Box H: Covid-19, the structural balance, and one-off/temporary measures

This box outlines the challenges in estimating the structural balance in light of the Covid-19 pandemic. It also provides a preliminary examination of the extent of one-off and temporary measures introduced in response to the Covid-19 pandemic on the basis of the standard approaches adopted in the fiscal rules.[71]

In its Draft Budgetary plan submitted to the European Commission, the Department of Finance included estimates of the structural balance.[72] However, following guidance from the European Commission, these estimates of the structural balance did not incorporate any one-off/temporary measures related to Covid-19. While at present it may be difficult to determine what measures are truly one-offs, to get a true sense of the structural balance, the impact of one-off/temporary measures needs to be factored in.[73]

Uncertainty, measurement issues and the structural balance

In normal times, the in-year and year-ahead estimates of structural balance are surrounded by some degree of uncertainty. Often, this is due to issues relating to measuring the current point the economy is at in the economic cycle (the output gap), and also due to the uncertainty in estimating the effect that changes in the cyclical position of the economy have on government revenue and expenditure.[74] The effect that the Covid-19 pandemic has had on the economy has exacerbated these issues.

The lasting effect of the Covid-19 crisis on the economy is not yet known. As a result, estimating the potential or sustainable level the economy can currently operate at is challenging. For instance, it is not yet known how many businesses will no longer be viable and how many job losses will become permanent.[75] The more viable businesses that fail, the lower the potential productive capacity of the economy. This creates substantial uncertainty about the current level of potential output and how far away from that level the economy is currently operating at.

Furthermore, the Covid-19 crisis is not a typical economic downturn. The structural balance adjusts the headline government balance for revenues and expenditures which typically fluctuate in line with the economic cycle. When an economy is booming, revenues are higher and expenditures are lower, than they would be if the economy were operating at a sustainable level. Similarly, in a downturn, revenues are lower, and expenditures are higher than they might otherwise be. However, the magnitude of this typical relationship between the budget balance and the economic cyclical may not hold for this unique downturn.

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[71] The structural balance is estimated as: $SB_t = GGB_t - Oneoffs_t - 0.588 \times OG_t$, where GGB, the general government balance, and one-offs are expressed as a per cent of GDP, and OG is the output gap expressed as a percentage of potential GDP. Alternatively, Modified Gross National Income (GNI*) can be used instead of GDP as a denominator.

[72] These estimates were not included in the documentation published on Budget Day (13th October 2020), but were submitted to the European Commission on 15th October 2020.

[73] Without factoring in one-off/temporary measures, the estimate is not a true structural balance, but simply a cyclically adjusted balance.

[74] A separate issue in estimating the structural balance, but unrelated to Covid-19, is the continued overperformance of corporation tax receipts that cannot be explained by the underlying performance of the domestic economy (for further information, see Box H of the May 2020 FAR (Fiscal Council, 2020a)). The structural balance estimates do not reflect the degree to which these receipts may prove transient.

[75] To date, there has been limited impact of the crisis on firm insolvencies, likely due to government business supports, loan payment breaks and other support measures introduced since the onset of the Covid-19 pandemic (see McGeever, Sarchi and Woods, 2020). However, these supports will not continue indefinitely, and a prolonged crisis will increase the likelihood of more business closures.

For instance, the typical elasticities between economic activity and income tax have performed poorly at estimating the fall in tax revenue (they predicted a much larger fall in tax revenue than was the case). This is partly due to the composition of the employment losses (mainly at the lower end of the income distribution) and the progressive tax system (those at the lower end of the distribution pay less taxes). Similarly, the typical elasticities used to estimate the response of the Government's budget to the economic cycle will not accurately capture the dynamics of this crisis. This will lead to measurement error in the structural balance.

In addition to those measurement issues, there is also some uncertainty around the degree to which measures introduced in response to this crisis are temporary or permanent measures. While temporary measures affect the headline budget balance, they do not affect the underlying budgetary position and so do not affect the structural balance. This box uses the best available information to determine what can currently be considered one-off/temporary measures to get a preliminary estimate of the structural balance.

Expenditure one-offs

As a starting point, all Covid-19 related expenditures are considered temporary measures. This amounts to some €16.7 billion in 2020 and €11.9 billion in 2021 on a general government basis. However, as outlined above, the structural balance also adjusts the headline government balance for expenditure that is cyclical in nature. Typically, this accounts for unemployment-related expenditure, which rises in downturns and falls in upturns in the economy. As a result, some of the Pandemic Unemployment Payment (PUP) expenditure can be considered cyclical. Were the PUP not in place, many of the recipients would likely have received standard unemployment benefits. To avoid double-counting these expenditures, the amounts for the PUP are subtracted from the Covid-19 related expenditure above.[76]

Revenue one-offs

Revenue one-offs for 2020 include: (1) an assumed (by the Department of Finance) unrecovered tax warehousing costing €500 million; (2) a temporary cut in the standard rate of VAT costing €280 million in 2020; and (3) €580 million relating to one-off stamp duty receipts.[77] For 2020, these net to a one-off reduction in revenue of €200 million (Table H.1). The one-offs assumed for 2021 are €140 million for the stay-and-spend initiative and €160 million from the reduction of the standard rate of VAT. These measures net to a one-off reduction in tax revenue of €300 million in 2020.

Table H.1 outlines the amounts the Council deems as one-offs at this time. In the future, some of these measures currently considered temporary, may be considered permanent.

With the above caveats in mind, Figure H.1 decomposes the headline general government balance into one-offs, interest payments, a cyclical component, and the structural primary balance. While most of the deterioration in the general government balance in 2020 can be attributed to one-off/temporary measures introduced in response to Covid-19, there was also a structural deterioration (Figure H.1). The headline general government balance is forecast to improve marginally in 2021. This is mainly due to a fall in one-off/temporary measures in 2021. This leaves an estimated structural primary balance of -0.9 per cent of GNI* largely unchanged from 2020.

[76] Note, this adjustment only applies to the one-offs included in this chapter, to avoid double counting of unemployment-related expenditure in the assessment of the Expenditure Benchmark and the structural balance.

[77] This receipt relates to a single, large transaction that incurred a tax liability. While tax receipts are not usually considered for one-offs, on this occasion the amount was considered worthwhile as it was (a) inherently once off in nature, (b) large (greater than 0.1 per cent of GNI*), and (c) outside of the usual volatility associated with this tax head.

Table H.1: One-off and temporary measures

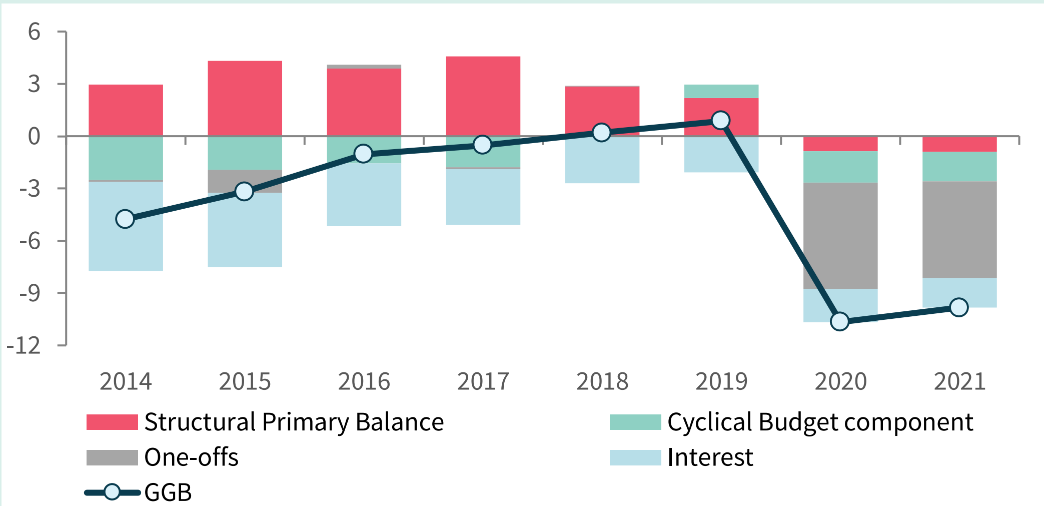
€ millions unless stated

	2020	2021
Expenditure		
Covid-19	16,699	11,887
less PUP	-4,550	-644
Expenditure one-offs	12,149	11,243
Revenue		
Tax warehousing write-off	-500	
VAT standard rate cut	-280	-160
Stay and Spend		-140
Stamp Duty	580	
Revenue one-offs	-200	-300
Total one-offs	**-12,349**	**-11,543**

Sources: Department of Finance; and Fiscal Council workings.
Note: The PUP expenditure is excluded from one-offs to avoid double counting of this expenditure in the adjustments for the Expenditure Benchmark and the structural balance. The cut in the rate of VAT for the tourism sector is not considered a one-off at this time. The previous time this measure was introduced it remained in place for several years. Instead, it is classified as a discretionary revenue-reducing measure. The figure for stamp duty relates to revenue from one extremely large transaction that incurred a tax liability.

Figure H.1: Decomposition of the general government balance

% of GNI*



Sources: CSO; Department of Finance; and Fiscal Council workings.
Note: The cyclical budget component is calculated as 0.588 times the Department's GDP output gap estimates.