Box 9

PROJECTIONS OF THE IMPACT OF AGEING ON PUBLIC EXPENDITURE

On 14 February 2006, the EU's Economic Policy Committee (EPC) and the European Commission published a report on "The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004-2050)". The report presents estimates for the ageing-induced fiscal burden from 2004 to 2050 for all EU countries. It considers five areas of public expenditure: pensions, health care, long-term care, education and unemployment benefits. The estimates are based on commonly agreed assumptions regarding the future behaviour of demographic and key macroeconomic variables. Different methodologies are applied to estimate the ageing-induced expenditure increase in the individual areas: pension projections were carried out by national authorities, using their own respective methods; in the areas of health and long-term care as well as education and unemployment benefits, the European Commission estimated the effects.

From the perspective of the euro area, the results point to substantial ageing-induced expenditure pressures stemming from increased pensions, health care and long-term care costs (see table below). By 2050 the increase in spending amounts to 4.6% of GDP for the euro area, ranging from 0.4% to over 10% of GDP for individual countries. The timing of the effects of ageing also differs from country to country, but in general the effects will accelerate after 2010. Reduced unemployment benefits and education expenditure are likely to have only a small easing effect of, on average, less than 1% of GDP.

Projected changes in selected age-related public expenditure between 2004 and 2030/50[1)]

(as percentages of GDP)

	Pensions		Health care		Long-term care		Total	
	Change from 2004 to		Change from 2004 to		Change from 2004 to		Change from 2004 to	
	2030	2050	2030	2050	2030	2050	2030	2050
Belgium	4.3	5.1	0.9	1.4	0.4	1.0	5.6	7.5
Germany	0.9	1.7	0.9	1.2	0.4	1.0	2.2	3.9
Greece[2), 3)]			0.8	1.7			0.8	1.7
Spain	3.3	7.1	1.2	2.2	0.0	0.2	4.5	9.5
France[3)]	1.5	2.0	1.2	1.8			2.7	3.8
Ireland	3.1	6.4	1.2	2.0	0.1	0.6	4.4	9.0
Italy	0.8	0.4	0.9	1.3	0.2	0.7	1.9	2.4
Luxembourg	5.0	7.4	0.8	1.2	0.2	0.6	6.0	9.2
Netherlands	2.9	3.5	1.0	1.3	0.3	0.6	4.2	5.4
Austria	0.6	-1.2	1.0	1.6	0.0	0.0	1.6	0.4
Portugal[3)]	4.9	9.7	-0.1	0.5			4.8	10.2
Finland	3.3	3.1	1.1	1.4	1.2	1.8	5.6	6.3
Euro area	**1.6**	**2.6**	**1.0**	**1.5**	**0.2**	**0.5**	**2.8**	**4.6**

Source: EPC and European Commission (2006), *The impact of ageing on public expenditure*, European Economy Special Report 1/2006.

Notes: These figures refer to the baseline projections for social security spending on pensions. For health care and long-term care, the projections refer to the "AWG reference scenarios".

1) The table excludes projections for education expenditures and unemployment benefits, which are provided in the original report.

2) Total expenditure for Greece does not include pension expenditure.

3) The totals for Greece, France and Portugal do not include long-term care.

The projections represent an important contribution to the discussion of long-term fiscal sustainability and the associated risks in this regard. They also indicate that, due to the effects of ageing, the euro area would have to expect a significant fall in the average potential real GDP growth rate from 2.1% (2004-10) to 1.2% (2031-50). As with all long-term economic assessments, there is considerable uncertainty surrounding the projection results. For example, the assumptions of continued rising participation rates in labour markets and of higher productivity growth than in the past may be optimistic and not materialise fully. In the area of health care costs, the impact of other factors in addition to ageing, such as the introduction of new and expensive technologies, may have been underestimated. In addition, the pension projections are based on national models whose structure has not been disclosed, so that the derivation of the results is not fully transparent and their assessment tentative. While some public pension systems may appear financially sustainable, this may reflect very low benefits for future pensioners and lead to pressures on policy-makers to raise benefit levels. Moreover, further fiscal risks could arise if private pension systems fail to provide the envisaged pension benefits.

From a policy perspective, the projections point to a clear need for some countries to address the issue of ageing-induced expenditure as a matter of urgency and for the other countries not to be complacent. The report shows that countries that have reformed their public pay-as-you-go pension systems have alleviated significantly the ageing-induced pressures on public finances. Uncertainty with regard to the projection results calls for increased prudence to ensure fiscal sustainability.

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