

THE UNEMPLOYMENT PROBLEM: WHEN AND HOW WILL IT BE RESOLVED?

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During the last four years Cyprus has followed a very strict and demanding 'memorandum of understanding' imposed by the 'Troika' (consisting of representatives of the European Commission, the IMF and the European Central Bank) with the purpose of restructuring the economy, mainly its banking and public sectors.

Unfortunately, and despite the sacrifices Cypriots were called to accept (a large and unfair reduction of deposits above the threshold of 100,000 euros in just two of the banks, the dramatic closure of a large number of SMEs, small and medium enterprises, the reduction in salaries and other benefits, just to mention a few) the end result is not at all bright.

Most specifically the economy hasn't been able to achieve any noteworthy growth rates. The latest available Statistical Service data indicates that at constant prices the GDP growth rate at the end of 2015 was at 2,5% which nevertheless wasn't enough to create new employment opportunities. The numbers of registered unemployed persons in February 2016 were still 45,961 (it must be stressed that this figure is not reflecting the real number of unemployed persons as many unemployed persons after receiving the unemployment benefit simply cease signing as unemployed persons but that doesn't mean they have secured any permanent employment).

The government, in its effort to alleviate this problem, has implemented a number of schemes (such as: the subsidization of salaries for firms employing unemployed persons and training programs) yet all these haven't brought about the much wanted result.

Unemployment is a complex problem and theorists view it through a variety of lenses:

Keynesian economists [supporting the various theories about how in the short run, and especially during recessions, economic output is strongly influenced by aggregate demand] proclaim that aggregate demand does not necessarily equal the productive capacity of the economy; instead, it is influenced by a host of factors and sometimes behaves erratically, affecting production, employment, and inflation and propose that there is a "natural rate" of unemployment because the skills of laborers and the positions available are slightly out of synchronization even under the best economic conditions.

Neoclassical economists [who support a set of solutions to economics focusing on the determination of goods, outputs, and income distributions in markets through supply and demand] believe that this determination is often mediated through a hypothesized maximization of utility by income-constrained individuals and of profits by firms facing production costs and employing available information and factors of production, in accordance with rational choice theory and postulate that the labor market is efficient if left alone, but that various interventions, such as the minimum wage laws and unionization, place supply and demand out of balance.

Additionally there are **other theorists** who approach the unemployment problem in different ways, such as 'ours' Prof Pissarides who in his book *Equilibrium Unemployment Theory*, as well as in other books and articles, has provided a standard reference in the literature of the macroeconomics of unemployment resulting in the analysis of both endogenous job creation and destruction. Furthermore the Mortensen-Pissarides model, that has resulted from his work, has been exceptionally influential in modern macroeconomics. In one or another of its extensions or variations, today it is part of the core of most graduate economics curricula throughout the world, yet it did not have the acceptance it deserves on the part of policy makers.

Solutions, such as the ones the Cyprus government is attempting to implement are only touching the surface of the problem and at best they are only going to bring about marginal and temporary results.

The unemployment issue (which must be stressed is not just an economic but also and most importantly a social one) will only be satisfactory addressed if growth stabilizes and if local and especially foreign direct investments (FDI) resume. None of these two prerequisites has been even remotely achieved. In fact, and despite the numerous efforts towards this direction, there haven't been any indications that FDI's are expected to materialize soon.

Foreign direct investment includes "mergers and acquisitions, building new facilities, reinvesting profits earned from overseas operations and intra company loans". FDI usually involves participation in management, joint-venture, transfer of technology and expertise. *Stock* of FDI is the *net* (i.e., inward FDI minus outward FDI) cumulative FDI for any given period. Direct investment excludes investment through the purchase of shares. FDI is one example of international factor movements. Foreign direct investment (FDI) is a controlling ownership in a business enterprise in one country by an entity based in another country. Foreign direct investment is distinguished from portfolio foreign investment, a passive investment in the securities of another country such as public stocks and bonds, by the element of "control".

The primary types are:

1. **Horizontal FDI**, that arises when a firm duplicates its home country-based activities at the same value chain stage in a host country through FDI
2. **Platform FDI**, that happens when foreign direct investment takes place from a source country into a destination country for the purpose of exporting to a third country.
3. **Vertical FDI**, that takes place when a firm through FDI moves upstream or downstream in different value chains i.e., when firms perform value-adding activities stage by stage in a vertical fashion in a host country

Having the above in mind it is obvious towards which direction our economy and its stakeholders and policy makers need to move in order to achieve sound and sustainable investments that will gradually face the unemployment problem. Any other approaches are only going to give the illusion that the problem will be faced.