

# FISCAL SUSTAINABILITY REPORT 2015

## Frequently asked questions

### What is the Fiscal Sustainability Report?

The Fiscal Sustainability Report provides an overview of the fiscal sustainability challenges faced by Member States in the short, medium and long term, identifying the drivers of the challenges.

The report is published every three years by the European Commission's Directorate-General for Economic and Financial Affairs (DG ECFIN). The analysis presented in the report is based on the ageing cost projections prepared jointly by the Commission (DG ECFIN) and the Member States (Economic Policy Committee) and presented in the Ageing Report 2015. All EU Member States, but Cyprus and Greece that are under financial assistance programmes, are covered. The report provides input to support multilateral surveillance in the context of the European Semester.

The report will also feed discussions in the Council on the issue of sustainability of public finances. It will be discussed by the Economic Policy Committee and the Economic and Financial Committee.

### What are the key elements of the report?

The report assesses the fiscal sustainability challenges faced by Member States and their drivers. It analyses the situation of the Member State over the low, medium and long term against their debt level, their initial budgetary position and the projected evolution of ageing-costs (notably pensions, healthcare and long-term care). The report also contains a section with country-specific sustainability assessments.

### Why is it important to identify fiscal sustainability challenges?

Sustainable public finances and smaller public debt burdens are important to ensure that Member States have sufficient fiscal space to cope with adverse macroeconomic developments over the economic cycle. Sustainable public finances are also necessary to be able to cope with projected public spending related to population ageing. In this sense, identifying fiscal sustainability challenges and their determinants allows supporting the design of appropriate policy responses.

### What are the overall conclusions of the report?

The report finds that fiscal sustainability challenges are significantly lower in the EU today relative to what was highlighted in the previous report released in 2012. Significant challenges nonetheless remain over the medium term, mostly due to the public debt stocks cumulated during the crisis years, and over the long term, mostly related to the projected increase in age-related public spending. Ensuring appropriately paced debt reduction is key

to support the return to more sustained growth prospects and contribute to bring inflation back to the ECB target.

### **What does the report tell us about the projected evolution of public debt at EU level?**

In the EU-28, there has been an increase of public debt by about 30 percentage points of GDP between 2007 and 2015. After peaking at almost 89% of GDP in 2014, a downward trend in the EU's public debt over GDP started in 2015 and is projected to continue till 2024, reaching 79,5% of GDP by that year, stabilising around this level until 2026 (based on fiscal policy in the EU remaining constant at the last year of Commission forecasts - 2017). Public debt over GDP varies significantly across EU Member States and is projected to remain high in a number of countries.

The current context of very low inflation and low GDP growth poses additional challenges to the reduction of public debt burdens in EU Member States. While the current historically low interest rates tend to support the reduction of the debt burden, the interest bill would be raised if they were to normalise over the long run, which represents a risk especially for high debt countries.

### **What does the report tell us about the evolution of ageing costs?**

Long-term age-related public expenditure projections show that population ageing poses a challenge for public finances in the EU. Age-related expenditure will increase by almost 1 ½ % of GDP by 2060 (1.3% for the EU; 1.4% for the EA), mostly driven by rising health care and long-term care expenditure. The fiscal impact of population ageing is expected to be high in most Member States, although there are considerable differences among them. This is due to the country-specific impact of population ageing on economic developments and age-related expenditure programmes.

### **What are the conclusions of the country-specific fiscal sustainability assessments?**

Of the 26 EU countries analysed none appears to face significant risks in the *short run*.

Over the *medium term*, more than half of the Member States would have a high or medium fiscal sustainability risk. For the majority of EU countries, challenges are mainly related to the still high projected public debt in 10 years. Projected age-related public spending also contributes, for most countries, to increasing the fiscal adjustment required to ensure fiscal sustainability in the medium term. These elements point to the need for further reforms on pensions, healthcare and long-term care systems to contain costs and raise efficiency.

## What are the key elements taken into account when analysing the sustainability of public finances?

Over the short-term, fiscal sustainability challenges are assessed by looking at elements that can lead to risks of fiscal stress (like public debt, government balance, government's financing needs, current account, private debt, private sector credit flow). Medium-term sustainability challenges are assessed by looking at the country's initial budgetary position (government deficit/surplus), the level and projected evolution of its public debt and projected public spending related to an ageing population. In the long run, the assessment is based on the country's initial budgetary position, including its initial debt level, and the projected cost of ageing and on how these components impact on the projected evolution of public debt.

## What other elements are also taken into account?

The report also takes into account additional factors that might affect the solvency of the government and could lead to fiscal risks, such as the structure of public debt financing, government contingent liabilities (such as state guarantees) and the value of government assets.

