corporate tax and other incentive devices with the idea of stimulating the growth in the manufacturing sector--especially in the high-technology and capital intensive sectors, but inadvertently, at the expense of traditional labor intensive industry and services. A by-product of this industrial policy is that over the 1980s labor has become relatively expensive while capital has become relatively cheap (Chart 13). At the same time, unemployment has been concentrated in the low skill-end of the labor force. The incentives are clearly tilted towards the utilization of capital intensive technologies that will demand little labor per unit of output.

Wage setting in Ireland may have also contributed to the structural unemployment problem. Ireland has been following centralized wage agreements for the last two decades, with the only interruption of the 1982-87 period characterized by a more decentralized approach. The argument in favor of centralized wage bargaining is that it allows all the parties in the bargaining table--especially trade union members--to internalize the overall macroeconomic consequences of a wage agreement (Calmfors and

Driffil, 1988; Ramaswamy and Rowthorn, 1993). With union membership close to 60 percent of all employees, centralized bargaining is considered to be a useful instrument to achieve lower operation costs through wage moderation and improved industrial relations. However, centralized wage agreements with pay increases locked in for long periods of time--such as the wage agreements in place since 1987--have also helped to preserve a rigid structure of relative wages that might not have corresponded to productivity differentials and structural changes occurring in Ireland during the last decade (OECD, 1987). In particular, it has been claimed that wage bargaining, as practiced in Ireland, has not been an effective incomes policy device in the sense of bringing actual wages closer to the levels consistent with reduced unemployment (Durkan, 1992).

A related, but not identical argument, stresses the unemployment effects of insider-outsider considerations (Lindbeck and Snower, 1988; Browne and McGettigan, 1993). Trade unions, as insiders, may have also tried to maintain their relative advantage vis-a-vis outsiders, composed mostly of the unemployed. In spite of labor shedding in traditional manufacturing and in the public sector, as well as increased unemployment during the 1980s, outsiders had little influence on the outcome of wage bargaining. Wages were thus bargained by insiders, who used their market power to avoid wage reductions. In fact, evidence of a 20 percent mark-up on wages from union membership and a smaller wage dispersion for union members supports the insider-outsider argument (Callan and Reilly, 1993). An immediate consequence of the insider power is that the large increase in Irish unemployment did not put sufficient downward pressure on wages in order to clear the labor market.

CHART 13  
IRELAND

# RELATIVE FACTOR PRICES AND UNEMPLOYMENT



Sources: Data provided by Irish authorities; and staff calculations.

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There are other factors in the Irish economy that are not so much controlled by economic authorities but still affect the unemployment performance of Ireland. An obvious candidate are demographic forces--such as natural population growth, participation rates and emigration--which have a large exogenous component and have already been described above.

The persistence of unemployment has fed-back some of its own determinants, and in the process it has generated a vicious circle. On the one hand, the long-term unemployed suffer a depreciation of their human capital, can easily become discouraged and cease putting a downward pressure on wages. On the other hand, employers may lack full information of the skills of a potential worker so the indication of a long unemployment spell can signal deteriorated skills. The long-term unemployed thus become stigmatized. Finally, certain institutional features of the Irish labor market may introduce additional rigidities that perpetuate the unemployment problem. For instance, some writers have asserted that Irish labor protection legislation has put serious obstacles to the creation of employment by imposing high turnover costs--i.e. costs of hiring and firing workers (Browne, Kearney and McGettigan, 1993).

## 2. Explaining the rise in Irish unemployment: review of empirical studies

This section reviews the most important empirical studies that attempt to explain the substantial rise in Irish unemployment using econometric techniques in a single country context. The focus here is on the results obtained by Newell and Symons (1990), Barry and Bradley (1991), and the most



recent examination of the problem by Browne and McGettigan (1993)--  
henceforth NS, BB and BM respectively. <sup>1/</sup>

These three articles share a similar methodological spirit although the econometric framework used is rather different. In all three cases the objective is to determine the causes behind the largest surge in Irish unemployment, which as shown above, took place mostly during 1979-86. To achieve this goal the studies assess the individual contributions of different unemployment determinants by simulating an econometric model. While NS and BM use small econometric models, BB simulate a full-fledged model for the whole Irish economy.

The results obtained by these studies are in Table 1, where the individual and joint contributions of the unemployment determinants are shown. The results of NS are strikingly different than the ones obtained by the other two studies. NS find that most of the increase in Irish unemployment during 1979-86 is explained by external factors: 2.6 unemployment points due to higher international real interest rates and 1.7 points due to the recession in the United Kingdom for a total of 4.3 percentage points in the unemployment rate. In their view, domestic policy variables contributed only to an increase of 1.9 points in the unemployment rate: 0.7 points from the higher tax wedge and 1.2 points from the rise in the replacement ratio. Finally, NS attribute the increase of 3 unemployment points to demographic factors, namely population increase and the participation trend. Absent from their results is a significant role for

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<sup>1/</sup> The analysis of the persistence (or hysteresis) of unemployment has been carried out mostly in the context of cross-country studies and is thus beyond the scope of this paper. See Layard, Nickell and Jackman (1991) and Browne, Kearney and McGettigan (1993).

contractionary fiscal policies, a role which is obtained by BB and BM. These other two studies-- which correspond to what has become the consensus view--attribute a much smaller increase in unemployment to the operation of external and demographic factors: 3 points in BB and 2.6 in BM for external factors, and 0.6 points in BB and 1.8 in BM for demographic factors. On the other hand, most of the rise in Irish unemployment (4.4 percent in BB and 4.5 in BM) is explained by domestic policy factors, namely the tax wedge and the replacement ratio.

Table 1. Decomposition of Unemployment Changes in Ireland  
1979-86

	Newell & Symons (NS)	Barry & Bradley (BB)	Browne & McGettigan (BM)
External Factors	4.3	3.0	2.6
Domestic Policy Factors	1.9	4.4	4.5
Demographic Factors	3.0	0.6	1.8
All Factors Combined	9.2	8.4	8.9
Historical Data	10.2	10.2	10.2

#### IV. Concluding Remarks and Policy Implications

This paper has examined the nature of the Irish unemployment problem. While Ireland shares many of the features present in other European countries, Irish unemployment has some distinctive characteristics. Put in simple terms, the bulk of unemployment during the last two decades has emerged from the combination of a labor supply that is growing relatively

fast and a demand for labor that is practically stagnant. Irish unemployment is characterized by (1) being predominately a male phenomenon; (2) exhibiting a high degree of persistence; (3) being concentrated in relatively low education levels; and (4) affecting youths relatively less than in other European countries.

Since the early 1970s, the unemployment problem in Ireland has been magnified by a series of exogenous adverse shocks together with some domestic factors. In particular, the strategy followed during the fiscal consolidation of the early 1980s, by raising both the tax wedge and the replacement ratio, may have aggravated the extent of unemployment. Also, institutional features of the Irish labor market--such as centralized wage setting, insider power, labor protection legislation, etc.--prevented a flexible response of wages and contributed, together with other hysteresis influences associated with loss of skills and discouraged workers, to the persistence of unemployment.

This analysis suggests a number of policy implications which can be summarized in a three pronged attack on unemployment. First, it is important to reduce some of the distortions introduced by the interaction of the tax and welfare system. This calls for reducing the tax wedge and the replacement ratio, shortening the duration of unemployment related benefits, and lowering the implicit subsidy to capital. Second, some of the institutional features that make the Irish labor market relatively inflexible in the face of structural changes need to be addressed. New production technologies and work organization patterns require a greater degree of labor mobility and flexibility in devising incentive structures (Ramaswamy and Rowthorn, 1993). Mechanisms to break the apparent rigidity

in relative wages within the context of the national policy of centralized bargaining should be considered. The possible stiffness of labor protection legislation and the lack of participation of outsiders in wage negotiations should also be examined. Third, measures to diminish the persistence of unemployment are needed. Training and manpower programs are natural candidates to reverse the skill mismatch and increase the employability of the long-term unemployed, but other alternatives--such as the employment subsidies advocated by Snower (1994)--could be explored.

The actions adopted in recent years by Irish authorities to face the unemployment problem contain some of the policy elements described above. A clear priority of tax policy in recent budgets is to reduce the burden of the personal income tax, and thereby to reduce the tax wedge and the replacement ratio. In addition, various training, education, and temporary employment programs for the unemployed, such as the new community employment program, have been introduced with the intention of breaking the vicious circle of long-term unemployment.

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