



Policy Implications of the output gap estimates

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Output Gap Working Group Workshop, September 5, 2018, Vilnius

Implications to Fiscal Policy: The final stage of the working schedule of the EUNIFIs-OGWG

- ▶ The EU IFIs Output Gap Working Group: Timetable (as in August 2018)
 - ▶ 2017-2018: Study output gap and potential output estimation issues
 - ▶ Highlight any data or methodological problems faced by IFIs
 - ▶ Back-test methods performance: data collection, analysis
 - ▶ Draft Working Paper: 'A practitioner Guide to Output Gap and Potential Output Estimation'
 - ▶ Clarifies theoretical concepts
 - ▶ Assesses alternative estimation methodologies
 - ▶ Highlights sources of uncertainty surrounding potential output or output gap estimates
 - ▶ 2019: Study the implications of methodologies for fiscal policy: structural balance estimates
 - ▶ Provide an overview of how output gap estimates are translated into structural balance figures
 - ▶ Assess the implications in terms of revisions and uncertainty of the structural balance estimates
 - ▶ Examine the connection with existing EU and national fiscal rules

Fluctuations in Public Finances and Fiscal Policy

- ▶ Fiscal variables and budget balance subject to various sources of fluctuations:
 - ▶ cyclical (i.e. public expenditure increase for unemployment benefits in recessions)
 - ▶ temporary (i.e. public revenue increase from liquidation of state property fraction)
 - ▶ discretionary fiscal policy (i.e. public revenue increase from permanent tax increase)
- ▶ Budgetary position (net of- or) 'underlying' (some of) the above fluctuations:
 - ▶ Fiscal position when economy operates at its potential level (i.e. full employment)
 - ▶ Permanent fiscal position
 - ▶ Budgetary position before and after a discretionary fiscal policy action
- ▶ Assessment of the 'underlying' budgetary position is necessary for fiscal policy:
 - ▶ Assessment of discretionary fiscal policy actions (and its effectiveness)
 - ▶ Avoidance of procyclical discretionary fiscal policy
 - ▶ Sustainability of Public Finances

Structural Balance and Output Gap

- ▶ Structural Balance: typical Indicator of budgetary position underlying both cyclical and temporary fluctuations
 - ▶ Change in Structural Balance: Change of Budget Balance due to impact of discretionary fiscal policy : Fiscal Effort
- ▶ European Commission Method: 'Output Gap Based' (Vade Mecum, 2018)
 - ▶ Formula: $SB = BB - \varepsilon \times OG - OO$, where
 - ▶ SB: Structural Balance, BB: Budget Balance
 - ▶ ε : semi elasticity of budget balance to output gap (degree of budget cyclicity)
 - ▶ Update estimates every six to five years
 - ▶ OG: Output Gap estimate (using the Commonly Agreed Methodology)
 - ▶ OO: One-off and other temporary (budget improving) measures
- ▶ Other institutions, i.e. ECB, use different ways (i.e. disaggregated) to adjust for cyclical fluctuations
 - ▶ Consider different degree of cyclicity of budget balance items
 - ▶ Hodrick – Prescott filter instead of CAM production function method to assess cycle



Uncertainty in Structural Balance

- ▶ Extensive empirical literature (i.e. Tureanu et al. 2014 IMF).
- ▶ Sources of Uncertainty
 - ▶ Uncertainty in Output Gap /Potential Output Estimation
 - ▶ Model / Data / End – Sample Uncertainty
 - ▶ Structural Balance Model Uncertainty
 - ▶ Semi-elasticities of Budget Balance, Aggregate vs Disaggregated Approaches
 - ▶ Identification of One – Offs and temporary measures
 - ▶ European Commission guiding principles (Report of Public Finance, EC, 2015)
- ▶ Workshop on Structural Balance and Uncertainty of Output Gap Estimation, National Audit Office of Finland, March 2017
 - ▶ Significant Revisions in Structural Balance Estimates (Austria, EU member states)
 - ▶ Revisions in Output Gap Estimates , Forecast Errors
 - ▶ Larger revisions in levels than first differences
 - ▶ Model Uncertainty / Parameter Uncertainty (Finland, Italy, Greece)
 - ▶ Alternative methods to estimate budgetary cyclicalities (Finland, Slovakia)



Implications for national fiscal policy under the Growth and Stability Pact and Fiscal Compact

- ▶ European Commission aware of SB's and OG's uncertainty
 - ▶ EC Recommendations based not only on SB but on other indicators and judgment as well
 - ▶ Plausibility Tool and "Constrained Judgment"
- ▶ Growth and Stability Pact based on various metrics/indicators:
 - ▶ Compliance to the Preventive Arm: MTO in terms of the level of SB, but
 - ▶ Matrix of requirements: Required fiscal effort in terms of SB changes, based on Potential Output and Level of Output Gap
 - ▶ Expenditure Benchmark based on Potential Output Growth
 - ▶ Compliance to the Corrective Arm
 - ▶ Expenditure benchmark based on Potential Output Growth
 - ▶ Careful Analysis (Bottom Up) of Effective Action
- ▶ Fiscal Compact and rules-based fiscal policy: Implementation of national fiscal rules that trigger automatic corrections based on single indicators
 - ▶ Assessment of the correct timing and amount of correction
 - ▶ Timing of assessment: Large Forecast errors in ex-ante / Large Revisions in ex-post assessments



Implications to Fiscal Policy: The final stage of the working schedule of the EUNIFIs-OGWG: Key study issues

- ▶ 2019: Study the implications of methodologies for fiscal policy: structural balance estimates
 - ▶ Provide an overview of how output gap estimates are translated into structural balance figures
 - ▶ Cyclicalities of budget balance items
 - ▶ Assess the implications in terms of revisions and uncertainty of the structural balance estimates
 - ▶ Measurement uncertainty: Frequency and magnitude of revisions in SB estimates
 - ▶ Asymmetric implications in economic upturns/downturns and/or across budget items
 - ▶ Examine the connection with existing EU and national fiscal rules
 - ▶ Internal consistency among the various cyclically adjusted criteria for fiscal policy assessment and surveillance



Thank you for your attention!