

Abstract

Okun's law postulates a negative bi-directional relationship between unemployment and output. The purpose of the present study is to estimate the relationship for the Baltic States for the period 1997/1998-2007. Several methods were employed to examine Okun's proposition. First, the cointegration analysis and application of the error correction model showed if there existed a long term link between the variables. Additionally, two original Okun's equations were estimated: the difference specification and the gap specification, which relates cyclical output to the cyclical unemployment rate. Cyclical components were extracted with the help of Hodrick-Prescott filter. The results did not indicate any persistent evidence of the strong relationship between output and unemployment for the samples. Two explanations are in order: data reliability issues and labor market features.