The Centre for Enterprise, Markets and Ethics

ENTERPRISE AND VALUES SERIES

The UK Savings Crisis

Rediscovering the Principle and Practice of Saving

Andrei Rogobete

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The Centre for Enterprise, Markets and Ethics
First Floor, 31 Beaumont Street,
Oxford OX1 2NP

About the Author

Andrei E. Rogobete is Associate Director with the Centre for Enterprise, Markets and Ethics. He is the author of several publications, including *Ethics in Global Business: Building Moral Capitalism* and *The Challenges of Migration*. His main areas of research include business ethics, sustainable governance, as well as the contemporary role of Judeo-Christian teaching. He also writes regularly on the wider socio-economic challenges facing Britain and the western world.

Andrei's background is in political consulting and media relations, having previously worked in Westminster for Media Intelligence Partners (MIP). During his time at MIP, he worked on bespoke political campaigns for several high-profile politicians and members of the Cabinet.

He holds an MSc from University College London in Business and a BA in Politics and International Relations from Royal Holloway, University of London, together with a Certificate in Theological Studies from the University of Oxford.

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Introduction

Over one-third of people in Britain have less than £1,500 in savings and 15 per cent have no savings at all.[1] Young people are the most affected group: an estimated 53 per cent of 22–29-year-olds have zero savings.[2] The House of Commons Treasury Committee estimates that over 75 per cent of 25–34-year-olds do not own any form of residential property.[3] In addition, the cuts in interest rates – to as low as 0.01 per cent in 2020 on savings accounts – have acted as a further disincentive to save.[4]

Against the backdrop of Brexit and Covid-19, this is a good time to set the economic and social foundations for Britain in the rest of the twenty-first century. The country needs to rediscover the virtues of prudence and stewardship in an increasingly complex environment in which a culture of consumerism, or 'Buy now, pay later', seems the norm.

The economic growth of the last decade has not benefited everyone equally, leaving some in difficult financial circumstances. The economic ghosts of the recession linger: lagging productivity; slow income growth; declining home ownership; low interest rates. These factors amount to a difficult environment for saving.

In a recent interview, the former Governor of the Bank of England, Mervyn King, said:

> We have not been looking at the underlying economic challenges for the United Kingdom. We have one of the lowest saving rates in the British economy of any G20 country. We're not saving enough for pensions, we're not saving enough to care for the elderly, we're not saving enough for infrastructure. What are we going to do about the education of 50 per cent

> of the population that don't go to university or college? These are the issues that will determine our prosperity in the future.[5]

Technology is also changing the way we use money. The 'Access to Cash' Review commissioned in 2018 found that the UK could become a cashless society in only 15 years. A decade ago, 6 out of 10 transactions were made with cash; today it is 3 out of 10. Britain's cashless transition would leave an estimated 8 million people who rely on cash struggling financially.[6]

Yet beyond our gradual move away from cash lie the associated difficulties and confusion of an increasingly complex spending system. The lines between what people hold as traditional 'cash in the bank' and what they can spend are blurred. More recent trends that merge activities such as shopping with previously separate ones such as entertainment and social time only add to the budgetary confusion. In such a context, financial literacy becomes essential if people are to avoid the pitfalls that come with heightened complexity.

'Britain needs to rediscover the culture and habit of saving'

Thus Britain needs to rediscover the culture and habit of saving. The purpose of this publication is twofold: first, to understand the causes of the current savings crisis and discuss some of the initiatives and measures that can be used to combat it; second, to discover how the virtue of prudence contributes to recognising the principle and practice of saving as central to the long-term socio-economic health and development of British society.

Chapter 1 looks at the economic situation in the UK and the key aspects of its low level of savings. It considers some of the predominant underlying economic and demographic issues that have made it difficult for people to save. The chapter also briefly surveys some of the theories associated with predicting future levels of savings, such as the Permanent Income Hypothesis and the Life Cycle of Consumption Hypothesis. It also evaluates current initiatives in three main areas: emergency savings; savings for a first home; savings for retirement.

Chapter 2 focuses on the historical use of money and the moral arguments for saving. It considers human nature within classical thought and presents Adam Smith's defence of prudence as one of the key virtues necessary to develop a culture of saving. The chapter concludes with a brief exploration of prudence within Judeo-Christian teaching, and argues that it is an integral part of human and spiritual flourishing.

Chapter 3 draws some conclusions and includes suggestions for further action. It argues that the UK's low levels of savings can be alleviated if changes take place in key areas: creating an environment that rewards saving; broadening asset ownership; reforming intra-generational equity; rediscovering the virtue of prudence in establishing a culture of saving, in particular promoting financial education.

NOTES TO INTRODUCTION

1 Charlie Barton, 'Saving Statistics', Finder.com, 20 August 2019; https://www.finder.com/uk/saving-statistics.
2 Ibid.
3 House of Commons Treasury Committee, 'Household Finances: Income, Saving and Debt; Nineteenth Report of Session 2017–19', p. 6.
4 David Byers, 'NS&I Rates: Big Squeeze hits 25m Savers and Premium Bond Holders', *The Times*, 22 September 2020, https://www.thetimes.co.uk/article/ns-amp-i-rates-big-squeeze-hits-25m-savers-and-premium-bond-holders-r56jb0bfq.
5 Andy Gregory, 'Brexit Stopping Britain Resolving Deep Problems with Economy, says former Bank of England Chief', *The Independent*, 20 October 2019; https://www.independent.co.uk/news/uk/politics/brexit-economy-mervyn-king-bank-england-election-recession-debt-a9163531.html.
6 Access to Cash Review – Final Report, March 2019; https://www.accesstocash.org.uk/media/1087/final-report-final-web.pdf.

Chapter 1

The UK savings crisis

1.1 The potential impact of Covid-19

First, the elephant in the room. The lockdown brought on by Covid-19 has had a profound impact on social and economic life in Britain. It has brought the wheels of the economy to an abrupt standstill. However, the lockdown was *imposed* – the economic activity downturn was not the result of a macro issue in the economy or the bursting of an overinflated market bubble. Economic activity in Britain has been shut down forcefully for the first time since the Second World War.

What will be the likely impact of the lockdown on savings? Will it exacerbate the discrepancy between the haves and have-nots? How quick could a recovery be? These are just a few of the questions that require answers.

Two likely outcomes

The biotech entrepreneur and social impact investor Dato Dr Kim Tan recently wrote in a report:

> Whoever said that Covid-19 is the great equalizer was wrong. We may be in the same storm, but we are definitely not all in the same boat. Covid-19 is widening inequalities. The poor will be hit the hardest by this pandemic.[1]

The most likely and unfortunate outcome of the lockdown will be a growing discrepancy between haves and have-nots: those fortunate enough – and those unable – to maintain a steady income.

For those able to maintain income, the lockdown has had a positive impact on saving. A report from Legal & General estimates that spending has decreased by around £18 billion per month in the wider economy since lockdown began, effectively decreasing household spending by over one-third.[2] *The Telegraph* reports that savings deposits were up by £13 billion in March alone.[3] Nigel Green, the CEO and founder of the financial consulting firm deVere, recently argued:

> The financial impact of coronavirus has driven home that the 'living for today' attitude is great, but what happens when tomorrow does come? Are you still able to fulfil your obligations? Are you still able to do the things you love with your friends and family? Are you able to maintain your lifestyle? The crisis will, again, underscore that we're increasingly living in an era of personal financial responsibility. The pandemic has brought savings back into sharp focus.[4]

It may well be that the impact of Covid-19 will be far more profound than just a transitory reduction in spending. The crisis could prompt a holistic change in attitude towards spending that will last long after the pandemic has passed. Households may become more conservative and forward-looking in their discretionary spending. So those who have maintained employment are more likely to have increased their savings and therefore be in an overall healthier financial position.

However, for those unable to receive or maintain a steady stream of income, the lockdown has had a negative impact. This could be due to the nature of their work (e.g. unable to work from home), unemployment (caused by layoffs), an abrupt and dramatic reduction in business demand, and would include those job seeking or laid off prior to the lockdown.

A report by the Resolution Foundation found that households with low income are twice as likely as those with higher income to fund the lockdown with debt. The average savings for those in shut-down parts of the economy between March and June were £1,900 compared to £4,700 for those able to work from home.[5] According to the economist George Bangham, 'These wealth divides have been exposed by the crisis. While higher-income households have built up their savings, many lower-income households have run theirs down and had to turn to high-interest credit.'[6]

'Wealth divides have been exposed by the crisis'

In summary, the long-term effect of the lockdown will probably be to increase the discrepancy between those who have and those who have not been able to maintain a steady income. Time will tell how lasting these effects will be on overall household savings. For now, it is important to emphasise the worrying impact the lockdown has had on low-income households and those out of work.

1.2 The underlying causes

Between the economic crisis of 2007–8 and the Covid-19 pandemic, the UK's economy grew by an average of just under 2 per cent per year.[7] Yet so far as savings are concerned, any beneficial effects have not materialised on the ground. As mentioned in the Introduction, one-third of Britons have under £1,500 in savings and 15 per cent have none[8] (and among those aged 22–29 that rises to over 50 per cent[9]). A report published by Theos found that 16 million British people have less than £100 in savings.[10] However, before delving deeper into these statistics we must consider the wider economic and demographic structural problems that have created a difficult environment for saving, both as principle and habit:

- Slow income growth;
- Lagging productivity;
- Declining home ownership;
- An ageing population;
- Low interest rates.

Slow income growth

Over the last decade, the UK's GDP has experienced moderate but positive growth. The exception of course was 2008–9, when the economy shrank by some 4.5 per cent, although since then GDP has grown on average by 1.9 per cent per year.[11] However, as Figure 1.1 shows, this trend has not been followed in real-wage growth.

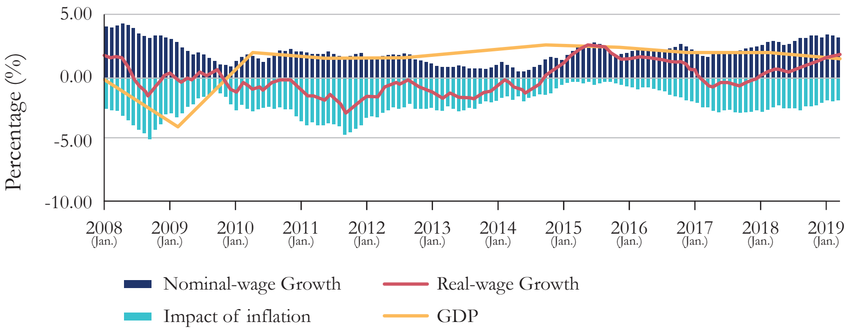

Figure 1.1: UK real wages vs GDP growth

For the working population, the real-wage growth line points to a more volatile trajectory in the level of income. From the beginning of 2010 towards the end of 2015, any increase in wages has been more than cancelled out by inflation, resulting in a net negative change in real income. This can also be seen occurring in parts of 2008 and 2017. The picture for 2018–19 seems to be on a more positive trend, with real-wage growth standing at around 2 per cent in January 2019. The Office for National Statistics (ONS) estimates that other economic factors played a role in this, including: an increase in the employment rate from 75.6 per cent to 76.1 per cent; an increase in the tax-free Personal Allowance from £11,500 to £11,850; a pushback in the 40 per cent higher income tax rate for those earning above £45,000 per year to £46,350.[12]

However, what is key is the contrast between positive GDP growth and predominantly negative real-wage growth in the period 2010–14. This could help explain why the growth in the UK's economy over the last decade has not been felt in people's pockets.

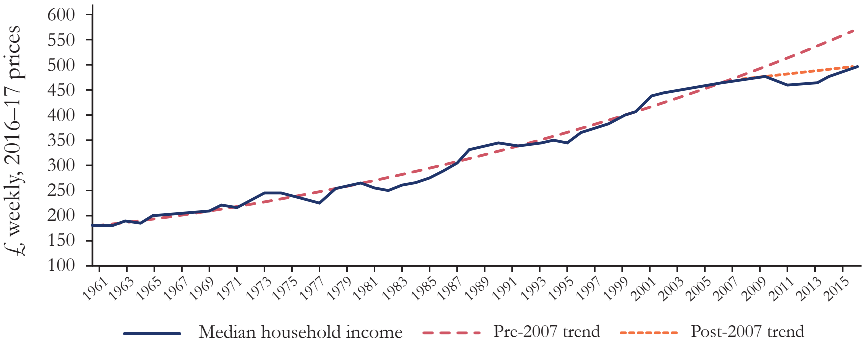

FIGURE 1.2: UK MEDIAN EQUIVALISED NET HOUSEHOLD INCOME

Digging a little deeper into the numbers, more worrying macro trends emerge. Figure 1.2 illustrates long-term growth in household income. There is a sudden change in the median income trend following the financial crises, albeit with some restoration around 2014. From the early 1970s to 2007, household incomes grew by an average of 2 per cent per year. After 2007, this dropped to just 0.6 per cent.[13] During a Parliamentary inquiry, Torsten Bell, the Director of the Resolution Foundation, told the House of Commons Treasury Committee that '[the effect on incomes of] the earnings squeeze that start[ed] to some degree in the mid-2000s and then became very severe from 2009 to 2014 ... is very big, and it dominates almost everything else.'[14]

Lagging productivity

Much like wage growth, UK productivity has also been lagging: despite a growing GDP, it stands among the bottom of the G7 countries, ahead only of Italy and 16.3 per cent lower than the G7 average.[15] Germany, France and the USA are more productive by 35, 30 and 20 per cent respectively. This means, for instance, that a French worker can produce by Thursday what a British worker cannot produce in the whole working week. The last time Britain claimed the top spot for European productivity was in 1960.[16]

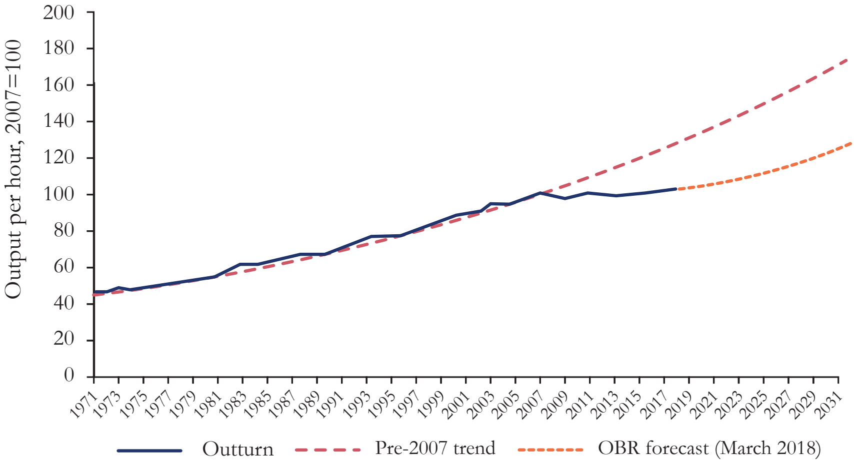

FIGURE 1.3: UK PRODUCTIVITY

Figure 1.3 illustrates the long-term trends in UK productivity growth. What appears clear is that the financial crisis of 2008 has had a significant impact not only on the initial growth trend but also on the UK's ability to return fully to its pre-crisis productivity growth trajectory. Even the prediction made by the Office for Budget Responsibility (OBR) sets productivity growth at 'roughly halfway between the pre-crisis (2 per cent) and post-crisis (0.5 per cent) averages'.[17] The 'productivity gap', which economists often refer to as the 'productivity puzzle', remains one of the most pressing issues for the British economy, and a direct contributor to low levels of household savings. Of course, the metrics are all interlinked, but the productivity puzzle has often been associated with: low capital investment; ageing technologies; limited bank lending; enduring skills shortages; poor levels of innovation. This all translates into a difficult environment for saving.

Declining home ownership

Home ownership in the UK has been on a downward trend since the early to mid-2000s. It reached a peak in 2002, when 58 per cent of all homes were owner-occupied, but by 2017 this had dropped to 51 per cent (with or without mortgages).[18]

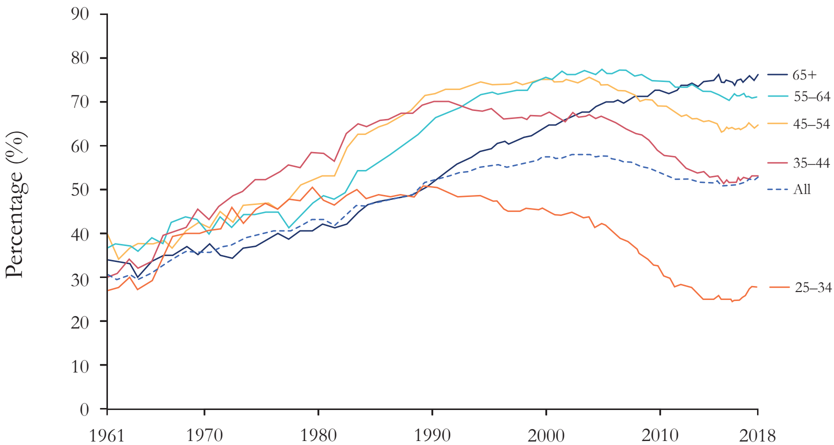

FIGURE 1.4: UK PERCENTAGE OWNING OWN HOME BY AGE GROUP

The more pertinent statistic, however, is home ownership trends among different age groups. Figure 1.4 illustrates how the turn of the century marked a downward trajectory for all age groups except one: those 65 and older. The youngest age group (25–34-year-olds) has been the worst affected – and by a very large margin. If in 1990 around 50.5 per cent of all 25–34-year-olds were homeowners, by 2016 just 24.5 per cent were – a historic record low.

'The savings/home-ownership dynamic can rapidly turn into a vicious cycle'

Again, it is not just the youngest adults in society who are finding it difficult to afford a home – all age groups except those above 65 are facing similar struggles, albeit to varying degrees.

This is deeply concerning not just from an economic standpoint but because it strains the social fabric of British society for future generations. It can be seen as both a symptom and a cause of low levels of saving. Unable to purchase property due to lack of savings, many are, conversely, unable to build savings due to lack of – or poorly managed – income. The House of Commons Treasury Committee found that: 'If today's younger households continue to experience a reduced rate of home ownership through their lives, more of them will need to finance rent payments out of their retirement savings.'[19] The savings/home-ownership dynamic can rapidly turn into a vicious cycle with significant consequences down the road.

An ageing population

This data is straightforward: the British population is getting older. However, while the numbers may appear simple, the implications are not. Table 1.1 shows the latest ONS statistics and predictions of population growth by age groups.

The only demographic predicted to increase their share of the total population are those aged 60 and older. However, the population as a whole is predicted to increase from roughly 65 million in 2016 to 76 million by 2046, due primarily to two factors: an improvement in life expectancy; positive net migration. Data from the World Bank set life expectancy in the UK at 80.96 years in 2016 compared to 71.97

in 1970;[20] and more people are entering the UK than leaving, with a positive net migration average of 113,000 per year since 1975.[21]

Interestingly, an ageing population and positive net migration have clearly offset any decline or slowdown in the total population caused by falling birth rates. In 1965 there were 2.9 births per woman, while by 2016 this number had dropped to 1.8.[22]

So how does an ageing population have an impact on savings? The answer is: indirectly. The ONS considered some 'consequences' of the UK's ageing population, chief among which was a reduction in the number of those at working age alongside an increase in the number at pensionable age.[23] This not only places pressure on the national economy but raises questions around the sustainability of adequate provision of healthcare, housing and education.[24] In a report published by the Government Office for Science, Professor Sarah Harper notes that: 'Responding to this demographic shift will require us to make adaptations across many aspects of our lives: how we work; how we care for, communicate, and interact with each other.'[25]

	0–15 years (%)	16–64 years (%)	65+ years (%)	UK Population
1976	24.5	61.2	14.2	56,216,121
1986	20.5	64.1	15.4	56,683,835
1996	20.7	63.5	15.9	58,164,374
2006	19.2	64.9	15.9	60,827,067
2016	18.9	63.1	18.0	65,648,054
2026	18.8	60.7	20.5	69,843,515
2036	18.0	58.2	23.9	73,360,907
2046	17.7	57.7	24.7	76,342,235

TABLE 1.1: UK POPULATION, AGE DISTRIBUTION, PROJECTED TO 2046