EQUAL SHARES?

BUILDING A PROGRESSIVE AND COHERENT ASSET-BASED WELFARE POLICY

Edited by Will Paxton

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Foreword

Savings and assets have an important role in people's lives, providing them with security, independence and opportunity. That is why the Government is implementing a strategy for promoting saving and asset accumulation throughout life, including the development of a series of saving products suitable for each stage in a person's life cycle. For example, the Saving Gateway will be an ideal starting point for many younger or low-income individuals, providing an effective bridge to other forms of saving. In time the Child Trust Fund will strengthen financial education, promote positive attitudes towards saving and ensure that all young people start their adult lives with a stock of financial assets.

The Government is also committed to empowering individuals by providing improved access to straightforward and honest advice, and simpler, easier to understand saving products. This includes the development of a suite of risk-controlled 'stakeholder' products as recommended by the Sandler review, alongside a simplified sales regime for these products.

This publication presents some interesting ideas on alternative incentives for wealth accumulation and saving for retirement. The Government's recent pensions Green Paper set out proposals to renew the voluntarist approach to pensions provision and to strengthen the partnership between individuals, employers, the financial services industry and government. Alongside the Green Paper, the Government also published its plans to radically simplify the taxation of pensions by replacing the current system of eight tax regimes for pensions with a single lifetime limit on the amount of tax-privileged pension saving. This will improve individual choice and flexibility, and by lowering administrative burdens on employers and pension providers, it should also provide better value for all savers.

I support the central premise of this book: if we want more people from all backgrounds to benefit from holding financial assets, the implications across public policy need to be considered. This includes a coherent policy on financial exclusion and removing barriers to asset building. How can we expect people to save when they are not even engaged with the most basic of financial instruments? Progress is being made, for example through basic bank accounts and universal banking services. However, the barriers to saving created by financial exclusion are about more than not having a bank account. We must build new ways of including the excluded. The Government recognises that it cannot do this alone. We must continue to develop better ways of working together with the private and not-for-profit sectors.

It is worth remembering that debates about aspects of asset-based welfare remain relatively new. I very much welcome this publication as an important contribution to the ongoing debate.

Ruth Kelly MP
Financial Secretary to the Treasury

1. Introduction

An interesting recent public policy debate has centred on *asset-based welfare*. This approach is founded on the notion that the stocks of wealth that an individual holds and not just their income or consumption should be seen as important when assessing their wellbeing.

Asset-based welfare has its philosophical foundations in asset-based egalitarianism, which has many historical antecedents. Indeed it can be understood as a rediscovery of a pre-existing strand of progressive thought, with a long history in civic republican thinking as represented by Tom Paine, but also, among other places, in the Guild Socialism of GDH Cole and the ethical socialism of RH Tawney and more recently the market socialism of James Meade. At its most simple the aim of asset-based egalitarianism is to influence the distribution of wealth. As Stuart White has put it:

> Egalitarian objectives in relation to the distribution of income (or welfare, or effective freedom…) can and should be pursued by action on the distribution of assets that people bring to the market place. Relevant assets may include financial capital, human capital and so-called social capital. (White 2001)

Human and social capital are important, and they are touched on in this publication, but the main focus here is on financial assets (and to a lesser extent physical assets such as housing). In relation to these more tangible forms of ownership, asset-based egalitarianism does not mean pursuing the objective of all citizens possessing precisely equal shares. Instead it postulates that wealth inequalities should be moderated and particularly unfair aspects of wealth distribution addressed. It is argued that this is best realised by ensuring that all citizens have a property or ownership stake.

In the asset-based egalitarian tradition the moral and political argument for redistributing assets rests on the claim that every citizen has a right to a fair share of resources. This is both so they can participate fully as citizens and also because ownership of property promotes opportunity and self-fulfilment. Translated into the language of social policy and asset-based welfare, the aim is to ensure that stocks of wealth *enable* citizens and build up their capacity to cope better with periods of transition and to take opportunities.

While the basic aims of asset-based egalitarianism today remain the expansion of access to private ownership, the precise formulation of policies now manifest themselves in different guises to the past. At the time of the French Revolution when Tom Paine was writing, the most obvious asset was land. While this can still be important in some instances, in the urbanised modern world for the majority it is inappropriate. As a result developing debates are centred on other, sometimes new, strategies and policies, which this publication seeks to outline. In this Introduction we outline where policy relating to asset-based welfare currently stands to provide the context for the remaining chapters.

Where are we now?

A history of regressive support for asset accumulation

It has long been the case that public policy in the UK has sought to promote individual asset-accumulation of one kind or another. Both the left and right have maintained asset-building policies primarily geared towards the affluent; what was described as the fiscal welfare state by Richard Titmuss (1959). Physical capital accumulation in the form of home-ownership was, until 1998, promoted through mortgage interest tax relief (MIRAS). To this day homeowners remain exempt from Capital Gains Tax. Personal and employer-based pension plans have benefited from tax-advantages, (an issue that Chapter 3 addresses in detail). Employee Share Ownership Plans (ESOPs) exclude those in the public and voluntary sectors and have also received encouragement through the tax system. In short there is nothing new about the *principle* of government seeking to encourage asset-building.

In the previous few decades policies that have allowed more people to build physical and financial assets have had a significant impact on the political landscape. The right of council house tenants to buy their properties at discounted rates has enabled 1.5 million tenants to own a sizeable asset for the first time. The Right-to-Buy has deleterious effects as it resulted in the loss of the most attractive council properties and reduced the supply of homes for renting, but it is highly popular. In the 1980s, the Labour Party remained uneasy about private ownership and in opposing the Right-to-Buy they were easily portrayed as standing against the aspirations of ordinary working people.

At a similar time privatisation of former public utilities and other nationalised industries opened up opportunities for wider share ownership. Between 1982 and 1988 the percentage of the population who held stocks and shares increased substantially from 7.8 per cent to 22.8 per cent. This trend has also been facilitated by government incentivising equity investments through the provision of tax relief in Personal Equity Plans (PEPs) and more recently Individual Savings Accounts (ISAs). Alongside the direct ownership of stocks and shares the past two decades have seen a marked shift away from state pension provision and towards private (either personal or occupational) pensions. These developments were accorded some coherence when New Right political theorists and Conservative politicians talked about developing a share- or property-owning democracy.

The drawback with these policies for social democrats is that while they extended opportunities for ownership for some, the impact has too often been divisive. Many households and individuals have been left out of the 'winner's circle'. Inequalities in wealth are far more skewed than disparities in income and recent evidence suggests that they are growing. In 2000 the top one per cent of the population held over 20 per cent of all personal wealth[1] in the UK (Inland Revenue 2002). Even more worrying has to be the number of people who are *asset-excluded*, that is those who have no wealth at all. In 2000 a quarter of the population had net financial assets after accounting for debts of minus £200 (Banks *et al* 2002). A key concern from an asset-based egalitarian perspective is a growing divide between the asset-rich and the asset-excluded.

Reclaiming the 'ownership agenda'

Partly owing to this disquiet, progressives have recently moderated their attitudes towards private property. Most significantly, grounded in the asset-based egalitarian ideas outlined above, the *ownership agenda* has been wrestled away from the right. Ditching the left's ossified commitment to common ownership, most starkly witnessed by the Labour Party's change of Clause-IV, opened up debates about ownership and allowed the rediscovery of rich traditions of alternative progressive views of ownership (Kelly and Lissauer 2000).

Tangibly, this laid the foundations for discussion about, and development of, new explicit asset-based welfare policies. The highest profile of these have been based on individual ownership accounts, intended to allow more people to accumulate financial assets. The Government's Child Trust Fund, for which all children born after September 2002 will be eligible, is a variation on the idea of a stakeholder grant intended to provide all young adults with a financial asset. The state will universally endow all newborns with a financial asset in their own individual ownership account. Supplemented by additional government tops-ups and family contributions, the fund will accumulate until the account holder turns 18. The then young adult will have access to the fund and will be able to spend it how he or she sees fit. Although universal, the endowment and additional tops-ups will be progressive with more being given to children from families with low incomes (for full details see HM Treasury 2001a; HM Treasury 2001b; HM Treasury 2003).

The Saving Gateway, though also an individual ownership account, is neither long-term nor universal. Instead, by providing strong incentives in the form of matching individual savings pound-for-pound, the policy aims to allow low-income adults to save. It draws heavily on experience in the United States with similar policies called Individual Development Accounts (IDAs), which have been up and running since the early 1990s. Indeed the range of different policy models that exist is indicative of the vitality in the debate. For example, IDAs, while also offering matching incentives for low-income savers, restrict what account holders can invest their fund in; something that does not happen with the Saving Gateway (Boshara 2001).[2]

If the Child Trust Fund and the Saving Gateway are progressive *financial* asset-building policies then proposals for Equity Stakes (allowing social housing tenants to build up an ownership stake in their property) is a possible *physical* asset-building policy, which is being debated. Common to different Equity Stake models is the desire to develop ownership models in social housing that do not continue to residualise the tenure, as the Right-to-Buy has done. Rather than 'buying out' of the social rented sector, allowing people to gain a relatively modest stake in the value of their property could ensure that tenants 'buy in' to social housing (Hill *et al* 2002).

An historic opportunity

This brief summary of the history of asset-based policies reveals three themes. Firstly, there is a picture of recent gradual progress. There has been increased recognition, across the political spectrum, of the importance of private ownership and politically some of the most popular policies in the last few decades have concerned asset-building. The political consequence of policies affecting private ownership remains high and the power of tapping into families' aspirations is an alluring prize for politicians.

Secondly, and positively for progressives, there has been a slow drift away from traditional approaches to supporting asset-building. The removal of MIRAS and tentative steps towards more progressive policies has helped to shift the debate. The recent emphasis on individual ownership accounts has been of particular importance and could provide the springboard for significant asset-based egalitarian policy developments.

Thirdly, it is evident that asset-based welfare remains in its infancy. While there has been progress we do not yet have a clear account of the implications across different policy areas. A notion that public policy encouraging accumulation of financial assets should be more progressive is increasingly accepted, but what this means in practical terms remains largely elusive. It is also the case that policy reform has thus far been piecemeal with little overall direction. To give greater coherence to policy development it is important to develop an idea of what the core objectives of asset-based welfare are.

There is an opportunity to develop asset-based welfare and to build on the progress made thus far. Indeed it seems inevitable that asset-based policies will play an important part in the future of social policy; the issue is whether it can be shaped for progressive ends. To accomplish this, policymakers on the left need to articulate what the end objectives are and how these can be achieved. One useful way of envisioning an ideal asset-based approach is to think about developing a *progressive* and *coherent* policy framework. In this publication the contributors, in different ways, seek to outline the implications of an asset-based approach to welfare policy. The potential impacts could be significant and might fundamentally shape the future of the welfare state.

The ideas presented in the following chapters, based on this broad conceptualisation of asset-based welfare, have implications across public policy. The role of Individual Ownership Accounts, such as the Child Trust Fund, is explored in detail, and leads into debates about savings policy, specifically reform of existing government incentives. Also relevant is the potential for greater use of endowments and lump-sums, which would encompass current grant-based policies. Finally, a coherent approach to asset-based welfare will necessitate a focus on removing barriers or disincentives to asset accumulation.

A summary of the chapters

Chapter 2. Progressive asset-based welfare

In Chapter 2 Will Paxton discusses different ways that the objectives of asset-based welfare, underpinned by asset-based egalitarianism, could be conceptualised. He sketches out the different visions of a progressive asset-based welfare policy. While the overall goal of an asset-based egalitarian will remain a more equal distribution of wealth within society as a whole, this may not be realistic, a priority or lead to clear policy formulation. Some clear and focused objectives for asset-based welfare are outlined and then set alongside some policy implications, some moderate and some more ambitious. Many of the issues raised foreshadow subsequent chapters and the overall message is that the implications of asset-based welfare, the vision of what the approach could develop into, could have far reaching consequences across public policy.

Chapter 3. Assets and the social investment state

Michael Sherraden suggests that changes in welfare policy can be characterised as a shift away from a *welfare state* to a *social investment state*, where the overarching role of government is to build up people's capacity. He believes that asset-building will inevitably play a central role in this shift. Indeed, we can already witness the growth of individual accounts. The important debates are not whether to adopt an asset-based approach but how it can be made to work for everyone. He outlines his vision of a comprehensive and coherent structure of individual accounts, which integrates various types of asset account (for retirement, education and those at different stages of the lifecycle) into a single progressive multi-purpose system. Above all it is a vision that is inclusive and one that leaves no one behind.

Chapter 4. Beyond tax relief: a new savings incentive framework

Ros Altman picks up in detail an issue raised by both Paxton and Sherraden, concerning the unfairly pro-rich nature of the current incentives to save. She argues that given the objectives underpinning savings policy, the current use of tax relief needs to be questioned. The evidence suggests it is both ineffective and inequitable and Altman clearly demonstrates the regressive nature of the incentives. It is also pointed out that the forgone revenue for the Treasury represented by tax relief amounts to more than the spending on means-tested benefits for the elderly. For Altman this has radical implications with the solution lying in moving beyond tax relief and using 'matching incentives'. The specific proposal outlined suggests matching initial savings pound-for-pound, but then reducing the incentive as people save more, first to £1 for every £2, then £1 for every £3. Most important though are the principles underpinning the proposal; that incentives should be fair and transparent. If adopted such innovative savings incentives would have far reaching consequences.

Chapter 5. Savings among people on low to moderate incomes: the barriers and how they might be overcome

As well as providing appropriate incentives to accumulate assets, barriers must also be addressed in order that policy is coherent. In the final chapter Will Paxton and Elaine Kempson point out that people on low incomes aspire to save and indeed often do so informally and with specific short-term needs in mind. Yet they face certain barriers. One example is the relationship between debt and asset building. For the worst-off in society breaking the cycle of debt can be the greatest obstacle to saving that they face and Kempson and Paxton suggest government funding for debt buy-out schemes and especially those that allow people to build up savings at the same time as reducing debt. The broader lesson of the chapter is that any vision of coherent asset-based welfare must account for barriers and disincentives at the same time as focusing on incentives.

Endnotes

1 By 'wealth' the Inland Revenue is counting financial and also physical wealth such as property.

2 The Saving Gateway is currently being piloted, but will be rolled out across the country in the near future. For further information on the Saving Gateway pilots see www.toynbeehall.org.uk/safe.htm where information on one of the pilots can be found and www.hm-treasury.gov.uk/topics/topics_savings/topics_savings_gateway.cfm where the Treasury outline the progress of the pilots.

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2. Progressive asset-based welfare

Will Paxton

There have been interesting recent shifts in policy thinking under the banner of asset-based welfare. The most notable developments are the Child Trust Fund and the Saving Gateway, two specific policies which are explicitly designed to build people's assets: in the case of the former, 18 year olds' benefit and in the case of the latter, all low income adults, will be targeted. Yet these two policies, and indeed any specific explicit policy like them, manifestly do not represent the full potential of asset-based welfare. In this chapter we outline, in various different forms, what an overall progressive asset-based welfare policy could look like.

What do we mean by the creation of a *progressive* asset-based approach to public policy? The response to this question may seem clear-cut in the light of the overarching asset-based egalitarian ambition of reducing wealth inequalities, and this is the first objective described below. A guide for practical policy formulation, however, may need more specific and nuanced objectives to be articulated. The different progressive objectives outlined below could sit comfortably alongside each other or they could stand alone. It is ultimately a political decision as to how ambitious the stated policy objectives should be and what should be deemed a priority.

Alongside the elucidation of several specific visions of a progressive approach to asset-based welfare, comments on a broad range of possible practical policy implications are made. Most obviously there are implications for savings policy. All current state action that directly concerns saving and investment, is relevant and therefore discussed. Policies intended to help people cope with transitions through the life-cycle, risk and uncertainty are also relevant, as are those which currently seek to reduce, and help people avoid, poverty.

Objective 1. Creating more equal overall wealth distribution

> There are forces which make the wealthy more wealthy and the poor still poorer…thus arrangements (must be) sought…to achieve a more equal distribution of the ownership of property. (Meade 1989)

> A more equal distribution of wealth will be needed to produce any given degree of equality in visible living standards. (Crosland 1956)

From a social policy perspective, asset-based egalitarianism's Holy Grail is a more equal overall distribution of wealth. The predominant goal is increasing the opportunities that individuals have to succeed in a market economy, yet asset-based egalitarians have other targets in their sights. A central argument is that a more equal wealth distribution creates more vigorous democratic institutions, as once people gain wealth they have both a greater incentive and greater resources to participate in the political process. De Toqueville made this argument in his exhaustive analysis of early democracy in the United States. If he were to make a posthumous return now may well have noted the opposite happening with increased disenchantment occuring concurrent with growing inequality.

In the UK, as well as across the Atlantic, evidence suggests that after a period of shrinking wealth inequality up until the 1970s, the situation has worsened over the previous decade (IPPR 2002). Policies such as the Child Trust Fund (and likewise some of the other suggestions found in this publication) may have some impact on overall wealth distribution but it would be minimal. In part this is because public policy is fighting against a tide of economic and cultural trends that give rise to greater concentrations of wealth, which are beyond the sphere of its influence. More specifically it is because the generosity of existing policy proposals is simply insufficient to have a major impact. As a result the ambitious target of narrowing wealth inequalities would require fundamental and far-reaching policies.

A considerably more generous Child Trust Fund

Calling for a more generous Child Trust Fund risks sounding premature. The policy is widely recognised as a brave and innovative step to take. It is a rarity in politics; a long-term universal and progressive policy. It remains in its infancy, yet this does not mean that progressives should lose sight of what the Child Trust Fund could eventually become.

As proposed, account holders will accumulate an average fund of £3 to £4,000. While this will have an important impact on young adults who currently turn eighteen with no financial assets backing them up at all, it is unlikely to seriously affect overall wealth distribution. There is no shortage of more radical and more generous policy proposals. Ackerman and Alstott (1999) argue for an $80,000 endowment to be paid to all twenty-one year olds (bar some with criminal records and some who fail to complete high school). In the UK Le Grand and Nissan (2000) have argued for a £10,000 stakeholder grant to be paid to all eighteen year olds. There are some particularly interesting suggestions about linking in a stakeholder endowment for young adults, of which the Child Trust Fund is a variation upon, with Basic Income policies. Wilderquest (2001) argues that all young adults should receive a generous grant but that they can only use interest on the endowment. The availability of the principle would be restricted to strenuous circumstances only. As this scheme would mature it would have the advantage of becoming self-financing, as people would be obliged to 'pay back' their fund on death.

Such ideas are fascinating and, though still largely confined to academic debates, they do provide useful pointers as to how the Child Trust Fund could develop. More realistically though, consideration should be given to simply making the Child Trust Fund, as currently envisaged, more generous and using the infrastructure of individual accounts for all citizens that it provides. Once this structure is in place the amount of money deposited by the state can easily be increased. Some have described this as a distinction between plumbing (the infrastructure provided by the Child Trust Fund) and water (the value of funds flowing into the accounts) and argue that if the policy proves successful and popular the government could simply turn the tap on further. Turn it on far enough and there could be a significant impact on overall wealth distribution.

A reformed inheritance tax and wealth taxes

A second option for influencing overall wealth distribution would be reform of inheritance tax, since its current lax nature sits ill with a commitment to equality of opportunity. For asset-based egalitarians the primary aims of inheritance tax should be the reduction of inherited financial privilege and the creation of a more equal distribution of wealth.

There are a number of reasons for the current policy failing on both counts. The yields from inheritance tax are comparatively small at £2.35 billion in 2001/02, in part owing to the relatively high threshold of £250,000 but largely because the tax is effectively voluntary for many of the well advised wealthiest in society. Passing on wealth as gifts allows people to circumvent the tax as do a range of different exemptions. Added to this there is little incentive for legators to divide an inheritance between more people or pass on wealth to those whose need is most pressing because the tax is based on the estate of the deceased and not the circumstances of the legatee.

There is a relatively well-charted roadmap for reform of inheritance tax. The tax burden should be shifted from the donor to the recipient of inheritances and to reduce avoidance there is agreement that inheritance tax should be conflated with a lifetime gifts tax. This is likely to have two impacts, both potentially creating more of an equal wealth distribution. Firstly, donors would have an incentive to spread their wealth amongst more people if they know that the recipient will be taxed. Secondly, it is likely to raise greater revenue that could be used to support progressive asset-building policies.

These ideas are not new and were articulated by Tony Atkinson as long ago as 1972 (Atkinson 1972) and have more recently found detailed expression in the Commission on Taxation and Citizenship (Fabian Society 2000). The stumbling block is that there seems to be little public appetite and therefore no political will for reform. A pessimistic reading of public opinion at present would lead to the conclusion that, if anything, with 'middle England' home owners finding themselves above the inheritance tax threshold (largely as a result of house price increases) there is a pressure on the Government to move in the opposite direction and raise the threshold. More positively though there are signs that parent's aspirations to hand down wealth to their offspring could be weakening. As society ages it makes less sense for parents dying in their eighties to bequeath to already financially secure children in their fifties. This motivational change is likely to lead in part to greater use of assets by people in retirement (or 'asset-decumulation' to adopt the jargon) and in part to the creation of some political space to reform inheritance tax.

Though it is not an immediate prospect, reform of inheritance tax should definitely remain a medium-term ambition. When attitudes do shift the left needs to be ready and confident with its arguments for reform. Indeed there is a need, as part of telling a wider story about equality as a core value of the left, to proactively make the case and shape public attitudes.

Another radical option, which to be viable would require a shift in public attitudes, is for a wealth tax. This would not be levied when assets are passed on at death or given away as a gift, but instead would fall on the value, at a given time, of people's existing capital holdings. Ackerman and Alstott, for example propose a two per cent tax on each individual's wealth in excess of $230,000, which would raise over $400 billion from the wealthiest 20 per cent of the US population. In this example the tax would be repeated annually, which raises clear problems. The cumulative effect could be substantial and the likely response of many asset-rich individuals would be to simply transfer their assets out of the country with significant unintended economic consequences. More fundamentally though, the lack of political will behind reforming inheritance tax is even more considerable in the case of a wealth tax.

One less ambitious option would be to reform Capital Gains Tax (CGT), which is not a proper wealth tax as it only affects the returns people make on capital and is levied when assets are sold on the value by which the asset has increased. A significant exemption from current capital gains tax is housing; individuals do not pay any tax on the increase in value of their first home. In many people's asset portfolios, housing wealth is the most important component and the value of the forgone revenue is large; £6 billion per annum according to the Inland Revenue (Inland Revenue 2003). This also represents a regressive and substantial subsidy to wealthy homeowners. One policy option would simply be to extend CGT to home ownership. To make the policy more palatable a generous threshold could be introduced and the rate made less onerous. Further exploration of this option would require an assessment of the likely impact on the housing market, but in principle there is a strong case.

For social democrats the case for several of the policies suggested above is clear, yet the public appetite and political will remains at best uncertain. Government can articulate and lead public attitudes to an extent and it might be possible to assuage public opinion and persuade people of the merit of radical policies. In reality though, until progress is witnessed on a more moderate scale and public debate has developed as a result, it is likely that the electorate's attitudes will prevent fundamental action.

Arguably too, the objective of influencing *overall wealth distribution* fails to provide a clear enough focus for tangible specific policy development. It could lead to the accusation that asset-based egalitarians necessarily desire that all citizens possess wealth at all times. There are clearly identifiable stages in people's lives when holding assets is unimportant and it may be sensible and appropriate to borrow in anticipation of future increased earnings (IFS 2000).

Objective 2. Creating a more equal distribution of wealth among young adults

> If citizens are to begin adult life under fair conditions, it is wrong to deprive them of their just share of the wealth created by prior generations. In a liberal society, this commitment should be cashed out in terms of private property – since property provides an essential tool for effective self-definition. (Ackerman and Alstott 2002)

> 'When a young couple begin the world, the difference is exceedingly great whether they begin with nothing or with fifteen pounds apiece.' (Tom Paine 1797)

One clearer conceptualisation of the goals of asset-based welfare is to increase wealth equality as people start their adult lives, helping to create more 'starting gate equality'. This time in people's lives is important because of its impact on life chances and the goal of opening up opportunity for all. Our society remains one where the wealthy are able to protect the social position of their offspring and inherited privilege cascades largely unabated through the generations. Social mobility within people's own lifetime (*intragenerational mobility*) is relatively prevalent, although much of it is only short range and, furthermore, levels have declined over the past twenty to twenty-five years. *Intergenerational* mobility (the chances of children born into one income group being able to move up the income scale) also appears to have declined in recent decades.[1]

Reducing inherited privilege and increasing social mobility is only achievable with a combination of policy interventions, including investment in education and provision in the early years of a child's life (something we return to below). Part of this strategy should be ensuring that asset-holding among young adults is more equal as this is one stage when life chances can be shaped. Financial assets, held between someone's eighteenth birthday and their early twenties, could be put towards education or simply spent on a car to get to work. Currently, many better off young adults not only have more financial assets in their possession, but they can also draw on the wealth of their parents.

Achieving a more equal distribution of wealth in early adulthood is not only part of an overall strategy to promote a more fluid social structure; it will also help prevent poverty. Asset-based welfare is inherently long-term and preventative. By investing financial assets wisely people can build up capacity and reduce their vulnerability (Sen 1999). In Chapter 3 Michael Sherraden describes asset-building as being symptomatic of moving from a *welfare state* towards a *social investment state*.

In order to achieve the goal of increasing equality of asset-holding in early adulthood we must build on the foundations laid by the Child Trust Fund. As was pointed out above it is true that the policy in its current form will not impinge significantly on overall wealth distribution, but more modestly, it will create a more equal distribution of assets among citizens in their early adulthood. As the Child Trust Fund is rolled out the distributional impacts need to be monitored, with an eye to adjusting the level and progressivity of the state deposits.[2] It is likely however, to be insufficient alone to achieve the goal of greater starting gate asset equality.

Tailored policies such as 'an Independence Trust Fund'

The means test on which the Child Trust Fund will be based is very simple. It merely divides children into two groups; those from low-income households and those from wealthier families. There is a danger of failing to account for the gradations of disadvantage in early adulthood. The paradox with the policy is that acutely deprived groups of children might be in the most need of an asset in early adulthood, but simultaneously least able to accumulate a significant fund, because their families (if they have them) will be less likely to contribute to the account. Greater nuance will be required to meet the needs of particular groups through tailored policies.

Groups of concern could include disabled people, homeless people, runaways and asylum seekers, but below, particular attention is paid to young adults who had previously spent time in care or those who had been 'looked after' by the Local Authority.

A tailored policy would ensure that upon leaving care young adults could be granted access to what could be called an Independence Trust Fund, which would provide them with a financial asset over and above that accumulated in the Child Trust Fund. State contributions would be paid through a hybrid of lump-sum endowments at given ages and on-going weekly payments into accounts. The weekly payments might be linked to Child Benefit, which is currently unreceived by children in foster care or Local Authority homes. Strategic timing of lump-sum state payments would ensure the policy is more appropriately targeted at those children who leave care directly to make the transition into independent adulthood.

Because policies like the Independence Trust Fund would be received over and above the Child Trust Fund, debates about the age of access and level of control over expenditure can be opened up. Whereas Child Trust Fund holders have access at 18, and are at liberty to spend the money how they like, an older age and greater paternalism could be more appropriate for a policy targeted at people in care. In principle stronger control is justified because of the increased state contribution and in practice it is more plausible given the role that personal advisers could play. Whereas policing the expenditure of a complete cohort of young adults is administratively problematic, doing it for a small, already well-supported group would be far simpler.

This policy could help enhance the life-chances of some of society's most disadvantaged citizens. As the corporate guardian of looked-after children, the state has a statutory duty to provide that expected of a reasonable parent and contributing to a tailored asset-based welfare policy would represent a fuller interpretation of the rights of young care leavers. Alongside other policies tailored to the needs of particular groups, it would help achieve the goal of greater wealth equality in early adulthood.

Objective 3. A more equal distribution of, or access to, assets during times of change

> There is a need for an intelligent welfare state that will be active throughout our lives, helping people to negotiate unpredictable change at work and home. Instead of a safety net to relive poverty, we need a social security system that can help prevent poverty. (Commission on Social Justice 1994)

A third potential ambition for asset-based welfare would be providing more equal and universal access to assets in times of change in people's lives. During transitions associated with particular 'life events' (such as having a baby, setting up home, coping with divorce or separation, bereavement or making the move into or out of work) there is often a mismatch between income and expenditure accompanied by lumpy one-off costs. If individuals and families have access to assets they can cope better with this; if they do not the result can be increased debt and/or an inability to take an opportunity that presents itself.

The risks associated with lifetime changes have increased in recent decades. It is commonplace now to argue that the predictable periods of change in people's lives, around which the post-war welfare state was designed (such as childbirth, unemployment and retirement), have been both magnified and added to by new risks. The most significant new risks are found in the labour market and in relation to family change. The extent of changes to employment patterns is debatable, though it is certain that risk has increased for some groups and people no longer expect or perceive long-term stability in the labour market (Heery and Salmon 2000). There is undoubtedly now greater plurality of household formation and more change experienced by individuals across their lifecycle.

Accompanying this among academics and policy makers there is an increasingly *dynamic* view of welfare, which sees poverty, income and employment, not as static, but in terms of processes occurring over time. The triggers that precipitate poverty, which might crucially include transitional stages, have moved to centre stage in policy debates. This has contributed to an understanding of the need to build more preventative provision, bringing forward welfare interventions to circumvent the high social and financial costs of poverty and deprivation. However, the practical responses remain in their infancy. The welfare state has always been effective at transferring resources to people in certain phases of their lives, childhood and retirement being the most significant, but it is not traditionally as adept at helping people as they go through *transitional* stages.

Another challenge thrown up by transitional stages is the need to fashion a welfare system that enhances personal independence and choice. The danger of current provision is that it provides little sense of control, which in an increasingly skilled and better educated society, fails to match people's perception of themselves as self-reliant citizens rather than passive clients to the decisions of government bureaucracies.

Asset-based welfare could play an important part in meeting these twin challenges, both supporting people through transitional stages and empowering them by creating greater personal autonomy. Access to assets during times of change will help provide a buffer, prevent falls into poverty and enable more certainty. In early adulthood a stakeholder grant like the Child Trust Fund can be used, but later as people get older, move in and out of the labour market and have children, they will still need to have access to, if not actual ownership of, assets. Below we outline a spectrum of policy options ranging from the relatively unadventurous adaptation of existing programmes targeted at specific life stages, through to a coherent integration of a range of financial support for people when they experience lifecycle changes.

Extended use of grants at specific life stages

Policies that provide financial assets at times of transition already exist: for example, 25 per cent of pension funds can be taken as a lump-sum before the remainder is annuitised, widows and widowers receive bereavement payments, and the Social Fund provides a range of grants.

The Sure Start Maternity Grant provides parents on low incomes with a lump sum to meet the one-off costs of having children. Similarly, concern about the transition into work from unemployment has led to action; there is a Job Grant paid when benefit recipients enter employment. Yet these policies could be adapted and built on.

Firstly, the Sure Start Maternity Grant is currently available for parents of newborn children who are in receipt of certain means-tested benefits and the payment made is only £500. The logic underpinning the grant is appealing. It helps meet the considerable one-off costs new parents are faced with and encourages greater autonomy by granting the parent control over spending the money. If the parent deems it important to prioritise buying clothes or a new bed, that is their choice. Alternatively they could use the money to help pay for childcare. Yet at its current level the grant only allows decisions to be made on a moderate scale and by a restricted number of parents. If it were more generous it would not only meet the basic set-up costs of having a child but could also be used for a wider range of costs over a longer time period.

Consideration should be given to eligibility for the payment being extended to more families or alternatively the generosity could be increased for those who receive the grant. One ambitious option would be roll up elements of the current support provided over the first year of a child's life and allow parents to draw on it as and when they deem it necessary. Care would have to be taken to ensure that this benefited the least well off. If the value of the grant were increased to at least £1,000, this would move it beyond being a symbolic payment and towards being a genuinely empowering policy.

The move from unemployment or economic inactivity into work is also a transition where an enhanced asset-based approach might be useful. Welfare policy must meet the needs of a flexible labour market and requires being increasingly active rather than passive, something that an asset-based approach would help provide, as a complement to tax credits and the New Deal. It could do this indirectly by building up capacity and more directly by providing support during the period of moving into a job.

Indirectly, policies such as the Child Trust Fund could build people's capacity enabling them to invest in education to improve their employability. Also, if holding financial assets ensures that people develop a long-term view, this might facilitate progression both into work and then into better paid positions. More directly support can be provided during the transition into work. A crucial factor affecting the ability to successfully make such a move is the availability of formal sources of financial support. This is primarily required to bridge the gap between moving off benefits and receiving the initial pay packet and to meet the start-up costs of work such as uniform, tools or travel (DWP 2002). Already in place is the Job Grant, valued at £100, for people moving from benefits into paid employment. In its present form the Job Grant has a number of drawbacks. It is not widely known about, reducing any motivational impact and it is a relatively small amount. For many people 'gaps' remain which are uncovered when they move into work.

The least ambitious reform would be to increase the value of the payment and to promote it more vigorously. A more radical option could extend the scope of the grant. At present it is designed only to help people through the first few weeks at work. Over a longer period entrants into the labour market could require broader financial support to enable them to retain jobs and progress from one job to another. Too many low-income workers continue to churn in and out of poorly paid jobs without making the step up into higher paid and more secure employment. This would require a larger and probably staged grant to be paid.

A radical response: the introduction of Life Accounts

Rather than simply targeting one specific transitional stage, introduction of a Life Account would mainstream asset-based welfare into the benefit system. The component of the benefit system currently intended to aid the worst off in society through difficult times, the Social Fund, is generally accepted to be inadequate. It provides some grants for certain purposes but predominantly it is intended to help people, when they face a one-off large expense, to access affordable *loans*. The main criticism of the Social Fund centres on the cash limited budgets, which are distributed on a discretionary basis. Potential recipients can be in acute need but still denied assistance. With its bureaucratic processes, lack of transparency and arbitrarily restrictive nature it is the opposite of freedom enhancing policy.

The Social Fund could simply be reformed or have more generous budgets for its discretionary element. While this should be considered, it would rely on a continued use of loans and as such is not an asset-based welfare policy. Another option is to adopt an asset-based welfare approach in the form of a *Life Account*. This would replace Social Fund provision (as well as potentially some other state support currently provided during times of transition) and provide individuals and families with a flexible, freedom enhancing pot of financial assets to draw on.

The core aim would be to promote real choice across the lifecycle in the balance of employment, education and leisure. People would be able to strike new balances between different responsibilities at different stages in their lives and would be able to anticipate problems and act to support or protect themselves far more effectively and quickly than a state bureaucracy is able to. Also by concentrating on people's financial health over time, rather than simply snapshot views of income, Life Accounts will help promote independence, reduce risk and prevent people from falling into debt and poverty.

They could take a number of different forms. One option is to implement a Time Limited Citizen's Income policy, an idea first suggested by Stuart White (2001). Using some indicative figures, the fund in each individual's name could total £20,000 over their lifetime and they would be restricted to withdrawing up to £5,000 in any one year to help them through difficult times. Strong incentives could be provided for people only to spend the money when in dire need and any money retained at pension age could be generously transformed into either a lump sum or increased retirement income.

A second option is a Rolled-up Benefit Account, which would draw together a range of prospective benefit entitlements that a household has or is predicted to have in the future. This would mean that the value of the fund would be determined by an assessment of the likely amount that would have been received over a given time period. This would provide a consolidated package of financial resources held either in an account or on behalf of the household by the benefits agency. With prudent limits, households would be able to draw forward or defer entitlements according to family circumstances. For example, if one partner suffered a reduction in earnings, the family might seek an advance on its childcare resources to allow the other parent to look for work. Families and individuals would be able to smooth out their financial capacity over time and mould their entitlements in response to economic change and insecurity, without being locked into a ridged set of departmental guidelines and categories.

Experience around the world could be drawn on in developing this approach. The Australian Labor government of 1983-96 pioneered the flexible use of social security accounts. Recipients of Basic Family Payment were allowed to access part of their entitlements as a lump sum giving them greater flexibility in dealing with life's contingencies. Similarly people receiving unemployment benefit were allowed to capitalise part of their future income support payments as a way of moving from welfare to work. Up to $1,000 could be accessed for a range of work-related purposes such as the purchase of tools for part-time employment or seed funding for the establishment of small enterprises. In Denmark and Sweden there have been similar proposals to package up benefits into individual accounts providing greater flexibility for claimants (Folster 2001).

There are, of course, a number of important questions that would have to be answered. Most importantly, given the potential for fraud, there is an issue about whether the spending would be policed in any way and if so how this would be administered. The difficulty here is that there is a trade-off between increasing autonomy and flexibility and being cautious about fraudulent expenditure. One workable option could be to use personal advisers, who are of growing importance in welfare provision, to monitor spending. As with Individual Development Accounts, dual signatures could be required for people to release funds.

It might also be possible for people to make additional contributions to their funds and for it to become a welfare savings account. It might be possible to link a Life Account to tax credits and benefits, allowing people to make deposits direct from their entitlements into their account. In the US schemes exist whereby contributions to savings accounts are automatically made from the Earned Income Tax Credit, something that has proved popular among many as they see it as an opportunity to move towards self-sufficiency (Smeeding 2000). The recent introduction of the Child Tax Credit and Working Tax Credit make this a real possibility in the UK.

Objective 4. Providing more progressive incentives to accumulate assets

> No-one ever got rich by passing up golden opportunities and that's exactly what a personal pension offers you. Why? Because one of the beauties of saving for your retirement is that the government actually gives you money – and lots of it … you get back every penny of the income tax you pay on the money you invest. [Small print] The value of the tax benefit depends on how much tax you pay. (Advertisement, *Guardian*, quoted by Le Grand and Agulnik 1998)

> The benefits (of tax relief) have increasingly favoured wealthier taxpayers, through the medium of tax-free lump sums and other devises. In this sense, they function as concealed multipliers of occupational success. (Richard Titmuss 1958)

The most significant existing government support of asset-accumulation comes in the form of tax relief, which is used to help meet savings policy objectives, most notably in relation to pensions but also to encourage shorter-term saving through Individual Savings Accounts (ISAs). These incentives are regressive and expensive, while at the same time it is unclear that they are effective at achieving their stated goals. There is evidence that tax relief is opaque and not even understood by people when they do stand to benefit (Jupp 1997). Options for reform are attended to in detail in Chapter 4 so here we restrict ourselves to making some general points.

Targeting innovative incentives?

The first is that as an initial step, to bring clarity to savings policy and to help guide reform, policy makers must prioritise who they want to save more. There is a danger of following the wrongheaded mantra: *all people should save more and they should be saving for the long-term.* The reality is that different groups, at different life stages need to save for different reasons or indeed not save at all. Of paramount importance for many on low incomes will be the accumulation of precautionary or rainy day savings. Those who government wants to save for retirement, and who are not doing so at present, are largely on moderate incomes or what has become known as the stakeholder target group (which captures households earning between £10 to £20,000).

Chapter 4 suggests that current resources allocated to tax relief for pensions (£9 billion a year net of taxation received from retirement income on the most conservative estimates)[3] should be rolled up and reallocated in a more progressive manner. A reformed system, it is suggested, would *match* people's savings to the same extent regardless of what their income is. All would be eligible for an identical cash incentive. If specific groups were identified and they could be effectively targeted with a means test then an alternative option would be to target incentives. An approach like this was at the heart of President Clinton's unsuccessful Universal Savings Account scheme that would have matched savings of moderate earners had it not been blocked by Congress (Friedman and Sherraden 2000).

Front loaded vs end loaded incentives

Placing asset-based welfare objectives in the context of existing savings policy begs some more fundamental questions. How compatible are the overarching objectives of existing savings policy with those of asset-based egalitarians? On the whole, asset-based welfare emphasises front-end investment in building people's wealth to help them take opportunities or to reduce the risks they face. In contrast traditional savings policy is largely driven by a desire for more people to build up assets to transform into income in retirement.

On another level, they clearly complement each other. Building up people's capacity when younger will, if successful, put them in a better position to provide for themselves in old age. The tension comes in making a decision on where to concentrate scarce public resources in support of asset accumulation. Most proposed reforms of tax relief envisage resources being redirected to help achieve the existing primary goal of increasing retirement saving. Given some of the policy objectives discussed in this chapter reform of saving incentives could presage a rebalancing of not just *how* the state supports asset accumulation but a rethinking of *when* in the lifecycle it is deemed important for people to hold assets and in what form. It could be that the logic of asset-based welfare will lead to state spending on asset-accumulation being more front than end loaded. In tangible terms for asset-based egalitarians reforming tax relief could make resources available for higher sending on Life Accounts or on a more generous Child Trust Fund.

Conclusion: new medicine required

The objective of building a progressive asset-based welfare strategy can be articulated in a number of ways; each have different implications for public policy. The four possible overall objectives outlined above – a more equal overall wealth distribution, a more equal distribution among young adults, greater equality of access to wealth in times of change and fairer incentives to accumulate assets – are not contradictory and could usefully complement each other. However, it is more likely that priority will have to be given to specific policies and for these to be allowed to prove themselves and bed down before the wider implications outlined above could be fed into government policy.

What seems certain is that the importance of asset-based welfare is set to increase. Many of the progressive policy aims listed above were not simply moral objectives. Instead they were in part instrumental responses to certain policy problems such as the need to promote greater social mobility by building people's capacity and the pressure on policy makers to provide support for people as they pass through periods of transition. A large part of the response to these challenges will lie in the continued investment in and development of income-based policies and the provision of public services. This *same medicine, higher dosage* approach will not be sufficient though. They need to be complemented with new approaches like the progressive asset-based welfare policies outlined in this chapter. Policy makers need to prescribe *new medicines to complement old approaches*.

Endnotes

1 It should be noted that this refers to what Sociologists call absolute social mobility. This should be seen as separate from what is labelled relative mobility. Absolute social mobility is concerned with the absolute number or proportion of people in a social group who are upwardly or downward mobile. Relative social mobility is concerned with the chances people from different backgrounds have of attaining different social positions.

2 At the time of writing the government plan to deposit £500 in Child Trust Fund accounts at birth for children from low-income families and £300 for children from higher income families. There will then be additional top-ups at the ages of 5, 11 and 16 to the value of £100 for poorer children and £50 for children from wealthier families. There appears to be no coherent rationale for these precise figures and the structure of the state deposits should be kept under review. It might be possible that they should be *end loaded* – that is the larger state deposit should be deposited when the child is older rather than younger better reflecting their circumstances in early adulthood. The deposits might also be more progressive, while retaining an element of universality.

3 This figure is taken from the National Association of Pension Funds (NAPF, 2002). A different, higher Inland Revenue figure is quoted in Chapter 2. Even if the most conservative figure is used this remains a substantial cost to the exchequer, equivalent to 3p on the basic rate of income tax.

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3. Assets and the social investment state[1]

Michael Sherraden

In the early 21st century the welfare state appears to be in the midst of a transformation. Gilbert (1995) describes a shift away from social entitlements and toward private responsibility, with an 'enabling state' treating individuals as actors who are capable of looking after themselves with assistance from the government, not as totally passive recipients of pubic benefits and services. In a somewhat different but complementary interpretation, others have described the 'productivist' nature of current trends and the emergence of 'social investment' as a dominant policy theme (Midgley 1999).

Though not yet well defined, a reformulation of the commonly held values which underpin the welfare state is underway. The original consensus was that, if the market economy was sufficiently productive, it could be taxed to support social expenditures. These social expenditures were assumed to be a diversion of capital from production and a drag on economic growth. Already though, the assumed competition between social protection and economic growth is being challenged. In my view, this will happen more and more in the future. There is recognition that social spending for some purposes and/or in some forms can contribute to both economic growth and social development. Reflecting this the best social policy alternatives will move beyond the idea of consumption-as-well-being, toward what Sen (1993;1999) identifies as functionings or capabilities. Building people's assets is one policy pathway to both increase capabilities and improve the trade off between economic growth and social development.

Why assets matter

To date, social policy for the poor has been focused almost entirely on income. The assumption is that income transfers will support a certain level of consumption. This is a noble and necessary goal, but it is not enough. For the vast majority of households, the pathway out of poverty is not through income and consumption but through saving and investing in education, enterprise, and property. Most importantly, asset accumulation enables the next generation to begin their lives with resources and therefore opportunities. This is important because social development is something which occurs across generations, not only within them.

When people begin to accumulate assets, their thinking and behaviour changes as well. Accumulating assets leads to important psychological and social effects that are not achieved to the same extent by receiving and spending an equivalent amount of regular income. These behavioural effects of asset accumulation are important for household well being. They are likely to include more long range planning, better care of property, increased learning about financial affairs, and increased social and political participation (Sherraden 1991).

To mention only a few examples from research, there is convincing evidence that, controlling for other factors, homeownership is associated with greater residential stability, maintenance and upkeep of the home, and social and political involvement at the local level. Controlling for other factors, home ownership *and* financial assets are associated with higher educational attainment in children (see Scanlon & Page-Adams in Boshara 2001). Evidence in the UK suggests that holding a relatively small level of financial assets can improve a range of outcomes, including labour market performance and health outcomes (Bynner 2001).

How assets accumulate

Mainstream economic theory emphasises the role of personal preferences and the rational choice of individuals in asset accumulation. From this perspective, people accumulate assets when they decide that they prefer to consume later rather than consume now. To be sure, such preferences always play a role, but it is also likely that institutional arrangements affect asset accumulation (Sherraden 1991; Beverly and Sherraden 1999). Assets tend to accumulate where public policy provides structures for this to occur, as in 'private' retirement accounts. People who have access to these accounts at the workplace are much more likely to save and accumulate. Key institutional factors, which affect the decision to accumulate assets or not include access, information, expectations, incentives, and facilitation (Sherraden, Schreiner, and Beverly 2002). Perhaps the most effective asset accumulation strategies are those where facilitation is nearly total, as is the case with automatic deposits into a savings account or pension.

The trend toward asset accounts

Income has been the central concept around which much of the twentieth century welfare state has been built. The goal has been to support people when they did not acquire sufficient income from industrial labour markets. The primary form of income support for the non-poor has been social insurance, and for the poor it has been means-tested transfers or, what in the US we call 'welfare'. In the developed economies, income-based policy has typically been delivered under the heading of social policy, and in turn social policy is seen as comprising mostly of public spending. On reflection, it is somewhat remarkable that one idea has defined so much public policy for so long.

The world has changed considerably since income-based policies were initiated. To be sure, people still require income security when they are not employed, but income alone is no longer enough. The labour market of the information age requires that people have resources to invest in themselves throughout their lifetimes. With less stable employment, workers will need to carry fully portable benefits in and out of the labour market, from employer to employer, even across national boundaries. 'Retirement' is likely to be redefined, no longer such a rigid period of the life course, and people will want greater flexibility in how they live in their older years (Morrow-Howell *et al* 2001). Also, policy should promote wealth accumulation across generations, so that more children begin life in households with at least some financial resources. Asset-based welfare and individual accounts have many advantages in these conditions (Sherraden 1997).

Largely for these reasons, a shift to asset-based policy is underway. Around the world it is uncommon to encounter a new or expanding policy of social insurance, but common to find a new or expanding policy of asset accounts. For a long time, provident funds with their very mixed record were the major examples of social security based on individual accounts (Dixon 1989). Today, the relatively successful provident funds of Singapore and Malaysia have been joined by systems of individual accounts in much of Latin America. Australia has created a system of 'superannuation' to largely replace its means-tested retirement policy. Less remarked upon but perhaps more noteworthy is the rapid rise of individual accounts as add-on policies in Western Europe and the United States. These add-on policies are not always considered part of social policy systems and are often ignored by analysts. Nonetheless, for many people in Western societies, asset-based policies are becoming the most important form of social policy.

For example, in the United States this can been seen in the introduction and growth of 401(k) accounts, Individual Retirement Accounts, the Federal Thrift Savings Plan, College Savings Plans in the states, and proposed individual accounts in Social Security. In the UK most noteworthy have been a similar shift to private pensions and the attempted introduction of Individual Learning Accounts. Some of these are public and some are called 'private', but it is important to bear in mind that private sector plans are typically defined by public policies, regulated by government, and receive substantial subsidies through the tax system. The fact that the expenditures come through the tax system does not make them any less real or the funding any less public. All of these asset-based policies have been introduced in the United States since 1970. Overall, asset accounts, for various purposes, are the most rapidly growing form of domestic policy in the United States, and it seems likely that the shift will continue.

Current asset policies are regressive

Unfortunately, asset-based policies are considerably more regressive than income-based policies. There are major shortfalls in both coverage and adequacy. For example, see the critique of Singapore by Asher (1991), of Chile by Borzutsky (1997), and of Australia by Rosenman (1997). The reasons for regressivity are twofold: first, the poor often do not participate in asset-based policies that currently exist; and second, subsidies for asset-based policies operate primarily through tax relief (tax expenditures) that benefit the poor little or not at all. In other words, asset-based policies have the potential to exacerbate inequality, and indeed are doing so, because the poor are left behind. Individual accounts in the United States are funded by government, via the tax system, at more than $100 billion per year. Other tax-based asset subsidies for homes and investments bring this figure to over $300 billion per year. These public expenditures are extraordinarily regressive. For example, in 1999 two-thirds of tax benefits for pensions in the United States accrued to the top 20 per cent of households, while only 2.1 per cent went to the bottom 40 per cent (Orszag and Greenstein 2000).

In other words, the vast majority of existing asset-based public policy actually contributes to the structure of wealth inequality. I emphasise this point because the common perception of social policy is that resources are redistributed downwards from the rich to the poor. This is to some extent true for direct expenditures, but it is decidedly not true for tax expenditures (Sherraden 1991; Howard 1997; Seidman 2001). Looking around the world, no country has instituted a substantial asset-based policy that is inclusive and progressive.

Reaching the poor

If assets can be successfully transferred to the non-poor, why not also to the poor? Because asset building can be accomplished with relatively simple policy instruments, and because public policy in many countries already does it for the non-poor, it should be possible to do so for the poor as well.

In recent decades, microfinance has promoted asset building in developing nations. We are beginning to learn that asset building for the poor can also be successfully put into place in developed nations, for example in Individual Development Accounts (IDAs) in the United States (Schreiner *et al* 2001). Despite these steps forward, worldwide expenditures for asset building by the poor are relatively small. The next challenge is to develop policies which will reach hundreds of millions of people.

Vision of a large-scale inclusive asset-based policy

It seems likely that by the mid-21st century, asset accounts will be the dominant form of social policy in many countries, although it has to be stressed any asset-based policy system should complement, not replace, existing income-based policies. Our vision of a mature asset-based policy should be shaped by four core principles:

Inclusiveness

Perhaps the most important issue in developing coherent and progressive asset-building strategies is inclusion. The goal should be an asset-based policy that is large scale and fully inclusive, with progressive funding, so that everyone participates and has resources for life investments and social protections. Everyone should have equal access to the asset-based system. The definition of 'everyone' will matter a great deal. The policy could include everyone beginning at birth, as with the UK's Child Trust Fund. As an alternative, it could include all adults or less desirably, only adults with labour income. Starting at birth would be the most sensible and desirable approach.

Progressivity

In asset-based policy, solidarity should come up front, with progressive deposits into accounts of the poor. Current asset-based policy in every country in the world is regressive. A great challenge is to ensure fairness and adequacy of accumulation for all. The minimum standard should be equal subsides in currency units (not per cent of income) for everyone. For example, whatever tax benefits a wealthy person receives on a pension account should be equalled by direct deposits into the account of someone on a low income. A better, but more radical principle would be progressive deposits in currency units. That is greater subsides for the poor, as proposed for the Child Trust Fund (HM Treasury 2001).

Coherence and integration

Eventually, various types of asset accounts are likely to be integrated into a single, multi-purpose policy system wherein everyone might have an account from birth, with funds accumulated and used over the life course for education, home ownership, life and health insurance, some aspects of medical care, and retirement. Policy should move toward a system with a simple, widely available, portable tool that serves multiple purposes across the life span. For example, in the United States, it would be desirable and seems likely that existing asset accounts (IRAs, Medical Savings Accounts, 401(k)s, Individual Training Accounts, Educational Savings Accounts, IDAs, and so on) will merge into one system.

Anticipating this, and recognising that in the United States context most of these accounts are delivered through the tax system, which excludes the majority of low-income persons, it is important to consider how this evolving system can include unbanked persons and provide them with equivalent incentives, through direct deposits and refundable tax credits, to participate (Boshara 2001).

Development

Asset-based policy is not primarily about problem amelioration or fighting poverty. It is about enabling individuals and families to be in control of their lives, develop capabilities, and contribute to society and the economy. While this will involve tackling, and indeed allowing people to escape poverty, we need to remember that the central goal of asset-based policies is development in a broader context. It is about building the capacity of people on low incomes and allowing them to take opportunities which at present they are barred from taking.

A step in the right direction

This vision for asset-based policy, or parts of it, are shared by many social analysts and political leaders. In the UK, similar analyses and proposals for a large-scale and inclusive asset-based policy have been presented by Blunkett (2000), Kelly & Lissauer (2000), Nissan & Le Grand (2000), Regan & Paxton (2001), all of which have influenced progressive, universal proposals for a Child Trust Fund (Blair 2001; HM Treasury 2001; HM Treasury 2003).

The Child Trust Fund, which will provide all newborn children with an endowment from the state, is a bold and innovative step towards a progressive and inclusive asset-based policy. It is progressive because it allows all young people the opportunity to accumulate an asset. What is more, because the endowment will be more for children from low-income households, the poor will potentially be able to accumulate a larger asset by the time they are eighteen.

The policy is also inclusive, mainly because of its universality. It will neither be specifically targeted at the poor, nor be only accessible to the rich, something which is very important. It will provide all people with an account throughout their childhood, which could, in the long term be linked in with other savings products and be part of a coherent asset-based policy across the whole lifecycle. It is an undoubted step towards achieving the vision of an inclusive and progressive asset-based policy, but it needs to be the first of many steps if the goal is to be realised in the UK.

Design principles for asset-based policy

There are encouraging signs that policy makers around the world are beginning to realise the importance of developing inclusive asset-building policies. Above, I have outlined the core principles on which an ideal asset-based system should be based. We also need to know how best to move towards achieving the vision practically. There are a number of design issues which need to be borne in mind if this thinking is to lead to successful policy implementation. These include the following:

Extension

It is easier to extend current policy than to create new policy. Because asset-based policy already exists and is successful, a sound strategy is to build on what we already have. For example, in the United States this could include democratisation of existing pension products, such as IRAs and 401(k)s for all workers. Policy extension can occur in other forms as well. In nations with child allowances, which includes all of Western Europe, a universal children's savings account could be viewed as an extension of the children's allowance.

Institutional framework

As mentioned above, institutional arrangements largely determine who accumulates assets. Low-income persons face four barriers: (a) insufficient income tax liability to take advantage of tax benefits for savings and asset accumulation; (b) weak or no attachments to the formal labour market, where most structured asset accumulation occurs; (c) asset limits in public assistance programs, which are disincentives to save; and (d) a greater likelihood of not being part of the financial mainstream, or being 'unbanked', which makes asset accumulation nearly impossible (Boshara 2001 Kempson 2001). The purpose of asset-based welfare should be to extend institutional arrangements for asset accumulation to low-income persons.

Infrastructure

In the US, Goldberg & Cohen (2000) have argued that, if the government set up accounts for everyone beginning at birth, and did nothing else, this would be a major step forward. Goldberg refers to this as 'putting the plumbing in place'. If the plumbing (asset accounts) were in place for everyone, resource flows, both public and private, would be facilitated.

Simplicity and cost control

Cost control is key, and the key to cost control is simplicity. This will likely mean a policy instrument with centralised administration and one or only a few investment options. One alternative is that individuals own share of an asset pool invested by government (or an agent of government). A second alternative is limited individual investment choices from low-cost mutual fund (unit trust) companies. This simple, low-cost system can, where necessary be complemented by financial education and other supports at the community level, but such costly features cannot be part of the basic policy.

Pathway to scale

It may not always be possible to reach everyone at the outset or fully fund a large-scale policy. In these circumstances, it may be necessary to start small, but with a policy design that can be expanded over time. To be specific, in order to end up with a large, low-cost programme, it is not be a good idea to begin with a small, high-cost programme. This is what has occurred with Individual Development Accounts in the United States, and we are now in the process of designing low-cost policy models that will work at a larger scale.

Concerns in asset-based policy

The vision of asset-based policy presented above is idealised. No policy system is perfect, and there is a possibility of major deviations from the approach suggested above. Indeed, there are a number of reasons to be wary of the shift to asset accounts.

Coverage and adequacy

A key issue is whether progressive principles are possible in a defined contribution system. The shift to asset-based policy could occur but leave many people behind, excluded from social protections. Indeed, this outcome is likely in many of the reforms that are now taking place around the world. If the shift to asset accounts is to be successful in the long run, extraordinary efforts must be made to bring everyone into the primary asset-based policy system. This will require, as a first step, the creation of accounts for all citizens at the youngest possible age, preferably at birth. Once such accounts are in place, a wide range of creative funding strategies can be developed to build assets for the poor.

Protection of funds

Another major concern is the protection of funds that individuals have saved and invested. For most countries, the best strategy will be to use financial markets for investments. The simple reason is that, unfortunately, there are few governments in the world who are capable of managing tens or hundreds of billions of dollars over the long term without depleting the resources in one way or another. On the other hand, care must also be taken to ensure protection of funds in private security markets, particularly where these markets may not be fully developed. The infusion of funds from an asset-based social policy can be a major vehicle for building financial markets in developing nations, but until those markets are reliable and efficient, government must play a major oversight role.

Conclusion

It is enormously challenging to create a universal, progressive asset-based policy. The odds against success are great. However, for perspective, it is useful to recall that, early in the 20th century, the odds against creating progressive social insurance policies were also great. Yet by century's end, social insurance had become, in a fiscal sense, the central characteristic of modern states. By the end of the 21st century, the social policy landscape will again look very different. Looking ahead, it seems likely that asset-based policy will continue to expand. Conceivably, it may eventually replace social insurance as the dominant form of policy in advanced economies. One reason for this will be accounts' portability, even potentially across national boundaries. For example, one can imagine a policy system that is perfectly integrated in the European Union. Indeed, with the rapid expansion of information technology, one can imagine a worldwide system of asset accounts, fully portable anywhere on the planet. This policy would be well suited to information age labour markets and social conditions.

Gradually asset accounts may serve more purposes, including retirement security, home ownership, business capitalization, some aspects of medical care, education, purchase of insurance, and various kinds of investments. Asset accounts may become an integrated social and economic development policy, structured and partially funded by government but controlled by individuals and families.

The major challenge will be inclusion. If we stay on the present course, the poor will continue to be excluded from asset accumulation and will not be fully participating members in this emerging policy system. If inclusion is to be achieved, it will likely not be a political victory of the weak over the strong. Instead, it will rest on the widespread recognition (which in turn must be based on sound research) that asset building is a sensible public investment because it increases the capabilities, engagement, and productivity of the people.

Endnote

1 This chapter borrows in part from Sherraden (1997, 2001, and unpublished documents prepared for the Growing Wealth Working Group in the United States). The design principles section borrows from Friedman and Boshara (2000) and Boshara (2001). The author is indebted to many unnamed people in different parts of the world for this publication.

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4. Beyond tax relief: a new savings incentive framework

Ros Altmann

Currently the UK has relatively high per capita retirement savings; higher than most of Europe. The development of a strong pension savings culture is related to the low and falling level of the UK state pension. Indeed if this continues then we will need an even higher level of private savings for retirement. Yet, a number of factors would suggest that this good savings culture may be at risk. There is the much publicised shift from Defined Benefit (DB) to Defined Contribution (DC) pensions (which is usually accompanied by much lower employer contributions), the failure of UK pensions laws to protect pension rights of non-retired members of final salary schemes, the incentive problems created by complex state provision (IPPR 2002); a series of mis-selling scandals and corporate failures in the financial services industry and the weakness of consumers of long-term saving products, due to lack of access to clear information and advice (Sandler 2002).

At the same time as this trend towards increasing *need* for individual provision, it is becoming harder for this to actually happen. There are many people who do not save much, if at all. If savings levels fall further, this will mean much higher costs of state support and the risk of more pensioner poverty.

Many people, especially the less affluent, currently seem to feel that the risks or difficulties of saving are greater than the risks or difficulties of not saving. This is partly symptomatic of the disincentives that exist in the current system. However, to concentrate exclusively on the *supply* side by simplifying taxation and offering 'simple safe products' as the recent Pensions Green Paper did, fails to recognise the importance of examining the *demand* side (DWP 2002). Something which has received relatively little attention is the UK's structure of incentives to save, and particularly the use of the tax system as the main means of incentivising saving. This lack of attention is surprising because the present system is highly regressive. Those who tend to be saving are in higher income groups and, as tax relief is given at the highest marginal tax rate, they receive a significantly higher incentive to save. If it is important to encourage all members of society, not just the better off, to develop the savings habit then this situation needs to be challenged.

The recent Sandler report recognised the limitations of tax relief and suggested that, while it might affect where people saved, it may not increase overall levels of saving. Although the academic literature is unclear on this question, if it is accepted, one thing that is certain is that Sandler's analysis stopped short of thinking in detail about any solution to this problem. The one thing that Sandler did suggest is that a system of matching grants could be more effective than the current system. This is exactly what this paper examines. What might an alternative and more progressive incentive structure look like?

What are the aims of government savings policy?

The Government wants to spread the benefits of saving and asset ownership to all members of society. 'Financial assets should be the preserve of the many, not the few' (HM Treasury 2001). The Treasury also argues it is important that individuals are encouraged to develop a regular saving habit.

As far as retirement support is concerned, the government has declared that it aims to shift the balance between state and private pension provision. Currently, state pensions account for 60 per cent of retirement income, with private provision accounting for 40 per cent, but the aim is to move to a position where this balance is reversed, with 60 per cent of retirement income from private means. This would entail a significant increase in private pension provision. Measures have been taken to try and encourage this trend. The most significant has been the implementation of Stakeholder pensions, which were designed to be attractive to middle and lower income earners. However, sales levels have been relatively low and it is unclear whether Stakeholders have created any new savers in their moderate-income target group (ABI 2001). If the Government is to meet its stated aim, further measures will undoubtedly be required.

Why does the Government want to encourage saving?

There are many benefits of saving, both from the individual saver's point of view, and from the point of view of society as a whole. Some of these benefits are practical and some behavioural. The latter are only likely to come from the actual act of saving. Just receiving cash benefits will not have the same effect.

Table 4.1 Benefits of Saving for Individuals and Society

	Behavioural benefits	*Practical benefits*
Benefits to the individual	Increased self-reliance and feeling of independence Improved attitude to personal development. Increased ability to forward plan. Affordability of luxuries.	Precautionary savings to provide cover in times of adversity such as emergencies, unemployment or retirement. Increased comfort in old age. Improved lifetime chances such as higher earnings or less unemployment. Ability to pass on bequests.
Benefits to society	Higher stock of national assets. The population being more focussed on the future should increase economic efficiency. Having a stake in the country's economic performance could make people more motivated.	Reduced cost of welfare support Improved capital stock of the economy. Improved long-run economic growth. Ensure sufficient domestic support for capital markets.

How does the Government currently encourage savings?

Since 1997 a number of policy measures have been introduced to increase saving. These include:

- raising capital limits for pensioners.
- introducing CAT standards (controls on Charges, Access and Terms of financial products).
- steps to fight financial exclusion, for example by promoting basic bank accounts.
- making financial education part of the national curriculum.
- launching Stakeholder pensions.
- the announcement of the Pension Credit.

There are also two other proposed measures that have not yet been implemented, namely the Child Trust Fund and Saving Gateway (HM Treasury 2001). These new measures could be particularly helpful to achieve two important aims. Firstly, the Child Trust Fund could help establish a lifetime savings culture, something we return to below. It would be socially equitable, giving the same amounts to all, regardless of income. The Saving Gateway (designed to match at a rate of one-to-one any savings made by the lowest income groups) could be particularly useful in allowing the poorest sections of society to experience the benefits of saving.

The major financial incentive that government currently provide to encourage people to save is tax relief. There are generous tax breaks on many forms of savings and most people could, if they realised, do all their savings tax-free. This represents a considerable cost to the Exchequer. As will be demonstrated below, this benefits higher income groups most and is of little or no benefit to non-taxpayers.

Tax relief is used for pensions as well as shorter-term savings products such as Individual Savings Accounts (ISAs), which have been designed to appeal particularly to young people and those on low incomes. Although there are these other tax-free or tax favoured products, the most generous treatment is of pension saving. In order to encourage people to lock their money away until retirement and to try to ensure that the state will not support them, the rules for pensions have been made more generous. For example, they provide a tax-free lump sum and the contribution limits are far higher than for ISAs.

The inequity of tax relief

Tax relief might work for higher earners (the top 10 per cent of taxpayers who earn over about £34,500) but it is not so much of an incentive, if any, for lower income groups. It is regressive and lacks transparency. Most people (and especially the 90 per cent of taxpayers on basic rate tax) do not understand tax relief and do not know exactly how much money the Government is putting into their pension fund from it. Surveys have found that some people believe that receiving tax relief is something 'negative' rather than 'positive' (Sandler 2002). Tax relief is also inflexible, since the amount of incentive the Government is able to give is determined by what tax rates happen to be, rather than by how much incentive is actually required to encourage people to save. It is certainly true that tax relief is much more beneficial to higher income groups and it could well result in increased inequality of income among the retired.

This can be illustrated with some examples. Tax relief on pension contributions means that higher income groups receive much more money from Government than basic rate taxpayers, even when they put the same net amount into their pension fund. Table 4.2 shows that higher rate tax relief, versus standard rate tax relief can exacerbate wealth inequalities. The effect of compounding over time on the extra amounts put into the pension from government tax relief means that for the same effective cost to the individual, (of £12 per month for 30 years in the case below), the higher rate taxpayers will end up with much higher pension pots than those on lower rate. They will have accumulated over £16,000, compared with just over £12,000 for basic rate taxpayers.

Table 4.2 The current system of tax relief exacerbates wealth inequality

	*22% taxpayer**	*40% taxpayer*
Gross or pre-tax contribution by individual	£15	£20
Net or post tax contribution from individual	£12 net per month for 30 years	£12 net per month for 30 years
State funded tax relief paid in per month	Government puts in £3 per month on top	Government effectively puts in £8 per month on top (£4 into pension and £4 off the tax bill)
Total state contribution over 30 years	£1,080	£2,880
Pension pot after 30 years	*£12,280*	*£16,373*

* Assuming 20% for simplicity

Note These figures assume 5 per cent real investment growth in all cases. The higher rate taxpayer receives the basic rate tax relief straight into the pension as with those paying in at the basic rate, but can then claim more money back at the end of the financial year, which it is assumed they simply put straight into their pension.

The current system has other inequitable effects. The ability to take 25 per cent of a pension pot tax-free is costly for the state and benefits lower income groups far less than others. For someone paying 40 per cent tax both when contributing to a pension and in retirement, the value of the effective subsidy provided by the tax free lump sum is twice as large as the subsidy for someone paying lower rate tax when contributing and in retirement. As shown in Table 4.3, with a £10,000 pension pot, the effective subsidy for a lower rate taxpayer is only £500, compared with £1,000 for the higher rate payer. However, the biggest benefits go to people who paid higher rate tax when contributing and lower rate tax in retirement. They receive five times the amount that the lower income group gets. This is arbitrary and inequitable. Although the tax free lump sum should not necessarily be abolished, its benefits should not be skewed in favour of a particular group.

Table 4.3 Inequitable effects of tax relief: the tax-free lump sum

*Marginal tax rate**	*Value of tax saved by having tax free lump sum of 25%*
20% while working and 20% in retirement	£500
40% while working and 40% in retirement	£1,000
40% while working and 20% in retirement	£2,500

* Assume basic rate 20 per cent rather than 22%

It seems clear that tax relief benefits higher earners most and those who stay in regular employment throughout their lives. As well as being regressive it is also extremely expensive. The cost to the Exchequer has fluctuated around 1.5 per cent of GDP since the mid-1980s and in 1999/2000 it cost around £12 billion (Sinfield 2000) and current estimates are around £14 billion (Inland Revenue 2002).[1] This is the net cost, after deducting the tax received from pensions in payment. The amount is so high partly because many high earners put large amounts into their pension fund, in order to get the benefit of 40 per cent 'grossing up' from the Government. Effectively this means that, for every £3 a higher rate taxpayer puts into his/her pension, the Government will add an extra £2 on top (that is, an extra two thirds). In theory, the tax should then be recouped from pensions when they are finally paid in retirement. However, there are many reasons why the full amount of tax relief is not paid back. Firstly, the 25 per cent of the pension fund accumulated that is paid out as a tax-free lump sum escapes tax altogether. Secondly, many people who are in the 40 per cent tax band when at work are not in this band when retired. They will, therefore, not pay back the full tax relief on their pension. Thirdly, tax relief is given at the highest marginal rate on the full amount of all contributions made, whereas the tax on a pension in payment will only attract 40 per cent tax on the top slice and the basic rate band is used up first.

In 1999/2000, the Government was spending £2.5 billion more on tax relief for pensions than on means tested benefits for the elderly and the sum spent on tax relief was about one third of the total spent on National Insurance pensions in payment. Yet estimates suggest that over half the money spent on tax relief for private pensions in the UK goes to the top income decile of tax payers and a quarter of it to the top 2.5 per cent of taxpayers (Le Grand and Agulnik 1998). This implies that looking across the population as a whole, including non-taxpayers, the regressivity is even worse.

Moving beyond tax-relief

Government needs to consider moving away from the whole concept of tax relief as the main means of financially incentivising saving. It is regressive, socially unjust and is not encouraging the majority of the population to save. Tax relief also lacks transparency in two ways. Firstly, from the individuals' perspective because people do not usually see the actual amount of money that the Government is putting into the pension and do not understand how it works. Secondly, for policy makers and people wanting to scrutinise government expenditure, transparency is reduced because it is not part of the annual public expenditure round in the way that direct expenditure is.

Tax relief is also inflexible. As we have already noted the amount of incentive that can be given is determined by what tax rates happen to be at the time, rather than by what particular level of incentive may be required to encourage people to actually save. The lower tax rates go, the less incentive can be given. This may not be optimal from the point of view of savings policy. It is costing the Exchequer huge amounts of money, which should be redistributed to provide better incentives to those who need them most: those on middle and low incomes. It would be much more equitable and efficient to give everyone the same level of incentive to save and to move beyond tax relief. This is not just a matter of removing higher rate relief, but one of more comprehensive reform.

The precedent for moving away from tax relief in this way has already been set by stakeholder pensions, which add 22 per cent to individual contributions even for non-taxpayers. We have also recently seen proposals from the Conservative Party for a Lifetime Savings Account, which would see a proportion of savings matched by the Government (perhaps £1 for every £4). At the time of writing the details remain unclear but the principles are important. Although the match given to people will not be as significant as we suggest in this chapter, it does suggest that this is a serious policy proposal (Conservative Party 2002).

The key principle for a reformed system of saving is that everyone, regardless of their income should receive the same matching or saving incentive for the same level of saving. The rates for this new system need to be determined independently of the tax system. To achieve these two aims the contribution limits should be set in monetary amounts. Overall, higher income groups will still receive more payments into their pensions from the state, because they are likely to be able to afford to save more than lower income groups. However, real incentives will be available for all people. If, for example someone on low income receives an inheritance, they will be much more likely to consider putting some or all of it into a pension because they know that they will receive substantial extra payment from Government to do so. In the current system their incentives would merely be at their marginal tax rate, which might not be enough.

The aim of pensions savings incentives should be that as many people as possible are encouraged to provide themselves with sufficient financial means to support themselves for the rest of their lives. This could perhaps be thought of as a 'minimum lifetime annuity', with policy using limits on the amount of pension savings which is incentivised, designed to achieve this 'minimum' level of income. These amounts could be actuarially calculated, using investment and interest rate assumptions projected forward over a number of years.

In order to control costs, there would need to be a limit on the amount of savings which will receive matching incentives. The level at which these limits are set will be important. Depending on whether Government was willing to commit extra resources to incentivising savings, the limits could be higher or lower. The principle which should be followed is that there should be a 'leveling up' of incentives to save, not an overall reduction. The precise limits would be calculated to try to ensure that the current amount of £14 billion (or possibly more) is used instead for a new system of standard matched payments added by Government to all pension contributions.

One possible structure for new matching incentives is outlined in Table 4.4. For every pound that a person contributes to their pension, Government could put in a certain amount extra, as an inducement to get people to deposit money in the first place. For the first part of the pension contribution (say £240 per year or £20 per month) the matching could be pound for pound, acting as a powerful initial incentive. The matching rate would need to be reduced for higher amounts of contributions, in order to contain the costs and to ensure progressivity. It is suggested in this chapter that Government could put in £1 for every £2 the person contributes for the next £10,000 per year, then £1 for every £4 of the next £10,000 (with limits carried forward to allow backdating of contributions). Table 4.4 shows a suggested representation of what these 'Government savings incentives' or matching payments could look like for pensions.

Table 4.4 Reformed government incentives for pensions saving

Level of contribution per annum	*Matching rate*
First £240	£1 for £1 matching
Next £10,000	£1 from Government for every £2 contributed
Next £10,000	£1 from Government for every £4 contributed
Above £22,240	No Government incentive

Encouraging savings throughout the lifecycle

The second key change that the government needs to make to current saving incentives is to think more coherently about saving across the life cycle. There are two main reasons for this. Firstly, it can help in simplifying the savings environment and secondly, it will help to ensure that people develop a savings habit early in their lives. Starting to save early will allow individuals to build up a stock of assets to use for emergencies, for funding unexpected needs such as mid-career retraining, as well as for retirement.

The current savings and pension regime has become extremely complex. People generally do not understand it; they do not receive adequate information, education or advice to be able to make the best decisions for their future. They often do not really understand how to plan their finances for the future, what options they have and what the benefits of saving and investing really are. Financial education is not well provided in this country, either in schools or in the workplace. If the Government really wants to encourage people to start saving, it needs to find ways of raising the level of understanding and education in financial matters. If children were to learn the benefits of saving, even as early as primary school, they would be more likely to develop the 'savings habit' and understand how important savings can be in influencing their future lifetime opportunities.

Policy should also encourage people to start saving from a much earlier age. The earlier people start to put money aside, the longer the period over which the funds can grow and the larger the amount of capital they should ultimately end up with. However, at the moment, pension policy discriminates against the young because of age related limits on contributions. This is despite the fact that those in their twenties, who perhaps are not yet supporting partners or families, would benefit from being able to put as much into their pension as those who are older. Savings could be encouraged in a variety of forms over the life cycle, with some being put into pensions, some into medium-term savings and some into shorter-term vehicles.

The Child Trust Fund: kick-starting a savings habit

In order to get more people saving, for more years, we need to change social attitudes and establish a lifetime savings culture. To facilitate this, it would be helpful to provide a more coherent structure of financial products which could be used to continue saving from childhood, right through to retirement.

The younger people start saving the better: thus the Child Trust Fund could be a powerful policy. It will be paid to every baby in the country and could therefore be used to start the savings habit for everyone. It is currently proposed that at 18, the individual will be free to withdraw all the funds and close the account. This would be a dreadful waste. It is vital that people are incentivised to keep their savings account open. This will make it much easier for people to decide to save, as they start working. Even if people have money to save, they often cannot be bothered to go and open an account, so they just spend it. Inertia is a powerful factor in financial services. However, if every young adult already has an account they are familiar with, which they have followed for many years, they will know what to do. For example, part of their first pay cheques could be paid into the savings account already in existence. If the account is closed at 18, then the potential for the Child Trust Fund to kick start a lifetime savings habits could be lost.

A new fixed-term ISA: encouraging medium-term savings

There is one new product which needs to be introduced into the Government-incentivised savings arena; a fixed term ISA that could hold equities and bonds. The funds in ISAs are currently totally accessible. A new ISA type product which limits access to the funds would aim to encourage people to keep their money invested for a longer time and help them become accustomed to managing longer term savings. Hopefully they can watch the investment grow over time. Many people will realise that they can manage without this money, and therefore will be encouraged to continue saving. They could either retain some precautionary medium-term savings or potentially start to accumulate retirement savings.

A fixed term ISA could have a standard 25 per cent financial incentive (£1 added for every £4 invested), which could be the same for everyone, regardless of their income and tax rate. Government would limit the amount that could be put into this each year, as is the case with the current £7,000 ISA limit. It would also be helpful to offer extra government incentives every time the funds are left untouched for a given length of time, say five years, to encourage maintaining an investment.

Retirement savings: highest financial incentive

Policy should aim to encourage people to move from the medium term ISA product into pension products. These would remain locked until later life, and should continue to benefit from highest levels of government financial incentive. In the previous section a revised incentive structure for pensions has been outlined in some detail. If all these products and changes were introduced then a more coherent savings environment that encourages asset-accumulation over the lifecycle, would be created. The diagram below shows what this would look like.

Summary of proposed savings vehicles and government incentives
Child Trust Fund Incentive provided at the age of 18 to keep the account open.
Cash/short term investment **Fully withdrawable ISA** Monetary Limit: Up to £2000 per annum Tax free on accumulation and withdrawal (No financial payment added to contributions from Government)
Medium term investments **Fixed term ISA (fixed for 5 years)** Monetary Limit: Up to £5000 per annum £1 for every £4 invested plus a further 5p in the £ every 5 years that it remains invested. Allowed to borrow against the funds for short term emergencies, without losing the matching payment, if repaid within 12 months All growth tax free, but taxed on withdrawal
Retirement/All stakeholder and DC pensions First £240 per annum: Pound for pound matching from Government Next £10,000 per annum: £1 for every £2 Next £10,000: £1 for every £4 Above £22,240 per annum: No financial incentive added by Government All growth tax free, but taxed on withdrawal (at a special 'pensions' rate to be set by Revenue).

The effect of new incentives

What impact will there be on individual savers from different income groups? These proposals will impact to some degree on saving of the highest income groups. It may be that, shorn of their previous incentives they will save in a different form, and not put so much of their money into pensions. There is a risk they will save less, though the extent of the effect is impossible to predict accurately. However, for the main target group of people on middle and moderate incomes, this new system is highly likely to encourage more savings than before. Again the exact nature of the effect would be difficult to predict and further work would be required.

We must also consider the impact on government expenditure. If the amount spent on matching contributions just redistributes the current expenditure on tax relief, there need be no additional cost to the Exchequer. However, it will be difficult to ensure what the exact expenditure will be, because the actual cost will depend on what happens to contributions. The impact on savings by different income groups is impossible to accurately predict, since this system of incentives has never been in place before. The system would be flexible enough to be changed quickly though. If for example, people started to put too much money into pensions and the cost rises higher than desired, the limits on contributions could be changed.

Conclusion

The Government wants and needs to encourage more people, especially in middle and lower income groups, to save. However, the current policy structure has a number of drawbacks, which make this difficult. There are serious disincentives for people on moderate and low incomes to save. At the same time the incentives that do exist are poorly focused and insufficient for the very people who most need to save more.

The Exchequer spends enormous amounts on trying to encourage saving. For pensions alone, the cost of tax relief is over one per cent of GDP, around £14 billion each year, even after the tax paid on pensions in retirement is accounted for. This is highly regressive expenditure with approximately half of this money going to the top 10 per cent of taxpayers. In no other area would we accept such a degree of inequity.

Using the tax system as the means of encouraging saving is regressive, inefficient, inflexible and illogical. It benefits those on highest incomes the most, even though these people probably need incentivising the least. The level of incentive is set by what tax rates happen to be, rather than with regard to how much incentive is actually needed to encourage people to save. It lacks transparency, both to those contributing to pensions and to those trying to evaluate or change the effects of government expenditure.

The Government also needs to think more coherently about incentivising saving across the lifecycle. Currently, people often do not start thinking about providing for their pension until they are in their 40s or 50s. This gives much less time for the benefits of saving to accrue. Ideally, saving should be encouraged from much younger ages, to fund emergencies, lifetime opportunities and retirement support. The earlier the 'savings habit' is encouraged, the greater the likely stock of assets that will be built up.

To help achieve these aims this chapter's recommendations include:

- To make incentives to save more coherent and progressive we need to move beyond tax relief.
- Everyone should receive the same financial incentive for the same amount saved. If the Government wanted any reform to be revenue neutral then it could redistribute the £14 Billion currently spent on tax relief for pensions to finance a more equitable and effective system.
- This could be achieved by the government matching pension saving. Initial savings could be matched pound-for-pound, though as people save more the incentive would be reduced, first to £1 for every £2, then £1 for every £4.
- To help encourage more saving across the lifecycle, savings products should be better joined up. To facilitate this, a new medium-term savings vehicle – a fixed term ISA – should be introduced.

Endnote

1 It should be noted that there is some disagreement as to the exact costs of tax relief. Here we use the official figures, though others have suggested the true costs could be lower. See NAPF (2002) for a fuller discussion.

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5. Saving among people on low to moderate incomes: the barriers and how they might be overcome

Elaine Kempson and Will Paxton

Surveys show that a third of people with low-to-middle incomes have no formal savings and many of the rest have very little put by (IPPR 2002; Whyley and Kempson 2000). But both surveys and official statistics fail to capture the complexity of saving behaviour, especially the complexity among people on lower incomes.

Most aspire to save, even though they may not always be in a position to do so. Like people who are better-off, many want to save for their children, for holidays and to have some money put by for emergencies. When money is short they tend to save informally and not in bank or building society accounts. This saving is not reflected in official surveys or statistics. People also differ in their approaches to saving. Some try always to have money put by, while others have cycles of saving and spending. In other words there is a dynamic to saving that cannot be measured in cross-sectional surveys.

This chapter will examine the nature of saving by people on low incomes, discussing informal savings and the dynamics of saving by many low-income people. It will then go on to focus of the barriers that must be overcome if more people are to be enabled to put money aside. The chapter concludes by arguing that the government is making progress in this area but more will need to be done; more coherent overall thinking and policy making is required.

Informal saving

Informal saving is widespread both in the population as a whole but particularly in low-to-middle income households (Kempson 1998). Such savings can take a number of forms, including:

- *Saving loose change*

  Putting spare cash into jars or other containers is extremely popular in low-income households. Some people save all coins of a particular denomination; some put all the loose change they have into the jar at the end of each day; others save all the money left in their purse or pocket at the end of the week. Usually such saving is for a specific item of expenditure such as a holiday or decorating the home. This is by far the most common form of informal saving and is by no means restricted to those on low incomes.

- *Letting social security payments build up*

  By allowing the money from a particular social security payment, usually Child Benefit, to build up in an account people are effectively saving a proportion of their income. One of the main advantages of this is that the money never goes through people's hands and the temptation to spend is reduced. Money saved in this way is often spent on children's needs.

- *Savings stamps*

  Savings stamps are used mainly to pay bills although they are also used to save money towards the cost of Christmas. Again people save in this way to avoid the temptation to spend it. Typically they buy savings stamps as matter of course immediately after drawing their social security benefits or receiving their wages.

- *Overpaying fuel pre-payment meters*

  Fuel bills can represent a large proportion of the household budget for someone living on a low income. Consequently, to spread the financial burden some people top up pre-payment meters for fuel during the summer, storing up credit for the more expensive winter months.

- *Children's moneyboxes*

  Even if parents cannot save themselves they may encourage their children to save some of their pocket money. They may also top up the money from time to time with loose change from their pocket or purse. Parents often use this method because know they will find it morally difficult to raid their kids' savings pot.

- *Family as bankers*

  People give money to friends or family to look after, effectively using them as informal bankers. Again the intention is to put the money out of reach. Although the money is accessible if really needed, people know that they must justify spending it to their friend or family member.

The levels of saving vary considerably according to the method used. Some methods, such as using children's savings and jam jars, will involve only small amounts. By contrast, using savings stamps and letting additional income from benefits mount up can involve considerable amounts. Indeed funds accumulated using these methods can often exceed those paid into formal savings vehicles. For people on extremely low incomes savings of £15 to £20 a week are not uncommon (Kempson 1998).

A number of important points need to be made concerning informal saving. Firstly, the people who save in this way are more likely to be motivated by the need to save up for specific purposes and far less likely to be putting money aside for a 'rainy day'.

Secondly, reasons for people saving informally can be divided into *push* and *pull* factors. One factor pushing some people away from formal savings is their attitude to banks and building societies. Many believe them to be inappropriate places to save. Often they can only afford to save small amounts and feel uncomfortable doing this in a bank. They feel they will be looked down on. Another push factor is the costs of actually getting to and from banks to deposit money; the transaction costs. Many people on low incomes live in neighbourhoods that are some distance from the nearest branch of a bank or building society. The bus fare to that branch if often a significant proportion of the money they have to save. There are also factors that *pull* people towards informal saving. It can be flexible and more under the saver's own control. It is simply less hassle than opening a savings account in a high street bank, credit union or building society (Whyley, Collard and Kempson 2000). Informal saving is usually part of a routine so that 'if you don't see it, you won't miss it'.

Thirdly, informal saving has some positive advantages for some people on low-to-moderate incomes. However, this does not mean that we should be starry-eyed about informal saving. It has clear disadvantages. Firstly, and most obviously, informal savings attract no interest (although the amounts being foregone might be negligible given the sums we are talking about). Secondly, and perhaps a bigger disadvantage, is the risk people face if they hold all their savings in cash in their home. Many have been robbed of all the money they have saved (Kempson 1998; Whyley, Collard and Kempson 2000).

Finally, people saving informally are often suffering from a wider financial exclusion caused by inappropriate products, by limited access to financial services or by a feeling that financial services are not for people on low incomes. Consequently these wider barriers will need to be overcome, if formal saving is to be increased. This will require a multi-faceted response including continued attempts to ensure that appropriate products are offered, that barriers to access are overcome and that the feelings of disengagement from financial services felt by many on low-incomes are addressed.

Different patterns of saving behaviour

Motivations for saving differ markedly and these have important implications both for the amounts of money people have saved, their pattern of saving and, indeed, whether they even have any money put by at all. Research has shown that people tend to fall into one of five categories and few people have never had any savings at all (Whyley and Kempson 2000).

- *Rainy day savers*

  These are people who save for some unspecified time in the future and with no particular purpose in mind. They are very likely to add to their savings regularly; they seldom withdraw the money they have saved and, as a consequence generally have the largest sums of money put by. This pattern of saving usually starts early in childhood.

- *Long-term savers*

  Others save for specific long-term purposes, such as buying a home, going into higher education or for their retirement. Long-term savers tend to be active and regular contributors to their savings. They too can have substantial sums of money saved.

- *Instrumental savers*

  Large numbers of people only save up for specific pre-defined short-term purposes, such as a holiday or to buy something they cannot afford from their regular income. This is by far the most common form of saving, especially among people on low-to-middle incomes. However, because they tend to save up and then spend all their savings there will be times when instrumental savers have nothing put by at all.

- *Passive savers*

  Some people have money in savings all of which they obtained from a windfall of some kind. They do not themselves add to the fund, indeed they are very likely to be running it down.

- *Incidental savers*

  Finally, there are people who do not consciously save but simply have money left over at the end of the month that slowly accumulates in a current account. This pattern of saving, needless to say, is rare among people on low-to-middle incomes.

The dynamics of saving

It will be clear from the above that saving is a dynamic process, with most people saving at some time in their life even if they have a low income. Moreover, their pattern of saving may also change over their lifetime. Rainy day saving is the most enduring pattern but even these people may have periods where they are having to draw on the money they have put by. Instrumental saving is the most volatile, with cycles of saving and spending. This, coupled with the extent of informal saving, goes a long way toward explaining why snap shot survey data show that a significant number of people are without any savings.

Both the level and the pattern of saving are affected by a range of factors, including:

- The stage people are at in the life cycle
- Life events and changes in income
- The extent of borrowing

The stage people are at in the lifecycle can have an affect on both the opportunity and the motivation for saving. For young people setting up home can act as an impetus for saving. Having children often encourages parents to put money away for the future, but for those on a low income children can make it far harder to find money to save. Approaching retirement also acts as a stimulus to people on low-to-middle incomes saving, having had little opportunity to save when their children were young (Kempson 1998; Whyley and Kempson 2000).

Life-events and associated changes in income also play a big part in levels and patterns of saving. Relationship breakdown, job loss and long-term sickness all restrict peoples' ability to save and act as a trigger for those with savings to start to withdraw them. They also encourage switching from formal to informal saving. On the other hand, setting up home with a new partner or returning to work have the opposite effect. But life events can have an effect even without an income change. Meeting a new partner who saves regularly can encourage some people to save for the first time. Experiencing redundancy can encourage people to start putting money for any further 'rainy days' in the future. While the death of someone close at an early stage can make some people feel that saving is futile.

Finally, the extent of some forms of credit use can seriously affect the ability to save. People who are committed to saving, (whether they be rainy day savers, long-term savers or even instrumental savers in a saving phase), may use a credit card or overdraft facility as a form of short-term credit to allow them to protect their savings. On the whole, having regular payments to make on credit commitments reduces people's ability to save. This has a particular impact in young families on low-to-middle incomes. Breaking this cycle of borrowing is one of the challenges to encouraging higher levels of saving.

Encouraging more saving: the key issues

There can be little doubt that people on low-to-middle income do want to save even if their circumstances sometimes make it difficult. The Government has also stated that it wants people on low-to-middle incomes to save more (HM Treasury 2001). But there are three broad challenges to these aspirations. These are:

How to encourage more people to start saving?

Most people save at some stage in their life so the key issue is really how to encourage saving from an earlier age. Research has shown that 'rainy day' saving starts in childhood and endures throughout the life cycle. Education clearly has an important role to play as do savings schemes in schools.

How to formalise informal saving?

Encouraging a shift from informal to formal saving will mean tackling the psychological barriers to using banks and building societies that are felt by many on low incomes. It will also mean finding less regressive ways of rewarding saving than tax relief. Many people on low-to-middle incomes do not benefit from current reward structures as they pay little or no tax.

How to encourage long-term saving?

Finally ways need to be found to encourage the large numbers of short-term instrumental savers to start putting money by for the longer-term or a rainy day. Two main barriers stand in the way of achieving this goal. Firstly, people on low income have short-term time horizons. They often budget from week to week and are unable to plan ahead for the medium and long-term. Secondly, the reliance on credit, and often expensive credit, can decrease the ability of people to even consider long-term saving.

The Government's current strategy: The Saving Gateway

Overcoming the barriers is a considerable long-term challenge. If this challenge were successfully met then this would go a long way toward ending broader financial exclusion as well as enabling more people to save. The Government has announced two important initiatives whose intention is to allow more people to accumulate assets and save. These are the Child Trust Fund and Saving Gateway (HM Treasury 2000 and HM Treasury 2001). Of the two, the former is more preventative and long-term. The Saving Gateway[1] is more directly intended to benefit people on low-to-moderate incomes.

The Saving Gateway being piloted is aimed at people who are eligible for out of work benefits or for the low-waged who are in receipt of tax credits. People's savings are matched pound for pound by the government. There seems little doubt that this provides a real incentive. (Indeed some of the debates about the Saving Gateway centre on it offering too much of an incentive. The dangers are that it could encourage people to save rather than spend money on immediate needs or that it leads to borrowing money to save into the account.)

Although it is essentially a savings product, with funds being held by a financial services company, the main interface with customers is provided by local community based organisations. The rationale is that such groups are trusted, they provide a less hostile environment and they can help overcome the psychological and practical barriers to using banks and building societies. They also aim to provide accessible financial education classes. Full details of the Saving Gateway can be found in Box 5.1.

Box 5.1 The Saving Gateway

- All adults of working age and under a certain income (probably decided by eligibility for a tax credit) will be eligible.
- People will be able to open an in individual account and personal savings will be matched at a rate of one-to-one by the government.
- There will be monthly and overall limits to amount which can be deposited.
- The account will last for either three to five years.
- People will only have access to the matched funds when the account matures; they will be able to access their own money whenever they want.
- The programme will be closely tied in with financial education classes.

Source: HM Treasury, 2001

The Saving Gateway will, therefore, help overcome some of the barriers to saving identified above. Most obviously it will provide strong saving incentives for people on lower incomes. (As noted in the previous chapter, current incentives, in the form of tax relief, are ineffective for this group.) This could well encourage more people to start to save, or to switch from informal to formal saving. However, it is not just the incentive that is important. Being delivered by community-based organisations will also help overcome the lack of trust in mainstream financial services. By encouraging more people to open accounts and therefore to have at least some contact with banks, one of the benefits of the Saving Gateway will be that people could be eased into using mainstream financial institutions.

The delivery mechanism for the Saving Gateway draws on the expertise of different sectors through a partnership approach. A bank holds and manages the money, local not-for-profit organisations act as the intermediary recruiting people and helping them to open a savings account and the government provides the framework and financial support. It is hoped that access will be increased through the use this model. It is interesting that while it is (or will be) a national policy, the Saving Gateway will be delivered through a local infrastructure. We have already stressed the importance of local delivery, but retaining national policies is also important. National policies provide portable products, they make people feel part of the mainstream and they can provide the framework within which a range of products and services can be delivered to people from one location.

The Saving Gateway could also encourage more people to think about saving for the longer-term. To attract government matching, people will have to retain their savings for three to five years, far longer than many will have saved for before. When the account matures there could be additional incentives to encourage people to go on saving into either an ISA or a Stakeholder pension.

A broader approach to overcoming barriers to save

Although the Saving Gateway has much to commend it, alone it will not be sufficient to encourage and enable substantially more people on low-to-moderate incomes to save. Any coherent and effective strategy would necessitate addressing a range of issues falling within different policy areas. We need to think across public policy and formulate a more comprehensive set of policies. The list presented below is not exhaustive, but it does indicate areas that could be prioritised.

Starting the savings habit in childhood

Rainy day and longer-term saving is a psychological approach that appears to develop during childhood. Our attitudes towards savings are shaped first-and-foremost through socialisation at home and school.

Financial education is now part of the national curriculum, though it is still optional and competes with other areas of citizenship education for space in a crowded timetable. Teachers can opt out if they wish and there is reason to believe that this is just what many will do. Teachers might feel uncomfortable or unqualified, but perhaps more importantly other demands on teachers time will take precedent.

School-based savings clubs can play an important role in fostering the saving habit at an early age. Many over-fifties well remember the savings stamps that they used to buy in school as part of the National Savings scheme. A new government initiative of this kind could play an important role in boosting savings. The Child Trust Fund could also play an important role in making school based financial education more relevant and grounded in the real world. If you ask fourteen year-old pupils to sit through a financial education class, without thinking very carefully, there is a danger that they will simply switch off. However, if they have a long-term savings policy in the form of the Child Trust Fund in their name then this could become the focus for discussions on saving.

Addressing attitudes towards saving and banks

Attitudes towards the financial services industry need to be changed at a number of levels. Overcoming the distrust of financial service providers is a problem that casts a shadow far wider than the issues addressed in this chapter.

The Saving Gateway provides one model, which uses trusted intermediaries to deliver financial services and products. The challenge for government is to consider how this approach could be rolled out across the country. It is possible to find specific areas where the approach will work but which organisations could allow it to be the basis of a nationwide policy? Credit Unions have been identified as one possible organisation that could fulfil the function more broadly, though they vary in quality and lack geographical coverage. Alternatives might be other local community based organisations and Registered Social Landlords.

Shifting attitudes through use of different forms of delivery has an important role to play. However, some responsibility should also be placed on banks providing simple savings products, suited to the needs of the poor. Such products would make it easy for people to make small and irregular payments and also easy to manage week-to-week expenditure.

Breaking the cycle of borrowing

Successful saving is less likely if someone has pressing demands on their income created by borrowing. Using credit is not a problem per se; it can be run alongside saving sustainably and can be a useful and normal method of financial management. However, inappropriate use of credit can lead to over-indebtedness when 'income is insufficient to cover reasonable living expenses and meet financial commitment as they become due' or when people's commitments boarder on the unmanageable (DTI 2001). There are signs that over-indebtedness is on the rise (Kempson 2002). People on low incomes are more likely to use (or only have access to) expensive sources of credit. At their more acceptable these include door-to-door home credit companies (such as Provident Financial), pawnbrokers such as Cash Converters, cheque cashing centres and mail order companies. At the extreme it means illegal, unlicensed moneylenders. (Rowlingson 1994; Whyley, Collard and Kempson 2000). Problems arise when people are caught in a cycle of borrowing.

The Saving Gateway might, in the medium-term, prevent the need to resort to expensive credit if people accumulate funds that they use as a buffer to fall back on. Financial education (delivered as part of the Saving Gateway) could equip people with a better understanding of credit and reduce future debt problems. However, the policy alone does not ameliorate the situation for people already experiencing problems. Other approaches are required.

There are no easy answers to over-indebtedness. Tackling the problem must involve both preventative and ameliorative measures. Prevention means building up financial literacy so that people can more confidently deal with financial services. There is also a role for regulating the provision of different products to the most vulnerable consumers. In terms of alleviation, already money advice agencies work with individuals with problem debt, examining their options and their budget and negotiating with creditors. An interesting development is debt buy-out schemes, where an organisation, (it could be local government, a not-for profit organisation such as a credit union or the private sector), buys out someone's existing credit commitments and offers them loans at more affordable interest rates. Such schemes do already exist at a local level, but it is not widespread. The government could consider providing financial support and a framework to enable debt buy out to be offered more widely.

Ideally such schemes could also encourage people to save at least some of the money they save each week by re-financing in this way. The amounts might not be huge but this could help move people into a more sustainable situation after they have paid of their debts. If paid into a credit union or other savings and loans scheme, the savings would provide long-term access to cheaper loans. Such an approach could act as a catalyst to further savings and enable people to break the cycle of borrowing.

One scheme is the Ely Debt Redemption Scheme (DRS). This scheme offers immediate help to families facing imminent loss of a major asset such as their accommodation. Having being referred to the scheme by the local CAB, an individual's debt is 'brought out'; leaving the money owed to the DRS itself. At the time of receiving the loan the individual is also required to join the credit union. The money they pay to reduce the debt is then divided between the loan repayments and the accumulation of savings in the Credit Union (Drakeford and Sachdev 2002).

Overcome practical problems

Some of the practical problems encountered by low-income people when they want to save have been touched on already. Most significant is the demand to be able to deposit small sums and the need to develop appropriate products reflecting this. Access is also important, given that many families face high transaction costs when they want to save formally. A local presence being maintained by national policies and programmes, often through different partnerships, is of crucial importance.

Making savings routine

Saving is most successful when it is facilitated and routine. Facilitating saving in this way is something the majority of the population do all the time. Few people actually physically deposit money into accounts. They save most frequently and best when the money is taken direct from wages and transferred to a pension or savings account. This raises questions about how this could be replicated for people on low incomes.

The Saving Gateway, with monthly limits to the amount that can be saved, is designed to encourage regular saving. However little thought has been given to developing mechanisms for making saving automatic or routine. Firstly, monthly time periods might not be appropriate for people on low incomes, for whom a weekly or fortnightly budgeting cycle is more common. More importantly many account holders, particularly those on benefits, will not have an easy option for the automatic facilitation of saving.

Thought needs to be given to facilitating saving in ways appropriate for people on low incomes. One option would be introducing specific Saving Gateway savings stamps. Alternatively, upon making a claim for benefits (including Job Seekers Allowance, Income Support and the various tax credits), people could be offered the option of deducting funds at source and depositing them in a savings account. Already people pay back social fund loans in this way. Likewise employers might be encouraged to deduct savings at source from wages.

Providing the right incentives for long-term saving

The Saving Gateway is an important development in moving incentives beyond tax relief. Matched saving does provide a real incentive to people on low incomes. However, simple financial rewards are not the only ways of incentivsing greater long-term saving. Other motivations could include linking savings with access to low-cost loans. This is the credit union model. In contrast to other forms of saving, credit union members on low incomes and benefits do not tend save up to buy something specific, but instead they want to gain access to loans which will provide them with a safety net in an emergency (Whyley, Collard and Kemspon 2000).

Another powerful motivation for people to save is children. Though having a young family can mean short-term outgoings are higher, making saving harder, children are usually the focus of most parents saving aspirations. The Child Trust Fund fits neatly with this motivation and will, at the very least, ensure that all people have an account into which they can save for their children. There may well be benefits of linking the Child Trust Fund to school based savings clubs.

Moving forward: policy recommendations

If policy makers are to remove the barriers to save faced by many people on low incomes, then first-and-foremost they need to understand what the barriers are. Non-saving is rare, though getting more people to think about saving is important. Equally important is the need to be overcome barriers preventing people from formalising informal saving and making short-term instrumental saving more long-term. Once the nature of the challenge is better understood a number of policy responses suggest themselves.

It is important to stress that no single programme or policy will overcome all the barriers. Instead a range of new approaches and policies are needed. These can have as much to with more general financial exclusion as with the specific need to enable more saving. New *approaches* include the following:

- Establishing ways in which saving in schemes such as the Saving Gateway can be promoted as a routine – for example through savings stamps or automatic deduction at source from wages.
- Developing one-stop-shops, which enable people in deprived communities to access a range of different services and products at one site.
- Increased use of partnerships between local community based organisations and the government and private sector. As with the Saving Gateway, this can ensure that national policies are delivered appropriately in local settings.

New *policies* that could be considered include the following:

- Government funding and support for debt buy-out schemes, especially those which are linked to some form of savings account.
- Promoting savings clubs in schools and linking the Child Trust Fund to financial education, thus developing the saving habit early.

Endnote

1 The Saving Gateway is currently being piloted in five locations around the country. This makes it premature to discuss the impact of the policy in any detail, though there are a number of generic observations which can fruitfully be made.

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