Honorable States? EU Sustainability Ranking 2013
– Summary –

After years of severe recession and soaring public debt, the economic situation in the European Union has been stabilized to some degree. In most countries, the process of economic contraction has been stopped. The highly expansive monetary policy of the European Central Bank – while being debatable – has helped to gain time for the necessary structural reforms in the countries struck hardest by the crisis, and to improve their economic competitiveness. But the time gained has not been used sufficiently. To some extent, the supporting-measures even have compromised the reform-efforts.

Europe is still in "crisis mode". Numerous important reforms, in both the member states and on the European level, await their realisation. With regard to public-budget-consolidation, little progress has been made. For most countries, the Maastricht-criteria of the Stability and Growth Pact are far out of reach. But without sound public budgets, a prosperous economic development in Europe will hardly come true.

Against this background, Stiftung Marktwirtschaft (Market Economy Foundation) in cooperation with the Forschungszentrum Generationenverträge (Research Centre for Generational Contracts) at the University of Freiburg, has analysed the long-run perspectives of the public budgets of the EU Member States on the basis of the latest economic data.

EU27* Sustainability Ranking 2013 (Base Year 2012)

	in % of GDP	Explicit Debt +	Implicit Debt =	Sustainability Gap**	Change to 2012
1	Latvia	41	18	59	increase of debt
2	Italy	127	-53	73	increase of debt
3	Estonia	10	83	92	increase of debt
4	Germany	81	73	154	increase of debt
5	Hungary	80	86	166	reduction of debt
6	Bulgaria	19	223	241	increase of debt
7	Sweden	38	209	247	increase of debt
8	Poland	56	197	253	increase of debt
9	Austria	74	184	258	reduction of debt
10	Portugal	124	159	283	increase of debt
11	Romania	38	265	303	increase of debt
12	Denmark	45	260	305	reduction of debt
13	Lithuania	40	286	327	increase of debt
14	Czech Republic	46	351	397	reduction of debt
15	Malta	71	337	408	increase of debt
16	France	90	359	449	increase of debt
17	Slovak Republic	52	402	455	reduction of debt
18	Finland	54	420	473	constant debt
19	Netherlands	71	503	574	increase of debt
20	Slovenia	54	555	609	reduction of debt
21	Greece	157	475	632	reduction of debt
22	United Kingdom	89	552	640	constant debt
23	Belgium	100	545	644	reduction of debt
24	Spain	86	586	672	reduction of debt
25	Cyprus	87	792	879	increase of debt
26	Luxembourg	22	1162	1184	reduction of debt
27	Ireland	117	1150	1268	reduction of debt

Legend: increase of debt (red); constant debt (yellow); reduction of debt (green)

** The sustainability gap is the sum of official/explicit and invisible/implicit debt.

Differences in summation (sustainability gap) are possible due to rounding errors.

The calculations start from the actual economic and fiscal position in 2013 (Autumn 2013 economic forecast by the European Commission). The data for future GDP-growth as well as for the long-run change in age-dependent expenditure, with the exception of spending on pensions, is taken from European Commission's 2012 Ageing Report. For the development of pension expenditures in each country, an average of the rates described in the European Commission's 2009 and 2012 Ageing Reports is used, if the 2012 Report predicts a smaller increase than the 2009 Report. Otherwise, future pension expenditures are projected according to the 2012 Report. For the years following 2060 – the last year for which data are predicted by the Ageing Report – the proportion of public expenditures on age-related items is held constant.

* Due to missing data, Croatia, EU Member State since 1 July 2013, is not included in the calculations.

Sources: European Commission, AMECO Database, Eurostat, Calculations: Research Centre for Generational Contracts.

1. Official Debt Calculations: Only Half of the Story

Public debt is ordinarily discussed in terms of the current budget deficit, which must be funded with new debt obligations, and the outstanding debt, which represents the debt that a government has accumulated from past borrowing. The debt and deficit limits of the Maastricht Criteria and the Stability and Growth Pact reflect this approach to public debt analysis, which focuses primarily on the past and present behaviour of governments. These fiscal limits, however, suffer from two key shortcomings, which have become even more conspicuous in light of the sovereign debt crisis in Europe.

First, the debt and deficit limits in the Maastricht Criteria and Stability and Growth Pact have lacked binding force, allowing many countries to regularly violate without sanction the three percent deficit limit and the sixty percent debt limit. While this disregard for the rules was not the only reason for the outbreak of the current sovereign debt crisis – indeed, badly affected countries such as Spain and Ireland had fulfilled the Maastricht Criteria prior to the outbreak of the crisis – this much is clear: were European countries to have had a stronger fiscal position at the onset of the crisis, governments would have been in a much better position to manage the fiscal challenges that have beleaguered them over the course of the past years. Moving forward, it is crucial that limits on public debt and deficits are made binding, so that they are resistant to political considerations.

Second, the traditional way of calculating government debt almost entirely excludes future revenues and obligations from consideration. At best, national and state governments look only a few years ahead just planning for the medium term. Even when such considerations are incorporated into financial planning, the economic and deficit assumptions tend to reflect rather wishful thinking. In general, official fiscal planning tends to ignore consideration of future revenues and expenditures, even when their underlying trends are foreseeable and calculable today.

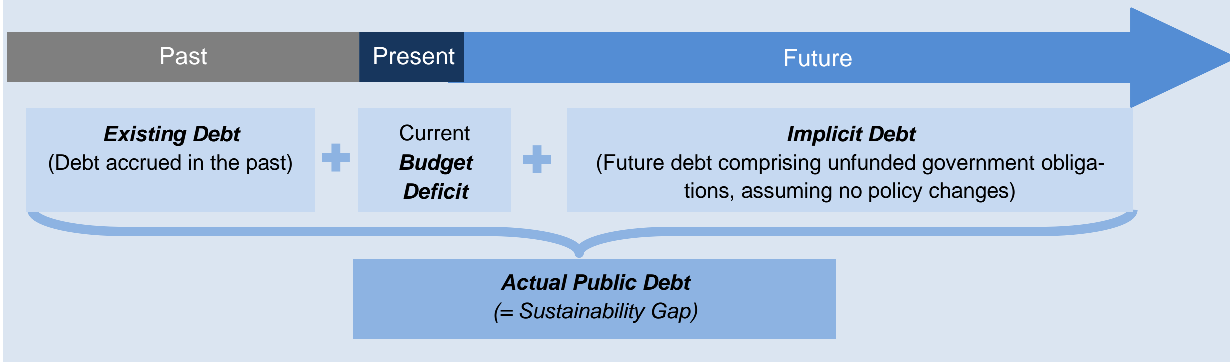
2. An Honest Consideration of Public Debt: Facing the Future

Taking the future into account reveals some troublesome developments. Demographic changes, namely a rapid ageing of the population, will significantly increase pressure on age-related public expenditures, such as retirement benefits, pensions, health care and long-term care. At the same time, the proportion of people of working age, on whom society depends to provide (a large share of) the taxes and contributions to social insurance schemes, will decline, creating a growing divergence in public revenue and expenditure over the coming decades.

The source of the impending gap between government revenue and expenditure lies in the present and must be addressed today: every year, in addition to their current expenditures, governments accrue legally-binding obligations that must be paid in the future, such as pension benefits and health care services. Most countries, however, fail to make adequate provision for these future obligations, which are generally designed in a way that ignores future demographic trends and their implications for revenues and expenditures. This imbalance – the gap between future government revenues and expenditures – is called the implicit government debt.

A realistic look at the actual level of public debt requires that the implicit debt of the future be added to the explicit debt of the past. The sum is called the "sustainability gap".

Actual Public Debt



The implicit public debt must be taken as seriously as the explicit public debt because it almost inevitably leads to increased taxes and social security contributions or a reduction in public benefits in the future. The third alternative – gradually allowing implicit debt to become explicit debt – is not an option if a country seeks to avoid risking national bankruptcy.

3. The Actual Level of Public Debt in Europe – The EU Sustainability Ranking 2013

The results of the "actual public debt" calculation – calculated by adding the explicit and implicit liabilities of each of the EU-27 member states – is presented in the "EU27 Sustainability Ranking" above.

Primary Findings:

- For the vast majority of countries studied, the size of **the implicit debt dwarves the size of explicit debt**. The traditional, backward-looking debt calculation provides a picture that is too optimistic. In almost all countries, the sustainability gap (sum of explicit and implicit debt) is many times higher than economic output (GDP).
- High sustainability gaps indicate that most countries must **continue to consolidate their public budgets and implement structural reforms**, especially with regard to the age-related social security systems.
- **Front-runner** of the debt and sustainability ranking 2013 is **Latvia**, which has the lowest total debt. Italy, the winner of last year's ranking, is in second place. The countries at the bottom end of the table are again Ireland and Luxembourg. Moreover, the different results for Italy and Luxembourg demonstrate that the **level of explicit public debt does not predict the level of implicit public debt**. While Luxembourg's high implicit debt is mainly driven by its excessively generous pension system, Italy (with a high level of explicit debt) expects only a small rise in age-dependent expenditures as a proportion of GDP and runs a significant primary surplus (budget surplus disregarding interest payments), both resulting in a small implicit wealth. While **Greece** makes significant progress consolidating its budget, its economic situation remains difficult.
- It is **alarming** that – with the exception of Spain – all **large member-states of the Eurozone** have **increased their sustainability gaps** in comparison to last year. A lack of necessary reforms seems to be prevailing. This is also true for the United Kingdom. With a sustainability gap of 640 % of GDP, it finds itself again in the last third of the ranking.
- Comparing the sustainability gaps with last year's results confirms that high economic **pressure seems to be a prerequisite for successful consolidation**. Especially countries from the lower half of last year's ranking managed to reduce their sustainability gaps. In contrast, countries with a relatively low sustainability gap tend to show some negligence in their consolidation-efforts.
- At first sight, **Germany** does fairly well, coming in on 4th place. However, Germany also faces a larger implicit debt than last year. This is true, even not taking into account the additional expenditures which the new grand coalition in Germany plans to implement during the next years. With 4100 Mrd. Euro or 154 % of GDP, the German sustainability gap outnumbers the officially reported explicit debt of 2160 Mrd. Euro (81 % of GDP) significantly.