Hearing on the economic and social effects stemming from the demographic transition

Summary

8 July 2025 | The Italian Parliamentary Budget Office (UPB) today held a hearing before the Parliamentary Committee of Inquiry on the Economic and Social Effects of the Ongoing Demographic Transition. The document presented by President Lilia Cavallari offers a critical assessment of the dimensions of these demographic changes and their economic implications, with particular attention to public finances. The analysis first focuses on demographic aspects and then examines their consequences for the labour market, potential growth, and the impact of population ageing on public expenditure, especially pensions, healthcare, and long-term elderly care. Finally, it uses simulations to assess possible effects on the dynamics of public debt relative to GDP.

The Italian population is undergoing a profound demographic transition that will substantially change its size and age structure over the coming decades. According to the latest forecasts by Istat, Italy will continue to experience, as it has since 2014, a decline in absolute population numbers. Net migration flows from abroad may partially offset but will not fully counterbalance the negative natural balance that has been evident since the early 1990s and is expected to become even more pronounced.

An aspect even more significant due to its financial and distributive implications is the reconfiguration of the population's age structure. The ongoing decline in the share of young people (aged 0–30), the parallel increase in the elderly (over 65), and the progressive shift of baby boomers from the central stage of life (31–59) into retirement are the most significant trends in this respect.

Another critical issue concerns migration trends. International migration contributes to demographic renewal but cannot offset the natural decline and the loss of human capital due to emigration, which consists mainly of young, skilled individuals. **Internal migration exacerbates territorial disparities**, with net flows of population and human capital from the South to the Centre-North, leaving some areas vulnerable and at risk of depopulation.

These phenomena will have a direct negative impact on the size and average age of Italy's workforce in the coming decades. However, the effective size of labour input in the future will depend on economic, social, and institutional factors that influence the employment rate and participation decisions. Over the past two decades, the Italian labour market has seen significant age recomposition, with a marked skew towards older age groups. The overall favourable trend in the employment rate (3.8 percentage points from 2004 to 2024) was mainly driven by the positive contribution of the 50–64 age group and, to a lesser extent, by rising employment among adult women (35–49 years).

Decomposing the overall change in the employment rate reveals that demographic dynamics have contributed positively only in the 50–64 age group, while the contribution was negative for younger cohorts. The specific variation in the employment rate, net of demographic changes, reinforced the contribution of the 50–64 age group for both genders. This suggests that the overall employment increase over the past twenty years did not result solely from mechanical demographic effects but also from greater labour force engagement by older adults and, to a lesser extent, by adult women. By contrast, younger generations made a negative contribution.

A key policy priority to mitigate the effects of demographic decline on the labour market is to encourage participation and remove barriers to employment, thereby reducing inactivity. Despite a significant rise in the participation rate in Italy in the years following the pandemic crisis (reaching 66.7 per cent in 2023), it remains well below the EU average, mainly due to high inactivity. In 2024, the number of inactive people aged 15–64 exceeded 12 million. High inactivity already weighs on productive capacity, and reducing it could help counter the downward trend in labour supply driven by demographic decline.

About two-thirds of the inactive population consists of women. Female inactivity is strongly influenced by family caregiving responsibilities, which, along with discouragement, are the main constraints on their labour supply, particularly in southern regions. More than half of the inactive population has low educational attainment, a factor that significantly affects the success of policies aimed at expanding labour supply. Low education levels, a lack of marketable skills, and poor motivation fuel a tendency to withdraw from active job search, complicating the design and effectiveness of policy interventions.

Italy's demographic transition—marked by a shrinking working-age population and ageing—affects both labour input and aggregate productivity, negatively impacting potential output. Historically, until the 1970s, demographic growth and the adoption of new technologies supported economic development, offsetting reductions in hours worked. Since the 1980s, however, demographic slowdown and weakening total factor productivity have increasingly constrained potential growth. Projections suggest that in the short term potential output growth could still benefit from investments funded by the National Recovery and Resilience Plan (PNRR) and higher participation rates. Nonetheless, a substantial stagnation of potential growth is expected in the next decade, primarily due to declining contributions from employment. Economic policy should aim to strengthen total factor productivity—leveraging new technologies and improving institutional conditions—while stimulating the labour market participation of inactive individuals and strategically managing migration flows. The combined effect of these policies could mitigate the impact of demographic trends on Italy's growth potential.

Regarding the direct impact of the demographic transition on public finances, current projections suggest overall sustainability, despite expectations of significant increases in age-related spending over the next decade. According to the 2024 Ageing Report by

the Working Group on Ageing Populations and Sustainability (AWG), in EU the total age-related expenditure is projected to rise by 1.2 percentage points by 2070, reaching 25.6 per cent of GDP. For Italy, which starts from levels above the EU average, age-related spending is projected to decline by 2 percentage points, reaching 25.3 per cent of GDP in 2070. However, mainly due to the retirement of the baby boomer generation, a 1 percentage point increase is expected over the next decade, pushing the spending-to-GDP ratio to a peak of 28.3 per cent in 2036, maintaining this high level until 2040. A partial recomposition of spending would occur. While pension spending will remain by far the largest component, its relative weight would decline due to a significant rise in the retirement age and a marked reduction in the ratio between pension and average wage. At the same time, the shares of healthcare and long-term care spending within overall age-related expenditure would increase.

Italy's projected reduction in pension spending relative to GDP (–1.9 percentage points between 2022 and 2070) is larger than that of other major European economies (Germany, France, Spain), despite Italy's less favourable demographic outlook (except for Spain). This outcome **mainly reflects structural reforms** introduced since the 1990s, **which will substantially lower the ratio of average pension benefits to per capita GDP**. The proportion of people aged 65 and over who are retired—already lower than in other countries—will fall further due to the automatic link of retirement age to life expectancy, and the near-total absence of early-retirement options.

While this substantial reduction in the pension-to-GDP ratio will help contain expenditure, it raises concerns about benefit adequacy. The automatic adjustment of retirement age to life expectancy trends will have a positive effect on replacement rates (the ratio of initial pension to final wage). However, it will not fully offset the decline in benefit levels resulting from the full implementation of the contribution-based calculation method from around 2040. It is crucial to maintain the automatic adjustment of age and contribution requirements to life expectancy, to mitigate the rise in the pensioners' dependency ratio and prevent benefits from becoming too low, which would generate pressures on social assistance systems.

The question of adequacy will be even more pressing for workers with low wages or short, discontinuous careers. The ability of the system to ensure future benefits comparable to current ones requires improving the economic and income conditions of the working-age population, while also guaranteeing adequate wage dynamics and a stronger link between wages and labour productivity. Long, well-paid, and continuous careers not only ensure higher pension benefits but also increase contributions to the pension system, helping to reduce the financial pressures generated by the progressive ageing of the population on its sustainability and on public finances.

The contribution-based calculation method, while ensuring greater transparency and better control over pension spending dynamics compared to the earnings-based method (which was in force in Italy before the reform process begun in the 1990s), must be

equipped with automatic adjustment mechanisms to respond to macroeconomic and demographic shocks. **The two main automatic mechanisms in the Italian system—the biennial update of the conversion coefficient and the adjustment of retirement age to life expectancy—help neutralise longevity risk and contain the rise in the pensioners-to-workers ratio**. Managing these instruments, especially when there are deviations between actual and expected life expectancy, should ideally be defined ex ante and transparently rather than through ex post and discretionary measures.

In healthcare and long-term care (LTC), the risk associated with greater longevity is that it may be accompanied by illness and disability. The increased demand for care and support may not find a sufficient response within the family, which is undergoing changes that could reduce informal support currently available. Meanwhile, existing welfare systems are not yet fully prepared to address the effects of the changing demographic composition of the population. European models for LTC delivery are diverse. In many countries, including Italy, these models are still far from achieving stabilisation.

Numerous studies have aimed to assess the long-term impact of ageing on healthcare and LTC spending. Given the length of the observation period for these estimates and the uncertainty of the assumptions—since many hard-to-predict factors influence healthcare—these exercises should be interpreted with caution.

The 2024 AWG Report projections on the impact of ageing on healthcare and LTC spending suggest a picture of overall sustainability. In the baseline scenario, there is a marginal increase in healthcare spending relative to GDP between 2022 and 2070 (0.1 percentage points, to 6.4 per cent). Even when **compared to 2024**, a normal year after the health emergency phase, **the increase by 2070 remains limited (0.6 points**). The impact of demographic transition driven by baby boomers appears muted. Meanwhile, more or less favourable assumptions about health conditions in the additional years of life gained through greater longevity imply variations in spending over the projection horizon ranging from an increase of 0.5 percentage points of GDP to a reduction of 0.2 points. If spending trends of the past decade are projected into the future, or if cost increases driven by labour costs are assumed, healthcare spending in 2070 would actually be lower than in 2022. **The main challenges arise from supply-side pressures**, which must be controlled through planning and regulation of the system, **and from the current weaknesses of the National Health System**, which should be addressed through structural strengthening, starting with measures to counter staff attrition. Such needs are reflected in a risk scenario that shows continuous spending increases, reaching 7.2 per cent of GDP from 2058 through 2070.

For LTC, the baseline scenario implies an increase in spending's share of GDP of half a percentage point between 2022 (when it was 1.6 per cent) and 2070. This rise is mainly driven by growth in home care (37 per cent) and cash transfers (34 per cent), while residential care would see a more limited increase (18 per cent). In other scenarios, the variation in spending ranges from a minimum of 0.4 percentage points of GDP (healthy

ageing scenario) to a maximum of 1.5 points (risk scenario). Once again, spending pressures operate mainly on the supply side, reflecting an expected strengthening of the LTC system to bring it closer to standards in other European countries, especially through greater public provision of in-kind services.

The territorial distribution of healthcare and LTC needs, as well as of resources, changes over time due to demographic and migration dynamics. Internal migration, in particular, leads to net flows of population and human capital from the South to the Centre-North, making some areas fragile and at risk of depopulation, especially in inland regions. It is therefore essential to reduce disparities in access to and quality of services, to avoid territorial differences reinforcing incentives for emigration. It will also be necessary to monitor in a timely manner—using detailed and integrated data across institutions—how healthcare and LTC needs evolve, to enable early planning of mitigation and adaptation measures.

Improving the healthcare system and elderly care services would require additional resources. Under the new European fiscal rules, these would need to be offset in other spending areas or through discretionary tax increases, to avoid negatively impacting the decline in the debt-to-GDP ratio.

In the new EU economic governance framework, ageing-related expenditures play an important role in determining the fiscal adjustment required by the Medium-Term Fiscal-Structural Plans (PSB). AWG spending projections for pensions (net of taxation), healthcare, LTC, and education are the expenditure components expected to influence the structural primary balance under unchanged policies in the decade following the adjustment period.

The UPB has carried out sensitivity exercises to assess the impact on public debt of three alternative scenarios vis-à-vis the baseline scenario of the 2024 AWG Report. These scenarios assume:

1. A 33 per cent reduction in net migration flows over the entire projection horizon;
2. Freezing the retirement age at 2023 levels and deactivating the mechanisms linking retirement age to life expectancy;
3. An increase in healthcare spending, driven by non-demographic factors such as technological innovation and expanded public coverage of new services, along with LTC spending, assuming convergence of Italy's formal in-kind provision to the EU average.

All scenarios entail an increase in ageing-related spending and, except for the third, a reduction in potential growth. On average, over 2025–2041, the increase in ageing-related expenditures amounts to 0.2 percentage points of GDP in the first scenario, over 0.4 in the second, and 0.3 in the third. Potential growth declines relative to the UPB

baseline scenario by 0.1 percentage points in the lower-migration scenario and by 0.2 points in the retirement-age freeze scenario.

The increase in ageing-related spending worsens the budget deficit relative to GDP, delaying the decline below the 3 per cent threshold planned by the Government for 2026. In the first and third scenarios, the deficit would fall steadily below 3 per cent of GDP in 2027. In the second scenario, the deficit would drop below 3 per cent in 2030, rising above that threshold again from 2036.

The debt-to-GDP ratio would deteriorate in all alternative scenarios compared to both the PSB and the UPB baseline scenario. By 2031, the ratio would stand around 134 per cent in the healthcare and LTC spending increase scenario, and 135 per cent in the lower migration scenario, both about 2–3 points above the UPB baseline. In the retirement-age freeze scenario, debt would reach around 139 per cent of GDP, about 7 points higher than the UPB baseline. While remaining on a downward trajectory, the debt-to-GDP ratio would decline less sharply than in the PSB, reaching 124 per cent in 2041 in the healthcare and LTC higher spending scenario and 128 per cent in the lower migration scenario. In the retirement-age freeze scenario, the debt would not decline and would stand around 139 per cent of GDP in 2041, around 25 points above the PSB scenario.

These results confirm the relevance of demographic assumptions and policy variables for reducing the debt-to-GDP ratio, and thus, under the new EU fiscal rules, for defining the required fiscal effort. This underscores the need to verify the consistency and realism of the AWG projections, and to carefully assess the impact of possible pension, healthcare, and LTC system reforms on debt dynamics and the fiscal effort required under the new EU framework. **In this perspective, it is desirable that the revision of the Public Accounting Law to account for the new EU governance strengthens mechanisms to ensure transparency in the planning of future interventions, monitoring of their implementation, and ex post evaluation of their effects.**