

## U3 or U5: a note

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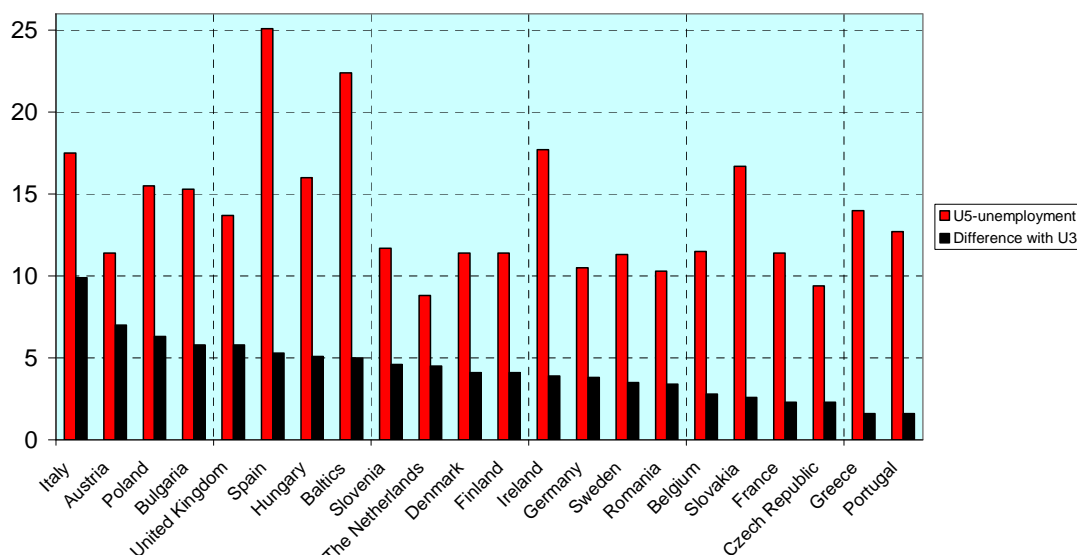
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**Summary.** In EU countries, differences between the widely used 'U-3' measure of unemployment and the less often used and broader 'U-5' measure vary from 1.5% for Greece to 9.9% for Italy, whereas in the USA state level differences vary only from 0.5% to 2.0%. Therefore, contrary to the situation in the USA, U-5 seems a better metric than U-3 for analyzing differences in EU unemployment. Looking at U-5 we see that Italy and the UK do relatively worse, while France does relatively better. As a consequence, differences within the Euro area as well as within the EU, which after the 2008 demand crash increased, become even more pronounced when considering U-5, complicating EU-level economic policy.

Despite minimal economic growth during the Berlusconi era, U-3 unemployment in Italy is, comparatively, surprisingly low. It is about as high as in the UK and quite a bit lower than in France. And the increase of U-3 unemployment in Italy between 2008 and 2010 was one of the lowest of the EU. Is this the result of a dynamic labor market, a phenomenon so rare in rich, capital intensive economies: adapting labor demand to labor supply without growth? Or are we just looking at the wrong metric? Eurostat has recently published estimates which enable calculation of 'U-5' unemployment, i.e. 'normal' U-3 unemployment plus the jobless willing and able to work *who do not seek actively for a job* (Eurostat (1) and (2), 2010, third quarter).<sup>2</sup> 'U-5' unemployment in Italy is, at 17,5%, surprisingly high. And much higher than in France or the UK. So, looking at 'U-5' instead of 'U-3' does make a difference. How does our view of the European situation change when we look at U-5 instead of U-3 for all EU countries (graph 1)?<sup>3</sup>. Some remarks:

Graph 1. U5-unemployment and difference with U3, 2010-III



Source: Eurostat. The Baltics: Estonia, Lithuania, Latvia.

<sup>1</sup> This research has been done independently of the author's position at Wageningen University and Research.

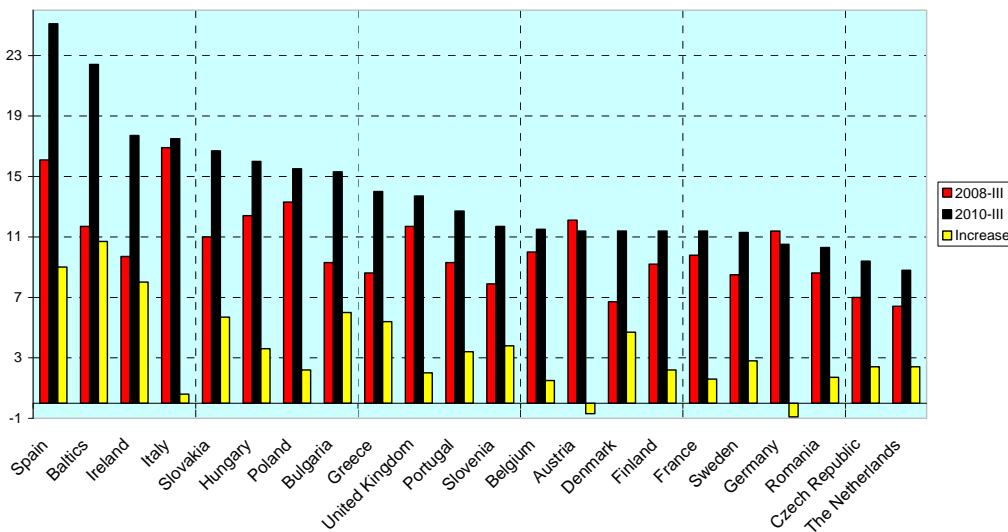
<sup>2</sup> As far as I could find, there is no Eurostat publication which shows U-5, it just publishes the building blocks. The exact definitions of U-5 can be found on the Bureau of Labor Statistics (BLS) website as well as on the OECD website.

<sup>3</sup> The more widely used U-6 index also adds those with involuntary short time work.

1. U-3/U-5 differences between countries are large and range from about 1,5% (Greece, Portugal, some transition countries) to about 6% in the UK and 10% in Italy.
2. Italy has by far the largest difference between the U3 and the U5 figures and does, despite the limited increase of unemployment between 2008 and 2010, as badly as countries heavily hit by the 2008 crisis, like Ireland and Slovakia and worse than Portugal and Greece (though unemployment in Greece is increasing).
3. Differences between the northern 'relatively (!) low unemployment' countries (Austria, the Netherlands, Germany) become smaller, and Finland, the Czech Republic, Sweden and Belgium also belong to this club (11,5% threshold). Denmark (11,7% U-5) is not added because it now seems to be in the feared 'double dip' as its GDP is declining and unemployment is rising. France might soon join the club.
4. Differences between countries with comparatively high unemployment (>15%) also become smaller, and Poland and Bulgaria join this club.
5. This means that differences within the EU, as well as the Euro area, become more pronounced.
6. Romania and Slovenia have quite low unemployment, which is not very consistent with their present level of economic development.

U-5 therefore accentuates differences between 'Greater Germany' and the rest of Europe. But should we generally look at U-5 unemployment instead of U-3 unemployment? Does it yield more meaningful information than looking at U-3? That, of course, depends on our goal. Looking at the data, I do get the idea that U-5 is better suited when one wants to make international comparisons, as the boundary between U-3 and U-5 seems to be sensitive to the phase of the business cycle and institutional differences between countries. Tellingly, state level differences in a more homogenous economic area like the USA differ, according to ocular inspection of the Bureau of Labor Statistics 2010 data, only between 0,5% for North Dakota to 1,8% for Mississippi (BLS (2)). For comparison: U-5 in the entire EU is 14,3%, up from 14% a year ago (2010, third quarter). In the USA it's 10.5%, down from 11.9% a year ago (2011, February, BLS (1)) <sup>4</sup>. So, U-5 might, especially for the EU, tell a better comparative story than U-3. What happens when we look at post-2008 developments (Graph 2)?

Graph 2. U5 unemployment in Europe, 2008 and 2010 (third quarter)



<sup>4</sup> The EU metric not based on national data but on an EU wide survey. Eurostat (1).

Source: Eurostat

I will restrict my comments to three noteworthy aspects of these data.

- A. *Real estate, real estate, real estate.* Of the five countries with the highest unemployment, four were characterized by housing bubbles which were at least partly fuelled by capital inflows (Italy is the exception). And they are not alone: of the three countries with the lowest increase in unemployment, two experienced a very or quite sluggish housing market (Italy and Germany, I do not know about Austria). *I'm not the first to state this, but preventing and detecting real estate bubbles is an urgent task for policy makers and economists. It 's beyond the scope of this article, but we might start with observing the difference between (re)building costs of dwellings (without land) and the price of land.*<sup>5</sup>
- B. *Flexibility or growth?* The OECD has a metric on 'employment protection', to measure the flexibility of labor markets (OECD (1)). There is no apparent relation between this metric and levels of and changes in unemployment. Alas, OECD economists do not seem to realize the consequences (Wölfl and Mora-Sanguinetti (2011)). Spain has the highest unemployment of the large EU countries. The OECD analysis of events is clear. Pre-2008 Spain had the most dynamic job market in Europe – despite existing rigidities. Post-2008, Spain had the fastest rise of unemployment, not because of labor market rigidities but because of a demand crisis induced by an exploding, easy credit induced investment bubble. Surprisingly, the report states that demand crisis unemployment has to be solved by taking away rigidities. Increasing the efficiency of the labor market might lower the **25%** U-5 unemployment rate by, well, maybe about **0.2%** - by lowering the vacancy rate. It's like stating that an Usain Bolt (the Olympic champion) with pneumonia has to be cured by making his shorter leg as long as his other leg by advanced surgery instead of giving him anti-biotics (yes, he has a shorter leg, as well as a bad back. Just like the Spanish labor market he's not perfect... but it does not stop him). Let's be honest: solving 25% unemployment does not require supply or demand side tinkering, it requires an entirely different economy, just as the Great Depression was solved by the rise of the middle-class, the backward bending supply curve of labor and the welfare state (when U-5 unemployment is 25%, the number of jobs has to increase by a quarter to bring unemployment back to 5%!) Anybody any ideas?
- C. *Euro-problems.* As U-5 indicates that differences within the Euro area, which post 2008 already increased, are even larger than indicated by U-3, designing Euro (or EU) level economic or monetary policy becomes even more awkward.

## References:

Wölfl, A. and J. S. Mora-Sanguinetti (2011), "Reforming the Labour Market in Spain", *OECD Economics Department Working Papers*, No. 845, OECD Publishing. doi: 10.1787/5kghtch277h-en.

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<sup>5</sup> Which boils down to making a conceptual difference between produced capital goods (and profits) on one hand and natural assets (and rent) on the other. See Gaffney e.a. (1994) on how neo-classical economists tried to extinguish this distinction, thereby doing the exact thing which they were, some decades earlier, accused by Marx of doing. To get an idea of the difference: is the wealth of the Saudi royals (or the Koch brothers in the USA) based upon profit and enterprise – or upon the expropriation of rents from society?

Gaffney, M., F. Harrison, and K. Feder *The Corruption of Economics*. (London: Shephard-Walwyn).

Bureau of Labor Statistics:

<http://www.bls.gov/news.release/empsit.t15.htm> (1)

<http://www.bls.gov/lau/stalt.htm> (2)

Eurostat:

[http://epp.eurostat.ec.europa.eu/statistics\\_explained/index.php/Unemployment\\_statistics](http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Unemployment_statistics) (1)

[http://epp.eurostat.ec.europa.eu/cache/ITY\\_OFFPUB/KS-SF-11-008/EN/KS-SF-11-008-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-SF-11-008/EN/KS-SF-11-008-EN.PDF) (2)

[http://epp.eurostat.ec.europa.eu/cache/ITY\\_OFFPUB/KS-SF-10-012/EN/KS-SF-10-012-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-SF-10-012/EN/KS-SF-10-012-EN.PDF) (3)

OECD:

<http://stats.oecd.org/index.aspx>

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