CHASM | Centre on Household Assets and Savings Management

Briefing Paper

Should people on low incomes be encouraged to save during an economic down-turn?

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People on low incomes in Britain today have an almost impossible time simply meeting their most basic, immediate needs. Should we therefore enable or encourage them to save? This is one of the many questions posed by the Financial Inclusion Commission[1], an independent body of experts set up in 2014 which aimed to make financial inclusion a national priority ahead of the 2015 General Election. CHASM was asked to provide evidence in November 2014 to the Commission on the issue of saving for people on low income and this briefing provides a summary of that evidence.

We know from rigorous research by the University of Loughborough[2] that means-tested benefits do not provide enough for people to reach a minimum income standard, as defined by members of the general public. In 2014, a single person on means tested benefits received only two-fifths (39 per cent) of what they would need to reach a minimum income standard and families with children (lone parents and couples) received just over half (57 per cent) – see table 1. It would clearly be very difficult if not detrimental for many people to save when their incomes are so low.

[1] http://www.financialinclusioncommission.org.uk/

[2] http://www.jrf.org.uk/sites/files/jrf/Minimum-income-standards-2014-FULL.pdf

Table 1 Minimum Income Standards, compared with out-of-work benefits, April 2014

£ per week	Single, working age	Couple, pensioner	Couple, 2 children	Lone parent, 1 child
MIS excluding rent, 91.5% of council tax* and childcare	184.5	243.29	461.51	275.45
Income Support**/Pension Credit	72.4	230.34	263.81	156.18
Difference (negative number shows shortfall)	−112.10	−12.95	−197.70	−119.27
Benefit income as % of MIS	39%	95%	57%	57%

* Assumed coverage of Council Tax Support, except pensioners for whom it is 100%.
** Including Child Benefit and Child Tax Credit for families, and Winter Fuel Allowance for pensioners

And many people in work, today, are very low paid. The minimum wage is no guarantee of avoiding poverty and of the 13 million people in poverty today, half are in paid employment.[3] Part of the reason for this is that about one in five (4.8 million) workers received less than a 'living wage' in 2014[4].

Many people therefore struggle on low incomes and so it would be extremely difficult for them to save. However, we know that some people on low incomes do, despite the difficulties, manage to save a little each week. About one in five of those in the bottom 10 per cent of the income distribution were saving something 'now and then' in 2010/11. In total, about half of those in the bottom of half of the income distribution were saving about £50 per month[5]. These are small amounts but could make a difference to people on low incomes (or to people whose incomes might fall further). They also show that some people

[3] http://www.jrf.org.uk/topic/monitoring_poverty
[4]http://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Latest%20News/living-wage-research-october-2014.pdf
[5] Rowlingson, K and McKay, S (2014) *Financial Inclusion Monitoring Report*, Birmingham: University of Birmingham

on low incomes are trying to save, despite the difficulties and despite the lack of government support to do so.

Clearly, and not surprisingly, the majority of people on low incomes are not saving and yet we know that when some people on low incomes face a big bill or an unexpected expense they turn, out of necessity, to high cost lenders. This means that they end up re-paying loans with high levels of interest which then have to come out of their low incomes. If these people could have saved in advance of needing such assistance then they would not have to pay out interest and, potentially, get caught in debt spirals.

Also, people's incomes do rise and fall as situations change. If people could be helped to save when incomes are a little higher, then this would also give them a cushion to fall back on if incomes fall or outgoings increase.

A final reason for helping those on low incomes to save is the question of fairness. Our tax system currently gives most help to the richest to save (through tax-free ISAs and tax advantages with pensions) and least to the poorest (who tend to save in other ways, such as in building society accounts or at home). And yet the richest need this help the least. Surely there should be a level playing field at best, if not more help for those who need it most.

What can we do about this? The previous government piloted the Saving Gateway twice and were about to launch it in July 2010. This scheme gave incentives to up to 8 million people on certain benefits to save up to £25 a month over two years, up to a maximum of £600. At the end of that term, their savings would be increased by 50% – up to £300 – by the government. The first pilot had shown that the average amount saved was £282 with about half of the participants saving the then maximum of £375. The second pilot suggested that the scheme did not particularly encourage new saving but encouraged people to switch from other forms of saving into the Saving Gateway. However, it nevertheless rewarded people for saving and we have no real idea about whether ISAs encourage new saving as these schemes were never piloted[6].

The government said that it could not afford the Saving Gateway (at a cost of £100m) but the cost of the tax breaks on ISAs is far higher than the cost of the Saving Gateway. In the 2014 budget, the Individual Savings Account (ISA) threshold was raised to £15,000 with complete transferability between cash and equity ISAs with this change alone (not the full cost of the tax allowances but just the changes) cost the Treasury £0.6 billion a year. Further changes in terms of reducing income tax on savings income cost £0.4 billion a year. Analysis of this latter change by the IFS suggests that most of the gainers from reducing income tax on savings will be those around the middle of the income distribution though biggest cash gains go to wealthy people.[7]

We should therefore argue for the introduction of the Saving Gateway both as a way of enabling and encouraging people on low incomes to save but also as a way of rewarding such behaviour. This policy, of course, must run alongside other policies around the living wage and benefit increases, as these are the most fundamental causes of financial exclusion. But the Saving Gateway would help some people and create a fairer playing field.

[6] see discussion in Rowlingson, K and McKay, S (2010) *Wealth and the Wealthy*, Bristol: The Policy Press
[7] http://www.ifs.org.uk/budgets/budget2014/pensions_saving.pdf

Other policies could also be considered. The Child Trust Fund was also abandoned by the Coalition government in 2010 despite showing signs of supporting families to build up assets for children and costing a relatively modest £500m. IPPR have proposed a lifetime saving account which would be simple, easy to monitor and pay 'bonuses' rather than interest. It should be flexible to enable people to withdraw money when needed but also encourage people to keep savings in the account for the longer term where possible[8]. The introduction of auto-enrolled workplace pensions also raises the possibility of introducing an auto-enrolled workplace saving scheme. Credit unions also need further support to encourage saving and the treatment of savings in means-tested benefits also need review, particularly with the introduction of Universal Credit which will extend such means testing to in-work benefits. Other suggestions for supporting people on low incomes to save could come from the financial services sector, such as through 'Save the Change' schemes (see Lloyds TSB) whereby the amount spent on a debit card is rounded up and the difference saved into a separate account. Other features of accounts such as slightly more difficult access conditions (eg 48 hours notice and withdrawal in person) might discourage people from accessing savings too easily, and other incentives to save such as product tie-ins and discount vouchers might also help.

Finally, the Birmingham Policy Commission on the Distribution of Wealth called for a not-for-profit organisation to be established to represent the interest of savers. This could be paid for through a portion of the fees paid by savers which already go to supporting trade bodies. If some could be directed to a body supporting savers themselves this could help to

[8]http://www.ippr.org/assets/media/images/media/files/publication/2011/05/saving_and_asset_building_1746.pdf

improve the competitiveness of this part of the financial services industry which various reviews have considered to be too low[9].

People on low incomes today certainly face huge challenges in meeting immediate, basic needs, from their current incomes and these incomes need to be higher. But some manage to save, others wish to, and more might be able to save when incomes are a little higher if they were given support to do so. There is also an important question of fairness in that we currently support those on middle and high incomes to save far more than people on low incomes. The balance of these incentives needs to change but this would mean reducing the advantages of ISAs, something that middle class voters, in particular, hold dear. Such changes would require politicians to make the case to the public. It is a clear and compelling case but one which is politically challenging.

The views expressed in this briefing are the views of the author(s) and do not necessarily represent the views of CHASM as an organisation or other CHASM members.

[9] Birmingham Policy Commission on the Distribution of Wealth (2013) *Sharing our Good Fortune: Understanding and Responding to Wealth Inequality*, University of Birmingham