

Tullett Prebon Research, a blog by Dr Tim Morgan

The generation game

by Tim Morgan on July 18, 2012

It can sometimes seem that the Office for Budget Responsibility (OBR) lives in a different, much better place than the rest of us. After all, if earlier OBR forecasts had been right, the economy would be growing by 2.6% this year (after 2.1% growth in 2011), inflation would be less than 2%, and unemployment would already have fallen sharply. On the OBR's 'fantasy island', no doubt, England would have won Euro 2012, Andy Murray would have triumphed at Wimbledon, and we'd be enjoying a long, hot summer....

Though justified, scepticism about OBR forecasts should not lead us to ignore their warnings about the likely economic and fiscal effects of the ageing population, warnings which, in any case, have already been made by the European Commission.

Where the fiscal equation is concerned, the message is stark – the rise in age-related costs (such as pensions, health and long-term care) will require, either that taxes be increased, and/or that spending in other areas be reduced.

The incremental figure that the OBR cites for 2017-18 is £17bn (at today's values). The ageing population has already impacted spending, of course, but the OBR number represents a sharp upturn – my calculations suggest that demographic change has added an average of about £5.5bn to public spending in each of the last ten years.

This adverse trend is affordable if – but only if – economic output improves. This, as I've explained many times before, is a much tougher call than most people realise. About 70% of the economy is accounted for by sectors dependent either on private borrowing or on public spending, both of which are dead in the water.

Fixing this – and meeting the cost of demographic change – requires robust long-term planning. Since the Government has already dismantled this year's budget, am I alone in wondering quite where this long-term thinking is supposed to come from?

The real problem lies as much in simple equity as in affordability. The current generation has burdened the young people of today and tomorrow with huge debts and quasi-debts. It has used part of this borrowing to price housing out of the reach of most young people. A generation of policymakers whose own university education was state-funded has burdened the next generation with tuition fees. Unemployment is highest amongst the young.

And now, on top of all this, the current generation expects to have its retirement years funded by its impoverished successors taking cuts in living standards? This simply does not add up. Put bluntly, the current generation has robbed posterity. Economic and social models do not get much more unsustainable than that.