Long-term projections of public finances in European Countries

Per Eckefeldt
European Commission
Directorate General for Economic and Financial Affairs

Tokyo Fiscal Forum
Fiscal Policy for Long-Term Growth and Sustainability in Aging Societies

June 10-11, 2015
Deficit to debt: legacy of the crisis

Government balance

Gross debt as % of GDP - European Union - Medium-term debt projections

Baseline no-policy-change scenario
Stability and Convergence Programme (SCP) scenario
Stability and Growth Pact (SGP) institutional scenario
Smaller but sizeable ‘tax gaps’

S1 indicator

% of GDP

S2 indicator

% of GDP
Composition of the sustainability challenge (S2)
2015 Ageing Report

- Published on 12 May
- Council (ECOFIN) conclusions adopted on the same day
- Dramatic changes in the population structure over the coming 50 years in the EU

- Living longer than ever before is an enormous achievement for mankind – a great gift - but policies must adapt so that all people - young and old alike - will benefit from this
Demographic changes (2) Ageing populations weigh on labour growth

Working-age population (20-64):
- Until 2011: sluggish employment and slow growth in working-age population
- 2012-2022: rising employment, declining working-age population
- From 2023 onwards: both employment and working-age population decline

Total employment (20-64):
- Until 2011: sluggish employment
- 2012-2022: rising employment
- From 2023 onwards: employment decline

Employment rate (20-64):
- Until 2011: stable employment rate
- 2012-2022: rising employment rate
- From 2023 onwards: stable employment rate
Potential TFP growth in the EA, % change
Productivity level trends in the Euro area vs. the US

- TFP
- Capital Intensity (in PPS per Hour Worked)
Potential GDP

- much lower than in previous decades
- Revised downwards compared with a few years ago
Population ageing put upward pressure on public spending in the EU (2013-60)

- But lower projected increase than 3 years ago
- Mostly due to pension expenditure now projected to increase less
Risk factors

Fiscal policies

Potential growth and spending trends

Age-related expenditure under different scenarios, 2013-2060, pp. of GDP

- 4 -2 0 2 4

Structural primary balance (2016)

Structural primary balance (average 1998-2012)

European Union

- 4 -2 0 2 4

2013 2060 - AWG reference scenario 2060 - TFP risk scenario 2060 - AWG risk scenario

Pensions
Long-term care
Health care
Education
Unemployment benefits

Pensions
Long-term care
Health care
Education
Unemployment benefits
2015 Ageing Report

Pension spending increases: factors and risks

- Making pension reforms a lasting success is a challenge
- Flanking policies needed

Future demographic impact on public pension spending now fully offset in the baseline scenario

But additional policy action might be needed to secure the projected ‘no-policy-change’ scenarios

-dependency ratio
-labour market effect
-coverage ratio
-benefit ratio

\[
\text{PensExp} = \frac{\text{Pop}>65}{\text{GDP}} \times \frac{\text{Pop (15-64)}}{\text{Pop(15-64)}} \times \frac{\text{PensNo}}{\text{EmplNo}} \times \frac{\text{PensExp/PensNo}}{\text{GDP/EmplNo}}
\]

Future demographic impact on public pension spending now fully offset in the baseline scenario

But additional policy action might be needed to secure the projected ‘no-policy-change’ scenarios

EU: -0.2 pp. Of GDP
EA: -0.0 pp. Of GDP
The **new Juncker** Commission recommends three main pillars for the EU's economic and social policy in 2015 and beyond.
“The European Union is facing a risk of prolonged low economic growth, which would aggravate the already serious social problems in parts of the Union.

This is why today we propose a strategic policy mix based on investment, structural reforms and fiscal responsibility.

By acting together now, we can make sure that the conditions for sound and sustainable growth in the future are met and that our citizens have more opportunities for employment.”
Thank you for your attention!
Background slides
# European Semester: A Partnership EU-Member States

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<td>Autumn Economic Forecasts</td>
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<td>Annual Growth Survey and Alert Mechanism Report</td>
<td>Commission opinion on draft budgetary plans</td>
<td>Bilateral meeting with Member States</td>
<td>Fact-finding missions to Member States</td>
<td>Country Report per Member State (reform agenda and imbalances)</td>
<td>Bilateral meeting with Member States</td>
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<td>Finance ministers discuss EC opinions on draft budgetary plans</td>
<td>National ministers adopt conclusions on AGS + AMR</td>
<td>EU leaders adopt economic priorities based on AGS</td>
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<td>National ministers discuss the CSRs</td>
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<td>Member States adopt budgets</td>
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**Glossary:**
- **AGS**: Annual Growth Survey
- **AMR**: Alert Mechanism Report
- **CSR**: Country-Specific Recommendations

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Fiscal sustainability indicators
(tax-gap indicators)

- S1: Required PB adjustment to reach 60 % debt ratio in 2030
- S2: Required PB adjustment to keep debt bounded over an infinite horizon (intertemporal budget constraint of general government)
Decomposing the S1 and S2 indicators:
sustainability gap indicators depend on
- the short-term fiscal conditions (IBP and debt level); and,
- the long-term budgetary developments (CoA)

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<th>Required PB adjustment given the initial budgetary position (IBP)</th>
<th>Required adjustment to reach debt to GDP ratio of 60% in 2030 (DR)</th>
<th>Required adjustment due to the cost of ageing (CoA)</th>
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<td>S1= Gap to the debt-stabilising primary balance</td>
<td>Additional adjustment over a five-year period after the last year covered by the forecast required to reach a debt target of 60% of GDP in 2030</td>
<td>Additional adjustment required to finance the increase in public expenditure due to ageing up to 2030</td>
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<td>S2= Gap to the debt-stabilising primary balance</td>
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<td>+ Additional adjustment required to finance the increase in public expenditure due to ageing over an infinite horizon</td>
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