

Ministry of Finance and Public Administration

Ageing and Economic Crisis

The challenges ahead

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Ageing and Economic Crisis

Introduction

The EC and EPC Ageing Report presents the impact of ageing population on public expenditure in a no policy change scenario. The report also shows possible effects of the current economic crisis on the ratios of long term age-related public expenditure, namely through changes in potential GDP.

Building up on the assumptions of the Report, our simulations, accounting in addition for the change in initial conditions, project the impact of the economic downturn (on top of the ageing effects) on the long term public debt path, leading to the conclusion that further policy actions (in the domain of fiscal policy and fostering economic growth) are needed to ensure public finance sustainability.



Ageing and Economic Crisis



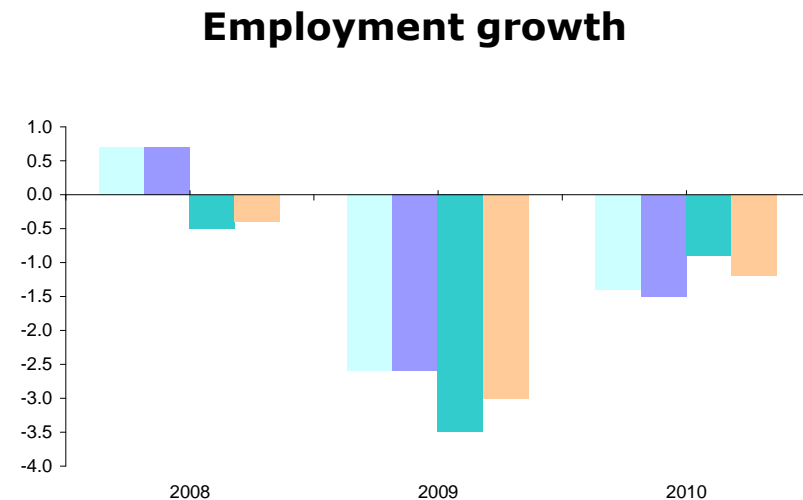
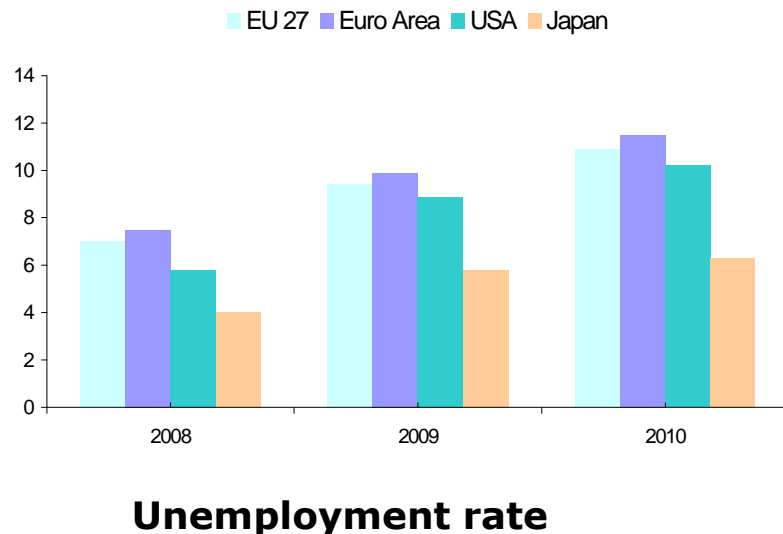
Outline

- **Current economic situation**
- **Ageing population**
- **Implications on public finance sustainability**
 - Public finance developments and long term projections of public debt
- **How to face these challenges - What can/should be done?**
 - Windows of opportunity...
- **Concluding remarks**

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Implications of current downturn on AWG projections

AWG projections depend critically on productivity and labour market evolution, which, in turn, is being affected by the current crisis



Unit: %

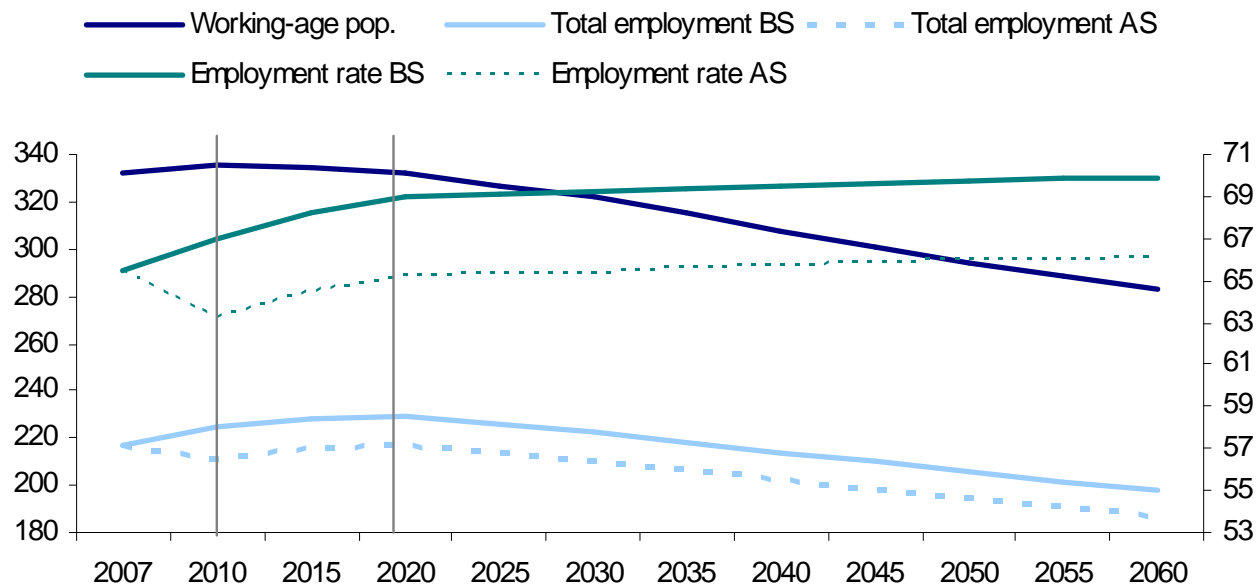
Source: EC Spring forecasts 2009.

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In addition, ageing population

also affects labour market more markedly from 2020 onwards

EU Population of working age and total employment



AWG baseline scenario (BS):

- working age population declines from 2012 on
- lower employment rate growth from 2020 on
- employment declines from 2020 on

Alternative scenario (AS):

- same working age pop.
- employment rate decreases until 2010 (EC Spring forecasts 09) and same trend afterwards

=>

same long-term trend but a lower level of employment

Units: 10⁶ and % (rhs)

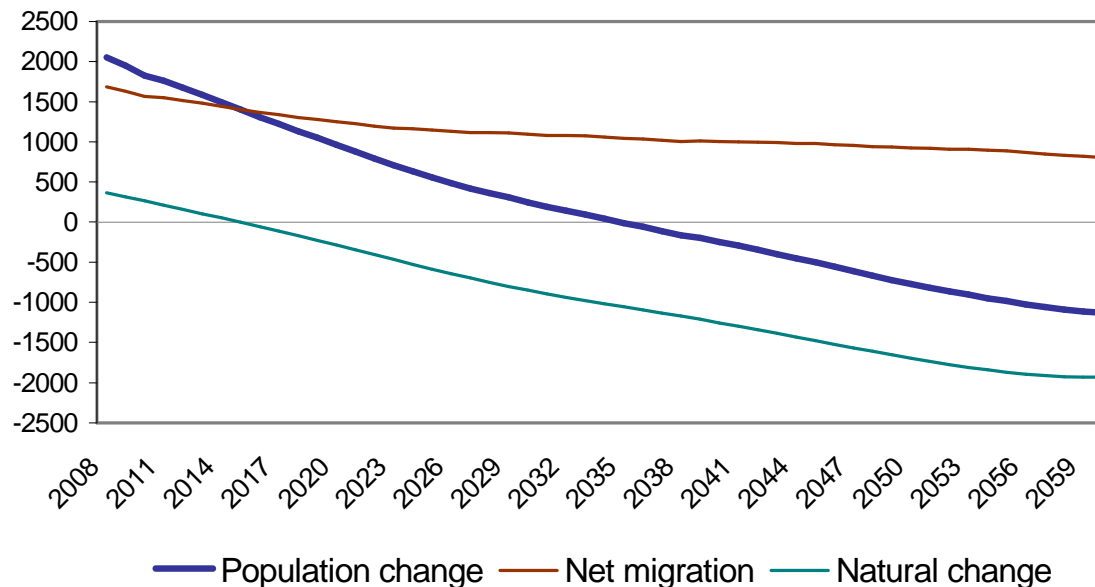
Sources: EC and EPC, The 2009 Ageing Report, EC Spring forecasts 2009 and own calculations.

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Ageing population

reasons behind (assumptions in Eurostat/AWG projections)

- **Low fertility rates, increased life expectancy => negative natural change from 2015 on**
- **Positive net migration driving population growth** (which, nevertheless, turns negative from 2035 on)



**EU Natural
change and
net migration**

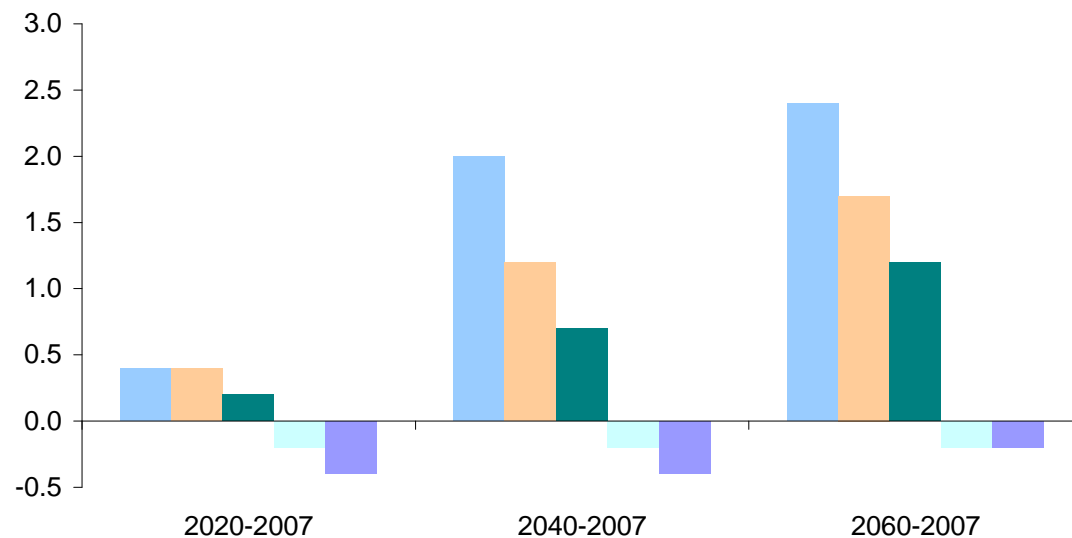
Unit: 10^3
Source: Eurostat,
EURÒPOP2008

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Ageing and public finance sustainability

Old age dependency ratio will increase sharply, nearly doubling until 2060, putting pressure on public age-related expenditure (baseline scenario)

■ Pensions ■ Health care ■ Long-term care ■ Unempl. benefits ■ Education



**Change from
2007 in EU
age-related
expenditure**

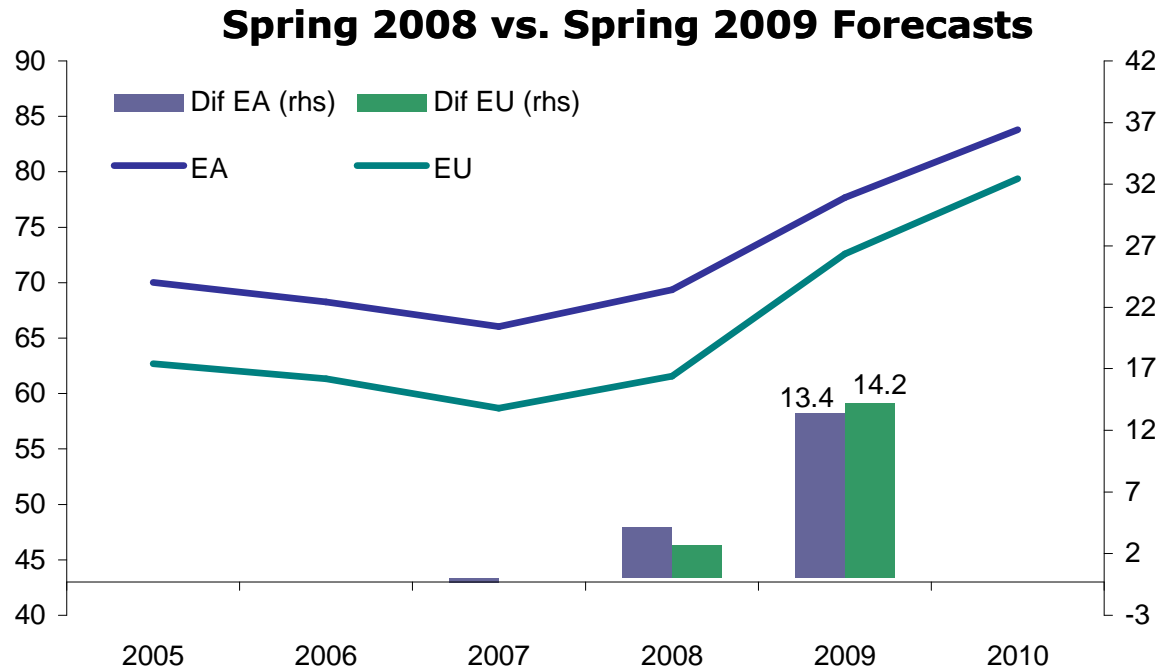
Unit: p.p. of GDP.
Source: EC and EPC,
The 2009 Ageing
Report.

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Public finance developments

Anti-crisis economic policies taken so far have substantial effects on public debt dynamics...

automatic stabilizers, discretionary measures (EERP and financial rescue packages)



Unit: % of GDP and p.p. of GDP.

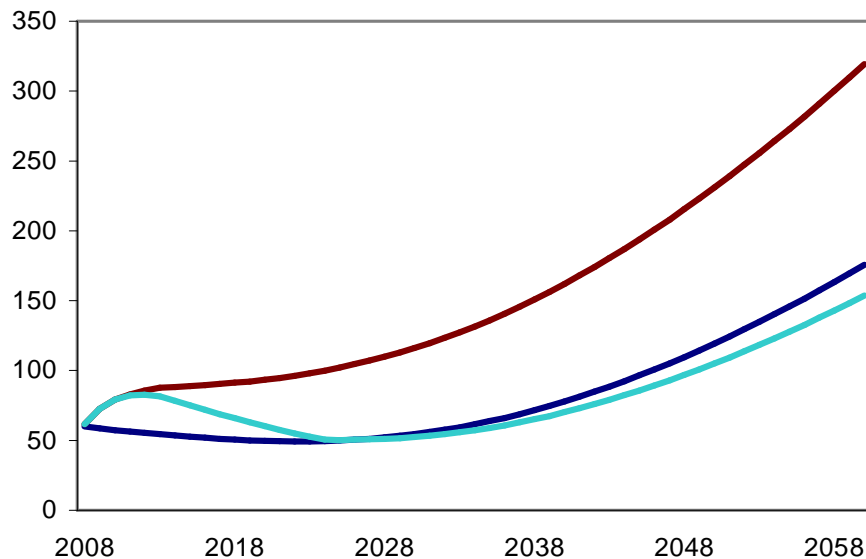
Source: EC, Ameco database.

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Public finance developments

Taking into account the change in initial conditions, our simulations show that anti-crisis economic policies have substantial effects on public debt dynamics...

Simulations with long term projections



— AWG Baseline — Hip 1 — Hip 2

Unit: % of GDP

Source: EC, Ameco database, EC and EPC Ageing Report 2009 and own calculations.

AWG baseline:

- 2008-09: EC Spring 08 forecasts
- 2010 onwards: baseline ageing impact

•Hip. 1:

- 2008-10: EC Spring 09 forecasts
- Primary balance (PB) = 0% of GDP in 2015
- 2016 onwards: baseline ageing impact

•Hip. 2:

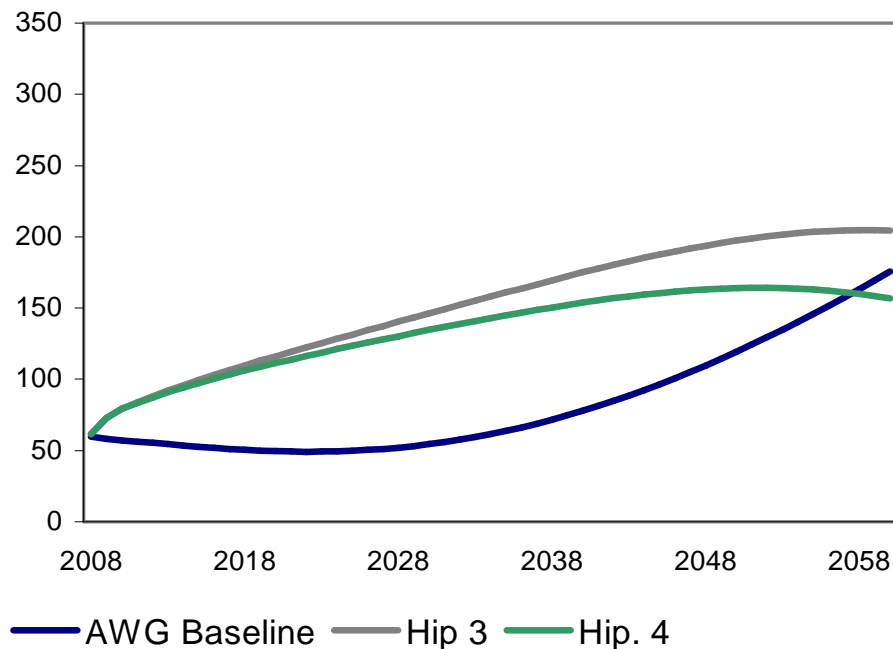
- 2008-10: EC Spring 09 forecasts
- 2011-15: $\Delta PB = +2$ p.p. of GDP each year
- 2015-23: PB = 4% of GDP
- 2024 onwards: PB = 2% of GDP plus baseline ageing impact

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Public finance developments

... anti-crisis economic policies have substantial effects on public debt dynamics...

Simulations with long term projections



Unit: % of GDP

Source: EC, Ameco database, EC and EPC Ageing Report 2009 and own calculations.

AWG baseline:

- 2008-09: EC Spring 08 forecasts
- 2010 onwards: baseline ageing impact

•Hip. 3:

- 2008-10: EC Spring 09 forecasts
- 2011 onwards: $\Delta PB = +0.25$ p.p. of GDP each year plus baseline ageing impact

Hip. 4:

- 2008-10: EC Spring 09 forecasts
- 2011 onwards: $\Delta PB = +0.25$ p.p. of GDP each year plus baseline ageing impact and permanent productivity increase of 0.5 p.p. (average value from 1.8 to 2.3%)

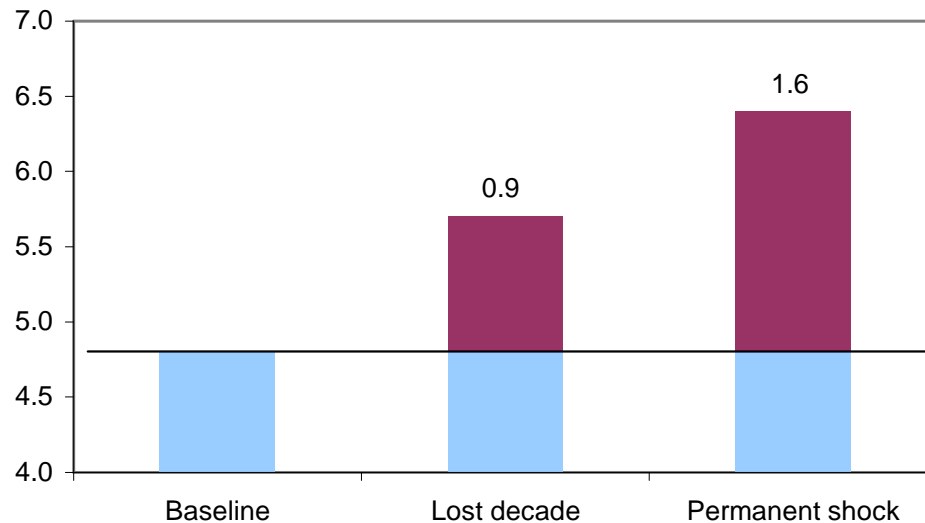
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Public finance projections

...and the Report shows that current crisis may have also significant long-term effects on primary balances, through the potential GDP effect on the cost-of-ageing ratios (on top of the baseline cost of ageing)

Assuming that potential GDP:

- resumes the baseline trend in one decade from now (lost decade) or
- keeps a lower growth rate (permanent "shock")



EU Cost of Ageing 2007-2060 and effects of economic crisis

(change in p.p. of GDP)

Source: EC and EPC, The 2009
Ageing Report

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What can be done?

- **Fiscal stimulus timely, targeted and temporary**
- **Resume fiscal consolidation as soon as possible**
- **Continue implementing structural reforms aiming at fostering long term growth (in particular, in the domain of labour market and human capital, in order to increase productivity)**



Post 2010 Lisbon Strategy

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What can be done?

In the domain of structural reforms

- **Ex. AWG public pension projections 2009 vs 2006:**

Recent reforms with visible positive impacts in the cases of Portugal, Denmark, Czech Republic and Hungary

- **Health and long-term care systems**

Higher impact on public expenditure than pensions in some countries

Improved projection methodology but baseline scenario does not consider technological effects over the expenditure path



This can be (partially) offset by improvements in the design and management of health systems in order to increase the efficiency and effectiveness of public expenditure

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Concluding remarks

- **Current crisis has a significant effect on public debt dynamics**
- **This reinforces the need to achieve a sustainable path in public finances**
- **In this context, structural reforms continue to play a major role (need to strengthen post 2010 Lisbon strategy)**
- **In addition the reforms in pension systems, focus on reforms in health and long term care systems are required in order to increase efficiency and effectiveness**

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