Summary for non-specialists
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Adjusting the budget balance for the business cycle: the EU methodology

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The importance of the cyclically-adjusted budget balance (CAB) and of the structural balance (CAB minus one-offs and temporary measures) was restated forcefully with the reform of the European economic governance since 2011. In this context, the CAB methodology was improved by using a budgetary semi-elasticity (rather than a budgetary sensitivity) as cyclical adjustment parameter and by updating all weighting parameters used in the CAB (see Mourre et al. (2013) for technical details). The Commission also asked the OECD to revise their estimates of country-specific elasticities underlying the CAB.

This paper first recalls the main lines of the computation of individual revenue and expenditure elasticities: (i) the OECD continued to apply the two-step methodology used in Girouard and André (2005), (ii) the OECD improved the 2005 methodology by introducing some necessary refinements and useful methodological innovations.

This paper then thoroughly analyses the effect of the revision of individual revenue and expenditure elasticities on the cyclical adjustment of the budget balance (CAB methodology). The following insights could be drawn:

- Revisions in individual revenue and expenditure elasticities can be substantial at country level but do not follow a clear pattern across EU Member States, except for corporate income taxes, the revised elasticities of which seem to be higher than the former ones in most countries.

- Overall, the revisions of individual revenue and expenditure elasticities have a fairly limited impact on budgetary semi-elasticities.

- Revisions of individual revenue and expenditure elasticities do not substantially alter the level of the CAB on average and in most countries for most years. However, for specific countries in specific years, where the level of the output gap is large, the revision of the cyclical components can be non-negligible.