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European Union warned on soaring public debt

By Tony Barber in Brussels

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The European Union's public debt could rise by 2014 to 100 per cent of gross domestic product - an entire year's economic output - unless governments take firm action to restore fiscal discipline, EU finance ministers will be warned today.

The stark message is contained in a European Commission analysis, which highlights the rapid deterioration in EU public finances caused by emergency measures over the past 12 months to save Europe's financial sector and combat economic recession.

The Commission's paper will be discussed by the 16-nation eurozone's finance ministers at informal talks this evening, and then at a follow-up meeting tomorrow of all 27 EU ministers.

In its latest six-month economic forecasts, published last week, the Commission predicted that the eurozone's public debt would rise to 84 per cent of GDP next year and 88.2 per cent in 2011. But the new document paints an even more sombre outlook.

The Commission states: "Projections based on a scenario of growth returning to the long-term path of before the crisis show that without consolidation, the gross debt-to-GDP ratio for the EU as a whole could reach 100 per cent of GDP as early as 2014, and keep on increasing."

As recently as 2007, the euro area's public debt amounted to only 66 per cent of GDP - but, even at this level, it was above the 60 per cent target set for countries aspiring to join the eurozone.

In spite of mounting concerns about the boom in debt, EU government leaders agreed at a summit on October 29-30 that the fragile nature of Europe's economic recovery made it advisable to delay efforts towards fiscal consolidation until 2011.

The new Commission paper backs this position, saying: "A financial meltdown and a generalised loss of confidence have been avoided. However, uncertainty remains high, and there are still risks of negative feedback loops between the financial sector and the real economy."

In a report published today the **Lisbon Council, a Brussels-based think-tank**, recommends that EU governments should cap expenditure at two percentage points below nominal GDP growth from 2011 onwards.

"The stimulus packages in place for next year are both necessary and appropriate. But it is time to start being vigilant again," said Michael Heise, the report's main author, who is chief economist at the Allianz insurance group. "We must learn the lessons of the past and not allow another bubble to develop."

The Commission identifies five countries as being at particular risk - Greece, Ireland, Latvia, Spain and the UK - because their public finances will come under strain from large increases in pension and healthcare costs, as well as from high budget deficits triggered by the financial crisis.

This is particularly the case for Greece, which faces the second-highest increase in age-related expenditure of the entire EU, while its very high debt ratio adds to concerns on sustainability, the Commission says.

Greece, a eurozone member since 2001, irritated its partners last month when the newly elected socialist government disclosed a huge hole in its public finances that had gone unreported by its conservative predecessor.

Last week's Commission forecasts estimated Greece's public debt would shoot up to 135.4 per cent of GDP in 2011 - a level for which there is no precedent since the euro's creation in 1999.

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