Saving for a Property-Owning Democracy

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The Covid-19 pandemic is the most significant crisis to have faced the United Kingdom since the end of the Second World War in 1945. The economic restrictions have had a disproportionate impact on people in customer-facing industries, the young, and those in low-income households.

In my recent publication on *the UK Savings Crisis*, I highlighted some startling figures about the current low levels of savings in the UK: over one-third of people in Britain have less than £1,500 in savings and 15 per cent have no savings at all. Young people are the most affected group with an estimated 53 per cent of 22–29-year-olds having zero savings. In addition, record cuts in interest rates have effectively made saving an unattractive financial proposition.

On the surface, the high savings ratio sounds like good news, yet in reality it is quite the opposite. The UK's savings ratio hit a record 29.1% in the second quarter of 2020 and the latest data sets it at 19.9% (Q1, 2021) according to the Office for National Statistics (ONS).[1] The ratio is based on how much households are able to save in proportion to their disposable income.

Unfortunately, the surge in saving signals an economy in deadlock. Rather than a welcome form of organic growth, restrictions have resulted in 'forced' savings, where discretionary spending (for both individuals and households) has been limited or denied by compulsion, not choice.

The Treasury is not exactly in a buoyant stance either. The Office for Budget Responsibility (OBR) figures revealed a budget deficit of £303 billion in 2020/21. This equates to about 14.5%

[1] ONS, *Households (S.14): Households' saving ratio (per cent): Current price: £m: SA,* https://www.ons.gov.uk/economy/grossdomesticproductgdp/timeseries/dgd8/ukea

of GDP – a level not seen since the Second World War in 1944/45. A total of £407 billion has been spent on Government measures to tackle the pandemic and in sustaining businesses, workers, and incomes.[2]

Against the backdrop of a very difficult socioeconomic environment, we may paradoxically find ourselves in an opportune moment to reset the economic and cultural incentives and re-discover the value of saving – both as a practice, as well as a principle.

Creating economic incentives

The starting point is rather evident - savers must be financially rewarded for their efforts. In other words, we need to make savings pay. This will require renewed efforts from government, banks, credit unions, building societies and all major facets of society.

Admittedly, we are facing challenging times at a macroeconomic level. The havoc wreaked by the pandemic with public finances means that we are likely to see an increasingly frugal Chancellor for some time to come. How will the Chancellor make up for this record-setting peacetime budget deficit and more importantly, how will it affect household finances?

As mentioned, Budget revealed in March 2021 highlighted over £407 billion to support furlough, the self-employed, business grants, loans and VAT cuts.[3] Rishi Sunak is thus facing a mounting challenge to pay for this record bill.

In this paper I highlight four key issues that will impact the future of savings.

The first issue is the proposed switch from the Retail Price Index (RPI) to the Consumer Price Index including Housing Costs (CPIH). Historically the CPIH has been about 0.8% lower than the RPI and is seen as the more accurate figure. This will now apply to all public sector pension increases and the statutory element of private pensions.

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[2] August Graham, (23rd April 2021), The Standard, "Covid spending pushes deficit to highest levels since Second World War", https://www.standard.co.uk/news/uk/office-for-national-statistics-government-graham-vat-obr-b931274.html

[3] Gov.UK, *Budget 2021 sets path for recovery*, https://www.gov.uk/government/news/budget-2021-sets-path-for-recovery

This change could take £122bn off the value of pensions and index-linked bonds. According to the Pensions Policy Institute, this means that many defined benefit pensioners as well as younger savers will see a reduction in their lifetime benefits. Morten Nilsson, head of the BT Pension Scheme, criticised the move as "a massive transfer of wealth" according to The Times.[4]

We may remember how back in September 2020 the National Savings and Investments (NS&I) made headlines when they issued "devastating" cuts to their interest rates on savings accounts, with Income Bonds reaching a low of 0.01% and impacting 25 million people.[5] The high street retail banks have also slashed interest rates for savings accounts across the board, making the problem even more widespread.

There is also a growing divide between public and private pensions with some public schemes generating three times as much in retirement savings compared to those in the private sector. Historically private sector wages were higher than those in the public sector (with the subsequent retirement savings), but this trend has reversed. The latest figures from the ONS show that the average public sector wage stands at £580 a week, compared with £530 in the private sector.

The Pensions Policy Institute highlighted this discrepancy in saying that private-sector defined contribution (DC) schemes, "…give far more varied outcomes as they are subject to uncertain investment return. This lack of security provides a far wider spread of results when an individual is more dependent on DC savings rather than defined benefit (DB) entitlement or state pension income."[6]

Yet the fundamental problem is not just about pensions for those in or approaching retirement, it is about those that are young - many of whom are either looking for work or are in work yet lack the necessary avenues and financial ability to start saving.

[4] The Times, "Pensions chief attacks Sunak over wealth grab", https://www.thetimes.co.uk/article/pensions-chief-attacks-sunak-over-wealth-grab-bgjpqfns5

[5] Emma Munbodh, The Mirror, "NS&I to slash interest rates and cut Premium Bonds prizes for 21million savers", https://www.mirror.co.uk/money/nsi-slash-interest-rates-cut-22716880

[6] Duncan Ferris, (8th July 2021), Pensions Age UK, https://www.pensionsage.com/pa/DC-schemes-offer-wider-spread-outcomes-than-DB-says-PPI.php

The second issue is therefore the need for new financial products that will encourage the younger generation to start saving. Of course, a key prerequisite to this is a rise in interest rates. It will be difficult to attract young people to savings accounts with interest rates that are not even an integer.

What would new avenues for saving look like? Thankfully, there are reasons for optimism. We have seen the rapid emergence of 'Fintech', or Financial Technology. A general definition of fintech is that it essentially aims to innovate and apply technology to improve financial activities.[7]

One of the positive outcomes of fintech has been the emergence of 'robo-advisors'. Examples in the UK include Nutmeg and MoneyBox – both of whom have been backed or are partnered with large financial institutions.[8][9] They also benefit from the Financial Services Compensation Scheme (FSCS) guarantee of up to £50,000 in the case of insolvency.

Robo-advisors are digital platforms that use algorithms and online planning to offer the most appropriate investment portfolios to customers. The vast majority of these come in the form of Exchange Traded Funds (ETFs), or even a selection of ETFs. Together they create portfolios with varying degrees of risk.[10]

Robo-advisors have proven attractive for young people trying to save for several key reasons:

- Low initial investment requirements (some accounts can be opened from £1).
- Relatively low management fees. This is particularly true when compared with fully managed funds (0.3% - 0.75%). Also given the low human capital requirements, robo-advisors are able to keep overhead costs at a minimum.
- Ease and simplicity – Moving everything online means greater mobility for the user. Online management also offers instantaneous and often detailed information on portfolio performance. The user can easily deposit or withdraw funds.

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[7] Schueffel, Patrick (March 9, 2017). "Taming the Beast: A Scientific Definition of Fintech". Journal of Innovation Management. 4 (4): 32–54.

[8] City Wire, "Nutmeg partners with JPM multi-asset team for funds suite", https://citywire.co.uk/wealth-manager/news/nutmeg-partners-with-jpm-multi-asset-team-for-funds-suite/a1427091

[9] The Times, "Aiming high by thinking outside the box" https://www.thetimes.co.uk/article/aiming-high-by-thinking-outside-the-box-rthnz27x3

[10] Finder, "Nutmeg vs Moneybox", https://www.finder.com/uk/nutmeg-vs-moneybox

- Very low risk when compared to alternatives such as single-stock retail investing. Investing will always involve some degree of risk. However, the extensive use of ETF's means that even the highest risk portfolios remain highly diversified financial products. In addition, many of them regularly benefit from professional oversight despite not being a fully managed fund in the traditional sense. Young people can also afford a greater degree at risk when looking to grow (comparatively) low amounts of savings.

Investing is not for everyone, but the emergence of new avenues and accessible methods of growing savings ought to be encouraged. However, the remaining problem is both a significant lack of awareness and a lack in basic knowledge about these new possibilities to save. It is inevitable that some will be weary about new financial products – yet with the correct education and a long-term investment horizon, they can play a significant role in ensuring financial security.

The third issue is the return of inflation. While we won't go into much detail here (CEME Chairman, Brian Griffiths has tackled the subject thoroughly in two separate papers which can be found here, and here), it is important to note that the rate of inflation directly impacts savings.

A high rate on inflation not only raises the cost of living for those wishing to save, it directly reduces the purchasing power of savings that are already accumulated. Those that might be tempted to dismiss the threat of inflation as an unfounded overreaction need to realise that even small rises in inflation can negatively impact all facets of the economy - from rising costs to small business, to interest rate hikes on home mortgages.

There have been three consecutive months when the Consumer Prices index outpaced the forecasters' consensus, standing at 2.5 per cent in June.[11] Jonathan Athow, deputy national statistician for Economic Statistics at the ONS said that "Inflation rose for the fourth consecutive month to its highest rate for almost three years."[12]

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[11] Katie Andrews, The Spectator, *Britain is ill-prepared to deal with rising inflation*, https://www.spectator.co.uk/article/britain-is-ill-prepared-to-deal-with-rising-inflation

[12] Ed Magnus, This is Money, *More misery for savers as inflation surges to 2.5% in June, https://www.thisismoney.co.uk/money/saving/article-9787049/More-misery-savers-inflation-rises-2-5-June.html*

There are growing concerns that should inflation spike beyond 3%, the country would lack the immediate tools needed to bring it back under control. Rising interest rates may be a first line of defence, but as Katie Andrews, Economics Editor from the Spectator argues, "…such a hike would create a lot of financial pain for the government, which has been banking on rock-bottom rates to fund its spending commitments. It needs the cost of borrowing to stay low to deliver them."[13]

The fourth issue that will impact savings is taxation and particularly, income taxation.

The 2021 budget saw tax increases as another area where the Chancellor had to maintain the Conservative's 'triple tax lock' pledge in which Boris Johnson vowed that we will not see an increase in VAT, National Insurance, or income tax.

However, the Chancellor did raise corporation tax to 25%, froze all income allowances from 2022 to 2026, as well as the Pensions lifetime allowance.[14] Chris Sanger, the head of tax policy at EY, described the budget as 'three years of support, followed by three years (and more) of pain'.[15]

However, in the long-term the necessary funds to pay for furlough will ultimately have to come from tax rises. Treasury Select Committee chair Mel Stride MP said that, "Given where we are, tax is going to have to play a significant role in getting us through and dealing with the deficit in the longer term, […] you have to look at the broad-based taxes to do the heavy lifting."[16]

Corporation tax for instance was an area where the Chancellor could have perhaps done better if left alone. Not just because of the tax itself - but the economic message it sends.

[13] *Ibid.*

[14] Which, *Budget 2021: what you need to know*, https://www.which.co.uk/news/2021/03/budget-2021-what-you-need-to-know/

[15] Philip Inman, The Guardian, "Rishi Sunak's £65bn budget tax increases are highest in 28 years" https://www.theguardian.com/uk-news/2021/mar/03/rishi-sunak-budget-tax-increases

[16] Parliament UK, Rt Hon Mel Stride MP- Speaking Engagements, https://members.parliament.uk/member/3935/contributions?page=10

Let us briefly turn to income tax in the UK. Income tax is important because it directly affects a household's finances and thus, the ability to save. The problem is that the system fails to take into account the number of dependants to the earner (or earners in the case of a household with two working parents). UK income tax is almost entirely based on the individual. This means that family on average earnings of £40,000 would be in the poorest 40% of the population, yet a single person earning £40,000 per year would be in the top 20% wealthiest.[17]

Married couples are treated as two separate individuals by the UK tax system. There is little to no provision on the number of dependants or the employment status of either or both parents in receiving any family tax breaks. This makes budgeting and indeed, saving, quite a challenge for the household. Measures like the "Marriage Allowance" are also of minimal financial impact, particularly for low-income families. For the 2019-20 tax year, it allows single earner couples or couples where one person earns less than £12,500 per year to transfer £1,250 to their partner. This would result in an annual tax saving of up to £250.

Although welcome, the main issue with the Marriage allowance is that a £250 saving per year is simply not enough to make a perceptible financial difference in households. The current format of the Marriage Allowance was first announced by David Cameron in 2013 and he admitted himself that, 'This policy isn't about the money but about the message that people who make a lasting commitment should be recognised in some way.' [18]

There is no surprise therefore that the pickup of the Marriage Allowance has been lacklustre. If in 2018 Her Majesty's Revenue and Customs (HMRC) prided itself with over 3 million signups, by 2019 this number would drop to 1.78 million. Meaning that out of an estimated total of 4 million eligible couples, over 2 million have not signed up to the policy. [19]

One solution to this would be a dramatic increase in the Marriage Allowance - perhaps to at least 50% of the total tax-free allowance. At current figures this would be £6,250 resulting in

[17] The Taxation of UK Families - 23 February 2021 (Care/ Tax & the Family)

[18] David Cameron in House of Commons Briefing Paper Number 4392, 14 January 2019, Tax, marriage & transferable allowances, p. 32

[19] Revised HMRC figures reveal more than 2 million people are missing out on this tax break, https://www.simplybusiness.co.uk/knowledge/articles/2019/06/marriage-allowance-hmrc-fluff-figures/

a total tax break of £1,250 per couple per annum. Approximately £104 saved per month would make a greater difference to families that are already struggling. This can truly make a significant change in a household's ability to build up savings for a rainy day, particularly when compared to the mere £21/per month tax saving under the current policy.

There is also the broader inconsistent approach when it comes to '…paying out benefits and tax credits according to family circumstances but levying income tax according to an individual's income'.[20] Income inequality also features serious discrepancies in measurement because the Office for National Statistics (ONS) evaluates inequality based on the household, not individual income.[21] This will have to be a discussion for another time but it is important to take note of this incoherence in measurement.

To effectively promote savings, we need new means such as LISAs, ETFs, and so on - but we also need a tax system that is fiscally supportive of families and individuals trying to build savings. Only once these key prerequisites are in place can we begin to talk about establishing an ethos and indeed, a culture of saving in the UK.

Final Thoughts: Creating a 21st Century Savings Culture

The country needs a fresh start in promoting healthy finances. This underlines the importance of savings – both as a principle as well as a lifelong practice. In order to re-establish a culture of savings the effort will be multidisciplinary and involve the financial sector as well as government, civil society, schools, charities, local associations and so on.

A good starting point would be to encourage greater congruence between government policy and the private sector. There is little scope in government setting out an agenda to promote savings if the banks and other financial institutions are not on board or are simply unwilling to implement.

One example of this failure is the lack of availability of Lifetime ISAs (LISAs). Account holders earn a 25% government bonus on deposits which could be a popular tool for young people to build up their savings for a first property or retirement. Unfortunately, no major high street

[20] IFS "Couple Penalties" ,p4.

[21] ONS - Household income inequality, UK: Financial year ending 2018

bank offers LISAs to the public. Out of 500 ISA providers across the UK only 14 offer the Lifetime ISA.[22]

This consequently means that adoption of LISAs remains low and raises the problem of awareness (or lack thereof). Research conducted by the University of Bristol found that,

> Far greater promotion of saving is required to help overcome the psychological barriers that prevent people on lower incomes (indeed, people generally) from saving. Targeted social marketing (i.e. marketing with a social purpose) through popular media such as television, radio and social media is one means to achieve this.[23]

The effort by government as well as the private sector have been minimal in this regard. Deposit-matching schemes like "Help to Save" have failed to gain traction due to their bureaucratic complexity, delay in the release of funds, and rather insignificant financial gain.

In addition, such schemes need to be better integrated and advertised within the retail banking sector. There is little scope of having new schemes for saving if the public remain unaware.

Indeed, one argument is that such initiatives are financially unprofitable for the private sector to adopt and offer to customers (such as in the case of LISAs and to a lesser extent 'Help to Buy'). Yet again, this comes down to a lack of coordination between policy development and application in practice. It is unfortunate that until this dynamic improves, we are unlikely to see a change in the efficacy of new initiatives for saving.

Another recurring topic of discussion is the possibility of financial education in schools. If the role of schooling system is to equip future generations for life, then surely offering some degree of basic financial literacy is appropriate. As of 2014, there has been a tentative approach in offering such classes at secondary level, but it appears that the management and implementation has been poor. A report published by the Money Charity found that,

> …while most schools deliver some finance education, teachers have little faith in its quality and are held back by insufficient time, negligible resources and

[22] Sylvia Morris, This is Money, "Beware the pitfalls of the Lifetime Isa", https://www.thisismoney.co.uk/money/mortgageshome/article-7752221/As-help-buy-Isa-closes-experts-warn-alternative-Lifetime-Isas.html

[23] Bristol University, *Promoting savings among lower-income households*, https://www.bristol.ac.uk/media-library/sites/geography/migrated/documents/pfrc1308.pdf

> school leaderships who do not view it as a high priority. Teachers we surveyed called for greater resources, and clearer leadership, and a mixed model of provision that includes direct delivery by experts from outside schools.[24]

A detailed review would be needed to address these issues, yet a more robust approach could entail introductory courses within the GCSE or A-Level curricula. These could offer pupils an elementary yet comprehensive understanding of budgets, savings, pensions, the use of credit, managing debt, and so on. Timing is also a key element here since many will either move on to further education, a vocational calling, or the workplace – all of which are places where they will have to independently manage their finances for the first time.

A third area of consideration is the charity sector. The UK benefits from a sizable list of charities and faith-based organisations that offer help with managing family finances. Notable ones include: StepChange (formerly the Consumer Credit Counselling Service), Citizens Advice, Christians Against Poverty, AdviceUK, National Debtline, and others.

Charities that offer financial advice would benefit greatly from increased government and private sector support. This may not just come in terms of funding but also in offering greater exposure and awareness. A first step in preventing unsustainable debt and promoting savings and healthy household finances comes down to expanding awareness and knowledge amongst the general public. Everyone would stand to benefit if government in partnership with the financial sector would give such charities a greater platform for public exposure.

Only then would people become more prudent and better equipped to weather life's unforeseen circumstances. The top reasons for debt in the UK are low income (23%), mental ill-health (19%), relationship breakdown (13%), poor budgeting (13%), long-term illness (9%), unemployment (7%), and others (11%).[25] A report by Christians Against Poverty (CAP) found that,

> When living without a savings buffer, it can be almost impossible to afford unexpected or large costs. There are instances where creditors will not have visibility of what their customers are borrowing money for. When CAP clients

[24] The Money Charity, *Financial Education,* https://themoneycharity.org.uk/media/Financial-education-in-schools-how-to-fix-two-lost-years1.pdf

[25] Christians Against Poverty, *Is Anyone Listening? – 2020 Report,* https://capuk.org/fileserver/downloads /general/Client-Report-2020-Final-Low_res.pdf

> were asked, two in three (66%) had borrowed money in order to pay another bill or debt. Three in five (61%) borrowed in order to buy food, clothes or to afford other living costs.[26]

It is concerning that a majority of 66% had to borrow debt to pay off debt. New programmes like the Debt Respite Scheme (Breathing Space) should offer some benefit to those facing mounting bills. The scheme provides legal protection from creditor action for up to 60 days and throughout a mental health crisis treatment (plus 30 days).[27]

The socioeconomic consequences of debt and financial difficulty are serious and have wide ranging implications for the individual, the household and indeed, society at large. We have to develop better strategies that would prevent people from reaching financially desperate situations in the first place – this means addressing the causes not merely the symptoms. Again, education and helping people understand the basics of budgeting will prevent difficulties in the long run.

In concluding, the solutions to encouraging saving – both in practice and principle, are multidimensional and will require cooperation between all facets of society. Yet the aspiration of establishing a financially secure country makes the effort all the more worthwhile. Achieving a property-owning democracy will take time but as the nation emerges from the pandemic, we are presented with a window of opportunity to plant the necessary seeds. With a collective effort we stand to considerably improve the social and economic outlook for generations to come.

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[26] *Ibid*.

[27] GOV.UK, "Debt Respite Scheme (Breathing Space) guidance for creditors", https://www.gov.uk/government /publications/debt-respite-scheme-breathing-space-guidance/debt-respite-scheme-breathing-space-guidance-for-creditors