Box B: Use of Alternative Output Gap Measures by EU Finance Ministries

This Box outlines the reporting of output gaps by Finance Ministries subject to EU fiscal frameworks. It assesses whether alternative estimates of the output gap are typically shown alongside (or in place of) estimates produced under the commonly agreed methodology, how alternative estimates are presented, and whether the approach used by the Department of Finance may be improved in light of the presentational approaches adopted elsewhere. Presenting alternative approaches is a favourable means of highlighting the uncertainty that surrounds estimates of the supply-side.

The output gap is an important indicator of the state of an economy's output relative to the output that could be produced if the economy were in a "normal" state.[1] Since an economy's potential growth cannot be observed and has to be estimated, the statistical and econometric methods used can be a source of some contention.[2] For these and other reasons, it is often advisable not to rely on any single method of estimating the output gap. The Department of Finance, however, presents estimates under the commonly agreed methodology as its official assessment of the output gap, thus mirroring the EU Commission's approach. The Department have expressed serious reservations with the approach's validity for Ireland in the past (as have others), however, and the fiscal rules do not explicitly preclude the use of alternative measures.

Table B.1: Stability/ Convergence Programme Output Gap Reporting Across Countries

Country	No. Output Gap Measures Reported	Commonly Agreed Methodology Output Gap Reported	Where	Alternative Output Gap Reported	Where	Link
Austria	1	Yes	Table 5	No	-	SP
Belgium	1	No	-	Yes	Table 6	SP
Bulgaria	1	Yes	Table 5	No	-	CP
Croatia	1	Yes	Table 5	No	-	CP
France	4	Yes	Table 5	Yes	Text (pp.10)	SP
Germany	1	Yes	Table 17	No	-	SP
Hungary	1	No	-	Yes	Table 4	CP
Italy	2	Yes	Table III.9	-	-	SP
Latvia	2	Yes	Text (pp.16)	Yes	Table 5	SP
Lithuania	1	No	-	Yes	Table 9	CP
Luxembourg	2	Yes	Box 2	Yes	Table 5	SP
Malta	1	Yes	Table 5	No	-	SP
Netherlands	1	Yes	Table 5	No	-	SP
Poland	1	Yes	Table 1	No	-	CP
Romania	1	Yes	Table 5	No	-	CP
Slovakia	2	Yes	Tables 4 and 5	Yes	Table 3	SP
Slovenia	1	Yes	Table 4.4	No	-	SP
Spain	1	Yes	Table 4.6.1	No	-	SP

[1] A normal state might refer to, for example, a situation where factors of production like labour and capital are being best employed, with unemployment near its natural rate, and productivity at trend levels and capital fully utilised.

[2] This is particularly relevant for small open economies like Ireland's where *ex post* national accounts revisions are large, labour supply is highly elastic and subsequent estimates of the output gap are subject to pronounced levels of uncertainty.

Sweden	1	No	-	Yes	Table 3	CP
UK	18	Yes	Chart 3.8	Yes	Chart 3.1	CP

* Note that the Netherlands Ministry technically only shows the CAM output gap in their Stability Programme, even though the CPB – who produce the estimates – report on alternative estimates in certain publications.

Table B.1 examines the cross-country variation in output gap reporting. Of the 20 Finance Ministries examined, 9 clearly present alternative output gap measures. In some cases these are completely unique approaches, while in others, they are adaptations of the commonly agreed methodology. It is not unusual for a country to present multiple alternative output gap estimates, including those from other agencies, where these are available, such as in the UK and France. Of the smaller economies examined, 8 out of the 14 rely on the CAM without presenting alternative estimates, whereas 6 of the 14 present their own favoured approach. Three of these (Latvia, Luxembourg and Slovakia) present estimates under both the CAM as well as their own preferred approaches.

The presentational form employed by those finance ministries that show several alternatives varies. In most cases, to avoid confusion, the preferred estimate of the output gap is included in the main Table describing cyclical developments. Estimates produced under the commonly agreed methodology are then given relatively more limited coverage, simply being referred to in the text or in accompanying charts.

Based on international practice, it does not appear unusual to see Finance Ministries presenting alternative estimates of the output gap to that of the Commonly Agreed Methodology. Given the advantages of doing so for Ireland where output gap estimates are subject to high levels of uncertainty, it would be advisable for the Department of Finance to examine its own presentational approach with a view to supplementing the estimates currently provided.