



IMF

Europe's Fiscal Tightrope

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Thank you for the invitation to attend this meeting.

As you are well aware, many European countries carry high public debt burdens and face growing spending needs, mainly linked to caring for the elderly, but also to meeting defense spending targets and investing in the energy transition.

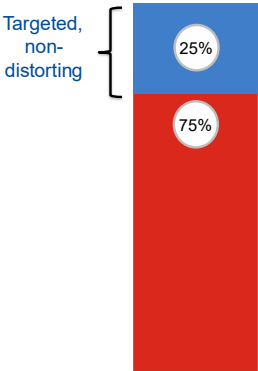
Today I will discuss how countries can meet these demands while keeping government finances sustainable.

I have two main messages:

- **First, this challenge is large.** Three in four countries must act. The **longer action is delayed**, the harder the task and the greater the risk that **financial markets force a painful correction.**
- **Second, the right strategy is a policy mix** – combining growth-enhancing structural reforms with fiscal reforms and consolidation measures.

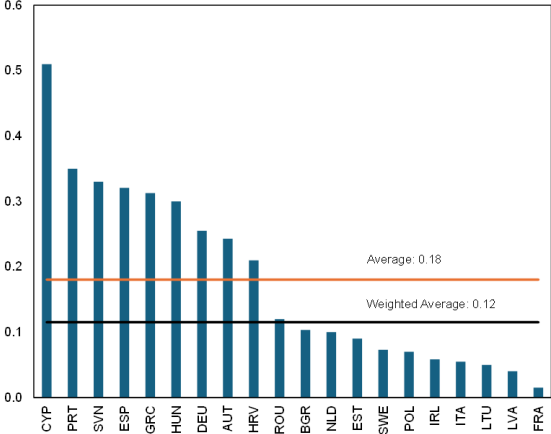
Energy shock dominating the near-term agenda

Energy Support Measures
(Percent of total fiscal cost; EU countries)



Source: IMF staff calculations (as of May 4, 2026).

Fiscal Cost of Energy Support Measures
(Percent of GDP; EU countries)



Source: IMF staff calculations (as of April 28, 2026).

Before we proceed, let us look at what has dominated the policy agenda over the last three months.

At the Eurogroup meeting on May 4th, we discussed how **European governments have provided relief to households and firms facing higher fuel prices.**

We have updated our policy tracker, and we now estimate that relief measures cost just under 0.2 percent of GDP on average. About 75 percent of spending goes to measures that are not targeted and blunt energy price increases for end users. These measures are expensive, tend to be difficult to unwind, disproportionately benefit high-income households, **and weaken incentives to conserve energy.**

The costs are still small, but could easily rise.

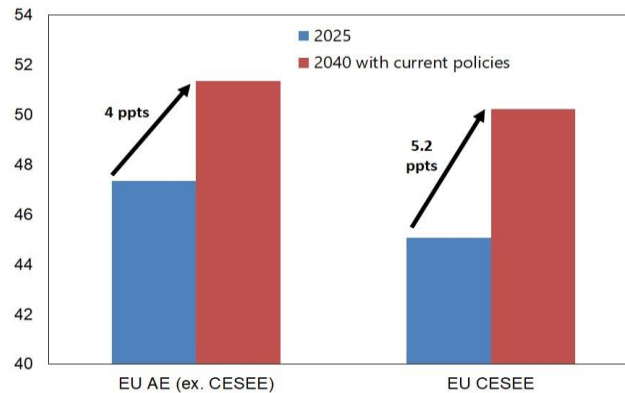
In many countries, measures expire in June, creating an opportunity **to shift** to targeted and less distortionary support.

The bigger point is that while we are focused on responding to the recurrent **shocks, major structural fiscal challenges are brewing in the background.**

This is what I want to speak to you about today.

Mounting spending from ageing, defense and energy

Public Spending Ratios
(Government expenditure in EU Countries; Percent of GDP)



Source: Eble and others (2025) and IMF Staff Calculations.

Note: EU Advanced Economies (AEs) (ex. Central, Eastern and Southeastern (CESEE) countries) include Austria, Belgium, Cyprus, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Spain and Sweden. EU CESEE countries include the remaining EU countries.

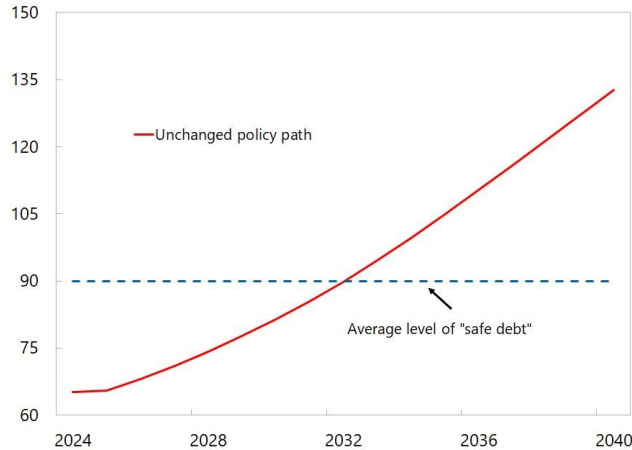
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Why is the fiscal challenge so daunting?

The key reason is **rising spending**. We estimate **additional spending in four areas**—pensions, health, defense, and the energy transition—at **about 5 percent of GDP a year by 2040**: somewhat less (4 percent of GDP) in advanced EU countries and somewhat more (**5¼ percent**) in CESEE. Put differently, spending is set to rise by 0.3 percent of GDP a year on average over the next 15 years.

Public debt could double by 2040 without policy action

General Government Debt
(Simple average of EU countries, percent of GDP)



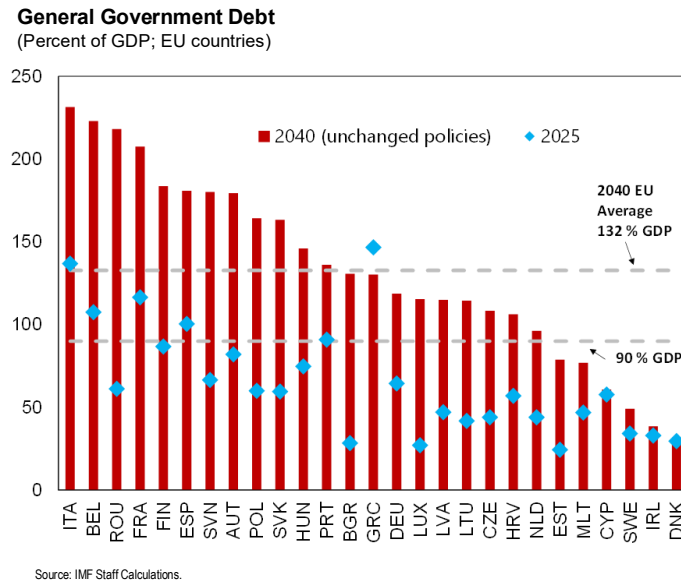
Source: IMF Staff Calculations.
Note: "Safe" debt is an estimate of the debt carrying capacity of each country, using the methodology proposed in the IMF October 2025 European Regional Economic Outlook, Note 1, averaged across countries.

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The consequence would be sharply rising debt burdens.

- Our simulations show that, without corrective action, the average **public debt ratio would more than double** (on a simple average basis) to over **130 percent** by 2040, from about 65 percent of GDP today. No action may not seem the most likely scenario, but in a shock-prone world with recurrent shocks and demands, it is not an implausible one either.]
- In many countries, debt would exceed 90 percent of GDP. We estimate that debt above this level puts countries at risk of adverse market reactions.

Most countries will have debt above 100 percent of GDP by 2040 without policy action



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Let me briefly explain where this safe debt estimate comes from.

- Drawing on international experience, we estimate a limit for each EU country beyond which debt would be hard to stabilize, then build a small buffer below it.
- The result is a **benchmark** of 90 percent on average; some countries have it above, some below. The 90 percent average, reflects some favorable changes in debt carrying capacity over the past three decades, including deeper financial markets, larger government revenue bases, and a long trend of lower borrowing costs.

What must countries do to keep debt out of the danger zone?

Countries with debt close to or above the safe level must improve fiscal balances enough to put debt on a downward path by the medium term. Those with lower but rising debt must at least stabilize it.

Countries would then need to reduce their deficits by 1 percent of GDP a year for five years. On average, that is a cumulative **5 percent of GDP**.

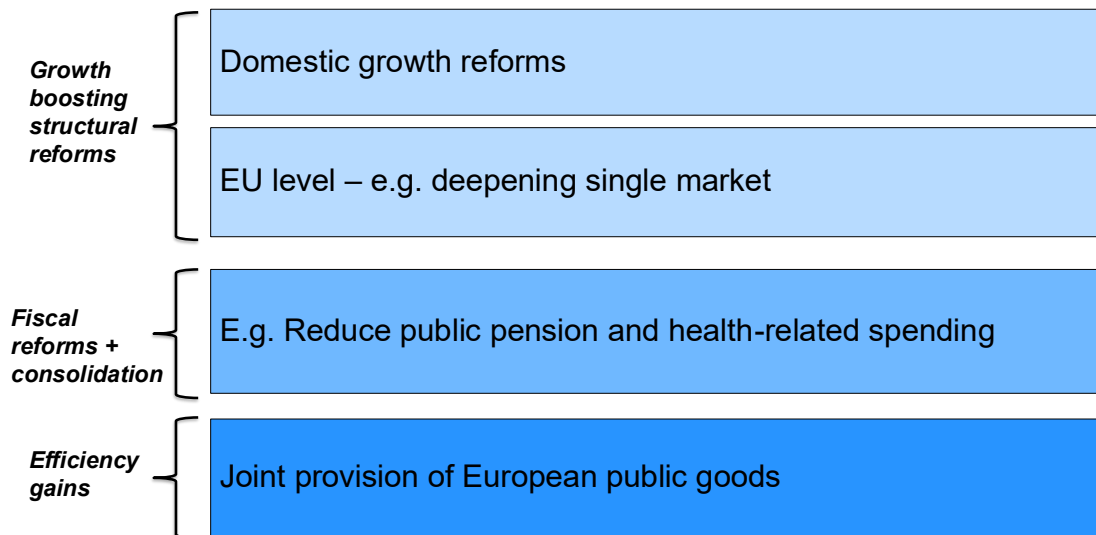
Such adjustments far exceed what **past European consolidation efforts** have achieved since 1980 outside crises.

- Successful campaigns yielded cumulative savings of only about **3 percent of GDP** over 3–4 years. Think of Germany in the early 2000s.
- Achieving 5 percent or more would be very difficult and, in some countries, would require **deep cuts to the European model of public services and welfare**.
- Larger consolidation efforts can be forced by **market pressure**. But they would bring economic harm and hardship for many and may not be sustainable.

This is exactly the kind of situation our advice is meant to avoid.

And delaying these consolidations would be costly. A 5-year delay would add close to 1 percent of GDP to the total adjustment need, making an already large challenge even greater.

Policy action needed: boost growth, efficiency and adapt benefits for longevity



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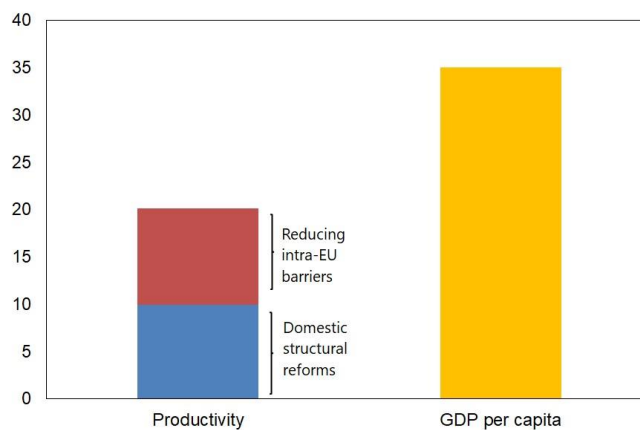
My second message is that given the challenge, growth-enhancing reforms must be part of a fiscal consolidation strategy that also includes **fiscal reforms and other deficit-reduction measures. We would propose a package that combines:**

- (i) Structural reforms that boost growth;
- Fiscal reforms—such as aligning social benefits with longer life expectancy—and other fiscal consolidation measures;
- (ii) Unlocking gains from an EU budget focused on common public goods. For example, the cost of the energy transition could be reduced EU-wide by 7 percent under joint action, rather than if each country acted on its own.

What are those growth-enhancing reforms and how much of a difference can they make to the fiscal challenge?

Large potential for growth gains from structural reforms

Long-term Gains from EU and National Reforms
(Productivity and GDP per capita, in percentage points)



Source: IMF European Regional Economic Outlook, Note 2, Fall 2025

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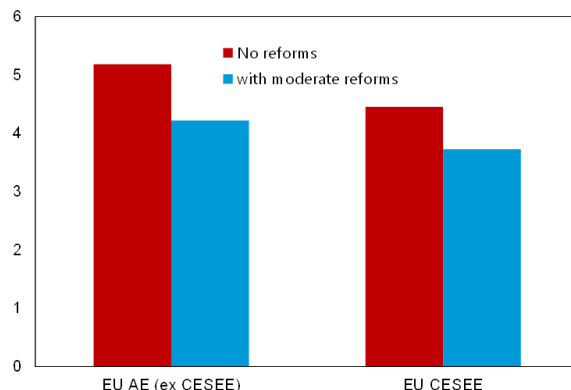
At the Fund, our analysis shows that a combination of:

- **domestic reforms** to product and labor markets, as well as governance; and
- **integrating product, labor, and capital markets across the EU** could raise productivity by up to 20 percent over the long-term, triggering higher investment. In the most ambitious case, per capita income would rise by 35 percent, closing the gap with the US.

To illustrate the fiscal benefits, we simulate a more feasible reform agenda (delivering about a quarter of the comprehensive gains) that could be implemented over the next five years.

A moderate downpayment on these reforms can reduce fiscal consolidation needs significantly

Fiscal Consolidation Needed to Stabilize Debt Ratios in EU Countries
(Percent of GDP, cumulative 2026-30)



Source: IMF Staff Calculations.

Note: This chart shows the medium-term fiscal consolidation needed (with and without moderate reforms) to absorb spending pressures in pensions, health, defense and the energy transition during 2026-2040, while adhering to a sustainable debt path, consistent with a long-run debt target of 90 percent of GDP. This methodology is based on IMF European Regional Economic Outlook, Note 1, Fall 2025.

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The relief from the growth reform component would be substantial.

We find that the **moderate pro-growth reform package I described**, a plausible downpayment on the more comprehensive agenda, would

- reduce cumulative fiscal adjustment needs from about **5 to 4 percent on average across countries**
- and bring the average debt path **one quarter** of the way to the sustainable path.

There is a political economy benefit as well. Stronger growth would also make fiscal reforms and consolidation measures easier to **accept**.

It is important to note that **not all countries face the same challenge**.

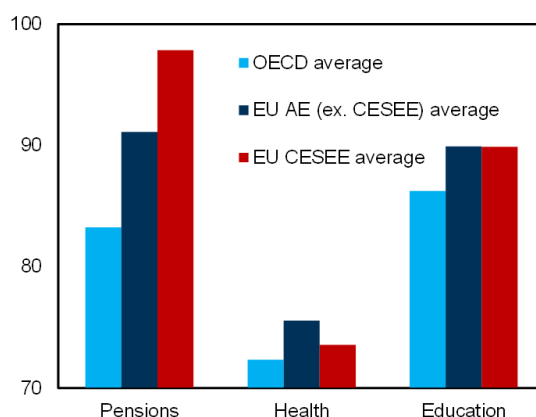
- About one quarter of EU countries have lower debt and smaller adjustment needs, and after implementing the growth reforms will require little or no additional adjustment.
- A **middle group of countries** still faces sizeable adjustment needs of at least ¼ percentage point of GDP per year, even after growth reforms.
- For one third of EU countries **with high debt**, adjustment needs exceed 1 percent of GDP per year even with growth reforms.

Beyond growth-enhancing reforms, **fiscal structural reforms** (such as entitlement reforms) and fiscal **adjustment measures** will also be essential to any strategy to shore up public finances.

For the remainder, let me focus on possible **consolidation measures**.

The EU public sector funds more than 70 percent of core services

Public Financing Share in EU countries is above the OECD average
(Percent of total; EU countries)



Sources: OECD, UNESCO, WHO, World Bank, and IMF Staff Calculations.

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One is cutting **energy subsidies** that are environmentally harmful. Germany's phased coal subsidy removal in 2018 is one example of what is possible. In Germany, Austria, Slovakia, we estimate that about 1 percent of GDP can be gained through such reforms.

Another is tighter **targeting of welfare spending** that also strengthens work incentives. Sweden, for example, linked certain benefits more closely to work capacity assessments after the GFC.

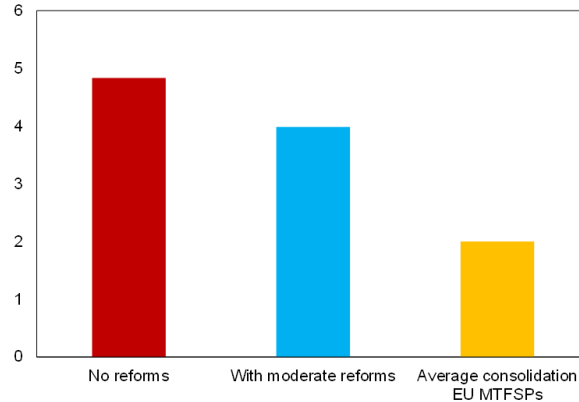
There is also scope to reduce the **public wage bill**, as identified as an option in Austria, Croatia, and Luxembourg, among others.

Tax reforms can raise revenue while improving economic efficiency. Many CESEE countries have relatively low revenue-to-GDP ratios and considerable room to raise them, including the Baltics, Bulgaria, Hungary, and Poland. Advanced economies could also raise revenue by reducing exemptions and strengthening compliance. Italy improved tax compliance under the National Recovery and Resilience Plan and could further increase revenue by reducing inefficient tax expenditures and eliminating the preferential flat-tax on self-employment.

In countries needing deeper adjustment, reconsidering the role of the state in the economy may also be necessary. European governments fund more than 70 percent of public services on average, and this may have to change. But spending cuts need not be broad-based. Linking access to public services to income, or introducing modest cost-sharing, could help manage usage while preserving free access for low-income groups. Ireland adopted both steps after the GFC, given its difficult fiscal situation at the time.

Current consolidation plans fall short

Fiscal Consolidation Needed to Stabilize Debt Ratios in EU Countries
(Simple average of EU countries, cumulative 2026-30, percent of GDP)



Source: IMF Staff Calculations.

Note: The first two columns show the medium-term fiscal consolidation needed to absorb spending pressures in pensions, health, defense and the energy transition during 2026-2040, while adhering to a sustainable debt path, consistent with a longrun debt target of 90 percent of GDP. This methodology is based on IMF European Regional Economic Outlook, Note 1, Fall 2025. The final column shows the medium-term consolidation planned in MTFSPs, cumulatively during 2024-2029, averaged over EU countries where consolidation is projected.

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How do our estimates of fiscal adjustment needs compare with what countries have already planned?

Our analysis shows that, even with growth reforms, the average adjustment exceeds what countries pledged **in their Medium-Term Fiscal and Structural Plans** under the EU fiscal framework. On average, submitted plans would meet only about half of the 4 percent of GDP adjustment need.

- Part of the gap reflects **timing**: the global outlook has weakened since the plans were adopted, and new demands have emerged, including the latest NATO commitment to raise defense spending.
- It also reflects the **longer time horizon** in our exercise, which captures **all the pressures** we have discussed.

Tackling Europe's Fiscal Squeeze



Doing nothing is not an option

- Debt is high, spending pressures mount, shocks are frequent
- Debt could reach **130 percent of GDP** on average



Reforms and consolidation are needed

- **More reform → less consolidation**
- Without reform, average country needs **5 percent of GDP** consolidation
- One third of EU countries need **>5 percent of GDP**, and will require government to carry less load for pensions, health, education



Societal dialogue needed to build support for reforms

- Communicate the scale of problem and consequences of delay
- Build consensus around policies that share burden fairly

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So, what does this tell us about how Europe can afford what seems unaffordable?

First, doing nothing is not an option. Debt would quickly rise to dangerous levels. **Europe needs a credible, long-term strategy—and must stick to it.**

Second, most countries will need a **mix of pro-growth structural reforms together with fiscal measures.**

Finally, major fiscal consolidations succeed best when governments **communicate clearly** and engage the public honestly. To garner broad support, it is essential to explain why these adjustments are needed to preserve the welfare state and to show they are being implemented fairly.

The alternative—quickly adopted spending cuts or tax increases—rarely works. Such measures are often politically fragile, watered down, and later reversed.

So it is time to start a public conversation.

The cost of inaction is simply too high.

Thank you.