

Prepare for a new 'age' of austerity

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The public finances have formed the basis for one of the biggest stories of the past 10 years. Budget pressures, cuts, and the ongoing efforts of policy-makers to put things back on an even keel after the impact of the financial crisis have been to the fore of the policy, media and public agenda. But in many respects, this narrative of 'clearing up the mess' has masked a more fundamental challenge emerging underneath. Some people may be expecting the public finances to 'return to normal' in the years to come, but the facts in relation to our ageing population tell us that 'normal' will be a very different thing from the past.

Indeed, only last week, ECB President Mario Draghi called for political leaders to press ahead with reforms that would save the Eurozone from its ageing crisis. In some western economies, the number of over 65 years is now growing at a faster rate than the number of children. Indeed, In Japan, changing demographics have seen sales of adult nappies overtake those for babies. This has huge public spending implications. According to Draghi "we cannot avoid the fact that, over time, the inherent speed limits resulting from the euro area's unfavourable dynamics will start to bite". The cost of delaying the implementation of the necessary reforms was according to Draghi "simply too high".

In Northern Ireland, the situation is even more acute. First, let's look at some recent demographic changes. In 1971, the population of Northern Ireland was just over 1.5 million. Today it is over one-fifth higher at 1.86 million. This increase is broadly comparable with the current population of Belfast. However, the age-profile of the population has changed remarkably. As of 2014, there were 100,000 fewer children than in 1971. Conversely, there were over 120,000 more >65 year olds. Improved health has seen the average life expectancy rise from around 72 years in the early 1980s to over 80 years today.

Looking ahead, Northern Ireland's population is set to increase by over 5% (98,000 people) in the 10 years between 2014 and 2024 and will ultimately hit 2 million by 2034. But what is most significant is the speed at which our population is ageing or 'greying'. The number of 65+ aged individuals will rise by over one-quarter during the same decade. By 2028, the number of over 65s is set to overtake the number of children, with the former set to account for one-fifth of the population.

In 1971 there were 19 people aged over 65 years of age for every 100 individuals of working age (16-64 years). As of last year, this ratio had risen to 24 per 100 of working age. By 2023, this figure will reach 30, so there will be as much change in the next 7 years as in the last 40+ years. By 2061 there will be 1 person aged 65+ for every 2 people aged between 16-64 years of age. This means that in the space of 90 years, we will have gone from having 1 person over 65 for every 5 of working age, to 1 for every 2. Meanwhile the number of people aged 85 and over will increase by a staggering 50%. Rural areas will experience the highest rates of growth, with Belfast the least.

When the UK state pension was introduced in 1908, it was paid to people aged 70 years or more and was means tested. At the time, the life expectancy was only 47. In 1925, a new non-means tested

arrangement lowered the age to 65 years. Note that life expectancy has been accelerating at a faster rate than the State Pension age. This has significant financial implications.

Retirement pensions were designed to allow people to stop working in their last few years in relative comfort and to make way for younger workers. Today, retirement is for an increasing number of individuals an extended period of state-supported or company-sponsored leisure, which was never intended. More recently, laws have already been passed to raise the pensionable age incrementally to 68 in the coming years. This helps improve the dependency ratio (of pensioners relative to those of working-age) a bit but it is only slowing the rate of increase. The scale of the fiscal challenge remains immense. We can expect the pensionable age to rise to 70 and beyond

Clearly the fact that we are living longer is something to be celebrated. However, for those in charge of our public finances and our elected representatives, it represents a financial headache. Taking a small example first; Northern Ireland's concessionary fares scheme, which allowed free public transport for those aged over 60 years of age. In 2014 this cost around £40m (note fuel costs have fallen significantly since). In the decade to 2024 an additional 100k individuals will be able to avail of this subsidy, a 27% increase on 2014 levels. However, this sum of money is nothing relative to the challenge in health spending.

An ageing population will place huge pressure on health and social care budgets. The health budget for this year is around £5bn, a 1% rise in real terms on last year. Of this, around £3.5bn refers to health and social care (HSC). Let's consider 42% of the HSC budget is spent on the over 65s, roughly £1.5bn. This compares to their population share of 14%. As was discussed earlier, the numbers of over 65s are set to increase by 27% by 2025. Doing the maths, before including an annual cost rise on medical costs, sees this figure spiral. Furthermore, the cost accelerates based on age. For example, according to the DoH the average annual cost of the average 55-59 year old costs £1,970 per head, rising to over £6,000 per head for 75-79 year olds and £14,000 for the over 85s.

In Northern Ireland, we continue to battle against things like water charging, increasing tuition fees, and doing away with free prescriptions. But the reality is that these are the low hanging fruit that other economies have long since come to terms with as they adjust to the new public spending realities. Northern Ireland needs to quickly do the same and to realise that these are just the thin end of the wedge. The era of 'austerity' is over and the era of 'the ageing population crisis' is in train. A philosophical debate raged about the need for the former, but no one can deny the realities of the latter and the massive adjustments needed as a result.

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