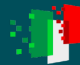

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SPOKE 4

D4.4.2 – Policy briefs on debt sustainability and financial stability also under compound risk

December 2024

Securing Italy's Economic Stability in the Era of Population Ageing

Andrea Consiglio

Executive Summary

Population ageing presents a significant challenge to public debt sustainability, particularly in the Euro Area. This policy brief highlights key findings from the study *"Debt Sustainability in the Context of Population Ageing: A Risk Management Approach"* by Ajovalasit, Consiglio, and Provenzano (2024). The study uses stochastic modelling to evaluate fiscal risks stemming from demographic changes in five European Union countries—Finland, France, Germany, Italy, and Spain—between 2023 and 2054. The modelling approach builds upon the risk management framework Zenios and Consiglio et al. (2021) developed, offering robust strategies to mitigate debt sustainability risks in the face of uncertainty. Particular attention is given to Italy, a country facing significant demographic and fiscal challenges.

Context and Importance of the Issue

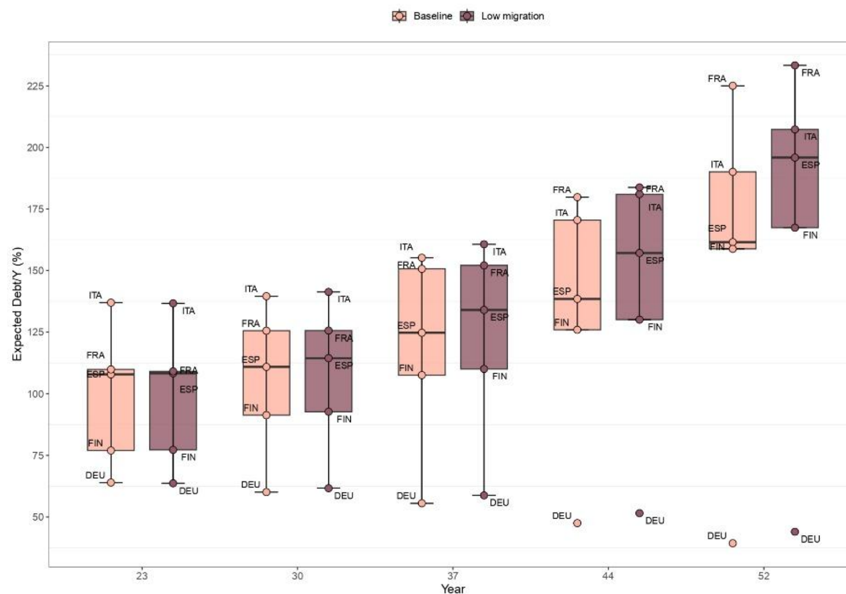
The European Commission's *2024 Ageing Report (2024)* estimates that *"the EU population is projected to decline from 449 million people in 2022 to 432 million in 2070"*. The demographic shift will increase public expenditures to face the total cost of ageing, rising from an EU average of 24.4% of GDP in 2022 to 25.6% by 2070. Pension and healthcare systems are the main contributors to this fiscal strain.

Italy will experience a decrease in the total cost of ageing over the projection horizon, but by 2050, the costs due to ageing will increase by up to 1%.

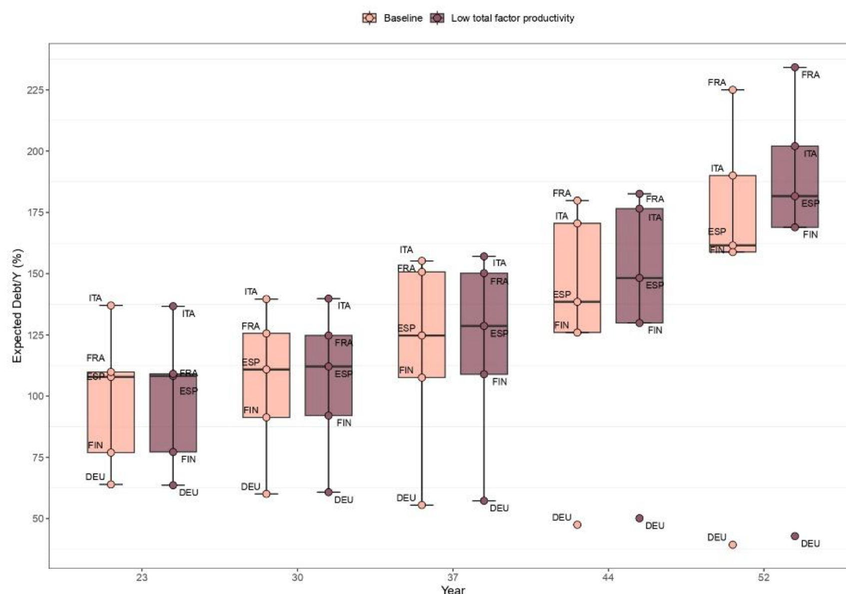
The Debt Sustainability Monitor 2023 also warns that high-debt countries like Italy could experience debt-to-GDP ratios exceeding 150% by mid-century unless urgent corrective action is taken.

The study by Ajovalasit et al. (2024) confirms these trends, showing that Italy faces one of the most severe fiscal challenges due to its rapidly ageing population, low fertility rates, and slow economic growth (see also Zsolt et al., 2024). The authors use stochastic debt models inspired by Zenios and Consiglio et al. (2021), which

incorporate uncertainty into debt sustainability analysis, allowing policymakers to optimize debt issuance and reduce refinancing risks under various economic and demographic scenarios. This integrated approach is critical for Italy's fiscal management amid demographic pressures.



(a) Low Migration



(b) Low TFP

Figure 1. Snapshots of the debt-to-GDP ratio over time under various demographic scenarios compared to the baseline. Each point represents the expected debt-to-

GDP ratio at a given time, with box plots illustrating the range of impacts across countries in the panel.

Policy Options and Analysis

Option 1: Mitigating the Impact of Low Migration

- Analysis: A low migration scenario significantly impacts debt sustainability, as reduced labour force growth directly affects economic output and fiscal revenues. Ajovalasit et al. (2024) show that in a low migration scenario, the debt-to-GDP ratio begins to increase visibly from 2037, reaching a worsening of 20 percentage points by 2052 compared to baseline projections (Figure 1, Panel (a)).
- Policy Implications: To attract and retain skilled immigrants, policies are critical to offsetting the decline of the labour force. This includes reforms to streamline immigration procedures, improve integration programs, and promote employment opportunities for migrants.

Option 2: Addressing Productivity Decline in Low TFP Scenarios

- Analysis: A low Total Factor Productivity (TFP) scenario exacerbates debt sustainability challenges by reducing GDP growth. Ajovalasit et al. (2024) state that the debt-to-GDP ratio worsens under low productivity conditions from 2045, with a cumulative negative impact of 15 percentage points by 2052 (Figure 1, Panel (b)).
- Policy Implications: Investments in productivity measures, such as R&D, digital transformation, and education, are crucial. Governments should focus on policies that foster innovation, upskill the labour force, and improve technological adoption to sustain productivity growth and mitigate fiscal pressures.

Option 3: Fighting Low Fertility Rates

- Analysis: A low fertility scenario has a smaller but still noticeable effect on the debt-to-GDP ratio. While its impact is less severe than low migration or TFP scenarios, it still contributes to fiscal stress by shrinking the future labour force. Ajovalasit et al. (2024) find that this scenario increases the debt-to-GDP ratio over the long term, even though not dramatically (4 percentage points. Figure not shown).
- Policy Implications: Policies to stimulate fertility rates, such as family support programs, parental leave incentives, and childcare subsidies, are necessary

to ensure a stable demographic base. Such measures can help sustain future labour force participation and reduce long-term fiscal pressures.

Recommendations

1. **Promote Migration to Stabilize the Labor Force:**
   - Develop policies to attract and retain skilled immigrants, including simplified immigration procedures.
   - Enhance labour market access and social inclusion for migrants to maximise their economic contribution.
2. **Sustain Productivity Growth:**
   - Increase public and private investments in research and development (R&D), digital transformation, and workforce upskilling to mitigate the negative impact of low TFP scenarios.
   - Foster innovation by supporting fast-growing industries and promoting partnerships between universities and firms.
3. **Support Fertility through Family Policies:**
   - Implement family-friendly policies such as expanded parental leave, subsidised childcare, and direct financial incentives for families to encourage higher birth rates.
   - Ensure long-term support programs to sustain demographic growth and stabilise future labour force participation.

Implementation Considerations

I. **Coordination, Public Awareness, and Political Feasibility:**
   - Effective implementation requires collaboration across multiple stakeholders, including national governments, local authorities, private sectors, and international organisations.
   - Public awareness campaigns are essential to build support for politically sensitive reforms, particularly in areas like immigration and family policies. Transparent communication about the long-term benefits of these measures can reduce resistance and foster stakeholder engagement.

II. **Data and Forecasting Tools**
   - Invest in robust data collection systems and advanced forecasting tools to monitor the impacts of migration, productivity, and fertility on debt sustainability.

- Platforms like AMELIA, developed under the GRINS project (grins.it), offer valuable scenario analysis and real-time monitoring tools, enabling policymakers to adjust strategies dynamically based on emerging trends.

Conclusion

The evidence from Ajovalasit et al. (2024) underscores the critical need for comprehensive policy responses to mitigate the adverse effects of demographic changes on public debt sustainability. Italy faces particularly severe challenges among the Euro Area countries due to its rapidly ageing population and associated fiscal pressures.

Without proactive measures, low migration, declining productivity, and low fertility rates will significantly worsen Italy's debt-to-GDP ratio, undermining long-term fiscal stability. Migration policies must be prioritised to counteract labour force decline, while targeted investments in productivity and innovation are essential to sustain economic growth. Additionally, family support programs should be implemented to address demographic imbalances over the long term.

By adopting these strategies, Italy can stabilise its debt trajectory, align with broader European Union fiscal objectives, and ensure economic resilience in the face of population ageing.

Acknowledgement

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