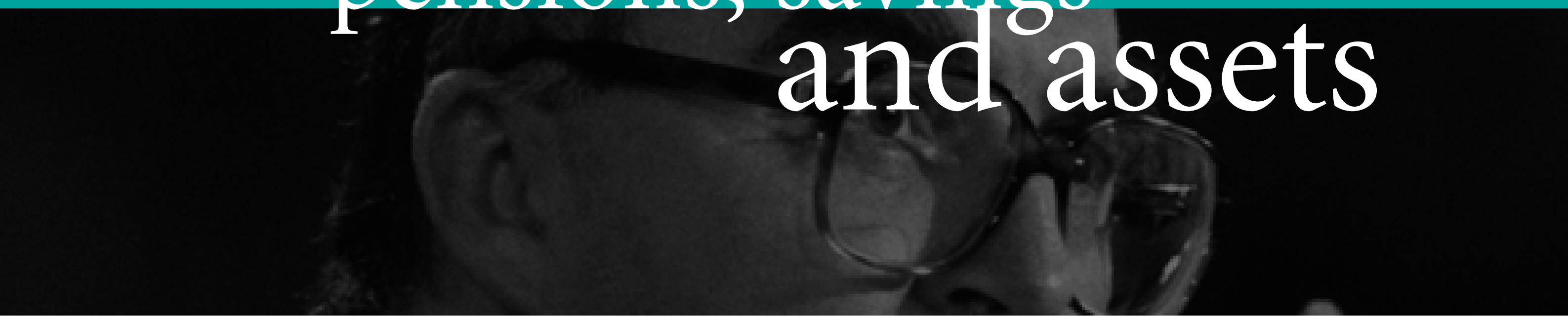
pensions, savings and assets



A series of two seminar held between

March and July 2001

Edited by Hugo Foxwood
and John Wilson

The Smith Institute

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Published by the Smith Institute

ISBN 1 902488 55 5

Preface

The Smith Institute has been set up to look at issues which flow from the changing relationship between social values and economic imperatives.

This booklet is based on a series of two seminars that took place between March and July 2001. The series explored the related issues of Pensions and more broadly, Savings and Assets, and is based on contributions made from David Willetts MP, Rt. Hon. Frank Field MP, Keith Bedell-Pearce (Executive Director of Prudential plc) John Bynner and Matthew Taylor (Director of IPPR). Each of the seminars was well-attended and in each case the presentations sparked off a lively debate. We have tried to reflect the debate which followed. Inevitably, in transforming a live event into print, some of the colour and the texture of the original have been lost. We hope, however, that those who attended the seminar will recognise much of what is included here, and that those who read it fresh will respond to the flow of good ideas which emerged during the series.

Seminar 1

Pensions: a still uncertain future

A Seminar held on Monday 19th March 2001 at
Social Market Foundation, 11 Tufton Street, London

Edited by John Wilson

Introduction

Phil Collins

Welcome. This is the first collaboration of The Social Market Foundation and the Smith Institute. The Social Market Foundation has, over the years, done a lot of work on pensions, most notably from two of our panellists, David Willetts and Frank Field. I always feel, when we return to this subject, that I am, in a very remote way, the subject, because although I started off my career working with Frank Field, and I spent six years as a stockbroker advising institutional investors, I nevertheless still do not have a pension!

Wilf Stevenson

The Smith Institute, as I am sure you know, is named after John, not Adam, but we can come back to that, because our interests span right across the interests of the earlier, lesser known Adam to John Smith, who had a considerable interest in the interaction between the market and social justice. Indeed, he coined the phrase *"Economic efficiency and social justice are two sides of the same coin."*

Although we are interested in that area and debate, we are still quite small, so, when we can, we try to work with other like-minded organisations. It was a conversation with Phil about four or five months ago that brought us to the idea that we might do an event around this topic. After all, as Phil has just explained, it is in his best interests! We have been working over the last year or so on issues to do with equality, and particularly in the last year on equality and low pay. We have been trying to look at some of the interactions at the bottom end of the pay distribution, where people in the bottom decile obviously have an interest in savings, pensions and related matters, but very often do not have either the wherewithal or the capacity to overcome the very real barriers which exist in that area to taking out the sort of savings plan that might be appropriate for them.

We have also, with the support of Prudential, been looking at US/UK comparisons. We ran a successful event just over a month ago which, as well as comparing and contrasting US and UK conditions, had a special focus on 401(k)s and Stakeholder Pensions. We hope to return to the topic in the future by looking at comparisons between the UK and Europe, where I think there are very different backgrounds to the pensions and savings debate.

Now, in order to get us started, Keith Bedell-Pearce from Prudential has kindly agreed to say a few words.

Keith Bedell-Pearce

Stakeholder Pensions – Or Compulsion?

I have just a very small number of contextual comments about the three territories under consideration, the UK, USA and Europe.

First of all, looking at the UK, of course Stakeholder Pensions hit the streets next month (if that is the right expression!). I have no doubt that this particular pensions vehicle will be a huge hit. Unfortunately, it will be a huge hit with what I call the savings classes, those who are already converted to savings through all of the tax-efficient vehicles that are available. I have no doubt that husbands and wives and partners will fill their boots to the £3,000 or so that they are allowed, and top it up with their ISAs, making about £20,000 a year of tax-privileged savings. Such amounts are, in fact, in excess of the national average wage and beyond the dreams of avarice and everything else so far as the vast proportion of the population is concerned.

Where Stakeholder Pensions will struggle is with the very group that the Government targeted as part of this initiative, those with incomes in the £10,000 to £20,000 range. It is what I call the capture problem. The reason is that there is a limit on charges (and that is something which we agree is sensible in the context of the whole thing), a one per cent charge. But when you realise that the minimum contribution that you have to offer with a Stakeholder Pension, which is £20 a month, that is £240 a year, one per cent of that is £2.40, which will barely pay the cost of the parking meter of the salesman who is going to visit to persuade this individual to save that amount. Therefore, there will remain a substantial proportion of the population, probably the proportion of the population that should be making pensions provision more than any other, who in fact will not do so. Ironically, the one per cent charge environment, coupled with the regulatory regime that we now have, means that progressively larger portions of the population are effectively disenfranchised from saving. I think this is a major problem that needs to be addressed by all of the political parties.

Reference was made to 401(k), and this is often seen as being some sort of miracle that has happened in the United States. But as Wilf mentioned a little earlier, we had a transatlantic seminar a month ago, and one of the interesting things to emerge was that 401(k) is pretty much an accidental thing. It was never actually designed for the purpose it was put to. Perhaps more significantly, even now, despite its apparent success, it is very much a large employer phenomenon in the United States, and penetration in what we would call the SME sector is relatively slight.

The conclusion that I have come to (and this is a personal view) is that if the lower income groups are going to be brought into the franchise of funded pensions provision, then compulsion is going to be inevitable. I think there is a fair degree of agreement that that is a practical solution, but probably a political impossibility, at least the way things are at the moment. I would be very interested to hear how David and Frank might square this particular circle.

The US Dimension

Turning very briefly to the US, it is the largest retirement market in the world. It is also the market that is committed to funded pensions based on real assets and therefore it is a must for any would-be global financial services player. Unfortunately, the rules of the SEC prevent me from saying anything more, in case I might be seen to be puffing a deal that was announced this time last week, so I will leave it there so far as the US is concerned.

The European Dimension

So far as Europe is concerned, it is not a single market, it is a patchwork quilt of very disparate markets where, more than any other geographical grouping, national preferences and prejudices still, so far as financial service provision is concerned, reign supreme. Funded pensions are getting into motion now in a number of the major markets, particularly France and Germany, but I predict it will continue to be a politically rocky path. It is often said that change of the type that is required to bring about funded pensions in France would require either a war or a revolution. I suspect that this is sufficiently difficult as to require both, but we will have to see.

Finally, I shall touch on harmonisation. Brussels is starting to get its teeth, if I can call them that, into the whole question of pensions provision and we have started to hear murmurs about harmonisation. I do think that there are some very fundamental dangers so far as that is concerned, particularly if we start to see the intervention of Brussels in asset allocation and fund management approaches and so on. Whilst no-one would describe me as a euro-sceptic, I do sense danger in that particular direction.

Those are the three topics I want to discuss. I hope there is a little piece in there which may be discussed as the session progresses.

David Willetts MP

Why American Pensions are Different

First of all, thank you very much to our hosts. It is very good of the SMF and the Smith Institute to bring us together. I am sorry we do not have Steve Webb here. I always enjoy discussing this with Steve as well, who is from the Lib Dems and who knows his stuff. We do not, of course, have a representative of the Government. We have a person who opposes the Government much more effectively than I do! Anyway, we will hopefully have a proper debate at any rate.

I will comment briefly on David Harris' paper on the US and the UK *(Common Horizons: Comparing Savings and Retirement in the USA and UK)* before turning to the European question. The one thing that I do not think came across in that document is the difference between the British system and the American system, which is very relevant to this 401(k) issue. The difference between the British system and the American system is that the American system is much more socialist than the British one! You have to understand that the American social security system is more ambitious and much more extensive than British social security. It is partly, of course, because in America, welfare and social security are different things, whereas in Britain, we get them all muddled up.

In America, social security is highly legitimate, highly popular, and they never had a Boyd-Carpenter. Boyd-Carpenter is the crucial point at which the British and American systems diverge. Pre Boyd-Carpenter, we had a system of flat-rate contributions paying flat-rate benefits. The flat-rate contributions were not generating enough revenues to pay flat-rate benefits, so the British policy debate in the 1950s was to shift to earnings-related contributions. If you shifted to earnings-related contributions, the view was you also had to have some sort of earnings-related benefits. The question was whether your system of earnings-related contributions and earnings-related benefits should be universal and compulsory or whether people should be able to opt out from the earnings-related benefit. It was Boyd-Carpenter who, contrary to the advice from his officials and the general mood at the time and the urging of the Labour Party (then in opposition), said that people should be able to opt out from the earnings-related element in our social security system.

It was that which really laid the basis for the massive growth in funded occupational pensions.

America, with some small exceptions for public service employees, has never had a Boyd-Carpenter. You do not opt out from the earnings-related element in American social security, so American social security is far more extensive than British social security provision for pensions. This is not just an historical curiosity, or teasing the Americans, this is relevant for the 401(k) debate, because what it means is that people who have funded pension savings in the US already have a level of social security financed pension provision which will keep them out of poverty. So you can afford to have a more tolerant and relaxed regulatory regime and take more risks with your 401(k), because even if your 401(k) is entirely invested in technology stocks and proves to be worthless, you have still got a level of social security which will mean that you are not going to starve and fall on to general assistance, such as it is.

In Britain, the value of the basic pension is so modest that occupational pensions provide a bread and butter income for many people. This means that funded pensions are more central to the income of retired people in Britain than 401(k)s and other devices are in the US. As a result, the fear in the DSS is, all the time, "If we allow people to do risky things with their occupational pensions and it does not work out, they will be back on means-tested benefits." Hence, the British regime is regulated in a much more conservative way than the American 401(k)s are. Unless you appreciate the difference between American social security and British state pension provision, you cannot grasp why 401(k)s can work in America in a way they cannot in Britain. I think that is relevant for the policy debate before we think we can lift the 401(k)s and apply them here.

Britain and Europe: Opposite Problems

What about Britain and Europe? We all rather complacently pat ourselves on the back and say, "Aren't we marvellous in Britain, we have all this funded pension provision and on the continent, by and large, they do not." Of course that is true if you take an historical snapshot. But Britain does have a problem; we just happen to have the equal and opposite problem to the one they have on the continent.

On the continent, the problem is unfunded liabilities, generating a future fiscal crisis when the state has to raise the revenues in order to meet the promises that have been made. Britain's problem is not, by and large, unfunded liabilities. Britain's problem is that many working people have unrealistic expectations of the level of their future pension. They will be shocked when they retire and discover that their pension income is so modest. The resulting political pressure from the grey vote could prove to be irresistible.

Frank and I were both at a seminar on this in Zurich last month or the month before where there were two fascinating presentations. A guy came along from Moody's, I think it was, and said that Moody's were very confident that governments would always rather default on their pension promises than on their sovereign debt. So Moody's did not worry about the continental economies, because they were sure they would not actually deliver their pension promises, so they could all have a healthy rating despite they have these massive unfunded liabilities.

Britain, of course, always looks good in these comparisons. Partly because of the decision taken in Margaret Thatcher's time, our unfunded liabilities look very small. You could argue that Margaret Thatcher was the person who 'defaulted' on the pensions promises by changing the expectations of pensioners. The question is whether democratic governments might not be tempted to default on that default. For example, if you put back into the OECD calculations of future costs of state pension provision the costs of the policy decisions announced by Gordon Brown in the past 18 months, you have quite a significant shift in the long-term liabilities of the UK Government as a percentage of GDP. That may only be the start of political pressures for more generous treatment of pensioners.

The only solution (and I think this is common ground for most people) in Britain is to drive further forward with encouraging more funded pension provision, so that people's access to funded pension savings is closer to what they are already expecting to enjoy. That is common ground. The question is how you achieve it and, of course, there is the very depressing evidence on how little progress has been made in achieving that in the past few years, with the savings ratio down from 10.6 per cent in the second quarter of 1997 to 3.4

per cent in the third quarter of 2000. Although that is partly a macro story, it is not just a macro story, there are also micro factors behind it.

The Stakeholder Approach

We have a problem of a low savings ratio and high pension expectations. We need to tackle the problem by encouraging more savings on pensions. I would describe three options for trying to tackle that problem.

First of all, there is the Government's approach, which is the Stakeholder model. I very much agree with what the man from the Pru said. The question about Stakeholding is whether it is going to increase the amount of pension saving by reaching out to the hitherto unpensioned, or whether instead it is simply going to churn through existing pension savers into Stakeholders, but with no increase in the aggregate amount of pension saving and no significant spread of pension saving to people with more modest earnings. My view is that there will be hundreds of thousands of new Stakeholder Pensions taken out and the Government will declare it an enormous success. The only trouble will be that they will almost all have been taken out by people who previously had some other form of pension saving and there will be virtually no extension of Stakeholders to the people that the Government is trying to reach.

Interestingly, as a footnote, it is a moot point whether it is even rational for people who have modest earnings to be opting to take out the Stakeholder Pension, given the value of the Minimum Income Guarantee, etc. Some people in the pensions industry, given the way they are now regulated and the way that they were hauled over the coals for the pensions mis-selling scandal, are very wary of selling Stakeholder Pensions to people on lower incomes. Some people will find they are no better off in their retirement as a result of having a Stakeholder Pension, as the extra income will be cancelled out by reduced entitlement to means-tested help. The $64,000 question which we regularly put to ministers is, "How much money do you have to have in your Stakeholder to float you off means-tested benefits?". The answer could well be $64,000, but sadly we have never had a reliable answer, although Frank and others, all of us, have tried to do the calculations. The question is whether the Stakeholder will successfully tackle this problem of increasing the total amount of pension saving, and I very much doubt it.

The National Insurance Approach

The second solution is Frank's. Frank, as always, contributes to these debates with great imagination. I do not want to put words into his mouth, but he essentially wants bigger, better contributory benefits paid for out of a genuinely funded National Insurance scheme. Is that a fair summary, Frank? I think that is a rough summary. (Conservatives love Frank. We all love Frank because he is a High Anglican euro-sceptic who talks about the pernicious effects of means-testing, so he scores on lots of Tory concerns. The voters love you as well.)

I think if you actually analyse that particular proposal for pensions, there are some problems with it. First of all, my view is that compulsory National Insurance contributions are basically the same as tax. The argument is that it is okay, people accept the big increases in National Insurance contributions (which you need for Frank's scheme), and it does not matter because they are proper National Insurance contributions and completely different from tax. I do not think, sadly, the argument that National Insurance contributions are fundamentally different from tax is easy to sustain.

Secondly, I do not understand the need for a National Insurance scheme to hold a fund. The point about the state is that it has the power to tax. The state does not need to hold a fund. An organ of the state, such as the National Insurance Fund, does not need to have shares. The state's ability to deliver on its promises to pay income in the future rests on its power to tax. It does not need indirectly to hold shares in most of British industry, in order to extract a flow of dividend payments, in order then to pay out benefits in the future. That is what private organisations need to do, because they are dependent on private contractual arrangements in order to secure incomes in the future. The state does not need to do it.

I personally would be uncomfortable with this body, indirectly under the control of ministers, ending up owning most of British industry. I would regard that, if I may say so, Frank, with great respect, as in many ways a classic Soviet model, where you try to deliver your public policy via arrangements such as extracting money out of businesses rather than by the straightforward modern capitalist device of taxes. If the state promises to pay people in the future, they should be considerably financed out of taxation.

Frank will say that the National Insurance Fund is so arm's length and so different that it is not really an instrument of the state, but I am afraid I am not with him on that. I think he is trying to have his cake and eat it by both saying this is really a continuation of basic state pension but it is sufficiently independent of Government, and now it is marvellously funded it will also be completely free of Government interference. I do not think, sadly, that trick can be pulled.

The Conservative Approach

The third option, which is the policy we are offering, is purely optional. That is to say, younger workers can, if they wish, opt out from the Basic State Pension and put the actuarially calculated sum of money, which is what they would be earning that year towards the value of their pension when they retire, into a fund instead.

The aim of this is not to devise new pensions vehicles. The last thing that the industry needs is politicians sitting around devising new forms of pension saving. I think the Stakeholder Pension cost three years of planning while politicians sat around trying to work out what it should be. We are not trying to define new forms of pension saving, we are simply trying to get more money into existing forms of pension.

So if you opt out, you can put your money into any form of regulated pension instrument: it can be an additional voluntary contribution; it can go into an occupational pension scheme; it can go into a personal pension; it can even go into a Stakeholder Pension. We thought teasingly of calling our policy "Stakeholder Plus" because you can put it into a Stakeholder. Anything just to have larger flows of funded savings, so that people are more likely to build up a personal fund or a fund via an occupational pension that is big enough to float them off means-tested benefits. It is not compulsory, it is not universal, but I believe it could at least encourage some people with middle incomes, younger workers, if they wish, to build up a bigger savings pot.

I guess, behind all this, there is a question of political principle, almost an ideological one if you like, which is, what is the best way for a society of ensuring that today's workers have a claim on resources in the future? You can either do it via the state's power to tax, which is one way of registering a claim on future resources, or you can do it via private contractual arrangements and the ownership of shares and other forms of assets. For me, as a free market Conservative, I much prefer resting, wherever possible, on the individual's free contract than the state's power to tax. But I do not think it is possible to jumble them up together by trying to run a state scheme that itself owns shares and secures income from dividends.

Rt. Hon. Frank Field MP

National Insurance vs Taxation

Like David, I wish to thank the sponsors of today's event, and pensionless Phil for the SMF's hospitality. Given that David has kindly given you a run through of what the group I am chairing may propose in July, and that I hope the SMF may have a seminar to discuss this when it is published, I would just like to make a few brief comments.

It is slightly extraordinary, is it not, for the Tories, who normally have such a good view about human nature, to somehow put on this puritanical guise and suggest that we cannot have our cake and eat it, when the whole aim in life is, wherever possible, to have our cake and eat it? I am all in favour of qualities that do that.

I also find it somewhat strange that a representative of a party that was so successful in winning elections on a ticket of cutting taxation while at the same time shoving up National Insurance rates – and being successful in doing that, partly because the Labour Party was then unelectable, but also because people did not view National Insurance increases as taxation – it is pretty rich for the party that mined that rich reserve for a decade or more to come back and say, "Everybody does view this as taxation".

Lastly, while history does not necessarily prove anything, it is interesting that the views David has about National Insurance not possessing assets was not the view that Lloyd George took originally when establishing National Insurance in this country. He took the private sector model of friendly societies and their reserves and brought that within the state system.

As I say, after July, when no doubt the election has decided who gets their cake and who eats what, we could perhaps return to this issue.

The Issue of Compulsion

Many of the issues upon which David touched I do not want to disagree with, I merely wish to add to the debate by making four comments. To some extent they reflect one of the themes that underpinned David's contribution. That theme is, what role might politicians have in using compulsion in the savings area? I do not believe that it is the business of politicians to try and make people save more than is necessary for them to save so that at later stages they are not dependent upon taxation. But I do believe there are some very important moral questions which arise for politicians as they move down this path.

The first is that we are using this compulsion in the way that David explains. Although he is in favour of extending the choices, underpinning everything he said is in favour of that minimum compulsion. We are now engaged upon efforts to extend compulsion to a group of people who did not save before and to compel them to save in an area where the returns are questionable. In today's circumstances, you look at individuals, and anybody with any sense would not take out pension schemes but would invest in property. Their capital assets would very significantly increase and their returns would far outweigh what would be offered and they would have a freedom about the control over that capital and how to spend it which they do not have by investing via pension schemes into equities. So while, of course, one is not advocating the whole of the population to jump on the bandwagon and push property prices up still further, there is a question, which politicians ought to consider when they are advocating the extension of compulsion, that we are putting some people into the market when returns at the present time do not look anywhere near as good as they have done over the previous 20 years or more.

That directly leads me to the second issue, where again it stems from the assumption I share with David, and that is how limited any compulsory move should be. Once the capital of a person ensures that they will be above means-tested assistance, I do not believe we have a right to say that capital has to be spent in a particular way – and that would be, in our circumstances, by laying down the timetable which scheduled annuitisation of those funds. At some stage in the next Parliament, whatever is now said, I am sure the Government will move to a reform which extends freedom over the ownership and disposal of capital, rather than further restricting it.

Developing PFI into a Hybrid System

Those are the first two points I wanted to comment upon. The third one is the worry I have (and I am expressing it now because of the cyclical developments) over significantly increasing the numbers of people with equity holdings when the equity base is not expanding as fast as, let alone faster than, the supply of savings which is entering the market to buy those equities. What we have experienced over the last couple of decades is a very significant widening of the ownership of equities, which I welcome. But we have seen, very largely as a result of those new savings coming into the market, that the value of equities has significantly increased and the returns on those equities have fallen.

There surely is a limit to a policy which, instead of doubling, is quadrupling equity prices and seeing the real return on equities fall, as they have done, from two per cent to one per cent to a half a per cent. Here, I think, there is an area for politicians to think about by linking up how we size up long-term investment opportunities with how PFI might develop. If it does not frighten David too much, what I do put forward for suggestion is a hybrid system between a pay-as-you-go scheme and an equity based pension scheme.

Parties now are accepting the distinction that Gordon Brown has made between budgets meeting revenue costs and governments borrowing capital costs. I think that could be taken usefully into the pensions arena. If we are going, as governments, increasingly to borrow for capital investments, it seems reasonable that we begin to think of financing our schools and our hospitals via bond issues and of expecting those saving for retirement to buy these. They would know that in those circumstances, as repayments are made year after year from current revenue, the electorate are more likely to meet those repayments (because they will be, in one form or another, using those schools or drawing down the services from those hospitals) than they would be if they were merely asked to foot the bill for increased taxation.

So the third point that I want to put before you is that there is no panacea in pensions about how we can deliver future claims on national income. In our political culture, it is quite clear that it is more likely to be delivered if you have claims on capital than if you are trying to enforce those claims via taxation. But if any one generation is too greedy about what claims they might want to make in the future on national income, they might themselves get a shock, in that the then current workforce might be unwilling to deliver the claim that that generation thinks it is going to make, via wealth holdings, on that year's national income.

Therefore, I do believe the development of PFI along the lines of needing new bases for longer term savings might help square the circle and fulfil the pledge that we can have our cake and eat it in this particular respect. I do not believe the current range of savings opportunities is adequate for any government that is trying to change the ratio of 60 per cent pay-as-you-go and 40 per cent funded to what the Government is advocating (which I support) of 60 per cent funded, 40 per cent pay-as-you-go. I merely offer that other model of developing PFI along these lines as a point for discussion.

The Danger of Future Violence

This raises my fourth and last point, which again, in a sense, was hinted at in what David was saying. If we are looking to the future and trying to guess, with all the limitations on guessing powers, where conflicts might arise and over what issues, the points of conflict may well arise, in this country as elsewhere, when a pensioner population is trying to extract from national income what it thinks of as a fair deal, and the working population does not believe is a fair deal. The working population, in those circumstances, will obviously try and redistribute from any settlement that it thinks is unfair, either through taxation or, if it fails to do that by commanding the ballot box to do it, it will attempt to do it via inflation. If then it fails to bring about the redistribution which it thinks of as fair, we can expect our politics to get much nastier and messier.

I would suggest that violence will be much more apparent in Europe, in the mainstream countries of Europe, than here. In that I somewhat disagree with the way David moved across this issue. The post-war settlement in Europe has taken a different form from the settlement in this country. It is quite clear that both before but particularly after 1945, pensions played a role in building that post-war settlement which it did not play in this country. In France, Germany and Italy, their governments find it impossible to make any sensible adjustments to their pay-as-you-go schemes. Germany has managed in theory to move its pay-as-you-earn pensions from 70 per cent of average earnings to 67 per cent, but it delayed it for a couple of decades and presents it as a mega achievement. We have seen riots in the streets of Germany, France and Italy over proposed changes.

Certainly that temper of politics is going to increase, as the workers of those countries increasingly become unprepared to meet the pay-as-you-go pensions bill, but governments believe that in the circumstances of the post-war settlement they cannot deliver through the electoral system the changes necessary to bring the expectations of both sides into balance. I do believe that, while we will have some difficulties, that marks us out from the politics of street violence into which pensions will erupt in the lifetime of practically all of us in this room. That violence will be at first most marked in Europe and will be easiest to contain in this country, because of the changes David spoke about that have already been enacted. But it will not be entirely absent if the unwelcome guest in this country is a form of savings compulsorily imposed on people which fails to deliver anywhere near the expectations to which the advertisements have suggested to people that they are entitled.

I end on this note. While I accept the definition that David gave us of political instability here, in a state system which is so poor that it is not sustainable, and it is those expectations which will be wrought in our system over the next ten years, I would also suggest that there is going to be instability arising from forcing people to save in a way which fails to deliver on their expectations. Difficult as that will be, the politics of managing that transaction, I believe, will be minor compared with the politics of growing violence in mainland Europe, where governments are unable to change the pension contract, but where workers are increasingly unwilling to pay the taxes to meet the pension bills.

Discussion

Rhoslyn Roberts

We represent employers who provide pensions to their employees. I found it slightly depressing that none of the speakers mentioned the role of the employer. We all recognise that it is very difficult for an individual, especially a low paid individual, to save enough for their own pension, and that was accepted. Is not the best way of doing it to use the partnership with the employer in joint contributions? I would like to know what the speakers would do to encourage employers to offer increasing pension benefits rather than, as we are seeing at the moment, a reduction in employee provision?

Keith Bedell-Pearce

In fact, Stakeholder Pensions will only really get their franchise in the market as a whole if employers are fully engaged, because that is the only economic way in which they can be distributed at the moment. Face-to-face individual selling is not going to work. It is not economic to do that. Indeed, the mechanism for doing that has pretty much disappeared, with companies like Prudential, Britannic and others within the last month deciding to close their direct sales forces. The link between the employer and employee and the sponsorship by the employer is going to be of very great importance, as indeed it is for 401(k) in the United States.

The major area of concern, however, is not the conversion of the large employers, who pretty much bought into occupational pension schemes in their various guises, and which the NAPF represents, but the small to medium sized enterprises which now employ more than half the working population of this country, where there is going to be very considerable difficulty, I think, as to getting their buy-in to the new types of arrangements – or, indeed, the old types of arrangements.

Tony Reardon

I am interested in the point David Willetts made about perhaps encouraging more people to build up their private pensions. I just wonder how optimistic he is about whether that will actually get off the ground, given that people can do something similar today, they can opt out of SERPS, and at the moment most people would agree that opting out of SERPS is not financially attractive. It is really a question of attitude to risk, if you want to give up the state benefits in return for a private pension. I think what David was proposing was similar to that.

David Willetts MP
On the employers, there is a problem about the decline in occupational pension provision, which as I recall it peaked in 1967. We now have a lot of funds that are closed to new members, for example. One of my worries about Stakeholding is that although it is not a necessary feature, for some reason one of the things that does seem to be happening is that employers are closing occupational schemes to new members, when they were making perhaps a more generous employer contribution, and instead opening Stakeholders for their new employees with a lower employer contribution. That is one way in which Stakeholders might send the process backwards rather than forwards.

This goes back to the lessons we can all learn from the pension mis-selling scandal. I think part of the problem has been a belief amongst employers that financial services regulation makes it difficult for them to tell their own employees of the benefits of their occupational pension schemes. One of the reasons why the pension mis-selling scandal arose was that people were leaving occupational pension schemes when it was clearly not rational. They were leaving occupational pensions and employer pensions and going into a personal pension with no employer contribution. When you took this up with employers, they said, "Ah, but because of the Financial Services Act", as it then was, "we do not feel that we can warn them of the consequences of what they are doing". So there is a question about the way in which financial services regulation impinges on the ability of the employers to build up what Keith rightly described as a link, a sense of a shared interest between employers and employees in these occupational pensions. I think that may be one of the many examples of the perverse effects of regulation.

On the second question on the opting out and how that is going, we are going to try to make it optional. We are not saying that people will be obliged to do this. Who knows how many would want to do it. The main thing is to give people that option of taking money out from the Basic State Pension and putting it into a real pension instead. We will not set targets, we will just see what individuals choose. We will not wish to incentivise it one way or the other, we just want a fair calculation on the basis of the Government Actuary's estimates of how much the thing will be worth. My worry about opting out from SERPS is that on the latest evidence from the Government Actuary's review of the contracting out rebates, I am not sure now that the contracting out rebates for the next five years are going to be a fair calculation. If anything, they seem to me to be tilted in favour of people staying within SERPS, because it does not seem to me that the rebates have been calculated so as adequately to capture what people should get if they opt out. At the moment, I would say that the problem is that the playing field is tilted in favour of the state pay-as-you-go system.

Rt. Hon. Frank Field MP
Can I first of all draw attention to David's considerable political skills in beguiling you into accepting the first part of his answer? Somehow you could walk away from this room thinking that the opting out of occupational pensions somehow just happened, somebody staggered down Mount Sinai with this suggestion, and you could have believed that David was not part of the government that allowed people to opt out of occupational pensions, in the big drive to hoover them up into personal pensions. As I am usually accused of not being partisan enough against the Tories, I want to thank David for helping me to ignite some differences!

I would also suggest that while, at the moment, the Tories' policy is one of voluntary opting out of younger workers from the National Insurance scheme, I can assure you that should they ever win on such a programme, the policy will not work. It is almost a rule of politicians that when policies do not work, they do not think maybe the policy is wrong, they move fairly quickly to compulsion to make people do what they think is right and in their best interests. That applies to the right of this country as to the left.

On occupational pensions, there is that wonderful phrase the Government has (and I believe it to be a wonderful phrase because I wrote it) that occupational pensions are the big welfare success of the previous century. I think what one ought to do is to recognise that the revenue policing of occupational pensions was necessary because as they grew up there was no other form of policing. Certainly over the past 15 years we significantly increased other ways of trying to regulate occupational pensions. I believe there is a case for a controlled bonfire of controls on occupational pensions. On the tax side, given that we now have other forms of regulation of pensions, the tax rules governing occupational pensions should be considered, each one individually, for the fire. Similarly, given that saving for pensions in this form is now a lot less tax-advantageous than it was, the case for a lighter regulatory control is made.

I also think it is the duty of every politician, when they speak on this topic, to state that while it is sensible to have a regulatory framework within which this activity takes place, regulation by itself cannot guarantee that there will not be fraudsters about who will nick assets. You should not think that because you have got a framework, however lightly or toughly designed, that does not actually mean there is not the requirement for vigilance on behalf of members and of trustees. The main reason why we have not had huge and massive pension scandals in this country is for the simple fact that most employers are honest, and while the cleverer ones could have manipulated and stolen assets, they have refused to do so. That is an enormous credit to them.

Keith Bedell-Pearce
Just on the occupational pension schemes, I think another dimension to this needs to be recognised, which is the dramatic change in the nature of employment that has taken place over the last 30 years. When I joined the Pru some 30 years ago, it was genuinely expected to be a job for life. I did not realise what I was signing up for at the time, but that was the reality for most people going into large company employment in those days. Of course, the defined benefits scheme which the Pru and other large employers provide is great for people who do stick the course. I am now very much in the minority in the Prudential and I suspect my own children will have no concept of a job for life. They will consciously switch jobs every three, four, five years throughout their working career and for them the defined benefits scheme will do them a profound disservice.

The reason why many of the defined benefits schemes that are now in existence are in such a well funded position is because of the rotten value they give to early leavers and have given to early leavers historically. Therefore, one has to turn to defined contributions schemes. I can see no reason why a Stakeholder type environment should be any worse than the classic defined contributions schemes that we have had in place for the last 20 or 30 years and, indeed, in some cases it will be more beneficial. The trick is to persuade the employer to make the contributions as well as the employee.

Nick Macpherson
I have two points. One is that I totally agree with you that the whole issue of excessive regulation is important. My one worry, in a sense, was highlighted by Keith Bedell-Pearce, the issue that the well-advised and well-off are incredibly quick to respond to incentives. My worry about the whole annuity issue is that of course it should be reviewed, and of course we have got to look at ways of making it better, but if you were to create open season for people to use their pension funds to hand money on to their children, you would ensure that the well-off would exploit every last pound of tax relief. Instead of liberalising something which seems quite minor, it could result in something costing hundreds, if not thousands of millions of pounds.

My other point is a question for David Willetts. I was quite interested by his point about the state and how it should not have funds and how it should pay for liabilities out of taxation. If you look at the state secondary pension arrangements above the basic pension, my guess is that the liabilities for that are broadly similar to the liabilities of state schemes where the state is operating as an employer, be it in relation to the Civil Service, the Health Service, the Army and so on. I was wondering whether David has any plans (and clearly on the basis of what he said he is very happy with the current pay-as-you-go arrangements) and any views on how you should move things forward in terms of public service schemes?

David Willetts MP
That last one is a very tricky one, because if we were to have the riots in the streets that Frank was saying are going to happen on the continent, the equivalent in Britain is if you get into the public service pensions issue. I did the calculations after the Budget Speech when Gordon Brown was talking about the national debt and we have reached the stage now where the unfunded liabilities to pay education and health pensions exceed the national debt. It is a larger sum of money. It does not appear on the balance

sheet, it is not balance sheet liability, but when you do the calculations it is greater than the national debt. You are tempting me to stray down dangerous territory. We have no plans to change the regime for personal public services. The logic is the logic that I described earlier: if you have got the state behind them, you do not need to build up funds as well. I am wary of these hybrid models, of something in between, of the state holding shares or holding other forms of assets. I think by and large we should keep them apart. I think regulation is an issue.

On Nick's first comment, it is an accurate statement of Treasury philosophy. The trouble is, if you approach every tax policy question from the point of view of how the well-advised are going to exploit it, you end up with a regime which is too restrictive to allow many people in the middle to benefit from it at all. That is the dilemma that Nick has wrestled with under successive governments.

Can I briefly make a point on compulsion, because Frank said our policy will end up with compulsion? I do not think compulsion is desirable and I do not think compulsion will happen. I do not think Stakeholders will become compulsory and I do not think that if we are in government, our policy will become compulsory.

The problem with compulsion is twofold. Firstly, there is another good old Treasury argument, which is, you start off by saying, "Let us roll back the state. Why don't we oblige people to save for themselves instead of being dependent on the state?" And then lo and behold you say, "But, hang on, what about the people who cannot afford to make the compulsory contributions? What we had better do is the state had better pay the contributions for the people who cannot afford them themselves." And before you know where you are, these bold attempts to roll back the frontiers of the welfare state have instead ended up inventing a new public expenditure programme, namely the state's contributions for the people who cannot afford to pay the compulsory contributions themselves. This is why the Treasury is always historically wary of these compulsory schemes. We can rely on it to continually be so under successive governments, and they will not happen.

The other thing is, and Frank is right, there is a moral question whether you can compel people to do things which may not yield them any personal financial benefit, especially after the mis-selling of personal pensions. Inviting people to save when their savings may be cancelled out by a loss of means-tested benefits is morally dubious – with all the legal issues around it might even be open to legal challenge. I think for that reason it will not happen. It would not happen under us and I do not think it will happen under Stakeholders. But I could imagine a minister under the current Government finding it helpful for the industry to believe that Stakeholders might become compulsory as a reason for entering the market. I would be perfectly happy for people to believe they are going to become compulsory even though they will not.

Rt. Hon. Frank Field MP
A couple of quick comments. Given that Stakeholder is such a bad deal for those on lower incomes, the last thing that one would now want would be that model enforced via compulsion. I see compulsion slightly differently from David. Anybody would think that David was standing in the Garden of Eden and outside was this terrible beast called compulsion. The policy I have been putting forward is redrawing where compulsion takes place as an extension of existing policy rather than saying, do we have compulsion or do we not have compulsion?

Secondly, I thought how charming it was to see David as old Tory rather than new Tory, in that he believes in a current generation building up debts which a future generation would meet, and that is what he was advocating by his pension policy. This year we will not, out of our own income, put forward the contributions the poor need so they are not a drain on taxpayers in the future, but we will push that forward in the hope that something deals with it in the meantime.

This is the last point I want to make. Nick, I congratulate you in drawing out what clearly is in David's mind on the worries of the state owning assets, because given that most, but not all, of the public pension schemes have assets, and that David feels there is some terrible worry about the public zone owning assets, either he has to accept, as I do, that it is possible for central government to put these assets at arm's length or, because he is so worried about the socialist influence this might have on government policy, he has to go down a road of making sure the state, in whatever form, does not have control over those assets in those public pension funds. That is not a dilemma I face, it is one that I leave for him.

Wilf Stevenson
I said I thought this discussion would yield an interesting perspective on the way in which the debates might go forward and, in fact, the similarities have almost been as strong as the differences, but nevertheless there are clearly some quite big issues still to be evolved as this debate continues.

I would like to thank our speakers very much indeed for contributing to the debate today, and also to thank Prudential very much for their support.

Seminar 2

Savings and assets for all

A Seminar held on Wednesday 18th July 2001 at
11 Downing Street, London

Edited by Hugo Foxwood

Introduction

Wilf Stevenson

Welcome to this seminar, which we are very happy to be presenting in association with IPPR. We are grateful that Matthew Taylor is on our panel today. We have been working with our first speaker, Professor John Bynner, on a number of issues, because the cohort studies with which he is particularly associated have proved to be a very powerful way of analysing issues around social exclusion. The studies allow you to look very closely at the trends over time of the impact of class, income, gender, and similar issues on life chances.

Now as you all know, we are reaching the end of a consultation period on *Savings for All* which was a green paper, issued just before the last election. Although much of the media attention around the publication of that paper was around the "Baby Bond" idea, really the document is about that thorny question of how to get the level of savings to rise – not just in the economy as a whole, but for every single person. And this is not just for pension purposes but for the situations that confront everyone from time to time.

Looking at that green paper, we were struck by two things: the first is that it draws on the work of the Centre for Longitudinal Studies and particularly John Bynner's work on the impact that assets and savings have on life chances, and it also draws heavily on work by Elaine Kempson and Claire Whyley at Bristol University on savings in the low-pay area, which was the subject of a recent seminar held here in the spring.

However, we were also struck by the fact that it might be useful to have a seminar which could contribute to the consultation process, so John Bynner is going to speak to us first on *The Effects of Assets on Adult Later Life Chances.* Then, our partner Matthew Taylor from IPPR, is going to look again at some of the issues that led IPPR to propose the Baby Bond idea, but also contextualise that in relation to a wider savings argument. And then we also thought that what was missing from the paper was an industrial response, because this policy can only work in partnership with industry. We are therefore delighted that Keith Bedell-Pearce is going to respond with some industrial perspectives.

Professor John Bynner

Director, Centre For Longitudinal Studies

I am delighted to be here to talk about this work, which was actually carried out as a project for the Department for Education and Employment. I should acknowledge the contribution of Gavin Kelly of IPPR, who inspired the analysis and raised questions as we worked through it, leading to more work, until we were able to produce some findings that, I think, at least raise interesting questions. Because of the limitations of our data we can never claim to have reached definitive conclusions about cause and effect in relation to possession of assets, but we can build up a strong case for causal attributions that looks plausible and convincing. That is what I am going to give you here in relation to *The Effects of Assets on Adult Later Life Chances.*

Focus of Research

These are the main research questions we addressed:

1. Do assets (i.e. savings, investments and inheritance) acquired by the age of 23 predict outcomes at age 33, taking account of earlier circumstances and achievements? In other words, is there an identifiable assets effect that stands up when we control for as many other experiences as possible in people's lives that could explain these outcomes? The point of the analysis is to try to remove the assets effect by means of statistical analysis. When the maximum number of statistical controls is applied to the data does the assets effect survive?
2. Does the amount of the asset – that is how much the asset is worth – count in the relationship, or is it the existence of a non-zero asset up to a threshold level that really matters?

The data source we used to answer these questions is the National Child Development Study. This comprises everybody born in a single week in 1958 in Great Britain who have been followed up in subsequent surveys at 7, 11, 16, 23 and 33. There is also a new survey, completed at age 42, which will enable us to pursue some of these findings much further, but the data are not yet available for analysis. In the sample for analysis, we have about 11,500 individual members of the cohort, for whom data were available from 33 back to birth. The sample is also a very good representation of the British population.

The data used in the present analysis relate assets information, collected at age 23, to outcomes at age 33. So we are looking at the situation of these adults in their early 20s – whether they had assets or not – and how this related to outcomes ten years later.

Assets Variables

The assets variables we are going to look at are: 'has savings as opposed to not having savings'; 'has investments as opposed to not having investments', 'has received an inheritance over £500 as opposed to not having received an inheritance. 82% had savings, whereas only 11% had investments as identified, and 12% had received an inheritance of some sort.

For a variety of reasons, although effects were evident in relation to investments and inheritance, they were not as impressive as the effects for savings. Accordingly, I am going to focus on the savings effects.

Outcome Variables

We looked at a number of labour market outcomes covering the age period 23 to 33: 'years spent in full-time education'; 'years spent in full-time employment'; 'years spent unemployed'; 'years spent at home' (mainly women looking after their families); 'self-employed as opposed to not self-employed at age 33' separately for non-manual and manual occupations.

Other outcomes were to do with health: a measure of depression, obtained from the 'Malaise inventory'; general health, a self-rating of how people felt about their general physical health; and smoking, an example of health-related behaviour.

We also looked at citizenship, asking whether people voted; whether they were interested in politics; and whether they were cynical about politicians and the political system. We also examined support for the work ethic, i.e., whether people signed up to the belief that work was an essential part of life and were committed to employment – this was based on a standard scale used by psychologists to measure commitment to the work ethic.

Finally, we looked at the impact of assets on different aspects of parenting. Was the child having any difficulties at school? How many books did the child have? How often did the parents read to his or her children? And how much did the children read?

Control Variables

For the controls, we started with circumstances at birth: family social class; age father left full-time education; age mother left full-time education. This identified the educational and class background in which the cohort members grew up. At age 11 we included whether the parents showed interest in the child's education by taking the initiative to discuss their child with the teacher. We also included various measures of poverty and household disadvantage: rented housing, free school meals and number of people per room in the family's home – a measure of overcrowding. We also included reading test and maths test scores at age 11.

At age 16, one other control was included – educational aspirations. To represent influences that might be confounded with assets after 16, we included the age the cohort members left full-time education, and the highest qualification achieved – a key influence and predictor of a great number of adult outcomes. So if an assets effect survives against highest qualifications, we are on to something interesting.

Post 23, we included home ownership: could the asset effect operate through home ownership, and disappear once home ownership was taken into account? Finally we included earnings at age 33 as a control.

The analysis took place in a number of stages. We started by seeing whether assets alone at age 23 predicted a given outcome. We then included in the analysis the different controls measured at birth, at 11, at 16 and in adulthood.

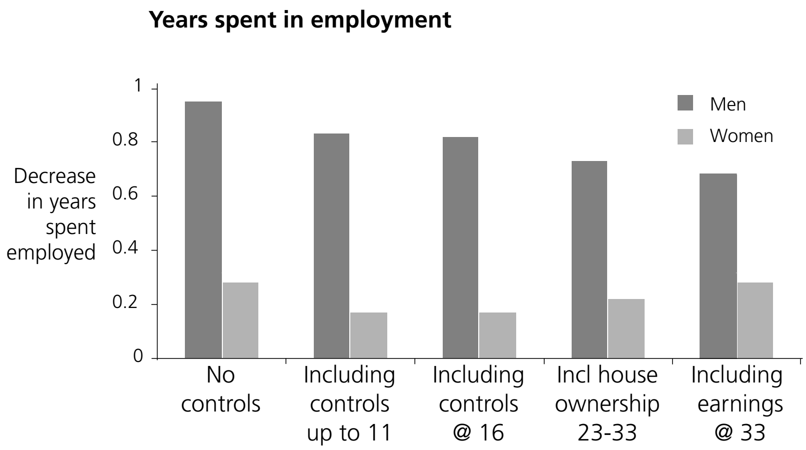
The main aim in using all these controls is to try to eliminate selection bias. In other words, we want to discount the sorts of people who have assets at 23 but also have fundamentally different characteristics from those without assets at 23. The controls make the two groups – assets and no assets – equivalent, at least with respect to the characteristics the controls represent.

Savings Effects on Outcomes

The first slide (see Slide 1) shows the effect of savings on years of unemployment. These are measures of the proportional *decrease* in years of unemployment between 23 and 33 – related to the difference between not having savings, and having savings. The proportional decrease in years spent unemployed is shown by the size of the bar.

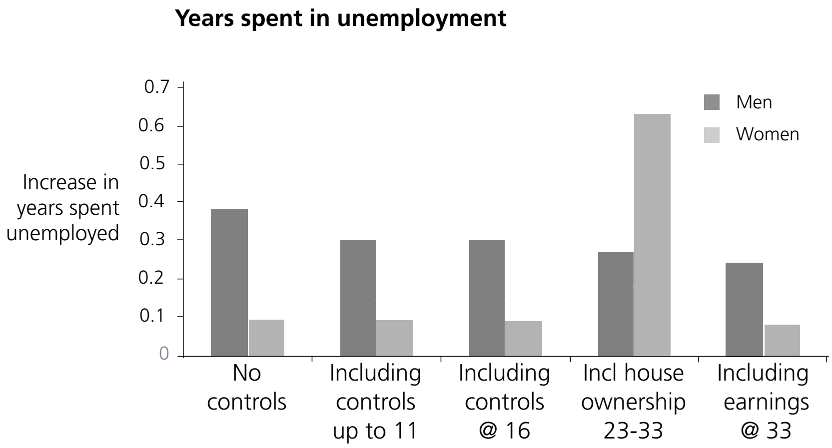
The first bar diagram is for men; it shows a big assets effect, i.e. the amount of unemployment experienced is substantially reduced when there are savings – an effect that is sustained when different controls are applied. For women the assets effect is much weaker. When house ownership is taken into account there is actually a substantial decrease in the experience of unemployment, signifying a tendency for women living in owner occupied houses not to be unemployed. Women in owner occupied houses spend significantly less time unemployed than those in rented housing. Nevertheless, savings also appear to provide a degree of protection against unemployment.

Slide 1: Savings effect on years spent in employment with increasing levels of statistical growth



The next bar diagram (Slide 2) shows the reverse picture – an increase in years of employment, given the existence of savings, as opposed to their absence. So what happens when we introduce all the controls? There is a small reduction in the assets effect, but we cannot get rid of it.

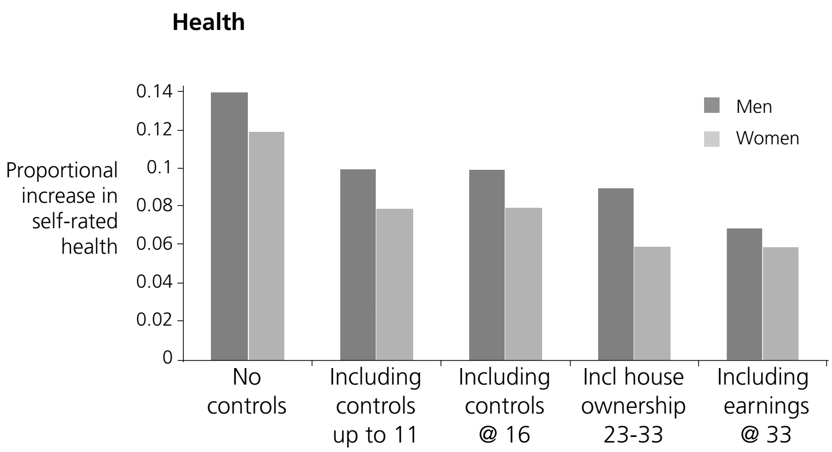
Slide 2: Savings effect on years spent in employment with increasing levels of statistical growth



The third bar diagram (Slide 3) shows the effect of savings on self-rated general health. There is a proportional movement up the health rating scale, given the existence of savings as opposed to their absence. The controls reduce the effect fairly steeply, but a highly statistically significant residual effect remains.

Finally the table (Slide 4) provides a summary of the results of the whole analysis, showing the savings effects for a number of outcome variables after all the controls had been applied. There was a negligible effect on the measures for citizenship and parenting, so these have been omitted. However the work ethic did show a distinct assets effect, but only for men.

Slide 3: Savings effect on health with increasing levels of statistical growth



Slide 4: Savings effects on outcomes

	Men	Women
Years in full-time employment	.68	.28
Years unemployed	-.24	-.06
Self employed	-.06	-.01
non-manual	-.10	00
manual	-.04	-.01
Health		
malaise (depression)	-.04	- .05
general health	.07	.06
Work ethic	.13	.03

The numbers in the table indicate the proportional change in the outcome for the different outcomes listed on the left-hand side, in the presence of savings, under the condition of *maximum* control. As an example, men's full-time employment is increased by 0.68 of a year, when there are savings, and women's by 0.28.

Self-employment is interesting, because assets seem to actually have a negative effect, i.e. people with savings were less likely to be self-employed than others. However this is one example where an independent effect of investment can be observed. Men with investments were more likely to be in manual self-employment; there were no effects for women. In other words, men in manual occupations do show a demonstrable relationship between having investments and self-employment (perhaps in the building trade?), whereas for those in non-manual occupations the effect is, if anything, in the opposite direction – those with savings are less like than the others to be self-employed.

As we might expect self-reported health was positively related to assets, whereas malaise, the measure of depression – showed a negative effect. In other words, people with savings are *most* likely to feel that their health is good and least likely to be depressed.

Amount of Assets

We look at two examples. The bar diagram plots years of unemployment against the amount of savings plus investments. As we move up the scale of the value of the assets, we find an interesting discontinuity. Beyond the £199 mark, there is a sharp drop in the years spent unemployed as the amount of assets increases. In other words, below £200, the likelihood of spending time unemployed is very much higher than above that threshold. What is more, above the threshold the actual amount of assets held adds nothing to the prediction of outcome.

Slide 5: Amount of savings/investments for males by average years unemployed 23

Unemployment for women shows a similar result. As for men there is a drop above a threshold. This time above about £100 of savings plus investments, less time is spent unemployed.

Slide 6: Amount of savings/investments for females by average years unemployed 23

Finally for malaise for men, there is a drop between £200 and £1400. And then the very wealthy appear to be more depressed. For women, the picture is a bit lumpy, but overall there is a similar trend towards reduction in depression, this time after £300.

Slide 7: Malaise (depression) by amount of savings/investments for males

Conclusions

There are several conclusions to draw from these results. First, assets appear to provide protection against unemployment and poor physical and mental well-being. There seems to be security in having savings at age 23, which is realised in tangible labour market and other benefits at age 33. The amount of the assets is less important than its existence. The size of the asset does not seem to matter as much as having it.

This last result suggests that the benefit of holding assets may well be as much psychological as economic. It is possible that having savings, as opposed to being in debt at this critical period of young adult life, provides a degree of confidence, and feeling of self-worth, that is underpinning some of the effects we see. This interpretation is of course highly speculative, but since the amount of the assets does not seem to have a role in the outcomes, the results might be seen as pointing in that direction.

As Charles Dickens' Mr Mcawber puts it:
"Annual income £20 – Annual expenditure £19.96 – Result: Happiness.
Annual income £20 – Annual expenditure £20.06 – Result: Misery."

Matthew Taylor
Director, Institute of Public Policy Research

I want to start with a question: "Why do anarchists and socialists drink herbal tea?" The answer of course is, "All proper tea is theft." I thought I would make that terrible joke as a basis for introducing some of the broader philosophical and political questions raised by asset-based policy.

Philosophical and Political Context

From Aristotle to Thomas Paine, philosophers and great social reformers have linked the distribution of financial assets to questions of social and economic entitlement and citizenship. But it's only in the last few years that we have moved away from the position of the Conservatives being the only politicians in the UK who felt comfortable with talking about a property-owning democracy. This is perhaps a reflection of the ideological knots that the British Left tied itself in. In this context, the announcement of the Child Trust Fund and Savings Gateway are a major advance, not only in developing welfare policy, but also in progressive thinking.

The challenge now is to firstly explore and then resolve the difficult questions raised in seeking to implement this policy; secondly to examine the way in which the policy might interact with other existing and proposed policy instruments; and thirdly to start to think ambitiously about other ways in which the principle of asset entitlement might be pursued.

But before that I think it is important to start by underlining the significance of the policy announcement made before the election, on which the IPPR was delighted to carry out some of the development work. The Trust Fund and the Savings Gateway clearly demonstrate that the Government is recognising the important role savings and assets play in giving people independence and financial security as a basis for opportunity, reflecting the evidence that we've just heard. Secondly, the announcement has put the issue of wealth inequality firmly back onto the political agenda.

Another important facet of the announcement is that we have, I think, become used over Labour's first term to a policy of a growing reliance on means-testing in welfare and tax-credit distributions. But as a new universal policy, the Child Trust Fund demonstrates that the Government sees universalism not as a fading anachronism, but recognises that there continues to be a valid political, philosophical, and administrative case for it as a form of allocation. Also, these new policies represent a departure from an exclusive reliance on tax relief to incentivise saving, and a recognition of the limitations of tax relief in relation to low-income groups.

Challenges for the Child Trust Fund and Savings Gateway
I turn now to the key policy challenges which need to be resolved as part of the consultation process. First, we need to ensure that a two-tier system is not created. The Child Trust Fund is designed to go to every child at birth, and it is important that the policy is implemented in a way that can achieve this. One danger is that parents, for whatever reason, might not open an account, leaving their children without a bond, or with a form of inferior provision. All children should be guaranteed access to an account, run by an appropriate financial institution.

Secondly, there is the contentious issue of whether or not 18 year-olds should be able to spend the funds on whatever they want; or whether the use of the funds should be restricted to certain worthy purposes, such as learning, business start-ups or home ownership. Now libertarians and paternalists clearly give a different answer, but the pragmatists – and here I include IPPR – point out the difficulty with controlling use in practice. Although these problems may not be insurmountable, they are substantial and need to be borne in mind. We must ensure the policy is kept as simple as possible.

Thirdly, there is the central role of education. Both the Child Trust Fund and the Savings Gateway provide great opportunities to reduce the worrying levels of financial illiteracy. Indeed financial education is also critical for the success of the policies themselves. School-taught financial education, running alongside the Child Trust Fund, will be critical to the policies' success. For adults, take-up and use of the Savings Gateway will be improved if financial learning is built in. This is one of the important lessons of the American experience.

The fourth challenge is getting the Savings Gateway to those who most need it. For this to happen, a system of support and financial education will be needed, particularly for certain groups. Community-based organisations have a key role to play in achieving this. The evidence, from Individual Development Accounts (IDAs) in the US, stresses the importance of good support and advice at a local level, being provided by people who are able to empathise with local communities.

Fifth is the important question of how these policies can promote active citizenship. Some see asset-based welfare as springing from a tradition of passive citizenship entitlement. We would argue that there is much scope for these proposals to bolster a more active citizenship. The sorts of ideas that can be explored include individuals volunteering in their community and earning credits for their accounts, or allowing flexibility for individuals to pool assets for a community good.

Fitting with other policies

So these are some of the major issues to be explored. But crucial to the successful implementation of the policy is the way in which it interacts with other initiatives, especially those intended to increase savings. Above all, we need to look closely at the link with pensions policy and how the Child Trust Fund and Savings Gateway may help to solve a problem being explored by other IPPR research, namely the risk that Stakeholder Pensions will not reach their target group of people on low-to-middle incomes. The Savings Gateway could represent a significant step forward in helping achieve the stated aim of Stakeholder Pensions.

Broader Policy Implications

More broadly, those of us with the freedom of being outside government need to ask hard questions about the general structure of savings incentives, a structure that continues to be regressive in nature. How far do we want to go in building a coherent, progressive, asset-based public policy? Should we be reviewing the use of tax relief across the board and even thinking of reforming inheritance tax?

Other issues include how asset-based ideas will be mainstreamed into welfare policy. Will, over time, individualised accounts become the central policy tool of welfare? How could a “life account”, which supported individuals through particular life cycle events, work? And responding to the concerns of some of the policy's critics, how do we prevent an asset-based approach contributing to the withdrawal of State provision? Are there means for embedding the policies so they are additional and complementary to current income-based policies and public-service provision?

Finally, I want to return to my opening comments. At the heart of the assets argument is an attempt to invert the traditional Left critique of property, and power over property. The argument here is that the problem with property is not its existence, but a structure of rights and allocations that excludes large parts of our community from accessing it.

I want to leave you with three other ways in which we might pursue this thought. First, there are IPPR's own proposals for using rents and benefits to build an equity stake for tenants of social housing. Second is the idea raised in the report of the Commission on Public and Private Partnerships that we might be more imaginative about what we mean by the public in PPPs. That is to say, can we look at partnerships and involve the community itself in owning and managing the public assets? Thirdly we need to examine the danger that incentives for employee-share-ownership schemes may suffer from the same problems of regressive distribution as existing savings incentives.

Now it is both churlish and opportunistic to respond to one exciting radical government initiative by demanding three more. Perhaps that is one of the luxuries of working in a think tank, rather than government, but I would prefer to rationalise my attempt to move rapidly from the acorn of the Child Trust Fund to the oak of a just property society with the words the Brazilian sociologist Robert Unger who said, "To be realists, we must first be visionists."

Keith Bedell-Pearce

Executive Director, Prudential Plc

The group of companies that make up the Prudential in the UK, which is Scottish Amicable, M&G, Egg, and Prudential itself, has undertaken an extensive consultation programme internally to look at the opportunities and the impacts of both the Child Trust Fund and the Savings Gateway. We are going to make a formal submission which, like Billy Bunter's postal order, is 'in the post', but rather than go through that today, I thought I'd really present a personal view of what I see as some of the key structural issues, and perhaps the options for their resolution. So I'd like to start with a beginning and, perhaps somewhat more controversially, an ending.

Historical Lessons

The beginning is, not surprisingly, the origins of the Prudential itself which, contrary to popular belief, did not emerge as a response to burial societies, but to the recognition in the middle of the nineteenth century by one Edgar Horne that there was an entirely new market coming into existence in industrial Britain. This was the market for insuring the lives of children. The Pru was founded on a recognition that child mortality was improving. In fact the very first products that were launched for that market were the nineteenth-century equivalent of the Child Trust Fund, which were first of all pure insurance policies, but then, very rapidly, endowment policies for infant children, where the policies matured when the children reached the age of 14 or 16.

The ending is the very last product that the Prudential produced for that market, in the middle of the 1980s, which was called 'Pru Saver,' followed in 1987 by another product called, 'Young Pru Saver.' Now Pru Saver was a short-term endowment policy with a five-year duration which had very many similarities with the Savings Gateway. Young Pru Saver was a reincarnation of the Victorian child savings policy and they were very successful products, except the men and women from the Pru who sold them hated the policies. I was Marketing Director at that time and I was alarmed to discover that both of these products had earned rather uncomplimentary names. The Pru Saver was known as "Pig" and the Young Pru Saver was know as "Piglet". The reason was that the agents saw them, in their words, as pigs of products. This was because although they delivered what the customer expected, they were extremely complex to administer and with a high cost base and small premiums per contract did not represent, compared with other products, good value for money.

So, what are the lessons that we've learned from 150 years of selling to lower-income groups? First of all, it is a huge market. Whilst Marie Antoinette's revolting peasants couldn't afford her alternative to bread, the lower-income groups in the UK for the last 150 years have historically wanted a slice of the savings cake, but have latterly found the cake shop closed, or at least they were worried about, or put off from, going through the door.

The second insight, and I think this is a very important one, is that for the lower-income groups our experience was that at least 90% of all of the decisions to take out a savings contract was made by the mother of the family. It was absolutely dominated by the matriarch of the family, who not only took the initial decision to buy the policy, but then took personal responsibility to maintain that policy during its ten, fifteen, twenty years of life. I believe so far as the Child Trust Fund is concerned, mothers and probably grandmothers are going to be a very important target audience.

The third lesson is that simplicity is absolutely key. Simplicity of the proposition therefore means – and this may be a little paternalistic – only having a very limited investment choice and simplicity in administration. No matter how simple the product, the provision of savings products like these requires marketing and sales processes, the money to be collected and accounted for, and the products administered – and all within an increasingly tough regulatory regime. All of this costs money and therefore there is a minimum fixed overhead, irrespective of the size of the amount saved. It is for this reason that the Prudential abandoned Pig, Piglet and all the rest of the industrial branch products in the mid 1990s.

Therefore, for low premium products to be viable, economies of scale are absolutely vital. However, there is a problem here, so far as the savings industry is concerned, because achieving scale is both risky and costly. A major worry I have about this is that many product providers may not choose to compete, faced with the risks involved with entry into this market.

Finally, there is an interesting insight in the *Savings and Assets For All* paper about the reasons for savings, and there are two quite distinct motivations given in the paper: *transactional savings*, such as for a daughter's wedding, or for a child reaching his or her sixteenth birthday; and *rainy day savings*, where there is just some sort of underlying need or feeling that some money ought to be put aside. We found that the persistency connected to those two types of products, varied dramatically. Where there is a motive to save with a targeted objective, then the money continues to remain in place until that objective is received. However, with rainy day money, as soon as a critical mass of savings, particularly with lower-income groups, is achieved – and we identified that critical mass being roughly the equivalent of the price of a new washing machine, or a package holiday – then there was an inclination to surrender the policy, take the cash, and usually start off again. I think one of the lessons on this is that if for the Savings Gateway there will be a degree of matching by the State, then this must be rear-ended, and probably aimed for a duration of five years, as opposed to three years which I think has been mooted in some places.

Applying the lessons that we have learned over the last 150 years to the Child Trust Fund and to the Savings Gateway, I come to the view that both are highly desirable for social and economic reasons. However, they are less attractive from a short-term commercial perspective. But it is very much in the interests of the savings industry that both of these initiatives succeed.

Setting the Frameworks

So what are the components for success? Well, I think both products will have three needs from the structures: a correct framework for distribution, a correct framework for administration, and a correct framework for fund management. The key to all three will be simplicity. Simplicity is vital first of all to capture the public imagination for this new type of savings vehicle, but simplicity is also going to be absolutely essential to make provision by the savings industry economically viable.

I have been asked a number of times recently about this avalanche of money, which is a real 'godsend' for the savings industry. Well, it isn't. To put it into perspective, even after eighteen years of operation, I estimate that the total amount of assets under management within the Child Trust Fund environment will probably be in the order of £10 billion. The figures may look impressive when you think perhaps there will be a 1% management charge, generating £100million per annum. However, at that point, there will be some 13.5 million participants, and therefore if you divide the £100 million by the 13.5 million participants, then it leaves you with £7.40 for each individual, per year, to maintain that contract. That represents very thin margins indeed.

So in setting the frameworks, the first assumption that I'm making is that the minimum piece of infrastructure should be some CAT marking approach to these products. That should come as no surprise. What may come as a surprise to you is that my own personal view is that there is a case for more centralised management, if not government management of infrastructure for administration and perhaps even for investment management.

Looking first of all at administration, given the tiny margins and the need for economies of scale, I think there is a case for a single central systems platform for both offerings, with a standard data architecture, accessed remotely over the internet, or by using internet protocol platforms. This would be accessed by the providers themselves, for which there would be a per capita annual administration fee. This would deliver real economies of scale. Transferability between providers would be extremely simple: there would be no real data interchange, just changing the designation within the account held on the central system. And it would encourage provider-entry and competition, as opposed to providers being put off by the very substantial cost of developing new systems, or adapting old systems, such as Stakeholder or ISAs, for these particular offerings.

The disadvantage of such a central approach is the problem of managing such a large initiative and of funding the initial system's development. And there is of course a high failure rate of big computer projects, but indeed that in itself would be a further incentive for simplicity of the overall offerings of the Child Trust Fund and the Savings Gateway.

Moving to the investment choices and fund management, I think there is a strong case for predominantly equity-based savings so far as the Child Trust Fund is concerned, with a progressive de-risking of that equity exposure as the Fund comes up to maturity for an individual who picks up the proceeds at 18 or 21. This could operate like the pools of money for pension arrangements, a progressive move into cash in the last three or four years.

So far as the investment vehicles are concerned, as I said, I believe there is an overwhelming case for equity or real asset-based investment. I think there are two options at this stage: either pooled managed funds conforming to predefined parameters, or access to a unitised 'with profits' fund with an explicit management charge.

For the Savings Gateway, assuming there is going to be a five-year duration in order for the incentive to be applied, but allowing exit earlier with a loss of incentive, I find it very difficult to make the case for an equity-based investment vehicle. I think probably a cash deposit vehicle would be the safest and most reliable, particularly bearing in mind the target audience, or market, for this.

There is the possibility of a relatively low-risk, asset-based fund, but no matter which five-year period you take, there is always going to be an element of market risk. And the creation of guarantees – I don't even think of that word these days – dramatically diminishes the competitiveness of a low-risk equity-based fund, compared with cash.

Choosing the Provider

The next point is, who should qualify to provide or manage these various investment funds? The first assumption I'm making is that there will be some form of investment framework, limiting the scope and nature of the investments which are going to make up these funds. And in fact there is a long and very reputable history of such a framework in the form of the Trustee Investment Act, which has been in place for more than 70 years. It has actually served trustees and charities extremely well; even some of the restrictions, which were railed against at the times, saved those who had trust funds from investing in such things as dot.coms. But there is the very real problem of how relatively unsophisticated savers are going to choose between Provider A and Provider Z and all the letters of the alphabet in between. A possible solution is to let those who feel competent choose a provider, but also to create a Default National Child Trust Fund.

I think the case for a default National Child Trust Fund is based on two premises. First of all, as Matthew said, a proportion of lower-income groups won't do anything to register a child with a provider at all, and therefore someone will have to do something on the child's behalf to prevent that child being disadvantaged when he or she gets to 18 or 21. A much larger proportion won't have the knowledge or confidence to make a choice anyway, certainly not an informed choice. I think a default National Child Trust Fund should be equity-based, conforming to prudential (with a little "p") investment rules, and managed by an independent Board of Trustees, with investment management sub-contracted to a number of independent fund managers. It is very important that the National Child Trust Fund should not be, or be seen to be, a creature of government.

There is an important link here with the proposition I made earlier, that there should be a standard systems platform for the Child Trust Fund and Savings Gateway. Because if the case for a National Child Trust Fund is accepted, then there will have to be a platform to administer it, and therefore why not make the platform available to all providers?

The Longer View

Wilf invited me to give the perspective of the savings industry taking the longer view. I feel that the economics of market size, the costs of marketing, the amounts involved, and the administration overhead means that there is going to be little profit as such within Child Trust Funds and Savings Gateways themselves. However, this should not diminish the enthusiasm of the savings industry for this particular initiative, and I'd urge the industry to take a longer view. It is very heartening that in fact the Government is taking a longer view so far as these offerings are concerned. The benefits of the Child Trust Fund, in social and economic terms, really won't show for the next 25 or 30 years, while it is very unusual for government, even considering pensions, to take a 20-year-plus view.

Given that encouragement, the savings industry should also take the long-term view and see the Child Trust Fund, in particular, as the precursor to a prospective profit stream from 60 years of savings, after the Child Trust Fund proceeds are delivered over to the 18 or 21 year-old in question. I think similar considerations in terms of taking the longer view apply to the market-expansion prospects of the Savings Gateway.

Conclusion

So to conclude, both the Child Trust Fund and the Savings Gateway have the potential to be fundamentally important elements in shaping the nature of society over the next 30 to 40 years. But as with all visionary ideas, they need to be implemented with determination and creativity. I think there is a strong case for a centrally provided internet protocol-based systems platform that all providers can access, and this case is strengthened by the need to have a default National Child Trust Fund.

For the longer-term benefits of both the public policy and commercial viewpoints, there will be a greater need to promote understanding of the need to save and how to save, and to increase financial awareness.

Finally, the key to the success of both schemes, in meeting the longer-term social and economic objectives, lies in the simplicity of offering, limited choice and low cost. Taken together they link to form a virtuous circle; break any one of those links and the longer-term public policy and commercial objectives will be lost.

According to the M&G Great British Savings Survey, 21 million adults in the UK have less than £500 in savings. This means that nearly half the adult population has only a tiny financial cushion, and lives in relative capital poverty. We hope that both the Savings Gateway and the Child Trust Fund will reduce capital poverty and create a personal asset base that means a stake in society is turned from a worthy concept into a tangible asset.

Discussion

Peter Thompson, Chairman, National Association of Pension Funds
I wonder if anybody has reflected on the impact of Student Loans on savings and assets, at age 23 or thereabouts? I noticed that John's cohort was born in 1958, and I think therefore they probably went through higher education before student loans came out. I have one aged 23 and one aged 21, and despite copious cheques written by doting parents, they both assure me they have negative net worth at that age, but I've no reason to believe that they won't have something to live on when they are 33. I would be interested in John's or anybody else's observations on that one.

My second and completely separate point is to do with the importance of pensions as a long-term savings vehicle, as provision for retirement, which was mentioned in the document and also mentioned by Matthew Taylor. I need to make the point that many people who are in the category addressed by this document are eligible for membership of Occupational Pension Schemes, including a lot of lower-paid people in the public sector, in local authorities, in large employers, and so on. Many of those haven't joined those schemes, even though there are substantial employer contributions available, and in virtually all cases employees who are offered membership of an Occupational Pension Scheme should get on and join it. And then, of course, the cost of the pension scheme is met by the employer and not by the State. I would have thought that was a higher priority than the Savings Gateway.

Kate Green, Director, National Council for One Parent Families
My question in a way develops Peter's first question about the relationship with student loans. I wanted to ask John and others whether there was any information they could give about the way in which assets have been applied, what has been done with them, and how that might have effected outcomes. Certainly for the lowest-income families, times of crisis and times when assets might be needed are likely to come right through a child's growing-up. There are quite complicated proposals in the Government's consultation documents about putting money in and taking money out again, particularly parents being able to withdraw savings that they have put into the child savings accounts. This obviously has quite complicated implications when parents separate and it has to be determined who those assets belong to.

So I am very interested in any information that can be given to inform sensible comments on the assets might most effectively be applied in terms of improving outcomes for the poorest families.

Response: John Bynner
Well certainly it's true that of the '58 cohort those who went to university, which is a fairly small proportion, about 12%, didn't experience the student loan arrangements. But in response to that, if they had, I think one has to recognise that most of their families were very protective, having assets themselves, so you can't entirely divorce the young person from the family in which they are located. I think one of the benefits of the policy, as I understand it, is really to make good the gap between the protection for children coming from a fairly affluent income and assets base, and that which is available to poor families. Therefore, as you expand higher education, you do run into this increasing problem: that where debt occurs it is going to be much more difficult for the young person from a poor family to find the recovery through the parental support that the more affluent families are able to give.

Response: Matthew Taylor
I think all the comments that have been made are important ones, and present challenges for the policy. I think it's important in all these areas not to make the best the enemy of the good in a sense that this policy cannot solve every problem which exists in relation to inequality, nor even in relation to inequality in terms of access to assets.

The student loans issue is one that we are looking at in IPPR. It is interesting that it has some resemblance, I think, to some of the arguments for assets. There is a cold economic analysis of student loans in terms of redistribution and in terms of the benefits which will be reaped by those who go through university, but I think we are becoming aware now of some of the behavioural side effects. Such side effects may have been underestimated and drowned out by a cold economic analysis of its fairness. That I think does need to be looked at.

I said at the outset that I think there would be huge problems with political support for this policy if it were seen to be merely a way of legitimising the withdrawal of other forms of public-service provisions. There is no question in my mind that the student loans policy is one of the things which could most undermine the Child Trust Fund in the eyes of ordinary citizens who simply say this is just a way of legitimising the further withdrawal of public-service provision. This certainly needs keeping in mind.

I think the pensions point is extremely well-made, and I referred to that myself. I don't think, however, that we should see improving the pensions framework as an enemy of asset-based policies. I think the two can go together, and that's what I tried to suggest, that asset-based policies can provide a reason for lower-income groups to feel that savings are worthwhile and relevant to them.

I think the point about the family break up is an important one and I don't know whether we have thought about that in detail. I won't respond to it because I don't know what the answer is, but I think you raise an important question.

Response: Keith Bedell-Pearce
A number of interesting points here. I think there is the danger, even in asking the questions that have been asked, of creating this aura of complexity around what should remain a very simple proposition. The Pru did not police what the proceeds of a 16-year endowment for a child was going to be used for. Nor do I think it is appropriate, certainly for the providers, nor the State, to police the use of the proceeds of the Child Trust Fund at the end of the period. If it is effectively an unconditional gift, then it's an unconditional gift.

I think the student loan point is something of a red herring because one has got to make an assumption, and it may be too bold an assumption, that those who take out student loans and have undergone higher education at a university are probably then on their way to solving the problem themselves, so far as capital poverty is concerned in the longer-term. Therefore, although I think there may be a cynical view in 18 years time that this is merely a way of funding part of the student loans, I don't think it is something that should exercise our minds unduly.

I'm rather concerned, and this really goes against the grain as one of the country's leading pension providers, not to make an over-linkage either between the Savings Gateway, or the Child Trust Fund, into pensions. I think the social reasons for the incentives for pensions provision are quite different from the social and economic reasons which underpin what I understand to be the propositions in the consultation document. And once again I think the solution to the pensions problem for lower-income groups does not involve incentives at all, it probably lies in compulsion. But that's probably the subject of another seminar in this room at some stage in the future.

Sue Regan, Senior Research Fellow, IPPR
Just to pick up on the points about trying to make asset-based policy solve the entirety of the problems that people on low incomes have: I think it is very easy to fall into that trap. However, one thing I don't think you can ignore is the relationship between saving and asset-building and debt, and that seems to have been an area which we haven't look at enough yet in the Government's proposals.

The relationship between savings and debt for people on low incomes is of course particularly acute. This raises the point of whether you allow access for people on low incomes to the money in their Child Trust Fund. We don't have an answer to that yet and we've certainly had a very strong perspective from the financial services industry that simplicity is of paramount importance, and therefore having access to the Child Trust Fund before the child turns 18 shouldn't be an option. I don't think it can be that simple. Certainly the focus group work we have done looking at the Child Trust Fund indicates that people on low incomes would find it very difficult if there wasn't at least some form of emergency access to their funds. I think that's an area that we need to look at more.

Professor Julian Le Grand, Department Of Social Policy,
London School Of Economics
I think the point about student loans does have to be taken quite seriously, but on the other hand, and I think Matthew is exactly right, it would not be politically wise at the moment to emphasise the way that the money could be used to pay off student loans. However, it is worth noting in the longer run that at the moment we heavily subsidise one form of capital accumulation – human capital accumulation – through universities and through higher education. But we don't subsidise, or if we do, very minimally, other forms of capital accumulation, and other forms of savings accumulation in the same

sort of way, or to the same extent. One of the great things of this proposal, in the longer-term, is that we might get something more of a level playing field in which we allow people to accumulate capital not just for higher education, which is not suitable for everybody, but to allow other forms of capital accumulation.

A second question to Keith on the National Children's Trust Fund. I think it is a good idea to have a default option. But I wonder: one of the essences behind this asset idea is that it encourages people to learn how to save, and about the risks and other aspects of saving. Might it not be a good idea for the Child Trust Fund to have perhaps a number of options within it, a number of plans within it, some riskier than others? Maybe none of them should be very risky, but some might have different degrees of risk associated with them of which people are informed, and then they are allowed to make choices within this kind of national default.

Elaine Kempson, Director, Personal Finance, University of Bristol
What our research showed quite clearly was just providing a lump sum to children was not going to encourage savings, and I think that is another matter. I think however that an asset in its own right may have value. I think with regard to low-income households, the Savings Gateway does have a lot of merit to it. The current incentives for saving don't really do anything to help people who have only got very modest amounts to save, and do an awful lot to reward the middle classes and the better off. So I think both proposals have merit in them, but albeit for slightly different reasons.

I think the other argument about education is extremely important, and a very powerful argument I've heard in favour of the Baby Bond is that it could be used within schools – as in fact Julian was perhaps even eluding – enabling children to think about savings and talk about something which is real, rather than something which for many of them at the moment is certainly not a reality. If they do have sums of money, then we could build school education around the sums of money that they hoard.

Paul Myners, Chairman, Gartmore Investment Management Plc
I listened to Keith talk about the economics of the Child Trust Fund and the low unit profitability, and I hear very similar arguments in the area of

Stakeholder Pensions, where it simply isn't possible for the vast majority of organisations to develop a profitable business in that area. And then I think about the default option, and I'm then directed to ask myself: 'Well why shouldn't the default option be the option? What is the role that the private sector has to offer here?'

The private sector can certainly provide support but does this product, the Child Bond, need to be provided through the private sector? I doubt it very much. The private sector carries with it legacy: legacies in architecture, in systems, in cost base, and in reputation – including association with bad products which have been badly sold. Incidentally I am alarmed that Keith might think that the 'with profits Fund' has some role to play here. I am very much hoping that the Sander Review and the FSA will together combine to kill the 'with profits Fund' within the next few months.

I ask myself whether in truth we shouldn't be considering that the Government should sponsor the creation of a National Endowment to provide the support infrastructure and management of these products, possibly supported by the industry in their charitable way of which Keith has spoken, recognising that there is a public good to be done here, in the same way that the banks are supporting a banking offering for the excluded communities around the Post Office system. The National Endowment could be essentially held under government sponsorship, but with independent control, with the intention that after five years it becomes a mutual; that those who are investing through it become co-owners of the business; and that they are accountable or the organisation is accountable to them; that there is transparency of governance; that they will have engagement, not just in owning a product, but actually in owning the product provider. The private sector can then stand back from a product which neither offers profit potential, nor which they are going to sell with great enthusiasm or passion because they have competing products to sell and in the natural interest of wealth and profit-maximisation they will give priority to more profitable products than they will over what, as Keith has told us and was quite palpably clear, will be a low product area. So I think there is a place here for the community, and for the Government to take the lead to sponsor, to incubate and then to spin out a National Endowment into community ownership.

Response: Keith Bedell-Pearce
I could see my colleagues from the Pru shifting a bit uncomfortably in the audience as you made the case for the single National Children's Trust Fund because actually that was my starting proposition, but I felt it would be a bit rich for me to bite the hand that's going to feed me, at least to the end of this year, and make a proposition of that kind. From a personal point of view I actually agree with you, but I think there will be differing views within the Prudential, so I should emphasise that personally, yes, I do agree, but the Pru, with commercial interests in the longer-term, will almost certainly take a different view.

I think there is a distinction also between Stakeholder Pensions, because so far as Stakeholder Pension providers are concerned, there is a degree of active competition. There is also a recognition that a Stakeholder Pension offers the prospect of the cross-selling of financial services of other thicker margin products to Stakeholder Pension participants as some stage in the future. Whether that materialises is another thing.

So far as 'with profits' is concerned, I put that forward with some diffidence, and I expected a response somewhat similar to that you gave. I think 'with profits' is much maligned. I think the view that there is of 'with profits' and Sander and the 'with profits' review is going to be an important watershed for the industry as a whole, but I do feel that if there were much greater transparency, a huge amount of the unnecessary mystique around 'with profits' would be stripped away. If there are explicit charges and there is a simple explanation of the 'with profits' concept, then for this type of market there is a case for it. I would stick very firmly to the view that, given transparency and explicit charges and an auditing of just how the smoothing process takes place, there is a strong case for the risk averse to have access to a 'with profits' option.

There was mention of how the default option that I proposed may fit in with the social requirement for creating a greater degree of understanding about financial matters and the importance of saving. I think that is a very important point. I also think it is something which supports the concept of at least the default National Children's Trust, if not a single National Children's Trust, because that could be coupled with an education programme and give a sense of ownership to the individuals from a relatively early age. One of the things which persistently sticks in my mind about the success of compulsory pensions provision in Chile was that there was one small device that caught the public's imagination in Chile, and that was the provision of the Little Red Book – it wasn't Chairman Mao's – it wouldn't be under Pinochet's regime – but it was a little red book which was effectively a passport, which people could put into an ATM at any time to get the value of their pension holding. A very similar concept, albeit via the internet or via digital television or whatever, could be provided to give that sense of ownership and interest in the growing value, we would hope, of the assets which were in the Child Trust Fund.

Response: Matthew Taylor
Two very quick points. The first is simply to say that if we rush to private sector involvement or the possibility of mutuality, I think the important thing is that we show imagination in thinking about how the public/private and other third sectors can work together. That is one of the themes of IPPR's work on private/public partnerships: the problem of policy has not been so much where the line has been drawn, but that it's been drawn too rigidly with a lack of imagination about new models.

The problem I want to emphasise more, and where I think the really interesting questions are, is about choice and the way in which the policy is understood. Keith's point about simplicity is crucial, but I also think that giving people choices is crucial to a policy being empowering. At the heart of this policy is an emotion of empowerment, and this is important for legitimacy of the policy in the eyes of citizens.

For example, thinking about student loans, if you give people choice over what they want – either a loan or graduate tax – then that would be an interesting way of introducing more legitimacy to the policy. This logic should be applied to the Child Trust Fund. Putting that aside, the problem I think is this: you can introduce choice, but the evidence from America is that what's crucial to that is a high level of support. What's worked in America has been when people sit with lower-income groups and work through the issues with them and provide them with the financial literacy in advance. I think it offers a great opportunity for new forms of engagement and to bring community groups into the policy, but it is not cheap to do.

Bishop Sentamu, Bishop of Stepney
My question is to Matthew Taylor. I was quite intrigued by your view on involving community organisations. An experiment in Tanzania, by Julius Neyerere, was based on that principle whereby power was donated and given back to the communities. Unsurprisingly, Tanzania has not had any coups because the power is in the communities. No-one aspires to be President, because the President lives in an ordinary little house.

Also, voting rates in Tanzania are still the highest in Africa because citizens are actually participating. In the light of recent research we did on power, participation and poverty, I wonder how this system could not only raise citizenship participation, but how it could actually be sold as the best way of doing so. It isn't cheap. Neyerere's experiment was very costly, and the wealth level of the rich was much decreased because the assets were being sent into the villages. It still remains a poor country, but a country which participates more strongly. I am intrigued by your suggestion because I think you are on to something very serious.

Richard Saunders, Director General, AUTIF (The Association Of Unit Trusts)
Can I just respond quickly to Paul's question about what the private sector can bring here? I think the vision painted of a nationally sponsored mutual with perhaps 13 million members is the makings of a bureaucratic nightmare. I think what the private sector would bring is what the private sector will always bring, which is enterprise and initiative. In particular I would pick up a point which was made earlier, one thing that hasn't been mentioned is that the Child Trust Fund is indeed an endowment, but is also a focus for encouraging savings during childhood and while the child is growing up.

I also would like to endorse very strongly Keith's simplicity – and I was disappointed to hear the number of bright ideas that have emerged to complicate it as we've heard the discussion. The costs have got to be kept down. Please don't put a 1% charge cap on it because it would drive equity providers out of the market. A way of simplifying is to dovetail in with the system which is already there, which is the Child Benefit system.

Theodora Zemick, Fund Manager, M&G Financial Services
To me the most exciting aspect of this particular proposition that it offers the

chance for education to a population that is financially relatively illiterate compared to other parts of the developed world. I was thinking particularly about the 401 K Policy in the US which is an entirely different animal, but over 20 years it has delivered massive benefits and has developed a very highly financially literate population.

To me one of the great horrors of life today is that none of our marketing departments in the financial industry has ever come up with a slogan as sexy as, “you’ve got to be in it to win it”. Most of the lower paid in the population are quite happy to devote a really high proportion of their income to something like the National Lottery, where the benefits are evident, or seemingly evident, whereas actually what we can deliver is much sexier, but we never get that point across. And so this is an opportunity in the long-term for our industry to educate, to justify ourselves and perhaps attract legitimately a greater franchise business.

Richard Excell, TUC
I thought Matthew’s point about all children having access to the same type of fund was really important. Whether we have a single national fund or private-sector involvement, that point is really important: it’s got to be a badge of citizenship.

The second point is, it’s not just about low premiums. Elaine Kempson’s research, that we have heard about in a previous seminar, shows that the way in which poor people are able to save is really important. People have got to be able to contribute with small amounts, varying at different times. The system has to cope with the people who can save 50pence this week, £2 the next week etc.

Karl Snowden, Director, Government and Industry, Zurich Financial Services
Paul Myners made the point that a large mutual would be a good idea. I don’t think there is such a thing as a large mutual. If a mutual is to work it has be small and the members have to be able to eyeball each other and have to want to participate. Low earners don’t tend to be committee members and don’t tend to want to participate, so the smaller the mutual the more we are likely to get real ownership of the way forward for their money. This is relevant to Matthew’s idea of community involvement and Bishop Sentamu’s point about Tanzania.

I would also like to talk about education. Matthew talked about financial literacy, and the concern that I have about financial literacy is that in all the organisations involved everything is based on the written word. In the US the Department of Labor has made major steps to engage people through the forum on K Plan to actually talk to people, not in Serbo-Croat or Cantonese but in a language they understand – if they're a Spaniard in Spanish; if they are semi-literate, using videos and board games. I don't think we can just say: "give somebody a pass book and they will start working on their education." I think we have to educate the parents to involve them, and to engage with the parents we have got to be a lot more creative. We have got to use TV; we have got to use games; we have got to use videos – and not just pamphlet after pamphlet after pamphlet.

Response: Matthew Taylor
I think there are a lot of incredibly useful comments and I just want to come back to this issue of community involvement.

I think it is crucial in all areas of public policy that we ask questions about any policy's implementation. To start with, "How does this policy impact on community capacity?" And I think that has been a question missing from public policy for a long time. It is one which politicians now talk about, but I still don't think the culture of government has yet adjusted to a proper consideration of the capacity-building consequences of policy. I think that asset-based policy was a classic example of where you can do it in a way which is passive, or you can do it in a way which is likely to lead to acts of citizenship and to community engagement.

I also think there is actually a lot to be learned from overseas. We should pay particular tribute in this whole policy area to the contributions that have been made by developing countries in advancing this thinking.

I would end by saying that I think there may be a win: win situation here, which is that one of the challenges I think the Government has is to try to get the public more implicated in the performance of public services. I think it is significant, for example, that people rate their own school 20-30% higher than they rate schools in general and the reason for this is not just because they've been to their school and they have read about other ones in the

Daily Mail, but it's also that if they say their school is rubbish then they realise they are partly responsible for it because why are they sending their kids there. Why aren't they joining the governing body? Why aren't they doing something about it? I think if the Government is going to ever get a nation which is anything more than sulky about the quality of public services, it's going to have to think systematically about how you get the public engaging with them.

Now that might sound like a long way away from asset-based policy, but is there a role for public-service providers, and the organisations built around them, in relation to provision of this policy, and in relation to financial literacy? I talked about schools and financial literacy. Now I don't think we've even started to think properly about this. But one other policy that IPPR is looking at is the possibility of using schools running Local Exchange and Training Schemes (LETs) as a way of bringing people into schools, of putting schools at the hub of the local community. I just wonder whether we can think of how important it's going to be to educate and inform people about this policy. The provision of financial literacy through schools or LETs, as part of asset-based policies, could be one way of closing the gap between public services and citizen's communities.

Response: Keith Bedell-Pearce
I think on the question of ideas I agree with Matthew. I think there are too many bright ideas swilling around on this, and I would like to set a benchmark for the development of both the Child Trust Fund and the Savings Gateway: if the concepts and rules can't be communicated in five or less bullet points, then you have built too much complexity into this. It would be a good challenge for the industry to actually develop those five bullet points. Any more than that, and I believe it's doomed to failure.

Finally, on the question of the National Trust Fund, I don't see it as a mutual. I think one of the flaws of mutuality, as demonstrated by Equitable, is that there is mutuality not just in sharing the benefits of pooled risk or investment; there is also mutuality in sharing the dangers of risk, and that's a lesson which is now being learnt in a very hard way.

I don't see the National Child Trust Fund as a mutual, I see it as a genuine trust where the assets are invested rather like a national unit trust, and are managed in that way. There will be some mutuality in terms of risk, but I think if the options are given for having a 'with profits' option, or possibly a cash option – I agree the education has to be proactive – then I don't see that as a problem. Nor do I see size as being a problem. 13.5 million may sound like a large number, but within my working career the Pru was administering in excess of 16 million industrial branch policies, without any difficulty. In fact I am amazed we were able to do it without computers.

Wilf Stevenson
It has been a very lively debate, and I think those who are here from the various government agencies and departments will take a lot back from those debates. I think we are probably just at the start of a consultation on this issue, but we are also left with Matthew's very important point, which is we have got to be quite clear which narrative this proposal comes from. Is it in a social policy mode, or is it in some sort of industrial policy? What is it about? Is it about active citizenship, or is about some other form of industrial empowerment, through perhaps enterprise or other areas? That line is very important if we are going to get this right.

Somebody said that what was important was sexy slogans. I don't think you can rely on think tanks for that, though IPPR do a very good job on this front as well as all the others! For us, it's the ideas that count. And the great thing about this morning is that there are loads and loads of good ideas here, and enough to keep us in work for a long time to come.

Thank you all very much.