General government structural balance

General government spending and revenues are highly sensitive to cycles in economic activity. Government revenues (particularly tax revenues) tend to decline during economic downturns, at the same time as public spending may increase given that more people become unemployed and qualify for social assistance or unemployment benefits. On the other hand, during upturns public finances improve, as tax revenues rise and the number of those receiving social benefits usually declines. These fluctuations in revenue and public expenditure –in the absence of any discretionary change in policy– make it difficult to assess whether fiscal policy is expansionary, neutral or restrictive during a given period, and to judge whether fiscal balances are sustainable in the long-run.

These factors are considered in the calculation of the government's structural balance, which results from subtracting the aforementioned cyclical effects in the economy, as well as one-off events, from both government expenditures and revenues. Separating the structural from the cyclical components of the fiscal balance provides a clearer picture of the underlying soundness and sustainability of fiscal policy.

In order to estimate the structural balance, the structural and cyclical components of both the fiscal balance and output (i.e. potential GDP) need to be estimated. In the case of fiscal accounts, structural spending and revenues are separated from discretionary spending and revenues, respectively. For potential GDP, a long-term output trend is estimated to distinguish between structural and cyclical output.

Even though structural fiscal balances deteriorated in the advent of the financial crisis, as of 2015 the magnitude of structural deficits decreased across OECD countries: on average, OECD countries experienced a structural balance of -2.4% of potential GDP in 2015, improving from -6.3% in 2009 and -3.2% in 2007. A comparison between 2009 and 2016 is stark: only Finland and Hungary had a deterioration of their structural balances, which resulted in structural deficits of 0.1% and 3.0% respectively in 2016, while all other OECD countries improved their structural balance. In 2016, the largest structural deficit was in Japan (4.8%), followed by the United States (4.3%) and the United Kingdom (4.1%). Conversely, the largest structural surpluses were in Greece (6.1%), where it was mainly due to a fall in potential GDP, Korea (2.5%), Luxemburg (1.6%) and Estonia (1.5%).

The estimated structural balance is best understood vis-à-vis the fiscal balance and net lending/borrowing positions, as the contrast helps gauge the differences between short-run and long-term sustainability of public finances. Between 2007 and 2015, even though the average structural deficit across OECD countries shrank from 3.2% to 2.4% of GDP, while the observed fiscal deficit increased from 1.8%

to 2.8% of GDP, both levels are converging as the economies approximate their long-term output levels after the crisis. For example, Ireland had a deficit of 13.8% of GDP in 2009 and a structural deficit of 8.7% of potential GDP for that year, yet in 2015 the observed deficit decreased to 2% of GDP while structural deficit reached 1.2%.

As structural fiscal balances weight the long-term trends more than short-term fluctuations, they can be more easily combined with other macroeconomic projections into the near future. Based on OECD estimates, fiscal consolidation has come to an halt as structural primary balances are expected to deteriorate between 2016 and 2018 for most OECD countries by an average -0.4 p.p. of GDP. For this period, the largest projected changes are for Greece (-2.7 p.p.) Hungary (-2.2 p.p.), and Luxembourg (-2.1 p.p.).

Methodology and definitions

Data are drawn from the *OECD Economic Outlook*, No. 101 (database). The structural fiscal balance, or underlying balance, represents the fiscal balance as reported in the *System of National Accounts* (SNA) framework adjusted for two factors: the state of the economic cycle (as measured by the output gap) and one-off fiscal operations. The structural primary balance adjusted also for the impact of net interest payments on general government liabilities (i.e. interest payments minus interest receipts). The output gap measures the difference between actual and potential GDP, the latter being an estimate of the level of GDP that would prevail if the economy were working at full capacity. Potential GDP is not directly observable and estimates are subject to substantial margins of error. One-off factors include both exceptional and irregular fiscal transactions as well as deviations from trend in net capital transfers. For more details, see *OECD Economic Outlook* "Sources and Methods" (*www.oecd.org/eco/sources-and-methods*).

Further readings

OECD (2017), *OECD Economic Outlook*, Volume 2017 Issue 1, OECD, Paris, *http://dx.doi.org/10.1787/eco_outlook-v2017-1-en*

Figure notes

Data for Chile, Mexico and Turkey are not available.

Information on data for Israel: *http://dx.doi.org/10.1787/888932315602.*

2.6. General government structural balance as a percentage of potential GDP, 2007, 2009, 2015 and 2016

◇ 2007   △ 2009   ■ 2015   — 2016

Source: OECD *Economic Outlook*, No 101, June 2017

StatLink ⧉ http://dx.doi.org/10.1787/888933531440
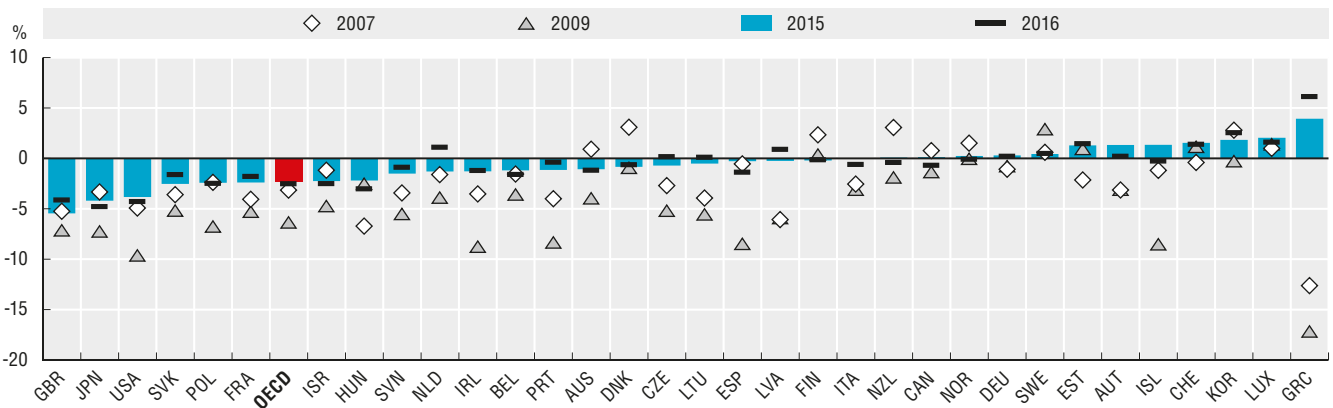
2.7. General government structural primary balance as a percentage of potential GDP, 2007, 2009, 2015 and 2016

◇ 2007   △ 2009   ■ 2015   — 2016

Source: OECD *Economic Outlook*, No 101, June 2017

StatLink ⧉ http://dx.doi.org/10.1787/888933531459
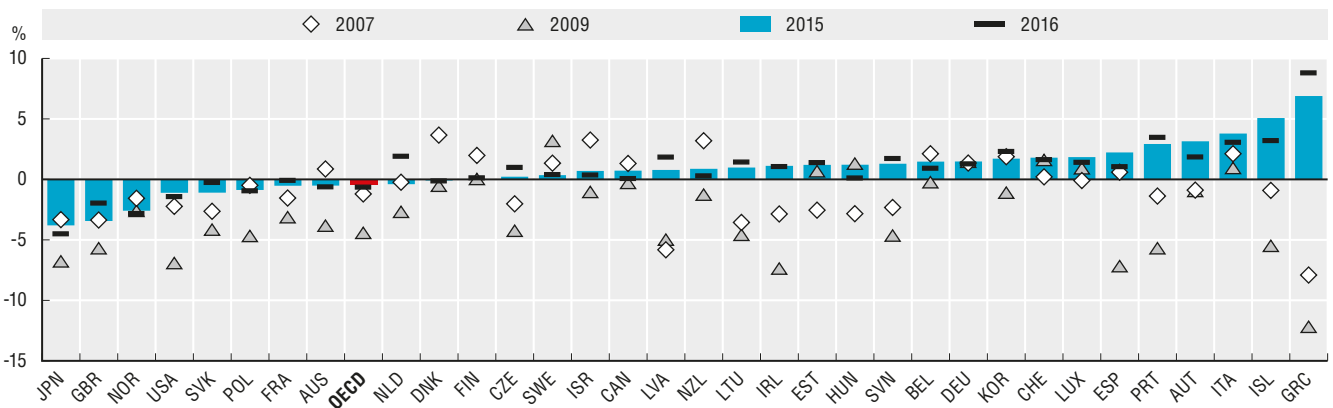
2.8. General government projected structural primary balance as a percentage of potential GDP in 2017 and 2018 and change since 2016

■ Change between 2016 and 2018   ■ 2017   △ 2018

Source: OECD *Economic Outlook*, No 101, June 2017

StatLink ⧉ http://dx.doi.org/10.1787/888933531478