

# Correlations between Labor Employment and Economic Growth

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## Abstract

*The main objectives of macroeconomic policy for most governments are: a high level of labour employment, price stability and high rate of economic growth. As far as I walk in life, I learn something new, everywhere I go, I find something that fascinates me. This is why this subject has an influence over me, I wonder every day why people find a job to maintain with such difficulty and why they are so lazy when they hear about work. This type of behaviour leads to a huge increase of unemployment, because people leave their courage under an invisible line and create a fake personality where they hide saying that they can't do what society wants. In case that increasing inflation is obvious, unemployment is decreasing and people are trying to find something to do, to work, because inflation also leads to some actions which affect directly the unemployed ones.*

**Key words:** wage policy, unemployment, monetary policy, public policy, declining wages

**J.E.L. Classification:** E20, E24

## 1. Introduction

This paper aims to bring to your attention one of the most significant advances in the world economy, thus making a comprehensive study on what illustrates the controversial relationship between inflation and unemployment: Phillips curve.

Any policy aims at both low levels of unemployment and moderate inflation, therefore, the essential purpose of creating a high and sustainable economic growth. And nowadays a sustainable and high economy is the highest aim which a state government may propose. What are the mechanisms that help its fulfilment and what should be done for a better development of things is precisely what I want to emphasize with this paper. Since the national economy is a complex system, its various components balance: economic growth, employment, unemployment, inflation and external economic and financial relations are interrelated to each other. In the expansion phase of the economic activity (phase two), the aggregate demand increases rapidly and consequently the difference between an actual output and its potential is reduced. Two of the objectives of macroeconomic policy record good results: the production grows rapidly and unemployment is reduced. In contrast, the other two are worsening because, on the one hand, inflation increases by request, on the other hand, due to higher prices, domestic products become less competitive on the world market (less exports) and foreign products appear cheaper (import increases), which entail a deficit in the current account of balance payments. As a result the equilibrium deteriorates the level of the exchange rate of the national currency (increase) and imports more expensive products which in this way maintain inflation. When it gets to the peak of economic growth despite the positive effects of record production and unemployment, the inflation and balance of imbalance payments problems become acute. When exceeding the peak of economic growth and pass the phase of recession, things are going exactly opposite to the trends described in the stage. The decrease in aggregate demands entails a negative movement in the economic activity, accompanied by job losses and thus increasing unemployment. Meanwhile, inflation rates tame and the balance of payments situation improves. State intervention in the development of employment encounters great difficulties. Inappropriate expansive policies may cause side effects, causing monetary

instability and other imbalances. If what you seek is a well remunerated job offer, sustained for a long-term, you have acted with care.

## 2. Literature Review

The broadest facts of experience run in precisely the opposite direction from that which the financial community and academic economists have all generally taken for granted. Paradoxically, the monetary authority could assure low nominal rates of interest-but to do so it would have to start out in what seems like the opposite direction, by engaging in a deflationary monetary policy. Similarly, it could assure high nominal interest rates by engaging in an inflationary policy and accepting a temporary movement in interest rates in the opposite direction. These considerations not only explain why monetary policy cannot peg interest rates; they also explain why interest rates are such a misleading indicator of whether monetary policy is "tight" or "easy." For that, it is far better to look at the rate of change of the quantity of money.

Both M. Friedman and R. Lucas argued their submissions on the relationship between monetary policy and unemployment present empirical evidence. The similarity of these speeches prove an important feature of macroeconomic theory being interconnected with empirical evidence.

Friedman emphasizes the role of mere evidence. He argued that the evidence of the instability of Phillips curve was instrumental in the formation of a new thinking. On the other hand, Lucas emphasized the role played by instruments advanced mathematical discoveries in economy. As he mentioned, the effect of money in the economy involves dynamic reactions of economic agents to change prices, interest rates and income. Economists have needed formal instruments suitable for that progress to be achieved and to be understood in the dynamic nature of individual decisions affecting the evolution of the economy over time. Lucas is the one who emphasized the role of theory in macroeconomics influencing policy.

Studies by Robert Lucas and Milton Friedman continue to guide studies in macroeconomics. Their works on the links between inflation and unemployment have influenced the course of economic theory and in practical discussions on anti-inflationary policies and reduce unemployment.

The most recent Nobel laureate Edmund Phelps contributes in inflation and employment through a different point of view from his previous Nobel prize winners colleagues. He said that the exchange will not be achieved between inflation and long-term unemployment because an expected inflation will be continuously adapted to the current INI inflation. Phelps stressed the importance in his analysis process by which future chances of achieving political stabilization targets are affected by current policies: higher inflation currently generates higher inflation in the future.

Phelps believes that current inflation is based not only unemployment, but also the prospects for its future development. A higher current inflation rate leads to higher expectations of inflation in the future, resulting in this regard in a number of difficulties in achieving economic stabilization policy.

During the 60's, Philips curve shows that there is an inverse relationship between unemployment and inflation. Phelp's research wanted a rectification theory of inflation and unemployment by modelling the behaviour of companies regarding wages and pricing. He brought the economic analysis' expectations and achieved a crucial dichotomy between the 'expected' and 'unexpected' inflation, examining macroeconomic implications of this distinction. Philips curve involves reformulating the concept of enlargement prospects.

Phelps's analysis was inconsistent with the old theories showing that low unemployment could be achieved mathematically by inflationary demand policies. This implies that there is a long-term exchange between inflation and unemployment, so how could there be a discrepancy between current inflation and the expected one. This hypothesis of a vertical long-term Philips curve at a steady unemployment rate is one of the most important ideas in macroeconomics over the past 50 years. This hypothesis has become crucial in terms of monetary policy developments. The contribution of Phelps in the inflation-unemployment report is remarkable because his works raise a new paradigm. The inflation-unemployment ratio, expressed their opinions and other researchers

whose contributions were important in macroeconomics, although not certified with the Nobel Prize.

Professionals analyzed the relationship between inflation and unemployment and have gone through two stages after the Second World War and recently entered into a third phase.

The first step consisted in accepting the hypothesis associated with the great economist A.W. Phillips, that there is a stable relationship between unemployment and negative rate of change in wages - high levels of unemployment would be accompanied by declining wages, while low levels of unemployment imply rising wages.

The changes were inter-conditional on the pay of the changes to prices, thus allowing an increase in productivity which took effect in the sense of an excess price higher than the cost of wages generated by a perfectly constant factor.

Unfortunately for this hypothesis, additional evidence was not consistent with it. Ratings on empirical Phillips curve relationship highlighted were unsatisfactory. More important, the inflation rate that seemed to be consistent with a certain level of unemployment has remained fixed: according to the circumstances of the period after the Second World War, when governments sought to promote the employment of total employment, unemployment however experienced increases in some countries and even unexpectedly varied between countries. Looking at it from another point of view, inflation rates which were previously associated with low levels of unemployment were held in conditions of high levels of unemployment phenomenon which involved simultaneous high inflation and high unemployment reached gradually to public attention and professional. It is classified as inflation speculated.

Milton Friedman and other economists were sceptical from the beginning about the validity of a stable Phillips curve, more theoretical reasons than the empirical ones. They argued that what mattered for the workforce did not constitute wages in dollars or pounds, but real wages - goods and services that could be purchased from wages. Unemployment fell would mean, really, pressure for higher real wages, but real salaries as could rise even if nominal wages would be lower if it were also supported by lower prices. Similarly, high unemployment would mean real wage pressure for a small but real wages might be small even if nominal wages would be high, and the prices were so high that the effects would be evident.

There is no need to assume a stable Phillips curve to explain the appearance accelerating trend of inflation to reduce unemployment. This can be explained by the impact of unforeseen changes in demand in markets characterized nominal (implicit or explicit) of long-term commitments, both in terms of capital and labour. Long-term commitments on employment can be explained by employers' costs to get information about those who wish to hire and costs for those who want to embark on various opportunities. Furthermore, individual specific capital is the amount an employee in the eyes of the employer and lead to a greater appreciation of its value in appreciation of other employers. If anyone could predict growth of around 20 percent per year in prices, then this prediction could be represented in future salaries, real wages would behave exactly as they would have behaved if everyone would have predicted that they will not there are price increases, and there is no reason for the 20 percent of the inflation rate to be associated with a different level of zero unemployment. An unanticipated change is very different, especially in terms of long-term commitments, particularly as a result of imperfect knowledge of the effects it would generate over time. Long-term commitments means, firstly, that there cleansings markets simultaneously, but only delay adjustment of both prices and quantities involved in the request or tender; secondly, that the commitments are contingent not only on current prices but also prices that are expected to be on during the engagement. Together with S.E. Phelps, Milton Friedman has developed a differentiated alternative hypothesis that short-term effects and long-term changes early on nominal demand. Starting from several stable positions of the prices was triggered, for example, an unanticipated acceleration of both, the demand nominal aggregates. This will be handled by each manufacturer as an unexpectedly favourable demand for its product. In an environment where demand changes for different goods have always held, the producer will not know if the change occurs especially for him or comprises all economic agents. Rationally, he will interpret the change in point of view and react as such, trying to produce more to sell at a price which he perceives to be higher than the price at which it is expected that it will sell future goods. Will be willing to pay higher wages than he was willing to pay them before, especially to attract a larger workforce. Higher nominal wages

can mean lower real wages from his point of view. For employment, the situation is different: what matters to employees is the purchasing power of wages but not particularly on the goods they produce, but on all goods in general. They and their employers are likely to adapt more slowly perception of prices in general, because it is costly to gather information only guess the prices of goods they produce in particular. As a result, an increase in nominal wages can be perceived by employees as an increase in real wages and thus to generate an increase in supply, while it is perceived by employers as an increase in real wages and therefore be requested an increase in the supply of jobs. Average price expressed in terms of expected future real wages are lower; Average price in terms of expected future real wages are higher. But this situation is temporary: if left free higher rate of growth of nominal aggregate demand and in prices, perceptions will adjust to reality. And when they do, the initial effect will disappear and even then will reverse for a while, so that employees and employers will find in inappropriate situations.

Finally, the workforce will return to the unanticipated acceleration allegedly taken before the nominal aggregate demand.

Unanticipation involves one change, while, of course, there is a continuous course of unexpected changes; not explicitly address any delays or exaggerations and expectations formation process. Nevertheless emphasizes the key points: what matters is not inflation, and unanticipated inflation; there is no stable relationship between inflation and unemployment, there is only a natural rate of unemployment (UN), which is consistent with the facts and correct perceptions; unemployment can be kept below the level of inflation only accelerated; or above it only accelerated deflation.

'The natural rate of unemployment', a term introduced by Milton Friedman and running parallel to 'natural rate of interest' is not a numerical constant but depends on monetary factors 'real' labour market efficiency, expanding competition or monopoly, barriers or encouragement to work in various occupations.

The connection between employment and productivity efficiency level of savings is another topic that has a fundamental importance for public policy but is another consequence of the problem presented. There is a tendency to presume that a high level of registered unemployment is evidence of an inefficient uses of resources and vice versa. Milton Friedman argues that this view is incorrect. A low level of unemployment can be a sign of a project forced an economy uses its resources inefficiently and convinces workers to sacrifice their free time for goods that they value less than cherish free time, convinced real misconception that their wages will be higher than prove. A natural rate, low unemployment may reflect institutional arrangements that allow changes.

An economy static, rigid, may have a fixed point for everyone while a dynamic economy, highly progressive, multiple changing opportunities and develop flexibility, could have a natural rate of unemployment increased.

The natural rate hypothesis or expectations adjusted Phillips curve is again accepted among economists worldwide. A few economists still adhere to the Phillips curve in its original format; most of them still recognize the difference between interpreting curves in the short term and long term but allude to the fact that long-term curve has a negative slope, curves more pronounced than for the short term. Other economists substitute for a stable relationship between accelerating inflation and unemployment with a stable relationship between inflation and unemployment - still being aware but not concerned that there is a possibility that the same logic that led them to a second derivative to lead them to the derived class higher.

Incertitude of the decision industrialized countries return to stable prices in the long term before the Second World War or to tackle inflation rates high, and more precisely the circumstances that produce this uncertainty lead to separating the conditions for Phillips Curve vertical.

The most important exception is that high inflation is unlikely to be constant during transition periods. On the contrary, with the higher this ratio, the more is more likely to be variable.

Governments have not produced the high inflation as a deliberate policy announced, but as a consequence of other policies - particularly employment policy entirely to labour and welfare state policies that increased government spending. They expressed their adherence to one goal: stable prices. They reacted so in response to the reaction of their constituents, which agreed with many of the side effects of inflation, but are still faithful to the concept of money set. One consequence of the Keynesian revolution of 1930 was accepting a rigid level of wages and price levels almost

rigid, as a starting point for analyzing short-term changes in the economy. It was taken as such they were first given institutional concern to operators, so that changes in aggregate nominal demand would be reflected almost entirely hardly yields and prices.

In this context, it is intellectually expected for economists to analyze the relationship between inflation and unemployment and nominal wage problem and not the real ones. These changes will default connection with changes that will affect equally nominal and real ones. Further, empirical evidence suggesting originally a stable relationship between unemployment and the rate of nominal wages were deducted in a period in which, despite fluctuations over short periods of price, there was a relatively stable price term long.

The hypothesis that there is a stable relationship between unemployment and inflation has been adopted by economists promptly as complete structure Keynes' theory. As the time passed, it became increasingly difficult to accept that assumption in its simple form. It seemed like it took inflation ever higher to keep unemployment low. This has created the concept of stagflation.

The assumption about normal unemployment rate Phillips curve hypothesis contains simple as special case and streamlines a wide range of experiments, especially the phenomenal stagflation. It was not universally accepted. However, assuming normal unemployment rate in its current form has proved not well enough developed to explain a recent development: changing stagflation. In recent years, high inflation has been accompanied by high unemployment, not lower unemployment as the Phillips curve suggest, nor with the same unemployment as natural rate hypothesis suggest.

The recent association between high inflation and high unemployment may reflect the impact of natural events such as the oil crisis, or independent forces have imposed an upward trend in inflation and unemployment. A major factor in some countries or a contributing factor in other countries may be that they are in a transitional period. State has not adapted the institutions' attitude and a new monetary system. Inflation tends to be not only bigger, but also to grow in a volatile, this being accompanied by state intervention in pricing.

Monetary growth, it is widely held, will tend to stimulate employment; monetary contraction, to retard employment. Why, then, cannot the monetary authority adopt a target for employment or unemployment-say, 3 per cent unemployment; be tight when unemployment is less than the target; be easy when unemployment is higher than the target; and in this way per unemployment at, say, 3 per cent? The reason it cannot is precisely the same as for interest rates-the difference between the immediate and the delayed consequences of such a policy. Thanks to Wicksell, we are all acquainted with the concept of a "natural" rate of interest and the possibility of a discrepancy between the "natural" and the "market" rate. The preceding analysis of interest rates can be translated fairly directly into Wickselian terms. The monetary authority can make the market rate less than the natural rate only by inflation. It can make the market rate higher than the natural rate only by deflation. We have added only one wrinkle to Wicksell the Irving Fisher distinction between the nominal and the real rate of interest. Let the monetary authority keep the nominal market rate for a time below the natural rate by inflation. That in turn will raise the nominal natural rate itself, once anticipations of inflation become widespread, thus requiring still more rapid inflation to hold down the market rate. Similarly, because of the Fisher effect, it will require not merely deflation but more and more rapid deflation to hold the market rate above the initial "natural" rate.

Volatility rising inflation and removal of increasingly higher relative prices of values that would establish a free market, transform the system into a less efficient introduce fictions in all markets and may lead to higher rates unemployment.

### **3. Conclusions**

The main conclusion to be drawn from the evolution of economic ideas about the existence of a relationship between inflation and unemployment level is that the incorporation of price expectations within the analytical framework allowed warnings that the early version of Phillips curve was too simplistic. Implicitly, the supposed relationship posed a naive behavior of economic agents. Monetarists warn authors which contributed to these shortcomings and failures of the facts that Phillips curve was one of the favorite targets of attacks of the counter-revolution monetarist.

That is why it is said that the monetarist counter-revolution has complied with a scientific purpose: to challenge and discard the enormous amount of intellectual banalities that accumulated after a successful ideological revolution in economics (Johnson 1971). Deflation will never create unemployment as inflation will never create jobs (although they will be created by the state by printing money, other jobs will be lost in the private sector by reducing the welfare produced by inflation).

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