

Treasury Committee

Oral evidence: Household finances: income, saving and debt, HC 565

Tuesday 14 November 2017

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Members present: Nicky Morgan (Chair); Rushanara Ali; Charlie Elphicke; Stephen Hammond; Stewart Hosie; Mr Alister Jack; Alison McGovern; Catherine McKinnell; Kit Malthouse; John Mann; Wes Streeting.

Questions 1–73

Witnesses

[I:](#) Ashwin Kumar, Chief Economist, Joseph Rowntree Foundation; Michael Johnson, Research Fellow, Centre for Policy Studies; Torsten Bell, Director, Resolution Foundation.

Examination of witnesses

Witnesses: Ashwin Kumar, Michael Johnson and Torsten Bell.

Q1 Chair: Good morning. Thank you very much indeed to all three of you for coming in. This is the first session in our inquiry on household finances. We talk a lot about the national balance sheet, and we are particularly keen to understand what is happening in terms of household balance sheets. Thank you very much for being here this morning to share your expertise; we look forward very much to hearing your evidence. Please introduce yourselves, because it is not just us you are broadcasting to; we are also streaming this and people want to know who they are hearing from. Torsten, can we start with you?

Torsten Bell: I am Torsten Bell, director of the Resolution Foundation.

Ashwin Kumar: I am Ashwin Kumar, chief economist of the Joseph Rowntree Foundation.

Michael Johnson: I am Michael Johnson, a research fellow at the Centre for Policy Studies.

Q2 Chair: Thank you all very much indeed. We are going to start with the savings ratio and the savings gap. I thought it might be helpful, by way of background—I am sure you all know this—to say that the household savings ratio is calculated as the difference between total household disposable income net of taxes and total consumption spending across all households. However, the full measure of household disposable income includes income from financial investments and imputed income that has little day-to-day relation to household finances, things like employers' pension contributions and income earned by pension schemes. The ONS has also produced a savings ratio on a cash basis.

Perhaps we could start with your understanding, as those who look at these figures, of what is more accurate in looking at household savings. Is it the ONS savings on a cash basis or is it the way that the household savings ratio has previously been defined—that difference between household disposable income and total consumption spending?

Torsten Bell: If your inquiry is focusing on family balance sheets and families' experiences of their living standards, you should focus on the cash basis from the ONS, not least because most human beings do not know what an imputed rent is and they definitely do not save it, so that sounds like a good idea.

Chair: Excellent. Does anyone else have any views?

Ashwin Kumar: I agree.

Michael Johnson: We have to be very sceptical about the household savings ratio as defined, because it essentially involves the difference between two very large numbers, and as we approach a low number, as



we have been, the volatility that is in that number increases. To take one simple revision, Q1 of this year was initially 1.7% and it has now been revised to 4%. There is huge variability in that number and it is widely misunderstood, because it is not a measure of what is saved; it is a measure of what is available to save—and there is a difference.

On the cash side, I prefer to follow cash, because cash does not lie.

Q3 Chair: The household savings rate that, Michael and Torsten, you have said is probably not the most accurate used to average 11%. For most of the last few decades it has averaged below 9%, and in 2017 it has fallen below 6%, where it is forecast to remain. Do you agree with the analysis from people like Aviva and Deloitte who have said that the UK has a long-term savings gap in the hundreds of billions of pounds?

Michael Johnson: Yes. Clearly there is a huge savings gap and it is particularly pertinent in respect of women. It might be premature to dive into the gender debate, but it is extremely important because it is so wide. If we look at the number of women, for example, who are participating in some form of DC savings arrangement, it is roughly 3.5 million; in respect of men, it is nearly double that. If you look at the size of the respective pots, a typical woman's pot at 60 or 65 is maybe £50,000 to £55,000; for men, it is more than double that.

I am afraid I am a pessimist on the subject of the savings gap, because there are so many independent things going on at the same time that are conspiring to make it worse. If one is going to start looking much more closely at the savings gap and we have successive Governments tinkering with the framework, I do not think it is going to get us out of a potential mess.

Ashwin Kumar: I would echo the point that the distribution is what matters. There is a debate to be had about whether or not there is enough saving going on in the economy, but it is manifestly the case that so many people simply do not have enough pension savings, in particular, to give them any form of credible savings income. I forget the precise figure, but the proportion of people who have below £100,000 of pension wealth is very high, and that will produce, on average, about £5,000 of income in retirement. When you think about what people's needs are going to be, it is simply not sufficient.

There are plenty of people who have ample savings—there is a correlation between high property wealth and high pension wealth—who are doing fine, and when you look at people in retirement, there is probably about one third of pensioners who you could characterise as just doing well. They are doing well in decent property, good pension income, but probably about two-thirds of people are a combination of either owner-occupiers with low pensions or renters still with low pensions, so in that sense, yes, we have a big problem with not enough people saving for retirement.



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Q4 Chair: I know colleagues are going to try to unpick some of that in generational terms. You make a very good point, Michael, about gender, which is probably something that we need to consider and ask some more questions on, and also about the income levels of people who save. Colleagues are going to pick that up in the questions in relation to pensions and property as well. In terms of your pessimism, have you seen anything that would make you more optimistic or have you seen any accurate figures that would at least give ministers an idea of where they should be heading in having a sustainable household savings rate?

Michael Johnson: We need to be much clearer about who it is we want to be saving more, and maybe it is premature to dive into the whole question of the incentives side of the equation. As you probably know, I have strong views that our incentive structure is fundamentally flawed, essentially because we have as a society bought in to the idea that income tax is progressive and tax relief is regressive, which unwinds that societal buy in, and we seriously need to confront that. More specifically, we need to ask ourselves why it is that approximately 70% of the Treasury's total investment in incentivising people to save goes to the top 15% of the income distribution, who are in least need of it.

Behind that observation is a fundamental question that countries around the globe are struggling with, which is: do financial incentives actually work? I am coming round to the idea, having done a fair amount of research on this, that the answer is no. However, you have to be very clear about what your question is. Do you want the nation as a whole to have a larger pool of savings in aggregate, or do you want to increase the rate of saving by those at the lower end of the income distribution? They are two very different objectives.

Q5 Chair: Let's pick that up for a moment. Do any of you have an estimate of the net savings rate among low-income households? Also, apart from the obvious question of why people are not saving, is there anything else that particularly leads people to not save? Is it cultural, as well as a question, perhaps, of just not having sufficient money at the end of the week or the month to put anything aside?

Torsten Bell: There are a number of things there. On the overall picture, because your question was really whether the level of household saving is sustainable, the hard question is this: is the level of debt optimal? That is a very hard question to answer. I will come back in a second to the micro of individual households, but is it sustainable for the household balance sheet of the population as a whole? We can take a view on that, and we probably need to be saving slightly more than we are now, but it would be wrong to say that it is clearly, for the household sector as a whole, totally unsustainable, principally because interest rates are so low. The things that matter for whether it is sustainable are the level of the debt, which is 140% of household income at the moment, the rate you are paying on that debt and your income, obviously. Of those, household debt is down but not down much, at about 40% for 16% of income, but interest rates are at the lowest we have ever seen them in



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history despite the last two weeks, and that is what is driving down most measures of household debt problems, particularly on secured debt.

The question is what is sustainable. If you are just looking at the macro, you are going to come to an answer that it looks quite stable, because it is very cheap to service debt right now. You probably want to ask a different question, which is: what is our margin of error? How much can you cope with that changing and, within that distribution, who are you worried about? You are probably going to end up looking more at unsecured debt than secured debt for that macro picture.

On whether people are constrained to save, manifestly yes. Wages are still £15 down on where they were before the financial crisis. Yes, we have record employment and the lowest unemployment for 40 years, which are big triumphs for policy, but after housing cost, incomes for low and middle-income families are still back to around 2003/2004 levels. That is a long time ago. Regionally, the wages of men in Manchester, for instance, are back to where they were in 2000—17 years ago. Housing costs have gone up quite a lot during that phase, and in those circumstances people are finding it hard to save. You can see from the Bank of England's data how many people say they would like to save just £10 a week and say they cannot afford to do it, and the number is up—and it is a lot.

Q6 Chair: Interest rates have been, as you say, at a historic low and people have become comfortable that that is the new normal. In terms of the households that we are most concerned about—low-income households—does the interest rate affect savings decisions? Is that a factor in people deciding to save?

Torsten Bell: The stock of debt held by a low-income household will be affected over time by changes in the interest rate. Changes in the interest rate do not feed through quickly into interest payments by those families, because only about 20% of unsecured lending is on a variable rate; 80% of it is fixed. It is more likely to affect the taking out or not of the debt than it is what they are paying for existing debt. Also, if you are looking at large chunks of unsecured credit, for example credit cards, we are talking about spreads over the base rate of 16%, 17%, so small changes in the base rate do not have the same effect they do on mortgages, where the spread is 2% or 3%. It has an effect, but not the same effect.

Q7 Chair: Is there anything that is particularly working well in terms of incentives to support savings? The Government have launched things like Help to Save, although there has been criticism that that failed to mention pensions. Michael, you mentioned incentives not working. Is there anything that is having a positive effect on people deciding to save?

Torsten Bell: If you are really rich, we are doing a really good job of incentivising you to put money into various silly forms of venture capital for huge tax incentives. If you are really rich, we are doing a really good



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job of tax-relieving all of your savings in very large ISAs and rollover PEPs. If you tried really hard, you could have got to £1 million in the tax-relieved savings pot. It is not clear to me that is a good use of Government funds. If you are really rich, you are getting large tax relief on your pension income, so we are doing a good job of providing those people with some cash.

We are doing a moderately awful job of encouraging those in lower income families to save. That is because the first suggestion of direct matching for those groups, which evidence does show has some effect, was in 2001. Direct matching has more effect than other forms of incentives, although it is still not as strong as some of us would like and you may be better just to give them the money. That policy was meant to roll out in July 2010—the Saving Gateway. It was scrapped in June 2010. George Osborne came back round to it in one of his last Budgets and that is a good thing, but it is now meant to start in 2018, which is 17 years after it was first proposed. It will be less generous than the original scheme and it will be a tiny fraction of the cost of what we are spending on incentivising higher income families to save, who do not need it much.

Ashwin Kumar: We have to be clear about what purpose we are talking about when we are talking about saving. There is retirement saving and then there is what you might call cash saving or enabling people to manage the pressures of day-to-day life and particularly unexpected costs. When it comes to pension saving, auto-enrolment has widened the number of people who are saving into a pension, but there is a real question about whether, even when you get to the full 8%, that will provide enough in retirement income.

When it comes to cash saving, as it were, when you look at the net financial position of the households with the worst quarter of net financial position, there is an age profile, and they do not reach zero until they get to the age of 55. Basically, people have a negative net financial position in the bottom quarter until they get to 55, and that has got a little later in recent years—it was 50 in 2006 to 2008 and 55 in the most recent year. The point is that when it comes to savings less debt, for a significant portion of the population while in working age there just simply is no cash saved at all.

Michael Johnson: I would reiterate the importance of auto-enrolment. At this stage, Dr Dolittle rears its head, because there is such a fundamental tension within Government between the Treasury, which wants us to go and consume so you can collect lashings of VAT, and the DWP, which wants us to go and save. Whilst automatic enrolment is the platform that has been put down—it is probably the most important initiative that the Government have taken in the last decade or two—the challenge now is, whilst we are aiming for 8%, let's be very clear: that is 8% of band earnings; it is not 8% of gross earnings, and there is a big difference, particularly at the lower end. There is a lot to learn from



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countries around the globe, notably the likes of Australia, which started this process in 1991. They are aspiring to 12% of earnings, and that is just the employer contribution.

Q8 Kit Malthouse: I wanted to ask a question about whether the changes in demographics and behaviours have an impact. I understand some of the ingredients that form this cocktail that have shifted this date back to where people hit zero. What impact has the fact that people are having children later in life had? A lot of people will tell you that when you have children that is the point at which you are least likely to save, because it is the most expensive period, the 16 years or so when you have these extra people in the house that you are looking after. If that is shifting back, so people are starting to have children not in their 20s but in their 30s, that shifts that expensive period finishing into their 50s, which means that they may not have the capacity to save because of that. Have any of you looked at whether that is a driver of savings habits?

Torsten Bell: Government policy to force earlier childbirth is obviously one option available to you to recommend. There is something going on with that, but obviously you have to be a bit careful. Yes, on average, people are having children later, but that is hugely different across the income distribution and you have to be a bit careful. It is middle-class and upper-middle-class people having kids in their late 30s, on average, but not everyone.

On what is driving the worst savings outcomes and bigger debt problems, who has increasing debt problems at the moment? The young and renters. They are the groups where we are seeing problems. What is the dominant problem for the young? That their wages are no higher today, for today's young, than people born 15 years before them. We thought each birth cohort got a higher income at age 25, 30, 35 than they did before, but now we are 15 years behind for today's young people. That is due to a large number of factors, but they are in worse jobs and the whole cohort is seeing lower earnings profiles. They are moving jobs less and getting lower pay rises as a result. That is a big problem, and that is the core of their financial problem.

If you are worried about that and you want to look at their incomes, then we are about to cut benefits from working-age families. You are right about having kids being the most expensive phase of life. How does the state deal with that? By having a benefits system focused on people with kids. Tax credits and Universal Credit both do that; that is the purpose of the system. It means the age profile of benefits is very much people in their 30s, because that is when they need the cash the most, and we are about to engage in the largest cut in that definitely in any of our political lifetimes. We are talking, on average, £800 a year being taken away from families in their 30s. That is a lot of money. If you want to look at the things that are driving some of these problems, there is somewhere to start looking. That is more important than the age when a kid turns up.



Q9 John Mann: On pensions, what is the single big-ticket change you would recommend that Parliament or Government should push through?

Michael Johnson: I would scrap all pensions tax relief, including employer NICs rebates. That creates a cash flow of about £46 billion a year. I would introduce a bonus structure that is an incentive disconnected from your tax-paying status. That is very much some of the thinking that lay behind the introduction of the Lifetime ISA. The Lifetime ISA is important because it breaks that disconnect in terms of incentive and tax-paying status.

I would also bring down the annual allowance from today's £40,000, which is irrelevant to virtually everybody in the country, to a number between £8,000 and £10,000. I would abandon the lifetime allowance as a quid pro quo, because it is essentially manna from heaven for consultants and does not do a great deal for everybody else. I would double the rate of incentive to save—the "bonus" in the new language—to 50% on the first £1,000 or £2,000 a year that is saved. I am really talking about an enormous redistribution of the Treasury's expenditure in this area, from a curve that looks a bit like this up to a £40,000 annual allowance. I would bring this down to £8,000 or £10,000 and I would squeeze the toothpaste down the income scale to the lower end of the distribution in the form of bonus payments.

Then we have to tackle one or two other fundamental conundrums, the biggest of which, for generation Y in particular, is the question of access. The deal historically is that the Treasury will incentivise you with some sort of tax relief in return for tying your funds up until you are 55, going out to 57 in 10 years' time. That does not work for Generation Y, because Generation Y's priority, first and foremost, is home ownership. Again, the Lifetime ISA was brought in to try to break that deadlock, but it is also against the background of something we have to touch on, which is pensions freedoms and choice.

Freedom, introduced in April 2015, puts an end to pensions. Let me be very clear about this. What is a pension? It is an annuity. Sales of annuities have gone down 90% since the introduction of freedoms, and it breaks the deal between the Treasury and the people. The deal is currently that we will incentivise tax relief and then, when you retire, we expect you to pay income tax on your pension drawdowns and annuities. Freedom and choice enables the individual to control his drawdown, and it will exacerbate the problem of what I call band shifting. This is one of the major economic components behind the whole pensions debate. Band shifting is when someone, as a worker, receives 40% income tax relief and then, when he retires, becomes a 20% taxpayer. In the last year, for example, the total cash flow to incentivise saving was about £46 billion. The amount of cash that was collected from the pensioner population was £14 billion. There is an enormous gap, which is going to get wider and wider, from the Treasury perspective, particularly as



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automatic enrolment contributions are ramped up—the tax relief bill will soar.

To be clear, we are about to walk into the ramp-up phase. At the moment, the employee contribution in automatic enrolment is 0.8% of band earnings. It is going to quintuple between now and April 2019. That is going to add further pressure to the Treasury in terms of tax relief, and I have attempted to convince you that tax relief is an incredibly ineffective use of Treasury spend. It is the lowest hanging, juiciest piece of fruit in the Whitehall wood.

Ashwin Kumar: To the point Michael mentioned earlier about the fact that auto-enrolment is only on banded earnings, if you are on a low wage, it simply does not cover a very high proportion of your earnings. It is not 8% of your total earnings; it is 8% of only a very small proportion of it, so we have to get to a situation where it is all earnings and then look at the 8%.

I have to say, although we have not necessarily advocated specifically the abolition of tax relief, I cannot see any justification for it being higher than the basic rate of tax, for the points that Michael mentioned about band shifting. The majority of the benefit goes to people who are better off and who, frankly, in general, are doing quite well in terms of their retirement saving and planning.

Torsten Bell: We all can agree that pension tax relief is an expensive, inefficient way of subsidising savings. The most important thing that can be done right now is to make a success of auto-enrolment and that not going wrong. For all of us who were involved in the late 2000s and into the early 2010s, there are not many public policy triumphs; this is one.

Q10 **John Mann:** Is there an improvement you would make to auto-enrolment?

Torsten Bell: There is a risk. There are things you want to look at, and I am sure you will in your Committee and the DWP is also looking at them in a report. The auto-enrolment review must be due in December this year, which will look at how we deal with the self-employed, how we deal with lower earnings and how we deal with people with multiple jobs. All these things are definitely good things for you to be looking at.

The risk is that we have been seeing very low opt-out rates from auto-enrolment. That is partly for the reason that Ashwin gave, which is the level of contributions are tiny at the moment and are going to go up a lot over the next few years. Just think about what those next few years are bringing. The Bank of England is not expecting earnings to grow more than 1.2% in real terms at their peak over the next four years annually. That is what they think is going to happen. At the same time that is happening to typical earners, they are having their contributions to auto-enrolment ramping up significantly. For a typical earner, it may well be that all of their earnings growth is taken in increased



auto-enrolment contributions, so they will see no take-home pay increase. We all think it is a good thing that they are saving more—we support the policy—but we want to think hard about what that is going to do to the opt-out rates from it, particularly for the groups that we have seen real successes among, the young and women. Auto-enrolment has changed savings behaviour among those groups, and I would be seriously thinking about whether we are doing everything we can to reduce the chance of opt-out.

Michael Johnson: There is a major initiative we could take to reduce that risk—and I agree entirely with your analysis—which goes back to the question of access and flexibility. I would like to see the employee contributions eligible to be paid into a Lifetime ISA. The access the Lifetime ISA gives for what is most important to Generation Y, which is home ownership, will encourage them to remain automatically enrolled and not to opt out. I would like to see the employer contribution step away from the conventional DC occupational pensions framework and to go into what I would call a workplace ISA that sits inside the Lifetime ISA. To be clear, there would be no access to the employer contribution until 60, yes, pension-like.

One of the challenges, if we are going to talk about the whole pensions and savings framework, is how we simplify, simplify, simplify. I believe, particularly in the digital era, that nobody needs more than one savings account. The model that I have been trying to push on successive Governments is an ISA-centric framework where everyone essentially has a Lifetime ISA within which their occupational savings component lies. One simple cradle-to-grave savings product is all that is required. At the moment, we have mind-numbing complexity around the word “pension”. We have armies of advisers having to explain the complexities. If you were to do away with the tax relief structure, you do away with so much of that complexity and can talk a simple bonus language, which is the language the man in the street understands.

Torsten Bell: I am worried we are all agreeing, so here is some disagreement. I am not in favour of the taxpayer putting more money in to subsidise money that we use for house buying, which I think is what Michael is suggesting, which is a version of what was done with the LISA.

Michael Johnson: No. This is a very important point. What I want to make clear—this goes back to wanting to minimise the risk of opt-out—is to acknowledge that, as far as Generation Y is concerned, access to cash for the purpose of home ownership is more important than anything else, including saving for a pension. The risk is that if they opt out of automatic enrolment, they will forgo the employer contribution. By introducing the workplace ISA to sit inside the Lifetime ISA you address that risk, because the employee can continue to get access to his own contributions through the Lifetime ISA for the priority in his life, which is about home ownership.



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Torsten Bell: The reason why that is a risky business is this: who buys houses? Well-off people. Who is going to be getting that tax relief and using it for that purpose?

Michael Johnson: Not tax relief.

Torsten Bell: Let me finish: your bonuses—the replacement for tax relief. What do we know already? Even from the tiny thing that we have done with the LISA, the OBR thinks that on its own is going to push up house prices by 0.3%. It sounds small—£900 on an average house price. The first-time buyer trying to buy an average house will have seen more effect on the price of that house from that policy than they will have had from the benefit of saving. You have to save £3,500 for the matching within the LISA to give you the money to make up for the higher house price, and 70% of under-40s have less than £5,000 in savings. You really want to think about the macro effect of more incentives.

Michael Johnson: I think that is very misleading.

Q11 **John Mann:** I am dealing with some horrific cases of financially irrational pension drawdown and disastrous consequences that could be foreseen but were not understood. I also do not see significant numbers of people going for any advice at all, be it on pension drawdown or on pensions per se. I hear plenty of examples of people, for example—this is an illustrative case but there are actual cases—buying a cheap property for their pension, which may or may not be a good thing, but it is clearly not the only credible option available to people. People are not doing any real calculations and do not feel capable of doing them. On the question of pensions advice, who should be giving pensions advice? Should the state be funding people to give pensions advice, and how bad is the situation at the moment in terms of the availability of information and knowledge to people when it comes to pensions?

Michael Johnson: I will respond to that initially by expressing a deep frustration with the word “advice”. Advice or guidance: I have sat in numerous events where this has been debated by great minds at great length and we all conclude we do not know the difference. At the moment, and certainly historically, we have had the Money Advice Service, for example, which is not able to offer advice. We have the Pensions Advisory Service, which is not able to offer advice in terms of the definition of “advice”, so we need to sort that out first. What do we mean by “advice”? What do we mean by “guidance”? Let’s stop pretending, because in the mind of the consumer there is no difference, but there is an enormous difference in the way that it is delivered and who can deliver it.

Going back to your initial concerns about what you are seeing in your constituency post box, with which one is becoming familiar, it is too early to make an assessment about the consequences of freedoms and irresponsible drawdowns. We have only been going a couple of years. A pattern is emerging. In the first year the average size of the drawing



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was about £8,500. This year, that has more than halved. We have seen from April 2015, the first few quarters, a rush as freedom's doors opened. It is now becoming more steady-state and we are seeing much smaller drawings. The challenge is that if one is, on average, making a drawing of £4,000, it is not really, in many people's minds, thought of as part of retirement or retirement saving, and therefore there is less of an inclination to go and seek advice for the purposes of retirement. It is early days.

There is a big question here about the role of the state. To what extent should the state be offering a nannying service to prevent the individual from pursuing his own foolish behaviours? I am not expressing a view here; I am just asking the question. As you well know, Mr Mann, the three major public sector providers of advice or guidance are being pulled together into a single service. That seems like a good idea. However, if the man in the street does not want advice or guidance, for good reasons or bad, changing the structures and the state offering will not change the degree of take-up.

Ashwin Kumar: The whole point of auto-enrolment was not to eliminate choice but to say that the default was an option that meant that pension saving took place, and particularly the difference was being made a lot to people on lower incomes. On that kind of proposition—that if you give people freedom, they are then able to make the choices for themselves—we have learned from behavioural economics that the way you frame those choices and the default option changes what happens. Therefore, we need to bear that in mind as we review the experience of pension freedoms.

Michael is right that the degree of freedom there is now is a potential death knell for pensions as a concept in the long term, and we will need to review that in the light of what we understand about behavioural economics—about how we can help people by default, for instance, to take simple annuity products that are reasonable and priced well. For people who are faced with a set of choices, we have seen in behavioural economics the idea that there is a paralysis from too much choice for some people. If you can create the right kind of defaults, it might help people who might otherwise not have felt able to make the right choices or pay for the expensive advice that may or may not be available to them.

Torsten Bell: We need to distinguish between a number of things. With the pension freedoms, a lot of the initial anxiety was about irresponsible early access to cash—people buying Porsches and things. On that, it is a safe bet to say that we do need to wait; there is not a lot of evidence that is happening on some kind of massive scale now.

There is a separate question, which I am a bit less relaxed about waiting for, which is not about the individual decision but about the advice for particular kinds of pensioners. You mentioned DB transfers as an area



that is definitely worth thinking about, and the incentive structure does matter. If you have advisers who receive commission if people transfer out of a DB scheme or if you have companies paying for the advice but the company has a strategy to reduce its exposure to those DB schemes—they want transfers out because that reduces the risk they bear—those are definitely things that we should be worried about. I think the FCA has said that it is now looking at both those issues, but if it is not then it certainly should be. Those are definitely issues where you want to be looking now. In the 1980s version of pension mis-selling, which saw people being told to opt out, in the end the mis-selling fees were, I think, £13 billion to £15 billion—it was a lot of money. Mis-selling happens in this area. It is worth looking out for. You do not need to be patronising about people's decisions about what they do on drawdown to think that those kinds of things are worth looking at.

Separately, without wanting to sound too much like a nanny—although it is slightly pejorative towards nannies, who I find are very flexible towards young people—I am worried. There is a micro issue about whether we have the optimal balance between letting people do what they want and leaving them at sea. Even if you think it is optimal from the micro perspective, clearly, from a macro perspective, one of our objectives is risk pooling. As longevity rises and the distribution of longevity remains big, pooling some of that risk is a very desirable thing, as a society as a whole. That is what the annuities market should do, but for that to happen in an inexpensive way it needs to be a big market. It needs to be liquid, it needs to be large and, as Michael has set out, we are doing the exact opposite of that.

Michael Johnson: Can I give you a bit more detail about this? I feel a bit of responsibility.

Chair: Please do, briefly, because we need to move on in a minute.

Michael Johnson: I proposed freedom and choice in 2009 and it was accompanied with the following sentence: abolition of the annuitisation requirement provided that both the state and the individual are protected from downside risks, and we have not done that bit. The risk that Torsten has alluded to, which is an absolutely fundamental risk, is how we pool life expectancy. The annuities world used to do that and does do that.

First, we cannot row back on freedom and choice; it is very popular. We can do more to embellish it and eliminate or tackle the substantial part of the risk. We spend the first 55 years pushing the individual up the hill and exhorting him to save with incentives and nudges. You get to 55 and you are on your own, potentially at a time for many people when they have access to the largest pot of cash they will ever have in their lives, and that invites mayhem. I proposed the idea of what I call auto-protection. The idea is that when you reach 55, which is, by the way, too early—it should be 60 or even later—if you do not take any



action, some form of auto-drawdown starts to occur. You can opt out. Then, later in life, when you are in your late-70s, phase two is what I call auto-annuitisation and, again, you can opt out. If you want to embrace freedoms wholly and you feel confident in looking after your finances, you can do so. However, we put in place a couple of defaults, first at 55 and then subsequently in the late 70s, which tackles the concern that is emerging from a number of different fronts about there being many individuals for whom it is not in their best interest to be left on their own.

Q12 Mr Jack: As someone who is 54, you have given me quite a bit to think about there. In May 2016, the National Institute of Economic and Social Research were reported as telling the *Financial Times* that those who own a property are less likely to save more towards their pensions or other savings accounts. I am conscious, Mr Bell, you said a moment ago that the young and renters were potentially the lowest savers or with the largest debt.

Torsten Bell: They are the people showing the largest increase in coming forward with debt concerns at the moment.

Mr Jack: Yes, okay. The NIESR report said that those owning a property had 15% less in pension income than those who did not own a home and have a mortgage. Are there risks that people are prioritising home ownership at the expense of pension savings?

Torsten Bell: We should be really clear about what that paper says. It is not saying that people who own homes have less other savings. In fact, the opposite is true. If you look at the distribution of those kinds of wealth, property wealth is our most evenly spread wealth, but it still has nearly double the inequality of income. It is still very unequal, but it is the most equal, and then pensions are a bit less equally held—ie they are more top-biased than housing. Other savings are incredibly top-heavy. The inequality of financial wealth that is not in a pension or a house is about three times the inequality of income, so it is very top-skewed.

That paper is saying a different thing, which is that once you correct for everything else—income levels and other things—does the fact that an individual has a house have any bearing on their pension? That is true. Clearly, on the marginal pound saved there is a choice about how much of it goes into property and how much of it goes into pensions or other savings, so that is true. There is a trade-off there. You can buy a second property or you can put a load of money into your pension; that is definitely true. To some degree, that is a normal budget constraint choice. Clearly, to some degree it will have a dynamic effect on what the outcomes are for those people: they are more exposed to house price changes or, if they are putting it into their pension, they are more exposed to rates of returns in the market. It does matter which one you are in, but I do not conclude from that that the thing we should be worrying about is people who own property having low other savings. It is the case on the margins that we might want some rebalancing, but it is not the problem.



Q13 Mr Jack: In that case, should we be concerned that people are too reliant on equity drawdowns from their housing?

Torsten Bell: I do not have the figures to hand, but my long-term view is equity drawdown is talked about a lot, and obviously there were big anxieties in the 1990s. It gets rebadged every now and again when people realise they have a brand problem with the product. The number of people with versions of those products now is quite small. If you look at the equity held by older people now and go and talk to L&G and others, they say, "Oh no, there is about to be a huge take-off in the level of that happening. It is going to be huge—it is massive." If you look at the level compared with the wealth stocks, it is pretty small. Does that mean we should not be taking it seriously, regulating it and looking at it? No, but I am not seeing some huge take-off in those products.

Ashwin Kumar: By and large, people keep property wealth in retirement. There is a fairly small degree of, as it were, using your property wealth for one reason or another, whether that is downsizing or equity withdrawal.

Q14 Mr Jack: Do you see it as a problem for the future? Property prices have gone up considerably in real terms—supply and demand is the problem. Do you see that as not a problem for the present but a problem for the future?

Michael Johnson: Absolutely.

Torsten Bell: Think about who cannot do it. A house price rises. The owner has more housing wealth, but it does not affect his or her other wealth. The person who is affected by that is the non-owner who wants to become a future owner and is therefore going to come on to the market and try to purchase a house at a higher price. That is going to squeeze out other saving, like pensions and others, and that does matter for their living standards in retirement. The people we should worry about are those coming on to the market at those higher housing prices.

Ashwin Kumar: It is also worth recognising that for pensioners there is probably £100 a week difference in your housing cost if you are a renter or an owner-occupier in retirement, so that sort of investment does produce a return in terms of lower housing costs once you are in retirement. There is an aggregate question about whether or not we should be investing as much as we do in housing wealth, which is a reasonable question. However, from the point of view of a person who wants to reach a situation where they do not have to pay rent in retirement, you can see why people want to do that. Undoubtedly those people who are squeezed by the difficulty of getting on the housing ladder are going to face difficult choices. For many, there is a stress both in pension saving and in buying a home.

Michael Johnson: There is less to learn from history on this than we might expect, because historically home ownership rates of people in



their 30s and 40s were much higher than they are now or are likely to be in the future. In parallel, of course, we have moved away from predominantly a DB world to a DC world of pensions, which, in value terms, is roughly a third. If we fast-forward 15, 20 or 25 years, equity release is going to have to play a much bigger role in the provision of retirement income than it has historically, simply because a number of independent things have gone on over the last 10 years and will go on increasingly over the next 15 to 20 years, as DB retreats and as the young find it harder and harder to get on the housing ladder.

It is indeed the case that for 15 years equity release has been touted around as the next great thing and, for a variety of reasons, it has not taken off. I have written analysis papers on the subject and have scratched my head—in fact I was doing it 15 years ago—thinking, “Surely it is going to be next year.” If we look at the changing pattern of home ownership, and I am just looking at one statistic, 20 years ago 55% of under-35s already owned a home. Now it is getting close to 30% and going south, and they are not accumulating their pension wealth, for all the reasons that we are familiar with.

Q15 Mr Jack: Do you think the model of lifetime financial planning is going to change in the United Kingdom?

Michael Johnson: Absolutely.

Ashwin Kumar: Yes.

Q16 Mr Jack: In other European countries renting is very much a norm. We have a fascination in this country with owning property. We live in an environment of very low interest rates. The multiple of earnings that people pay is 4.6 over a 20-year average or 3.6 for the average property price. Do you think we have a problem both in terms of a risk from interest rate rises, which a whole generation for the last 10 years have not really cottoned on to, allied to not putting enough into savings in the dash to this desire to get on the property ladder? In that, I am asking whether renting in the future should become more of the norm.

Ashwin Kumar: In theory, when you buy a home there are two components. There is the interest payment, which is like your rent—it is the payment for housing services—and then there is the capital, which is an investment. If you could beat that investment with other forms of investment, it would be rational to do so, except of course that is not the UK experience. We have seen trend increases in house prices that have significantly exceeded most other forms of medium-risk investment, and so it is perfectly rational for people to think that housing is the thing to do, because it beats the other ways in which you could invest that money.

Q17 Mr Jack: The psyche is that your rent is paying someone else's mortgage.



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Michael Johnson: People may not enjoy that—I am sure they do not—but they do not have a choice. If we look at the proportion of under-35s who rent, 20 years ago it was about 20%; last year it was nearly 50%. This is moving quite fast.

Ashwin Kumar: Yes, and the bequest issue is an important aspect of this that we do not fully understand. Home ownership has seen cohort effects, where we have seen increases in the 1950s and 1960s, and then another big increase in the 1980s. You have more and more people reaching retirement, and that issue of equity withdrawal will relate to whether or not they want to pass on their home to descendants and whether those descendants have been able to afford a home. I do not think we are even at the start of understanding how those interactions are going to play out.

Q18 **Mr Jack:** It is a geographical problem. I just want to pick up on this. I represent a Scottish constituency and there is a housing surplus. It is a fact; there are empty cottages to rent and quite a lot of property for sale. Is it very much a south-east of England problem?

Torsten Bell: We need to be careful. Obviously, the ludicrous stories are about London.

Q19 **Mr Jack:** Yes. Is it lack of supply?

Torsten Bell: There definitely is a lack of supply problem. There is one way to deal with the supply problem, which is to build some houses. However, it is not just that. A lower interest rate environment does mean a higher house price environment, and the main effect of that is that your repayments may be the same, but the deposit required changes the distribution of who can get on and who does not. Those are both important: the interest-rate effect and the supply-and-demand effect. Obviously, it is demand as well as supply. You might want to look at the demand side of things.

However, we are wrong if we say this is just a London thing, and I will give you two reasons for that. One, the falls in home ownership are very large in other parts of the country as well. Greater Manchester, in some ways, has seen faster falls in home ownership than some parts of London, as have Leeds and others. Even where you do not have fast falling home-ownership rates, you are seeing rises in housing costs. In the end, for day-to-day living standards, the housing cost issue is the big problem rather than the home-ownership issue, which for other reasons we care about, and the longer term lifecycle.

The other reason, which we always underestimate, is that home ownership is the best way of hedging against future housing cost rises. It is the best way of hedging: buying a product that lets you live in that area whatever else happens. That is the economic rationale lying behind lots of it and that is a good reason to want to own a house, because you cannot buy another product.



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However, if that is a desirable thing, where do you go in a world where fewer people, as Michael says, are going to own? We have fallen from 58% to 50% home ownership since the millennium. That trend is not going to stop, although in the next few years it will probably slightly pick back up again, but that is the big picture trend. We should start worrying about how we provide that security to people who are going to be renting, because it is not just that today's millennials are owning less; they are not in social housing in the way the baby boomers were when they were young. They are 10 times more likely to be in private renting than the boomers were in their 20s, at 30, so four times. That is not some marginal change; that is a big difference. All we have done is reduce the security in the private rented sector, and we have gone from 600,000 kids living in the private rented sector in 2000 to 1.6 million today. The people living there are older, with kids, and it is beyond me why we have decided to have one of the most—

Q20 Mr Jack: We are straying into different territory there. We can start talking about increasing population, green belts, pressures on planning, but it is a whole different area. Do either of you want to add to that?

Ashwin Kumar: The correlations between being in poverty in retirement and renting are also very high, so we are storing up problems for the future in the housing stress that we see at working age today.

Torsten Bell: Also, think of the housing benefit bill. In a world where lots of pensioners privately rent, as the Treasury Committee, think of what happens to the housing benefit bill.

Mr Jack: Mr Johnson, do you want to say anything?

Michael Johnson: Oh dear.

Chair: Briefly.

Mr Jack: I have no more questions. This is it.

Michael Johnson: The household wealth in this country is roughly £10 trillion to £11 trillion. About 40% of that is in pensions, about 35% or 36% of that is in house equity, and about two-thirds of that is land. Essentially, if we are going to head off a lot of these social problems that we are confronting now and that are deteriorating, we are going to have to grasp the nettle and ask ourselves a question about redistribution. Given the distribution of household wealth across the country, there are only two areas to go to. One is pensions and the other is equity in homes.

I am beginning to convince myself that we ought to scratch stamp duty—it is a barrier to entry—and we are going to have to introduce a primary property gains tax. I am going to get personal here for a moment. I have been very fortunate. I worked in the City for a while. I bought a four-bedroom house in north London 20 years ago. I have painted it a bit, and I have generated—not earned—£3 million of equity. I believe I



should be taxed on that when I sell it. I am not talking in my own best interest, but I believe it is going to have to happen.

Mr Jack: Interesting, thank you.

Chair: Plenty of thought-provoking statements are coming out of today's session. Wes, let's see if you can generate some more.

Q21 **Wes Streeting:** Going back to the anxiety about household debt levels, which we have already touched on this morning—standing at 140% of income and rising at the fastest rate for 11 years—we need to separate out the two dimensions of those big numbers, which is secured lending and unsecured lending. First, a general question: how anxious should we really be about both?

Ashwin Kumar: It is worth saying that when you look at the relationship between unsecured debt and income, there are higher levels of unsecured debt for people who have higher income. It is not the debt per se; it is the problem debt that is the problem, as it were. It is people who are in arrears, people who are finding their debt a burden. Therefore, the aggregate amount of debt is perhaps not the issue. It is the stress that some people feel when they are in debt, because they are not able to service the repayments.

Torsten Bell: On secured debt, which is almost all housing, obviously the big picture is only of a small uptick, about 3% on the most recent data. The average is 9% pre-crisis, so I do not think we should be hugely worried about that. On all measures of household stress related to financial stress related to housing debt, those are all down significantly, because of interest rates and because fewer people are home owners. The FPC found something like only 1% of households were facing what they used to see as their 14% threshold of really severe pressure. If you look at our estimates of the effect of the recent interest rate rise, we are talking very small effects: only about 11% of households are on a variable rate and are owners. Obviously, we have seen a big move towards outright owners. We now have more outright owners than owners with mortgages, which none of us thought could be possible. That is where we are today. More people own a house without a mortgage than own a house with a mortgage. That is quite hard to achieve, but we have managed it.

If you look at what is happening to housing cost ratios, the last 10 years have been really good for mortgages in general and for the population as a whole—all mortgages, on average. Obviously, though, if you are young and have come more recently into ownership, particularly if you bought a property in the south-east at a high value where the baked-in is ongoing—very low interest rates—you are the people at risk from any higher than expected rises in interest rates. If the markets are right, and we are only talking about a 1% rise between now and 2021, overall we are probably talking about 24% of the population seeing an increase. That is how many people have mortgages today, and it will take three



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years for those fixed to roll forward and see some increase in their bills. The benefit freeze will have a bigger effect on more families over the next four years than that interest rate rise will have on higher income families, so you should not worry about that.

On unsecured credit, where there have been fast rises in the last 18 months—there were big rises, around 10%, which is not quite as fast as pre-crisis, but we did see a big rise in unsecured credit—there are definitely pinpricks of areas to worry about. You will have seen all the news about cars and other things last year. My personal view, and we will have to wait and see because we do not get the data hugely timely, is that it looks like the lending criteria are tightening. The supply is going to fall slightly and it looks like the demand is also falling slightly. That comes down to what was going on in those 18 months. We were coming out of a strong-ish period of income growth in 2014 to late 2015, relatively, compared with the 10 years as whole, which were a catastrophe, but that was like the mini-boom for incomes. Credit costs kept falling through that phase, even though rates did not fall again, and people had been deleveraging for a large chunk of the previous seven years, so it is not surprising that there was a growth in unsecured credit then; people had not bought anything for six years or whatever.

It does not look, to me, as if that is continuing. That may be because people thought that was a temporarily lower income level that they were smoothing through quite sensibly last year. They are now deciding that there are reasons to think some of that income loss is permanent and are therefore responding appropriately. I would be very surprised if we do not see a fall in the growth rate of unsecured credit next year.

Michael Johnson: I have a slightly different perspective. I am talking here about consumer credit: store cards and credit cards. We saw that peak at the end of 2008 at about £210 billion. We then saw it down to about £150 billion at the end of 2012, early 2013. It is now virtually back up at its peak. Just looking at the numbers in front of me, it has been growing at about 8% per annum for the last two or three years. It is growing way ahead of earnings growth and so on.

There is another way of looking at it, which is if one looks at the total stock of consumer credit and compares that with total disposable incomes, the peak ratio has been about 22% and, at the moment, we are around about 14%. If one uses history as a guide—always dangerous—then in terms of sustainability there is quite a lot of growth in consumer credit before we go back to the peak relative to disposable income.

Torsten Bell: Worry about micro bits of it. Worry about the 13% of households that are only making the minimum payment on their credit cards. For half of those people it is because they are financially savvy and have got themselves on interest-free credit cards, but the other half are only making minimum repayments despite having a large interest bill on those cards. Worry about that, rather than the macro picture, which



looks like it is okay, or worry about young people or worry about the one-third of the working-age population who say they are worried about their debt. Focus on the bits of the population where problems are, and people with large credit card bills is definitely something worth worrying about. The hard thing is to see through the mass of the data looking better overall, big picture, to get to the people who are problems. Renters and young people are those kinds of people; old people are less of an issue than they were.

Michael Johnson: Can I connect this observation with automatic enrolment for a second? Many of the people who are serial borrowers at APRs of 20% through store cards, credit cards and so on are also exactly the same audience that we really want to auto-enrol. Take NEST as an example. We know that more than 99% of their membership immediately go into the default fund. The default fund's target return is 2% real per annum. Many of the people going into the NEST default fund fall into this consumer credit, borrowing side of the equation as well. On the one hand, they are paying out 20% per annum APRs on consumer credit cards while they are being encouraged to save in a default fund that is generating 2% real. That seems to be a flaw. That is a classic arbitrage of the financial system.

It would make eminent sense for the target audience for automatic enrolment to be asked one simple question before they are auto-enrolled, which is: are you a serial borrower of consumer credit? If they are, it would make an awful lot more sense to redirect that automatic enrolment contribution to cut down their consumer credit bill than it would to put it into a default fund earning 2% per annum. I call this thinking "negadebt". The most powerful way to encourage people to save is to reduce high-cost debt, because you are earning a very high risk-free return on it. Whilst your inquiry here is about the consumer credit side, we should not forget about what we are also trying to achieve with the same population—the problem population that Torsten was referring to—in terms of other areas of Government policy, such as automatic enrolment.

Q22 **Wes Streeting:** Your last point and Torsten's are connected, which is about how we deal with specific problems rather than assuming that there is this thing called the household debt crisis and it is all terrible and every aspect of borrowing should be frowned upon or even every aspect of looser credit arrangements. There could be anxiety, for example, about 0% card balance lengths doubling and the generosity of interest rates on personal loans coming down. As Andrew Bailey has warned recently, we are not talking here about reckless borrowing; this is directed at essential living costs. If you are the sort of person who is borrowing, the access to low-cost credit to help people through a difficult period is a good thing. The difficulty comes when you get debt dependency and people are stepping outside of the 0% period into much higher interest rates.



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Taking up Torsten's challenge, which is how we deal with the real problems that exist under the umbrella of household debt, what do you think needs to be done in public policy terms? Do you think the FPC is adequately focused on the real problems as opposed to the macroeconomic, financial stability dimensions of all this? Does Government have the right focus and, if not, what needs to be done?

Ashwin Kumar: Can I come in here on perhaps the kinds of people who are using short-term, high-cost credit, payday loans and rent to own and schemes like that? What you tend to find in terms of the reasons why people are using those kinds of credit is there is one group of people for whom it is survival; it is just the only way that they can get through and pay for essentials. Then there is another set of requirements, which is the unexpected costs: the repair of the car because you have to go to work; the boiler breaks down—that sort of thing. I am struck how there is a relationship between savings and the need for that kind of debt.

There was some analysis done for the StepChange debt charity a couple of years ago, which found that having savings of £1,000 reduced significantly the likelihood that people were going to get into problem debt. There is a relationship between that notion that a significant proportion of people during working age do not have that level of savings and then the need to go into problem debt when those costs occur. Of course, the people we are talking about often have very poor credit ratings or no credit history.

One of the things that we have seen in the credit rating business is that once you have anything bad on your credit file, basically you are in a black box and then you have no access to mainstream credit. People have been talking about a couple of things but not a whole lot has been done about it. For instance, people's housing association rent records could be taken into account in credit histories, so that you can provide access to more mainstream credit. Mainstream credit has interest rates that are still high, but they are nothing like the interest rates people pay in short-term credit.

There is a problem about access to credit at reasonable rates for people who are on very low incomes with poor credit histories. Therefore, they resort to products such as rent to own and high-cost credit.

Torsten Bell: There are a number of different chunks to that. On Government's role, it is worth saying that Government have done some good things recently. The capping of repayments for high-cost credit payday loans has had a huge effect: Citizens Advice had an 86% fall in people coming to them with payday-loan problems between 2013 and 2016. These are proper, big success stories; they are good arguments.

More generally, there is a totally changed environment from the 2000s on regulation and on consumer protection in lots of these areas. The regulators know: you can just tell if you watch them giving their speeches. It is the same white men, but they are giving different



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speeches and they are more concerned about this stuff. They know their job.

You guys will have them in here and they will feel under pressure on this, not on whatever it was before 2010. That is a good change, and that is definitely shifting. You are seeing that not just from Government but from Andrew Bailey, as you mentioned, and others. You can just tell they are in a different space.

However, on the FPC specifically, one, it is too early to tell regarding the big macro picture. We will be able to tell you in 100 years when we have seen how many banking crises we have had over that 100 years. But I would say there are some good signs. If you look at their most recent meeting, they are clearly right to be nudging lenders on their lending criteria and saying that unsecured credit, for the reasons you raised, is a bit of an issue. They rightly say that it is likely to become a problem. For them, it is a macro-stability risk issue, which is obviously that unsecured credit has much higher rates of default in a downturn.

In the recession in the 1990s, we tried really hard to get a lot of people out of their houses, but in this recession you do not see many people defaulting on their mortgages. You see a much higher default rate, although the amount being defaulted on is smaller in unsecured credit—and they are right to be adding that more explicitly into their stress tests, which they have talked about. It would be good to get an update from them on where that is going and what specific advice they are giving to particular lenders—so that is a good area. It would also be good to hear what they are doing about non-bank lenders in that regard. I would say there are good signs. We were talking about those things in a way we would not have done before.

Does that mean we are doing everything possible? Does it mean the Government are doing everything possible? No. The best thing we could do is get wage growth going again, because a lot of what is going on is parts of the population just having very squeezed living standards. When something bad happens, that is when we start seeing problems. If you look at surveys of people who are in debt struggles, they do not tend to say the big problem is the level of debt. You can compensate for what you think is their view of it. They say it was a change of circumstances: they lost their job; there was a huge bill; something else bad happened; they had to go and look after a family member. That is what starts the spiral. In that world, everything we can do to increase the buffer and the resilience of those households is a desirable thing—and wages, I am afraid, are a huge chunk of that. They are a complete catastrophe. We have never seen anything like this.

Obviously, for lower income groups who are most at risk from changes in circumstances, clearly changes to our benefits system are a problem. A lot of the focus has been on the six-week wait in Universal Credit, which is from a change of circumstances. The Government are obviously going



to move on that in the Budget, and that is a very welcome thing, but the generosity of the benefit system to low-income working families is falling significantly over the next four years. That is a worry for the resilience of these household budgets in the longer term.

Wes Streeting: Mr Johnson, do you have anything to add?

Michael Johnson: I understand that Scotland has a slightly different approach in respect of how problem debts are handled: something called the Debt Arrangement Scheme. From what I have read about it, it seems like something we ought to consider in this country, too.

Q23 **Catherine McKinnell:** Yes, I was going to ask about that, because, Torsten, you mentioned how you have to look differently at the macro picture and some of the micro issues in households, and particularly vulnerable households. What trends are we seeing in terms of problem debt and over-indebtedness? What are the primary drivers of this within households?

Ashwin Kumar: The big picture is the income squeeze—the squeeze on wages—but it is also the growth in self-employment, and particularly low-wage self-employment and other forms of insecure employment. It is called the gig economy, but if you are on a zero-hours contract you have this uncertainty and you effectively need a savings buffer to manage your way through that process, which too many people do not have. That creates a huge amount more stress, dependence on savings or reliance on credit, which is the flipside of it, when you cannot manage those fluctuations in income.

Torsten Bell: It is worth thinking about the big, long-term drivers of pressure. You then have specific things that happen. In terms of long-term drivers, why do family budgets feel under more pressure in Britain today? This is because of the earnings squeeze that started to some degree in the mid-2000s and then became very severe from 2009 to 2014. We get a small phase of slightly better growth and we are now back into falling wages. That effect on incomes is very big, and it dominates almost everything else. It is why, in all focus groups on people's finances, that sense of squeeze, even among middle-income people, is the defining feature.

On top of that, you want to add very large rises in housing costs as a percentage of income. If you go back to the middle of the 20th century, people were spending 10% to 12% of their income on their housing. The average for millennials—just the average—is 25% of their income. That includes people who are lucky enough to own outright because their parents gave them a house. That is staggering.

Even the boomers saw a big rise in their housing costs. The silent generation, who came before them, owned a house in exchange for it and they were seeing fast income growth, but we are seeing low income growth and these higher housing costs. That is why everybody feels



squeezed and why probably, when everybody was telling them everything was going brilliantly for the last 20 years, they were a bit like, “What are you talking about? Have you seen my housing costs?” That is a big problem.

Then you have specific things happening like the financial crisis, which you might have noticed. That is pretty bad for family budgets. You see specific things happening to specific groups. Again, I do not want to bang on about the benefit cuts, but we are asking over the next four years probably the bottom third of the population to see a fall in incomes. No one is doing well, so the macro picture is not an inequality picture. It is that everybody is squeezed here—including the top. Everyone has had a pretty bad time. But the difference for the next four years versus the previous five is that we are moving into more of a skewed thing.

Chair: This is because of benefits.

Torsten Bell: It is because of the benefit freeze. Also, one of the best things that has happened in the last five years is very strong employment growth. Who has benefited from that employment growth? The bottom third of the population have benefited. Almost all of the employment growth since 2010 has gone to households in the bottom third to 40% of the income distribution.

Compared with the United States, the UK has seen a very positive effect on incomes for that bottom third. We have seen significantly higher income growth among the poorer families here than in the US, despite overall GDP per capita growth being roughly the same. At some point, our employment growth—the Bank of England thinks we are heading here—is not going to carry on growing. At that point, it is earnings growth and higher income families who do slightly better, because you cannot keep adding workers to the bottom bit of the population.

It is benefit cuts; it is probably slowing employment growth at some stage, although we have been expecting it to slow for most of the last few years; and it is low earnings growth. Earnings growth is a disaster overall except for the very lowest earners, who are seeing quite strong earnings growth now because of the minimum wage rises.

Q24 **Chair:** If employment growth slows, then wages for people in work should be going up—although that is not what we are seeing when you might expect it.

Torsten Bell: That is a big macro question about whether the Phillips curve turns up or not. What do we know about wages? We know we are £15 down on where we were pre-crisis. On the average weekly earnings from the ONS, we are seeing nominal wages stuck at about 2.1%, when we were used to 4% pre-crisis. Obviously, it is inflation that has gone up, but nominal wages are basically stuck.



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If you want to be optimistic, what is the best case for thinking there is wage pressure building? This is kind of where the Bank of England is. If you just look at the private sector over the last six months, we can see an annualised wage growth figure probably getting up to 3%. The only flipside of that is the reason they are optimistic about wages is they think the supply side of the economy is so bad. They are so grim about the long term they think in the short term our wages are going to have to go up because we are hitting up against the supply constraints in the economy. It is better for individuals for the next day, but the result is that we are not going to get wage growth above 1% for the next four years.

Chair: I am sorry—I cut across you earlier.

Ashwin Kumar: No, no. One aspect we have not covered is inflation. If you look at the relative incidence of inflation, it has been higher for lower income households since 2003. It was the other way around in the years before that, but since 2003 lower income households—ie the bottom quintile—have faced higher inflation than others.

Even when we are talking about real wage growth and real wages being £15 below the pre-recession peak, on average lower income households will feel that even more.

Catherine McKinnell: Do you have anything to add to that, Michael?

Michael Johnson: I only have one little comment. Torsten was suggesting that everyone has experienced a wage freeze and suffers from that. I would suggest that the top two or three deciles of the income distribution, and certainly the top decile, do not notice it at all.

Catherine McKinnell: Okay. That is disputed.

Michael Johnson: I guess we actually disagree on something.

Q25 **Catherine McKinnell:** This is perhaps slightly too large a question and perhaps requires a session all of its own. When talking about future projections, I know the Government and others have been modelling the impact of—and we have managed to get all the up to 11.25 without bringing up the B-word, but I am going to bring it up—Brexit.

Chair: Oh, Catherine.

Catherine McKinnell: I am sorry.

Chair: We were doing so well.

Catherine McKinnell: This is in terms of modelling outcomes. Obviously, there are potential significant impacts in terms of household indebtedness and the resilience that you have been talking about that is perhaps not built into the system enough currently. Is this something you are modelling currently? Is it something you are able to model?



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When you are making future projections, to what extent are you factoring Brexit into that?

Torsten Bell: The blunt answer is not really. That is because it is very hard to do that with any degree of high-level accuracy—and unlike the OBR we do not have a legal responsibility to do so. We do not do things that are really hard unless someone makes us do it—to be blunt about it. The answer for us is no. We look at things like, if tariffs end up going up, the mathematical impact on family budgets. These are things that are definitely quantifiable, where we know there is a visible effect we can show and we definitely do not have to make value judgments about what would happen.

What do the Bank of England and the OBR kind of agree on? Before the OBR's latest bout of productivity pessimism, which we are going to get next week, their current productivity pessimism is based on a short-term productivity effect from lower investment because of Brexit, ie higher uncertainty, lower investment and lower productivity, meaning lower wage growth over the next few years. That is what they have said previously. By the way, they do not assume the productivity growth will see slower changes overall. So far, they have been agnostic on whether lower trade feeds through to lower productivity in the medium term, which other economists would say is optimistic—but who knows?

The Bank of England takes a slightly different view, which is that there is a lasting effect. They have basically just become very pessimistic about Britain full stop. They say that our productivity growth is stuck about 1%. The trend is 1%. We are growing below that right now and we will be growing slightly above that trend by the end of this five-year period. They are not absolutely explicit about how much of that is down to Brexit and how much of it is down to Britain being rubbish, but you can ask them when they come in.

Q26 **Catherine McKinnell:** Okay, but what about in terms of household debt and the potential impact there?

Torsten Bell: That is what matters. In the long term, what matters is what you think the effect is on productivity and what effect that has on family incomes. It will feed through to debt. In terms of overnight effects on household debt, it is a pretty risky business to start guessing.

Ashwin Kumar: As Torsten says, the studies that have been done have said, "If this is the future tariff scenario, this is the consequence for the economy overall." Various people—you guys have done this as well—have attempted to look at the distributional impact based on the industries that are affected in terms of employment and the distributional impact in terms of spending patterns and the kinds of goods that are going to be affected, potentially, by higher prices. That tends to find a fairly even distributional pattern.



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However, of course, if those negative effects turn out to be the case—and that is clearly an open question—if you have a fairly even percentage reduction in family incomes, the people it is going to hurt most are those at the bottom, because if you are at the top of the distribution, you can cope with it. The question, however, as to precisely what the effect is going to be on productivity and economic activity is highly contested.

- Q27 **Catherine McKinnell:** I do not know whether you had anything to add to that, Michael. I was going to mention the thing that you raised, which is a potential breathing space scheme. We know the Government have promised one and that it has cross-party support. For those households that are in problem debt, it would be useful to look at how that breathing space would best serve those families.

One thing I have heard—I do not know whether you have heard this—is that it could be restricted to just commercial debts rather than central or local government debts. What will be the impact of that? Therefore, how wide does it need to be to have the maximum benefit?

Torsten Bell: I do not know whether I am hugely qualified to comment on the details of this. There are charities like StepChange and Money Advice Trust, who know a lot more than I do about the individuals, and also Citizens Advice and others, who have that day-to-day experience. We do not take calls from the public on their debts, so they will have a better handle on that.

From looking at the data on what people are concerned about, you are seeing a rise in council tax arrears. You will be finding that in your constituencies; you are seeing that in large chunks of the country. When you are looking at designing a scheme, you want to look at what is going on now. We are seeing a slight rise in worries about paying just basic household bills, because of what I was saying about squeezed living standards, and you are seeing council tax arrears going up.

- Q28 **Catherine McKinnell:** The other thing I was going to add in as well is Universal Credit—the way that is being rolled out and the built-in waiting period. Certainly from my own constituency postbag, I can see it is having an impact on debt and the accumulation of debt. Do you have concerns? Is there any evidence emerging of debt increasing among households or is it too early at this stage to detect that?

Ashwin Kumar: It is probably too early to detect it at this stage, but the observation I would make is that the rhetoric from the Government in terms of designing the month-by-month assessment period for Universal Credit was that they wanted to make it like being in work. They indicated that through the automatic data transfer from HMRC there would be a seamless transfer from one to the other.

Of course, a lot of people on low incomes are not paid monthly. They might be paid weekly or they might be paid fortnightly, which is different from the classic professional salaried, middle class person that gets paid once a month. If you have a different payment arrangement and you



have a monthly assessment period, you might have some months where you have two fortnightly payments and another month where you have three. That will suddenly cause a fluctuation in your Universal Credit income.

It has been designed with a particular view of what payment patterns are like, which is not the reality for many people on low incomes. When you add that to the fact that so many people on low incomes have very little savings, those little things—like the difference in your payments from month to month just because of how the payment dates fall or the seven-day waiting period, which I know is going to be looked at, and the month assessment period—start to have quite a bit of impact, if you have no resilience in your household finances at all.

Q29 Catherine McKinnell: There is a strange correlation between the proposed breathing space of six weeks in the scheme and Universal Credit and the six-week wait. But just going back to the breathing space, is six weeks enough to provide that level of support for families to be able to work their way out of problem debt?

Michael Johnson: This is something I know nothing about, but I suspect there are people who are at the recipient end who have strong views. I would encourage you to invite them in and ask them.

Catherine McKinnell: Okay, that is fine.

Ashwin Kumar: Likewise, StepChange and Citizens Advice would be very well qualified to comment specifically on that.

Q30 Kit Malthouse: I just want to ask you a bit more about the credit product market for people on low incomes. Is there a functioning market for credit for people on lower incomes?

Ashwin Kumar: It is a highly constrained market, partly because of the point I was making earlier: credit ratings are not particularly differentiated. As soon as you have got any negativity on your credit file, basically, you are excluded from the mainstream credit market and you are into the high-cost credit market. In a normal functioning market, you would not expect to see such a cliff edge; you would expect to see continuity. But because of the way that credit ratings work, there is much more of a cliff edge than there should be.

Michael Johnson: That is something I am not qualified to comment on.

Q31 Kit Malthouse: Mr Bell, earlier you talked about the impact of regulation on payday lending. Obviously, the number of problem cases going to Citizens Advice has dropped because the number of people using payday lending has dropped very significantly—it has gone down by a factor of 10. At the height, that industry was lending something like £1.6 billion; it is now lending less than £400 million. The last time I looked it was around £250 million. That is an awful lot of people who were accessing it who are now going elsewhere or not going anywhere at all. Is that a



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problem? Is there likely to be an impact elsewhere on the informal or less savoury market?

Torsten Bell: Is it a good idea that policymakers looking at levels and types of regulation of credit markets look at things they do not like about the status quo but worry about what could happen, what the alternatives are and where the problem could re-emerge? Yes. Did we used to have a much bigger illegal or at least informal part of the lending economy that we do not want to return to? Yes.

I have not seen any data that shows that is happening. Obviously, you also saw some of that reduction in payday lending was happening during this deleveraging phase. Some 40% of the firms have gone out of business. That is a good thing to be looking at. For example, I have not seen any data showing that there has been an increase in the cost of credit for low-income families who have been forced into other forms of credit. Does that mean policymakers should not be looking at where that pressure has bulged out into? No, that is a really good thing and that is definitely what they should be doing.

Where are you seeing some growth? You are seeing some growth in the hire-purchase market.

Q32 **Kit Malthouse:** Guarantor loans seem to be growing very significantly; credit cards are growing very significantly.

Torsten Bell: Some of that growth has been starting to slow for the reasons we have been discussing.

Would it hurt for regulators to be looking at some of these hire stores? No, that would be a very good idea. Are they directly growing as a result of shrinking payday lending? I do not know, and I have not seen anybody do any causal work to show that.

Q33 **Kit Malthouse:** Obviously, I am involved in small business lending but not in consumer lending. The question in my mind about this issue is the nature of the lending. Because payday lending is short term, quite a small number of people build up a problem balance, whereas in other forms of credit that they may move into it is much easier for that to build up.

If you move into a credit card, obviously you have a much longer term obligation. You can pay your minimum amount, which can push you out to a payment period of seven or eight years, or even longer in some cases. Similarly, if you go to one of the rent-to-own shops or whatever they are called, you are buying into a four or five-year agreement, whereas payday lending was only ever a month.

Torsten Bell: Remember that there used to be no cap on the rollover. We said it was a month, and for lots of human beings it was not a month.

Kit Malthouse: It was also relatively small-ticket lending.



Torsten Bell: It was relatively small compared with credit volumes overall, though for some individuals, compared with their overall incomes, it was quite significant.

Q34 **Kit Malthouse:** The question in my mind is whether the heavy-handed heel of regulation starts to choke this off. There are two aspects you are raising. Mr Kumar, you are raising the inability or unwillingness of companies to price for risk correctly.

Ashwin Kumar: Yes.

Kit Malthouse: At the same time we have got a regulatory push that is choking off access. When you bring those two together, is there an overall reduction in the ability of these people to access credit?

Torsten Bell: I do not think we know the answer, and I have not seen data that proves that is the case. You could just take the bottom 20% of the population and look at what has happened to lending. The problem is that you are going to get a domination of macro effects on their wish to take out unsecured credit over the flows between different kinds of credit. It is quite hard to do in a simple way. That growth rate is falling anyway. You can look at whether the different elements of it are outperforming or underperforming the growth of the market as a whole. That would show you some degree of that—ie how preferences for credit are changing.

Obviously, the regulation does matter. It would be worth looking at the 6% of the population who are paying interest on their credit cards but are not making more than the minimum payments and looking at how that has changed. That is a valid thing to look at. If your hypothesis is that people have been forced into that form rather than payday lending, you can see whether that 6% is growing. I do not know the answer to that off the top of my head.

Q35 **Kit Malthouse:** But it all points, fundamentally, to a market that is not functioning properly, and it certainly does not seem to be competitive on price.

Torsten Bell: Yes.

Chair: Mr Kumar, did you want to answer?

Ashwin Kumar: I guess there are two points. StepChange did talk to some of their clients who had previously had payday loans and then been refused them. There was quite a high rate of loans from family and friends and other credit providers or going into arrears on household bills. The basic proposition that there is a demand for credit is definitely there. We have talked quite a bit about the stress on incomes and the lack of resilience to cope with unexpected bills. That then raises the question about other mechanisms for cheaper credit, such as the Social Fund, which was given to local authorities and changed in form so it essentially does not exist anymore.



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Also, what really is the capacity to scale up credit unions and other forms of credit whereby people on those kinds of incomes with poor credit histories are able to access more reasonable credit?

Q36 **Kit Malthouse:** Credit unions are not that cheap, though, are they?

Ashwin Kumar: No, but they are cheaper than high-cost credit, ie payday loans. Whether it is the state through the Social Fund or it is mechanisms like that, we need to take that a lot more seriously—because the demand for credit is clearly there.

Q37 **Kit Malthouse:** Are you concerned at all that the advance of regulation into other areas—such as credit cards and all the rest of it—that might look at similar caps might then similarly squeeze the volume of credit that is available? If the record of payday loans is that they were effectively decimated—there was a tenfold decrease in the number of people using them—presumably you would think the same—

Torsten Bell: But what does that tell us about the business model? The only cap is on charging them double what the original loan was. The fact the degree of it is as big as that does tell you something about the level of cost and how expensive that form of borrowing was in the first place.

Q38 **Kit Malthouse:** Yes, but the fact that people have exited the market or gone bust tells you something. That they have gone bust tells you something about the level of risk they were dealing with. Pricing for risk is fundamentally what you have to do when you are lending money. If a company that was lending money in this market went bust—nobody does that voluntarily—they went bust because they were unable to price correctly for risk.

Torsten Bell: They were also unable to raise money themselves.

Ashwin Kumar: It is also worth saying that the regulation did not just focus on the price; it also focused on the lending practices. Some of StepChange's evidence is that some of those practices have improved but not completely, so they have figures around the proportion of people who were not being given money advice when they did come into problems etc.

Q39 **Kit Malthouse:** Future moves on regulation will not choke off access to credit, then.

Torsten Bell: We will see what the moves are.

Ashwin Kumar: It depends on what the moves are and it depends on the availability of lower cost alternatives that look at better ways of identifying risk among people with poor credit histories, which the market typically has not been good enough at doing.

Kit Malthouse: Mr Johnson, did you say you did not want to comment?

Michael Johnson: It is not an area I can add very much to.



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Q40 **Kit Malthouse:** I wanted to just move on and ask a bit about intergenerational wealth, which you touched on a little earlier. Before I do that, I wanted to ask something else. Mr Johnson, you talked about taxation of property on sale. Before that, you said stamp duty was a barrier to entry. Presumably, though, a tax on sale is a barrier to exit. Any tax on capital transactions, at whichever end of the transaction, reduces liquidity, presumably.

Michael Johnson: Yes, I ought to expand the definition of sale, which includes death. This rubs shoulders very strongly with inheritance tax, and we are going to have to face that.

Q41 **Kit Malthouse:** The family home should be taxed at the marginal rate, then.

Michael Johnson: At the moment we have a system where those who can afford advisers—ie people who can explain the likes of the seven-year rule and so on—can get around the taxes the Government wish to raise. That seems to be totally wrong to me.

Kit Malthouse: Right, okay.

Michael Johnson: To be clear, the purpose behind a property-gains tax upon sale or death—and in many cases it is more likely it is death—is to socialise the fact that we do not make land anymore. If one looks at the £10 trillion to £11 trillion of household wealth in total, one-third of the component deemed dwellings is land. Land relative to the value of dwellings has gone up by 250% in the last 20 years.

Q42 **Kit Malthouse:** If it is on death, I do not know whether you have done the maths, but the fact that we are living longer—we are very successful at keeping people older for a lot longer—will mean the number of transactions will presumably start to fall over time, because hopefully live births are outnumbering deaths at any one time. If you produce a relatively higher marginal tax on property disposal, it will—

Michael Johnson: Except property wealth is concentrated in those who are older, so they are nearer to death. To the extent that one introduces a property-gains tax, there will be a trickle to begin with, but then the baby boomers will come rushing through, and Generation Y and the rest of society will hopefully benefit. At the moment, it is so utterly out of kilter. Many of us feel this in our gut. It is not in our best interests to be proposing or talking about these things.

Q43 **Kit Malthouse:** Out of interest on this, there may well be, then, a generation that gets skipped. If you look at our Royal Family—

Torsten Bell: They are not the best example.

Kit Malthouse: We have a Monarch who will hopefully live and reign for a lot longer. Her son therefore is unlikely to inherit at a time in his life when it is productive and useful for him. His generation will effectively get leapt over and the wealth would move to the—



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Michael Johnson: It is a question of degree. I am not advocating that one introduces a 100% property-gains tax.

Kit Malthouse: No.

Michael Johnson: I would suggest starting at an index of around 1953, which is when the Nationwide index starts, and maybe we contemplate 10% or 15%.

Q44 **Kit Malthouse:** If you do slow things up, one of the things it might spur is multigenerational households. In Italy and Japan, this is a very common occurrence.

Michael Johnson: It is happening. It is happening.

Kit Malthouse: We are getting it here, too.

Torsten Bell: Actually, that is not true. We are getting slightly more young people living with people for longer. It turns out that for all this stuff about the boomers having all their parents move in, the numbers are going down. It is not true: there are fewer very old people moving in with their kids than there used to be.

Kit Malthouse: That is true.

Torsten Bell: In the UK, we are going the other way.

Kit Malthouse: But there are more 40-year-olds still living with their parents.

Torsten Bell: Yes, although 40-year-olds is quite an extreme case. But yes, there are more 25-year-olds than there were.

Q45 **Kit Malthouse:** You talked a lot about the build-up of balance sheets, effectively, in the elderly. There will come a point when these are realised through death and inheritance. Given that over the last 30 or 40 years we have seen a particular acceleration in longevity in a way we have not before, can you see a point at which that starts to correct the situation a little and we see a bit more of a cascade of that particular capital that has been built up over the last 20 years?

Torsten Bell: That is a good question. We are doing a lot of work on this. We are running a thing called the Intergenerational Commission with various members of the great and the good, looking at a number of these issues. There is a bit of work we are hoping to publish in December or January getting at exactly this: what do we expect? Given we are showing this big age distribution of wealth and different distributions within each cohort of that wealth, what will inheritance do to it?

To state the blindingly obvious, Britain has absolutely horrendous data on this, so knowing exactly what is going to happen is very hard. I would say two things. One is that, although lots of the work out there shows



that inheritances reduce wealth inequality—as in there are some poor people who get a very large inheritance as a percentage of their wealth—if you look at it as a percentage of lifetime income, people who get inheritances, particularly large ones, tend to be much richer—so it will reinforce that inequality trend in the next generation; it will not solve it.

In particular, assortative mating, I am afraid, means that there is a very strong correlation between the wealth of my parents and the wealth of the parents of the woman, in my case, who I married. Those things are heavily correlated. People with parental wealth marry each other, and so it makes it harder to get the dispersal that we might want to get.

Now, will it help on the generational aspect to some degree? Clearly, passing wealth down between generations is part of the answer to some of these challenges. Exactly what happens is very hard to know for a number of reasons. One, we do not know the long-term path of house prices in the UK. Remember that 82% or over three-quarters of the net property wealth accumulated in Britain since the 1990s is due to passive accumulation. It is nothing to do with savings; it is nothing to do with people being savvy; it is nothing to do with home improvements. It is all being driven by the increase in property prices—82%. No one has been a genius investor. They are just all bloody lucky. I mean, someone has probably been a good investor—but you get my point.

Is that going to last? Rates cannot fall any further, and the fall in rates has been a large driver of this housing wealth increase, particularly in bits of the south-east and during the 2000s more generally, I would say, across the whole country. The long-term decline in interest rates since the 1980s is a big part of that. We are probably in the other half of the cycle, even though the equilibrium rate is probably going to be still very low.

Q46 Kit Malthouse: There must also have been a role for the inflation of the 1970s and 1980s, which effectively eroded the value of debt versus assets.

Torsten Bell: Yes. I am just talking about since the 1990s. Some people got huge windfall gains then for exactly the reason you raise as well.

Q47 Kit Malthouse: They are now in their 70s.

Torsten Bell: Yes. That is a really good point. Who are the biggest winners from Britain's wealth distribution over the last century? Everyone thinks it is the boomers, but, basically, wealth has been declining among cohorts in Britain for everybody born after the late 1950s. It is not that the millennials are getting stuffed: everybody has had progressively lower wealth than the people who came before them for the last 50 years. It is just that millennials also happen to have no income.

Q48 Kit Malthouse: The people who are the worst off are the people born in



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the 1960s.

Torsten Bell: No, we see a completely steady decline. They are worst off in the sense that they missed some of the music, but they are not the worst off in terms of—

Kit Malthouse: They missed the 1970s and 1980s, but they did not get the—

Torsten Bell: No, you want to be older and older and older until you get to the war, basically, obviously.

Chair: And then you were dead.

Torsten Bell: Then you have a high chance of being dead. It is very bad.

There is less wealth on average for these cohorts, for everybody. Although wealth inequality has been falling consistently in Britain in the 20th century—it fell basically until just before the crisis and it has now started ticking up—inequality within each of these cohorts is higher progressively. Each cohort born has higher inequality within the cohort.

Q49 **Kit Malthouse:** You raise an interesting point about, effectively, rich people marrying rich people and the correlation between that. But my sense is that the creation of wealth or family wealth is a multigenerational exercise. It can take two or three generations linked to access to education, higher paid jobs or whatever it might be—but also the starting of saving by one generation being built up by the next. I have not seen much Government policy that recognises that. Is there a place for that?

In the good old bad old days, there was some talk about multigenerational mortgages, where you could have a house and a mortgage and then carry it across, which implies that the same property would stay in the same family. They do it in Japan. Would that be a sensible thing?

Torsten Bell: We are seeing a trend towards 30-year mortgages. I am not in favour of moving to multigenerational mortgages. I would say that although it is true among some people that become very wealthy—

Q50 **Kit Malthouse:** We are moving to a place of multigenerational pensions, where you can inherit your parents' pensions.

Torsten Bell: That is a very good question. One of the things nobody talks about as an outcome of some of this pension freedom stuff is that we are going to be tax relieving large pots of cash, which are in danger of then being passed down and reinforcing exactly the dangerous trend we are talking about. We are not going to be having risk pooling, and the people who can most afford to opt out of risk pooling are the very wealthy, who could have very large pension pots. They will have had a lot of tax relief, and that could be passed down in a very unequal way.



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That is a really serious risk, and I do not know why we do not talk about that.

Why we are tax-relieving the building up of savings for the purposes of bequests—we used to have three different policy barriers to stop that happening—is a really good question. I have no idea why we are doing that.

Q51 Kit Malthouse: Is the creation of a multigenerational family balance sheet a good idea? You might not think that. I cannot tell from what you are saying.

Torsten Bell: Families wanting to look after their kids is both normal human behaviour and sensible.

Q52 Kit Malthouse: It is not just looking after their kids; it is looking after their grandchildren and beyond.

Torsten Bell: Yes, and you see that very clearly in all the humans we meet. In all the surveys, people want to do that—and that is a good thing. There is a separate question.

Q53 Kit Malthouse: This is the whole idea behind family businesses and farms.

Torsten Bell: The state does a huge job to encourage that. We completely relieve all farm and industrial equipment from inheritance tax.

Q54 Kit Malthouse: It does in commercial situations, but not necessarily in private ones. Should it? That is my question.

Torsten Bell: My answer is that in practice we do quite a good job of not using the tax system. Less than 6% of estates pay inheritance tax now, so we do quite a good job of allowing that to happen. The danger is the opposite.

We do not want to stop people passing things down, but the danger is the opposite. In a world where we are seeing both a widening of the age distribution of wealth—ie the old having progressively more of it—and a growing inequality of that wealth among younger cohorts, and now in the population as a whole, we should be worried about the passing down of that wealth in narrower ways. Inequality is being created by things, principally property, being less equally distributed among the young today, and their parents are then reinforcing that distribution later.

Kit Malthouse: Did anybody else have anything to add?

Ashwin Kumar: I am particularly concerned about the idea of reinforcing inequalities through inheritances. The stress people feel currently about housing and access to housing will be amplified in future generations if we do not do anything about that.



Michael Johnson: We are also forgetting that Generation Y have burdens the previous generations have not had. Currently there is around £101 billion or £102 billion of student debt, for example. Although it is income-contingent, it is not an experience that many of us in this room have had, along with all the other challenges that Generation Y has: no DB pensions, fragmented careers etc.

There are two other aspects we need to bear in mind in terms of the background noise of household finance in the last decade or so. One is QE, but the other is PPI, which is a form of soft QE. That has been another source of many tens of billions of cash going into households. It is not necessarily caught in the data.

Q55 **Kit Malthouse:** I read that during the recession PPI was the biggest stimulus to the economy.

Michael Johnson: Yes, it is a form of QE.

Kit Malthouse: It helped much more than QE.

Torsten Bell: The bad news is that it is about to stop. It is about to stop rolling down.

Michael Johnson: Whilst we might try to look at history, there are lots of other things that have been going on in the last 10 years that are not necessarily going to be around in the future—or indeed are going to be much worse. Student debt will be something that is discussed next week.

Chair: Yes, we have an inquiry looking at student debt and the effect on the nation's balance sheets as well.

Michael Johnson: Can we talk about that now?

Chair: We might ask you back, if we might.

Q56 **Rushanara Ali:** We have covered quite a lot of ground, so please just add any additional points to what I am about to ask you. This is particularly around incomes and why you think income growth has performed relatively poorly and the consequences of that in terms of households' ability to save. You have covered some of those points, so, if you could make any additional points on that, it would be helpful. Who would like to start?

Torsten Bell: The blindingly obvious answer is that we have had the biggest recession since the Second World War. Unsurprisingly, that has had a pretty bad effect on household incomes. That is the dominant problem; that is your first starting point.

Your second point is that there is the depth of the GDP loss, and then the recovery from that recession has been, in a way none of us expected, rooted in weak productivity performance. We are now at whatever it is—



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0.3% above pre-crisis productivity—ie none. We are basically at exactly the productivity levels we saw then. We did not think that could happen.

Now, obviously to a degree that is feeding through to earnings and into the weak income forecasts we talked about earlier, but it is obviously a two-way street. Some of what is going on is that very weak productivity is driving weak wages, and that very weak wages and labour costs—what wages look like to businesses—are feeding into low productivity. That is almost certainly the case.

Probably in a way that lots of us did not appreciate at the time, there has been this big depreciation in sterling. Although we are all focused on the post-Brexit depreciation, the depreciation in the financial crisis was much bigger for Britain, even though other countries were going through a crisis. That is what lies behind a lot of that wage squeeze.

The big inflation—it briefly got up to 5%—on the back of that depreciation led to a big squeeze on wages and lower labour costs relative to consumer goods costs in the UK. That has given firms an incentive to hire labour and not to invest—plus they have huge uncertainty about future demand, which is also suppressed.

The two things have come together: a large loss in GDP because we are poorer as a country, and then a productivity problem growing from that. If we are honest, we do not know the exact answer to this, but I would suggest that you have a two-way dynamic from low wages to low productivity and from low productivity to low wages.

This is kind of what the Bank of England is saying. The minimum wage and the reduction in labour supply to some degree from lower migration may be part of that. We are about to put up labour costs for lots of businesses, and we are about to see how they respond to that happening.

Ashwin Kumar: The only thing I would add is the poor performance in terms of progression for people on low pay. We have had all sorts of things happening in the labour market. Zero-hours contracts affect a certain number of people, but they are reflective of the approach of many firms. This is by no means all firms: there are many firms that take directly the opposite approach.

However, there is now a body of the economy where a commodified approach to labour means there is lower investment in training and lower prospects of progression for workers in that position. This makes it harder for the firms who want to do things the other way, because they face competitive pressures from those kinds of firms. It is one thing to look at incomes now and the possibility of income, but at the individual level the possibility of escaping it seems to be more remote, because of some of these things going on in the labour market.

Q57 **Rushanara Ali:** Yes, particularly in that growing sector of those who are on zero-hours contracts and the gig economy and so on.



Michael Johnson: It is now in play. The Uber law case is something I am sure you are taking considerable interest in. Let's not forget Matthew Taylor's report and some of the recommendations in there. That report talks about introducing dependent contractors as a new category of employment.

Rushanara Ali: Did you say "dependent"?

Michael Johnson: Dependent, yes—it is dependent through your app, typically. As to whether that starts to push back on some of the deleterious employment practices that we have seen in the gig economy—and let's hope that is the case—it may be a double-edged sword. It might push incomes up a bit, but it might increase unemployment.

Ashwin Kumar: To follow up on the living wage campaigns, for instance, you have seen some pushback. Supermarkets like Aldi and Lidl have pledged to be living wage employers, and they are not the only ones. Typically, when firms have needed to generate the productivity to justify the higher wages that come with adopting the living wage, they have looked at job design, the productivity of individual workers and the amount of flexibility that people have in the workplace to be able to learn new skills.

If there is still a lot of pressure the other way within the economy, that constrains the degree to which we can expect pay rises at the bottom of the distribution.

Q58 **Rushanara Ali:** Within that sector of the economy that is low-paid, low-security and which uses new technology and so on, could productivity be enhanced if there were more stability and predictability in terms of hours and salaries and so on?

Ashwin Kumar: As Torsten said, we are still getting to grips with the order of causation on productivity. We have just commissioned some work that has been looking at the relationship with productivity by sector in a number of OECD countries. That did find that one of the explanatory factors in higher productivity in a given sector was fewer temporary employment contracts.

I am not going to say that is the end of this discussion—we are going to have to understand more about it—but there is something about the forms we now have in the labour market and their potential effects as part of this productivity puzzle.

Torsten Bell: To state the blindingly obvious, clearly all those sectors could be more productive—because lots of countries have the same sectors producing the same outputs and do it in a more productive way. Clearly, it is not hard to envisage. In British supermarkets, every morning people walk around and put in paper prices. The computer prints them all out, and they walk around and put them in. Every British



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supermarket does that. In France, not in every French supermarket but in large amounts of French supermarkets, they press the button and the computer flashes up on the LCD screens below each of the products and changes their prices.

Now, there are lots of reasons why that happens. All I am saying is that productivity can clearly be done differently. We used to wash cars with machines; we now wash cars by hand. Technology does not go in an upwards direction.

Q59 Rushanara Ali: I am just going to come back to incomes and savings. Given what we know about household income and the link to savings, given the context of what has happened, is it realistic to expect people to be able to save?

Michael Johnson: This is about the future of Help to Save, which of course has not yet kicked off.

Rushanara Ali: I mean for both pensions and savings for more short-term issues.

Michael Johnson: It is probably difficult for everyone in this room, including me, to answer that kind of question, because we are probably not in the bottom two or three deciles of the income distribution. It is not our immediate experience. I would have thought that if you are in that area, then it is impossible.

Rushanara Ali: Ashwin, your organisation works with a lot of people who are in severe poverty.

Michael Johnson: I am sorry. One suggestion with Help to Save would be to introduce it as a default, like automatic enrolment.

Rushanara Ali: Right, yes.

Ashwin Kumar: When you ask people on low incomes about saving, there is a desire to save but a stress and a worry that people will not be able to. There are particular things people are worried about. One of them is access to the cash, because of that worry about the boiler or the unexpected bill. I mean savings products that tie up money for a long period of time or disincentivise withdrawal. There is interest in forms of auto-enrolment in savings if it is done at an appropriate level and where people have access to the cash.

Q60 Rushanara Ali: That is about a methodology rather than the money.

Ashwin Kumar: The methodology will have some impact, but the basics of the money do dominate.

Perhaps take us back to the pension tax-relief conversation we had at the start. If you have all this money that is going to incentivise people who are already doing perfectly well or okay within their lifetime saving, can



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some of that money not be used for bigger bonuses or bigger incentives to make it more worthwhile for people on low incomes to save?

If we look at the context for saving as simply, "Okay, we can give you some tax relief and that is the maximum incentive we can offer," then you ask a very good question. We may well be saying to people whose finances are so stretched that, actually, there is not much possibility. If the bonuses are bigger, if the incentives are bigger, maybe we can encourage it to a greater degree.

Help to Save will test this, but—let's face it—the cost of Help to Save will be £70 million by 2021. It is not a huge amount of money that is going to this, and it is dwarfed by the increases in costs for additional ISA allowances.

Q61 Chair: The bonuses could be easier to understand. Tax relief is something that for most people, like their tax code and the stuff that comes out of HMRC, is as much of a mystery as their mortgage terms. Is that fair to say?

Ashwin Kumar: Yes.

Michael Johnson: It also creates some people who lose out for all the wrong reasons. I am thinking about the net-pay mechanism for tax relief. Essentially, if you earn between £10,000 and the personal allowance, you miss out on tax relief. All these sorts of ridiculous complexities would disappear if we swept that system away and replaced it with a bonus structure.

Ashwin Kumar: Yes. There is evidence that mechanisms like bonuses are more transparent. That is precisely why Help to Save is being, as Torsten said, reintroduced, effectively, 17 years on.

Torsten Bell: Yes—17 years on.

Q62 Rushanara Ali: But it is not to a scale that is going to make a significant difference.

Ashwin Kumar: No, not to a sufficient scale and not with sufficient incentives that might make the difference we want to see.

Q63 Rushanara Ali: What scale would it need to be at?

Ashwin Kumar: That is a hard question to ask.

Rushanara Ali: Torsten, do you want to have a go?

Torsten Bell: You want to think about two different objectives for the state. One is the tone we are focusing on, which is how does the state encourage people to get into the habit of saving? You can imagine policies like Help to Save working on that, and I would not quibble much with the detail of Help to Save—except that it is more targeted on higher earning families and slightly less generous than Saving Gateway.



You can encourage that. That is a different objective from: "I want lower income families to have some savings." There is only one route to that. Personally, given what we have said about what is happening to the wealth distribution and given what we have said about some problems with what is happening to income and the level of squeezed incomes, you probably want to think about ways of giving people savings as much as you want to think about encouraging the savings. You want to transfer wealth, not just encourage them to get into the habit of saving.

Remember that lots of people oscillate in and out of the very lowest part of the income distribution; it changes a lot. If you are in the unlucky group that is stuck in that part of the distribution, you are not going to save—with everything I have said about housing costs and wages.

If that is what you want to try to solve—to give them more of a buffer—then the state provides that resilience either via the welfare system or via direct wealth redistribution. Those are different things from incentive structures in savings.

Q64 Rushanara Ali: Could you give some good examples?

Torsten Bell: We used to have the Child Trust Fund.

Rushanara Ali: I was going to come to that.

Torsten Bell: There are things you can do. That is on the more popular end, because it has the word "child" in it, but you could imagine lots of ways.

Q65 Rushanara Ali: But that did encourage savings, didn't it?

Torsten Bell: Yes, it did encourage savings, but it did just give money to everybody.

Chair: It was not targeted.

Torsten Bell: You got more if you were poorer. My point is that it was giving you cash, not saying, "I am going to give you a 20% rebate on your savings," because lots of people cannot save.

Why do savings products end up being regressive in their spend? It is inevitable, if you provide anything that looks like a flat rate matching for savings, better-off people can save more. That is why it ends up being regressive.

Q66 Rushanara Ali: Unfortunately, my constituency is second highest in terms of the rankings of people with problems with debt, after Newham, at nearly a quarter of the population. I just wanted to get you to develop your thinking a bit more about some of the products that could be developed. You talked about payday lending; Kit has talked about some of the perverse or unforeseen consequences, perhaps, with fewer products. You mentioned credit unions. Again, there is an issue about scale; there is an issue about access.



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What could the Government do to try to address that end of the population? There is a ticking time bomb of more people who are going to be in that position, and younger people, as you said, paying for their living costs through debt. What should the Chancellor do ahead of the statement he is due to make?

This is your opportunity to make some suggestions. We will try to lobby him for it.

Chair: I am sure you will all come up with budget submissions. Certainly Joseph Rowntree and the Resolution Foundation have.

Rushanara Ali: It is still quite at a micro level, given the challenge that is facing us.

Michael Johnson: The question you are asking is about the interface between the welfare and benefits system and the saving-incentives arena. To the extent that many of your constituents are unable to save at all, then the incentive side of the equation is irrelevant.

Q67 **Rushanara Ali:** Hang on. I was getting to the point about those who face indebtedness who need access to debt that is not expensive to serve. Given that, rightly, some of the worst forms of those practices have been improved, there is obviously still a demand for credit that is hard for people to access but does not get them into this trap. Are the Joseph Rowntree Foundation and others looking at some big ideas around how that could be addressed?

Michael Johnson: Forgive me, but are you suggesting that, to the extent that credit is sourced from wherever it is, it is not actually priced to reflect the risk?

Q68 **Rushanara Ali:** The question is: should the Government be managing that risk?

Michael Johnson: Should they be subsidising it?

Rushanara Ali: Should the Government be subsidising that risk. Obviously, you mentioned the Social Fund, but it is not going far enough. This is clearly a market failure, in essence. What should the Government do to try to address it? We keep going around and around. I was on the Committee a few years ago. We did a similar Inquiry. We are just going in circles; the problem gets worse. What are your thoughts and ideas on how the Government could support a more scalable solution to deal with these imperfections in the system?

Ashwin Kumar: Essentially the question is around the pricing of risk, as you were saying, Michael. The point is: are there ways of managing the risk without using the price mechanism? If the risk is only managed through the price mechanism, what you default towards is high-cost products. That is the point of mechanisms like the Social Fund and credit unions: they are effectively managing the risk not just through the price. I am not the expert on the precise design of all those products, but



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StepChange, Citizens Advice and others have been floating different ways of constructing credit products that enable people with poor credit records to access them.

I guess where we come from is that the problem is acute; there is a demand for credit, particularly with insecure incomes. People need those forms of credit to bridge the gap when their income is uncertain. However, no, I am not an expert on the design of the products.

Rushanara Ali: Does anyone else want to come in?

Torsten Bell: You should speak to those organisations about specific proposals, and they have lots.

Why is the undesirable situation you set out happening? One, it is because of decisions we make about where risk lies between the state and the individual, or the collective and the individual, when they fall on hard times. Two, in your constituency, it is due to housing costs. Is the credit market the issue or is the underlying living standards challenge the issue? I do not want to speak specifically about your constituency, but overall a bigger challenge is the very high rise in housing costs, largely in the 1980s and into the 1990s—and in London, and other places, more recently in rents—and the compositional shift of tenures into private renting. That is why family budgets are strained.

Added to that, among low-wage groups, and in London in particular obviously, the living wage has much less bite. If you look at the likely earnings distribution of families over this year and the last few years, over the country as a whole it is very progressive: poorer families are seeing higher earnings growth than middle-income and high-income families. In London that is not the case, and that is because the National Living Wage does not bite. Low earners are not as low paid as the minimum wage in London, so they get less benefit from it.

Michael Johnson: Could I talk about breaking the debt cycle? Historically, the way that is done at country level, if you think about the Latin America debt crisis for example, is essentially by rescheduling and purchasing of time. Latin America reschedules its debts over 30 years, and in the interim all sorts of structural reforms and democracy arrived. Ultimately, though, that was also accompanied by some form of debt forgiveness, which meant that somebody had to pay.

If one is looking for a parallel in the world you are describing, that means you are socialising the payment through the taxman. As to the specific detail of what the product looks like, I am struggling.

Q69 **Rushanara Ali:** Maybe that 13% is the group to use to look at that idea, because paying it off is going to be very challenging.

I have one final question, which is about those who are self-employed and not eligible for auto-enrolment. Is there a case for reforming that so that they are also part of the auto-enrolment programme? Given the



way the gig economy is structured around the notion of self-employment with the Ubers and others, did the design of this proposal not anticipate the growth in that sector? Is it time that we do look at reforms to include those who are not included in the auto-enrolment programme?

Michael Johnson: Yes, absolutely. In a fairly detailed paper I put forward an outline of one way of doing this, starting off with the observation that class 1 or class 4 NICs is a 3% difference but you earn the same entitlements. I am afraid this suggestion for the gig economy and the self-employed is revisiting a challenge the Chancellor attempted in terms of raising NICs.

We can do this within an automatic-enrolment framework, where we essentially create a quasi-employer, because a self-employed person by definition does not have the benefit of employer contributions. If the self-employed person makes a quasi-employer contribution, the 3% rise in NICs that accompanies this would go into his pot, not to the Treasury.

Ashwin Kumar: The broader problem with self-employment is that effectively, because the taxation is lower, there is a strong incentive, particularly at the level of the employer or the firm that is utilising the services, to push people in that direction. Whilst you have that tax disparity, you then get people pushed in that direction and then a whole series of reduced protections, such as holiday entitlement, as well as the financial implications of it.

As somebody who has been self-employed, I am absolutely not in the world of thinking that we need to squash self-employment—but on the other hand fake self-employment is bad for the economy; it is bad for the people in question. The reason why it occurs is that companies are getting fairly sophisticated at exploiting the difference and seeing the opportunity.

Q70 **Rushanara Ali:** Which ones would you describe as fake self-employment? Does Uber fit into that?

Ashwin Kumar: I am not in a position to comment on specific companies.

Chair: That was a nice try.

Torsten Bell: The courts have answered that already.

Ashwin Kumar: Where you do not have the choices that genuinely exist with self-employment, it is not self-employment. We should have a legal framework that rules that out. Part of the reason we get into that territory is because of the differential tax treatment.

Torsten Bell: One, the growth in self-employment is not due to technology. There is a bit of a risk with the gig economy: that we all focus on that as the issue. The issue is not that; the issue is self-employment more generally.



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Rushanara Ali: It has grown.

Torsten Bell: The gig economy is quite small. What we care about is self-employment. What is driving the growth in that? 45% of the jobs growth since 2010 is in self-employment. It has got nothing to do with technology and the gig economy; it has everything to do with a loose labour market at the same time as a big tax incentive.

Where does that take you on auto-enrolment and pensions? If you do not bring the self-employed into auto-enrolment in some form with some form of employer contribution or contribution from the contracting organisation, then you have got a big problem: you are about to increase the incentive for self-employment that has been driving that very increase.

My view is that you do not really have much choice. Even if it was not because you were worried about the self-employed having no pensions, you have got a problem if you do not do it: you are about to increase an already strong fiscal incentive for people to go down the self-employment route. That is not what is happening in other countries, and the fact that we are not doing anything about it is a disgrace.

Q71 **Rushanara Ali:** To pick on the gig economy, I take your point that it is not a huge number, but it could grow. The way it is structured does have an effect on auto-enrolment, does it not?

Torsten Bell: It does, but let me give you an example. Uber has managed to lose its court case twice. The taxi firms have been winning this same court case for decades. These minicab firms also use self-employed labour—not all of them, but almost all of them. They have the same tax treatment as Uber.

Is it sustainable that they have completely different tax treatments? No. Uber is not going to live in a world where they are paying national insurance and every other minicab firm in the country is not. They will keep changing their business model until the courts decide that their level of control of the workers gets them back into being self-employed.

The question for politicians and for Parliament, not just for the courts, is: what world do you want? Do you want your minicab drivers being self-employed and having more flexibility, or do you want them brought within the realms of employment protections, pension savings and paying an equal amount of tax?

Q72 **Rushanara Ali:** What would you do on pension savings? Do you have any recommendations on pension savings for those kinds of workers?

Torsten Bell: I am saying that you are going to have to bring them in, because if you do not, you are going to get more of these incentives. There are a number of ways you could do that. The employer bit of this picture is exactly analogous to the employer's contributions to National Insurance. The others should lose in the court cases, but for people who



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are genuinely self-employed you are probably going to want some form of contractor levy. That could cover pensions or it could cover National Insurance Contributions. I would prefer that to an equal amount of National Insurance Contributions from the self-employed—I see no case for them paying different rates anymore—being used as some kind of employer contribution.

People contracting that labour should pay for the labour in the same way that they pay for employees. If they want to use self-employed labour, that is fine—but it is not for the tax system to incentivise those differences.

Chair: Kit, did you have one final question?

Q73 **Kit Malthouse:** Finally, would it be mad or eccentric of me to propose the idea that the National Lottery had had an impact on saving over its life? Apart from the nearly £8 billion or whatever that goes into the lottery, which we know is skewed towards lower income levels, it also has a psychological impact: “I can win rather than have to work or save for it.” Has any of you looked at that?

Michael Johnson: No.

Torsten Bell: No, not so much. We have not done a detailed report into the effect of the National Lottery on the nation’s savings habits, unfortunately, is the answer.

Ashwin Kumar: No, likewise.

Michael Johnson: It comes under expenditure, doesn’t it, rather than savings?

Kit Malthouse: Yes, but £8 billion or whatever a year gets spent on the National Lottery.

Michael Johnson: No, I understand your point.

Torsten Bell: Whether the existence of upside risk discourages us from dealing with our realities is what you are getting at. I have no idea.

Chair: We will have to see if they want to give us evidence. Can I thank you all very much indeed? That has been absolutely fascinating, and your time is greatly appreciated. If there is anything after today’s session that you think about or further work, please feel free to write to draw our attention to it, but for now thank you very much indeed for your time this morning.