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Europe needs more reforms to be able to cope with raising age-related costs

European Union governments need to step up reform efforts in the face of rapidly ageing populations. In a report submitted to EU Finance Ministers prepared jointly by the European Commission and the Economic Policy Committee, detailed new projections are provided on the economic and budgetary costs for all Member States up to 2050. The scale of the demographic challenge is immense. The retirement of the baby-boom generation as of 2010 and continuous increase in life expectancy means Europe will go from having four to only two people of working age for every elderly citizen by 2050. With unchanged policies, EU potential growth rates will be almost cut in half by 2030. Public finances will come under severe strain due to increased spending on pensions, health care and long-term. There are positive signs that many Member States are facing up to the challenge. Several countries have curtailed access to early retirement schemes and have made reforms to their pension systems. This report shows that such reforms pay-off, both by raising effective retirement ages and by better controlling future public spending pressures. But there is no room for complacency and clear sustainability risks remain. The next few years offer a window of opportunity to intensify reforms before the full effects take hold. Delaying inevitable reforms will only raise the painful and budgetary costs.

"*While the process of an ageing population cannot be turned around, the consequences for prosperity and sustainability lie in the hands of governments. Some Member States have already carried out reforms to avoid overburdening future generations. But there is no room for complacency. Member States should exploit a fast-closing window of opportunity to intensify reform efforts, especially in those cases where the long-term sustainability of public finances is most at risk. Unless this is done, many EU countries, from the old to the new members, will simply not be able to face the cost; not when there will be two workers per elderly citizen as opposed to a ratio of four to one now. Delays will simply increase the cost and pain of adjustment, which is not fair for our children and grandchildren. The prospects of much lower growth combined with the risks to the sustainability of public finances vividly underlines the need to live up to commitments to implement the Lisbon strategy and to modernise welfare systems*" said European Economic and Monetary Affairs Joaquin Almunia.

A new study[1], which will be discussed by EU finance ministers this week, shows that the pension, health and long-term care costs linked to an ageing population will lead to significant increases in public spending in most Member States by 2050 on the basis of current policies, although there is a wide degree of diversity across countries.

The following are the main findings:

- Europe's population will be slightly smaller, but significantly older in 2050. While the total population of the EU25 will register a small fall from 457 to 454 million, starting already from 2010, the working-age population (15 to 64) is projected to fall by 48 million (or 16%) by 2050 whereas the elderly population aged 65+ will rise sharply, by 58 million (or 77%);
- Potential growth rates are projected to fall across the EU*.* The annual average potential GDP growth rate in the EU25 as a whole is projected to decline from 2.4% in the period 2004-10 to 1.9% in the period 2011-30, and to only 1.2% between 2031 and 2050.
- Ageing will lead to significant increases in public spending**.** For the EU as a whole, public spending is projected to increase by about 4 percentage points between 2005 and 2050, mostly concerning public spending on pensions and health care. The pressure on public spending will be somewhat stronger in Euro area countries. For example, spending on pensions in Portugal (+9.7% of GDP between 2005 and 2050), Luxembourg (+7.4%) and Spain (+7%). The projected spending increases on pensions for Ireland (+6.5%) and Belgium (+5.1%) are also significant.
- At first sight, the new Member States, whose situation is being reviewed for the first time, appear to be in a better position overall. But this overall picture is distorted by the sharp drop in public pension spending in Poland – by far the largest of the 10 countries that joined the EU in May 2004 – as a result of the switch from a public pension scheme to a private funded scheme. Excluding Poland, age-related spending in the other EU10 countries is set to increase by more than five percentage points of GDP. Very large increases in pension spending by 2050 are projected in Hungary (+6.7% of GDP), Slovenia (7.3%) and Cyprus (12.9%).
- reforms enacted in several EU15 countries, since the last age-related expenditure projection exercise of 2001, appear to have curtailed the projected increase in public spending on pensions significantly in half of all EU15 Member States[2]. In addition, pension reforms are also expected to lead to an increase in average retirement ages and higher employment rates of older workers.

The unique quality of this report is that it was produced jointly by the Commission and Member States within the Economic Policy Committee. It thus provides comparable estimates of the budgetary impact of ageing for the assessment of the risks to the sustainability of Member States' public finances in the context of the Stability and Growth Pact while taking full account of the very different national pension, health care and education systems*.*

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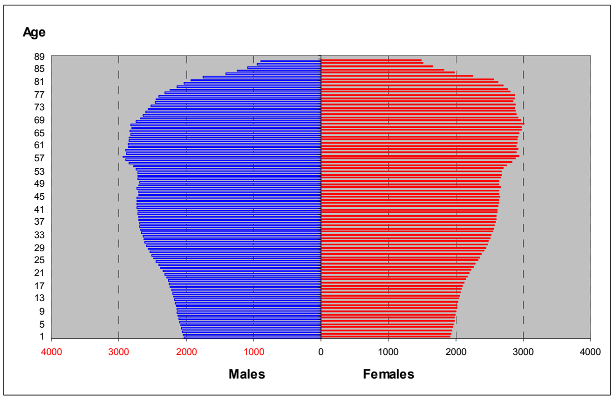
1 The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health care, long-term care, education and unemployment (2004-2050) by the Economic Policy Committee and the European Commission's Economic and Financial Affairs Directorate General. The full report can be found at
http://europa.eu.int/comm/economy_finance/publications/eespecialreports_en.htm
http://europa.eu.int/comm/economy_finance/epc/epc_publications_en.htm

2 More detailed information about the impacts of enacted reforms are provided in the 'country fiches" published on the web site of the Economic and Policy Committee: *http://europa.eu.int/comm/economy_finance/epc/epc_sustainability_ageing_en.htm*

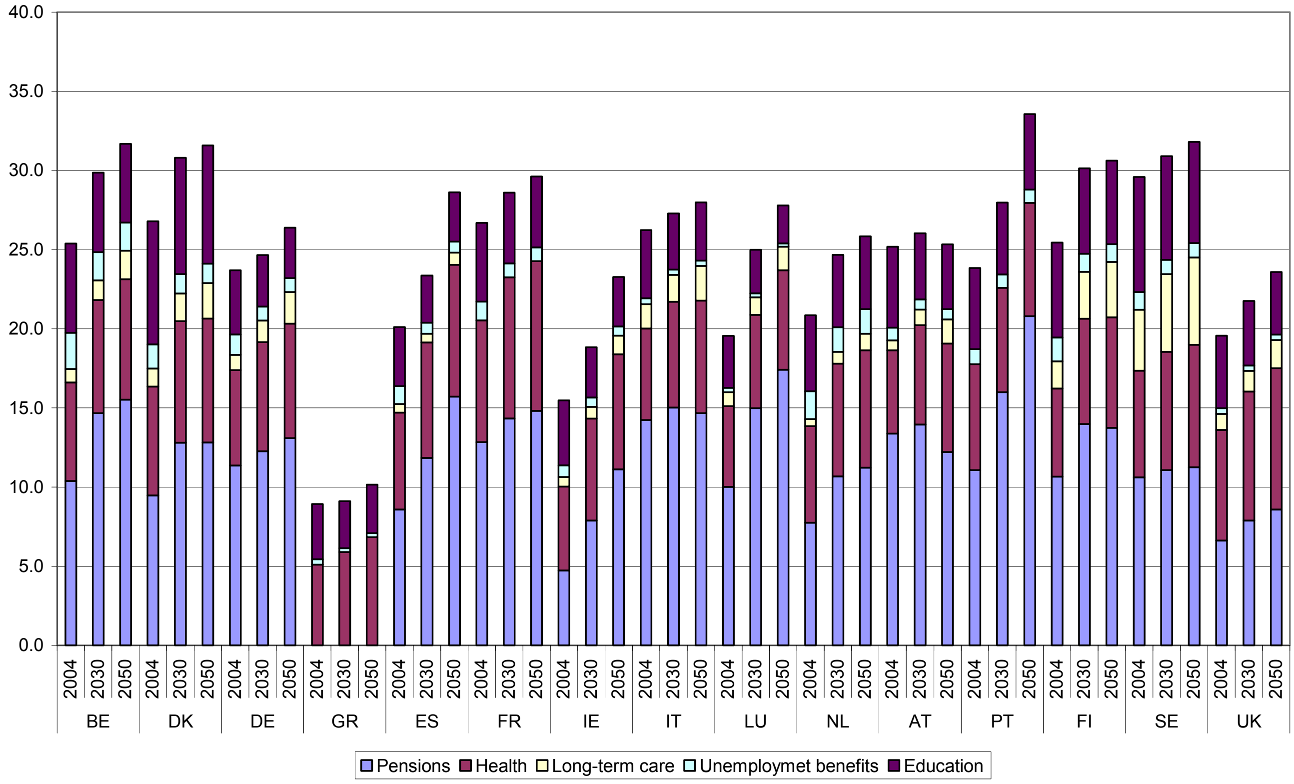
Age pyramids for EU25 population in 2004 and 2050

2004

2050



Source: EPC and European Commission (2005)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Long-term care
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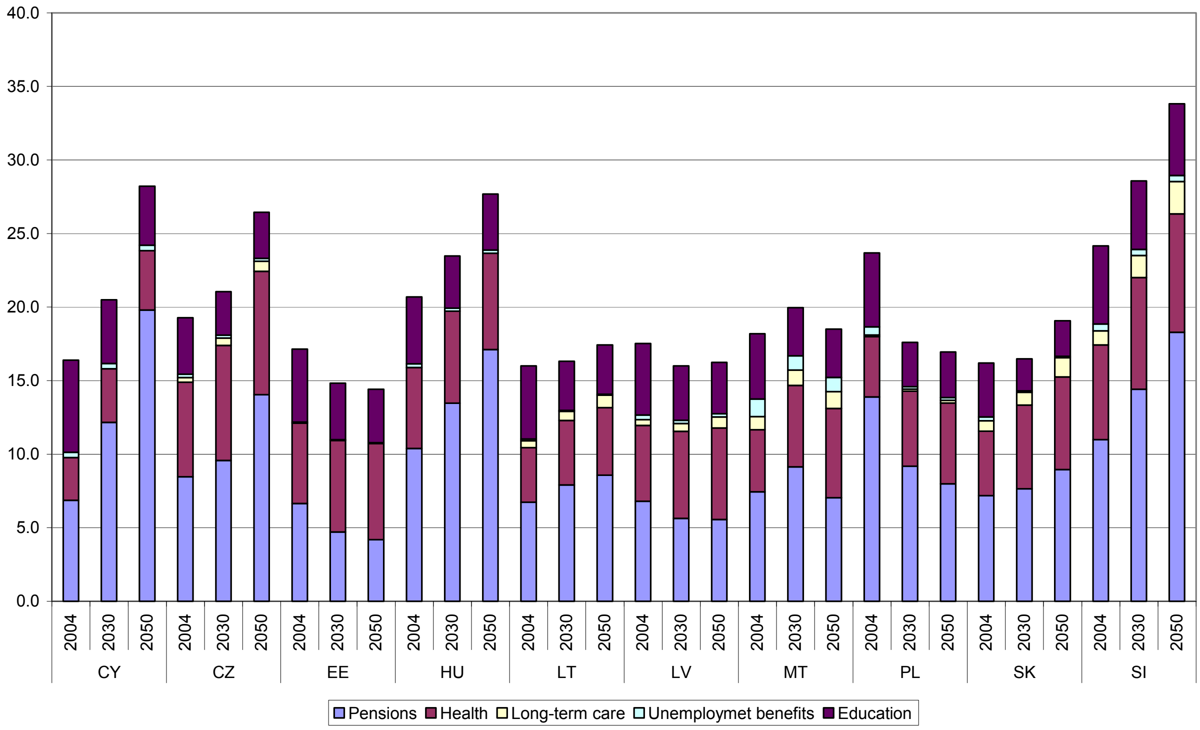
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