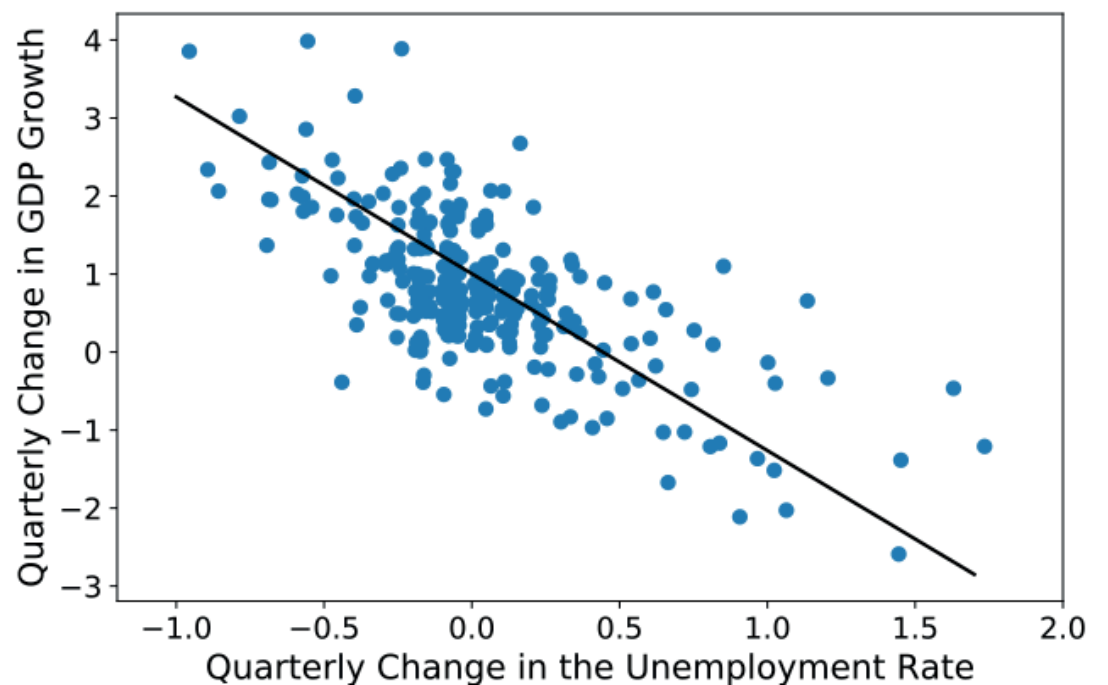


## Seminar

# The revival of Okun's method for the estimation of potential output

theoretical and empirical issues



## NAPLES

**30 | 3 | 2023 | 3:00 pm**

National Research Council  
Institute for Studies  
on the Mediterranean

CNR-ISMed  
Via Cardinale Guglielmo Sanfelice, 8  
Naples

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## The Journal of Insurance Issues

Publishing opportunities

### Abstract

Especially after the Great Recession, the mainstream view of potential output has been affected by interpretative difficulties and low reliability of empirical estimates. We identify in the demand-led growth perspective a more promising theoretical framework both to define the notion of potential output and to gauge the long-term effects of a demand slow down. We also propose an alternative estimation method, based on an update of Arthur M. Okun's original one, which, differently from the estimation methods currently in use, does not rely on the notion of NAIRU, thus being immune to its theoretical and empirical shortcomings. Our calculation, based on a re-estimation of Okun's Law on US quarterly data, shows both how far an economy generally operates from its production possibilities, and how much potential growth is affected by the actual growth of demand over time.

Based on the essential role, in Okun's estimation procedure, of the official rate of unemployment and on the apparent incapability of the latter to fully account for labor underutilization (especially apparent during and after the COVID crisis), we also extend our Updated Okun Method to broader measures of the labor input, by using both alternative unemployment indicators (according to the BLS definitions) and an indicator of 'standardized hours worked' which we propose as a novel measure. The method we employ invites reflection on the possible different empirical measures of full employment. We define a 'corridor' of output gap estimates and propose a procedure to identify in different circumstances the most relevant gap for policy purposes.



### Info and contacts

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