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SAVINGS POLICY IN THE UNITED KINGDOM

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Asset ownership is seen as having an increasingly influential link to a variety of social outcomes. While the UK has experienced increases in economic wealth and improvements in overall living standards over the past 40 years, trends in asset ownership have reversed. More recently, 15 years of economic stability led to a feeling of increased financial security and individual savings were eroded in a boom of consumerism. The distribution of this increase in wealth has been unequal and the distribution of asset ownership follows a similar pattern. The link between asset ownership and social outcomes has explicitly led to the UK government directing a selection of policy interventions towards incentivizing personal saving.

This paper explores the savings landscape in the UK, assessing current savings behavior and reflecting on the policy direction that has been adopted in relation to savings over the last decade. It examines policies that encourage saving and asset ownership, and how such policies interrelate with broader government objectives. It then identifies specific interventions that have attracted international attention, such as the Child Trust Fund, before concluding with an assessment of the policy implications and a discussion of the future role of savings.

THE RATIONALE FOR PUBLIC POLICY INTERVENTION

Before diving in depth into the UK savings and asset building policy situation, a general rationale for public policy targeted to increase asset ownership needs to be outlined. Increasing individual asset ownership across a broad population influences positive social outcomes and also helps bridge deficiencies in government finances. This section outlines the rationale for public policy intervention and provides some criteria to evaluate savings policies.

POSITIVE SOCIAL OUTCOMES

A sophisticated approach to savings is likely to pay dividends for governments across a broad range of social outcomes. More traditional welfare provisions have involved a relatively straightforward reallocation of resources through tax relief, such as tax credits, and cash transfers, such as public benefits. Michael Sherraden's seminal book *Assets and the Poor*[2] brought the limitations of this approach into clear focus. While tools such as cash transfers are an effective means of insulating people from the most acute aspects of poverty, they are something of a palliative measure. Developing routes out of poverty that are sustainable require a more sophisticated approach that includes measures that seek to develop the capacity of individuals. Sherraden advanced the view that the value of holding assets went beyond a narrow monetary definition. He contended that owning assets leads to individuals making better long-term decisions and also to greater civic engagement through the ownership of a stake in society.

Sherraden's approach was reinforced by analysis in the UK, where evidence suggests that owning a financial asset of between £300 and £600 (at 2001 prices) at age 23 is positively associated with a greater chance of employment and improved mental health outcomes at age 33, controlling for other factors.[3] This move away from the perception that asset ownership is valuable only because it provides increased financial security, and towards the idea that it has the potential to change behavior, is a vitally important shift.[4]

Given the positive social outcomes from asset ownership, governments should pursue ways to increase asset ownership. An equitable savings policy should fulfill three criteria:[5]

- ***It should not penalize individuals for saving for the future***. In other words, income that is saved should not be taxed twice; it should either be taxed at the point at which it is earned **or** taxed at the point at which it is withdrawn, but not both.
- ***It should be progressive***. Those who would benefit most from holding an asset (such as savings) are less likely to have one. To counteract this, savings incentives should be greater for those on low incomes.
- ***It should be as simple as possible to understand***. This is the most straightforward of the three criteria. The more complicated a policy initiative is, the more likely it is that its impact will be restricted.

HELPS TO BALANCE PUBLIC FINANCES

From a government perspective, a return to greater levels of personal saving will be essential. For example, in the UK, the annual budget deficit tips 12 percent of GDP. The UK government faces an uphill battle to balance the public finances. The likelihood is that achieving this will involve spending cuts, with the impact for citizens being that they may need to self-finance services that are currently provided by the state. Utilizing savings could prove to be a highly effective way to achieve this.

Moreover, for the government to continue to invest in public services and planned infrastructure projects, it will need a functioning market in which it can sell bonds. Increases in overall levels of personal savings will provide financial institutions with the capital reserves that enable them to trade in this marketplace. In recent years, these same institutions have been able to finance the purchase of government bonds through other means, but with the era of cheap and easy credit drawing to a close, it is increasingly clear that more traditional methods of financing will be required to fill this vacuum. The economic shocks of the last eighteen months may have transformed the outlook for saving as a policy objective, but the ripples that will be felt for years to come will reinforce the need for the need for policies that effectively incentivize personal saving.

As asset building policies can be beneficial to balancing the government budget, a saving policy's impact on the government budget is also an important consideration.

SAVINGS BEHAVIOR IN THE UK

In the UK, two surveys – one from the UK National Savings and Investments agency and the other from the Department for Work and Pensions – provide insight to the general savings behavior in the UK. Personal savings in the UK have increased since last year. However, this increase is concentrated among higher income households. Lower income households are at a disadvantage when it comes to accumulating personal savings. This section details the results from the two surveys.

UK NATIONAL SAVINGS AND INVESTMENTS QUARTERLY ASSESSMENTS

Since 2004, the UK National Savings and Investments (NS&I) agency has published a quarterly assessment of citizens' attitudes towards saving and how this corresponds to the realities. The emergence of good quality time series data is germane; recession can have a profound impact on attitudes and approaches to personal finance. When people see their income drop during a recession, they feel less secure and aspire to save more for greater financial security. However, they are less capable of saving at this time. The data from the Summer 2008 Quarterly Savings Survey is summarized in Table 1.[6]

Table 1. Summary of the Summer 2008 Quarterly Savings Survey

- The most recent survey data shows that in summer 2008 the ideal savings level to which UK citizens aspire rose to its highest level since the inception of this dataset.
- This ideal savings figure has risen by 22 percent year on year, and in summer 2008 represented over 15 percent of total income for the first time since this dataset was conceived.
- The shortfall between actual savings and ideal savings has increased markedly; from a differential of £93.48 per month in summer 2007 to £126.14 in summer 2008.
- Regular savers represent less than half (47 percent) of the UK population and save over twice as much (121 percent more) than the overall UK average.
- Regular savers' year on year increase in monthly saving outstrips the UK average (11.1 percent compared to 7.1 percent) although neither has come close to keeping pace with the increase in the level of ideal saving over the same time period (22 percent).

Source: Quarterly Savings Survey: Issue 16. London: National Savings and Investments, 2008.

The data in Table 1 demonstrates that, under the current economic uncertainty, people *would* like to save more than they did twelve months ago. However, the evidence suggests that people *have* increased the amount that they are saving compared to the same stage last year, despite facing competing demands on their income brought about by higher food, fuel and energy prices. Between summer 2007 and summer 2008, the average monthly amount saved increased from £81.43 per head to £87.23 per head, an increase of 7.12 percent. This increase was achieved at a time when the annual rate of inflation (measured by the Consumer Price Index) was approaching five percent – 2.5 times the Bank of England's two percent target. Although the ideal savings rate has moved further away from the actual amount being saved, the notion that saving has increased at all amidst these pressures and negative growth is notable. This has the potential to present monetary policymakers with a quandary. The typical monetarist response to recession is to lower interest rates in an attempt to stimulate consumer demand, a move which also acts as a disincentive to save. Returning an economy to growth is clearly a valid and desirable policy objective, but the notion that people are keen to increase their level of savings at this time should not be completely overlooked.

The quarterly summary makes a cursory assessment of the factors that prevent people from saving more than they currently do. Over half of those surveyed (54 percent) said that they could not afford to save any more than they currently did. A further 27 percent saw no need to save more than they currently do (although there is no indication of how much those who expressed this view were saving – their analysis could be correct). Finally, evidence from this summary suggests that where respondents identify a specific reason for saving, they are increasingly citing ”in case of emergency” as a leading motivation (up to 58 percent of respondents, from 42 percent at the same stage in 2007). The most recent data has this reason as the most frequently cited, ahead of ”holiday or special occasion” and “retirement”.

The NS&I quarterly summary disaggregates data relating to savings and savings aspirations across various demographic indicators. These include regional geography,[7] gender, and age group. However, they do not include breakdowns by socio-economic group or financial position. The impact of these characteristics could prove to be influential, as there is a general consensus that those on lower incomes would benefit the most from taking up saving.[8]

FAMILY RESOURCES SURVEY

Data that *does* disaggregate UK savings behavior by socio-economic status can be drawn from the annual Family Resources Survey.[9] The Family Resources Survey passes no judgment on what an optimum level of saving might look like; it presents the facts dispassionately. The survey demonstrated that the socio-economic profile of a household may influence its propensity to save; 88 percent of households with one adult and an unspecified number of children hold less than £1,500 in savings. This is compared to 37 percent of households with two adults and no children. Furthermore, households with a weekly income of less than £200 a week are four times as likely to hold less than £1,500 in savings as households with a weekly income greater than £1,000 (64.5 percent versus 16 percent). This is a slight distortion, however, as the relationship is a fairly linear and positive correlation for households with a weekly income up to £1,000.

This data, while by no means comprehensive, provides a useful summary of savings patterns in the UK, and the trends that they display. It is important that policymakers take cognizance of such patterns and trends when developing initiatives that are targeted at specific groups – a notion that has been highlighted by other studies, recognized by policymakers and reappears throughout this paper.

PUBLIC POLICY OPTIONS

Various strategies can be employed to influence savings behavior. Providing tax relief, match contributions, financial education to improve financial management capabilities, and programs tailored to match various life stages are four options available to policymakers. A brief description of how the strategies influence savings behaviors and relate to broader government objectives is discussed in this section.

TAX RELIEF

Tax relief is a powerful, if controversial, means of incentivizing saving. It offers a strong and unambiguous incentive to save for those who are able to. Theoretically, these incentives are universally available, but, as outlined in the previous section on Savings Behavior in the UK, the reality is that saving is an ambition more achievable by those with high incomes than those with low incomes.

A review of the UK's tax relief structure conducted in 2001[10] alluded to the regressive nature of tax relief as a policy instrument, an approach that has been seized upon and developed elsewhere.[11] The progressive income tax system in the UK dictates that as income increases, so does the proportion of income paid in taxation. If tax relief on savings is offered at the highest marginal rate paid by the individual – as it is in the UK system of pensions tax relief – the model leads to higher income earners receiving a greater incentive to save than those on low and medium incomes. Evidence from the 2009 Budget highlights this:

> In 2008-09 individuals with income over £150,000 represented 1.5 percent of pensions savers, yet received a quarter of tax relief on contributions. This amounted to an average of £27,000 per person, an amount in excess of median earnings, and compares with £1,000 for people who pay income tax at the basic rate.[12]

The way in which the UK pensions system incentivizes pension saving draws widespread criticism, particularly due to its regressive nature. Here are just three of many criticisms. First, the pension contributions of taxpayers in the highest tax bracket are eligible for tax relief at the highest marginal rate for all contributions made during their working lives. When they retire and their pension fund goes into payment, they will pay an equivalent rate of tax only on the top slice, and only the basic rate up to this point. Second, the role of tax relief on savings will have at best a peripheral role in determining the prevailing rate of income tax. The principal demands of the income tax system will typically be to contribute (as part of an overall taxation framework) to a stable public balance sheet while simultaneously – for political reasons – achieving public approval. The impact of any change to the income tax system on incentives to save will not be a central consideration in this policymaking process. Third, the release of 25 percent of a pension fund as a lump sum upon retirement is currently not subject to tax by the UK Government. At this stage, the Government has already foregone tax revenue on this capital when it was earned and yet here it is being foregone again. While a progressive savings framework should support the principle that savings should not be taxed twice (at the point of saving and at the point of withdrawal) foregoing tax revenue at both stages is unnecessarily generous. Moreover, it is regressive, as it benefits those on higher retirement incomes more than those on lower retirement incomes.

The 2009 UK Budget provides an example that neatly illustrates the first and second criticisms. Faced with an increasing budget deficit, Chancellor Alistair Darling declared that it was an appropriate time to introduce a top rate of income tax at a marginal rate of 50 percent for those with annual earnings over £150,000. One effect of this would have been to further incentivize pension saving for those on high incomes which, as outlined in criticism one, is a questionable policy objective in itself. Furthermore, this scenario arises as an unintended side-effect of a broader fiscal policy decision, exactly as the second criticism predicts. This required a countervailing measure and government acted to taper the rate at which tax relief was available on pension contributions. This sees it decrease from 50 percent on annual earnings of £150,000 to 20 percent for those with annual earnings of £180,000 and over. Twenty percent is the same rate of tax relief that basic rate (those earning up to £37,400 per annum in 2009-10) UK taxpayers receive. Tax relief at the higher rate of 40 percent will still be available to those with annual earnings of between £37,401 and £149,999. Without this countervailing measure, the UK government risked not getting the intended increase in revenue as a result of the new top rate of tax (assuming that taxation has not yet reached the peak of the Laffer curve).

Asset ownership can, of course, take many different forms and the way in which the alternatives are treated by the tax system can influence their relative desirability. Wakefield provides an excellent comparative analysis of the how assets are taxed in the UK – and what role tax relief plays in incentivizing saving – as part of the forthcoming Mirrlees Review of the UK tax system.[13]

MATCHED CONTRIBUTIONS

Critics of the tax relief model advocate a program of matched savings that offers greater progressivity. The basic premise of the system is that government offers a direct incentive to save, in the form of a ‘match’. For example, for every £1 that is saved by an individual, the government supplements this with a 50p ‘match’. There is flexibility within this system to vary the level at which the government matches saving depending on economic circumstances. There is also the potential to introduce a ‘tapered match’ that incentivizes saving more heavily for an initial set amount, and then gradually reduces the incentive.

A principal advantage that a matched saving scheme holds over a system of tax relief is that it offers an incentive to save for those who pay little or no tax. Those with low incomes typically fall into this category and therefore would be directly targeted by this policy. Those in support of a system of matched contributions claim that it is also simpler to understand than tax relief and therefore more appealing to those who have low levels of financial capability, many of whom often earn low incomes. It is also possible for the government to control the level at which it incentivizes saving directly, thus avoiding the perils of savings incentives being ‘hostages to fortune’ in their relationship with broader government policy objectives.[14]

The system has attracted criticism, however. Critics argue that the likelihood of a matched contribution scheme leading to a new cohort of people taking up the saving habit is overplayed. Should the matched contribution incentive exceed the rate at which people could borrow, this would not lead to a net increase in saving and could distort the market for borrowing with broader implications for macroeconomic policy. There are also concerns that such a scheme may lead to deadweight loss to the Exchequer on the basis that people would have saved without the matched contribution as an incentive.[15] Alternatively, matched contribution schemes might potentially lead to people ‘under-consuming’. While saving is an important means of alleviating the impact of disadvantage, it is important that those on low incomes do not forego essential items such as food or fuel in order to save. Should this scenario materialize, it would have a detrimental and undesirable impact on individual health and well-being. The level at which the ‘match’ is set is likely to be influential on whether or not it becomes a reality.

The Saving Gateway is a prescient example of a UK policy intervention that operates as a matched contribution model. A summary of this is provided later in this paper.

IMPROVING FINANCIAL MANAGEMENT CAPABILITY

There has been a view that personal financial planning could be improved in the UK and that people are not saving enough to fulfill their future aspirations. This rather unsophisticated conclusion has been enhanced by separating different financial competencies.[16] The research methodology used in this study identified five different capability tests and conducted these with five thousand randomly selected adults. Using factor analysis, the researchers developed eleven typologies ranging from those who were not deficient in any of the five capability tests to those who were deficient in all five. Sixty-one percent of the participants fell in the nine typologies in between, suggesting that the majority of people have some degree of financial competence but could do with improving other aspects of their understanding. The study identified four competencies that could be enhanced; *managing money, planning ahead, choosing products* and *staying informed*. The majority of people are proficient at some but not all of these competencies and, in various combinations, they will impact an individual's ability to achieve his or her financial ambitions. Therefore, targeting these shortcomings is in itself a legitimate government policy response – but evidence from this study suggests that such an intervention would need to take due account of the variation across different competencies and offer guidance and/or training that reflects this.

Measuring the impact of interventions that seek to improve financial education and competence is more difficult than quantifiable initiatives such as tax relief and matched contributions. Nevertheless, the nuanced needs of different groups suggest that a system of targeted interventions would be worthwhile in the UK.

SAVINGS AND THE LIFE-CYCLE

Taking a long term view of personal finances across the life-cycle is linked to the notion of financial capability. Essentially, people are asked to acknowledge that their financial position will be subject to variation over the course of their lives; at some points their income will exceed their expenditure and at others the inverse will be true. People could experience anticipated fluctuations (such as a decrease in income when they retire), unanticipated fluctuations (such as suddenly losing their job) and those that might or might not be anticipated (such as having children).

The conventional wisdom suggests that consumption and savings follow a comparable pattern over the life-cycle.[17] This pattern is that people's consumption will exceed their income over the early stages of their adult lives and that this pattern will reverse as they enter the later stages of their working lives, before resuming again when they reach retirement age. This model has attracted criticism for failing to give necessary attention to real-world factors, such as the difficulty in establishing what an optimal allocation of personal income might look like and, should this be possible, the challenge of maintaining sufficient financial discipline to turn it into reality.[18] In other words, Friedman's model is too simplistic. In the real world, there are young people at the beginning of their careers that save more than they spend and older people in their prime working years that spend more than they save. Further work has investigated awareness of the life-cycle model of saving, finding that the impact of credit availability and the state retirement age can be significant.[19]

For example, the savings behavior of young adults is more complex than the Friedman model predicts. Qualitative research commissioned by the Department of Work and Pensions (DWP) in the UK seeks to explore the first segment of this life-cycle model; young adults who are typically expected not to have entered the saving phase of their working lives[20] Some of this evidence is consistent with expectation, with young people seeing retirement as being a long way off. However, other aspects of the research are less predictable. For instance, young people with a clear plan for their future – be that future education, buying a car/house, or defined career – were more likely to either be saving or to understand the benefits that saving might offer them. Perhaps more perniciously, participants indicated that they felt that, for them, borrowing was more socially acceptable than saving and that the media encouraged them in this direction.

Seeing saving as part of the life cycle highlights some important challenges for policymaking. Effectively encouraging saving at various stages of the life cycle will require a flexible approach to incentivizing saving and, in all probability, a coherent and innovative menu of incentives targeted at different demographic groups. Understanding the savings behavior of UK citizens is therefore a pre-requisite to introducing incentives that will be effective and durable.

THE DEVELOPMENT OF SAVINGS POLICY IN THE UK INITIATIVES

The principle that asset ownership has a value beyond a financial sum underpins a raft of savings reforms adopted by the current UK government. This is characterized by the assertion that "financial assets should be the preserve of the many, not of the few".[21] The ideological foundation of these reforms may lie in social justice, but they also face empirical examination through a process of economic modeling that seeks to quantify the future gains to the Exchequer, the UK's national treasury, of increased asset ownership now. Ultimately, the Exchequer must be confident that the income that it foregoes now will be an investment that represents a worthwhile return.

Over the last decade the UK government has shown a pronounced and unremitting interest in increasing individual asset ownership. This policy objective has become entwined with broader social ambitions and acts as the cornerstone of some attempts to reduce inequality. This section will explore how this agenda emerged and the specific initiatives that have been – or are in the process of being – implemented by government.

INDIVIDUAL SAVINGS ACCOUNTS

Individual Savings Accounts (ISAs) have been an integral part of the UK government's commitment to incentivizing short-to-medium term saving. ISAs were introduced in 1999. They replaced roughly equivalent products; the Personal Equity Plans (PEPs) and Tax-Exempt Special Savings Accounts (TESSAs) which had been introduced in 1987 and 1990, respectively. However, the current Government identified shortcomings with TESSAs and PEPs that were alienating low and middle income earners: TESSAs required savers to leave their fund untouched for five years and PEPs exposed them to the volatility of the equity market. ISAs were designed to simplify the savings process, and to appeal directly to young people and low- and middle-income earners.[22]

The motivations were comparable in the sense that all three sought to incentivize saving, although the PEPs were embedded in an ideological desire to move the UK towards a mass share-owning democracy. ISAs are structured to retain an incentive to invest in UK equity markets; savers can use ISAs to invest in equities (stocks and shares) or in cash (like an ordinary savings account). The overall maximum that someone can invest in an ISA is currently £7,200 per tax year. Of this £7,200, a maximum of £3,600 can be held in a cash ISA. Should someone wish to take up their full allowance, they would have to invest a minimum of £3,600 of their £7,200 in an equity ISA. Budget 2009 announced that, from 2010-11, this overall limit will increase to £10,200, with the same proportional restrictions in place.[23]

ISAs are offered by private providers and offer tax benefits. First, gains that are accrued by ISAs are not subject to capital gains tax. Second, income tax is not payable on capital that is held in an ISA when it is withdrawn.

One incidental advantage of the ISA scheme is that, because providers have to be authorized by the Financial Services Authority (FSA) and approved by HM Revenue and Customs (HMRC), they provide a rich source of data for statistical analysis.[24] The annual Family Resources Survey[25] presents the level of ISA uptake across a range of other demographic and socio-economic variables, with some interesting results. Overall, just over one in three UK households holds an ISA (35 percent). A household's demographic profile is influential; UK households with two adults and no children are most likely to hold an ISA (46 percent). This cohort is over four times as likely to hold an ISA as a household with one adult and an unspecified number of children (11 percent). The distribution of ISAs across the age profile resembles an inverted U-shape. It rises steadily among those aged under 60 and peaks at the 60-64 group before declining again. Household income is also significant and consistent with expectation; with one anomaly,[26] there is a positive correlation between the income of a household and the likelihood that it will hold an ISA. Households with a total weekly income of >£1,000 are almost three times as likely to hold an ISA as those with a total weekly income of between £100 and £200 (54 percent versus 19 percent).

ISAs draw a mixed response from policy analysts. The market is competitive and, generally speaking, ISAs compete favorably with other personal savings products offered by commercial providers (at least in part because of their preferential tax status). This is important as policymakers would like ISAs to be seen as the first choice savings option. A 2001 review of the UK savings industry concluded that the multitude of savings products combined with the multitude of savings providers made the market unnecessarily complicated.[27] Therefore, establishing a product that is a clear first choice – or default option – simplifies the selection for savers, as they only have to compare between providers. However, empirical work by the Institute for Fiscal Studies suggests that the introduction of ISAs has not led to a net increase in saving, but instead to a reallocation of savings and a deadweight loss to the Exchequer.[28]

ISAs dominate the landscape for short and medium-term savings incentives; over 18 million people now hold an ISA.[29] Yet they display the classic shortcomings of schemes that center on tax relief; they are not simple to understand and they are not progressive. The subsidy that is paid falls disproportionately in the pockets of those on high incomes, offering relatively little – and sometimes nothing – for those on low incomes.

PENSION REFORM

Meeting the needs of an ageing population is a germane policy debate in the UK, asthe number of people aged over 65 is predicted to almost double between now and 2055. Central to this dialogue is a concern over how public finances will balance the predicted increase in costs (brought about by an increased reliance on public services) with a reduction in revenue (caused by a less populous working aged population). One component of the solution is to encourage people who are currently working to plan for their retirement so that they can be financially more self-sufficient.

Saving for retirement in the UK is incentivized through the system of tax relief outlined earlier in in the "Tax Relief" subsection of "Public Policy Options." The distribution of those who take up the incentive is skewed – perhaps *because of* its structure – towards those on higher incomes. The government response has been to introduce a change to what Thaler and Sunstein might term the 'choice architecture' of retirement saving.[30] The foundations of the current reform can be found in the parliamentary Pensions Act 2008. This Act is being taken forward as part of the Enabling Retirement Savings Programme (ERSP).

Crucially, from 2012 employers will be required to register all eligible employees into an approved workplace pension scheme. This therefore becomes the default position, providing an influential distinction in the psychology of saving for retirement. Individuals will be able to opt-out should they wish to. The scheme aspires to address the seven million people in the UK who are not saving enough to generate the pension income that they are likely to want in retirement.

CHILD TRUST FUNDS

The Child Trust Fund (CTF) is a UK government policy initiative that has captured the imagination of policymakers across the world. Despite only having been introduced in 2005, it has already attracted analysis and evaluation. Excellent summaries of the CTF initiative can be found elsewhere[31] and this paper will provide only a brief summary for those unfamiliar with the principles of the CTF, before moving on to reflect on the initiative using freshly released data.[32]

Every child born in the UK on or after September 1, 2002 receives a voucher worth £250 from the government. Children from low-income households (classified as those where household income is less than £15,575 in 2008-09) will receive an additional £250. Parents use the voucher that they receive to open an account with a private sector provider; should they fail to do so, the government will invest the voucher on the child's behalf on his/her first birthday. When the child reaches seven years old, the government issues a second voucher for every child on the same terms as the first. Interest accrued in the fund is paid tax-free and parents/relatives/friends can collectively deposit up to £1,200 per year. The account cannot be accessed until the child reaches 18, upon which point they have full and unrestricted access to the fund. There are three variants of CTF account. First, the Stakeholder account, which holds funds in equities and is protected by a set of standards; this is the government's preferred option and acts as the default when parents do not open accounts. There are two non-stakeholder accounts, one of which holds funds in cash only. The other holds funds in shares, but without the protection offered by a stakeholder account.

Table 2. Child Trust Fund Statistical Report: Summary

In November of 2008, HM Revenue and Customs published the third annual Child Trust Fund Statistical Report. To summarize:

- The percentage of children eligible for the £250 supplement has risen from an average of 29 percent over the course of the initiative up to 2007 to 31 percent up to 2008.
- The percentage of accounts being opened by parents remains relatively constant at 74 percent, with the remaining 26 percent being opened automatically by government.
- Stakeholder accounts remain the most popular option. Of those parents who actively decide in which account to invest, they take approximately two-thirds of the market. This is fairly consistent with figures from previous years.
- The average (mean) value ranking of the three different types of account changed between 2007 and 2008. In both years, the highest mean value was the non-stakeholder equity account. In 2007 the stakeholder account finished second, with the cash account finishing third. This was reversed in 2008, although the stakeholder account held its mean value, the mean value of the cash account leapt by almost 14 percent. This should not infer, however, that the investments of those who manage the stakeholder funds have been poor, as there is no way of disaggregating the impact of additional contributions made by friends/relatives from the performance of the fund.

Source: Her Majesty's Revenue and Customs, *Child Trust Fund Statistical Report 2008,* November 6, 2008.

While the appeal and recognition of the CTF appears to be growing, its cost is likewise rising. Between the current tax year (2008-09) and tax year 2011-12, the cost of the CTF to the government will more than double (from £240 million to £490 million per annum). It is important, therefore, that advocates of the policy maintain its momentum.

In the 2009 UK Budget, Chancellor Alistair Darling announced that the UK government will increase its contribution to the CTFs of disabled children. This additional contribution will be £100 per year for children who are disabled and £200 per year for children who are severely disabled.

The Saving Gateway

The principle of a Saving Gateway has existed since 2001. The proposal has always been to introduce a system of matched contributions to encourage those on low incomes to save. A thorough examination of the Saving Gateway can be found in previous work completed by the Institute for Public Policy Research.[33] As with the Child Trust Fund, the purpose of this section is to introduce the initiative to the reader and provide a summary of the contemporary policy position.

Two Saving Gateway pilots have taken place. Pilot 1 ran from August 2002 through November 2004; Pilot 2 from March 2005 through February 2007. Through these pilots, 22,000 people took part in the schemes, cumulatively saving over £15 million.[34] There were distinctions between the two pilots, summarized in Table 3.

Table 3. Savings Gateway Pilots

Pilot 1

- 1,500 accounts were opened across five locations;
- The monthly contribution limit was fixed at £25;
- contributions could be made in a maximum of fifteen of the eighteen months of the Pilot;
- The "match" was £1 for every £1 saved;
- The maximum "match" available was £375.

Pilot 2

- Over 22,000 accounts were opened across six locations (the same five as Pilot 1 plus one new area);
- The monthly contribution limit was variable (£25 per month in three case study areas; £50 per month in two case study areas; and £125 per month in one case study area);
- Contributions could be made in a maximum of sixteen of the eighteen months of the Pilot;
- The match for every £1 saved was variable (£0.20 in one case study area; £0.50 in three case study areas, one of which offered a £50 bonus; and £1 in one case study area;
- The maximum "match" varied between £160 and £400.

Source: Her Majesty's Treasury, *Budget 2008 Stability and Opportunity: Building a Strong, Sustainable Future* (London: Her Majesty's Stationary Office, 2009).

Clearly, the government was encouraged by the outcomes emanating from Pilot 1 and, as a result, Pilot 2 was more ambitious and more dynamic. Evidence from Pilot 1 suggested that 41 percent of savers were still saving 3 months after the scheme ended and 60 percent said that taking part in the scheme had made them feel more financially secure.[35] Evidence from Pilot 2 suggested that participants overwhelmingly felt that the matched contribution was simple to understand and that ease of access to an account provider was important, although there was also some evidence of those at the higher end of the qualifying income scale did recycle existing savings.[36]

The 2008 Budget announced that the Saving Gateway will be rolled out nationally from 2010.[37] Its availability will be restricted to those receiving a selection of government benefits and tax credits, approximately eight million people in total.[38] Later in 2008, the UK government confirmed that the 'match' rate offered by the Saving Gateway would be £0.50 for every £1 saved by those that qualify for an account. The matched contribution will be capped at £300 over the two year lifespan of the account, meaning that savings up to £600 – or £25 per month – will attract the 'match'.[39] The version of Pilot 2 that best reflects this was that held in South Yorkshire, which incidentally was the 'new' area that appeared in Pilot 2.

Provision of the Saving Gateway will be through financial institutions. The UK government has committed to producing further guidance on the details of how this relationship will work later in 2009, although indications are that there will be similarities with the way in which the Child Trust Fund operates.[40]

The Saving Gateway does not penalize saving. It is available exclusively to those on low incomes and it is relatively simple. Previous models included variation in the "match", for example.[41] However, it could still experience problems consistent with those outlined earlier in this paper. These potentially include the destabilizing macroeconomic impact that could result should the rate of return offered by saving exceed the rate at which capital can be borrowed, and the risk that citizens could forego essential items such as food and heating in attempt to save. These concerns are in addition to further issues over the potential for those who are entitled to hold Saving Gateway accounts facing pressure to illicitly hold money for those who are not.[42] The current transition plan for funds held in a Saving Gateway account is that they will be moved to an ISA when the account matures; this policy might require some revision before 2012, as the appeal of the ISA is very different to that of the Saving Gateway.

FUTURE POLICY DIRECTIONS

As the UK continues to build upon existing asset building policies, several key considerations should influence decisions. First, the UK has already introduced a myriad of asset building initiatives that aid citizens at varying life stages. These initiatives could potentially become a comprehensive plan to increase asset ownership throughout an individual's life. However, several issues need to be addressed before a comprehensive and complementary framework can be established. Second, the current economic downturn will have long-term effects that need to be accounted for in the national asset building policy agenda.

A COMPREHENSIVE AND COMPLEMENTARY SAVINGS FRAMEWORK?

Reflecting on the policy initiatives outlined above, it is clear that the UK government's approach has embraced personal savings as a policy objective that goes beyond its value in and of itself. Its motivations vary from the desire to encourage greater self-sufficiency in retirement, to the recognition that asset ownership is an effective means of alleviating poverty. The result are savings initiatives that address individuals's varying needs at different points in their life. The current structure of asset building programs in the UK is conducive to the creation of a comprehensive and complementary savings framework. To progress in that direction, several issues need to be considered.

First, the appropriateness of savings initiatives throughout a person's life cycle should be evaluated. The segmentation of demand for savings products is recognized by government. One influence on this is the life course paradigm outlined earlier in this paper, which emphasizes the evolution of income and expenditure over individuals' lives. With this is mind, saving for retirement is heavily incentivized in recognition of the concerns held by policymakers over the high proportion of adults whose income in retirement is currently scheduled to be less than they would like. Incentivizing saving for retirement takes cognizance of the life course principle, but alone it is inflexible; pension funds are typically inaccessible until they reach maturity. In contrast, ISAs offer instant access to savings and hence are more popular with savers who do not want to be tied into such a long-term commitment. ISAs have utilized this flexibility to appeal to younger savers.

Second, the comprehensive framework should be simple to use. In 2001, the UK Government asked Ron Sandler, a European bank executive and financial expert with experience of troubleshooting in insurance markets, to review the savings industry in the UK.[43] Sandler's Review identified a number of obstacles that make the UK savings market unnecessarily complex. The market for savings products was criticized for being unnecessarily complicated and prone to using obscure technical language that excluded many potential savers. Furthermore, Sandler's Review went on to criticize the role of public policy, suggesting that the tax framework that interfaces with the market for savings products can in some instances exacerbate confusion through its different treatments of products that are ostensibly the same. The Review identified that the complexity of the products on offer led to a disproportionately low uptake of savings products amongst those on lower incomes.

Finally, how the varying savings initiatives can be integrated into a unified system deserves much thought. The use of asset ownership as a policy instrument that can address inequality is a recurring theme. Child Trust Funds (CTFs) allocate additional resources to children in low income families and the Saving Gateway will be available only to those people entitled to certain benefits. Understanding how these initiatives interrelate will be an interesting debate in years to come. The first CTFs, for example, will mature in 2020. At this stage, moving the capital to a Saving Gateway account might be a sensible financial decision for those who are eligible to do so. However, rolling over a CTF into a Saving Gateway account should not be seen as a successful outcome in and of itself. One of the ambitions of the CTF initiative is to reduce the incidence of young people beginning their adult lives in a disadvantaged financial position. Qualifying for a Saving Gateway account would, by definition, mean that the account holder is in a low income group. Such a scenario, would not reflect well on the CTF as an intervention to adult poverty. Alternatives to avoid this hypothetical should be developed in advance of 2020.

As the amendments to various savings incentives in the 2009 Budget demonstrate, asset ownership is a dynamic and evolving policy discourse in the UK. It is likely that some segments of the market for savings products will evade the matrix of incentives currently available, so further incentives should not be ruled out. However, these will need to be carefully considered so as to ensure that personal saving does not become unnecessarily complicated.

IMPACT OF THE GLOBAL RECESSION ON UK POLICY

The impact of the current global economic downturn should not be underestimated. Its impact permeates many of the issues that are discussed in this paper. For example, a program of tax cuts introduced by the US government in 2008 was designed to stimulate the economy. Yet the impact of this stimulus package has been stifled by the cautious response with which it has been met; people have responded to the economic uncertainty by saving at least some of the rebate. In the UK, the high street banks which for so long provided an assortment of risk-free savings options have been left with little option but to agree a £400bn bailout with the government to regain financial stability. Despite government legislation to increase the limit of savings protection, it is difficult to imagine that people will trust the banks with such readiness in the future.

The UK government's willingness to innovate in the savings policy area in recent years has been welcome. However, the economic landscape against which these innovations were developed was one of steady economic growth and consumer confidence. As with many other policy innovations, there is a danger that as government resources are reallocated towards dealing with the economic downturn, some of the initiatives outlined in this paper might be marginalized. Incentives to save are particularly precarious, as encouraging consumer spending is a central plank of the economic recovery plan. From a monetary perspective, the prevailing base rate of interest inevitably impacts the appeal of retail savings products. This rate is currently at an unprecedentedly low level in the UK in an attempt to offer a stimulus to consumer spending. Given the non-pecuniary benefits that savings deliver over the longer term, the UK government would be well advised to utilize other policy instruments to counteract these pressures. The progression of the Saving Gateway Bill through parliament and the announcement in the 2009 Budget of increases in ISA allowances, initially for those aged 50 and above and subsequently for everyone, are welcome in this respect.

Furthermore, as potential priorities for the UK Government's fiscal stimulus package were debated by the commentariat in advance of the Chancellor's 2008 Pre-Budget Report (PBR), many were advocating targeting increases in disposable income at those on low incomes on the basis that they would be more likely to spend what they received.[44] Public policy needs to be sensitive to the needs of those on low incomes. It would be inconsistent to introduce initiatives to encourage those on low incomes to save, on the one hand, and on the other hand, to view this group as the panacea to insufficient spending. It is important that those on low incomes are not targeted as the most expedient means of alleviating the current economic crisis, as this might compromise the longer-term policy objectives of saving outlined in this paper.

If, as predicted, unemployment rises in the UK in 2009, tax revenue received by the Exchequer will decrease. Compounding this, those who become unemployed will increase the aggregate cost of out of work benefits to the Exchequer. An initiative such as the Child Trust Fund is not immune from the impacts of increased unemployment; it will lead to a greater proportion of families qualifying for the supplementary voucher, with the eventual impact being that the aggregate cost of the initiative increases. Also, the first recipients of the CTF will have their seventh birthdays (and consequently be eligible for their second voucher) from September 2009, so the initiative will begin paying out first and second installments concurrently for the first time.

CONCLUSION

This paper has outlined a selection of initiatives retained – and in some cases introduced – by the current UK government to encourage saving. These measures have been focused towards those with low incomes on the premise that ownership of an asset will increase their financial management capability and enable them to plan for the future with a greater sense of security. Beyond this particular focus, the requirement for individual saving will intensify in the long term. Over the last 25 years, we witnessed a profound change in the way that consumerism in the UK was funded. Increased levels of personal debt and diminished levels of personal savings that became the norm during sixty quarters of unbroken economic growth have proved to be unsustainable. A more austere approach to personal financial management is already being advocated and the future may hold a comprehensive policy framework that encourages people in the UK to make building assets a lifelong endeavor.

[1] Michael Johnson is a Research Fellow at the Institute for Public Policy Research in the UK. Pamela Chan and Reid Cramer provided valuable research assistance.
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[6] *Quarterly Savings Survey: Issue 16* (London: National Savings and Investments, 2008).
[7] Based on the NUTS 2 territorial scale, a European Union standard for referencing the administrative divisions of countries for statistical purposes.
[8] Ruth Lister, "Poverty, Material Insecurity and Income Vulnerability: The Role of Savings" in *The Saving Gateway: From Principles to Practice,* ed. Sonia Sodha and Ruth Lister (London: Institute for Public Policy Research, November 13, 2006).
[9] Department for Work and Pensions, *Family Resources Survey United Kingdom 2006-07* (London: Her Majesty's Stationery Office, 2008).
[10] Ron Sandler, *Review of Medium and Long-Term Savings in the UK* (London: Her Majesty's Stationary Office, 2002).
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[12] Her Majesty's Treasury, *Budget 2009: Building Britain's Future* (London: Her Majesty's Stationary Office, 2009), 107.
[13] Matthew Wakefield, *How Much Do We Tax the Return to Saving?* (London: Institute for Fiscal Studies, March 2009).
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[16] *Levels of Financial Capability in the UK: Results of a Baseline Survey* (London: Financial Services Authority, 2006).
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[18] Richard Thaler and Shlomo Benartzi, "Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving," *Journal of Political Economy* 112, No. 1 (February 2004), 164-187; Axel Börsch-Supan and Annamaria Lusardi, "Saving: A Cross National Perspective" in *Life-Cycle Savings and Public Policy: A Cross-National Study of Six Countries*, ed. Axel Börsch-Supan (San Diego: Academic Press, 2003).
[19] Tatiana Kirsanova and James Sefton, "A Comparison of National Savings Rates in the UK, US and Italy" (working paper, National Institute of Economic and Social Research, July 28, 2006).
[20] Specifically, this research was commissioned to explore young peoples' attitudes to the introduction of the personal accounts pension system, but the data it produced can be applied more broadly. Department for Work and Pensions, *Live Now, Save Later? Young People, Saving and Pensions: Research Report No. 438* (London: Her Majesty's Stationery Office, 2007).
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[22] Inland Revenue, "A New Individual Savings Account," press release, July 2, 1997, http://archive.treasury.gov.uk/pub/html/budget97/ir4.html.
[23] This increased limit will be available to those aged over 50 in the 2009-10 tax year.
[24] The same can be said of generic NS&I savings accounts, but the take up of these accounts is much lower than ISAs across the board.
[25] Department for Work and Pensions, *Family Resources Survey*.
[26] Incomes of <£100 a week, perhaps populated by financially aware but low income groups, such as those who are retired.
[27] Sandler, *Review of Medium and Long-Term Retail Savings.*
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[30] Richard Thaler and Cass Sunstein, *Nudge: Improving Decisions about Health, Wealth and Happiness* (New Haven: Yale University Press, 2008).
[31] See Reid Cramer, *Asset-Based Welfare Policy in the UK: Findings from the Child Trust Fun and Saving Gateway Initiatives* (Washington, DC: New America Foundation, November 2007); Jim Bennett, Elena Chávez Quezada, Kayte Lawton and Pamela Perun, *The UK Child Trust Fund: A Successful Launch* (London: Institute for Public Policy Research, July 9, 2008).

[32] Her Majesty's Revenue and Customs, *Child Trust Fund Statistical Report 2008*, November 6, 2008.
[33] Sodha, "A National Saving Gateway".
[34] Her Majesty's Treasury, *The Saving Gateway: Operating a National Scheme* (London: Her Majesty's Stationary Office, 2008).
[35] *Ibid.*
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[38] Her Majesty's Treasury, *The Saving Gateway.*
[39] Her Majesty's Treasury, *Pre-Budget Report 2008.*
[40] *Ibid.*
[41] Sodha, "A National Saving Gateway"; Her Majesty's Treasury, *Pre-Budget Report 2008.*
[42] Carl Emmerson and Matthew Wakefield, "Increasing support for those on lower incomes: Is the Saving Gateway the Best Policy Response?," *Fiscal Studies* 24, No.2 (June 2003),167-195.
[43] More specifically, the review was to evaluate the market for medium and long-term retail savings. Sandler immediately drew a distinction between the impact the market has on the everyday lives of British citizens and the impact it has on the behavior of capital markets in the UK. In times of financial uncertainty – such as those we are currently facing on a global scale – it would be injudicious to wholly overlook the role of capital markets in individual wellbeing. However, the focus of this paper will remain on the role that saving might play in improving social outcomes for UK citizens through the public policy instruments that can be used to influence consumer behavior.
[44] Including Will Hutton, "Tomorrow, Mr. Darling Must Introduce Morality into the City," The Observer, November 23, 2008.